Searching for Fiscal Responsibility: A Critical Review of the Budget Reform in China

Alfred M. WU

The 2008–2009 global financial crisis has made budget management and fiscal responsibility more imperative in many developed economies. A budget crisis has not occurred in emerging economies such as China. However, in China, the demands of fiscal responsibility have increased against the backdrop of bulging government revenues in recent years. Over the past decade, the Chinese government has started to promote self-constrained bureaucracy and strengthen its fiscal responsibility and accountability in budget formulation and implementation. The 1999 budget reform that aimed to improve fiscal responsibility was hailed a success by previous literature. Drawing on field research in five counties in China between 2008 and 2010, it is argued that though some achievements have been made, the budget reform has not substantially improved both accountability and transparency within the bureaucracy. The implication of this study is that top-down, supply-side reforms led by the state may not be effective.

Budget troubles swept through developed economies during the financial crisis of 2008–2009. A number of developed countries are thus reiterating the importance of fiscal responsibility and economic stability. For example, in the United States, the Obama administration has emphasised fiscal conservatism and the need to root out waste and inefficiency in public service provisions. Over the past decade, more than 10 emerging market economies have also passed fiscal responsibility laws. Not only has deficit control been emphasised, but the procedures for budget compilation and execution have also been re-evaluated. For example, the line-by-line approach has been re-emphasised in budget reviews at the federal level in the US.

Despite surviving the crisis of 2008 and 2009, the Chinese government encountered the challenge of spending public money more effectively and efficiently. About a decade ago, the Chinese central government started to tame its self-serving bureaucracy and strengthen the fiscal discipline in local governments. Yang argues that China’s budget reform can “serve the twin purposes of saving money and curbing...”

Alfred M. Wu (wumuluan@gmail.com) is Lecturer in the Department of Asian and Policy Studies at the Hong Kong Institute of Education. He earned his PhD in Public Administration from the City University of Hong Kong. His research interests include public sector reform, central-local fiscal relations, corruption and governance, and social protection in Greater China.

corruption”. Furthermore, the reform will be self-enforcing because “no politically attuned leader would openly seek to end [the budget reform]”. But in the literature, there is scant critical evaluation of the budget reform. Against this backdrop, the author poses the following questions: What drove this budget reform? What are main components of this reform and its impacts on public finance and governance in China? What are the policy implications of this study?

This article is largely drawn from field research in five counties in Fujian (an economically advanced area in east China) and Hubei (a relatively poor province in central China) provinces between 2008 and 2010. Six county-level finance bureau heads and 22 other officials or legislators in charge of public finance were interviewed. The budget process and implementation were the foci of field discussions. Apart from the author’s field notes, statistical sources and official documents were also used. A caveat is needed. In addition to a general discussion of budget-maximising behaviours across the board, most findings refer to county bureaucracy in China. As county governments provide the bulk of public services and implement the majority of central mandates, the author argues that investigating the implementation of the budget reform at the county level will reveal the complex governance structure in China.

One of the major findings in this article is that mixed results have manifested in Chinese budget reform. The reform did not lead to self-constrained bureaucracy while fiscal accountability within the bureaucracy has not yet become apparent in China, suggesting that a Confucian bureaucratic structure still works in China, sometimes too well, against the backdrop of an economic transition to the market economy. Despite of the rule of the Communist Party of China (CPC), the Confucian bureaucracy is still the foundation of the administrative system in the country. The Chinese government has reinforced the civil service examination system, the state bureaucracy consisting of “good” officials and elite control to promote social harmony, especially in recent decades. More importantly, in the Confucian bureaucratic structure, obedience has been emphasised; therefore, the hierarchical structure is of paramount importance to the understanding of the Chinese administrative system, especially intergovernmental relations. Higher authorities impose mandates, funded or unfunded, on lower-level governments extensively. Promotions are tightly associated with public officials’ ability to fulfil the targets. In the meantime, paternalism protects local governments from fiscal insolvency as soft budget constraints are in place in reality. One of the negative consequences of the current fiscal structure is that local governments seek their own interests and spend beyond their means. Fiscal responsibility is therefore hardly realised.

---

3 Ibid.
This article is organised in the following sections. The first section introduces the budget reform and its components. The second section reports a gloomy picture of budget maximising behaviours across the board in China after the 1999 budget reform. Based on an investigation of the government wage bills and other benefits of civil servants, especially those in leading positions, the author argues that the enhanced fiscal capacity has more or less benefited self-serving bureaucrats. Then, drawing largely on field research, the third section examines the implementation of the budget reform at the local level. It reveals that though the budget reform aims to strengthen fiscal responsibility and “accountability within the bureaucracy”, changes that occurred are more superficial than real. The fourth section discusses the policy implications and draws a conclusion.

THE 1999 BUDGET REFORM

In contrast to the 1994 tax-sharing system, the budget reform inaugurated in 1999 did not garner much public attention. It is, nevertheless, a crucial and far-reaching reform, which may enhance the fiscal transparency of both central and local governments, strengthen the effectiveness of central oversight and help rein in reckless local fiscal behaviours. If the reform were to be successfully implemented and developed, not only would public money be saved, a government with improved transparency and accountability is also likely to emerge in China. As noted by Yang, the restructuring in financial management, albeit “simple but extremely important”, may alter the incentive structure of local cadres and the relationship between the government and the general public. However, empirical evidence suggests that despite some improvements in budget formulation and the relationship between the budget agency and the legislature, the budget reform has created more problems than it has mitigated.

