
4. Decentralization and Local Governance in the Context of China's Transition

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I. Introduction

When discussing decentralization and local governance in China, we have to keep three things in mind. The first is the vast size of the government in China. China is a huge country with five levels of government. Below the central government are 31 provincial level units (42 million inhabitants on average), 331 prefecture level units (3.7 million inhabitants on average), 2109 counties (580,000 inhabitants on average), and 44,741 townships (27,000 inhabitants on average). Furthermore, there are about 730, 000 villages in rural areas below the township level (World Bank, 2002). The multi-level nature of Chinese bureaucracy frequently causes confusion when commentators talk about decentralization and local governance in China, since the level of local governance discussed can range from the provincial to the village level.

Second, China is a transitional economy in the process of marketization. Since China's economic activities were mostly under the central government's control in the past, the reforms since the late 1970s involves the delegation of more and more economic powers to lower level governments. As a result, decentralization in China deals with economic transition and liberalization (see Qian and Weingast 1996 as an example), while decentralization in other countries focus on the transfer of public functions to lower level governments.¹ (See Bardhan 2002 for an excellent survey.)

Third, China is still a one-party state, with government officials of each level appointed from above by the ruling Communist Party. Only in the 1990s did grass-root elections begin to take place at the village level (which legally speaking does not constitute a governmental entity). Therefore, the concepts of "constitutional decentralization" and "political decentralization" do not quite fit the case of China since there are neither institutionalized rights for local governments to participate in the central government's decision-making nor genuine elections at and above the township level.

This paper focuses on a number of topics essential to China's decentralization and local governance while taking into account the three main principles outlined above. First, we focus on decentralization and governance issues at the local level, i.e. at the county, township and village levels. Second, since the decentralization of non-public functions took place simultaneously with the decentralization of public functions, we study both dimensions. Thirdly, the centralized political system has not only shaped the administrative and fiscal decentralization process, but also constitutes a basis for our understanding of many local governance issues in China; we therefore discuss their impacts at length.

This paper is structured as follows: in Part II, we review China's decentralization process during the reform period, and the resulting system that greatly affects local governance. Part III deals with the roles played by local governments in local economic development, especially their support for township and village enterprises during the 1980s. In Part IV we discuss local governments' function of providing public services. In Part V, we explore the problem of local

¹ In general, decentralization in the economic literature means the transfer of authority and responsibility for public functions (provisions of public goods and services) from the central government to subordinate or quasi-independent government organizations or the private sector.

government accountability and the village elections that were meant to curb this problem. Part VI offers some conclusions.

II. Decentralization during the Market-Oriented Reform Period

Economic reform in China began in the late 1970s. With the implementation of management at the local level, reform policies attempted to establish a system of economic stimulus and improve incentives for economic activities. In rural areas, the household responsibility system was initiated in 1978 and soon became the most common form of microeconomic organization, leading directly to the abandonment of the People's Communes system. In cities, early reforms of enterprise management centered on the delegation of managerial power and profit sharing. The "contractual responsibility system" in both rural and urban areas made individual households and state-owned enterprises (SOEs) *de facto* residual claimants.

Accompanying these micro-level reforms was a process of general administrative and fiscal decentralization. In a large country like China, the micro-level reforms and ensuing marketization necessarily warranted both administrative and fiscal decentralization. Without giving incentives to and seeking cooperation from local governments, the central government could not have implemented these reforms.

2.1 Administrative Decentralization

From the administrative perspective, the reform period saw a significant strengthening of local governments' role in local economic management, especially in areas such as investment regulation, entry regulation, and resource allocation. A striking example is the "opening-up" policy in coastal regions. Starting from 1979, many provinces were allowed to set up their own foreign trade corporations. The "one step ahead" policies were implemented in Guangdong and Fujian in 1978. In 1980, the four special economic zones (Shenzhen, Zhuhai, Shantou and Xiamen) were established, and in 1984, 14 coastal cities were declared as "coastal open cities". Not only did these areas enjoy lower tax rates and higher share of revenues, but also, and perhaps more importantly, they enjoyed special institutional and policy benefits and gained more authority over local economic development and the establishment of special economic zones and economic development zones.

