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An Invisible Hand Behind: The Myth of the Chinese Tax System

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Abstract
To the casual observer, China in 2014 bears little resemblance to imperial society in place two thousand years ago. The agrarian rural society that dominated until recently has shifted to an urbanized services and manufacturing society. The emperor is long dead, along with the Republic government that followed and the subsequent Communist regime has morphed into Party led oligarchy guiding a state controlled market economy. A closer look, however, reveals a remarkable continuity of features. It seems that some aspects of life in China are more resistant to change and the continuity of these features to today indicates that some fundamental aspects of Chinese society remain, albeit in new clothes. This article illustrates the phenomenon with a look at the tax systems over the long history of China. In particular, it identifies five key phenomena that characterize Chinese taxation and shows how the five features remain in place throughout the long history, even today. The resistance to change suggests the underlying factors that give rise to these phenomena are as strong in today’s society as they were in past times. Any institutional changes in China’s political and legal system today that can be effectively applied to preventing abuses of power and protecting individual rights will, thus, be achieved only if those fundamental aspects are reformed or transformed to reflect the development of the economy and the society of the nation.

I. Introduction
A remarkable feature of 4000 years of history of the Chinese tax system is the continuity of the system. Similar themes, conflicts, and resolutions recur time and again. To be sure, there have been tremendous changes in the tax bases, rates, imposition methods, and technical aspects of the taxes but the underlying dynamics have remained remarkably unvaried. Historically, tax reforms were taken place inevitably as a result of external stimuli, almost inevitable economic dislocation. An examination of the Chinese tax system today reveals five primary features – the existence of an informal tax system lacking necessary legal basis, inequity in allocation of tax burdens with inadequate legitimacy justification, the significant role of discretion in preference to certain and fixed law, a tension of the taxing power between central and subnational governments, and a hierarchical tax administration
working under an institutional framework with insufficient safeguards against abuses of power. None of the features that define Chinese taxation today is new, however. To the contrary, a study of Chinese taxation history demonstrates that features and issues of today’s tax system are merely a modern manifestation of those that have defined Chinese taxation for four millennia. These features are not simply unique to the area of taxation, but rather, they serve as a window from which the basic fundamentals and characteristics of the Chinese political, legal and socioeconomic systems can be readily viewed.

Taxation comes into being with creation of a political entity. The formation and operation of a tax system reflects the level of economic development of the entity. The government of a simple agrarian-based political entity cannot rely on taxing incomes from labour and business activities to fund itself and will not be based on universal franchise and democratic representation. In Europe and North America, an industrial revolution and consequent urbanization as well as the rise of the middle class led to a changed political system and a fundamental shift in tax systems from impositions on the use and transfer of fixed property to levies on consumption and taxes on income from the provision of labour services and from the application of capital and labour in business. The economic changes and resulting social shifts to urbanization and the growth of a middle class have happened in China on a full-fledged scale only in the past three and a half decades. As was the case in the west, the Chinese government responded to the economic change with a shift in tax bases from state ownership of most assets during the period prior to the economic “open-door” policy adopted in late 1978 to consumption and income taxes. While there has been a change in the tax base, the fundamental features of the system of tax collection and administration remain the same. What underpins the extraordinary continuity of these features? Is there an invisible hand behind?

This article considers the question by way of an account of the historical development of the tax systems and a scrutiny of the general socioeconomic and political factors that explain the survival of the fundamental features and the points of intersection between tax policy and administration with political and legal institutional developments over the ages.

The article is divided into five sections. Following this Introduction, the second section provides an overview of the five features that characterise the contemporary tax regime and that have been reflected in the historical tax systems over the long stretch of time. The following section tracks the development of taxation in China over four historical periods, i.e. the Feudal period, the long Imperial period, the Republic period and the People’s Republic period, and shows how the recurring themes manifest themselves in each period. The review of the Chinese tax systems
over the first three periods focuses primarily on the development of the land tax system as land tax had been the largest and most fundamental revenue source for the government and served as the basis for many other imposts in history. The last period has seen a shift from traditional land and property taxes to taxes on profits and consumption but, as will be shown, the shift has not diminished the power of the recurring themes. The fourth section explores, from political and socioeconomic perspectives, factors that may underpin the durability of the recurring features through the evolution of China’s tax systems. The article concludes in section five, considering if China can have a different story today, that is, whether or not the political and socioeconomic factors that explain the recurring features would remain foundations of the “socialist market” system today as they did in the predecessors. Is it the case that plus ça change, plus c'est la même chose?

II. Enduring Features of the Chinese Tax System

This section and the section following it demonstrate that the five distinctive aspects that define China’s tax system today feature throughout the history, although the structure and details of the tax system have changed over time.

A. Informal Taxation

Informal taxation has long been in existence in China, in historical times as well as at present. Informal taxation is opposed to formal taxation to which formal laws passed by a legislature are applied. It could be an important mechanism for a government of a yet developed economy to have public goods and services financed.\(^1\) However, the legality and legitimacy of informal taxation is questionable in that most informal imposts are introduced without going through formal legislative process and are applied by normative documents lacking binding force. The existence of informal tax, be it monetary contribution or in-kind payment or labour from payers to the government, causes many problems, not least that it undermines the value and authority of formal laws and regulations and infringes upon private property rights of the payers. The current Constitution and Law of Legislation of China have made it clear that the power to enact taxes lies exclusively with the national legislature and no

\(^1\) The term of informal taxation is defined by some studies as “a system of local public goods finance coordinated by public officials but enforced socially rather than through the formal legal system”. Benjamin A. Olken and Monica Singhal, ‘Informal Taxation’ (2011) 3 American Economic Journal 4, 1-28. In essence, compared with formal taxes whose implementation is based upon formal laws passed by a legislature, informal taxes are extra-legal and enforced without a legal basis.
government is allowed to impose taxation without law. In reality, a variety of levies, though not labelled as taxes but most of which have the characteristics of tax, are enforced without a legal basis. At the local levels, a predominate part of local public goods and services are financed by informal taxation, with the degree of the importance of informal taxation varying from region to region depending on the exact economic development level of the relevant regions. As the government itself estimated, non-tax revenues including various charges and fees and social insurances imposed by governments across levels and departments amounted to half of total tax revenues, and in some local areas, non-tax revenues outstripped formal tax revenues, which implies a heavy hidden burden on payers. The land-related transaction has been said as the largest non-tax revenue source for many local governments in recent years.

Informal taxes are usually regressive, that is, while wealthier households are more likely to pay and do pay more, they pay less as a percentage of income than poorer households. One of policy implications is that the true tax burden of poor households may be understated and the perception they do not generally pay taxes except some indirect taxes such as value added tax (VAT) may be misleading. Another implication is formal budget figures underestimate the true size of the public sector and the level of revenue decentralization. This is particularly true in China where although there is no explicitly stated fiscal decentralization on the basis of relevant laws and regulations, de facto decentralization does exist given that local governments have the ability to raise revenues through means other than formal taxes. Informal taxation has been a persistent feature since the creation of China in historical times, with not only tax and fiscal implications but social and legal effects. Informal taxation may not be unique to China, but its existence is exceptionally long. It is worth thinking why and how it occurs and can be persisted for so long a period of

3 Take Zhejiang Province, Henan Province and Gansu Province as examples of economically developed regions, moderately developed regions and under-developed regions in China for example. Non-formal tax revenues in the three provinces in 2012 accounted for 6.2%, 27.97% and 32.78% of total local government revenues, respectively. Non-tax revenues in total local government expenditures in the same year accounted for 5.13%, 11.4% and 12.6% in the three provinces, respectively. Data sourced from the official series of China Year Book 1980-2013.
5 A study found that land sales contributed to 74% of local governments’ revenue base in 2010, as a striking contrast to 10% in the late 1990s. Simon Rabinovitch, ‘China Land Sales Decelerate’ Financial Times, 6 January 2012, Page 3.
6 Olken and Singhal (n 1).
7 Ibid.
B. Share of Tax Burdens

Equality in taxation encompasses two dimensions: horizontal equality and vertical equality. Horizontal equality means people in a similar situation pay the same amount of tax, whereas vertical equality requires people situated differently be taxed differently so that they make the same sacrifice. Vertical equality usually boils down to an income tax system in a progressive fashion.9

Generally, the progressive feature is applied to all types of income in a personal income tax system, which ensures people in different situations pay differently and the more they earn the more taxes they pay. Progressive taxation is regarded as justifiable on the ground of the “ability to pay” principle and it is considered necessary for achieving the wealth redistribution purpose of an income tax system. In contemporary China, the individual income tax law currently in force applies progressive rate schedules only to income from personal services (wages and labour income of the employed) and business income from unincorporated sole proprietor businesses.10 All other types of income are subject to a flat rate of 20 per cent, much lower than the highest marginal rate of 45 per cent on the income from personal services.11 No justification, however, has ever been given from legal and policy perspectives to explain the legitimacy of this disparate tax treatment on different types of income. Wealthy persons often derive their income from a variety of sources, most of which are not related to labour income or sole proprietor businesses, and very often, they have a number of means to manipulate their incomes in different categories to avoid or evade paying taxes. As studies have found that in China, while individual income taxation as a whole has been ineffective in income redistribution, the inequality in distribution of labour income is much less skewed than that of other types of income, in particular property income.12 The ineffectiveness of income taxation in wealth redistribution has contributed to the increasingly widening gap between rich and poor in recent decades in China.13

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10 Law on Individual Income Tax, art 3.
11 Ibid.
13 The degree of income inequality in a society is normally measured using a scale known as the Gini coefficient. A society with complete equality of incomes would have a Gini coefficient of 0; one with complete inequality (a handful of persons derive all income) would have a Gini coefficient of 1. OECD, ‘OECD Database: Income Distribution – Inequality’ (OECD iLibrary)
income gap between different groups of individuals, typically rural and urban residents, is also as acute as that between different categories of income.\(^\text{14}\) The inequality in individual income taxation in China can be attributed partly to the lack of a global system that subjects all types of income to a progressive rate schedule and partly to the incompleteness of an information system that timely and accurately monitors personal transactions and thereby preventing tax evasion and illegitimate avoidance.

