

Readjusting the Relationships between Central and Local Governments in a China in Transition

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Abstract: In the process of China's promoting its economic growth and social development, the adjustment of the relationships between the central and local governments have played the key role. The decentralization policy implemented in China has resulted in great economic achievement but, at the same time, has created many difficult problems. Fiscal and investment decentralization, and other important decentralizations, have been the main levers for the central government to gear the relationships between central and local governments. However, these levers require a thorough examination. Decreases in the central government's revenue, enlarging regional disparities and the upheaval of the local-interest-centered activities are the unintended by-products of China's decentralization policy. To eliminate decentralization's negative impacts and overcome the shortcomings, relationships between the central and local governments need to be readjusted. While offering further discussion and making key suggestions in conclusion, the author thinks that some immediate measures should be taken. Enormous effort is dedicated to theoretical discussion and empirical studies on the cause and result of decentralization of China in transition.

INTRODUCTION

China has witnessed a dramatic change in its economy and society since it initiated its policy of reform and opening up. In this process, the Chinese government has consistently played the most important role (Wang, 1998). Several key factors have been identified to explain the success of China's government in leading the country towards industrialization and economic prosperity, among which the adjustment of the relationships between

the central government and the localities is thought to be crucial (CPAS, 2002).

Many great figures in modern Chinese history, including Sun Yat-sen and Mao Zedong, blamed the country's weakness and backwardness on the lack of a strong central state and had dedicated themselves to reforming the situation. By the founding of the People's Republic of China, their dreams were realized, and China found itself with a strong central state. The most prominent characteristic of the state power of the PRC is that it is endowed with all-encompassing and unrestricted functions that are intended to cover all the spheres of political and economic life (Pu, 1999). The success of building such a strong central power was because China devoted its greatest efforts to the integration of the nation and the recovery of the national economy. Through three kinds of institutional arrangements, the state achieved the goal of taking overall control of society. First, all the people were forced into certain kinds of organizations that were designed to take care of their members both politically and economically. These

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organizations included the People's Communes in rural areas; work units for the state cadres; and factories and enterprises for the workers and related staff members. Every member of society is subordinate to certain organizations directly under the control of the government. Secondly, the government set up a planned economic system along the lines of the former USSR, in which the government administration was typically "strip or vertical management by economic specialized ministry." Thirdly, the government made certain there was only one power center --- the central government, which was under the direct leadership of the Central Committee of the CPC. The localities had all their powers delegated to them by the center and were little more than implemental tools for the center. Local governments were actually the copies of the central government at a smaller scale, both in structure and function, which enabled the central authorities to control the localities more effectively (Zhu, 1997). The principle of "regarding the whole country as one chess-board" was applied in handling the relationships between the center and local governments or different regions. That principle played an important role in amassing and mobilizing the human, material and financial resources of all regions in the construction of key projects and for national defense (Hu, 1995:105).

In the early years since the founding of PRC, this highly centralized state system helped China overcome many political and economic difficulties. However, the system's shortcomings were soon revealed, and even resulted in the paramount leader Mao Zedong's cautioning about the ten relationships concerning important aspects of Chinese society. These included the relationship between the central and local governments, with Mao's paper delivered to the central committee being the greatest illustration (Mao, 1956). While prescribing the power and interest balance between the central government and the localities, Mao actually

stressed the localities should be granted more power in order to stimulate their initiative to develop their own regions (Ren, 1998).

Practically, China did attempt to transfer power from the center to the local governments numerous times, but after each instance, the central government would soon renege on the transferred power. Because of complicated reasons, this transfer and renege has become a famous phenomenon named "the evil cycle" --- chaos whenever the powers were transferred down, followed by stagnation whenever the power was taken back (Zhang, 1994).

THE DECENTRALIZATION OF CENTRAL POWER TO THE LOCALITIES IN THE EARLY YEARS OF REFORM

It was not until Deng Xiaoping launched his strategy of opening up china to the world that the decentralization of power had a new meaning. First, the decentralization of state power was a constituent part of the total reform package that was combined closely with other reform plans and strategies made by the central government. Second, the decentralization of state power played the key role in the economic reform, which intended to energize the initiatives and creativities of localities as well as of the common people. Third, having drawn lessons from the experiences of transferring the central power to the localities, central government leaders were even firmer in their determination to carry out the reform. Detailed plans were made to meet the challenges, and a systematic strategy was taken to avoid chaos (Xin, 1995).

Throughout the 1980s and 1990s, a great deal of power was gradually transferred to the localities from the central government, which caused enormous changes in the economic situation, interest structure, the political power sphere and social balances in different regions. Among various

powers transferred to the localities, the most prominent ones are described below.

Fiscal Decentralization

It has been for more than 25 years that the Chinese government had the fiscal system named "unitary revenue and unitary expenditure," which meant that the central state was fully responsible for all the fiscal receipts and expenditures of both the central and local governments. The budget plans of the governments at various levels would be balanced by the central government. It is easy to imagine that under this fiscal system there was no real independent financial position for the governments beneath the central level, which would make it difficult for local governments to play active roles in the development of their regions (Kou, 1998). Actually, there was no better choice than the fiscal system as the crucial reform pivot for the purpose of adjusting the relationship between the central government and the localities and motivating the localities to actively participate in the economic reform and social development. As an American scholar noted: "The most important element in the reform period has been the decentralization of powers away from central government agencies to those at lower levels, especially the effective decentralization of the fiscal system." (Saich, 2001: 152)

In 1980, the central government embarked on a new fiscal system, which symbolized the beginning of a continuous adjustment of the fiscal power between the central government and the localities. In 1985 and 1988, the central government brought all the provincial governments into the new system, the "fiscal contracting system," which was implemented until 1994.

Several characteristics distinguish the fiscal contracting system. (1) The fiscal revenue and expenditure of both the central government and local governments were differentiated. Based on the different income resources, the government

revenues were divided into three basic categories: central government revenue, local government revenue and revenue shared by the central and local governments. At the same time, each level of government was responsible for its own expenditures. The basic revenue and expenditure quotas (baseline) were defined according to the actual income and payment of the previous year. (2) The core problem of the new fiscal contracting system was the income sharing stipulation, which promised that the provincial governments could retain certain amount of local revenue for local use. The share local governments kept depended on the economic performance and taxation ability of each province. (3) Because there were no effective methods to determine the amount of local revenue each province should keep, the central government relied on negotiations with local governments to decide their proportion. This had turned the command relationship between the central and the local levels into a pattern of face-to-face bargaining, through which different provinces had established different fiscal relationships with the central government (Wang, 1998:54). (4) While almost all the tax classifications and tax rates were set by the central government, the localities almost monopolized tax collection, regardless of whether the tax revenue belonged to the central or local governments (Ren, 1998).