Another important dimension of administrative decentralization starting in the early 1980s was increasing delegation of control of SOEs to local governments at the provincial, municipal and county levels. By 1985, industrial SOEs controlled by the central government had decreased to only 20% of total industrial output, while provincial and municipal governments controlled 45% and county governments, 35% (Qian and Xu, 1993). With the newly transferred firm ownerships from the central government, local governments were provided with incentives in taxes and profits to step up their efforts at revenue collection. At the same time, the fixed asset investment burden for local-SOEs naturally fell on the shoulders of local government. Since SOEs usually provided a wide range of social services like education, health care, pension services to their employees, more local government ownership of SOEs meant that local governments had primary responsibility for these expenditures, which continued to have significant impacts on local public finance in the 1990s.

2.2 Fiscal Decentralization

The fiscal dimension of decentralization was no less dramatic. In 1980, the system of inter-governmental revenue sharing was changed from the "unified revenue and unified expenditure"

(tongshou tongzhi) system into a "cooking in separate kitchens" (fenzao chifan) system, which divided revenue and expenditure responsibilities between the central and provincial governments. After that, the central-provincial fiscal arrangement experienced further changes: the proportional sharing system implemented in 1982 and the fiscal contracting decree of 1988. All of these changes were unsuccessful attempts by the central government to stem the decline of the central government fiscal revenue: local shares rose steadily from 54% in 1978 to 61% in 1988 and further rose to 78% in 1993 of the total government revenue. This trend in the end pushed the central government to install the tax-sharing system in 1994.

The tax-sharing system fundamentally changed the way revenues are shared between the central and provincial governments. Under this system, taxes were assigned either to the central or local governments, with central government receiving the bulk of the tax revenue. Local taxes consist of mainly business taxes, personal and enterprises income taxes, and other small taxes such as urban construction, land use and real estate taxes, and agricultural taxes. In later years, the central government revised this arrangement, making the consumption tax, income tax and the securities trading tax part of the tax-sharing system.

In general, during the decentralization of the 1980s, local governments not only began to enjoy more autonomy in economic management, but also began to assume primary responsibilities for local public goods and provision of services.

2.3. A Disequalizing System

Three essential characteristics of the current fiscal arrangement affect local governance. First, the current arrangement is structured as a nested hierarchy, in which the central government determines the broad outline of the system but deals directly with only provincial governments. The central government sets the revenue-sharing rules with the provincial government, which specifies the sharing system with its prefectures, which with its counties, and so on. Allocations of expenditures are structured in a similar way.

Second, lower level governments (i.e., provincial governments and below) have little formal taxing autonomy, in the sense that almost all formal tax rates are decided by the central government. In addition, local governments are only permitted to borrow through on-lending of external loans contracted by the central government or from the state development banks.

Third, there is no clear assignment of responsibilities among different levels of governments below the province. This leads to a high degree of concurrent and overlapping expenditures among the sub-national levels in China. In practice, concurrent responsibilities directly result in unclear accountability for the delivery of particular services. In many cases, due to the weak bargaining position of the lower level governments, it is likely that revenues are collected primarily by upper level governments, while responsibilities for public services (and the associated expenditures) are delegated to the lower levels of government.

These three structural features means that local governments assume greater responsibility for providing education, health, housing, social security, local infrastructure, and so forth. Fiscal stress and declining central government revenues had already led to dwindling inter-governmental transfers and a *de facto* devolution of responsibilities to local governments. With the introduction of fiscal contracts in 1988, the central government formally ended its responsibility for financing local expenditures. The role of local governments was thereby shifted

from providing services to financing them, a decentralization of responsibilities.²

As a result, the sub-provincial levels (prefecture, county, and township) face extremely heavy expenditure responsibilities that are out of line with international practice. This is specially the case at the county and township levels, which together provide the bulk of public services, including 70% of budgetary expenditures for education, and 55-60% of those for health. Cities at the prefecture and county levels account for all expenditures on unemployment insurance, social security, and welfare. By contrast, in most other countries social security and welfare are provided by the central government, and education and health are normally shared between the provincial and central governments.³

As the higher level governments transfer more and more expenditure responsibilities to lower level governments, the local governments, lacking formal taxing autonomy and often finding transfers from higher levels increasingly unreliable, tend to energetically pursue extra-budget revenue expansion (Wong 1998). In this disequalizing fiscal system, local government has to meet their responsibilities for providing public services with whatever resources are available to them. Besides profits from local SOEs and infrastructure user fees, much of these governments' extra-budget revenues came from either various quasi-fiscal fees levied on local enterprises or direct illegitimate fees imposed on farmers. According to an IMF report (Ahmad et al 2002), the ratio of local off-budget revenues to total local revenues remained around 40% throughout the 1990s.