The inequality in tax payment is further compounded by the design of the overall tax structure. Unlike most developed economies that have relied largely on income taxes for revenue purposes,\(^\text{15}\) China has heavily depended on indirect taxes, particularly VAT and business tax applying to goods and services, for revenue generating.\(^\text{16}\) Indirect taxes are regressive and if revenues generated from these taxes can be spent to fund programmes that assist the poorer segments of the society, the regressive feature may be alleviated. However, this is not the case in China. Indirect taxation has served as a stable revenue source for the government on one hand, but on the other, tax revenues have not been effectively used to fund social welfare programmes particularly for poor people. Various tax revolts and social unrest have been occurring, a trend associated with the perception that tax burdens are not distributed and shared fairly and equally in China.

The problem of inequality in taxation similarly existed in historical China and there were tremendous upheavals arising from unfair allocation of burdens of taxes (and other levies in similar nature). Throughout the long history, fair taxation seems to have never been achieved.

\(\text{C. Administrative Discretion}\)

China has long been having a strong and powerful administrative government, manifested, among other things, by the width and depth of administrative discretion.


\(^{14}\) Statistics from the National Bureau of Statistics (NBS) of China show that the income of urban residents has been increased from 343 yuan in 1978 to 24,565 yuan in 2012, while the income of rural residents rose from 134 yuan to 7,917 yuan during the same period. The statistics available at NBS, \text{http://data.stats.gov.cn/workspace/index;jsessionid=9B11AD56CF2A868FC41207E9A6C8C278?m=hgnd}. The agricultural taxes that had been applied to Chinese peasants for over 2000 years were not abolished until 2006.

\(^{15}\) In most OECD countries, tax revenue from income and profits amounts to more than 30% of total tax revenue. If taking account tax revenue from social security and payroll, the tax revenue could be around 70% of total tax revenue. OECD iLibrary, ‘Tax Revenue by Sector’, \text{http://www.oecd-ilibrary.org/taxation/taxation-key-tables-from-oecd_20758510}.

\(^{16}\) Tax revenue from VAT and business tax and other types of indirect taxes including excise tax has been around 60% and even more of total tax revenue in China since the inception of these taxes in the 1980s.
Administrative discretion can be found in many jurisdictions and seems ineluctable as a means to deal with a complex and constantly changing world and peculiar differences in specific cases. Nevertheless, the degree and the scope of discretion in administration including tax administration appear to be deeper and wider in China than in many other jurisdictions. As mentioned earlier, the national Legislature has the exclusive power to enact taxes, but this power has been delegated to the executive branch, the State Council, to levy taxes by way of regulations. Consequently, the majority of taxes have been implemented as purely the result of regulations but not law.

Thus far, only four tax laws have been promulgated by the national Legislature, and even where there is legislation, the legislation is remarkably short – 15 articles in the Law on Individual Income Tax and 60 in the Enterprise Income Tax Law, for instance, with the substance of these laws largely based on departmental and local rules issued by the Ministry of Finance (MOF) and the State Administration of Taxation (SAT), China’s highest revenue authority, as well as local governments. While these departmental and local rules ought to be interpretative in nature (for the implementation of laws or administrative regulations in situations where no national laws are applicable), a large number of these normative documents that have general binding force and have been applied widely on a daily basis go beyond merely interpreting higher laws and regulations. More significantly, much of the interpretation of tax laws is left to individual assessments given by the tax authorities. This inevitably invites discrepancies in implementation and conflicts of rules and policies across departments and levels of government, and gives rise to disputes between taxpayers and tax authorities. Administrative discretion may be needed to make the application of formal laws and delegated regulations more legitimate and responsive to individual, specific situations. However, this does not necessarily mean formal tax legislation should be comprised for administrative discretion and

17 See note 2.
19 Similar issues have occurred in other taxes. For example, the MOF and SAT have recently issued a notice of increasing tax rates on certain types of oil products specified by the Provisional Regulations on Consumption Tax. MOF and SAT Notice on Increasing Consumption Tax on Refined Oil Products (Caishui [2014] No. 94) and SAT Public Announcement on Several Issues concerning Consumption Tax on Refined Oil Products (SAT Gonggao [2014] No. 65). Both the documents were issued on 28 November 2014 and became effective the next day. Tax rates are one of most important elements in a tax and any changes in tax rates will directly impact on the property rights of taxpayers. In this case, however, the increase in consumption tax rate on some oil products was made by departmental decisions, and there was no any formal legal process for the issuance of the rules. The issuance was immediately followed by the implementation of the rules, leaving no time for taxpayers to know the rules and to make decisions for their future affairs.
20 Law of Legislation, arts 71, 73.
administrative discretion can go beyond the scope of formal laws. Essentially, discretion is based upon applicable laws, and, even if the executive branch is granted the power to make rules for implementation and to make decisions on interpreting and applying laws and regulations to specific cases, such power must be exercised on the ground of laws and regulations with sound justification for decisions and the power must be subject to rigorous procedural control and judicial review so that arbitrary uses of the power can be prevented. The conundrum has been how to find a delicate balance between the authority of legislation and the flexibility of administration in law enforcement.

While legislative control over administration is comparatively weak in China due to a number of particular political and legal reasons, supervision within administrative hierarchy and judicial control are also limited. The central tax authority has not been effective in supervising tax administration at the local levels, even though computerization, network building and other technological improvements made to government offices have enhanced the quality of work in tax administration in recent years. Courts are restricted in their power to only review concrete tax disputes, leaving out of the legality problem of various administrative regulations, rules, circulars, notices and issuances which are considered being under purview of the executive branch of the government. This is not conducive to the effective protection of taxpayers’ rights, and indirectly creates incentives for abuses of discretionary power.

D. Inter-governmental Fiscal Relationship
The fiscal relationship between central and local governments and between sub-national governments below the provincial level is rather perplexing and elusive in China. There has been a tension between central and local governments with directives coming from the centre but policy implementation responsibilities at the

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21 For example, the national legislature including the National People’s Congress and its Standing Committee does not convene discussing legislation and other related matters on a regular basis. Moreover, if a departmental or local rule is considered illegitimate or in violation of laws and regulations of higher authority, the power to repeal or alter such rule resides with the State Council and/or local people’s congresses in the case of local rules. Law of Legislation, art 88.


23 Administrative Litigation Law, art 12.

24 Constitution, art 89; Law on Legislation, arts 86-88.
local level. Bureaucrats are able to implement laws and policies in a way that protects their position and avails themselves of available resources in the region where they administer. The balance of the controlling influence has swayed back and forth between the centre and local from time to time.

China does not formally apply fiscal federalism. The tax-sharing system established by the 1994 reform does not mean fiscal decentralization since it only assigned tax revenues but not expenditures among different levels of government. The sharing of tax revenues does not proportionately come with the provision of public goods and services. While major profitable taxes are assigned, in a significant proportion, to the central government, most social welfare and infrastructure expenditures are the responsibility of the provincial and lower-level governments. Some governments that are located in wealthier regions may have adequate fiscal resources for expenditures responsibilities within their jurisdictions, but many others, particularly those in the north and west and at the very bottom level of the economic ladder, have difficulty in financing local public expenditures, which leads them to resort to other sources such as land or informal imposts for financing.

Put aside the economic and social problems caused by such other means of financing at the local levels, if taking this matter of fact, together with the significant administrative discretion into account, a degree of implicit fiscal decentralization may exist in reality in China. This type of fiscal decentralization, which lacks clear demarcation of powers and responsibilities, has affected the central government’s ability to implement laws and policies, effectively, across the whole country. For shared taxes that involve local administration, local governments normally have incentives to interpret laws and policies in their favour in order to extract more revenues from the shared revenue pools. It would be more efficient in providing public goods and services to the communities if the local governments were given more autonomy in fiscal and tax matters on one hand. On the other, however, formally applying fiscal decentralization that separates central and local powers seems not feasible in current China where strong legal institutions capable of preventing

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25 The concept of ‘fiscal federalism’ was originally defined by Musgrave and Oats. There has been rich literature on the concept from economics, political science and other disciplines. Economic analyses emphasize the need to concentrate on the necessity of improving the performance of the public sector and the provision of their service by ensuring an appropriate alignment of responsibilities (expenditure) and fiscal instruments (revenue). See, generally, Richard A. Musgrave, The Theory of Public Finance: A Study in Public Economy (McGraw-Hill, 1959); Wallace E. Oates, Fiscal Federalism (Harcourt Brace Jovanich, 1972); C. Tiebout, ‘A Pure Theory of Local Expenditure’ (1956) 64 Journal of Political Economy 416; and David R. Cameron, ‘The Expansion of the Public Economy: A Comparative Analysis’ (1978) 72 American Political Science Review 4, 1234.

26 Local governments have been given certain authority to make implementation rules regarding taxes assigned as local exclusive taxes. Local exclusive taxes tend to be minor in total local government revenues.
abuses of power and holding governments accountable to the general public are yet in place. Historical experience has shown that the local governments would scatter if the central control was loosened, applying laws and policies at will, but equally disappointingly, once the centralization was tightened, the local would lose their vigour, and strict implementations of central laws and policies would lead to unfair consequences to the local areas.

