The Origin of the High Centralization of Tax Legislative Power

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Abstract: The high degree of centralization of tax legislative power in China has produced frequent controversies in practice, and is also fundamentally inconsistent with certain basic principles of public finance and the rule of law. However, this arrangement is commonly assumed as a given for the contemporary Chinese polity. This article challenges this prevalent view. It argues that the centralization of tax legislative power began only in 1977, and was by no means a fixed institution before that time. Moreover, such centralization strengthened between 1977 and 1993, which was a period regarded as the golden age of fiscal decentralization. Thus there was a sharp contrast at the time between the distribution of tax legislative power and the predominance of fiscal decentralization. The article argues that this contrast could not be explained by the lack of importance of law during the period. “Taxation according to law” was a core idea in the development of the tax system, and this was inevitable due to the need to have a consistent set of tax rules for everyone to follow, to give these rules the backing of the force of the state, and to ensure that such rules were known to the public. The high degree of tax legislative centralization in China is thus historically contingent, and cries out for explanations as to its causes.

Key words: tax legislative power, taxation according to law, fiscal federalism, system of tax sharing, relationship between central and local governments

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Introduction

The current, high degree of centralization of tax legislative power in China is widely recognized among Chinese tax law scholars. A core basis for this arrangement is the Decision of the State Council on the Implementation of Tax Sharing System in 1993 (hereinafter the "Decision on Tax Sharing"), which declared that “the legislative power regarding central taxes, shared taxes and local taxes should be reserved to the central government, to ensure the reunified implementation of central government decrees, and to safeguard a unified national market and equal competition for enterprises.” Other provisions in the Law on the Administration of Tax Collection and the Law on Legislation also give expression to this paradigm of centralization. However, quite a number of scholars have expressed doubts about the justifiability of this paradigm. The questionable legality of many local fiscal initiatives in recent years has further fueled scholarly debate about whether the present allocation of tax legislative power is sustainable.

Even at a highly abstract level, the complete centralization of tax legislative power is problematic, because it makes it impossible to simultaneously satisfy two principles: (1) that the rules of a tax system should be set forth in forms that have the force of law; and (2) that sub-national governments should be given some discretion over some tax matters, as a part of fiscal autonomy. Both principles are sufficiently weak so as to be consistent with a wide range of conceptions of proper lawmaking procedures and of the appropriate degree of centralization. To satisfy both principles, the lawmaking power of sub-national government entities only has to substantially track the extent of fiscal discretion given to such entities. The doctrine that tax legislative power must be centralized, however, makes the violation of one of these two minimal principles inevitable. Thus on the one hand, in certain historical circumstances during the last thirty years, local governments were able to adopt tax policies that contradict national law and trespass on the authorized limits of local legislation, without attracting any sanctions. The norms of the rule of law face serious challenges on these occasions. On the other hand, in the more common type of case, the monopoly of tax legislative power by the central government has perpetuated a situation where local governments look to transfer payments as well as under-regulated sources of revenue (e.g. proceeds from land sales), instead of taxation, to finance local expenditure needs. These are

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1 Law on the Administration of Tax Collection (as amended in 2001), Article 3, “The collection of tax or the cessation thereof, the reduction, exemption and refund of tax as well as the payment of tax underpaid shall be implemented in accordance with the law or the relevant provisions stipulated in administrative regulations formulated by the State Council, provided that the State Council is authorized by the law to formulate the relevant provisions.”

2 Law on Legislation, Article 8, “Only national law may be enacted in respect of matters relating to...(viii) the fundamental economic system and basic fiscal, tax, customs, financial and foreign trade systems.”


options generally considered to be incompatible with fiscal autonomy.

The foregoing conceptual objection to strict legislative centralization in taxation is supported by the fact that, from a cross-country comparative perspective, China’s current high degree of tax legislative centralization is unusual, even among politically unitary states. This raises a question: how, and why, has China come to adopt the current centralization paradigm in tax legislation? As important as this question may seem, few scholars have tried to confront it.

Two prevalent views probably have suppressed the question in the past. The first view is that the centralization of tax legislative power, perhaps as a part of a more general tendency towards the centralization of legislative decision-making, is an essential Chinese tradition. It is so richly tied to Chinese political history and culture that there is no single explanation for it. Raising the question of how centralization has come about would take one too far away from the usual perspective adopted for understanding Chinese law. The second view is independent of the first, but may complement it. One might argue that not only is it unsurprising, given Chinese culture and tradition, that tax legislative power should be centralized, it may also not be an important phenomenon. Although it is fitting for legal scholars to draw distinctions between different types of taxing power——such as tax legislative power, tax collection power and the claim to the benefits of tax revenue——in reality, tax legislative power may be much less important than other types of taxing power to fiscal politics. This is because the legislative system and the rule of law were, after all, introduced in China only in recent history. They can become effective only gradually. Very often, the law is still treated as no more than an after-thought. Under such circumstances, how tax legislative centralization developed is a rather esoteric question, and its importance unclear.

This paper aims to show that both of these two widespread views are too complacent. First, I argue that the current paradigm of tax legislative centralization in fact has a rather recent origin: it began to take hold only after 1977. Not only were there important episodes of legislative decentralization in tax matters before 1977, but even the most centralized arrangement before 1977 was less centralized than the 1977 arrangement. More importantly, the paper traces how centralization evolved during the years between 1977 and 1993. These years after reform and opening are generally considered to constitute a golden age of decentralization, both in fiscal and other economic spheres. However, it appears to be precisely during this era that the doctrine that tax legislative power should be centralized gradually gained ascendance. This juxtaposition challenges the unreflective position that tax legislative centralization is somehow simply a natural and an unavoidable consequence of the way the Chinese polity is organized.

Indeed, the contrast between tax legislative centralization and fiscal decentralization

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5 For discussion of the systems of tax legislation in unitary countries (such as Italy, Spain, France and the United Kingdom) and in federal countries, see C. Sacchetto & G. Bizioli, *Tax Aspects of Fiscal Federalism: A Comparative Analysis*, Amsterdam: IBFD, 2011.

6 Zhang, supra note 3, p 47.
between 1977 and 1993 makes it rather tempting to fall back on the second customary view, namely that arrangements for tax legislation cannot have possessed much importance. Against this view, the paper argues that although the rule of law was of course weaker during the decade and half after the end of the Cultural Revolution than it is today, the law still played a very important and salient role in tax administration. Indeed, in many ways it is unthinkable how China’s tax system could have developed in the 1980s without relying on the legal system. The realities of tax administration during this time would not support an attitude of indifference towards the law.

Together, these arguments show that the question how China came to adopt the current model of tax legislative centralization is an important one to study. The paper does not attempt to offer a full explanation in answer to that question, and merely suggests that an explanation should be sought. Even this interim conclusion, however, should be of significance to legal scholars. Surely it is a relief to know that what is clearly a defective arrangement from a normative perspective is not an inescapable burden that the Chinese tax legal system is saddled with. And the better one can understand the historically contingent causes of the arrangement, the better targeted and more effective one’s argument for change may be.

The paper is structured as follows. Section 1 describes the arrangement for tax legislative centralization in 1977, how it compared with earlier models of tax legislation since the founding of the People’s Republic, and how the 1977 model continued to strengthen and culminated in the centralization paradigm in 1993. Section 2 contrasts this development with the important—and better-known—dimensions of fiscal decentralization between 1977 and 1993, and demonstrates that tax legislative centralization was poorly matched with fiscal decentralization at the time, was not clearly optimal given policy uncertainties at the time, and required substantial political resources to implement. The fact that it was sustained in the end was a political outcome that had by no means been guaranteed. Section 3 explains why the discrepancy between legislative centralization and other forms of fiscal decentralization could not be explained by the weakness—and presumed insignificance—of the legal system. Instead, law played a crucial role in tax administration during this period. Section 4 briefly describes a potential theoretical framework for more fully examining the causes of legislative centralization in China.

