CHINA

UNITARY COUNTRY

BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: UPPER MIDDLE INCOME

LOCAL CURRENCY: CHINESE YUAN RENMINBI (CNY)

POPULATION AND GEOGRAPHY

Area: 9 634 057 km^2 *
Population: 1 386.395 million inhabitants (2017), i.e. 0.5% per year (2010-2015)
Density: 145 inhabitants / km^2
Urban population: 58.0% of national population
Urban population growth: 2.7% (2017 vs 2016)
Capital city: Beijing (1.4% of national population)

ECONOMIC DATA

GDP: 23 300.8 billion (current PPP international dollars), i.e. 16 807 dollars per inhabitant (2017)
Real GDP growth: 6.9% (2017 vs 2016)
Unemployment rate: 3.9%% (2017) (*Urban areas only)
Foreign direct investment, net inflows (FDI): 168 224 (BoP, current USD millions, 2017)
Gross Fixed Capital Formation (GFCF): 41.9% of GDP (2017)
HDI: 0.752 (high), rank 86 (2017)

*The area includes the two special administrative regions of Hong Kong (China) and Macau (China) as well as Chinese Taipei.

MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

The People's Republic of China is a unitary country governed by the Chinese Communist Party since 1949. China has a unicameral national legislature, the National People's Congress (NPC) and its Standing Committee, which operates under the leadership of the Communist Party and is defined by the constitution as "the highest organ of state power". The State cabinet, the State Council headed by a Prime Minister, and "people's governments" at lower levels of governments implement and execute policy.

The Constitution recognises three levels of subnational government: provinces, prefectures and counties. Historically, subnational governments have a relatively high degree of autonomy, but the political system remains highly centralized. Therefore, each subnational government unit is governed jointly by a secretary from the communist party, appointed by party committees from higher levels of government, and by a mayor, or governor in the case of provinces, who are selected and appointed by the local people's congress, but higher levels of government often influence this selection. Central government ministries have offices in each province, which report both to their ministry in Beijing and to the provincial leadership, even though on specific topic (e.g. environment), they tend to increasingly interact directly with their line ministries. Provinces have the right to pass their own regulations, which may supplement national laws and regulations, although not conflict with them.

Since China's last major fiscal reform in 1994, a large vertical imbalance between revenue allocation and spending responsibilities across levels of government has prevailed. Recently, the State Council announced a forthcoming intergovernmental fiscal reform plan with the aim to alleviate misallocation, imbalances and risks, by increasing the role of the central government.

TERRITORIAL ORGANISATION

2017	MUNICIPAL LEVEL	INTERMEDIATE LEVEL	REGIONAL OR STATE LEVEL	TOTAL NUMBER OF SNGS
	counties *(县级行政区)*	prefectures *(地级行政区)*	provinces *(省级行政区)*	
	Average municipal size:			
	2 851	334	31	3 216

These statistics cover mainland China only, without the special administrative regions of Hong Kong (China) and Macau (China) or Chinese Taipei.

OVERALL DESCRIPTION. China is a unitary country with four layers of subnational governments: provincial, prefectural, county and township/village levels. The Constitution only recognises the first three layers of subnational governments, yet townships and villages are addressed in the Budget Law and in the fiscal system. China has also encompassed two independent Special Administrative Regions (SARs), namely Hong Kong (China) and Macau (China), since 1997 and 1999, respectively.

At the provincial level, the country is divided into 22 provinces, five autonomous regions and four centrally administered municipalities. The intermediary level is composed of 334 prefectures including 283 prefecture-level municipalities. The lower-tier of subnational government, i.e. counties, is made up of 2 851 municipal districts, county-level municipalities and autonomous counties. Townships, towns and districts form the fourth level of subnational government, the lowest level of administration (39 862 according to the 2016 census). They are further divided into villages in for towns and townships, and neighbourhoods (jie dao) units in urban areas at the township level that serve as a channel of communication to the population.