Serious problems were caused by the fiscal contracting system and resulted in severe damage to the relationship between the central government and the localities. Therefore, it was urgent to abandon this system and establish a new one. Consequently, a new fiscal system, the "tax sharing system" was introduced in 1994 (Kou, 1998). We will discuss the effects of the two fiscal systems on the relationship between the central and the local governments later in this paper.

Investment Decentralization

Another core component of the relationship

between the central and some local governments was the investment system, which for a long time had been highly centralized. The central government directed almost all the investment activities, whether theoretically or practically debated if they could be or should be taken over by the localities (Editing Group, 1995). The reform of such an investment system was no doubt important for China central government to provide local governments with more autonomy. The reform plan began in 1979 when the central government gradually introduced a new investment system to involve other investment entities. A multi-layered investment decision-making and management model was formed, with the central and local governments being endowed with different powers of investment planning and management according to the classification of the qualities of the projects (CPAS, 2002). The local governments have gradually acquired additional investment power from the central government. In 1988, the State Council issued the "Recent reform plan of investment management," which clarified the investment responsibilities of the central and local governments. In principle, the central government invested in important projects of national concern, and the local governments took on the responsibilities of common projects, as well as the projects of local importance.

In the meanwhile, local governments gained much greater power to approve local investment projects, while the large and medium-sized investments in production infrastructure still had to be approved by the National Planning Committee. Initially, there was an upper limit of 10,000,000 yuan before 1985. This was raised to 30,000,000 yuan in 1985, and then raised again to 50,000,000 yuan after 1987. Some provinces along the coast gained the power were allowed to approve investment projects up to the value of 200,000,000 yuan in 1985. The Shanghai municipality could approve all the large and medium-sized investments purporting the

cultivation of the Pudong area in 1992. While foreign investment projects above \$100,000,000 should be approved by the State Council after being verified by the National Planning Committee, projects beneath such amount could be approved by the National Planning Committee or simply approved by the provincial government within the limitation defined by the central government (Wang, 1998).

China attempted to make its investment policy more flexible in the more developed areas. The central government agreed that the provinces, municipalities, autonomous regions and special economic zones (Tianjin, Shanghai, Guangdong, Fujian, Beijing, Liaoning, Hebei, Shandong, Jiangsu, Zhejiang, Guangxi) could all approve production projects of Chinese-foreign joint ventures or Chinese-foreign jointly operated enterprises below the value of \$30,000,000. Inland provinces, the provinces, municipalities, autonomous regions, special economic zones could approve the same kinds of projects less than \$10,000,000, which shows that China has had a preferential development policy towards different regions for a long time (see below). However, the main tendency of China's investment system reform was to transfer as much investment power as possible of the down to the local governments, with the aim of making the local governments more ambitious in industrialization. The effect of this investment power decentralization was sharply reflected in the fiscal expenditure of the central and local governments. Before the new fiscal reform of 1994, only about one-quarter of all state expenditures occurred at the central level, and the major responsibility for financing infrastructure and providing social welfare was at the local level (Saich, 2001:152).

Decentralization in Other Aspects

China's decentralization is multi-dimensional. While considerable central government power of the has been transferred to local governments, other

important reform measures were also tried in different economic and social fields, that range from finance, prices, international trade to enterprise management (Ren, 1998). Due to the successful banking reforms, local governments found it easier to collect and dispense funds. An insurance market and foreign financial institutions were approved in many cities. The separation of policy and commercial banks enabled the local governments to entrench banking systems and maneuver them to provide loans for local development plans (Wang, 1998).

Previously, almost all prices for goods, labor and services were regulated by the central government or its agencies. However, the central government's pricing reforms in 1982 directed that as many prices as possible (except some specially important ones for industrial and agricultural products, transportation, and non-commercial fees) should be determined according to the various needs of local governments, or simply should be allowed to fluctuate according to the changes of the market. This allowed local governments to begin competitive price strategies with their counterparts from other regions (Ren, 1999).

Throughout the reform process, China's policy has been one of uneven development: placing priority on some areas' developing quickly and getting rich first, while allowing other areas to lag behind. The policy was originally intended to decentralize power to some regions first and other regions latter, and as a result, many provincial governments and cities benefited from the policies of the central government. The best examples are the cities of Shenzheng, Zuhai, and Shantou, which were the earliest granted privileges regarding the cultivation, the use of real estate, tax exemption, and autonomy in foreign trade. The State Council levied a tax of only 15% on the use of land (much lower than that in other regions) for all foreign enterprises, Chinese-foreign joint ventures or Chinese-foreign jointly run enterprises in Shenzheng, Zuhai and

Santou. Later this policy was expanded to other special economic zones and some other cities and areas.

Another privileged policy was that industries and enterprises considered important to state development, whether established by foreigners or Chinese-foreign joint ventures, were either free from taxation or taxed at a lower tax rate. The equipment and other necessities were imported duty free, and the products of those enterprises were not subject to an export tax. With the decision of further opening up, 14 cities along the coastal (Dalian, Qin Huangdao, Tianjin, Yantai, Qingdao, Lian Yungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai) significantly increased autonomy in absorbing foreign capital, foreign techniques and foreign-aided projects. Later the same power was transferred to the so-called "specially-planned cities" (Jihua Danlie Shi) and special economic zones (Ren, 1998).

The system of specially planned cities, ratified by the State Council in 1984, provided an excellent cross section that illustrates decentralization in China. The specially planned cities of Chongqing (later the fourth municipality in China), Wuhan, Shenyang, Dalian, Ha Erbin, Xi An, and Guangzhou were granted the power of provincial level governments mainly in respect to economy, science and technology, and social development. Their various development plans could be drafted independently of their province and were reported directly to the central government, which would then assign the special rights and duties to them. The cities' budgets would be balanced by the central government, while other cities were required to first set their accounts with their provincial governments. By being excluded from of interference from the provincial governments, they enjoyed the privileges of taking a comprehensive control and management of the city affairs, ranging from industrial and agricultural production,

fixed capital investment, urban and rural construction, communication and transportation, domestic and foreign trade, to cultural and educational affairs. (Bo, 1988:169-171)

Under the planned economic system nearly all the enterprises were subordinates of the state, despite the names of state owned enterprises (SOEs) or the collectively owned enterprises (COEs). During the reform process, many SOEs were handed over from the central ministries to the cities where they were located. This reform has also greatly affected the relationship between the central government and the local governments because a big part of the state revenues coming from the profits of those SOEs, now fall into the coffers of the local governments.