I. The Establishment and Consolidation of Tax Legislative Centralization between 1977 and 1993

The evolution of the locus of tax legislative power between 1977 and 1993 was bounded by two seminal documents, the Ministry of Finance’s “Decree on the Tax Administrative System” in 1977 (hereinafter referred to as the “1977 Decree”), and the Decision on Tax Sharing in 1993. Both documents delineated the tax legislative power—broadly defined as the power of levying taxes, setting the tax base and tax rates, as well as adjusting the tax base and tax rates through tax reductions or exemptions—of different levels of governments.
The 1977 Decree was devoted entirely to the questions of which government entities had the authority to make tax rules, and which entities were allowed, under certain circumstances, to stipulate deviations from these rules. The decree provided first that “any changes in national tax policy, the promulgation and implementation of tax laws, the levy or the cessation in the collection of any tax, the addition or subtraction of tax items and the adjustment of tax rates, shall be uniformly prescribed by the State Council.” Second, important provincial tax policies must be approved by the Ministry of Finance, including (i) the cessation of collection or exemption from a tax within the entire province or the imposition of a tax, tax reductions or exemptions for a taxable product, a certain industry, or the four products of tobacco, alcohol, sugar, and watches, (ii) adjustments to the salt tax amount, as well as (iii) issues involving diplomatic relations or the taxation of foreign business. Third, provincial-level revolutionary committees received permission to grant tax reductions and exemptions to address the special needs of specific types of businesses, under a detailed set of guidelines regarding when such authority may be exercised. (These needs were mainly couched in terms of “difficulties” businesses were having as a result of various government policies under the planned economy.) Finally, “provinces, municipalities and autonomous regions in general should not further delegate the above authority...Except as permitted under the above provisions, no region, department or unit has the authority to grant tax reductions or exemptions on a discretionary basis, or issue documents in conflict with the tax law.”

These provisions of the 1977 Decree were not perceived at the time to implicate radical changes. This was also consistent with the transitional political situation of the central government in 1977. Nonetheless, in some important respects, the 1977 Decree marked a watershed in the evolution of the allocation of tax legislative power.

First, it represented a major recentralization of such power in comparison to the immediately preceding years. Because of the central government paralysis in the aftermath of the height of the Cultural Revolution, and because of the fear of a war due to the breaking of ties with the Soviet Union, fiscal management in China had begun a strongly decentralized phase after 1969. For the period between 1970 and 1973, most provincial governments only had to make lump sum transfers to the central government, and were otherwise able to control their own expenditures, retain surplus revenues, and divide revenues and expenditure responsibilities with lower levels of government in their jurisdictions. In the meantime, the power to make many items of tax policy had been delegated to the provinces. While, between 1974 and 1976, the central government reclaimed greater revenue shares, significant sub-national fiscal autonomy remained. Indeed, a legacy of this period that remains until

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7 See Ministry of Finance (MOF), A Report in Request for Instructions regarding the Tax Administrative System, submitted to the State Council in August 1977, included in the Editorial Office of Contemporary Chinese Public Finance (ed.), Historical Reference Material for Chinese Socialist Public Finance, 1949-1985, China Finance and Economics Press1990 (hereinafter “Reference Material in Public Finance History”), p 532. In the rest of this article, references to the “tax administrative system” (shuishou guanli tizhi) should be understood in the specific sense in which the phrase was used in the 1977 Decree, as denoting the system of tax legislation/policymaking, and is to be distinguished from the notion of tax administration and collection (shuishou zengguan).

today is that provinces became exclusively responsible for determining the fiscal relations with subordinate administrative units, so that in budgetary matters the central government dealt directly only with provincial governments. Even after the highly centralized system of tax legislation in 1994, as to fiscal management below the provincial level, the central government only provides a guideline.

What the 1977 Decree proclaimed, however, was that whatever bargains were struck among provincial and sub-provincial governments, the delegation of tax lawmaking power was not to be part of it. Other aspects of the budget and financial management could be delegated down further layers of government, but the formulation of the tax rules could not. Provincial governments were to form the “lower bound” of decentralization of tax legislative power. Thus if we measure the degree of tax legislative centralization not just in absolute terms, but also relative to budgetary decentralization, the degree of re-centralization in 1977 is further accentuated.

Moreover, even compared to the pre-1970 period, the 1977 Decree’s turn towards centralization of tax legislative power was unprecedented. Both Chinese and western scholars of the history of public finance in China tend to refer to the system adopted in 1950 under the Main Points on the Implementation of National Tax Policy as a paradigm of “high centralization”. However, according to the letters of the Main Points, “where the relevant local tax legislation is within the scope of a county, the county people's government must submit a proposal to the Provincial People's Government, requesting the latter to verify the proposal and then transfer it to the People's Government or Military and Political Committee of a Large Administrative Region for approval; the proposal must also be filed for records with the central government.” Only local tax legislation within provinces (municipalities) needed to be “proposed and reported to the People's Government or Military and Political Committee of a Large Administrative Region, so that the latter may verify and transfer the proposal to the Central Government for approval.” In other words, county-level governments had tax legislative power which was not directly controllable by the national government. There was no room for such arrangement under the 1977 Decree.

In addition, we have to take into account that national unity was newly established in 1950, and fiscal centralization only constituted a direction for government efforts, but was not completely achievable. A highly centralized system was strictly speaking not an institution capable of being built at the time, but a fiscal policy compelled by urgent needs. Once the emergency situation at the initial establishment of new China was under control to some extent, the central government began to retreat from total centralization in order to give incentives to local governments to build government capacity. After several years of exploration, with the completion of the first five-year plan, the State Council and National People's Congress reached a consensus in 1957 that powers should be decentralized to lower

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9 Id., Section 4.3.
10 See Decision on Tax Sharing; Approval of the State Council to the Recommendations of the Ministry of Finance on Issues Related to Improvement of the Fiscal Management System Below the Provincial Level (Guofa [2002] 26).
11 Huo Jun, “The Evolution of the System of Fiscal Management in the 60 Years of New China,” Studies of Contemporary Chinese History, 2010(3); Oksenberg and Tong, supra note 8, p 5.
levels to change the situation of excessive centralization. On this basis, the Provisions of the State Council on Improving the Tax Administrative System in 1958 adopted a decentralization arrangement that embodies a strong version of "fiscal federalism": “any tax, which can be administrated by provinces, autonomous regions and directly-controlled municipalities should be handed over to [them]; for any tax that is still under central government’s administration, provinces, autonomous regions and directly-controlled municipalities should be given the authority to make adjustments within a certain range; and [they] should be allowed to formulate tax measures to collect regional tax. Even though some attempts at recentralization were made in the early 1960s, none restricted the range of government authorities capable of tax law/rule-making to the degree that the 1977 Decree did.

Although a detailed examination of the decentralization of tax legislative power before 1977 is beyond the scope of this paper, the above discussion should be sufficient to raise substantial doubts about the attributability of the centralization of tax legislative power to any pre-1977 tradition.

After 1977, however, centralization did become entrenched. In contrast to the fluctuations between 1950 and 1997, the 1977 Decree remained valid until they were replaced by the Decision on Tax Sharing in 1993—which represented an even higher degree of centralization, as discussed below.

This process of gradual entrenchment can be observed from a number of angles. First, many of the government documents in the 1980s and early 1990s cited the 1977 Decree for its procedures for provincial grants of limited tax reductions and exemptions. The following charts summarize the pattern of citations of the rules in the 1977 Decree found in central and local government regulations and policy documents issued between 1978 and 1993, which we have gathered through several different databases. ¹³ From Chart 1, it is clear that the number of reference to the rules of tax legislation grew over time. In Chart 2, central and sub-national documents are further divided into two categories: those that deal specifically with matters of tax policy (tax document) and those that deal with other matters but referred to the issues of tax policy (non-tax documents) ¹⁴. It can be seen that while the majority of Central Government documents referring to the tax legislative system (128 out of 149) are tax policy documents, local non-tax policy documents referring to the tax legislative system are far more numerous than local tax policy documents (119 and 35, respectively). This indicates that the increase in the number of documents referring to the tax legislative system was not only due to the expansion of the central and local tax collection agencies, but also due to the growing complexity and influence of China's tax system. The 1977 Decree provided a basic framework for the increasing number of specific tax policies in these years, as well as a

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¹³ The documents were found through the central laws, regulations and interpretations database and local regulations and government rules database of (1) China Law Info (www.chinalawinfo.com) and (2) Infobank (www.infobank.cn), with full-text search for the key words of “tax administration system” or “tax administration authority”. Other searches were based on material contained in Reference Material in Public Finance History, supra note 7, and Major Tax Events in China. We have checked each document to ensure that it either explicitly or likely refers to the content in the 1977 Decree.