III. Decentralization and Local Governance: TVEs

In the 1980s, enabled by administrative and fiscal decentralization, local governments started to play an important role in local economic development through their promotion of township and village enterprises (TVEs). The success of TVEs is one of the most distinctive institutional features of China's economic transition. By 1993, TVEs already accounted for 36% of Chinese national industrial output, up from 9% in 1978. Within the rural sector, the TVEs accounted for three-quarters of rural industrial output, or more than one-quarter of the national total (Che and Qian 1998).

In the early to mid-1980s, when prospective private entrepreneurs were still uncertain of the directions of the central government's policy regarding private enterprises, local governments stepped in and assumed an entrepreneurial role, starting the process of rural industrial development. According to investigations of the World Bank (Byrd and Lin 1990) and Oi (1994), although most TVEs enjoyed a considerable degree of enterprise autonomy, the community government made three types of strategic decisions: in investment and finance, in manager selection, and in the use of after-tax profits for public expenditure.

The community governments usually initiated internal fundraising, either from general collections or from individual contributions, to start up community owned enterprises. By retaining property rights over TVEs, the community governments could take revenue from one enterprise and use it to develop another through an informal process of "borrowing" and redistribution of debt. Thus funds for investments could be accumulated (Oi 1995).

² As a result, local expenditures grew much faster than central expenditures, especially social security expenditures, unemployment insurance expenditures, increased pension spending, increased subsidies for housing and fuel, etc. The share of local expenditure grew from 54% in 1978 to 66% in 1993 and 64% in 1999.

³ While these levels of government had always provided such services, they had previously provided them as agents of the central government, i.e., the central government always subsidized the financial gap when necessary.

In the course of TVE development, the community governments were also pivotal in securing loans from either the Agriculture Bank of China (ABC) or Rural Credit Cooperatives (RCCs), two major external sources of financing (Whiting 2000). The township and village level governments not only initiated the process of bargaining and borrowing from the ABC or RCCs, but also used community assets (which could be assets of other enterprises in the same community) as collateral and provided loan guarantees in support of TVEs. In addition, although the managers of TVEs were often employed under contracts that specified tenure and compensation schemes and put in charge of day-to-day enterprise management, they were still employees rather than entrepreneurs. Important decisions, including the appointment of managers and major investment decisions remained within the purview of local officials.

At the start of TVE development in the early 1980s, most economic resources were still within the control of the central government and therefore market information was scarce. Using information and contacts that they developed using their relationships with other governmental entities, local government officials could usually provide many essential services to local enterprises, such as access to raw materials and information about new products, technology and potential markets for TVE products.

The TVEs can be best characterized as community enterprises with a governance structure in which the community government has control. This has led scholars to characterize China's distinct form of state-led growth as "Local State Corporatism" (Oi 1994): local governments foster and support enterprises within their administrative purview and treat them as one component of a larger corporate whole. Local officials act as the equivalent of a board of directors and sometimes more directly as the chief executive officers of these corporate entities.

Such are natural responses to the institutional environments of China's transitional processes. In the earlier period of transition, private ownership was not protected by the state due to the absence of the rule of law and institutions that might constrain the state from arbitrary revenue expropriation.⁴ The nature of public ownership made TVE property rights much more secure. At the same time, the imperfect capital markets in the early transitional period also made it difficult for individual enterprises to obtain credits. Community government ownership and the guarantees that came with it made it much easier for TVEs not only to get loans, but also to get access to raw materials, new technologies and market information through administrative channels in a still plan-dominated economy.