China has experienced rapid urbanisation since 1978, and between 1978 and 2017, the residents-based urbanisation rate increased from 18% to 59%, still below the urbanisation rate of most other advanced and emerging economies. In contrast, based on *hukou* (household registration), the urbanisation rate would be 24% and 42%, respectively. Despite the emergence of a number of megacities and urban regions, metropolitan areas and megacity regions are not designated as specific administrative units, and their management and coordination across jurisdictions is taken up by the upper level of government, most often provinces. Similarly, cities are a geographical concept, not an administrative one, and they exist at each of the three administrative levels. Regional disparities are also growing significantly.

In 1983, the government adopted a Municipality-Managing-County (MMC) system to enhance rural–urban interdependence and integration. Under this system, a prefecture-level municipality has a jurisdiction over a central city and surrounding rural counties or districts. Yet this system often led to an ambiguous division of government functions, fund diversions, and resource rivalry between different levels of government. The MMC system has been replaced in a number of provinces since the 2000s by the Province-Managing-County system (PMC), which aims to allow provincial governments to deal directly with county governments on almost all fiscal affairs, and to free themselves from the subordinate relationship with prefectures. Moreover, a decree regarding the management of administrative divisions (enforced in January 2019) focuses on urban integration and coordination between rural and urban areas where administrative divisions need to be adjusted.

SUBNATIONAL GOVERNMENT RESPONSIBILITIES

Intergovernmental organization in China has mainly emerged through economic reform, and not directly from national law, the constitution of any other dedicated legal basis for decentralisation that would clarify the functions of each level of local government. The Comprehensive Fiscal Reform (1994), Budget Law (1995), and Tax Sharing System (1994) have helped define the role of subnational governments.

Governments at each level are all-purpose governments, responsible for public service and local affairs, as well as economic development, judicial administration and urbanisation. In principle, subnational governments are agents of the central government, tasked with implementing national policy objectives within their jurisdictions. The allocation of responsibilities and expenditure to the various tiers of sub-national government is uneven, and varies among provinces, which have considerable regulatory control over lower levels.

The 2016 Guiding Opinion by the State Council aims at clarifying spending assignments between the central and sub-national levels by 2020. In many cases, prefectural and county governments have very broad and overlapping expenditure responsibilities, and overall they deliver about 90% of major public services including health, education, social protection and environmental services.

Regarding social welfare, China has developed both a public pension system, and unemployment insurance managed at the local level.
Lower-tiers of subnational governments are devolved not only pre-determined sub-national responsibilities, such as urban maintenance and construction, but also the incremental part of service provision for education and healthcare spending.

MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

	PROVINCES	PREFECTURES	COUNTIES
1. General public services	Civil affairs; Judicial administration	Judicial administration	Civil affairs; Ethnic affairs; Judicial administrations
2. Public order and safety			
3. Economic affairs /transports	Infrastructure construction; Agricultural production	Infrastructure construction; Agricultural production	Infrastructure construction; Agricultural production
4. Environmental protection			
5. Housing and community amenities			Urban and rural development
6. Health	Health	Public health services	Public health services
7. Recreation, culture & religion			
8. Education	Education	Compulsory education	Compulsory education
9. Social protection	Unemployment insurance; Social security and welfare	Social welfare	Social welfare

SUBNATIONAL GOVERNMENT FINANCE

Scope of fiscal data: provinces at the regional level, encompassing autonomous regions, provinces and municipalities, in addition to prefectures at the intermediary-tier of government, and counties at the lower-tier. The SARs of Hong Kong (China) and Macau (China) as well as Chinese Taipei are not included in these data.	Other	Availability of fiscal data: **Medium**	Quality/reliability of fiscal data : **Medium**

GENERAL INTRODUCTION. Provinces, prefectures and counties in China are fiscal units with their own revenue, budget and expenditure assignments. Villages and townships, at the sub-county level, have their own budget but they have no own revenue source, and rely exclusively on transfers from higher-levels of government. There exists no consolidated budget document in China that contains all the expenditures and revenues of local governments, which are divided between four separate budgets, the largest one being the Public Finance budget, being used in this country profile. On the revenue side, it includes all local tax revenue and the local portion of shared taxes, non-tax revenues from user charges, administrative fees, and other sources, as well as most intergovernmental transfers. Regarding expenditure, it includes almost all current expenditures of local governments, in addition to some capital expenditures. Other budgets are the Government Funds budget, the Social Security budget, and the State-Owned Enterprises Operating Fund budget.