E. Bottom-up Accountability

China has a highly advanced bureaucratic system in which the officials of the executive branch hold greater and broader power than their counterparts of the legislative and judicial branches at almost all levels of the government. Bureaucrats have developed complex but affinitive networks among themselves for mutual benefit and support. The existing election system is to a large extent symbolic in that there lacks universal suffrage and the career prospect of officials is primarily determined by officials or leaders at the next higher level but not the people they govern and to whom they should be accountable.

Institutional checks and balances between the legislative, executive and judicial branches appear to be weak due to a variety of constraining factors. For instance, local judiciaries have to rely on local governments for funding and the legislative branch does not have the real power to oversee all regulations, rules and decisions made by the executive branch. An ill-defined relationship between power and accountability in the case of administration has contributed to the failure of preventing abuses of power including the taxing power and the power to spend.

This problem does not stand alone. To some extent, all the abovementioned features and associated problems have interrelated and reinforced one another. As the review of China’s historical tax systems will illustrate, none of these features is new. The fundamental features found in today’s tax system have been a feature of Chinese taxation throughout its history.

III. Historical Review of China’s Tax System

A. The Feudal Period: Three Dynasties and the Spring and Autumn and Warring States Period (2070 – 221 BC)

Taxation is necessary for the formation and maintenance of a state.27 The most

27 The term of “state” in ancient China needs to be carefully defined according to the particular historical context of China. A recent study in Chinese history has defined “state” as above all “a political, territorial, and economic unit”. There are two important features of a state. First, the state has
important levy at the very early stage of the development of the state in China was a land tax. The tax was paid from primarily in labour to mainly in kind and the system of land upon which the tax was based was moved in its nature from community property to private property. It is in this sense that some study has argued that the land tax during this period was in essence rather a tax than a tribute or contribution. The form of payment and the ownership of the fundamental economic resource, land, reflect the primitive feature of the economy and the political entity at the time.

The earliest recorded imposition in China was a land tax based on a land system called well-field (Jing Tian) in the second feudal dynasty, the Shang Dynasty (1766 – 1046 BC). The well-field system was essentially a system of public ownership in that land was held for and ultimately belonged to the community at large. There are a number of competing interpretations about the meaning of the system, but one commonly cited is from Mencius, an influential Confucian thinker. According to Mencius, a square of land was divided into nine small plots of land and the eight outer plots were averagely distributed to eight private households. The central plot was regarded as public land and each household had the right to use its private assigned land. All the eight households must firstly complete the work on a clearly defined territorial boundary, an authoritative political institution applying a central control over the entire territory or all the land within its boundary, a group of people residing and born upon its land who were bound together by political and military means, and a powerful war machine for both external and internal functions. Secondly, the state must have economic resources and sources to support its members for subsistence and beyond. Chun-shu Chang, *The Rise of the Chinese Empire* (University of Michigan Press, 2007) vol 1, 14-15.

Han Liang Huang, *The Land Tax in China* (Columbia University, Longmans, Green & Co, Agents, 1918) 19.

As another study found, the turning point of the State from tribes to empire in early China was the establishment of the first imperial dynasty, the Qin Dynasty (221-206 BC). The Qin was a unified and centralized bureaucratic empire with a political system and administrative institution, as well as a socioeconomic structure that was completely different from that of those previous dynasties. Chang (n 27) 10.


For landholding in historical China, see Xu, ibid.

Huang (n 28) 19, 21.


‘Teng Wen Gong’ in Mencius. Mencius further remarks that this is a rough outline, and it is up to the ruler to make adjustments. A study maintains that the well-field system seems to reflect three related principles: sufficiency, equality, and government obligation. “Sufficiency” means that each person should have an amount of land that is sufficient for his material well-being and also his ethical life. “Equality” refers to the amount of land to be allocated should be the same for every person who is a commoner (officials receive more land because they make a greater contribution to society). And “government obligation” implies that it is the duty of the government to ensure that the land demarcation is properly drawn and the division of land according to the well-field system is equal. Joseph Chan, ‘Is There a Confucian Perspective on Social Justice?’ (2007) Department of Politics and Public Administration of the University of Hong Kong Working Paper Draft.
the public land before they were allowed to cultivate their own land, and produce from the public plot belonged to the state while produces from each assigned plot belonged to the relevant household. The operation of this system indicates the land tax was paid in labour and the tax rate applying to each household was practically a tithe.\textsuperscript{35} In addition to the land tax, there were a number of tributes applying to common serfs. The whole level of these payments was, however, kept low because of a policy requiring impositions on people be limited to a reasonably moderate level.\textsuperscript{36}

The land tax in the following dynasty, the Zhou Dynasty (1046 – 256 BC), was similarly built upon the well-field system. Unlike the Shang Dynasty, the land tax in Zhou was usually paid in kind. While land remained as community property, it was no longer delineated between public and private plots, and all plots of land were to be cultivated uniformly. Upon harvest, certain plots of land were specified as public land and produces of these plots were collected as land tax. This change was made to solve the problem of the lack of incentives of serfs to work hard on public land in the previous system, but the change only solved the problem to a limited extent because there were always “free-riders” who did not work as hard as others and supervising and measuring the productivity of each serf entailed high administration cost.\textsuperscript{37} The tax rate was a tithe of the gross produce, but it varied from land to land according to the quality and types of produce of specific land.\textsuperscript{38} There were other imposts, one of which was forced labour duty (ding). The compulsory duty became a poll tax in the Han Dynasty (206 BC – 220 AD) and since then had been a heavy burden on common people.

In the second and also the last part of the Zhou period, known as Eastern Zhou (770 – 221 BC), the Zhou king became a figurehead and many individual states with separate rulers existed side by side. The Easter Zhou was consisted of two periods, the Spring and Autumn Period (770 – 476 BC) and the Warring States Period (475 – 221 BC). During these periods, the basis of the well-field system was shattered owing to the emergence of private land from reclamation of land by common farmers and the encroachment onto public land by the overlords. The collapse of the well-field system was also facilitated by the rapid increase in productivity with the widespread use of iron tools and animal power, the development of irrigation, steady population growth and increased expenses of wars. Some regional states\textsuperscript{39} took

\textsuperscript{35} Xu (n 30) 530-1.
\textsuperscript{36} Wu Zhaoxin, \textit{History of the Tax System of China} (Taiwan Shangwu Press, 1965) 8-9.
\textsuperscript{37} The ‘free-rider’ problem can also be found in early modern China between the 1950s the 1980s when public ownership was applied.
\textsuperscript{38} Xu (n 30) 532.
\textsuperscript{39} The Zhou king during these periods held little real power. Strong regional warlords, by defeating
initiatives to reform the well-field system to make the land system compatible with a changed economic and social environment. The most well-known reform was a reform launched in the Qin state, which essentially allowed private ownership of land for common people. Land could thus be sold and bought freely, which, together with other measures, fundamentally changed the foundation of the economic system and transformed the serfs to free or employed peasants who owed only a tax to the state (or a tax via rents to a landlord) but no longer stated amounts of labour to their overlords.

The private ownership opened the door for institutional changes in the socioeconomic and political areas of the state. The institution of primogeniture was repealed, large clans were broken into nuclear families, and a double tax was applied to households having more than one married son. These changes were made to promote productive agricultural activities. In respect to the political governing, towns expanded into cities, smaller villages were incorporated into prefectures and the power of the aristocracy was devolved to meritocracy. An administrative system of operating local affairs at several levels from the province to the county was gradually created, which was further developed into the provincial and prefectural system (Jun Xian), a matured administrative system, in the following Qin Dynasty (221 – 206 BC). The reform laid a solid foundation for the Qin state to build the first imperial dynasty, the Qin, over a unified China.

B. The Long Imperial Period: From the Qin Dynasty to the Qing Dynasty (221 BC – 1911 AD)

The Imperial Period lasted more than two thousand years in China. During the long period, the centre of the economy had always been agriculture and the agrarian economy developed to a highly sophisticated level. There were a number of important improvements in the tax system, particularly the land tax system. The main tax policy, i.e., equalization of payment and light taxation on peasants, was meant to promote agricultural development and keep peasants work on the land, which were in line with the economic thinking of Confucianism, that is, agriculture alone provides necessary economic foundations for the state and people, and the development of commerce and trade should be limited to a moderate level so that it would not contaminate people’s soul and draw them away from the basic pursuit of weaker ones, gradually formed seven major states and rose to prominence. The seven states are Qi, Chu, Yan, Han, Zhao, Wei and Qin.

40 Book of Lord Shang, Order to Cultivate Waste Lands.
41 Records of the Grand Historian (Shi Ji), Biography of Lord Shang (vol 68).
42 Records of the Grand Historian (Shi Ji), Annals of Qin (state) (vol 5) and Yearly Chronicle of the Six States (vol 15).
life. Private property was recognised in most of times throughout the long period, which facilitated agricultural development on one hand, and created serious problems including excessive land annexation and unfair tax treatment on the other. Towards the end of the Imperial Period, the land tax, though had been a major revenue source, had outgrown itself. The outdated system could no longer meet economic and societal development needs of the time. The five features in taxation, as will be unfolded below, emerged and persisted during the long period.