CHANGES BROUGHT ABOUT BY DECENTRALIZATION

The decentralization policy has had a great impact on the relationship between the central and local governments, as well as the lateral relationships among governments. Whether the impacts are positive or negative has also been the subject of discussion and debate. Some scholars hold that the decentralization policy really sparked initiatives and creativity in the local governments and spurred China's long upward spiral of economic growth, while others argue that there are excessive negative effects to the policy (Yang, 1994; Hu, 1995).

Some scholars have interpreted the decentralization trend of positively by arguing that what is developing is, "Federalism, Chinese Style." They believe it is wise for the state to allow local governments to have autonomous control in its own sphere of authority. They credit the new system with placing limits on central control and providing richer local governments with substantial independent sources of revenue, authority and political support. At the same time, the policy brought about local competition and served to

constrain their behavior and provide a range of positive incentives to foster local economic prosperity (Montinola, Qian and Weingast 1995: 50-81).

On the other hand, many controversial results have been observed that substantiate the claim decentralization has caused a lot of trouble for the central government and has triggered some unintended consequences. Many scholars and policy makers argue that additional economic, social and political problems will result in if this situation is not changed soon (Xin, 1996). Their concerns seem obvious.

Decreases in the Central Government's Revenue

The central fiscal capacities constitute the economic basis for the central government to exert macroeconomic control. Ever since the central government introduced the contracting fiscal system, the fiscal situations of the central and local governments have changed. The central fiscal capacity has been dropping steadily since the beginning of the 1980s. The proportion of the central fiscal revenue and expenditure in GDP was the lowest in the world, 6.5% and 4.2% in 1994 (Cf. Table 1).

Several facts contained in the fiscal contracting

Table 1. Comparison of the Increasing Fiscal Spread between the Central Government and Local Governments from 1988 to 1993

Year	Central government	Local governments	Disparity between the central government and local governments
1988	100.00	100.00	0.00
1992	106.17	116.42	10.25
1989	128.10	122.88	-5.22
1993	121.11	139.73	18.62
1990	126.44	158.22	31.78
1991	129.92	213.31	84.39

Source: National Statistics Bureau. China Statistical Yearbook, 1995, 220.

system have contributed to the decline of the fiscal revenues of the central government. The original intent of the fiscal contracting system was to empower local governments and thereby induce the growth of the central and local government revenues. However, local governments lacked the initiative to strengthen the fiscal capacity of the central government because they only cared about the fiscal interests of their own regions (Wang, 1998). As described above, the fiscal contracting system generates a guaranteed revenue share for the central government with the remainder of the revenue kept by the local governments. Further, since local governments realized that the central government's share of revenue would increase after bargaining they preferred to pursue a strategy of "hiding wealth in their own regions" (Xin, 1996). They tried to avoid the usual methods of taxation and developed other ways for their own convenience. The reason is obvious: since formal taxation would be scrutinized by the central government and the tax revenue would be shared by the central government, local governments wanted to increase their own revenue by informal methods such as raising fees and funds. Their self-aggrandizing impulses are also demonstrated by the local authorities having different policies towards the state and locally run enterprises. While they cared little for the former, they were very enthusiastic to reduce the latter's taxes because the former profits belonged to the central government, and the latter belonged to the local government. Given this interest structure, local governments tried hard to support local enterprises against those of the center. This has put some state-operated enterprises in more difficulty (Ren, 1999).

Another systemic shortcoming is that the central government lacked its own dedicated agencies for tax collection because that power was monopolized by the local governments. This arrangement allowed local governments to treat local and central taxes differently. Officials worked hard for the

former and with less effort for the latter.

Knowing these deficiencies in the fiscal contracting system and seeing that its fiscal capability and revenues were not guaranteed, in 1994 the central government introduced a new "tax sharing system" to replace the old tax system.

The reform intended to delineate the tax categories of the central government and the local governments based on the classification of central affairs and local affairs. The central tax categories were for affairs such as defense, diplomacy, public administration at the central level, micro economic control and coordination etc, while local tax categories were limited to the expenditures of the economic and social development of the regions, local public administration, locally-managed infrastructure, local culture, education and sanitation. Two important institutional arrangements were given prominent positions in the reform. The former Taxation Bureau was divided into two divisions, one division being the Local Taxation Bureau under the control of regional administrations and the other division being the State Taxation Bureau under control of the State Council. The State Taxation Bureau was a vertical bureaucratic system independent of the local governments with its powers extending down to the grassroots level. It was considered the institutional guarantee for the central revenues. The other institutional arrangement is the establishment of a revenue redistribution system, which was regarded as an effective method to balance incomes and expenditures among the regional governments, and permitting a micro control of the social and economic development in the whole country (Kou, 1998).

In any event, the result of the fiscal system was not bad. As reflected in the statistics, the central government's revenue has steadily risen, with growing from 22.02% in 1993, to 55.7% in 1994, and 52.1% in 1995. In 1996, for the first time in more than ten years, the growth of total state

Table 2. Various Fiscal Indices From 1992 to 1996

Year	State Total Fiscal Revenues (Billion Yuan)	Increase Index	Income of the Central Government %	Revenues of the Local Governments %
1992	348.337	100.00	28.1	71.9
1993	434.895	124.85	22.02	77.98
1994	521.810	119.99	55.7	44.3
1995	624.220	119.63	52.17	47.83
1996	740.799	118.68	49.42	50.58

Source: National Statistics Bureau. China Statistical Yearbook, 1997.

revenues was higher than the growth of the national economy and the proportion of fiscal revenues as a percentage of GNP was 0.2% higher than that in the previous year. (See Table 2.) While initially the ratio of the budgetary revenue continued to decline as a percentage of GDP to 10.7 percent in 1995, it rose to 11.6 percent in 1997, and 14.2 percent in 1999. The center's share of budgetary revenues grew from 2.8 percent of GDP in 1993 to 6.2 percent in 1998 (Chung, 2000, p.46).

However, not all distribution problems disappeared with the establishment of the new system. New troubles emerged. The most serious is that while the center's revenue is guaranteed by the system, local governments frequently experience fiscal deficits (Wang, 1998). This results from the unbalanced tax structure between the central and the local governments, of which the local tax variations are inadequate, which causes revenue instability especially in rural areas. The once again overly centralized tax legislation has impeded local governments from cultivating new sources of tax revenues.