China's fiscal system is characterised by a strict vertical hierarchical relationship between different tiers of government, similar to its administrative system. Counties bear the largest share of fiscal mandate among Chinese SNGs. China’s local governments do not have taxing power, have limited access to borrowing, and are often overloaded with unfunded mandates. However, they have a considerable degree of autonomy over land concession revenues, and may engage in indirect borrowing from banks or the bond market through local government financing vehicles, to finance infrastructure investment and local economic development. The last comprehensive change in inter-governmental fiscal relations dates back to 1994, with the introduction of a tax sharing reform, which allocated a greater revenue share to the central government level. Since 2004, provinces that chose to implement the PMC system have the power to determine the assignment of both counties’ revenues and expenditures, bypassing the prefectural level, which introduced greater spending autonomy for county governments. In August 2016, a major intergovernmental fiscal reform was announced to address the long-standing misalignment of revenue and spending across levels of government, which should be ready by 2020 with the drafting of an Intergovernmental Fiscal Relations Act.

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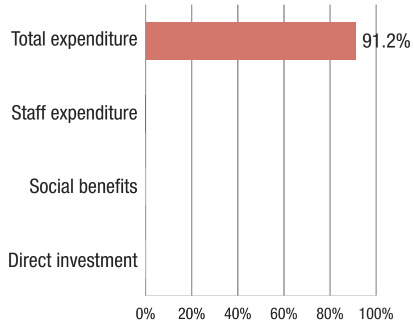
SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

2016	DOLLARS PPP / INH.	% GDP	% SNG EXPENDITURE
Total expenditure	3 338	21.6%	100%
Inc. current expenditure			
Staff expenditure			
Intermediate consumption			
Social expenditure			
Subsidies and current transfers			
Financial charges			
Others			
Incl. capital expenditure			
Capital transfers			
Direct investment (or GFCF)			

% GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY)



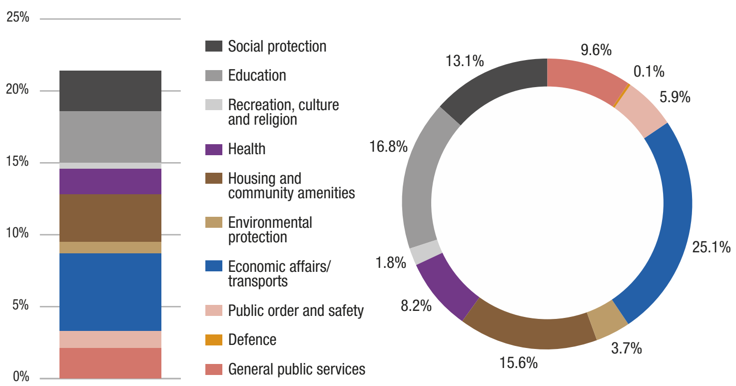
EXPENDITURE. According to data from the Public Finance budget, subnational expenditure in China in 2016 amounted to CNY 15.854 trillion, representing 85.4% of total public expenditure and 21.6% of GDP. Expenditure arrangements of Chinese local governments are more decentralised than revenue arrangements, generating high fiscal pressure for local governments. This high figure marks an increase of almost 6 percentage points since 2013. Their spending autonomy, and in particular counties' leeway, is still largely constrained, as the system remains highly centralised through the use of laws, regulations and directives. Local governments are "spending agents" acting on behalf of the State, spending according to the objectives and priorities set by the central government.