Local governments also saw it as part of their duty to lobby on behalf of the community enterprises. Local officials often tried their best to circumvent central or provincial government regulations to allow TVEs to receive the best possible tax advantages and exemptions. They do this so that more revenues could be kept within the locality. Such revenues then can be used for enhancing TVEs and for local projects and services.

The rise of TVEs in the 1980s was closely related to institutional changes in other areas. With the decollectivization of agricultural production, local governments had to seek further revenue sources. The fiscal reform that gave a greater share of revenue (i.e., TVE profits or tax payments) to local governments and granted them the rights to use any fiscal surplus paved the way for local governments to support TVE development with better incentive systems. The decentralization

⁴ As a matter of fact, along with the growing collective enterprises, private rural enterprises also emerged, but they are the so called "Red-capped" private enterprises—fake collectives that used the collective label for protection and economic benefit. This phenomenon existed mainly in the more marketized provinces such as Zhejiang .

policy granted local government officials great autonomy over their economies, including the autonomy to set prices, to make investments with self-financing, and, more importantly, the autonomy to restructure their firms and issue licenses to newly established firms. Overall, decentralization better delimited the property rights between different levels of government, such that the government at each level became the real residual claimant and controller of its own public economy.

Starting from the mid-1990s, however, local governments started to push for TVE privatization. There were two main reasons. First, TVE economic performance deteriorated as the overall economy slowed down, market competition intensified, and the advantages of local leader involvement in TVE management declined even as the incentive problems of public ownership became more apparent.

Second, real interest rates rose significantly as inflation came down, but nominal rates adjusted slowly. Financial competition increased. In 1996, the rural credit cooperatives (RCCs) were separated from the Agriculture Bank of China (ABC) and began competing directly in the market with one another. The government also encouraged specialized state banks to compete across sectors, which in many areas sharply increased competition for TVE borrowers. Both the competition in the consumer and financial markets led to a dramatic change in the lending preferences of banks in favor of private firms, eroding the joint-lending advantages of collective enterprises. Whereas in 1994 nearly all bank managers, all other things being equal, favored lending to collective firms, by 1997 only 14% favored collective firms while 58% favored private firms (Park and Shen, 2003).

The wave of TVE restructuring and privatization that started in the mid-1990s was often initiated by local governments themselves out of concern for the financial health of TVEs and the fiscal impact losses in TVEs might have on local government budgets. In the southern parts of Jiangsu Province, one of the two model areas of TVE development (and characterized by higher shares of community ownership than in neighboring Zhejiang Province), local governments were not only unable to secure funds from capital markets and to subsidize massive losses resulting from deteriorating TVE performance, but also unable to retain good managerial teams and skilled workers as the more efficient private and foreign firms could offer much higher wages. As more private rural enterprises in Zhejiang were getting stronger due to better governance structure, local governments in Jiangsu started to privatize TVEs on a large scale.

In retrospect, the developments of TVEs since the early 1980s marked a significant phase of Chinese economic transition. The successful experiences of TVE development in 1980s led to the argument that government could play a larger role in economic development than merely protecting property rights and providing public services (see, e.g., Oi, 1994). In fact, however, the success of collective enterprises was limited. It was mainly located in coastal provinces such as Jiangsu and Shandong, and took place mainly before the mid-1990s. Later, as the marketization penetrated into inland areas, some inland local governments imitated their coastal counterparts in promoting local TVE development. But they were unsuccessful and often found themselves trapped into huge debts to local banks and RCCs (Chen 2003). In reaction to the deepening marketization and competition of the late 1990s, local governments in the coastal regions quickly exited from TVE and returned to traditional public services functions.

IV. Decentralization and Local Governance: Public Services

The current fiscal system leads to highly differentiated local disposable revenues across regions, resulting in a highly heterogeneous spectrum of local public services provision. In richer

regions—mainly the coastal areas—local governments, especially those at the township and village level, are able to provide decent public goods because they enjoy not only higher tax revenues from the development of non-agricultural sectors, but also can draw on high-priced land use fees and non-taxable profit remittances from TVEs.

