

**INTRA-PROVINCIAL FISCAL DISPARITY AND PROVINCIAL FISCAL
TRANSFER SYSTEM IN CHINA: EVIDENCE AND POLICY INSIGHTS FROM
TWO PROVINCES**

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ABSTRACT

This study seeks to examine the impact of province-local fiscal relationship on fiscal disparity across local governments in China. The 1994 tax-assignment reform determined the fiscal relations between the central and provincial governments, but no central laws or regulations stipulate fiscal arrangements between provincial and local levels. Sub-provincial fiscal relations are ordered at the discretion of individual provincial governments, thus, provinces vary in their revenue and expenditure responsibility assignments between provincial and local levels and also distribution schemes of intergovernmental transfers. In such a multi-level government structure, the effectiveness of national equalization efforts greatly depend on the further degree of vertical decentralization and the equalization efforts of intermediate-level governments, particularly the provincial governments. Nevertheless, provincial governments as “economic agents” have their own preferences and objectives and their efforts in implementing national equalization policy might be different given their different preferences and development strategies. This study explores the level of intra-provincial fiscal disparities in China and the extent to which the undesirable fiscal inequalities can be traced to the sub-provincial fiscal relations, in particular, the equalization role of provincial fiscal transfer systems in individual provinces. This study has generated case studies of Henan and Guangxi provinces to better understand the dynamics of sub-provincial fiscal relations and the equalization effects of their provincial fiscal transfer systems. It uses decomposition methods to investigate the contribution of different transfer schemes (general-purpose transfers including equalization transfers and other general-purpose transfers, specific-purpose transfers, and tax rebates) to county-level fiscal disparities in the two provinces and a comparative approach to evaluate their provincial equalization efforts. For Henan and Guangxi, both of which are deficit provinces, their provincial and local governments rely heavily on central transfers to balance their budgets, but the two provinces’ transfer schemes have shown very different equalization effects on horizontal fiscal disparities across local governments in those two provinces. The findings provide insight on how to reform intergovernmental transfers in Henan and Guangxi provinces to better achieve equalization at the sub-provincial level. Similar research on other provinces is highly desirable to have a more complete picture of fiscal equalization performance of provincial policies in China.