The worst consequence is that local governments have to develop new methods for self-sufficiency, which worsens the relationships between local officials and citizens and harms the reputation of the state and its cadres. Observers have noted that government revenue as revealed in Chinese statistics is comprised of two major components for both the central and local governments: the unitary budget and Extra- Budgetary Funds (EBF). The unitary budget comprises taxes, fees and revenues

collected by state finance offices and is subject to formal budgeting by the center. The EBF covers officially sanctioned charges such as surcharges from taxes and public utilities, road maintenance fees and incomes from enterprises run by various administrative agencies. Originally, the largest part of these funds came from the retained profits, depreciation and major repair funds from the SOEs (Saich, 2001: 153). This is no longer the case. The changes made under the tax sharing system cause local governments to meet recurrent costs from locally-generated revenues, and force local administrations to derive more funds from management fees, fines and other sources for extra budget revenues. The use of EBF and the self-raised funds (*zichou zijin*) is increasing. A 1995 nationwide audit suggested that EBF amounted to 6 percent of GDP (the formal budget is only 12 percent), but some experts think that the real figure is much higher (Kou, 1998). The excessively exploitive activities by local enterprises and increasing burdens on the individuals result in frequent protest and demonstrations. A predicament has emerged in the relationship between the state and society and the relationship between the central and local governments. China's government could resolve the predicament only by the sacrifice of either of the relationships, which means that new policies are needed to meet the challenge.

Enlarging Regional Disparities

The most unexpected consequence of China's reform policy is the increase in regional disparities,

which has provoked frequent policy debates and incited numerous conflicts among regions at different levels of development. The increased disparities have eroded the relationship between the central government and the local governments (Xin, 1996). For a long time, China was a country with enormous variation in geography, economy, culture, nationality, social development, productivity, etc. These disparities were expected to diminish after the founding of the PRC and especially after the implementation of the power of effective reform and opening up. However, the reverse has happened. The disparities among different regions were not eliminated, but as we shall see, increased mainly with respect to the economy.

During the recent reform period, the differences in economic growth among different regions were large as were the differences in their contributions to the national economic growth. From 1979-1992, Guangdong recorded the highest average annual GDP growth at 13.3%, followed by Zhejiang at 12.5%, Fujian at 11.6%, Shandong, Jiangsu and Xinjiang, all at 11.1%, and Hainan (1987-1992) at 12.0%. The seven provinces and autonomous regions had the fastest economic growth and contributed the most to the national economic growth. The lowest GDP growth was registered in Heilongjiang province at 6.0%, followed by Qinhai at 6.2%, and Shanxi, Liaoning, Tianjin and Shanghai all below 8%. The difference between the highest and the lowest was 7.3% percent. The regional disparity in economic growth rate was even greater after 1992, with Jiangsu as the highest, with 26.2%, and Heilongjiang as the lowest, with 6.5%. The gap between the two was 19.7 percentage points. Zhejiang recorded the highest GDP growth rate in 1993, 25.7% while Heilongjiang remained the lowest, with 5.8%. The gap between the two was 19.9 percentage points (China Statistical Yearbook: 1978-1994). The disparities were reflected both GDP growth of, and the changes in

regional development. While relative disparity in terms of per capita GDP has narrowed, and the per capita GDP disparity between the richest region and the poorest region narrowed steadily, the absolute disparity in per capita GDP among different regions has widened steadily. The total absolute disparity coefficient of per capita GDP was 451 yuan in 1978, but it grew to 658 yuan in 1985 and further to 1,133 yuan by 1990. The absolute disparity in per capita GDP between the richest and the poorest kept widening. The per capita GDP differences between Shanghai and Guizhou was 2,323 yuan in 1978, but it grew to 3,437 yuan in 1985 and up to 5,024 yuan by 1990. During the Eighth Five Year Plan period (1991-1995), very attractive new changes took place in the per capita GDP disparity. On the one hand, the relative per capita GDP disparity began to be expanded. The total relative disparity coefficient in per capita GDP was 64.2% in 1990, and up to 70.9% in 1993. On the other, the absolute per capita GDP was further widened. The total disparity coefficient of per capita GDP was enlarged to 2,220 yuan in 1993 from 1,133 yuan in 1990. The absolute per capita GDP disparity between the richest and the poorest began to widen. The per capita GDP difference between Shanghai and Guizhou was 5,024 yuan in 1990, which was up to 10,468 yuan in 1993 and was more than 13,000 yuan by 1994 (China Statistical Yearbook, 1978-1994).

Recent statistics show no break in these trends. Further, as reflected in income disparity, the average 1998 rural income for coastal regions was about twice that of the southwest, and Shanghai was three times higher. In urban areas, real income was also consistently higher, with Shanghai enjoying real income approximately twice that of the northwest and 60% higher than in the southwest. Per capita net annual income for rural households in Shanghai was 5407 yuan, for Beijing 3952 yuan, Jiangsu 3377 yuan, Sichuan was 1789

yuan, Xinjiang was 1600 yuan, Gansu 1425 yuan, Guizhou 1335 yuan, and Tibet 1232 yuan. For urban residents the real income per capita was 8825 yuan for Shanghai, 8521 yuan for Beijing and 6065 yuan for Jiangsu. For Sichuan, it was 5160 yuan, Guizhou 4581 yuan, Xinjiang 5042 yuan, Gansu 4034 yuan and Qinhai 4258 yuan (China Statistical Yearbook, 1999, pp. 339 and 325).

While it is easy to find evidence to defend the inevitability of the uneven development in China's economy, the preferential development policies against some regions and the actual discriminatory policies towards other regions made by the central government are surely among the first to be blamed. Two specifics are crucial for the rich to get richer and the poor to get poorer: one is the favorable tax treatment granted to the defined coastal areas and the other is the center's preferential investment policy towards the coastal areas, which causes the concentration of investment to be shifted to the opening up areas. These two preferential treatments combine to create geographic losers and winners. As one scholar has pointed out, these policies have reversed the fortunes of a number of provinces. Guangdong was one of the poorest provinces during the Mao years, but it has benefited enormously from the policies of international trade and economic liberalization. By contrast, the most prosperous provinces during the Mao years, Liaoning, Jilin and Heilongjiang, which benefited from the emphasis on heavy industry and the centrally planned economy, have suffered significant decline under the reforms. (Saich, 2001: 149).