DIRECT INVESTMENT. Infrastructure investment in China is mainly the responsibility of subnational governments, even though strategic projects of national and interregional nature are financed by the central level. In the wake of the 2007/08 global financial crisis, most of the economic stimulus package, whose major components were urban and rural infrastructure projects, was therefore implemented through China's local governments. Overall, the central government gives provinces considerable leeway in adopting policies to boost investment and economic growth, and encourages them to undertake approved policy experiments. Infrastructure investment relies increasingly on PPPs, financed by banks, government funds and local government vehicles. The Thirteenth Five-Year Plan of the PRC for 2016–2020 promotes improvements in the resource allocation in order to make investment more efficient. As a result, the growth rate of total public investment as a share of GDP has started to slowly recede. Priority subnational investment area are poverty alleviation and shantytown rehabilitation, agriculture, education and ecological progress, as well as lessening regional disparities.

SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG

Main subnational areas of spending in 2016 were economic affairs and transports, education and health. According to the Public Finance budget, in all economic functions, except for defence and general public services, subnational governments in China are responsible for more than 80% of total public expenditure. Chinese Provinces in particular were responsible for the lion's share of these expenditures, including almost all public spending at the national level on education, health, unemployment insurance, social security, and welfare. Education and healthcare are the fastest-growing expenditure categories because of ageing and urbanisation dynamics. Lower-tiers of subnational governments keep being devolved additional assignments related to local development and infrastructure.

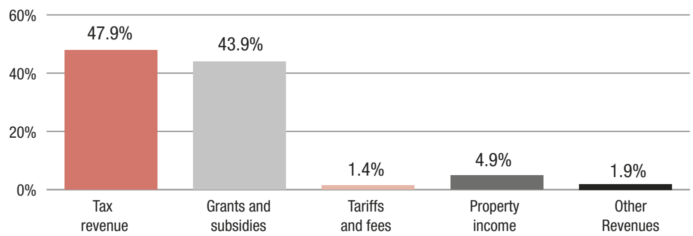
% GDP | % SNG EXPENDITURE



SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY

2016	DOLLARS PPP / INH.	% GDP	% GENERAL GOVERMENT REVENUE (SAME REVENUE CATEGORY)
Total revenue	1 816	11.7%	54.7%
Tax revenue	1 347	8.7%	49.6%
Grants and subsidies	239	1.5%	
Tariffs and fees	39	0.2%	
Property income	139	0.9%	
Other revenues	54	0.3%	

% SNG REVENUE



OVERALL DESCRIPTION. Subnational fiscal imbalances in China have been growing recently due to the increase in the level of subnational spending, compared to a decrease in subnational revenue. According to data from the Public Finance budget, SNG revenue amounted to CNY 8.724 trillion in 2016, representing 11.7% of GDP, compared to 15.9% on average in the OECD.

China has a multi-level financing structure, according to the Tax Sharing System Reform put in place in 1994, which removed control of local governments over local tax revenues, and reallocates tax revenues collected at the central level through a system of tax sharing and transfers. Overall, revenues are highly centralised, and resources can be transferred from rich provinces to poorer ones through an equalisation transfer system. Chinese provinces have their own revenue streams, whereas lower-tiers local governments, counties, are mostly dependent on both transfers from the central administration, tax-sharing agreements which differ across provinces, and land concessions as sources of subnational revenue (land rights sales constitute the bulk of the revenues of prefecture-level cities).

Tax sharing rules were last modified significantly in 2016, with the transformation of the business tax levied on services into a VAT tax, incurring reduced budget revenues at the subnational level.

TAX REVENUE. The central government is the sole legislative tax authority, enacting laws or provisional regulations for all types of taxes. Local governments collect more than half of local taxes, but they have very limited powers of their own to set the rate of define the base, and the heavy reliance on revenue sharing exposes subnational governments to uncertainty and limit their fiscal autonomy. Each provincial government determines the revenue-sharing rules within their respective prefectures; each prefecture then determines the revenue-sharing rules within their counties. In the provinces that adopted PMC, county governments can no longer share subnational tax revenue with prefectures but only with provincial governments and, therefore, they can retain a higher proportion of the tax revenues generated in their jurisdictions.

