

**CHINA'S NEW REFORMS TO ENHANCE
LOCAL GOVERNMENTS'
FISCAL CAPACITY**

QIAN Jiwei

EAI Background Brief No. 1193

Executive Summary

1. The division of labour between central and local governments pertaining to the financing and provision of public services has been adjusted in the guideline issued by the State Council of China in August 2016.
2. The current intergovernmental fiscal system is defined by the 1994 fiscal reform. Under this system, responsibilities for financing and providing public services have been delegated to the local governments.
3. Local governments do not have sufficient fiscal capacity to meet their expenditure responsibility. The current system is also inefficient and lacks accountability
4. There have been a number of initiatives to address the intergovernmental fiscal system since the Third Plenum of the 18th Communist Party of China (CPC)'s Central Committee in 2013.
5. In the August 2016 guideline, concerns of local fiscal capacity, efficiency and accountability have been addressed. Division of labour between central and local governments for funding and providing public services have to take into account both spillover effect and local information advantage.
6. Future reforms for allocating responsibility would also have to improve accountability of local government and central ministries for funding and providing services.
7. According to this guideline, the expenditure responsibility of the central government for providing public services will increase moderately while the shared responsibility between central and local governments will be decreased.
8. Public services including providing national security, establishing a national integrated market and promoting coordinated regional development are the responsibilities of the central government.

9. Local governments' responsibilities include financing and providing public services such as local public security, local transportation and local community issues.
10. The number of responsibilities shared between central and local governments will be decreased. However, these shared responsibilities will include financing and providing public services such as education, health care and social security.
11. According to this guideline, relevant reforms to reallocate responsibility will kick off in 2016 and reforms in all major policy areas are expected to be implemented before 2020.
12. Remaining issues include achieving effective coordination with other reforms of the fiscal system and reforms in other areas such as health and pension, and the performance evaluation system for local officials.