In a study of the excessive difference in per capita investment of various regions, a Chinese scholar found that there are two main reasons that account for it. One is that the central government introduced the non-equilibrium development strategy at the beginning of the 1980s. The focus of investment projects was shifted to the coastal regions with per capita investment in centrally

financed projects in the coastal developed regions much higher than that in the less developed regions. For example, of the basic capital investment in 1993, the per capita investment for central projects in Beijing was 884 yuan while it was only 48 yuan in Guizhou, which leaves a difference of 796 yuan in absolute terms or 17.6 times in relative terms. Beijing has the highest per capita investment in central projects, followed by Shanghai and then Tianjin, Liaoning and Guangdong. Instead of balancing the per capita investment in local projects of different regions, investment projects by the central authorities have increased such gaps (Hu, 1995).

In connection with the previous descriptions of economic disparities, we can see that input resources (total investment, total state sector investment, loans, foreign capital and government spending) are biased towards developed regions. This leads to a bias of output resources (GNP, national income, total industrial output value, and tax revenues) towards developed regions, with the latter bias further intensifying the former.

Although the policy reforms and opening up have been highly praised, they are beginning to clearly show indications of policy failure. Policy failure here refers to the failure of the government to realize the objective of social equality because of excessive interference, or through preferential or discriminatory policies toward certain areas. The upshot is that this has stimulated uneven economic development, unfair market competition, and unequal allocation of resources and has accelerated the widening of economic disparities among different regions. As the Chinese scholar, Hu indicates, it is obvious that at present, both the economic and political resources in China are unevenly distributed (Hu, 1995).

Regional disparities have become the major problem for the center. China may feel that this is a difficult task because now the provinces do not have an incentive to share their wealth, and the

center's funds for redistribution have declined. This decline in the central fiscal capacity means less capability for macroeconomic control by the central authorities (CSPA, 2002). However, the central government has no choice but to shoulder the responsibility. The widening and narrowing of regional economic gaps depend not only on economic development in different regions but also on the income distribution policies and related policies of the central government.

New policy suggestions have been proposed, including the tax sharing fiscal system introduced in 1994, that represent the first step in China's tax reform. The aim was to raise the fiscal capacity of the central government and to strengthen and improve macroeconomic control. The second step of tax reform should be to establish a tax-revenue redistribution system, aimed at assisting the less developed regions and narrowing the excessive disparities in regional development. The current tax sharing system is a scheme by which the central authorities have made concessions to some local governments and has resulted in regionally differentiated financial transfer payments with "rich provinces to turn in more and poor ones, less and each province following a different rate or amount" (Wang, 1998). In order to achieve the goal of common development and common prosperity, we need to think hard to come up with improved strategies and change our policies accordingly.

The Upheaval of the Local-Interest-Centered Activities

China is single, unified country. After the birth of the new China, the central authorities stressed the use of initiatives by both central and local governments; however, the central interests would always override the local ones. This has changed dramatically since the policies of reform and opening up were initiated. The continual decentralization of power to local governments and the recognition and respect of local interests have

mobilized the enthusiasm of local governments to develop their economies and societies (Ren, 1999). Their ambitions have been stimulated and their urge to expand power has abated. It certainly has caused shock and turmoil wherever such a decentralization policy was introduced. Therefore, in China different "fevers," such as investment fever, stock market fever, commodities fever, real estate fever and development fever, would recur. If prosperity expresses as one aspect of China's economy, chaos expresses the other.

Under the present political structure, the decentralization of the central power necessarily implies the expansion of local autonomy, which has been demonstrated in many fields. As a central government official once said: "in the course of developing a market economy motivated by local interests, we have encountered many disadvantages such as market segmentation, local blockage, local protected skullduggery, protected smuggling, duplicated construction, pollution, plant damage, worker's life ignorance, etc." (Zuo, 2002). Overall, three kinds of local-oriented phenomena have accompanied decentralization. The center has tried its best to eliminate them but has found no way to eradicate them completely.

One phenomenon is the illegal competition between different regions. Many tactics have been attempted to promote economic growth and extract more tax revenue. The price tactic is often used. When a local government needs important raw materials from other regions to develop the enterprises in their own region, it would pay higher price to attract the raw materials to the region. When they wanted to dump their goods into other regions, they would lower the price (Xin, 1996). In the 1980s, a fierce price war broke out between Zhejiang Province and Anhui Province. Since many township enterprises invested in silk production, silkworm cocoons were in great demand. However, the silk cocoon produced in Zhejiang Province was insufficient for the demands

of the many silk factories. Therefore, Zhejiang province fixed a much higher price than in Anhui Province to attract silkworm cocoons produced by the breeders in its relatively poorer neighboring province. The local governments in Anhui province tried to prevent the silkworm breeders from selling material to its neighboring province and even mobilized the civil military force and armed police to guard the border (Xin, 1996). Tax exemption and favorable treatments are also thought to be most effective ways to attract investment. Local governments lower their land price as much as possible, and some cadres even claimed that no fees would be charged to investors in their regions. A lot of tax revenue has disappeared into frequent exemptions, which has seriously harmed state interests.

Another phenomenon is the local protectionism, which is closely related to illegal competition. As mentioned above, many SOEs, formerly subordinated to the central government, have been transferred to the local governments, and an increasing number of enterprises have been established in almost every region of China. With this, local governments have developed the very incentive to protect them. The consideration of fiscal revenue is perhaps the core reason. Fiscal reforms are causing local governments to meet recurring costs from locally generated revenues. Notably in resource-deficient areas, this has driven them to short-term planning in place of long-term development design. The fiscal pressure leads to a preference for a development plan that maximizes short-term concerns and that is balanced with social and welfare priorities. In particular, they result in a desire to expand township and village enterprises as the first priority because these are seen as the most stable sources for local tax revenue. This has led many inland counties to try to ape the coastal areas by setting up similar industries irrespective of whether there is the necessary skilled labor force, a sufficient infrastructure or a market for the product

itself (Saich, 2001). These small-sized and low-level-skilled enterprises are replicated everywhere and lack economic efficiency, nevertheless they are mushrooming under the protection of the local authorities. Protectionism has caused many serious problems. In fact, it prevents the growth of an integrated domestic market, wastes social resources and precludes the rational mobilization of productivity.