The budget reform, consisting of three parts, namely the departmental budget reform (bumen yusuan, DBR), the treasury management reform (guoku jizhong zhifu, TMR) and the government procurement reform (zhengfu caigou, GPR), intends to address the weakness of the previous budget system. A senior official of the Ministry of Finance of the People's Republic of China (PRC) perhaps described it best:

> The budget [regulated by the old system] submitted for examination and approval at the beginning of the year was a rough budget that was drafted by function only and did not show the budget allocations to departments. It did not reflect specific details of revenues or expenditures. There was no overall expenditure limit. It did not reflect all revenue and expenditure activities. The government’s fiscal policy had only coarse control over the expenditure composition; our capacity to control and manage public expenditures was very weak.

---


7 Yang, *Remaking the Chinese Leviathan*, p. 239.


Among others, the DBR is in all respects expected to tackle the aforementioned problems. The DBR is new in several aspects. First, the budget is compiled on a departmental basis. The government budget was previously divided along functional lines, such as education and agricultural sectors, which were inherited from the practices of the Soviet Union. A number of government departments performing similar functions formed an appropriation cohort; budget compilation was based on the needs of this cohort rather than individual departments. Under the new arrangement, the budget is organised on a departmental basis whereby individual government departments submit their budget requests in the form of a simple table to the budget agency. The budget agency, in turn, decides whether to accept, reject, or modify the request. Second, bottom-up elements are introduced into departmental budgets. Functional budgets used to be accompanied by a top-down appropriation wherein individual spending units had very limited leverage over budget decisions. Under the DBR, individual departments need to participate in budget compilation and take the initiative with regard to it. Consequently, zero-based budgeting, albeit different from that in the West, has been incorporated into the new system. The zero-based budgeting—in contrast to incremental budgeting—entails a reconsideration of all spending requests based on current financial priorities rather than the figures of the previous year. The zero-based budgeting signals the fact that local initiatives that are valued in the budget compilation as spending units (yongqian danwei) can have an active role in compiling the budget. Third, the budget is consolidated while the “comprehensive principle” is emphasised. The DBR does not allow for a fragmented budget whereby non-budgetary revenues are not subject to the scrutiny of the finance department. The budget reform has ambitions of bringing non-budgetary financing to an end.

The DBR—a representative of the 1999 budget reform in China—entails some key elements of the reform. First, the DBR is expected to promote a self-constrained bureaucracy. One of the great perils of the old budget system was that public money was readily seized by greedy bureaucrats. Many documented that non-budgetary financing had served to increase civil servants’ benefits. An inflated wage bill, giving rise to local fiscal crisis, was depicted as a by-product of fiscal prolificacy at the local level. A more transparent, accountable budget process may decrease the self-serving tendency of public officials in China.

Second, budgeting on a departmental basis can improve the “accountability within the bureaucracy”. Accountability lies in the forefront of public governance as

---

12 Prior to the DBR, “separation of revenue and spending” (shouzhi liangtiaoxian) was promoted in order to discourage local cadres from collecting non-budgetary revenues.
14 Yang, Remaking the Chinese Leviathan.
Accountability to its constituency through direct election is not an option adopted by the Chinese government. The “accountability within the bureaucracy”, referring to some checks and balances within the government, is therefore central to better public governance in China. Recent literature on administrative accountability has already focused on governance instead of government with the former emphasising the involvement of both public and private actors in public affairs. Scholars have “developed a threefold definition of accountability, reflecting the different public demands on the political system: accountability for finances (financial accountability), accountability for fairness (legal accountability), and accountability for performance”. Financial accountability is relevant to this study. Public officials should be held accountable for fiscal prolificacy. Nevertheless, in the Chinese authoritarian context, it does not mean making budget information available to the general public. The government, instead, attempts to install some monitoring measures within the bureaucracy. That is, spending units should be held accountable to those that fund them. More specifically, individual departments must be held accountable to public finance bureaus and local legislatures.

The “comprehensive principle”, as mentioned, adds to the “accountability within the bureaucracy” since individual departments cannot escape the scrutiny of the budget agency through non-budgetary financing. Revenue collection and public expenditure should be monitored by both public finance bureaus and local legislatures.

Third, the DBR can enhance allocative and operational efficiency in public finance. Individual departments no longer need to rely on prolonged interdepartmental coordination and transfers before implementing the budget. Furthermore, public money can be channelled to high-priority areas rather than scattering scarce resources among all government projects under zero-based budgeting.

In addition to the DBR, both the TMR and GPR also intend to improve accountability and efficiency and constrain self-serving behaviours in the public sector. According to the TMR, only a single treasury account system is allowed to operate at each level of government; consequently, individual departments cannot hide their revenues and expenditures from the budget agency. Aiming at corruption control and operation efficiency, the GPR introduces a centralised procurement system wherein a specific government unit is responsible for government procurement. A caveat is in order. The DBR, TMR, and GPR are intertwined with each other; the successful implementation of one reform is contingent on the others. For example, if individual government departments still have various bank accounts to manage their incomes and expenditures, the centralised procurement system will be nullified since spending units can purchase whatever they want through accounts under their control.