1. The Qin and Han Dynasties
The Qin and Han Dynasties were a period of the first magnitude in China’s history and the most fundamental mechanisms including the structure of government, political ruling ideology and fiscal and tax systems established in this period had endured for over two millennia, and, still continue to influence today. The First Emperor of Qin, Shi Huang, created a centralised bureaucratic state and relied his power not on the loyalty of tributary dukes but a hierarchy of professional bureaucrats whose appointment was based on merit but not hereditary rights. A set of highly sophisticated imperial institution and administrative bureaucratic systems (civil and military) was established with a series of new nomenclature of titles, terms, rituals and court rules applied to govern political conduct and daily routine work of the government. The feudal system of parcelling out land to the feudal lords with communal ownership was abolished and the integrated empire was now divided into administrative units of the province with subdivisions down from the district, the county to hundred-family units. A hierarchy of professional bureaucrats were employed to govern the empire from central all the way to administrative units at the local levels according to the administrative laws and legal codes issued by the Emperor. The local government units were strictly controlled by the centre and were held responsible to the next higher level of officials up till the Emperor. This system of provinces and prefectures (Jun Xian) was considered useful for not only

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43 Wu (n 36) 1-7.
44 Huang (n 28) “Preface” 7.
45 Gu Yanwu, Records of Daily Study (Ri Zhi Lu), vol 17; Gu Yanwu, Complete Works of Tan Sitong. Although the ruling ideology, Confucianism, of almost the whole imperial period except the Qin time, is no longer officially part of CCP and Chinese government’s policy since 1949, it does not disappear from people’s thinking and it remains influential on the ideology entrenched in the Chinese society. In recent years, Confucianism has emerged in new forms tailored by modern Confucian scholars to combine the revival of Confucian values with the transformation of its doctrines in terms of other traditions. The Chinese government also has taken effort to revive and promote Confucianism not only domestically but internationally.
46 Chang (n 27) 43-4.
47 Ibid., 43.
48 Ibid.; Huang (n 28) 34.
49 Chang (n 27) 44.
maintaining political stability, but also achieving effective tax collection, military conscription and systematic social control. It was applied in all the following dynasties and remains in place today. The private land ownership established during the period of Warring States was maintained, and a universal land tax was applied to the entire empire. The tax was assessed on the gross produce of land. Tax burdens, including those levied in produce and in service, were heavy during the Qin period as shown in historical records that the average taxes on land, on persons (poll-tax) and on iron and salt per person were twenty times as much as in the first part of the Zhou Dynasty and the amount of taxes paid in service via forced labour was thirty times as great. Those who could not afford the tax burdens had to sell their land to large landlords, usually rich merchants and traders. A class of large landlords appeared, for the first time, in China’s history. This, together with the Emperor’s brutal rule, led to the overthrow of his reign.

The Han emperors, after having reflected the collapse of the Qin Dynasty, incorporated a more moderate philosophy, Confucianism, into its political governance. Agriculture was given formally preference over commerce and trade and this policy remained unvaried throughout the following dynasties. At the beginning of Han, the founders took special measures to recover a badly disrupted economy after many years of constant warfare. A general policy of economic relaxation and reduction of government spending was adopted based on the thinking that the government should intervene in people’s lives as little as possible. At the beginning of the reign of the first Emperor of Han, the land tax rate was reduced to one-fifteenth of the gross produce of land and the amount of forced labour duty was decreased to three days. The land tax rate was later even reduced to zero during certain periods of time and it was formally reinstalled at one thirtieth in the reign of Emperor Jing in 156 BC, which remained standard afterwards. The taxes on the iron and salt monopoly were abolished also to facilitate agricultural development.

As can be seen, the land tax of the Han Dynasty was light. However, a number of taxes were imposed indirectly via the produce of the land. As noted earlier, there was a poll tax in Han, applying to average adult male commoners (aged from 15 to 56)
at 120 cash and male children (between 7 and 14 years) at 20 cash per annum.\textsuperscript{55} An additional levy required of male adults aged from 23 to 56 to render one month of service to the local government per annum was imposed but commutable at the rate of 300 cash.\textsuperscript{56} This labour service gradually evolved into a permanent feature of taxation. Merchants paid double poll taxes, in addition to market dues and assessments on accumulations of all property they owned.\textsuperscript{57} Though commerce was not particularly encouraged by the government, the government did not close its door to trade with other regions. Commerce and international trade was developed and flourished during the Han era,\textsuperscript{58} bringing economic prosperity to the empire.

Nevertheless, land acquisitions by a small group of big landowners gradually drained the tax base because this group, after accumulating an important part of the best-irrigated land from small landowner-cultivators who could not afford paying taxes due to unexpected natural disasters and unstable incomes from selling harvest, was able to avoid or evade tax payment.\textsuperscript{59} As argued in historical records, the low rates of land tax merely benefited the rich landlords because the land tax was paid by the land owners.\textsuperscript{60} Although the tax rates were lower than those of the previous dynasties, the situation of common peasants was not as good as in the Zhou Dynasty.\textsuperscript{61} Some emperors attempted to limit the land holding as a way to remedy the situation, but they failed since the government was controlled by powerful landlords.\textsuperscript{62} The severe land annexation and other related economic and political problems helped Wang Mang\textsuperscript{63} successfully overthrow the Former Han (206 BC – 9

\textsuperscript{55} Zheng Xuemen (ed), \textit{China’s Taxation History} (Xiamen University Press, 1994) 46-58. Zheng’s study shows that there were four types of poll-tax in Han depending on individuals’ age and the purpose of the imposition. The first was levied on adult commoners and the second on children. The third was a payment substitute for the labour duty of providing service in prefecture each month by people of the right age. The last was a payment for the frontier duty. These types of taxes placed a heavy burden on common people. See also Ma (n 51 \textit{Comprehensive Investigation of Literature}), Population (vol 10).

\textsuperscript{56} Chan (n 27) 78. However, the study by Huang maintained that the amount of labour service required was 3 days. Huang (n 28) 38. The \textit{Book of Han} mentioned three days, but it was not clear whether the three days were levied per annum or per month.

\textsuperscript{57} Zheng (n 55) 2-3; \textit{Book of Han}, Treatise on Food and Money (vol 24).

\textsuperscript{58} During the reign of Emperor Wu (141-87 BC), iron tools and weapons were widely used for agriculture and military purposes. The weaving of silk fabrics also excelled in this period. The economic development facilitated trade beyond border boundaries of Han. Meanwhile, to seek allies to defend against Xiongnu’s invasion, the Emperor Wu twice sent diplomatic missions led by Zhang Qian to the western regions, which initiated the Silk Road. The Silk Road later served as the route not only for the international trade of goods but for the transmission of knowledge and culture between East and West. For a detailed account of commerce and trade in Han, see Chuang (n 27) 81-88.

\textsuperscript{59} Huang (n 28) 39.

\textsuperscript{60} \textit{Book of Han}, Treaties on Food and Money (vol 24).

\textsuperscript{61} Huang (n 28) 39.

\textsuperscript{62} Ibid.

\textsuperscript{63} Wang Mang was a member of the consort families of the emperor. \textit{Book of Han}, Biography of Wang Mang (vol 69). The orthodox historical literature considered him a usurper but later on more objective study thought of him as a critical reformer in directly challenging the privileges and interests of elite
AD) and established the Xin Dynasty (9 – 23 AD). Although Wang took substantial reforms including abolishing private land ownership and limiting the amount of landholding to solve the problem of excessive land annexation and its related problems,\(^{64}\) his reform did not gain support because they were too drastic to be implemented.

The Han was reinstated after Wang’s short reign. Towards the end of the Dynasty, land annexation by wealthy landowners, excessively higher taxes on small peasants, arbitrary informal impositions, illegitimate and even coercive assessment and collection, significant wealth gap between rich and poor, tax evasion of big landlords and revenue loss of the government became rather severe and contributed to the fall of the Dynasty. The light tax policy became nominal from the middle to the end. The government became no longer strong and stable in governing the state.

2. The Sui and Tang Dynasties
The Sui Dynasty (581 – 618 AD) reunited the country after nearly four centuries of political fragmentation during which the north and south of China had developed independently. Although its duration was short, the Sui government established many institutions that were to be adopted by its successor, the Tang Dynasty (618 – 907 AD). The Tang, like the Han, kept the trade routes open to the West and the South via Silk Road, the most important pre-modern route for trade and cultural exchange between East and West.

In the beginning, to prevent aristocratic families and gentries from accumulating large amounts of land and also to promote agricultural development and ensure social stability, the Tang government adopted an “equal-field” land system,\(^{65}\) allowing the officially owned land to be allotted to individual households according to their ability to supply labour, i.e., able-bodied males.\(^{66}\) In 624, the government formally promulgated a law on land distribution and tax payment.\(^{67}\) Males aged from 16 to 60 were allotted much more land than females and disabled persons. Eighty per cent of

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\(^{64}\) Book of Han, Biography of Wang Mang (vol 69).

\(^{65}\) According to studies, the equal-field system was firstly adopted in the last of the Sixteen Kingdoms and inherited by the following Sui Dynasty. John King Fairbank, China: A New History (Belknap Press of Harvard University Press, 1992) 77.

\(^{66}\) Under the Tang laws, males were categorised into five groups according to their age: birth (huang), child (xiao), juvenile (zhong), able-bodied (ding), and old (lao). The stipulation of ages of able-bodied males and juveniles was closely relevant to taxation. In the early times, juveniles were males aged from 16 to 20 and able-bodied males were aged from 21 to 60. There were some variations afterwards. From the middle Tang onwards, the age for able-bodied males was postponed to 25 and the age for old males was brought forward to 55. Nothing was changed until the end of Tang, Old Book of Tang, Treaties on Food and Money (vol 48); see also Zhang Zexian, Tax History in the Tang and Five Dynasties (Zhonghua Book Company, 1985) 2.

\(^{67}\) Old Book of Tang, Treaties on Food and Money (vol 48).
the allocated land was required to revert to the state upon one’s death while twenty per cent of the land could be inherited. Based on this land system, a land tax consisting of threefold taxes was applied: a field tax paid in grain on those who had fields, a poll tax paid in silk or things alike on those who had household registrations, and labour duties (personal service) on those who were adult males. Tax rates were moderate and fixed at certain amounts, but administrators at the local would be fastidious about the quality of payment goods. The essence of this land tax was the same as before in that it based tax assessment and collection on the number of able-bodied males in a household. The more able-bodied males the higher the taxes a household had to pay. This was on the assumption that the land was equally distributed to able-bodied males and a household with more able-bodied males had more land and hence higher tax duties.