The third is the phenomenon of “the three arbitraries” (*sanluan*): namely, arbitrary taxation (*luan shoufei*), arbitrary fines (*luan Fakuan*) and arbitrary expropriation (*luan tanpai*). The model of China’s modernization is that of a state-generated and state-promoted modernization-----something like the developmental state model. As the center but having to rely on the local governments to promote its economic reform and social development, the Chinese government has developed a system called by some scholars the “pressurized system” (Rong, 1998). Under this system, the central government outlines a total development goal, which can be calculated in quantity and divided into smaller scale goals that the various regional governments are expected to achieve. Local governments are pressured to fulfill certain tasks of economic production and social development without receiving funding. The *de facto* decentralization has meant that higher-level agencies put administrative pressure on lower levels of government as manifested in the political contract. This system divides and establishes tasks for organizations and individuals at the lower-levels, and they are expected to fulfill them within a prescribed period (Rong, 1998). This political contracting and the responsibility for fulfilling the tasks by local leaders provide an important incentive to guide their behavior. This political contracting system along with the economic contracting system imply that as long as the contracts are insured, any experiment can be attempted, and the simple way of assessing the governing effects is

to see whether the various goals have been achieved. Efficiency-orientation rather than fairness-orientation has distorted the behavior of the local governments. The leaders are encouraged and promoted if the economy in their regions is growing, and punished if economic growth is too slow. So far, since every economic and social development needs money and since the money has to be squeezed from the enterprises and households in their regions, local governments have different motives for such harmful behaviors in spite of the center's frequent demand to stop.

REAJUSTING THE RELATIONSHIP BETWEEN THE CENTRAL GOVERNMENT AND THE LOCAL GOVERNMENTS

Some Immediate Measures

Decentralization is thought to be an efficient way to adjust the relationship between the central and local governments. However, it is time that China reflected on it and made a rational assessment. The by-products or the unintended consequences are becoming apparent and they are being discussed. The reasons for China's persistence in the decentralization, and most of all, its methods of decentralization are being undermined. While it was reasonable to follow Deng Xiaoping's strategy of "letting some people and some regions become rich first," it now appears more reasonable to abrogate the outdated decentralization policy and try to find new methods. Several changes are worth careful examination.

Change the Paternalistic Ways of the Central Government

For a long time China's central government has held arbitrary power over the local governments and society. It seems to have changed with the

reform process, because local governments have become more active and aggressive in their governance. However, this proves superficial because local governments never acquired their power legitimately (Bo, 1991). The growth in local power comes from policy and not *de jure*. In other words, the center still sits as the father with his sons, the local governments, around him. Since the father's love is a love for all his sons to compete, the father can always distribute his love preferentially. Due to his favorable love, the coastal areas developed much faster than the inland areas, and his preferential policy has created an economic miracle in some areas. However, this policy has also created regional gaps and intolerable differentiated strata in society. It is time for the central government to change its paternalistic way and try to eliminate the disparities among different regions and different people. In this sense, an efficient and fair fiscal transfer payment system, together with a welfare and education system should be established.

Change the Relationship between Government and Enterprises

China has been all along stressed that government enterprises should be separated from the government. However, under different contracting systems and economic contracting systems, this has been difficult to realize. Government and its organs are always finding excuses to interfere in enterprises either by deliberate policy initiatives or by other means. Favorable treatments of some enterprises and discrimination towards others, intervention into the operation of enterprises, and expropriation have all greatly harmed the exterior environment and the interior relationships of the enterprises and rendered the fair competition of market economy impossible. To establish a solid, lasting relationship between government and enterprises, institutional arrangements are critical, after which the impulses

of local governments for expanding their power are probably impeded.

Alter the Functions of Government

The policy of decentralization and counting on local government autonomy of to deliver greater economic growth has increased pressure on the local governments and their organs, changed the roles and distorted the functions of government. While the government could play an important role in economic growth, experience has shown that it more often meddles with the affairs that should be left to the market and the society. Modern public administration shows that the government does well in certain areas, but does very poorly in others (Mao, 1998). Therefore, there must be limits on government intervention. Functions of the government should be carefully designed. In the case of China, government managed too much of what it should not manage, while minding too little what it should have minded. This caused trouble in two dimensions. One is that the ongoing meddling with economy caused the "fever and chills" of the national economy and resulted in irresponsible behavior and the corruption of the local governments. The other is the inflation of government organs and their staff. The present fiscal difficulties have resulted mainly from this inflation in the size of government and the corrupt needs of the local officials and aggravated by the fiscal system reform.

We may say that with the steady rise in the marketization within China, the massive administrative organs have come into serious conflicts with economic development, especially where the fiscal strength is inadequate. China cannot avoid such problems but has to take the initiative and work energetically to reform the current administrative and political structure. This means a large-scale reduction of the administrative organs, reducing the excessive interference in microeconomic activities and changing government func-

tions to fully utilize its public service functions (Zuo, 2002).

One Step Further in the Discussion

Everything discussed to this point is critical for building a healthy relationship between the central and local governments in China. However, with the next step we may find things are even more complicated, and we may be convinced that Chinese intergovernmental relationships cannot be confined within the literature, in which "the change of the paternalistic way of the central government, the change of the relationship between government and business, the alternation of the government functions" seems simplistic. An interaction and contextualization method of treating the issue rather than a managerial method might help us develop a new conception regarding the relationship between the center and local governments of a China in transition. This would enable us to probe into the party polity, political structures and other institutional arrangements to locate the underlying roots of the problem.

Rule of Law: a Platitude but Key Problem

In China today, the rule of law has become commonplace, but for the Chinese government the law is still more of a veil, rather than something tangible. Suffering from a severe deficiency of laws, rules and regulations, the Chinese government conducts its administration irresponsibly and arbitrarily. Currently, no laws concerning the relationship between the central and local governments have been proposed. China does have a law entitled "The Organization Law of Local People's Congress and Local People's Government," but it is more of a copy of the structure and function of the central government on a smaller scale, and no chapters in the law specify the relationship between the central and local governments. In China's current constitution, some sections do mention the relationship

between the central and local governments; however, they are too general to have any useful meaning. No section in any laws addresses the issue of horizontal intergovernmental relationships. Laws concerning the establishment and abandonment of administrations and government organs have not been passed since 1957, and the establishment of agencies is not under legal control. Administrative procedural law is also absent (Liu, Z., 1999). The laws of administration and government in China are the most primitive in the world. The existing laws, which say one thing on paper, always succumb to the logic of politics and relations in reality (Yang, 2002).

This institutional shortage leaves a lot of room for the Chinese governments, both central and local, to maneuver. Not institutions but strategies, not laws but officials, play the key roles in the adjustment of the relationship between the center and local governments. This in turn has severely harmed the relationship between the central and local governments and has induced great transaction costs during the administrative process.