In less developed areas—located for the most part in inland China—local revenues depend on agricultural activity and are usually much smaller. Without sufficient and dependable equalizing transfers from higher-level governments, local governments often find it difficult to run on a balanced budget. The situation became increasingly serious after the 1994 fiscal reform. Provincial governments in less developed regions tend to squeeze larger shares of revenues from lower level governments and at the same time assign more responsibilities to the lower level. As the World Bank reported in 2002, there was a trend towards an increasing share of expenditures at the provincial level, and a declining share for the county and township levels combined, during the period of 1994 to 1999 (World Bank, 2002).

In many less developed provinces, county and township governments suffered the most in fiscal terms after 1994. Facing an increasingly large bureaucracy, many county- and township-governments found themselves in serious fiscal imbalances. Most of their revenues were spent on government employee wages (including employees of local schools and local public health institutions), and funds for local public goods and services provision became very limited. When various development mandates are un-funded, local governments have to find their own ways to meet the requirements. Many less-developed counties or townships face fiscal crisis: in some cases, even basic wage payments are delayed for a long period (often for a year or more), or government employees may receive only half of their nominal wages.⁵ In many regions, significant “hidden deficits” emerged, as budget funds officially recorded as designated spending were in fact diverted (or borrowed) to more pressing needs such as wage payment.

For example, in the mid-1990s, many local governments, driven by budget incentives and TVE development mandates set by upper-level governments (usually the provincial governments), borrowed huge amounts from local banks (especially the local branches of the ABC and the RCCs) and initiated a frenzy of TVE investment, resulting in huge debts at the township and village level of government (Chen 2003). One estimate is that the national average township level debt is RMB 4 million (Zhu 2002). To ensure local tax revenue, some less-developed regions took administrative measures to erect barriers to the import of industrial products from other regions. In some extreme cases, local government employees were forced to buy locally produced cigarettes before they were paid their wages.

As Park et al (1996) observe, the current fiscal system has led to local governments’ increasing self-reliance in meeting expenditure responsibilities, resulting in greater inequality in the provision of local public goods and services, and creating incentives for local governments to stress revenue mobilization at the expense of other distributional and growth objectives.

A telling case is funding for education. County and township governments are primarily responsible for local education development and the implementation of the state-mandated “Nine-Year Compulsory Education” program. However, most government funds for the education sector are used to make wage payments. Nationwide, only 7-9% of total budgetary expenditures

⁵ An example is the middle-income coastal province of Hebei. In 1998, wage arrears to school teachers alone reached RMB 155 million, and an additional RMB 186 million deficit emerged in 1999. Although provincial governments raised RMB 740 million in recent years to solve the widespread wage arrears problem during the past several years, total provincial wage arrears still reached RMB 1.29 billion at the end of 2000 (Chen 2003).

on education went to non-personnel costs in 1999. For example, in two typical counties in the northwestern provinces of Gansu, Hezheng and Jishishan, personnel costs absorbed 98% and 93% respectively of total recurrent education expenditures in 1999. As a result, schools are dilapidated and lacking in instructional materials, which adversely impact the quality of teaching (World Bank 2002). At the same time, deficit-ridden local governments passed more of the costs of education along to the students and their parents through various school fees.⁶

Another example is the central government's wage and employment policy for civil servants. In 1999, the central government implemented a policy of an across-the-board increase in civil servant salaries, but also asked local governments to provide shares of funding. This caused serious problems in less developed regions that are fiscally fragile (World Bank, 2002).⁷

In recent years, one of the most serious headaches for the central government has been the expansion of local bureaucracy (Chen 2003).⁸ Despite the central government's downsizing efforts, township bureaucracies have continued to expand since the mid-1990s. However, under many circumstances, bureaucratic expansion is simply a response to new mandates from above (Yep, 2002). Local governments are frequently instructed to take up newly designated "core tasks" in addition to routine administrative tasks. These are policy priorities identified for immediate action or extra attention, such as suppression of "superstitious activities" and improvements in public security. As a result, *ad hoc* offices are set up, but many soon become permanent and require extra staff. In other cases, new offices are set up as the central government develops new regulatory functions. These staffing and operational expenses are in large measure financed by local budgets (Lu, 1997).