---

17 Some local governments did publicise budget information. It was nevertheless not institutionalised; therefore, some governments rolled back the reforms in the end.
The 1999 budget reform was introduced in a changing political-economic environment in China. First, the top-down requirements had promoted these reforms. As noted by Hofman and Yusuf, a detailed and comprehensive budget is crucial to the effectiveness of a country’s macroeconomic policy. Nevertheless, due to persisting non-tax-based income and reckless spending, higher authorities in China have very limited information on the real situation of revenues and expenditures at the local level. The late 1990s had seen a surging demand for fiscal information by central policymakers.

Second, satisfying the bottom-up demands of a benign government coincides with the need for an overhaul of the fiscal management. The 1994 tax-sharing reform has imposed formidable fiscal burdens on local governments since the central government demands the lion’s share of total government revenues, while leaving increased expenditure responsibilities to local governments. Aggregate data suggest that almost no government at the county level can make ends meet without transfers from higher authorities. Local governments thus resort to imposing fees or surcharges in addition to formal taxes on local businesses and individuals. For example, according to the study of the Ministry of Finance of the PRC, 530 types of non-tax revenues totalling 160 billion yuan were collected by transportation, construction and public security departments in 1997; out of 530 types of revenues, 245 types were illegal. Non-tax revenues closed the gap between expenditure needs and government income; on the other hand, public money might be pocketed by local officials. The general public has thus put great pressure on the central government to reform the budget process.

Third, other political factors have also contributed to this budget reform. The monopoly on interest articulation and aggregation by the CPC was predominant for several decades in China. It is not surprising to see that “there is no institutionalized mechanism to involve ordinary citizens in the government budgetary process”. As the government revenue increasingly relies on individuals and private firms’ contributions rather than the profits of state-owned enterprises, both accountability and transparency in public finance have become exceptionally crucial in today’s China. As noted previously, both accountability in relation to the constituency and the citizen’s participation through elections seem to be impossible in the near future despite some direct elections at the village level. Power-sharing and checks and balances within the state, however, are likely to happen in China. This strategy has been explicitly embraced by the central government and used as a way to enhance

---

21 Yang, Remaking the Chinese Leviathan.
the legitimacy of the state and the political power of the CPC. Against this background, the legislature and the budget agency have boosted their leverage in the political arena in recent years.

Improving the clout of the people’s congresses in the budgetary process has attracted wide public attention. The 1999 budget reform was initiated by the Standing Committee of the National People’s Congress. Members of the National People’s Congress are increasingly eager to exercise the power of the purse. For example, in March 2012, roughly 20 per cent of members of the National People’s Congress did not approve the budget report offered by the finance minister. Compared with the National People’s Congress, some local legislatures seem to be more proactive and assertive in exercising the power of the purse. For example, the Guangdong Provincial People’s Congress has been allowed to retrieve the data on provincial revenues and expenditures through an interconnected system. In a county in Zhejiang province, local legislatures even move a step forward; that is, local people’s congresses and citizens have been much better informed about their spending and agenda-setting in local public finance. When budget details are revealed to the members of congresses, citizens’ opinions can be incorporated in the budget decision-making through the legislature, at least theoretically.

In parallel with the heightened importance of the legislature, the Ministry of Finance has improved its status within the Chinese bureaucracy in recent years. Bachman points out that the Ministry of Finance was surprisingly weak compared to other government departments in China. The reason behind this is that the government budget was only part of the state plan. Ma and Hou aptly argue that “[g]overnment finance was run in the fashion of ‘budgeting without a budget’, with no means to ensure financial accountability”. As noted by Przeworski et al.,

24 The budget report got the highest percentage of negative votes compared with other reports and amendments. Some deputies argued that the approval rate would be much lower if the fiscal system did not improve substantially in the next year. See Susan V. Lawrence and Michael F. Martin, Understanding China’s Political System (Washington, DC: The Congressional Research Service, 2013), at <http://www.fas.org/sgp/crs/row/R41007.pdf> [16 Mar. 2013].
authoritarian regimes tend to tax more and spend less on citizens’ welfare, resulting in great income inequality and extreme poverty; this situation, in turn, causes social instability and leads to the collapse of these regimes.\textsuperscript{29} It appears that the Chinese central government is well aware of the perils of weak redistributive capacity. For example, it injected large amounts of fiscal resources into the poorer parts of China under the “Western Development” programme launched in 1999. An enhanced redistributive power of the central government requires a fundamental change in the role of the Ministry of Finance. In addition, a powerful budget agency, aggregating opinion from individual government departments, can serve as a unique interest aggregation within the hierarchy.

There has been “a trend of very modest political pluralization”\textsuperscript{30} in China. Local legislatures and some departments within the government are willing to speak out. It is nonetheless too early to conclude whether non-state actors can play a larger role in public governance. Nevertheless, budget reform through empowering the legislature and the budget agency is a clear direction, which may have a positive impact on improving interest aggregation of the Party-state and public governance in China.

SELF-SERVING PROBLEMS AMONG BUREAUCRACY IN CHINA

Before conducting fieldwork at the grassroots level in China, aggregate evidence is presented to illustrate the general situation: Bureaucrats in China, despite a budget reform aimed at promoting self-constrained bureaucracy, have successfully improved their own benefits across the board in the first place. Civil service compensation was historically low in the PRC. The growth level measured in both absolute and relative terms has been, nevertheless, very striking over the past decade. The author collected 20 years’ worth of data between 1989 and 2008 wherein data between 1999 and 2008 (the post-budget reform period) were measured against data from 1989 to 1998 (the pre-budget reform period).