Devoid of the rule of law, the center has developed a paternalistic policy process. Since the center does not recognize the limitations of its power and responsibilities, it tends to behave in a paternalistically. Local governments imitate the center by treating lower administrative levels the same way. Since the center is accustomed to flaunting its power through administrative orders and coercion, it tends to neglect the importance of the rule of law. In general, compliance by local governments officials was based on coercion and administrative orders rather than compatible incentives and laws. A typical example regarding the fiscal relationship between the center and the local governments is that the center does not bother to rationalize demanding local governments to remit more revenues whenever the center faces budgetary pressures. When the center wanted to increase its tax revenue by an additional 100 billion yuan in

1998, it merely held a video conference call to mobilize tax collection. It threatened that if the target for tax revenues was not met, the bureau chiefs would be removed from office (Chen, 2002).

However, frequently using administrative orders and coercive ways does not necessarily mean that the center is efficient in achieving its multiple goals. It rather shows that the center's authority has already become fragmented. Feudalism is embedded in the ground where paternalism originates. Lieberthal created the term "fragmented authoritarianism" to describe the complex policy process in China. For Lieberthal (1992, 8), authority just below the apex of the political system is fragmented, disjointed and structural, and this has increased the reforms pursued since 1978. Clearly, this means that the relationship between the center and local governments has turned into one of principal - and agent: one based on negotiation, bargaining and compromise. It is not strange that scholars have argued that bargaining had become a crucial element of the policy process (Oksenberg and Lieberthal, 1988, and Lampton, 1992).

Market and entrepreneurial ways dominate the methodology of local officials because economic growth has been given priority over all the other bureaucratic values. As mentioned above, however, the different political and economic contracts are not guaranteed by laws but dependent on the officials' bargaining ability and the relationships between the central authorities and the local cadres. Thus, it renders the center's anti-corruption efforts virtually fruitless. Public power contracted out has enabled local officials to continue their predatory actions without the constraints of law. In light of this, one scholar commented that it was foolish to entrust public managers with complete freedom over resources when they had not yet internalized the habit of spending public money according to prescribed rules because these individuals had learned how to beat the system and outmaneuver the controllers (Yang, 2002). However, as long as

feasible laws and rules are not enacted, the Chinese government will not be able to escape the cyclical embarrassment of whether to delegate or retain public power. Some scholars have noticed the link between corruption and the embarrassment of centralization and decentralization in China. With the metaphor of a helping hand and a grabbing hand, they pointed out that the helping hand and grabbing hand's behavior could be used to describe the behavior of government in transition economies. In both cases, there is corruption but a different type with different consequences for economic development. With the helping hand, corruption is organized, and the government assists development. With the grabbing hand, corruption is more individualistic and disorganized, and government impedes development. The grabbing hand has been described as being present in Russia and other former Soviet countries, whereas, the behavior of local government officials in China was previously described as having a helping hand (Chen, 2002). The helping hand and grabbing hand dilemma means that whatever division of tax revenues the center chooses, the local government might respond by choosing between the helping hand and the grabbing hand. Under the fiscal contractual system, the local governments have clawed corruption with the helping hand, under the fiscal sharing system, the local governments changed to the grabbing hand.

Devoid of guidelines in the policy process, China's government has failed to achieve the full effect of restructuring and reforming its administrative system, which is significant for normalizing the relationship between the center and local governments. Before the reorganization of 1998, China had conducted six rounds of similar initiatives since the early 1950s (Liu, 1999). The common measures included decentralization, centralization, downsizing, merging ministries, and simplifying bureaucratic procedures to support economic development. In general, the reforms

were limited to internal changes within the administrative branch (at all levels) through organizational adjustment (Yang, 2002). As a result, no matter how hard the state has tried, the reforms eventually unfolded to vicious cycle: "decentralization---centralization---decentralization" between central and local government, and "separation---merge---separation" in terms of agency establishment. Despite reform, administrative costs increased rapidly and continuously and exacerbated the fiscal pressure on the government (Tan, 1999).

Little has been done to form a law-based policymaking and implementation process in order to create a more proper governmental relationship-----although the authorities are always ready to talk about the rule of law. Further, the fluidity, ambiguity and messiness (Siach, 2002) in the policy process have been exacerbated by other institutional realities, including party-state polity and dysfunctional political structures and relations that show that in China's case, any administrative problems should be discussed within the political realm, otherwise no solutions will be last. As scholars have argued any explanation of Chinese policymaking and reform has to consider formal structures, political issues and informal politics, all of which play a significantly different role in China than in western countries (Dittmer, 1995; Fewsmith, 1996).

Political Reform: a Core Hinge

In China, the political institutional structure is one in which that the party, the government and legislature are interwoven. Nominally, according to the constitution, the institutional order is legislature first, government second and the party third. Actually, the reverse is true. This institutional arrangement, together with other formal and informal political relations has created a labyrinth for outsiders, which means that considerable tension and uncertainty exist in Chinese state life.

The most serious tension and uncertainty result from the relationship between the party and the administration. The two parallel lines of organization of the party and the government tend to cause many problems other than a government that lacks administrative and legal independence (Li, 1998). The accountability mechanism is ambiguous because the administration should be accountable to the Congress in law, but it is accountable to the Party in reality. The ambiguous functional boundaries have led to inefficient decision-making. In addition, redundancy and inflated party institutions lead to fiscal pressure because they absorb two thirds of public expenditures (Yang, 2002). In the relationship between the center and local governments, it is hard for people to tell to which the center and the local governments relate: the party or the government. The party-state polity allows the party easy access to the administration, and thus turns managerial affairs into political ones and over politicizes the policy process. It is clear that administrative reform is hindered by the party-state polity and other institutional arrangements.

Typically, the party and the central government stress that the organs and functions of the party and the state should be clearly differentiated from each other and that the government and business should be separated. In fact, however, that goal has never been achieved and perhaps will never be achieved if China does not take measures to reform its polity. The priority for the Chinese government is economic reform and development, not political reform and development. Apparently, the Chinese government refuses to acknowledge the close relation between the two, and deliberately distorts the relationship by claiming: "Economic development is really the greatest politics." This dichotomy, as well as rather vague attitude towards the relationship between economy and politics, confuses even the central government itself. For on one hand, the center bases its legitimacy on

economic development, but on the other hand, it hesitates to embark on political reform to promote economic development. Whenever such political reform is urgently needed, the administrative system tends to be blamed. Thus in China, while administrative reform is a very hot issue, political reform is seldom discussed in earnest. The assumption is that as long as the economy creates growth and a higher standard of living, society will not demand changes in its political institutions and distribution of political power (Yang, 2002).