At the subnational level, the National Taxation Bureau and Local Taxation Offices merged in 2018 to form a single Tax Administration Agency, responsible for both collecting central taxes (VAT and CIT) under the direct administration of the central government, and collecting subnational taxes and PIT (under the direct administration of subnational governments). More recently, they also started to collect social security contributions. Since 2013, the country is engaged in a new fiscal policy reform to optimise the tax structure, and increase direct tax revenues, in particular the PIT, the private residential property tax, and the future property tax. In 2016, the business tax, formerly levied exclusively by SNG on services, was transformed into a VAT (also encompassing finance, construction, real estate and personal services), shared across levels of government, reducing subnational government revenues stream.

China has a multi-level government tax system that divides all taxes into three categories: central, local and shared. Subnational taxes are primarily indirect taxes, levied on firms, leading local governments to implement horizontal tax competition through discretionary tax enforcement.

Shared taxes, which altogether amount to 51% of subnational tax revenues, comprise the subnational component of the VAT, the PIT and the CIT. Fixed ratios set the shares received by subnational governments to 50% of the VAT (in 2016, they perceived 46% of VAT revenue, accounting for 29% of SNG revenue and 21.5% of their tax revenue), 40% of the PIT (4.6% of total SNG revenue and 6.2% of tax revenue) and 35% of the CIT (11.6% of SNG revenue and 15.7% of tax revenue). In addition, they also receive 50% of security and exchange taxes.

Several local taxes are related to real-estate properties: urban and township land use tax, arable land occupancy tax, the real estate tax, the deed tax and the land appreciation tax. They account for a total for 17.2% of total SNG revenue, 23.2% of subnational tax revenue and 2% of GDP. However, the taxes are based on physical area and transaction values of properties, instead of recurrent assessments based on properties' market value. There is no property tax on ownership of private residential properties as such yet, but a property tax law is in discussion at the National People's Congress. Finally, SNG also collect the vehicle and vessel tax, the tobacco tax, and social security contributions to finance local insurance systems.

GRANTS AND SUBSIDIES. In addition to the tax-sharing system, subnational governments receive current transfers from the central government, which can be divided between earmarked transfers and general-purpose transfers. Intergovernmental transfers have grown in China since 1994, to compensate for the delivery of public services in urban areas. Generally, upper-level government can provide transfers to all levels of government that are below them, yet, since the PMC reform, county governments may receive fiscal transfers directly from provincial governments.

General-purpose transfers include tax rebates, which were established after the 1994 tax-sharing system reform, to compensate for falling SNG revenue resulting from the reform, and to ensure local governments have enough revenue to cover for their basic need. Tax rebates include VAT rebates, excise tax rebates, income tax rebates, and tax rebates from the reform of taxes and fees on refined oil products. General transfers also include an equalisation transfer, which aims to ease disparities across provinces. Other general transfers are used to finance social security and pensions and government wages. Conditional earmarked transfers, on the other hand, are granted by the central government to subsidise local programmes, mainly in the fields of transportation, social housing, education, energy saving and pollution reduction. Overall, the system of conditional transfers is relatively opaque and complex, with high administrative costs.

OTHER REVENUES. Chinese subnational governments, counties and prefectures in particular, receive revenues from the sale of land-use rights for periods of 30 to 70 years. According to the Chinese constitution, urban land is owned by the State and rural land is owned collectively by village communities. The Land Administration Law provides all levels of governments with the power to control and regulate land use, to convert rural land into urban land, and to sell land rights to real estate developers, within the limits set by the national farmland preservation policy. Land is often used as collateral for the LGFV to borrow from commercial banks, and the net revenue from land sales must be dedicated to investments. In some provinces and municipalities, land-right sales revenues accounted for up to 40% of total revenues in 2014 (Chongqing, Anhui or Zhejiang). However, the volatility in land sales has recently slowed down local governments revenue. Other local non-tax revenues include fees, levies, penalties and profits from local State-Owned Enterprises (SOEs). In contrast with the situation in most countries, tariffs are exclusively assigned to the central level.