¹⁴ We categorize the documents issued by finance or tax departments and with the title of “tax” as fiscal documents, and others as non-fiscal documents.
This systematic role that the 1977 Decree could be expected to play is of course reflected in more than just the documents that directly cited it, because the rules were also incorporated indirectly or implicitly into law in a number of ways. For example, in 1986, the 1977 Decree was incorporated by reference in the Interim Regulations on the Administration of Tax Collection. In the Detailed Implementation Rules for the Interim Provisions on Penalties for

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15 Interim Regulations on the Administration of Tax Collection, Article 3: “Levying or reduction of or exemption

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Violations of Fiscal Regulations in 1987, “ultra vires and unauthorized tax reliefs” is construed as including “local people's governments' violation of the provisions of the tax administrative system.” Similarly, many specific national tax policy documents adopted the practice of allowing provincial governments to make certain narrowly-circumscribed decisions regarding tax reductions and exemptions. By contrast, instances of direct delegation to lower government entities all but disappeared.\(^16\)

Second, beyond being a constant frame of reference for tax lawmaking, the 1977 rules attained growing significance and attracted increasing emphasis in the 1980s. Before 1980, the rules did not receive much mention, and there were even instances where the national government seemed willing to delegate tax policy to provincial-level governments to a greater extent than contemplated by the 1977 rules.\(^17\) However, the continuous state budget deficit in 1979 and 1980 and inflation brought by monetary policy led the central government to begin to emphasize "rectification". In early 1981, the State Council released the Decision on the Balance of Revenue and Expenditure and Strict Fiscal Management, announcing that "to ensure fiscal balance in 1981 and to eliminate the deficit, the State Council considers it necessary to adopt the principle of centralized and unified allocation and use of financial resources, as well as strict fiscal management and financial and economic discipline ...The national tax system must be resolutely safeguard, and no discretionary change of taxes, tax rates and tax reliefs is allowed. " Under such circumstances, “the collection and cessation in collection of national taxes, the addition and elimination of tax items, the increase and reduction of tax rates, and any additional tax collection or relief must be managed uniformly. Any policy on such matters should be issued by the Ministry of Finance, or approved by the State Council and issued by the Ministry of Finance. In the future, any tax provisions adopted by other agencies will be null and void. " For some central bureaucrats, this raised the question of whether the 1977 rules should be further tightened and tax policymaking further centralized.\(^18\) Even though no such step would be taken until 1993, policy documents and internal speeches specifically urging the enforcement of the 1977 Decree began to

\(^16\) In other words, the following example became a rare exception. According to the Notice on Further Reducing and Exempting Business Income Tax for Township Enterprises (March 29, 1984), for those township enterprises that did not compete with large-scale industries for raw materials, that had difficulties to pay business income tax and truly needed tax relief, tax reliefs for fixed terms may be granted upon the review by county and municipal tax departments and the approval by county and municipal governments.

\(^17\) For example, the State Council approved the Report on the Implementation of the Agricultural Tax Threshold Approach submitted by the Ministry of Finance (August 28, 1980), and indicated that whether agricultural tax adjustments for different counties within a province should be made could be determined by the provinces. On October 9 of the same year, the Ministry of Finance issued a Notice on Issues in Improving the Payment of Commercial and Industrial Income Tax by Cooperative Shops and the Individual Economy, providing that the burden of the corporate income tax on a cooperative store should in principle be set at a level equivalent to the 8-bracket progressive rate structure of handicraft businesses, and provinces, autonomous regions, and directly-controlled municipalities should make specific rules according to their own circumstances.

\(^18\) "Based on this request, the former tax administration regime should be revised correspondingly. The current situation of over-decentralization and over-dispersion of tax administrative power should not be allowed to continue. Before the announcement of the new revised tax administration regime, local government can work according to the original regime. The authority of tax deduction and exemption, however, should be in the control of the central and provincial levels, and should not be decentralized further. " Speech of the Minister of Finance Bingqian Wang at the National Taxation Work Conference and Enterprise Accounting Work Forum (January 27, 1981), in Reference Material in Public Finance History, supra note 7, p 643-646.
proliferate.\textsuperscript{19} Campaigns against unauthorized local tax reductions and exemptions began in 1987. Since a major intent of the 1977 Decree was to delineate the scope of authority for granting such tax preferences, they became inextricably implicated in such campaigns.\textsuperscript{20}

This growing emphasis on tax legislative centralization led to the centralization provision in Law on the Administration of Tax Collection in 1993.\textsuperscript{21} And that provision merely foreshadowed the practically more important Decision on Tax Sharing of the State Council in 1993, which further strengthened centralization. Under the new regime after 1993, even provincial governments were no longer authorized to grant tax reductions or exemptions to enterprises “having difficulties”. Initially such enterprises may enjoy “refund after collection” at local governments’ discretion. Subsequently, the central government adopted the position that refund after collection was a disguised form of tax reduction and therefore a practice to be eliminated. Provincial-level discretion on tax policy remained possible, in theory, only as a result of specific delegations from the central government. The game between central and sub-national governments for granting tax reductions and exemptions privileges became largely focused on the issue of “refund after collection”, whereas disputes about policy measures to increase fiscal revenue mainly related to the control of arbitrary charges and extra-budgetary funds. Any “discretionary” expansion of the tax base and increase of tax rates by local governments have been basically the result of the use of revenue targets in tax collection, instead of reflecting local policy initiatives.

For those who are familiar with the centralization of tax legislative power after the 1994 tax reform, the increasing emphasis on centralization throughout the 1980s and early 1990s may merely re-enforce the idea that this is the way that the Chinese government has “always” operated. However, the development before 1993 is surprising from at least two perspectives. The first is that the 1980s is widely regarded as an age of fiscal decentralization, and indeed the strength of decentralization forces was supposed to have triggered a crisis in the central government’s fiscal capacity, resolved only by the 1994 tax reform. It seemed precisely to be a time when centralization should not be taken for granted. The second perspective is that as China evolved away from planned economy, the system of taxation had to be, and in fact was, completely reinvented. Just as it was not clear for a long time how economic reform should be conducted, how to tax economic activities was also not clear and had to be experimented with. For the central government to claim for itself the exclusive right in such experiments meant being under pressure to develop new rules and making mistakes all the time. Given the difficulty of designing tax policy during this era of transition, why was the central government so interested in precluding the initiatives of local governments? Why prevent others from trying when one doesn’t know oneself what one should be doing?

\textsuperscript{19} See infra note 46. See also Notice of the Ministry of Finance on Strengthening Salt Taxation Work (March 7, 1981); Proposal of the Ministry of Finance on Strengthening Industrial and Commercial Tax Work (December 16, 1983); Peijian Lü, Summary Speech at the National Taxation Work Conference (March 29, 1982), in Reference Material in Public Finance History, supra note 7, p 697-699 (“Zhao Ziyang stressed at the National Industry and Traffic Conference in March, 1982 that the tax administrative regime must be centralized.”)

\textsuperscript{20} Through the databases mentioned in note 13, supra, we found 24 central government document issued between April 1987 to June 1993, which focus on improving centralized tax administration, and local government issued approximately the same number of documents in response.

\textsuperscript{21} Supra note 1.
The following section will elaborate on these two perspectives, and show that tax legislative centralization was politically highly contentious.

II. The Contingency of Tax Legislative Centralization Before 1993

The overall evolution of fiscal management and fiscal decentralization between the end of the Cultural Revolution and the 1994 tax reform is a complex subject that has already received extensive studies by both Chinese and foreign scholars of Chinese public finance. The following will not survey this very voluminous literature but merely highlight a few themes that command general consensus and that underscore how unusual the gradual consolidation of tax legislative centralization should really be regarded as.