The real reason is that the government has always given primary emphasis to the stability of the party-state, and the limit of any economic and administrative reforms is whether they help or hinder the regime. Any reform measures, if they are deemed harmful to political concerns, will be struck down even if they are truly worthwhile in an economic and managerial sense. As Yang (2002) noted: "China's reform has always been to strengthen the bureaucratic capacity and in turn the economy for the purpose of the Communist Party of China's political legitimacy and the regime stability. When technical efficiency clashes with it, the reform measures will be discontinued." This has been the most important "strategic dimension" of China's economic and administrative reforms. The issue of political strategy makes any Chinese reforms unpredictable and unpromising. It has further made the reform process "lengthy and tortuous, characterized by incrementalism, pragmatism and compromise" (Liu, 1999).

As early as 1984, at the third plenary of the 12th CPC initiated the idea of the "separation of government from business." As early as 1986, Deng Xiaoping recognized that the essence of streamlining government was to restrain the power of the state and change the function of the government. This was set as a principle in the 1988 restructuring. However, only in the 1998 restructuring were these principles implemented, although not in their entirety. On the technical side,

the 1998 reform was intended to (1) to reduce administrative cost by closing or merging ministries and departments, and dismissing excess staff; (2) to separate more clearly the governmental functions from the commercial functions; and (3) improve the effectiveness of government in the management of the economy (Yang, 2002). Since the reforms are restricted in the scope, without acting politically the long-term consequence does not look optimistic. Yang (2002) finds that although the reform since 1998 appears to be substantial, "by themselves they may have little impact either on the effectiveness of government or on the performance of the state industries." It is even doubtful that the reform has changed the behavior of government employees because little has been done to change the way the government works.

In the political context there seems to be a managerial tendency to use reform as a strategy. Thus, reform objectives are limited to efficiency, economy, efficacy and sometimes responsiveness, while more important values such as equity and justice are ignored. As a result, reforms will not reshape the Chinese administration and governance system.

For China, on the one hand, managerialism might work as a tool to separate policies from administration, but by ignoring political reforms, managerialism exacerbates the severe corruption of the political system. Professor Hu An-gang of Tsinghua University put the cost of corruption as high as 13.6 percent of GDP, and estimated that 15.20 percent of public project "leak" funds into private hands. The sources of corruption include the expanding income gap resulting from market competition, the pervasiveness and effectiveness of the informal network based on *guanxi* (relations) and clientelism in the administrative system, the lack of accountability, the informal politics, and the party-administrative confusion. This is partly why some argue that the corruption is institutional (He,

1997) and has become collective (Gong, 2002). Without a view to governance and political resolve for reform leading toward democracy, anti-corruption efforts are meaningless in dealing with increasingly complex corruption (He, 2000).

It is difficult for the Chinese government to fully control and intervene in the relationship between government and business even if the government is clear that the SOE problem is the bottleneck of its reform. Tough measures such as privatization taken would surely produce more lay-offs and cause even more political and social instability. However, faced with entry into the WTO and cautioned by the economic slowdown in 1998-1999, the government did take some reform steps including trying to solve the ownership and property right issues and reorganize its banking system. Nevertheless, the rather conservative and tentative reform package seems to have had little real effect. Kim found that conventional reform packages still leave a room for ad hoc government intervention in key management areas. This implies that without the full transfer of the government's control of SOEs to the private sector, the politicized nature of the relationship between the state and the SOE sector will continue (Kim, 2000). As we have just seen, it is hard for the Chinese government to take further radical measures because of the great concern for political issues.

Some Suggestions as Conclusion

Thus far, we have probed several institutional shortcomings concerning crucial aspects of law and politics. We maintain that the three changes of paternalism, the intermeshing of government with business and the government functions are the immediate measures that should be resolved in the relationship between the center and local governments. We argue, however, that laws, rules and regulations on the one hand, and political institutions and structures on the other are in fact elements that are more fundamental. Without

proper laws and regulations, and leaving the concurrent political system untouched, the three changes cannot be realized. Thus, a fruitful intergovernmental relationship cannot be established. Consequently, we offer some suggestions in conclusion:

- Some laws concerning the relationship between the center and local governments need to be passed. (1) The relationship between the central and local governments should be clearly stated in the Constitution. (2) The Organization Law of Local People's Congress and Local People's government should be revised to be made clearer and more detailed as to how they are to be organized, structured and to function. (3) An administrative procedural law should be enacted that requires the governments are required to perform properly. Those changes are critical for the center to change its paternalism and for the local governments to change their ingrained habits of negotiating and bargaining with the center.
- Since some articles of the Administration Litigation Law, the State Compensation Law and the Administration Reconsideration Law are too simple, they should be revised. The rights and responsibilities of the government and citizens in policy process need to be made clearer. They are critical to make the center, local governments and citizens interact properly.
- Since China is quite different from the developed countries whose key concern is deregulation, China should attention more to regulation and re-regulation in some areas, while deregulate in other areas.
- China should take practical measures to reform its polity to create a supportive environment for other reforms. (1) China should clearly define the boundaries between the party and the state by law and limit the power of the party to intervene in the administrative process. (2)

China should raise fixed funds for the activities of the party and keep the party from relying on the state budget, which would not diminish its legitimacy but rather help enhance its authority; (3) The government should streamline the party organs at the lower levels while continuing to reduce the size of government organs.

- No remedies are better in treating the illness of corruption than democratization. Depending on the democratic institutions and procedures, the state would find itself more effective in monitoring local officials and the local residents might find it a better way to supervise the cadres. (1) An election system should be established that would redirect the local governments from regarding the upper governments as their customers to instead regarding local residents as their customers. By relying on democratic elections, the state might overcome the dilemma of principal-agent, and local governments might be compelled to act in the more responsive manner. China has already developed a village, city and community election system. Based on such experiences it can promote the election system to upper-levels of governments. (2) China should establish a local autonomous governance system as Korea has done. Since all the provinces and counties are economically unbalanced, and have developed huge disparities among themselves, local autonomy might become a pragmatic way for local governments to shoulder their responsibilities and for residents monitor their rights and government activities. Interactions between local governments, citizens and society are crucial elements for creating a government that is accountable to the people. This can stimulate the initiatives and creativities of both local governments and their people. Horizontally functioning networks rather than a vertical chain of command might prove promising for China as it tries to handle the complex

relationship between the center and the local governments.

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