The equal-field land system was abandoned after the An Shi Rebellion (755 – 763 AD) in the middle of Tang due to weakened central control and poorly maintained government records of population, land and crops for taxation. Land began to be bought and sold before and during the Rebellion and land reversion was no longer enforced. Large areas of land became concentrated in a small group of wealthy landlords who paid the same amount of taxes (or perhaps less) as small and landless peasants, and who even could avoid paying taxes by joining the government or becoming Buddhist monks. To recover the disrupted economy and lost tax revenues, in 780, the government under the reign of Emperor Dezong (780 – 805 AD) introduced a substantial reform to the law of land ownership and tax system. The reform allowed free trade of land and replaced the previous threefold taxes and other subsidiary levies by one formal tax with two components: a poll tax on households and a wealth tax. The most significant change was to make tax assessment based on the level of wealth but not the number of able-bodied males in a household. This change reflected that the previous tax base on labour in the context of equal distribution of land would lead to very unjust imposition in the situation where people no longer held equal amounts of land. Applying taxes according to wealth in such a changed circumstance thus could make payment more

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68 Ibid. Households were divided into taxable and non-taxable for tax purposes. Usually, aristocratic families and officials were non-taxable households.
69 Three decrees on the threefold taxes system were issued in different times in the early Tang. The basic mechanism was the same but details varied. Zhang (n 66) 4.
70 For reasons why employing labour as the base unit for tax purposes, see Xu (n 30) 541.
71 Sima Guang, A Comprehensive Mirror to Aid in Government (Zi Zhi Tong Jian) vol 226.
72 Ibid.
74 Old Book of Tang, Biography of Yang Yan (vol 118).
equal in line with the ability to pay, though the determination of the level of wealth would be difficult in practice.\footnote{Ye (n 73) 375.} This change marked a significant improvement in the development of tax systems in China’s history.

In addition to the land tax reform, the government also expanded an income tax with progressive rates to the nobles and officials as well as merchants.\footnote{Old Book of Tang, Treaties on Food and Money (vol 48).} The compulsory labour duty for border defense attached to the land tax was reformed to a more reasonable conscription system that recruited professional soldiers and used the government revenues to pay for them.\footnote{Ye (n 73) 406-9.} This change greatly liberalized the working population and fostered the economic development.

However, the central government’s control over local governments declined after the An Shi Rebellion with the rise of military governors in local areas. With the shift of power to military governors, the central government had to give away part of the taxing power to the local governments in order to get a guaranteed share of the revenue collected through the local governments. Tax revenues were divided into three parts: one for the centre, one for the regions with a military governor who usually governed several prefectures, and one for the prefectures via which the taxes were collected.\footnote{Ye (n 73) 391-3. This revenue allocation method continued till the Song Dynasty. Zhang (n 66) 177.} This fiscal decentralization recognized the financial need of the local governments, but it in effect legalized local fiscal control and weakened the centre’s ability to effectively reign over the state, leaving future troubles to the central government. The reform improved the government finance and won support from common people,\footnote{Old Book of Tang, Treaties on Food and Money (vol 48); Comprehensive Investigation of Literature, Land Tax (vol 3).} but triggered a political crisis from vested interest groups since their previous privilege of tax exemption was abolished in the reform. Towards the end of the Dynasty, widespread land annexation, more arbitrary informal impositions on common agrarian population, unfair tax concessions for elite groups and tax evasion of wealthy landlords and merchants occurred once again.

3. From the Five Dynasties and Ten Kingdoms to the Yuan Dynasty

The Song Dynasty (960 – 1279 AD) unified and gained power over most of China after another period of political disunity (907 – 960 AD).\footnote{Fairbank (n 65) 88.} Like the Tang Dynasty, foreign trade and commerce were allowed and the increase in trade and commerce increased the use of paper money, which had firstly appeared in Tang.

However, unlike the previous dynasties, the Song government did not adopt any
restriction policy on land annexation from the very beginning. Rather, it applied a laissez-faire policy and encouraged people to reclaim land by granting them land ownership as long as they paid a land tax. As a result, accumulation of land developed into an unprecedented level during the early Northern Song period (960 – 1126 AD). However, the government could not effectively prevent large landowners from evading or avoiding taxes and the lost tax revenues were made up by more strictly taxing small and even landless farmers. The continuing drops in government revenues, unreasonable allocation of taxes, successive deficits and widespread inflation as well as other related severe economic and social problems compelled the government to remedy the situation. During the reign of the Emperor Shenzong (1067 – 1085 AD), a comprehensive socio-economic reform known as New Policies was launched. A new tax law, “standardizing land and equalizing taxes”, was enacted. The new law did not alter the basis of the two taxes system; rather, its major aim was to polish the system to make its implementation more equal by applying differential rates to different grades of land on the basis of a standard square unit. A substantial land survey was launched to sort out and update the badly maintained land and household registrations for tax purposes. This survey was necessary and important in that it could help lower the tax burden for ordinary farmers and make untaxed farmland subject to taxes. The new law, however, was not well implemented because of fierce objection from powerful conservatives as well as interruption from foreign invasions of the time.

At the end of the later Southern Song period (1127 – 1279 AD), ordinary people once again became the source of income for the government and informal taxes and charges were widely applied. With the lost revenues, the central control was loosened and ineffective, and the local, though could extract revenues via informal taxation, had to assume heavier expenditure responsibilities shifted from the centre.

The Mongol invasion and conquest for the first time brought the whole China to the reign of a “foreigner” in view of the majority of Han Chinese populace. The Mongol, Yuan Dynasty (1271 – 1368 AD) was ultimately conquered and replaced by the Ming Dynasty (1368 – 1644 AD).

81 Sima Guang, Sushui River Record (Historical Record of the Song Dynasty) vol 1; Song Annals, Treaties on Food and Money (vol 174).
82 The recorded land by the government was 5.25 trillion qin in 1021, but it quickly dropped to only 2.15 qin in 1049. The government lost substantial revenues. Ye (n 73) 427.
83 Song Annals, Treaties on Food and Money (vol 174).
84 A Comprehensive Mirror to Aid in Government (n 59). One square was extended to one thousand feet in all four directions, equal to 41 qin and 66 mu and 160 feet. Song Annals, Treaties on Food and Money (vol 174).
85 Ibid.
4. The Ming and Qing Dynasties

During the Ming and Qing Dynasties, the problems with the tax system, including land accumulation, informal imposition, unequal distribution of tax burdens, tax evasion and corruption in assessment and collection, remained almost unchanged, subject only to brief periods of abatement.

The founding emperor of the Ming empire, Hongwu (1328 – 1398 AD), put a greater emphasis on agriculture and applied a stricter control over trade in order to secure political stability of the empire, but this virtually led China to a state of limited seclusion until the twentieth century. Initially, the Ming government applied the previous two taxes system for land taxation. Land was generally classified into public and private land and the latter constituted about five-sixth of the cultivated area of the state.\(^{86}\) The two taxes system was implemented relatively well with the strict control of land and household registrations in the beginning. However, the strict implementation of the registrations was gradually loosened, and large landlords and wealthy households were able to avoid or evade taxes by various means including bribing officials and under-reporting their land and wealth. Land annexation became increasingly severe and extra taxes were imposed by the government one after another in order to make up the lost revenues from tax evasion and avoidance. Many small cultivators had to abandon their homes as they could not afford excessive taxes.

By the middle of Ming, the state fell in financial strain and the government had to take measures to solve tax and finance problems. A tax reform called “Single Whip Reform” was introduced in 1581 under the reign of Emperor Wanli (1573 – 1620 AD). This reform consolidated various types of payment for the labour service levy\(^{87}\) into a single payment at a uniform annual rate, and the consolidated payment was further incorporated into the commuted portions of the regular land taxes and thus tax assessment could be based uniformly on the general fiscal unit and be collected in silver.\(^{88}\) The reform was meant to base the levy taxes on land (wealth) and whoever owned land had the tax liability. It eased tax administration of the levy taxes and alleviated tax burdens on ordinary peasants, but it did not simplify the tax structure and remained limited in scope.\(^{89}\) By the late sixteenth century, the tax base became much broader and the general rates were complicated by the addition of other

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\(^{86}\) Huang (n 28) 52.
\(^{87}\) According to a study, there were four types of service levy. The first was a service of tax collection and delivery, as well as supplying raw materials. The second was a full-time and year-round labour service. The third was to provide equipment and service for postal stations. The last was militia service. Roy Huang, *Taxation and Governmental Finance in Sixteenth Century Ming China* (Cambridge University Press, 1974) 112. Another study shows that the labour service levy only contained the first two types, plus services under certain emergencies. Wu (n 30) 143.

\(^{88}\) Ming Annals, Treaties on Food and Money (vol 78).

\(^{89}\) Huang (n 87) 119.
surtaxes and charges.\textsuperscript{90} From the middle to late periods of Ming, similar problems – additional, informal surtaxes, brutal collection and widespread corruption – occurred again and became very serious. The mining tax, one of the most onerous surtaxes, was viewed as a critical factor causing the fall of the Ming Dynasty.\textsuperscript{91}

The successor of Ming, the Qing Dynasty (1644 – 1911 AD), inherited many institutions of Ming, including Confucian norms, administrative governing structures and fiscal and tax systems, for fear that any disruptions may affect its political stability. Much like the previous dynasties, the government at the beginning of the Dynasty reduced ordinary peasants’ tax burdens by way of abolishing informal taxes and arbitrary charges, countering tax evasion of large landlords and wealthy households, and equalizing taxes and service levies among people. Two major changes were made in the land tax system. The first was a permanent freezing of the number of taxable able-bodied males by reference to the census of the year of 1711, and therefore a fixed poll tax for all times.\textsuperscript{92} This policy in effect lowered tax on people and it laid the basis for a subsequent merger of the poll tax into the land tax and then imposed the tax according to the amount of land (wealth) owned. Consequently, more land more taxes. This reform was regarded as another important improvement in taxation as it eventually completed the process of moving the focus of the tax base from labour to wealth, and changing the payment method from labour provision to monetary submission.