To begin, it is well known that during the period between 1977 and 1993, as a result of the government’s attempt to deal with inflation, deficit, and the gradual dismantling of the planned economy all at the same time, fiscal regimes changed quickly and each was short-lived, some lasting only for one year. At each time, the central government agreed to different packages with different provinces.\footnote{The different fiscal regimes between 1977 and 1985 are discussed in Oksenberng and Tong, supra note 9; developments from 1977 up to 1988 are discussed in Christine P. W. Wong, “Fiscal Reform and Local Industrialization: The Problematic Sequencing of Reform in Post-Mao China,” 18 Modern China at 200-4 (1992). See also Huo, supra note 11.} For example:

- In 1977, most provinces implemented the “sharing total fiscal revenue” (\textit{zong'e fencheng}) system determined on an annual basis, but six provinces and cities implemented the “revenue and expenditures contracting” (\textit{shouzhi baogan}) system, while Jiangsu Province introduced “fixed ratio contracting” (\textit{guding bili baogan}) system to be determined every four years.
- In 1978, 10 “experiment” sites adopted five different sharing ratios to try out the “increment pro-rata” (\textit{zengshou fencheng}) system.
- In 1979, 21 provincial jurisdictions implemented the “surplus prorata” (\textit{chaoshou fencheng}) system; Sichuan began to try out the “separating revenue and expenditures, contracting level-by-level” (\textit{huafen shouzhi, fenji baogan}) system; and Guangdong and Fujian began to implement the fiscal contracting (\textit{caizheng dabaogan}) system.
- From 1980 to 1982, five different fiscal systems of dividing revenue and expenditure between the central and local governments were implemented at the same time, and within each system different central and local sharing ratios were adopted.
- In 1983, the “fixed ratio contracting system”, to be negotiated every five years, began to replace the “separating revenue and expenditures, contracting level-by-level” system in select jurisdictions.
- In 1985, the State Council proposed the system of “separating types of taxes, assessing revenue and expenditures, and contracting level-by-level” (\textit{huafen shuizhong, heding shouzhi, fenji baogan}); but due to the uncertainties brought by the “tax-for-profit” reform, the fiscal contracting system was implemented instead from 1988 to 1993. Thirty-seven provinces, autonomous regions, directly-controlled municipalities and separate-planning cities respectively implemented six forms of contracting: “income increment...
contracting” (*shouru dizeng baogan*), “sharing total fiscal revenue”, “sharing total fiscal revenue plus growth” (*zong'e fencheng jia zengzhang fencheng*), “incremental upward payment contracting” (*shangjie'e dizeng baogan*), “fixed payment” (*ding'e shangjie*), and “fixed subsidies” (*ding'e buzhu*).

Among these different regimes, the system of tax sharing according to tax types was closest to the tax sharing system that began to be considered in the late 1980s. It may be argued that because revenue from certain specific taxes is shared between the central and local governments, the central government has a strong interest in setting the tax base and tax rate through legislation. That, presumably, is one of the important motivations for centralizing tax legislation. However, when revenue sharing depends not on specific taxes but overall tax revenue, and especially when central and local governments have adopted “fiscal contracting”, and were no longer negotiating the sharing of tax revenue, the argument that the central government must set the tax base and rate for every tax and make sure that tax collection is carried out accordingly seems much less compelling.

This point was partially acknowledged in the Summary of the Conference with Guangdong, Fujian and the Special Economic Zones approved and forwarded by the Party Central Committee and the State Council on July 19th, 1981. This summary proposed that Guangdong and Fujian would continue the “fiscal contracting system”. In respect of taxation, although in principle, “all the formulation, promulgation and implementation of national tax law, the collection of tax or the cessation thereof, increase or decrease of tax items and tax rate adjustment, as well as tax regulations involving international relations, should be decided by the central government”, the two provinces may make their own determinations regarding tax reductions and exemptions for products other than tobacco, alcohol, sugar, and watches, for certain industries or businesses, as well as the relief, collection, and the cessation thereof, of various local taxes.” This clearly allowed much greater tax policy discretion to the two provinces than was generally contemplated by the 1977 Decree. The exceptions made for Guangdong and Fujian were consistent with the most drastic degree of fiscal decentralization that these two provinces enjoyed before 1993: since Guangdong only had to deliver a fixed sum to the center while Fujian only received a fixed transfer payment, it should not matter much, from a fiscal perspective, exactly how each collected tax.23 But this reasoning makes the general pattern of legislative centralization described in the last section more puzzling: aside from Guangdong and Fujian, why was the 1977 Decree applied uniformly across China, regardless of the varying degrees of fiscal decentralization that the provinces each enjoyed?

Moreover, not only did tax legislative centralization not reflect the geographical variations in central-provincial fiscal relations, it did not match the pattern of variation over time, either. We have seen that fiscal management became more decentralized in the late 1980s, in the sense that the center needed to negotiate different fiscal packages with different regions (to reflect differences in regional preferences and bargaining power), and that more of these packages consisted in “sharing of total fiscal revenue” and all-around contracting than

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23 There are other non-fiscal reasons why the central government should exert control over local tax legislative power, for example, to avoid local protectionism or other forms of unfair competition. But those reasons are not enough to explain why central government should deprive local governments entirely of tax legislative power.
the early 1980s, and fewer consisted in sharing revenue according to tax types. Further, from the late 1970s to the late 1980s, revenue sharing arrangements tended to allow greater revenue retention by provinces. This should mean that the central government’s interest in controlling tax bases and tax rates weakened over time. However, the last section showed that there was greater and greater emphasis on tax legislative centralization towards the late 1980s and early 1990s, and the pronouncements against unauthorized local tax reductions and preferences became more and more strident.

This contrast remains even we take a more nuanced view of the trend of the period. Some commentators have cautioned that “[it] would be inappropriate to characterize the [Chinese fiscal] system as evolving towards either greater centralization or decentralization” for this period. The reason for this caution was basically threefold. First, outdated tax policy and the worsening of the performance of the state-owned sector meant that fiscal revenue consistently declined relative to GDP, enough so that many local governments ended up in worse budgetary situations then before. Second, at the same time as allowing local governments greater revenue shares, the central government dramatically decentralized most expenditures. And third, the central government claimed important revenue sources, by taking national ownership of the most profitable enterprises in certain industries, by designating important taxes such as tariffs as exclusively central sources of revenue, as well as by taxing local non-budgetary funds or special funds. However, none of these ways in which the central government’s fiscal position arguably improved relative to those of local governments depended on the central government’s setting tax bases and tax rates. To the extent that the central government was able to improve its own fiscal position before 1993, it did so not by monopolizing tax legislative power. In itself, such monopoly would have only limited fiscal benefit for the center, given the grant of greater revenue shares to local governments.

In summary, there was an increase in the practice of tax legislative centralization that was nearly uniform across the country (with the exception of Guangdong and Fujian) and monotonic in time between 1977 and 1993. This pattern stood in sharp contrast with the diversity of fiscal arrangements and the decentralizing tendencies of the period. This is the first way in which the centralizing development is surprising. Another way in which the development should be seen as surprising is how it put pressure on the central government to deliver an adequate quantity of implementable tax rules. Although central bureaucrats still in

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24 This pattern over time crucially underlies the argument made by Yingyi Qian and others that fiscal decentralization made an important contribution to Chinese economic growth. See Hehui Jin, Yingyi Qian and Barry R. Weingast, “Regional Decentralization and Fiscal Incentives: Federalism, Chinese Style.” 89 Journal of Public Economics 1719-1742 (2005).
25 Oksenberng and Tong, supra note 8, p 31 (“[Instead], a major theme...is the growing complexity of central-provincial budgetary arrangements.”)
27 Id., p 699, (“Even though decentralization had raised the local share of total expenditures from approximately 50 to 64 per cent, its effects were dominated and offset by the overall fiscal decline: as total government revenues fell from over 41 per cent of national income in 1978 to 24 per cent in 1988, the portion allocated by local budgets shrank from approximately 20 per cent to 14 per cent.”)
28 Id., p 701-6.
29 Id., p 701.
the grip of a planned economy mentality may be used to this kind of pressure (and even to the failures and inadequacies of centrally-designed policies), they are precisely the type of officials who were losing credibility in the 1980s.