The average wage of civil servants in subnational governments has rocketed since the late 1990s, and has been much higher than the average salary of all job categories since after 1998. In 1989, the annual salary of civil servants was 61 yuan less than the national average wage of jobholders. In 1998, the salary of civil servants was 294 yuan higher than the average. In 2008, civil servants were earning 3,726 yuan higher than the annual average of all categories. During the same period, as shown in Figure 1, the real annual salary of civil servants had escalated significantly from 1,874 yuan in 1989 to 13,236 yuan in 2008. Moreover, the average growth rate of real wages between 1999 and 2008 (13.18 per cent) was much higher than during


\textsuperscript{30} Lawrence and Martin, “Understanding China’s Political System”, p. 1.
the period between 1989 and 1998 (8.08 per cent), suggesting that civil servant remuneration had substantially improved since the budget reform. Comparing the average civil service compensation with gross domestic product (GDP) per capita in the same year, the author learns that the civil service pay level was higher than GDP per capita during the investigated period. The gap has substantially widened since 1999, indicating the significant impact of civil service pay enhancement since the late 1990s.

Not only has the average wage increased substantially, so have the total wage bills. The total wages of local civil servants skyrocketed during the period of 1989–2008 when the wage bill in 2008 was a whopping 26-fold increase from that in 1989. Figure 2 shows that the share of wage bill as proportion of the GDP rose steadily during the period despite a decline that occurred between 1995 and 1997. The wage bill as a percentage of the GDP in the second decade was much higher than during the first decade.

Some may wonder what has caused the bulging wage bills. Is it the average pay level or the size of the government payroll? The answer is that the enlarged pay bills were largely due to the improvement of civil service compensation since the number of local civil servants grew by 2.77 times over the 20 years, as compared to the 26-fold increase in the total wage bill during the same period.31

---

31 The author does not deny that bureaucratic expansion was also substantial during this period. Compared with the increase in civil service remuneration, the growth in the number of civil servants was less significant in affecting government wage bills at the aggregate level.
It should be noted that the aforementioned data only refer to the formal wage of civil servants. Civil servants in China enjoy substantial extra benefits in addition to the formal wage. Drawing on a large-scale survey among civil servants, Su and Yang suggest that the extra benefits ranged between 100 per cent and 200 per cent of the formal salary in coastal areas. In poorer regions in central and west China, the perks ranged between 30 per cent and 40 per cent of the formal salary. Some senior public personnel management experts in the Ministry of Personnel had a similar estimation of the size of fringe benefits in China. Compared with other countries, the civil service wage bill as a share of the GDP in China may not be as alarming as supposed. Nevertheless, given the trend of rising civil service pay and the implementation of an income distribution policy that is in favour of the public sector, the implications of an enlarged civil service pay bill deserve sufficient attention.

Furthermore, some lingering problems relating to fiscal prolificacy and self-serving bureaucracy have intensified in recent years. For example, the provision of luxury cars for leading cadres, among others, is a salient feature in China’s public administration. Although wasteful expenditure on official cars had drawn strong criticism from the public, fiscal profligacy in buying and using cars has never been mitigated in reality. Rather, the extravagance had worsened as local governments were obtaining increased fiscal resources. Constraining the use of public cars dates back to the early 1990s.

33 Interview, 15 June 2009.
Soon after the Tiananmen Square protests in July 1989, the CPC decided to rein in several important unethical practices among cadres. Luxury cars for the Party and government were identified as a kind of serious unethical practice, which should be eliminated immediately.34 In 1994, the Central Committee of the CPC and the State Council jointly issued a regulation on public car administration, which was updated in 1998. According to the regulation, the value of official cars for ministers and vice-ministers should not exceed 450,000 yuan and 350,000 yuan, respectively. Other official cars should be capped at 250,000 yuan.

Local officials, however, have never paid serious attention to the aforementioned rule in practice. A 1994 report by the Central Commission for Discipline Inspection of the CPC revealed that 84 per cent of ministers, vice-ministers and their equals purchased cars that were more expensive than the stipulated value.35 According to an updated investigation by the Ministry of Finance, more than half of the official cars exceed the price limits. Many cadres even utilise two or more luxury cars with one for official use and the other(s) for private use. In many cases, for one-third of the occasions, official cars are used for official purpose, but for the majority of the time, they are used for private purpose by leading cadres’ relatives and drivers.36 Public spending related to car purchase and maintenance roughly ranges between 150 billion yuan and 200 billion yuan (excluding cars for public hospitals, schools and the army), an equivalent to the national spending on environmental protection in 2008 (145 billion yuan).37

Comparatively, civil service compensation in mainland China is not as generous as that in some advanced economies such as Singapore and Hong Kong. Civil service pay, however, is fair based on the comparison of salaries among different job categories in both the government and the private sector. Anti-corruption was apparently one of the considerations involved in increasing civil service pay at the very beginning. As the then Premier Zhu Rongji emphasised, salary increases should be adopted to reduce corruption in China despite there being no guarantee for high compensation.38 Nevertheless, salary increments have actually moved far beyond what was stated by the premier. Cadres actively seek economic benefits trickling down from China’s economic boom.39 Meanwhile, non-wage benefits for civil servants have also developed in a stunning way, albeit in favour of senior bureaucrats.