The second reform was to formally incorporate the widespread additional, informal charges on meltage and wastage during tax collection into formal taxes, while eliminating all other arbitrary charges attached to that practice. The incomes from the incorporation, called “money for nourishing honesty”, were used to supplement meagre official salaries and insufficient administration expenses.\textsuperscript{93} This policy alleviated serious problems associated with the unrealistically low salaries of officials and scarce local administrative funds to a certain degree.\textsuperscript{94} Unfortunately, those informal charges later appeared again, and were never effectively eliminated.

The two Opium Wars in late Qing (1840 – 1911 AD) made the imperial treasury bankrupt twice, and the western encroachments and the continuing domestic rebellions led Qing, once again, to wildly engage in imposing exorbitant taxes and levies. One particular informal charge, \textit{li-jin}, literally meaning percentage money,

\begin{footnotesize}
\textsuperscript{90} Ibid., 141.
\textsuperscript{91} Ibid.,
\textsuperscript{92} The Draft of History of Qing (vol 121); Record of the Emperor Shenzu (vol 240). But Huang’s research suggested the reference was based on the year of 1713. Huang (n 28) 89.
\textsuperscript{93} Zhou Yumin, \textit{Public Finance and Social Changes in Late Qing} (Shanghai People’s Publishing House, 2000) 13-21; Ye (n 73) 553-63.
\textsuperscript{94} Ibid.
\end{footnotesize}
brought extremely onerous and unequal burdens to common domestic people. This charge was initially imposed at one per cent of sales value of goods passing through inland barriers, but the rate then rose to 5-10 times the previous rate, later even reaching 20 times in some regions. The heavy charge burden was transferred to the next producers and eventually customs. Domestic merchants had to pay it more than once, while foreign merchants were exempt from it (and even other domestic taxes). New problems in taxation, such as unequal treatment between domestic and foreign merchants, were added to the already problematic tax system. Abuses of taxing power across levels of the government aggravated the problems in the tax system and adversely affected the fiscal system of the following Republic of China.

C. The Republic of China: 1912-1949
The Republic of China ended around 2,000 years of imperial rule. However, it was a period that fraught with wars and battles from foreign invasion as well as internal power struggles. It was also a period in transition from an agrarian economy to modern economy based on industry and commerce. Private ownership was retained and some modern elements of taxation were introduced, but the tax system remained primitive and unstable.

The taxing power was, perhaps for the first time, formally assigned between the central and local governments – primarily provincial governments. The assignment made three indirect taxes, i.e. customs tariffs, salt tax and sales tax on certain goods, the pillow of central tax revenues. Other types of tax that usually were not profitable belonged to the local governments. The land tax became for the first time a local tax and it was the most significant revenue source for the local governments. Nevertheless, the assigned local revenues were not sufficient enough to meet local expenditure needs including the need paying for frequent wars. As a result, local governments resorted to the old means to address the problem – imposing extra, informal taxes and charges on common people, despite the prohibition by the centre. Informal tax burdens doubled or even tripled formal tax burdens. However, in the absence of an effective political institutional control that held local officials accountable to the public, these informal taxes could be readily introduced, collected and used at the discretion of the local governments.

There were other changes in the tax system, including introducing a schedular

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95 Zheng (n 55) 633.
96 Treaty of Commerce and Navigation between Britain and China (1902), Section 8.
97 Zheng (n 55) 633. Treaty of Commerce and Navigation between Britain and China (1902), Section 8, which exempted various payments for foreign merchants.
98 Zheng (n 55) 691; Wu (n 36) 311-13.
99 Ibid.
income tax on businesses and individuals, though such tax did not properly come into force. Tax laws were rather vague and lacked binding force in practice. Similar to the problems in preceding periods, tax evasion of wealthy persons, illegal and arbitrary informal levies, unequal tax treatment, coercive collection and corruption spread across the country. Outbreaks of tax resistance were a common feature of the rural economy in the Republic period, and peasants’ refusal to tax, in some historians’ view, made an indirect contribution to the victory of the Communist Party.  

D. The People’s Republic of China: 1949 – Present

Forces loyal to the Communist Party eventually defeated those aligned with the Nationalist Party and established the People’s Republic of China (PRC) on 1 October 1949. To differentiate from the past regimes, the new unitary state adopted a “socialist system” with “Chinese characteristics”.  

The currently effective Constitution was enacted in 1982 and it has since then been amended for four times, bringing into it some important changes in the economy and society that were gradually recognized by the government over the development period. The Constitution provides that China pursues “a socialist market economy” and strives for “reform and opening”, the two concepts that have enabled China to acquire not only rapid economic growth but also significant modernization of its legal system over the last three decades.

The Constitution adopts the notion of “democratic centralism” to govern the state, which means the state’s functions and powers are divided into central and local with the uniform leadership of the central government while allowing a wide range of initiatives of local governments.  

The term of “central government” is referred to the Central Government in Beijing, while the term, “local governments”, is used to denote local governments at three levels: the province, the prefecture, and the county. This system is in essence the same as the system of prefecture and county (Jun Xian) adopted in the Imperial Period since the first imperial dynasty. The judiciary system including courts and prosecutors was built upon this hierarchy of government units.

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101 Constitution of the PRC; Constitution of the Chinese Communist Party (CCP). However, some scholars have argued that a more realistic description of the state should be ‘capitalism with Chinese characteristics’. Yasheng Huang, Capitalism with Chinese Characteristics: Entrepreneurship and the State (Cambridge University Press, 2008).
102 Specifically, the Constitution was amended in 1988, 1993, 1999 and 2004 respectively.
103 Constitution, Preamble and art 15.
104 Constitution, art 3.
105 Constitution, art 30.
The state economy is mutated from a system of public ownership on which almost every thing was owned by the government on behalf of people to a hybrid system of public and private ownership that has allowed private investors to grow and to prosper along with the state-owned entities from late 1978. Accordingly, the tax system prior to late 1978 comprised mainly profits remittance from state-owned businesses in urban areas and compulsory procurement from peasants in the countryside, with a limited range of formal taxes.106 The rapid development of private property from late 1978 has driven tax reforms to make the tax system compatible with the principles and the application of private property. A relatively comprehensive system, including direct taxes such as income taxes on enterprises107 and individuals108 and indirect taxes, typically VAT,109 has been established with a variety of further improvements in the economic reform period. One of the most important tax reform in this period, the 1994 tax reform, created not only a tax structure that is still in force today but also a formal central-local tax sharing arrangement that echoed closely the arrangement adopted following the An Shi Rebellion more than a dozen centuries earlier.110 Tax administration was correspondingly separated into national and provincial arms, which led to two streams of tax administration at the local levels.111 This reform, as was intended, bore fruit to the central coffers and enabled the centre to employ tax policies more efficiently for

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106 The application of the tax system of the time was influenced by the practice of the Soviet Union and other then communist countries. The profits remittance and compulsory procurement were essentially hidden taxes on incomes of enterprises, workers and peasants.

107 A dual track income tax system was established after 1980 and had been applied until 2007. The system was reformed a number of times. From 1994 to 2007, domestic enterprises paid income taxes according to the Provisional Regulations on Enterprise Income Tax passed by the State Council on 13 December 1993, whereas foreign enterprises were subject to the Law on Foreign-invested Enterprises and Foreign Enterprises issued by the NPC on 9 April 1991. The two separate pieces of legislation were replaced by the Law on Enterprise Income Tax passed by the NPC on 16 March 2007, which has come into effect since 1 January 2008.

108 Law on Individual Income Tax (NPC, 10 September 1980, effective 10 September 1980, revised 31 October 1993, amended 30 August 1999, 27 October 2005, 29 June 2007, 29 December 2007, and 30 June 2011). The Law was initially intended to mainly apply to foreign individuals working in China, because the tax threshold was higher than the average salary of most Chinese citizens at the time. The State Council issued two separate regulations in 1986 in order to effectively tax Chinese individuals as well as individual industrial and commercial households. The Law on Individual Income Tax began to apply to all individual taxpayers from 1 January 1994.

109 Provisional Regulations on VAT (State Council, 13 December 1993, effective 1 January 1994, amended 10 November 2008). The VAT Regulations are applied mostly to goods. Provisions of services are governed by the Provisional Regulations on Business Tax (State Council, 13 December 1993, effective 1 January 1994, amended 10 November 2008). The currently ongoing VAT reform aims to integrate the VAT and business tax into a single VAT.

110 State Council Resolution (n 8).

111 Ibid., art 4(2). The central arm of tax administration has established its offices at local levels down from province, to municipal and to county. Similarly, the local arm of tax administration at local levels is consisted of three levels: province, municipal and county. SAT, ‘Organizational Chart of China’s Tax Administration’, http://www.chinatax.gov.cn/2013/n2925/n2959/c307250/content.html.
macro socioeconomic objectives. Nevertheless, the reform unwittingly brought
difficulties to local governments, in particular those in underdeveloped regions, since
the excessive reliance on consumption taxes (the VAT and business tax) left the
central government as well as commercially successful provinces with more revenues
and commercially under-developed areas with fewer revenues. Financing local
expenditures by non-tax revenues, especially by sales of land use rights in recent
years at the local levels, has contributed, among other things, to the notorious
informal tax problems, inequality in income and wealth among individuals, and
unhealthy property market development.