While implemented nationally, central government policies are subject to heterogeneous enforcement, which leads to differential impacts across regions and even households. Taking the birth control policy as an example, the central government's policy is more or less homogeneous across regions. However, the difficulties in implementing the policy vary greatly across regions. In poor areas where income is low, non-agricultural employment limited and women less educated, farmers usually want to have more children than farmers in richer regions. Therefore, implementing birth control in poorer regions is much more difficult, which entails higher administrative costs and more staffing.

A related issue is the excessive burdens on farmers in many less-developed regions in China. Since the mid-1990s, the problem of rural taxation, especially that of increasing local informal fees assessed to farmers, has become acute. In 2002, after a difficult decision-making process, the central government decided to implement rural taxation reform in twenty provinces, accompanied by a central government funds transfer of RMB 25 billion and provincial funds

⁶ For example, in one county of Gansu Province, even though school fees are only around RMB 30 per year in primary school, on average students also have to pay RMB 75 for textbooks. With annual incomes averaging only RMB 853 in Jishishan, it costs 3-4% of average family income to send a child to primary school (assuming 3-4 members in the household). In terms of cash income, which is typically only 50-60% of total income, it costs 6-8%, leading to school dropout and low enrollments (World Bank, 2002)

⁷ Many local governments, especially the county and township governments in less developed regions, are also burdened with requirements from upper-level governments to hire recent graduates of universities, high schools and technical middle schools, and veterans. There is a similar problem with the uniform national wage system, which forces local government agencies to become in effect the employers of last resort in less-developed regions that have very limited opportunities for decent jobs.

⁸ In 1980, a township government had on average a total staff of 20-30 employees. The average has now expanded to over 200. The ratio of farmers to local cadres is often as large as 40:1. In 1995 alone, about one million new personnel were added to the state payroll and this figure does not even include new recruits paid with local resources. (Yep, 2002)

transfers of about the same size. The reform can be summarized as “fee-tax-swap”, which removes all local informal fees but increases the rates of formal state agricultural taxes and aims to prevent arbitrary charges by the local governments and “quasi-governmental” community organizations.

However, just ordering local government to stop charging fees without coordinated reforms in other aspects of rural governance simply does not work. In some regions, a rebound of informal fees seems very possible (Qin, 2001). Our conclusion is that higher-level government policies and interventions, such as grain procurement, birth control, and many other unfunded development mandates such as the nine-year compulsory education program, play a key role putting strains on local governments (Lin et al, 2003).

Starting from 2003, the central government began to relax the grain procurement policy in some provinces after incurring huge financial losses in the grain markets. However, more center initiated policies are being formulated and implemented, such as the Rural Health Care Development Program, and the Sloped Land Conversion Program, both of which requiring local governments to provide certain shares of funding and providing intensive administrative support. The newly installed policies and the political system that continues to create un-funded mandates may very possibly make the current rural taxation reform unsustainable.

Higher-level government needs local governments to implement policies, but at the same time it does not provide sufficient funding. Since there is also an information asymmetry in regulation enforcement between the two (i.e., the higher-level government cannot perfectly monitor the implementation of regulations by the lower-level government), local governments may easily expand local bureaucracy and engage in rent-seeking in the name of implementing government mandates. Expansion of local government encourages rent-seeking, crowds out private investment, and reduces farmer consumption. As a result, government expansion will likely aggravate rural tax burdens and lower rural income growth.

In general, although the current fiscal system has hardened local budget constraints and promoted local governments’ incentives to foster local economic development, their positive impacts are limited in the relatively well-endowed coastal regions. At the same time, low revenue capacity and insufficient fiscal transfers have largely incapacitated local governments in the less-developed and agriculture-dominated regions, making it impossible for them to provide adequate public services to their inhabitants.

V. Decentralization and Local Governance: Accountability and Direct Election

Under the current political system, local governments are held responsible more to upper-level governments than to people in their localities. Without sufficient supervision and checks and balances and without free flow of information due to lack of press freedom, the inevitable result is a serious lack of government accountability. In practice, local governments in less developed regions have great freedom to manipulate information. Complaints about corruption are common. In many cases, local officials fabricate statistics about economic growth and government revenues, exaggerate farmers’ income growth and underreport rural tax burdens. To meet the targets set up by higher levels of government, local governments launch either showcase projects (such as highly visible roads or expensive education and health care facilities) or various excessive local fee charges assessed to farmers.