Government internal speeches in the late 1970s and early 1980s not infrequently acknowledged the shortage of tax rules for governments and taxpayers across the country to follow while carrying out economic reform. Although the central government quickly began an impressive series of tax legislation and rulemaking, in many cases local governments had to adopt policies before such central policies became available, and the transactions governed by these local policies had to be “grandfathered”. For instance, on September 11th, 1982, State Council issued a Notice on Issues of Taxation of Sino-Foreign Joint Ventures and Cooperative Projects," admitting that prior to promulgation of the Sino-Foreign Joint Ventures Income Tax Law, the Individual Income Tax Law, and the Foreign Enterprise Income Tax Law, various localities, departments and enterprises, with the approval of local governments, had signed joint venture and cooperation project contracts with foreign and Hong Kong businesses, some of which contained terms regarding tax burdens that were inconsistent with the provisions of the laws. The notice then announced that prior to the expiration of such contracts, the terms regarding tax burdens should be upheld. Similarly, when the Ministry of Finance finally launched the “tax-for-profits” (ligaishui) policy, corporate profits contracts had already started in many places. The Ministry of Finance thus had to make what it thought was a transitional compromise:

“Before the Tax-for-Profits Trial Measures (Draft) were issued, some local governments had already entered into profit contracting with commercial enterprises, and some large and medium-sized enterprises had signed increment profit contracts, emulating Shougang (Capital Steel), and some places had implemented a tax-for-profits policy or other forms of contract of their own design. These enterprises were in most cases approved by the provincial, city or county governments, and some contracts were made for one year, some for three years. After the launch of the tax-for-profits policy, these enterprises should be treated differently according to several circumstances: the vast majority of them should change to following the tax-for-profits policy; the minority that experience difficulties may delay until next year. This is mainly to accommodate practical needs, so as to ensure a good transition from various forms of contracting to the tax-for-profits system, in order to make the efforts to implement tax-for-profits proceed more smoothly.”

Numerous other instances could be found where local policy “experiments” that had begun before central government tax rules became available precluded the immediate application of

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30 Bingqian Wang, ”Be Sure to Finish the Work of Enterprise Changing Profits into Taxes”, China Finance 1983(5). On April 24, 1983, a Report of the Changing Profits into Taxes Work Conference issued by the Ministry of Finance and endorsed by the State Council and the Trial Measures for Changing Profits into Taxes by State Enterprises both provided detailed arrangements for “how to deal with the problem that some places had already implemented profit contracting and pre-tax contracting measures this year”.

13
such rules.31

But clearly worse from a legislative perspective than delays in the implementation of central policy was the basic rejection of such policy. The tax-for-profits (ligaisi) policy was the most prominent instance of such rejection. Instead of profit contracts and pre-tax contracts being replaced by the tax-for-profits policy, as the MOF had intended, the latter policy was itself quickly defeated by the contract system. The second round of implementation for the tax-for-profits policy that began in late 1984 continued to grandfather existing profit contract arrangements.32 But in 1986, the state decided to “deepen enterprise reform”, and the tax-for-profits policy was essentially suspended, first in the state-owned large and medium-sized enterprises, and then in more enterprises. On October 5, 1987, Ministry of Finance expressly admitted: “Because of the 55% income tax plus regulatory tax, the tax burden of state-owned enterprises, especially medium-sized enterprises, is heavier than collective enterprises. In deepening enterprise reform, in order to enliven the state-owned large and medium-sized enterprises and keep a good relationship with enterprises, the State created various forms of contract systems, according to the principle of separation of ownership and management. After reaching the contract, the tax department should still collect taxes levied in accordance with tax provisions, and if tax payments made by enterprises exceed the amount of the agreed contractual payment, it would be appropriate to give some more benefits to the enterprises, and finance apartments should allocate the excess funds back to the enterprises.”33

On February 27, 1988, the State Council issued the Interim Regulations on the Contract and Responsibility System for State-Owned Industrial Enterprises, which more expansively provided that while enterprises should pay tax according to tax law, finance departments should return any portion of tax payment in excess of what was agreed to in the contractual agreements.34 On August 14, 1988, the Ministry of Finance and the State Commission for Restructuring the Economic System issued Pilot Measures on “Separating Profits from Tax, After-Tax Debt Repayment, and After-Tax Contracting” for State-Operated Enterprises, and started to replace the 55% income tax plus regulatory tax with a 33% income tax plus after-tax profits contract. As one foreign scholar studying the period put it, profits contract system “spelled total defeat for the tax-for-profit scheme.”35

Of course, all tax policies could fail, whether they are proposed by central or local

31 See, for example, the Decision of the State Council on Fiscal Balance and Strict Financial Administration (January 26, 1981, hereinafter the “1981 Decision on Fiscal Balance”) (“Some enterprises and cities that already experimented with “substituting tax for dividends, independent accounting, and self-responsibility for profit and loss” may review their experience and continue with implementation; the introduction of experiment units should be reported to the Ministry of Finance for approval first.”)


33 The Ministry of Finance, Notice onDisallowing the Contracting of Income Tax for Collectively-Owned Enterprise (October 5, 1987)

34 Interim Regulations on Contract and Responsibility System in State-Owned Industrial Enterprise, Article 11. See also Article 19, “if the State Council makes major adjustments regarding types of taxes, tax rates and mandatory planning product prices, the contracting parties may negotiate to modify the agreements on contracted management according to regulation issued by the State Council.”

35 Wong, supra note 22 (see especially the discussion on pp 216-219).
governments. But the failure of the tax-for-profits policy was not just any type of policy failure, but was directly the result of decentralizing tendencies as well as the differing preferences between central and local governments at the time. And it was certainly not the only tax policy area where some local governments disagreed with the center. Consequently, one would expect the doctrine of tax legislative centralization to have been highly controversial. That this was the case is supported by a substantial body of government documents, internal speeches, newspaper editorials and articles from the time. It may be useful to revisit some of this historical material, which vividly depicts local dissent from the centralization doctrine.

“All pilot programs that involve the financial system and fiscal revenue and expenditures in any locality and department must receive prior agreement from the Ministry of Finance. No one shall make unauthorized policy or divert state income in the name of ‘pilot projects’. Those wrongful practice should be resolutely corrected.”

“It is improper for local leaders to decide for themselves to reduce the tax rates of certain products, to relax the time limits on reductions and exemptions for some enterprises, to expand the range of tax-free new products, to stop collecting tax on small wineries and cigarette factories for a long term, and even to take the tax contracting approach. Some places even embezzled taxes ad libitum...and poached state tax revenues. These practices of ignoring the overall situation and self-authorized policymaking are contrary to the current orientation of national economy adjustment and the principle of centralizing and unifying fiscal policy.”

“In the current economic reform process, some leading comrades in local governments have misconstrued the relationship among the state, enterprises and individuals, are only concerned with the parts instead of the whole, and unilaterally emphasize the ‘policy of benevolence’. They take advantage of the expansion of enterprise autonomy to lower statutory tax rate arbitrarily, expand the tax reduction or exemption range, extend the tax reduction or exemption time limitation, and even describe tax as an obstacle to reform. Some departments and individuals unilaterally emphasize ‘unfettering’, ignoring the provision in Article 56 of the Constitution of the People's Republic of China, and refuse to pay taxes in accordance with the tax law.”

“Some people think that to reform and invigorate the economy, we must cut taxes and bring more profits to enterprises, otherwise one is not supporting reform...Currently, some localities and departments have taken a very unserious
attitude in dealing with tax laws and tax collection work. Whenever there is some
call from below, they would start from only local interests, and casually expand the
range of tax reductions and exemptions. Some reduce tax rates beyond their authority,
and some arbitrarily grant tax reductions and exemptions, all resulting in a large
amount of fiscal revenue loss. This is extremely erratic, and is contrary to the spirit
of tax administration according to law.”39

“We should correct the misconception that pits taxation according to law against
production development. Some people say, ‘enterprise contracting and fiscal
contracting imply that a unified tax code is no longer necessary’. Others say doing
‘without taxes for three years, productivity can certainly improve’. These claims are
one-sided. ...... At present, in some regions and departments, leaders lack the holistic
perspective, and hold parochial concepts. They are confined to the local interests,
and often ‘modify’ tax law at random, resulting in a tax disorder. People like to say
‘creek and river share water’. But if the tax power is decentralized, and local
governments and departments are allowed to swallow up profits, the creeks will be
full while the river will run dry, which is bound to affect the overall situation of
reform and development.”42