It is not until very recently that the government decides to seriously address the
non-tax revenue problem, income inequality and unbalanced intergovernmental fiscal
relations through tax reforms. Despite these laudable plans, there is still a long way
to go to solve the problems associated with the five longstanding features of the tax
system and to achieve the “rule of law” objective stipulated in the Constitution.\textsuperscript{112}

IV. Enduring Echoes in a Changing Landscape

A. Evolved Repetition of Features of the Tax System

As can be seen from the chronological review of the development of Chinese tax
system, a number of features appear time again during the long history, albeit the
system has evolved from one based on an agrarian economy and controlled by an
absolute ruler to one relied upon a modern market economy and governed by an
established written Constitution (though nominally).

Historically, the aim of most tax policies was to apply low taxes to peasants but
heavy taxes to merchants for the purposes of promoting agricultural development, and
at the same time to keep government expenditure commensurate with the receipt of
revenues and thereby constraining it to a moderate level. In practice, however,
ordinary peasants – mostly small cultivators with a tiny portion of land and landless
peasants – assumed proportionally heavier tax burdens than large landlords and
wealthy merchants. Almost invariably in each Dynasty, the policy of light taxation
could be well enforced in the beginning, but from middle towards the end of the
Dynasty, tax policies became nominal and additional, extra surtaxes and charges were
levied one after another, which made tax payment increasingly heavy and unfair on
ordinary peasants. Correspondingly, government expenditures could be kept at a
reasonably low level in the beginning but became exorbitantly high (with little, if not

\textsuperscript{112} Constitution, art 5. This article provides the PRC practices ‘ruling the State according to law and
constructing a socialist rule of law State’.
Informal taxation has never been absent, in the long history and even this day. Though almost every government of a particular historical period attempted to seriously restrict informal taxation, informal taxation never really disappeared in practice and could be rampantly developed across the regions of the state and rival formal taxes in importance of government revenues. It may be controlled comparatively well at the beginning of a new government but it became severe and widespread from the middle to the end. The time when informal taxation grew to prominence is always the time when the implementation of tax policies that were in favour of ordinary taxpayers for effective economic development and the application of formal tax laws and rules became lax and marginal. It is also the time when the central control was weak and the time when the discretionary power of local administration was strong.

Fair taxation or equality in taxation seems to have never been achieved. In the past, elite families and government officials above certain levels were usually exempt from taxation, even though they held a larger amount of wealth than ordinary people. This was partly attributed to the difficulty of accurate valuation of land and other types of wealth and then assessing land taxes properly for each taxpayer. Land survey and population censuses were inherently difficult to carry out in a regular fashion and changes in household wealth and labour conditions could thus not be reflected timely, causing problems to tax assessment adjustment. The phenomenon of land without land taxes in the case of large landlords and land taxes without land in the case of small and landless cultivators was not uncommon in history. Wealthy persons could take advantage of the difficulty to hide or under-report their wealth and hence avoid and even evade paying taxes. The difficulty of measuring wealth and monitoring changes of wealth of individuals is still a problem today. Wealthy persons have more means to move their wealth to low- or no-tax jurisdictions, and to make use of the loophole of the current law to pay taxes at a lower rate. As noted earlier, the progressive rate schedule for individuals under the individual income tax law apply only to wages and labour income with the highest marginal rate set at 45 per cent. A lower flat rate of 20 per cent applies to property income, income from investment and other types of income that constitute the major sources of income of high-income persons. Such design does not conform to the “ability to pay” principle in modern tax law. The problem of fair taxation reflects a long unlearned lesson, that is, to achieve fair allocation of tax burdens, an effective information system that accurately and timely records and monitors situations of income and wealth of individuals is much needed.

Another long-lasting issue is the intergovernmental fiscal relationship. China
has long been a unitary state from the Imperial Period until this day. The state was constructed like a pyramid with the largest number of small administrative units (counties) forming the structure base, at the next higher level fewer but bigger administrative units (prefectures) governing certain commonly located bottom units, and the next higher level further fewer but bigger administrative units (provinces) all the way up to the top in the centre. Professional bureaucrats that were selected through competitive procedures were assigned by the central government to different levels of the administrative units to govern state affairs including tax collection at the local levels. This structure of administrative organisation and bureaucratic hierarchy could allow the central government to exercise central control over fiscal and tax matters on one hand. On the other, it affects local initiatives of responding to real local needs. Legislation of fiscal and tax matters was almost exclusive to the central power, which often could not fully take into account different economic and social conditions of the local. As an agent of tax collection for, and an administrator of local affairs under the central government, local governments would have incentives not to work diligently in tax collection and delivery, or adjust or even issue rules without authorisation to deal with local issues as well as achieve their own interests. When fiscal centralisation was strong, local variations and arbitrary adjustments may be controlled but may not be eliminated effectively completely. When the central power declined or was weakened, fiscal decentralisation would become more preeminent and make macro socioeconomic management difficult. Although China almost never formally exercised fiscal decentralisation, the existence of de facto legislation of tax rules and the abuses of discretionary power in tax administration and collection at local levels imply there was always a certain degree of decentralisation. The fluctuation of the fiscal relationship between central and local governments indicates there was a constant competition for financial resources among the governments. The underlining reason would be that while most of administration is done at the local levels, the local governments do not have sufficient financial sources to meet local public expenditure needs; and in the absence of an effective mechanism that holds local officials accountable to the local constituency, local governments may have incentives to deviate from formal laws and rules enacted by the centre or simply make rules at their wish.

This leads to the problem of government accountability as a whole in the state. Throughout the long history till this day, government officials including tax administrators have been kept responsible for their superiors but not the people they govern because their career prospect is determined by the above but not the bottom. It would be much easier to please one head than to deal with many more persons with divergent interests and preferences. The current system of electing government
leaders at various levels has until now been ineffective in holding governments accountable to the people to whom they govern.

All the repeated features have been with China for a long time. The creation of a new China and the adoption of a market economy have not made these features fade away, even though they may appear in different forms. All these features are not independent from each other, but rather, they are closely inter-related and reinforced one another. An interesting question is why they have such a remarkable “longevity”. Is there an invisible hand behind?

B. An Invisible Hand Behind?

As discussed earlier, the five features in tax systems are not particularly unique to China, but the scale and the length of the existence of these features make China stand out from many other states. A variety of factors may explain the perpetual features of the Chinese tax system.

To being with, why can informal taxation exist and sustain for so long a time? There would be under-taxation of formal levies that were not commensurate with the level of government spending. It seems that the emergence and the increase of informal taxation is always hand in hand with the increase of government expenditures and the rise of tax burdens on ordinary people, and these always appear in the middle of a dynasty or a political entity and then remain until the end of the dynasty or the entity. What is behind this scene is that formal taxes had been deliberately kept at a low level by the government. Historically, the statutory tax rate of land taxes was fixed at one thirtieth during the Han Dynasty and the low rate was maintained in many of the following dynasties. Such low level taxation means that, as the most important revenue source for the government, the formal land taxes were rather moderate, even without regard to any deadweight loss from the process of tax collection and administration. Apart from the low level of formal land taxes, rates of various businesses taxes such as tax upon setting up a business were also low. Such a low level of formal taxation would be manageable in the beginning when the scope of government was small and there were no many expenditure needs. However, once the government gradually expanded in scope and

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113 For example, the land tax rate during the Song Dynasty varied between one twentieth and one thirtieth of gross produce. Huang (n 28) 51. In the Ming Dynasty, formal taxes including regular lands, surcharges, portions of the service levy collected from land and other payments alike were generally less than 10%. Huang (n 87) 174.

114 Some studies have pointed out that formal taxes including land taxes on peasants and business taxes on merchants were rather moderate. Moreover, there were tax exemptions or reductions for taxpayers when some disastrous events happened, such as flood, bad years of harvest and things alike. Huang (n 28); Huang (n 87). Various historical records and literature also showed formal tax burdens were low.
size and when more public spending was needed, the low level of formal taxation would not be sufficient to meet expenditure needs.

Although in the past, China did not exercise state welfare,\textsuperscript{115} the government had to provide necessary public programmes including, \textit{inter alia}, construction and maintenance of roads, regional and frontier defense, local security, creation of post or communication service systems, building canals for irrigation of land and dealing with flood, drought and insects calamities, establishment of grand courts at top and government units at the local, provision of funds for local administration as well as salaries for government officials and employees, and maintenance of military forces preventing external invasions that occurred from time to time. The government must find other means to meet the increased expenditure needs when it became bigger with time going by. The tax policies adopted by almost every government in history – applying light taxation on land and keeping expenditures within the limit of revenues – constrained the government from raising burdens of formal taxes, especially the land taxes, and to circumvent this constraint, the government used informal means such as various charges attached to the formal land taxes, additional labour duties or extra payment on top of formal land taxes for revenue purposes. These informal impositions were not labeled as formal taxes, which rendered the tax policies nominal in effect but intact on the surface and kept formal taxation artificially low. Historically informal tax revenues could be comparable with or even higher than formal tax revenues. As a result, formal tax burdens on ordinary people may not be high, but once combined with informal taxes, the burdens could be very high. On the other hand, the low-level formal taxation did leave room for extra extraction.