The central government has hoped village elections will solve the accountability problems at the village level. Before 1979, village leaders were appointed by the higher levels of government.

Following the collapse of the People's Commune system, farmers first began experimenting with various forms of self-government in the early 1980s. These creative initiatives were soon seized upon by the central government in order to maintain social stability. After a tenacious battle led by a few reform-minded political leaders, the self-governing procedures were written into a law that was passed by China's National People's Congress on a provisional basis in 1987.

It took another decade before the Organic Law on Villager Committees was implemented in earnest and finally revised in 1998 to include universally-recognized procedures that guaranteed electoral openness, fairness and competitiveness. Up to now, all administrative villages in China, totaling about 730,000, conduct direct elections every three years.

However, many problems still exist. First, while the procedures for village elections have seen a steady improvement over time, significant regional variations still exist. Some village elections have been plagued by problems that are found in elections in other countries, including vote buying and various forms of upper-level government manipulation. In many cases, standardized approaches for the organization of elections across the countryside are plainly not being followed.

Second, the relationship between the un-elected village Party Secretary and the elected villagers' committee chairman ("Village Head") can also be delicate. The division of administrative responsibilities between the Party Secretary and the Village Head is not always clearly defined. Empowered by the support of villagers, the Village Head is in a better position to negotiate with or even confront the Party Secretary, which in many cases lead to paralysis of local governance and direct administrative intervention from a higher level (township or county) of government.

Third, there is a need to adjust the relationship between township government and elected villagers' committee. Although in principle villagers' committee should not be subordinate to township officials, in practice, township administrators are motivated to intervene in village affairs since the township leaders need the Village Head to enforce state policies such as birth control, grain procurement, tax collection and educational development.⁹ Disturbances at the village level are surely a liability for township officials whose individual performance appraisals are directly affected by such occurrences. In some cases, township or other higher level governments disrespected the rights of villagers and intervened directly in elections by nominating their preferred candidates or manipulating electoral procedures, even directly interfering with village affairs whenever they suspect incompetence or any form of unacceptable behavior by elected village leaders.

We argue that the sheer volume and onerousness of upper level government regulations and unfunded mandates, which play essential roles in rural governance, significantly affect (township and county) local governments' willingness to support grass-root elections and their tendency to refrain from election manipulation and intervention. If the policies and mandates from the central government or provinces are very difficult to implement, in the sense that more taxes need to be levied on farmers or other corrective measures (often involving coercion) need to be taken, local governments may tend to run roughshod over grass-roots democracy.

VI. Conclusion

⁹ As with the relationships between higher levels of government, both the Village Head and Party Secretary are evaluated by higher levels of government on the basis of their success in meeting targets set by them. Performance contracts tie wages explicitly to meeting these targets and to other economic and social variables like village economic growth and equity.

In this paper, we review some key issues of decentralization and local governance in the context of Chinese economic transition. We argue that although local governments, especially those in coastal regions in earlier periods of the reform, played positive roles in promoting township and village enterprise development both directly by establishing and managing the enterprises, and indirectly by providing support in credit, technologies, market information to facilitate enterprise developments, such roles have gradually diminished to the more “normal” provision of public goods and services as marketization made further inroads in the national and local economies. Although the administrative and fiscal decentralization of the 1980s promoted local governments’ incentives to foster local economic development, the recentralization in 1994 that did not provide for clear and appropriate division of responsibilities for expenditures by different layers of governments has significantly impaired the capacity of local governments to provide adequate public goods and services in less developed regions.

On the one hand, a centralized one-party political system has inevitably led to the lack of local government accountability to local population and widespread corruption; on the other hand, various un-funded development mandates and policies from the central government, and the current system of cadre supervision and monitoring (characterized by the use of performance contracts) endogenous to the political system have resulted in distorted local government behavior such as excessive rural taxation and fake statistical reporting. Although village elections since 1990s have helped to promote transparency and supervision from local population and reduce local corruption, progress has varied across regions. In order to establish an effective local governance system with appropriate decentralization elements, China must stop the imposition of un-funded development mandates and unreasonable interventions from the central government onto local governments.

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