18, 1987
40 Notice of the People’s Government of the Guangxi Zhuang Autonomous Region on implementing the Decision
of the State Council on the Seriousness of Tax Law and Discipline and Enhancing Tax Collection (Guizhengfa
41 Notice of the General Office of the State Council on Forwarding Several Opinions of the State Administration
of Taxation (SAT) on Rectification and Stringently Controlling Tax Deductions and Exemptions (January 3, 1989).
sold to other jurisdictions, while increasing taxes on products flowing into their own jurisdictions from others and pursuing local protectionism. The problems of establishing preferential tax policies for foreign investment beyond the scope of national regulations also appear with frequency.\footnote{Notice of the State Council on Ratifying and Forwarding the Report of the SAT on Further Advancing Taxation According to Law and Strengthening Tax Administration (December 9, 1991)}

Less colorful but just as revealing of the resistance to centralization was repeated campaigns launched by the central government to crack down on unauthorized local tax preferences. These campaigns were carried out first in 1981-2.\footnote{See the 1981 Decision on Fiscal Balance, supra note 31; Public Notice of the SAT of the Ministry of Finance (May 5, 1981); Notice of the State Council Ratifying and Forwarding the Report of the Ministry of Finance on Checking Tax Evasion and Underpayment and Strengthening Tax Collection Work (March 4, 1932); and Notice of the State Council on Ratifying and Forwarding the Report of the Ministry of Finance on Strengthening Fiscal Administration and Restraining Arbitrary Measures That Decrease Revenue and Increase Expenditure (March 26, 1982).} They were then incorporated into the annual tax and finance comprehensive inspection (\textit{shuishou caiwu dajiancha}), which lasted until 1997.\footnote{Notice of the State Council on Ratifying and Forwarding the Report of the Ministry of Finance on Carrying out Tax and Fiscal Inspection (August, 19, 1985).} And they were repeated with greater emphasis beginning in 1987 and almost annually all the way up to the eve of the 1993 tax reform.\footnote{See the Decision of the State Council on the Seriousness of Tax Law and Discipline and Enhancing Tax Collection (April 8, 1987); Interim Regulation of the State Council on Punishment of Violating Fiscal Regulations (June 16, 1987); Urgent Notice of the General Office of the State Council on Strengthening Tax Collection Work (May 14, 1988); Decision of the State Council on Rectifying Tax Order and Strengthening Tax Administration (December 9, 1988); Notice of the State Council on Ratifying and Forwarding the Report of the SAT on Further Promoting Management of Tax According to Law and Strengthening Tax Collection Work (December 9 1991); Notice of the General Office on the Strict Enforcement of Late Fines for Delinquent Tax Payments (February 23, 1992); and Notice of the State Council on Strengthening Tax Administration and Controlling Tax Deduction and Exemption (July 23, 1993).} All of them were initiated by the State Council, indicating that keeping unauthorized tax preferences under control required serious political resources and could not be managed as a routine task by the Ministry of Finance and tax agencies alone.

It may be fairly pointed out that that fact that an institutional arrangement is controversial does not mean that it is surprising or that there are practical alternatives. Although many local governments may often have found it convenient to disregard rules concerning when and by whom tax reductions and exemptions may be granted, this may simply mean that they were free-riding with respect to rules that would be optimal if everyone complied with them. The textual evidence given above thus does not, it may be argued, lead to a clear conclusion that there was significant political resistance to tax legislative centralization. Even if bureaucrats in Beijing accustomed to central planning were not the ideal candidate to design tax systems for an economy the reform of which was being pushed mostly by local governments, there may have been no other clearly good candidate, either.\footnote{This skepticism about whether there was any practical alternative to legislative centralization was already captured in a statement made by Yao Yilin in 1981: the 1981 Decision on Fiscal Balance (supra note 31), Yao argued, was "issued by the State Council and should be implemented resolutely. Up to now, no one, including central and local governments, has written a report to announce that this notice is wrong and should not be implemented. No one challenged the documents issued by the central work conference, either, and thus those documents should be implemented, too." Reference Material in Public Finance History, supra note 7, pp 663-665.} Nonetheless, this section has shown that given that fact that local governments gained strong fiscal autonomy in the 1980s, and given that there was a high degree of uncertainty regarding...
what was good tax policy at the time, the case for tax legislative centralization should have been at its weakest. The fact that the drive for tax legislative centralization increased during this period should thus be puzzling. We will return to some possible explanations for this phenomenon in Section 4, but in the next section, we will first refute an explanation that may seem tempting to some, namely that the allocation of legislative power may not have mattered during 1977 and 1993 because the rule of law was weak.

III. The Significance of Law to Taxation in the 1980s.

If one delved into tax policy documents from the 1977-1993 period, especially those that address the overall tax system and its direction of change, one will discover that “enforcing tax law and order”, “levy tax in accordance with law” were among the most persistent and prominent themes in them—perhaps even comparable to the persistence and prominence of the theme of reform. An impression will be formed of an extraordinarily tight bond between taxation and law. However, one does not need to be familiar with the rhetoric of the period to be persuaded of the importance of law to taxation at the time. Reflections on several functional requirements of tax collection during this period should suffice.

Throughout the 1980s China was liberalizing its public sector by permitting greater enterprise autonomy, and was also allowing the growth of a significant private sector. For both sectors, taxation generated public revenue on the basis of autonomous enterprise decisions, and increasingly the government and taxpayers no longer stood within an administrative hierarchy. Because the state had depended for so long on the public sector for revenue, finding a balance between enterprise autonomy and the assurance of revenue from that sector was difficult. How much autonomy was needed to make SOEs work was unknown—indeed, it turned out that autonomy alone was not enough, the creation of market competition with unregulated prices was necessary. It was thus very tempting for ministries and local governments to provide more “autonomy” by giving tax breaks. In the meantime, for the private sector, the system of tax collection from private parties simply did not exist and had to be created from scratch. Thus for both sectors, taxation was an unfamiliar tool.

In this context, there were three conditions that, among others, must be satisfied in order for the government’s attempt to introduce taxation to succeed: there must be a consistent set of tax rules for parties to follow; the rules must be backed by the compulsory force of the state; and they must also be made publicly known. The satisfaction of these three conditions, however, are also essential features of law.48 Thus promoting tax rules as law was instrumental to achieving the goal of successful tax collection. This is the underlying reason why references to the law filled tax policy documents at the time.49 Each of the above three preconditions of successful tax collection, and how promoting taxation according to law helped satisfying them in the 1980s, will be illustrated with some examples below.

49 By contrast, after the 1990s, especially at present, the significance of emphasizing taxation in accordance with the law (see, for example, the Outline for Comprehensively Promoting the Practice of Law-Based Administration issued by the State Council in 2004) is to reach the overall goal of accountable government.
In respect of the condition of having a consistent set of rules, the offending parties against the 1977 Decree during its initial years of implementation were not only local governments, but also ministries other than the MOF (and their local counterparts). These ministries had dictated the management of the enterprises in the sectors they supervised, and from a mentality typical under the planned economy, they initially acted as though they could also make decisions on tax matters. Early in 1982, the Ministry of Finance spot-checked thirteen documents issued between September 1981 to February 1982 by other ministries of the central government that involved issues of fiscal revenue and expenditures. “Nine of those documents were issued without prior consultation with the Ministry of Finance, or without approval. Instead, the ministries simply had those documents approved by their supervising authorities or simply issued them on their own.”

Therefore, the Ministry of Finance requested the State Council to reaffirm that “each department, when formulating policies and strategies that may decrease revenue or increase outlays, should engage in prior consultation with and receive consent from the Ministry of Finance. They should also specifically propose such policies and strategies for approval, instead of insert them in other proposals.” Tax collection “must be uniformly managed, regulations involving tax collection should all be issued by the Ministry of Finance, or be issued by the Ministry of Finance after a report to the State Council for approval.”

Clearing up tax rules made up by the various agencies themselves, preventing the ultra vires adoptions of tax deductions and exemption issued by these agencies, improving the status of tax and finance agencies in the government system, and explaining that the emphasis on tax law and order is not ‘infringement upon other departments interests,” all became important themes in the fiscal system in the 1980s. Given these objectives, it made sense to present tax rules as law, since an essential feature of any legal system is that specific authorities are identified as the origin and ultimate interpreter of legal rules, and are entrusted with the task of ensuring that legal rules do not conflict with one another.