35 Ibid.
37 Ibid.
FEELBE OR STRONG GATEKEEPERS?

Many scholars find that China’s governance structure is highly complex. Liu Yia-Ling points out that the higher authorities tend to impose their wills and commands through assigning increased burdens to local authorities while the central government also provides paternalistic care to local governments in a bid to get things done. Therefore, this Confucian bureaucratic structure implicitly encourages local authorities to pay more attention to tasks assigned by the central government. Process accountability, wherein governments should be held accountable for the process used to attain goals, has been largely ignored. The budget reform and the “accountability within the bureaucracy” nonetheless attempt to improve process accountability per se. The reality is not as promising as expected.

The overall observation based on field research is that local officials are well aware of the importance of the budget reform but the implementation is problematic. As of today, the budget is organised on a departmental basis in all field sites. Zero-based budgeting more or less appears in various official documents. Nevertheless, many compromises still exist in reality. According to a head of county finance bureau, it is still a common practice in some areas that the budget is organised along functional lines. For example, funds for agricultural development are still under the control of a leading department but on paper, each department in the cohort is assigned some monies for recurring spending and project expenditures.

It is the so-called concentrating our financial resources on a few projects in a bid to get big jobs done (jizhongcaili bandashi). Pulling together all financial sources for individual departments, albeit not conforming to the departmental budget reform, it can make public finance more flexible and efficient. The county finance bureau head reiterated that for the sake of better utilisation of public funds, the old budgeting approach is still useful. It should be noted that the DBR was originally intended to improve allocative and operational efficiency with regard to financial management. As for the zero-based budgeting, the scenario is similar. The informant observed that:

Leaders often talk of this budgeting approach, but that is all. To the best of my knowledge as a grassroots cadre for roughly 15 years, I don’t think that it is possible to distribute public resources without referring to previous figures.

Based on interviews conducted in Fujian and Hubei provinces, the author noticed similar feedback with regard to the 1999 budget reform. The results of the budget reform are mixed. Local budget officials have learnt more about new practices or

40 Liu Yia-Ling, “From Predator to Debtor the Soft Budget Constraint and Semi-Planned Administration in Rural China”, Modern China 38, no. 3 (2012): 308–45.
42 Interview, 22 Dec. 2010.
43 Ibid.
approaches in public budgeting. But the budget reform has not led to significant organisational and behavioural changes in the Chinese political-bureaucratic system. Under the Confucian bureaucratic structure, local bureaucrats, especially public finance officials—benefiting from paternalistic care—nonetheless cannot challenge the current governance structure at the local level.

Local legislatures do play a role in enhancing political pluralisation and interest articulation at the grassroots level. For example, some legislative debates have attracted wide public attention as many legislators openly criticise government policies, especially those introduced by local governments. The power of the purse is nonetheless still feeble in realpolitik. It is well recognised that the power of people’s congresses is in reality weaker than that stipulated in the Constitution and the Budget Law of the PRC. For example, the Budget Law and the explanatory notes indicate that people’s congresses have extensive power in ex ante and ex post control over public budgeting and spending. There is no article in the law that states explicitly how the situation when congresses veto budget reports presented by finance departments could be handled—in addition, this has yet to happen in today’s China. The people’s congresses have improved their leverage over executive power in recent years but not substantially with regard to budget approval. According to the author’s field research, congresspersons can only approve the budget with a minor change when the draft budget is presented to them. Any significant changes are rarely expected in the real world. As budgeting issues are viewed as an important distributive game in local politics, only Party secretaries and county executives can have the final say. On some occasions, congresspersons vehemently disagree with the draft budget. Finance bureaus may respond to the concerns. The substantial revisions are, however, entirely executed by only two to three top people in the county bureaucracy at the most, rather than legislators. In the end, congress meetings are, more often than not, ceremonial or procedural because the important issues have already been discussed and decided by top local bureaucrats.

Technically, with a budget speech of less than 10 pages, local congresspersons find it truly difficult to make substantial comments on budget drafts within a couple of days of meetings. More importantly, they need to review documents of higher

46 Zeng provides an intriguing example to elucidate the role of local congresses in the appropriation process. When congresspersons disagree with budget drafts endorsed by government executives, finance departments often simply ignore the disputes. If congresspersons do not compromise, finance departments will consult them for further revisions. However, if revisions conflict with suggestions of county executives, finance departments will send budget drafts directly to the standing committees of people’s congresses. In this case, a senior budget official argued that “although congresspersons may be upset, it is politically risky to challenge the budgets approved by county executives”. See Ming Zeng, “Policy Effect of Fiscal Transfers: Evidence from County-Level Data in Jiangxi Province”, Doctoral dissertation, Nankai University, 2009.
importance such as government work reports and personnel appointments under their jurisdictions. In addition, most local congresspersons lack the expertise in public finance and hence, they are reluctant to challenge budget agencies and related executive branches in local governments.\(^{47}\) Worse yet, with an increase in concurrent appointment of county party secretary and chairperson of people’s congress, the power base of local legislatures is eroded especially on budgeting issues.\(^{48}\) As mentioned, only two to three top leaders (probably including county party secretary, county executive and a deputy county executive) have real executive power over local public finance. With the concurrent appointment, once top leaders have made decisions on spending issues, local legislators, who are accountable to their bosses instead of the general public, can hardly challenge the status quo.

When the legislature does not have enough power in monitoring government budgeting, the role of gatekeeper rests with the budget authorities within the government. Finance bureaus do play a larger role in public governance. No longer a “cashier”, finance bureaus discuss budgets with individual departments and local people’s congresses extensively (there are at least two rounds of formal discussion between spending units and the budget agency). They can also provide professional advice to individual departments. However, their role remains largely a technical advisor to local party bosses or county executives. The real discretionary power lies with the county party secretaries and county executives.