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SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

	DOLLARS PPP/INH.	% GDP	% GENERAL GOVERNMENT DEBT	% SNG DEBT
Total outstanding debt	**3 189**	**20.6%**	**46.6%**	**100%**
Financial debt*				

* Currency and deposits, loans and bonds

FISCAL RULES. China subnational government financing is subject to soft budget constraints. In 2014, the China State Council issued Rule no. 43, which laid out less strict guidelines for the supervision of local government debt and operating procedures for the public release of local budgets and financial accounts. Subnational borrowing through off-budget local government financing vehicles (LGFV) is being widely used by subnational governments in China to finance massive infrastructure construction until today. The Chinese government has multiplied its efforts in recent years to bring local debt under control, reduce outstanding debt and promote more transparency. In 2010, in an effort to provide guidelines and regulations, the China State Council issued the "Notice of the State Council on Issues concerning Strengthening the Administration of Companies on Local Government Financing Platforms".

DEBT. The amended 2014 budget law allowed provinces and cities to issue bonds for investment projects (subjected to the approval of the central government and the local people's congresses), within approved debt limits. The total debt limit is set by the National People's Congress (NPC), and debt limits for different provinces are approved by the State Council. A few wealthier municipalities have been allowed direct access to capital markets under central government supervision. The 2014 Budget Law also aims to close the "back-door" on local governments' off-budget activities by prohibiting guarantees and any source of financing other than approved bonds. However, some local governments have kept piling up debt in ways not permitted by regulations, including through the use of public welfare assets (roads, sewage systems) as collateral to borrow from banks and financial institutions, due to the persistence of the underlying fiscal pressure. As of 2018, the amounts of debt issued by LGFV was close to or even exceeding local debt in some provinces (Jiangsu, Tianjin, Chongqing and Beijing), and accounted sometimes for over half of total local revenue.

By the end of 2017, China's local government debt accounted for CNY 16.51 trillion, and by the end of 2018 it reached CNY 18.26 trillion, according to data from the Ministry of Finance. This amount remained below the CNY 21 trillion debt ceiling set by the national People's Congress for 2018. A debt swap programme was set up to facilitate the transition from LGFV debt to local government bonds, and between 2015 and 2016, LGFV debt totalling CNY 8.7 trillion was swapped to bonds. In 2016, 88% of subnational debt was held in the form of bonds, and this share increased further in the next years.

SNGWOFI
World Observatory on Subnational Government Finance and Investment

Lead responsible: OECD
Last update: 02/ 2019

www.sng-wofi.org

Socio-economic indicators: OECD // Eurostat // World Bank // UNDP // UN DESA // ILO.
Fiscal data: China Statistical Yearbook 2017 // China Data Insights // CEIC // China National Audit Office of the People's Republic of China.
Other sources of information: OECD (2019), OECD Economic Surveys: China 2019 // Zhuo C., Zhiguo H., Chun L. (2018) The financing of local government in the people's republic of China : Stimulus loan wanes and shadow banking waxes, Asian Development Bank Institute // Wingender P. (2018), Intergovernmental Fiscal Reform in China, IMF Working Paper // Liu Z. (2018), Land-Based Finance and Property Tax in China, ATI Working Paper // Guangrong M., Mao J. (2017) Fiscal Decentralisation and Local Economic Growth: Evidence from a Fiscal Reform in China // Wu L. (2017) The Impact of the China's Province-Managing-County Reform on Economic Growth in the Short Term and Long Term, Scientific Research Publishing // OECD (2017), OECD Economic Surveys: China 2017 // Jaros K. (2016) Rethinking subnational government capacity in China // OECD (2015), OECD Urban Policy Reviews: China 2015.