Two points are specifically worth noting in this connection. First, the problem of coordination was of course not just a problem for the central government; local governments had to make the same efforts to carry out tax policy in the presence of multiple agencies. This is one of many illustrations of how the functional importance of the rule of law for successful tax collection is regardless of the level of government: one would expect both local and central governments to take interest in the law for this reason. Second, it is precisely in this context, of coordinating inter-agency relations and ensuring that non-tax agencies do not undermine the consistency of tax law, that tax policy documents from the 1980s repeatedly articulated an important principle, namely that law is binding before it is revised, and the revision of law must follow specific procedures. A very important reason why the Chinese tax system cannot be said to follow the rule of law today is that tax lawmakers in the executive branch (most often the central government and ministries in charge of tax policy) do not bother with the revision of law when they want to try out different tax policies. As long as a

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reform “experiment” has the approval of the State Council (or is even just in accord with “the spirit of the State Council”), the argument that “there is no need of legislation for ‘experiment’ sites” and “legislation is needed only after a policy has matured” is considered sufficient to dispose of doubts about the legality of “experiments” that contravene existing law. However, a common refrain in the 1980s emphasized non-tax agencies’ need to defer to the tax authorities on tax matter: if one finds problematic issues in existing tax law, one can report the issues to the relevant authorities, even to the Central Authorities, but before the modification of tax law, one must implement the provisions of the current tax law. That this principle was so clearly pronounced in the 1980s but is so easily forgotten today perhaps shows a lack of commitment to the rule of law, but that is consistent with the fact that the government may find the rule of law very expedient, even necessary, under certain circumstances. It is this latter fact that this section is aiming to establish, in order ultimately to conclude that the allocation of tax legislative power mattered.

A second precondition for successfully introducing a new tax system was giving tax rules the backing of the compulsory force of the state. The central government made a series of decisions throughout the 1980s to expand the national tax bureaucracy, but just as important as providing ample staffing for tax agencies was to give them civil powers, including the necessary right of inspection, as well as the power of detention and disposal of assets, and taking enforcement measures. Tax agencies did not clearly possess these powers at the beginning of the 1980s; taxpayers that refused to pay tax were often subject instead only to internal administrative sanctions. And when tax agencies tried to collect tax, raw force quite often became involved. Verbal abuse, beatings, siege of tax officials and tax authorities and other phenomenon of refusal to pay taxes continued from the beginning of the 1980s to 1993. In 1989, the Supreme People’s Court claimed that “at present, tax evasion is very serious and violent tax revolts occur with some frequency. According to incomplete statistics, about 50% of the state-owned enterprises and collective enterprises engage in tax evasion, and about 80% of small private business practice tax evasion. Since 1986, nationally there have been 8,017 cases of assaulting tax authorities and besieging tax officials, 11 people were killed, 26 people maimed, and 713 people heavily injured.” In 1992, Jin Xin, the Minister of the State Administration of Taxation, reported that “the phenomena of assaulting, beating and smashing...
tax offices, besieging, vituperating, beating, insulting and hurting tax officials, intimidating, retaliating, and persecuting tax personnel and their families happen constantly, with more than 2,500 such cases per year, and in the last two years even rising to more than 3,000 cases a year. Confronted with such a situation, the legal system was mobilized from the early 1980s to support tax collection. Not only had the public security organs, prosecutorial organs, and criminal justice authorities to severely punish tax evasion and tax revolt crimes, in 1989, the Supreme Court even expressly required that in administrative cases, the court should be partial to tax authorities:

“Regarding cases where taxpayers, withholding agents or other parties refuse to accept the decision made by tax authorities involving tax collection or violations and initiate an action in the court, the people's court should strictly review whether conditions for such proceedings are satisfied, and if not, should not accept it. If the facts are clearly ascertained and the law and regulations are correctly applied in tax decisions, those decisions should be upheld; if tax decisions are substantively correct but procedurally defective, after the defects are remedied by the tax authorities, those decisions involving tax collection and punishment should be upheld. If tax authorities have reasonably determined the tax amount and time limit for tax payments on the basis of taxpayers’ (private-owned small businesses) declarations, and of representative surveys, projections, and appraisal through democratic discussions, and have given written notices to taxpayers to comply accordingly, then if taxpayers disagree and challenge the determination in court, the people’s court should generally uphold the tax authorities.”

It is hard to think of an illustration more poignant than this passage of the basic argument of this section, namely that although the Chinese legal system was quite underdeveloped during this period, the tax system was in many ways even more undeveloped. Thus even a weak legal system could turn out to be instrumental to tax administration. For this reason, it was important for tax rules to be presented as law.

Finally, a third prerequisite for the successful implementation of tax policy during the 1977-1993 period was securing voluntary compliance through giving publicity to tax law. Administrative extractions of taxes from state-owned enterprises did not require such publicity. Moreover, voluntary compliance was particularly important given that the system of tax agencies across the country had yet to be adequately staffed and made operative.

58 Notice on Issuing the Speeches of Leaders at the Joint Press Conference of the Supreme People’s Court, the Supreme People’s Procurate, the Ministry of Public Security and SAT (April 16, 1992).
59 The Criminal Law (July 1, 1979), Articles 121 and 124; Notice of the Supreme People’s Procurate on Cooperating with Tax Authorities on Thoroughly Checking Tax Evasion and Revolt Cases (April 30, 1981); Joint Notice of the Supreme People’s Procurate and the Ministry of Finance on Further Working on Tax Evasion and Revolt Cases (June 16, 1986); Notice of the Ministry of Public Security on Diligently Processing Cases of Assaulting Tax Personnel (May 29, 1987); Notice of SAT of the Ministry of Finance on Strengthening Relationship with People’s Courts to Promptly Investigate Cases of Tax Evasion, Tax Revolt and Assault of Tax Personnel (August 15, 1986); Notice of the Supreme People’s Procurate and SAT on Establishing a System for Keeping Record on and Transferring Tax Evasion Cases (October 21, 1991).
60 Fa (Xing) Fa [1989]31, supra note 56.
Consequently, the law enforcement system was enlisted to publicize tax rules. In 1987, the Ministry of Finance and the Ministry of Justice issued a joint notice asking agencies across China to use a variety of methods to give publicity to tax law, in the ongoing effort to popularize knowledge of law. The goal was to "establish a social climate of feeling glorious about paying tax according to law, and feeling shameful of tax evasion." Meanwhile, tax agencies claimed that the lack of understanding of the legal nature of tax rules was a major obstacle to tax collection. "At present, our citizens have little knowledge of the concept of tax law, and lack awareness and understanding of taxation. Some regard taxes as extra burdens, and cannot distinguish taxes from fees." That there is legal basis for the collection of tax (whereas there may be no such basis for the collection of fees) was crucial to the legitimacy of taxation, and therefore to voluntary compliance.

It is arguably for this reason that a peculiar statutory drafting practice, which has survived until today, began in the 1980s, namely the practice of mentioning the obligation for paying taxes in non-tax statutes, even when no further rules are provided to define and enforce such obligation under these statutes. Indeed, the single provision regarding taxation in the Constitution itself—"it is the duty of citizens in People’s Republic of China to pay taxes in accordance with the law"—was probably drafted to give publicity to taxation and to signal that the legal system stands behind tax collection.

Today, after more than 30 years of development of the Chinese legal system, discussions of the "rule of law" tend to emphasize independent adjudication as well as democratic participation in legislation or rulemaking. The distinction between the “rule of law” and “rule by law” is also widely accepted, and it would not be inaccurate to say that the emphasis on law in tax administration in the 1980s (aside from the development of administrative reconsideration and administrative litigation in the late 1980s) was entirely a matter of “rule by law.” However, there is also much in common between "rule of law" and “rule by law”, including the necessity to achieve a substantial degree of consistency among legal rules, the way such rules secure compliance through publicity (instead of bureaucratic command), and giving legal rules the backing of the compulsory powers of the state. For these reasons, the

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62 Notice of the State Council on Ratifying and Forwarding Report of SAT on Further Advancing Taxation According to Law and Strengthening Tax Administration (October 11, 1991). See also the Editorial in People’s Daily (October 9, 1885), “Taxes and Fees Are Different” (“Taxes and fees are two different concepts in nature. Taxation is a means of the State to obtain fiscal revenue without compensation and compulsively, through its political power. What taxes to impose, how much to tax and how they are collected are all based on tax legal decrees promulgated by the State. Tax Law is adopted pursuant to the State’s legislative procedure by the National People’s Congress, or promulgated and implemented by the State Council upon delegation from the Standing Committee of the National People’s Congress.”)