In recent years, in view of using public monies for political projects, county party bosses and executives have imposed heightened controls over local public finance. As a part of the executive branch, senior employees of the budget agency are appointed by county executives and they need to communicate with their bosses. On most occasions, they have to follow orders. It is nearly impossible for the budget agency to subvert the decisions made by Party secretaries and county executives in China’s local state. Aside from this institutional constraint, the budget agency is at a severe disadvantage over information about spending units. For example, interviewees confided that education expenditure should be closely related to the number of registered students, the data of which, being closely guarded and monopolised by the education departments, remains non-transparent to the budget agency. Local financial officials admitted that their capacity is seriously constrained by this information disadvantage.\(^{49}\) Worse yet, departmental budgets are always backed up by county executives or deputy executives, who are in charge of the education sector. A war waged against the education department virtually means ostensibly challenging county executives or deputy executives.\(^{50}\)

\(^{47}\) Ibid.

\(^{48}\) Interview, 11 Jan. 2009. Some argue that the concurrent appointment will increase the People’s Congress’ leverage within the bureaucracy; see Zhong Yang, *Local Government and Politics in China: Challenges from Below* (Armonk, NY: M.E. Sharpe, 2003).


\(^{50}\) Interview, 22 Dec. 2010.
In addition to the problematic review process, the monitoring of budget implementation by the budget agency is also not effective. Local officials had shared in fieldwork interviews a popular saying at the local level that “the approval of the budget is decided by review bodies; when money has reached spending units, the control over funds is entirely up to individual departments (shenbao zijin shangji zuozhu, nadao zijin ziji zuozhu).”51 This saying paints a daunting picture of local budget implementation. It means that public spending is no longer under the radar of the budget agency once public funds have reached the account of individual departments. Financial accountability nonetheless requires a dynamic, process-based monitoring of public spending.

Based on her field observations, Christine Wong argues that local governments do not distinguish the funding sources in their public expenditure.52 The line-by-line control is impossible to be carried out since money is actually pooled together. As noted by Ahmad et al., ideally no money can be utilised or spent without an authorisation in the public domain.53 Under the Chinese budget reform, the same principle has been reiterated—that every line item of the departmental budget should be reviewed in detail and spending must adhere to the approved plan. It is, however, common that department heads divert funds from one spending category to another without any approval.54 Some public monies are even spent on banquet and private entertainment.

Leadership turnover affects the budget process in local governments. Budget uncertainty increases consequently after leadership turnover. New local leaders introduce new projects when they assume duty; the approved budgets should therefore be changed accordingly. On the one hand, new projects reflect their leadership legacy. If new leaders launch new projects that are successful and generate revenues for local governments, their promotion opportunities will therefore be enhanced.55 On the other hand, power consolidation is imperative to new leaders and they extend to their friends and relatives the access to patronage. Outsourcing or awarding new public projects to family members and friends is thus a common practice. With new leaders having several promotions in a short space of time, these partners in the private

51 Interview, 6 Jan. 2009.
54 Interview, 22 Dec. 2010. Due to emergency needs, interfund transfers exist in many countries; however, it is curtailed to a small fraction of the approved budget and for special purposes. Furthermore, it is allowed only within a certain category such as recurrent spending; see Ahmad, Kennedy and Klering, “Budget Laws, Control, Review, and Management in China”, pp. 49–73.
sector could reap the bulk of profits from public projects. An interviewee frankly remarked that:

Local leaders care about new projects and GDP growth because they will reap some benefits from them. For example, they may get 20 million yuan from a 200-million yuan public project. More often than not, they would get promoted faster once they receive more income. This is a positive cycle to further their career.56

New leaders show greater enthusiasm in initiating new projects, as local informants remarked. Many of these new county bosses have asked their subordinates to introduce and propose projects within three to six months after assuming office.57 Consequently, supplemental budget requests and appropriations, which are only implemented under special circumstances in some developed countries, become commonly used in China. The frequency and scope of supplemental budget requests being utilised have made China distinct from other countries. New leaders may be appointed at any point of time during the budget year, and this implies that the budget agency has to accommodate new requests for changes or overhaul the approved budget. Sometimes, government finance officials are vexed with the situation but more often than not, there is little that can be done to stop the new projects.58

Individual departments’ new projects or recruitments also require submission of supplemental budget requests. The heads of county finance bureaus being interviewed said that they are busy not only at the beginning and end of the year but also during other months such as June and July because spending units regularly make new requests in the middle of a budget year (from 1 January to 31 December).59 There are a variety of reasons. The central government may have new mandates requesting local governments to implement them. For example, the central government launched six civil service pay increments across the board after the late 1990s. Most of the pay increments took effect on 1 July. Local public finance bureaus therefore made an overhaul of the approved budget as the civil service pay bill was one of the largest spending items at the county level.60 In addition to the central mandates, local demands add to supplemental budget requests. For example, when civil servants enjoyed a raise, schoolteachers requested a comparable pay rise as the Compulsory Education Law of the PRC stipulates that schoolteachers and civil servants must have a comparable pay level in the same localities. Bottom-up factors therefore embody the complexity of local public governance. Public finance bureaus have to adjust their overall budget based on changing circumstances.