The existence of informal taxation may also be attributable to two other factors. One is the idea of private property in the Chinese economic and legal context in history and the other is tax evasion and avoidance accompanied by excessive land accumulation. According to some historians, private property emerged in China at a very early time – the establishment of the Qin Dynasty in 221 BC.\textsuperscript{116} Private land accounted for a large portion of land in the state and it could be sold, bought and mortgaged by ordinary people. In normal times, private ownership of land and other types of wealth was honoured and protected by the government. However, one key difference from the concept in western sense is the incomplete exclusive attribute in historical China, that is, private property was held against all others, except the government. This means when the government needed revenues, it could demand

\textsuperscript{115} A reformer, Wang Anshi, who introduced a comprehensive socioeconomic reform during the Northern Song period were regarded as a pioneer of state welfarism, but his reform was eventually failed due to opposition from strong conservatives in the government.

\textsuperscript{116} Huang (n 28) 19.
more payments via informal taxation or directly appropriate private property from ordinary people without compensation. In the past, enacting and enforcing laws and rules as well as adjusting disputes based on laws and rules were all mixed within a single government unit, it was difficult, if not completely impossible, for ordinary people to challenge the government’s extra impositions or appropriation at courts. The application of private property, however, provided possibility for people, including gentries, officials, merchants and ordinary peasants, to acquire more land and wealth. As there were no many investment means in the past, land became the first and foremost investment source for people. Some successful households could therefore gradually accumulate a large amount of land and rent it out to small and landless peasants to farm. The large landholders usually had a variety of methods to evade or avoid paying taxes, such as under-reporting or hiding the amount of land they held or bribing government officials. Worse, government records on land and population could not timely reflect real situations and changes of land ownership, even though they could be maintained comparatively well in the beginning. As more and more land became concentrated in a smaller group of households and revenues from the land taxes based on outdated records became less and less, the government had to levy informal taxes, one after another, on ordinary peasants with fewer or even no land. This leads to the second feature of the tax systems – unequal distribution of tax burdens.

Fair taxation in absolute terms may never be attainable, but in relative terms it would be achieved by taxing people according to their ability to pay and using taxation to achieve redistributive justice. One major reason why despite the policy of low taxation on peasants, ordinary cultivators had long assumed heavier burdens than other people would be the lack of understanding of the role of taxation in wealth redistribution at the time. In situations where there was a market and private property was allowed, there would be always a tendency of accumulation of wealth by a small group of persons. Excessive wealth accumulation would reduce resource allocation efficiency and impede economic development, but the market could not remedy the situations itself. Taxation, particularly direct taxation such as income taxation in the modern time or land taxation in the past, can be used to prevent excessive land and wealth accumulation by more heavily taxing the owners in line with the level of their wealth. Such role of taxation in wealth redistribution has been considered one of important functions of modern tax laws. However, in historical China, taxation was primarily employed as a tool of government to extract revenues for spending. The government might never had been aware of the role of taxation in wealth redistribution, which may explain why land annexation had been a persistent problem obsessing the government and why the government failed to use taxation to
solve the problem. Another reason for the existence of unequal tax payment and excessive land accumulation would be the inadequate maintenance and update of land and household records. To be fair, historically, there were various measures made by the government that reflected the ability to pay principle, for example, assessing land taxes based on the qualify, size and location of land as well as conditions of households and adopting graduate rate schedules on taxpayers – the more quantity and the better quality of land, the higher taxes. However, without complete and updated records of wealth and population, such measures would be limited in their role of fair distribution of tax burdens.

The features of significant administrative discretion in taxation and ill-defined accountability relationships between government and people are interrelated. To govern so vast a state like China is by no means easy. Social and economic conditions vary from region to region. The establishment of a unitary state with a strong central government by the founding emperor of the first imperial dynasty after defeating a number of feudal warlords can be seen, in a degree, as a reaction to the shortcomings of the preceding feudal political system. To ensure effective control over a large territory, the emperor created an administrative system dividing the local into several levels and each level was equipped with a group of professional bureaucrats whose appointment and career prospect were decided by the emperor. The central government as well as its local units controlled all necessary political powers from legislation, administration and adjudication to defense and external affairs, and there was no clear separation of different powers within the government, even thought there was a division of administrative functions of the government. In modern times, the bureaucratic system has been developed into a highly sophisticated level and been used in not only administration but also judiciary, military, and state-owned companies, universities and the ruling party - CCP. Bureaucrats have been an influential force in the state’s politics and socioeconomics in history and today. With access to a wealth of information that may not be known to both the rulers at the very top and the general public at the very bottom, they have been able to make use of the acquired information to achieve their own interests without necessarily leading to accountability problems.

Usually, laws and rules were enacted and reformed by the central government and enforced by various levels of the government units in local areas. As laws and rules were normally general and local conditions were divergent, administrative discretion was inevitable. Government officials including tax administrators were able to interpret and apply laws and rules at their disposal as long as they satisfied the requirements of the higher government officials and top rulers. Arbitrary discretion would rarely be sanctioned through a court as such judicial power was mixed into a
single government body, together with the administrative power and other powers in the past, and is limited at present due to a number of political and legal reasons as discussed in section two of the article. Because of the top-down leadership and systematic hierarchical control, there was no accountability of the government at every level towards the people to whom it governs.

The longstanding feature regarding the intergovernmental fiscal and taxation power would be, to a large extent, attributable to the political system of the unitary state and the concern of political stability for the state. As noted earlier, there has always been a tension of the taxing power between central and local governments. The history in the Feudal Period showed to later rulers that a weak king and loose political control could threaten the durability and stability of the feudal dynasties; not coincidently, the rise of local warlords at various historical points in the Imperial Period reinforced the thinking that to maintain political stability, it would be prominently necessary to keep local government units under the central control. Taxing power, as one of most fundamental powers for the state to survive and develop, was consequently always in the hand of the central government, even though the control was not always strong and effective. However, most of administration and the provision of road, canals, communication services and things alike as well as the enforcement of state laws and rules were carried out at local levels, all of which would be extremely difficult, if not impossible, without sufficient government revenues. The unmatched revenue and expenditure relation meant an inherent conflict of interests between central and local governments. As the basic feature of the political system remains almost unaltered till this day, the problems of intergovernmental fiscal relationship still exist and government’s accountability to people remains problematic; as the central government still controls a large part of profitable revenue sources, administrative discretion and informal taxation continue to be engaged with by local governments; and as long as informal taxation remains with no effective control, fair taxation would remain an ideal.

A number of important implications can be made from the above analysis. Firstly, to control and to ultimately eliminate informal taxation and to make taxation more equal, it is vital to recognize the true size of the government and to link expenditure needs with revenue sources. If it is needed to increase revenues to meet public expenditure needs that are desired by the general public, it is best to do it by means of formal taxation, and at the same time to effectively put all other types of government revenue into strict scrutiny. This would help make the revenue system more transparent, tax administration less abusive and the distribution of tax burdens more equal. Secondly, it is necessary to increase the role of taxation, in particular personal income taxation, in wealth redistribution. The market economy has
demonstrated convincingly its ability to help many people achieve economic betterment but without intervention by the state it is incapable of addressing the redistribution problem. With the continuing market economic development, inequality in wealth would continue to be a significant social and economic problem if without effective solution. The government must not ignore historical lessons if it aims to pursue sustainable development of the state. Last but not the least, the political system needs to be reformed to make the government more responsive and accountable to people. To some extent, the success of the political reforms will determine whether China can distract from historical patterns and have a different story today.

V. Can China Have a Different Story Today: Concluding Remarks

The features in China’s tax systems over history are not merely problems in taxation, but rather, they reflect the features and problems of the general political, legal and socio-economic systems of the state. The question of whether these features are sustainable in the new era, therefore, cannot be answered without taking into consideration of a broader picture.

There are both pros and cons for the continuation of these features. On one hand, profound changes in the economic foundation have been made: the adoption of a market economy in the late 1970s. Modern institutions such as modern laws, courts and tribunals, and banking systems have been developed to various degrees. These modern institutions will provide necessary foundation for a transformation from rule by law to rule of law. There is also technological advancement in the information system, and computerization and internet network has been applied to help government administration. More importantly, new ideologies including democracy, rule of law, individualism and private property have been introduced to China and have heavily influenced people’s thinking and behaviour. With the rapid development of the economy, more and more people have become wealthy and the demand for more effective protection of their rights and interests has risen to demonstrate that the protection of private rights can only be effective through the protection of political rights.

On the other hand, the market economy is still controlled by the government and there is too much government involvement and intervention. The current market economy is perhaps more precisely a state capitalism. The implementation of laws and rules is problematic, due largely to the lack of a real independent judiciary. Some vested interest groups with influential power, in particular the group consisting of government officials, are closely tied with each other and with private businesses
also, in a hundred and one ways for their own personal interests. The information system is still under-developed in particular at the very bottom level of government. Properties and wealth an individual owns in one region are usually not necessarily known by governments of another region where the individual also holds properties and wealth. Last but not the least, the bureaucratic system seems to have become stronger since more young, well-educated students and scholars have been attracted to join the government through civil service examinations. Their incentives to become part of the ruling class provide them with little desire of eliminating fundamental political and legal problems from within.

Throughout history, financial difficulties have proved key catalysts for fundamental changes to government institutions. At present, with sufficient government revenues and fiscal reserves, China seems to have no pressing need to introduce some substantial changes in its general political, legal and socioeconomic systems. However, China may have come to a key turning point, under the circumstances of shrinking external demands, sluggish domestic spending, rapid ageing problem, primitive social welfare system, distressful environmental pollution, corruption and other problems alike. Corruption has contaminated almost all aspects of government and broader society. The evidently huge wealth gap, the limited role of tax in wealth redistribution, and the ineffective control of government spending have instigated social anger. Can China afford the continuation of these past problems? Can tax reforms help improve China’s political and legal systems today? The answer to the first question is definitely no. The answer to the second question will depend on how tax reforms evolve. Importantly, if a tax reform could result in fair taxation of all citizens of China, there will be potential for a meaningful political and legal improvement in the state that continues has a long-lasting legacy of the past.