63 For example, see the Law of Inheritance, Article 33 (“The successor to an estate shall pay all taxes and debts payable by the decedent according to law”); the General Principles of Civil Law, Article 49 (if an enterprise legal persons conceals facts from the tax authorities and practices fraud, in addition to the enterprise bearing liability as a legal person, its legal representative may also be subject to administrative sanctions and fines and, if the offence constitutes a crime, criminal liability shall be investigated in accordance with the law); the Law on Foreign-Capital Enterprises, Article 17 (Enterprises with foreign capital shall pay taxes in accordance with relevant state provisions for tax payment, and may enjoy preferential treatment for reduction of or exemption from taxes); and the Law of Industrial Enterprises Owned by the People, the Law on Sino-Foreign Contractual Joint Ventures, etc.

64 The Constitution of People’s Republic of China (1982), Article 56.
allocation of legislative power is also important, indeed essential, for both "rule of law" and "rule by law". Thus the central government's ability to maintain its grip on tax legislative power during a time when the law is so fundamental to tax collection cannot be fail to be highly significant.

However, centralization is not a necessary feature of legal systems. There is no reason why a decentralized system of governments could not operate on the basis of law, and the necessity of law does not translate into the necessity of centralization. Thus why sub-national governments ceded tax legislative power to the central government before 1993, when they were able to bargain for so many other forms of decentralization, remains to be explained.

IV. Three Theoretical Frameworks for Explaining the Centralization of Tax Legislative Power

The previous sections of this paper have tried to establish that the centralization of tax legislative power in China today cannot be taken for granted, as something that “has always been the case.” In fact, it has not. Historical evidence both of how decentralization had prevailed during certain periods (especially for the years after 1958 and after 1970) and of how centralization gradually took hold in the 1980s also amply illustrates how centralization is not an inevitable consequence of the modern Chinese polity’s formal feature as a unitary state. Even though the national government is the only sovereign of the country, it may delegate legislative power to provincial and lower levels of governments, either directly or through repeated delegation. What requires explanation is the refusal to engage in such delegation, as far as taxation is concerned, with respect to sub-provincial governments in general and also, except to increasingly limited extents, to provincial governments.

Three very different types of explanations may be suggested, each with different theoretical implications and methods of verification. First, one might accept the contingent nature of the development of tax legislative centralization in the 1980s, and argue that centralization was adopted because it was the optimal institutional arrangement for that historical period. In particular, one may believe that during the transition from a planned to a market economy, centrally-controlled tax reform may be on balance superior, despite manifest mistakes and setbacks such as tax-for-profits reform. In designing new tax law for a new economy, the central government might enjoy advantages in terms of both information and the economy of scale: it has better access to knowledge about international practice and can more readily obtain international assistance, and it is in a position to spread successful local experiments (such as in implementing the value-added tax) nation-wide. As compared with local governments, it may have held a more long-term view and therefore has greater foresight in an era of radical social change. In general, “experimentation under hierarchy” could be argued as lying at the “institutional foundation” of China’s reform and development, and a number of social scientists seem to have come to endorse this approach as making a

positive contribution to Chinese economic reform. Legislative centralization may be understood as part of the “hierarchical” aspect of this approach: the central government generally reserves the right to adopt new policies to itself, while selectively carrying out local “experiments”.

The problem with this explanation is that one cannot simply assert that centrally-controlled policy experiments are optimal: one must demonstrate that they are, either in the abstract or in connection with specific policy areas, despite their obvious shortcomings. Moreover, in fiscal management, it is widely understood that in the 1980s the central government was on the verge of losing control, and local governments had a powerful voice. This was not a policy area where the central government picked a few policy pilots and kept everything else within the status quo. Instead, it had to engage in extensive and repeated bargains with many local governments, all at the same time. Centrally-controlled policy experiments became the accepted approach to tax policy after 1993 but it arguably was still not the approach in the 1980s (as we saw in Section 2, unauthorized tax reductions and exemptions were rampant). Finally, of course, it is not clear why legislative centralization continues as an institutional arrangement even today, when the transition from the planned economy has arguably long been completed. For these reasons, the first explanation may seem too facile.

A second explanation of the centralization of tax legislative power is that, historically, the legislative and judicial branches of government are more closely associated with the central government in China. Especially because—as argued in the last section—the legal system was necessary for launching a new tax system, the central government had a dominant advantage in putting the legal system to work to help with tax collection. Most local governments, with perhaps the exception of special economic zones like Shenzhen, were unfamiliar with legislative tools and were even more inadequate when it comes to supporting and making use of the judiciary. This allowed the central government to consistently conflate law with centralization, even though local tax legislation was allowed constitutionally and under local government organizational laws. This explanation may go a step further and point out that the Chinese legislative system is generally quite centralized. For example, relatively few sub-provincial jurisdictions possess any legislative power. This makes tax legislative centralization in the face of other forms of fiscal decentralization less surprising. Conversely, it may be argued that legislative decentralization is possible only when the legal system is less important to taxation, as was indeed the case in 1958 and 1970.

Nonetheless, this explanation seems incomplete, since tax is more centralized than other areas of legislation in China, which means that the centralizing bias of the legislative system itself isn’t the whole story. Moreover, the explanation of course begs the question of why the legislative system in general is so centralized.

A third explanation of tax legislative centralization since 1977 should be understood in

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terms of the logic of contemporary Chinese politics. Perhaps legislation, like political appointments and personnel management for local governments, was one of the powers that the Chinese Communist Party (CPC) found increasingly attractive to keep centralized after the Cultural Revolution.\textsuperscript{67} It helped the central leadership of the CPC to keep political control even during periods of decentralizing government responsibilities and the encouragement of local politicians to “compete for growth”. The effectiveness of tax legislative centralization thus should not be assessed in public finance terms, but in political terms, and the political resources devoted to maintaining it in the 1980s should be understood accordingly.

While speculative, this third explanation is consistent with recent scholarship in political economy that emphasizes the importance of centralization, especially in the management of personnel decisions and political promotions, to China’s economic transition.\textsuperscript{68} Such scholarship has not explicitly taken into account centralization in legislation, although sometimes it implicitly assumes it. The idea that the monopoly of legislative power may be closely connected to political centralization deserves further investigation.

\section*{Conclusion}

When a certain institution appears irrational by commonly accepted standards, the question of why it persists becomes obvious and unavoidable. In the study of Chinese tax law, however, a high aptitude has developed for avoiding the question of why tax legislative power is so centralized. There is a tendency to assume that there are obvious answers, such as the fact that China is a unitary state, that there has been a entrenched tradition of centralization, or even that, really, high centralization is not irrational after all. The view that high centralization is both irrational and historically contingent is uncommon. That is the view advanced by this article. Looking for the political or other causes of the centralization of tax legislative power for the recent three decades undoubtedly requires a great deal of in-depth research. This article has only attempted to show that the neglect of the centralization of tax legislative power is likely to be the result of a misunderstanding either of history or of the concept of fiscal federalism. To reach a new consensus on the basis of renewed studies of the relevant concepts and historical facts is a significant task in the study of Chinese tax law.

\textsuperscript{67} See Yao Yilin, “On Fiscal Issues” (May 27, 1981), Reference Material in Public Finance History, supra note 7, p 664 (“Stopping the phenomena of ‘straying, unevenness, wrangling and leaking’ [pao, mao, di, lou] is not only the problem of increasing fiscal revenue, but also of rectifying Party conduct and saving a group of people.”) Wang Bingqian, “Speech on the Teleconference on National Cleaning and Checking Tax Evasion and Delinquent Tax” (July 13, 1981), id, p 666 (the Announcement on Checking Tax Evasion and Delinquent Tax was issued “to coordinate with the rectification of Party conduct in the economic area and the enhancement of law and discipline work. The Central Discipline Inspection Committee decided the rectification of harmful practices in economic fields as the highlight of discipline inspection work, and demanded financial departments as its advisor and assistant.”) Such formulations could also be found in efforts to control of ultra vires tax deductions and exemptions in the late 1980s.