56 Interview, 7 Jan. 2010.
58 Interview, 22 Dec. 2010.
60 Interview, 14 Jan. 2009.
The author’s field research has shown that the 1999 budget reform has aggravated the problem of overusing supplemental budget. A local budget official described the situation as follows:

The employment of supplemental budget appropriations has become more common due to the introduction of the zero-based budgeting system. Under the DBR, individual departments propose a moderate budget increase at the beginning of a budget year and then make a supplemental budget request several months later to get a substantial increase of fiscal resources.61

The zero-based budgeting system has become the same old wine in a new bottle. Taking the previous year’s figures as a reference, individual departments play it safe when finance bureaus start to allocate public monies to every department; the departments will then try to persuade the finance bureaus to offer them a “due” share of the budget.62 This practice not only increases the workload of the budget agency but also renders the budget less stable and more unpredictable, which is detrimental to fiscal responsibility ultimately. A senior cadre from a local budget agency even stated that though some county governments implemented the budget reform roughly 10 years ago in the coastal areas, the ideas embedded in the budget reform are alien to them. In many cases, the reform itself has injected bewildering complexity into local budget formulation and implementation.63

Aside from a problematic implementation of the DBR, other initiatives in the attempt to improve fiscal responsibility have not achieved their original goals. Based on an examination of treasury management in the central government, Ang observes that the reform has improved the monitoring capacity of the finance department while enhancing efficiency within the hierarchy.64 This situation, however, may not be true at the local level. Though the Chinese government hailed the elimination of the multi-account system a success, small coffers (xiaojinku)65—deemed a violation of the single treasury account system (TMR)—are omnipresent in local China. Spending units, for example, created illegal “department head funds” (juzhang jijin) to channel public money for department heads’ discretional uses.66 Evidence suggests that although the central government claimed triumph in the war against small coffers in the early 2000s, the size of detected small coffers was found to be 100 million yuan and 200 million yuan in Hainan and Fujian provinces, respectively, in 2009.67 In

---

61 Interview, 12 Jan. 2009.
62 Ibid.
63 Interview, 22 Dec. 2010.
65 This refers literally to another kind of, albeit relatively small, treasury account.
66 Interview, 6 Jan. 2009.
2011, the Auditor-General reported in a review of budget implementation in the central government that small coffers amounting to 414 million yuan were discovered. The money was not used for public interests. Furthermore, the annual reports of the Auditor-General reveal that fiscal discipline in China has not improved significantly after the 1999 budget reform. For example, according to the 2006 national civil service remuneration reform, ministries are not allowed to pay extra allowances to their employees beyond the rate set by the Ministry of Finance and the Ministry of Personnel. The sum of overpayments discovered by the Auditor-General was 173 million yuan in two ministries and their subordinate units in 2009. This amount was nevertheless traceable; many government departments even fabricated false invoices to “steal” public money to improve their civil service remuneration. For example, 5,170 false invoices were identified in 2009 among 29,363 invoices being investigated in the ministries.

Examining the audit reports between 2003 and 2008, Liu and Jiang observe that wastage and mismanagement in the fiscal system had not been curtailed in both the central and local governments. The author’s fieldwork at the local level reveals a worrisome situation about fiscal prolificacy and mismanagement. For one thing, extra allowances disbursement was never abolished in resource-rich departments such as taxation bureaus.

The budget reform failed to consider the perils of reform at the very beginning. For example, cross-national evidence has demonstrated that zero-based budgeting involves too much paperwork during budget preparations. Many local fiscal officials told the author during field visits that budget approvals are still based on previous year’s figures instead of current priorities according to zero-based budgeting. Some departments at the county level have even stopped implementing the zero-based approach because it causes many problems instead of solving them. The World Bank reports that “none of the levels of government is truly practicing or plans to introduce a rigorous version of zero-based budgeting”, with a prediction that local governments

---

70 Ibid.
72 Interview, 15 Jan. 2009.
74 Interviews, 5 and 12 Jan. 2009.
75 Interview, 22 Dec. 2010; see also Deng Fengjiao, “Jicheng yanghang bumenyusuan zhixing zhong de wenti ji jianyi” (Problems in Departmental Budget Compilation and Implementation in Local Branches of the Central Bank), Hubei chengren jiaoyuxueyuan xuebao (Journal of Hubei Adult Education Institute) 16, no. 3 (2010): 72–3.
may find alternatives to circumvent the regulation several years later. This has happened based on the author’s fieldwork and other accounts.

Though the central government launched an ambitious budget reform a decade ago, the author’s recent field research suggests that the reform has not brought substantial changes over fiscal management at the micro level. Macro-level goals such as “accountability within the bureaucracy” and improved interest articulation have not been realised as well. In many cases, the installed mechanisms such as zero-based budgeting have been reversed at the local level.

CONCLUSION

This article reviews the implementation of the budget reform in China. As compared with the 1994 tax-sharing reform, the budget reform seems less important. Nevertheless, as suggested by the experiences of both developed and emerging economies, the budget reform may have a fundamental impact on the incentive structure of civil servants. As the Chinese government attempts to reform the budget process and implementation in many areas, the impact of these deep reforms cannot be underestimated.

The 1999 budget reform has reaped some benefits. The budget agency and the legislature have become more articulate than before. Legislators are increasingly awarded the power of the purse while the budget agency tends to be more assertive with regard to budgeting issues. Some reforms such as the DBR render the government budget more readable to legislators and the general public. The TMR poses some constraints on off-budget financing. The Ministry of Finance even attempted to end off-budget financing across the board starting in 2011. In sum, the 1999 budget reform, together with other reforms during this period, such as government information disclosure, have emphasised interest articulation and political pluralisation within the public sector in China.

Nevertheless, the author finds that none of the key goals of the budget reform have been fully realised in China’s local state. Bureaucrats increasingly employ the reform as an effective way to improve formal benefits while being free of blame for fiscal prolificacy. More seriously, similar to other reforms, the achievements of the budget reform show a reverse turn over a longer period. When the central government progressively demands local compliance, the goals can be fulfilled partially shortly after its implementation. This improvement will however level off or even diminish later. The 1999 budget reform manifests itself in a tortuous path of which the implementation of DBR is illustrative.

Various discussions about the achievements of the budget reform over the past decade reported that the share of misused funds in the total budgetary expenditure peaked in the late 1990s and plummeted after the budget reform. On retrieving data from the yearbooks (The Audit Yearbook of China), the author finds that the situation had not improved as it was supposed to for a longer period. There were no reports

on misused funds discovered by local audit authorities in the yearbooks for 2004–2006. Although audit data for the above-mentioned were missing, there were full reports on three important items related to misused funds, namely funds that should be returned to finance departments, funds that should be reduced in the following budget year, and funds that should be returned to sponsors. The ratio of these funds to the total public spending declined from 4.18 per cent to 2.16 per cent between 1999 and 2002; however, it rebounded thereafter to 2.69 per cent in 2007. Liu and Jiang’s observation about misused funds indicates a similar finding\(^7\) —the improvement of financial management in China is not as promising as expected.

This study suggests an “assertive” bureaucracy and a “passive” examining body in China. As noted by the budget-maximising theory, this structure is not beneficial to promoting self-constrained bureaucracy and strengthening fiscal responsibility.\(^7\) Although the budget agency attempts to assume the responsibility of monitoring public finance across the board, it suffers from institutional deficiencies. Wong argues that “[t]he budget law [in China] did not put the [Ministry of Finance] squarely in charge of government money.”\(^7\) In addition to legal constraints, local leaders, such as county executives, have never depicted budget agencies as instrumental to decision-making in economic management and other crucial affairs.\(^8\) The author’s field research suggests that only a small number of top leaders above finance department heads have real say over public finance at the county level.\(^8\)

The author also learns that there is a serious impediment to implementing the budget reform and enhancing fiscal responsibility at the local level. In fact, officials only understand some important reforms superficially. For example, the zero-based budgeting should not be taken as a norm or a standard practice for all spending reviews.\(^8\) Instead, according to the author’s field research, local fiscal officials either treat it as a straitjacket for all budget reviews or ignore it entirely. It is therefore suggested that a capacity-building plan should be in place before some important reforms are introduced at the local level.

The Confucian bureaucratic structure suggests that the career progression of local executives hinges on the ability of their implementation of central mandates. On the one hand, local governments try to accommodate requests from the central

\(^7\) Liu and Jiang, “Woguo zhongyangbumen yusuan jixiao shenji de nandian ji duice” (Dilemma in the Audit of Performance Budgeting in the Central Government).


\(^7\) Wong, “Budget Reform in China”, p. 10.

\(^8\) Bachman (1989) explained that under a planned economy 20 years ago, the finance department only served as a cashier. Admittedly, spending units may not view the finance department as a cashier in today’s China. Instead, spending units see the need to approach finance departments and bargain with them. However, there is still a long road for budget authorities in China to play more important roles in policymaking.

\(^8\) Interviews, 6 and 14 Jan. 2009; see also Zeng, “Policy Effect of Fiscal Transfers”.

\(^8\) The author thanks a reviewer for highlighting this point.
government. On the other hand, local governments have less incentive to promote fiscal responsibility as higher authorities would bail out local governments if they plunge into financial difficulties. Under this structure, one is offered a better understanding of the making and implementation of the 1999 budget reform. The central government initiated the reform for a variety of reasons, namely to promote macro-economic management, accountability within bureaucracy and modest political pluralisation. The Chinese government, however, has no intention of having wide participation by non-state actors in financial accountability. The patronage nature of central-local relationship in China renders the making and implementation of the reform half-baked in reality. Aided by many international organisations such as the World Bank, the Ministry of Finance has devised several decent plans on budgeting issues, but local key officials in public finance are constrained by the central-local relationship and the current governance structure.

China’s attempt to strengthen self-constrained bureaucracy and improve transparency and accountability, especially within the bureaucracy, is a crucial step towards improving local governance, and the relationship between the government and citizens. Powerful civil servants, however, may take advantage of any opportunity to financially benefit themselves rather than advance their public services, thus nullifying all the goodwill encapsulated in the reform. The Chinese experience suggests that top-down, supply-side reforms led by the state may not be effective and citizen participation is much needed. As Vietnam’s achievements in its budget reform have shown, the involvement of citizen participations may be instrumental in building a self-constraining civil service system and well-functioning local governance.

ACKNOWLEDGEMENTS

An earlier version of this article was presented at the workshop hosted by the Asian Development Institute, Seoul National University, on 22 January 2013 and the Inaugural International Workshop for Young Scholars in Public Policy and Administration Research organised by the American Society for Public Administration (ASPA), Xiamen, on 2 June 2011. The author is indebted to Kilkon Ko, David Hai Guo, Ting Gong, Ningxi Zhang, Meredith Newman, Eduardo Araral, Jonathan London, Liangping Guo, and Jingwei Alex He for their helpful inputs.

---

83 Put simply, central mandates may be challenged by non-state actors.