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Fiscal reform, decentralization and poverty alleviation in the context of China’s 12th Five-Year Plan

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China is said to be one of the world’s most economically decentralized countries. While the claim that economic as well as fiscal decentralization had much to do with the success of China’s reforms is controversial and it has been argued that China’s approach to administrative decentralization might over time threaten the success of the reform process, the highly remarkable extent of fiscal decentralization could have the potential to aid the effort at poverty alleviation, especially in the context of the ethno-regional dimension of the country’s poverty problem, and reduce the extent of social stratification and enhance stability. This paper analyses the various issues related to fiscal reform and fiscal decentralization in China in the context of the country’s 12th Five-Year Plan and explores the Plan’s implications for poverty alleviation and the overcoming of stratification.

Keywords: China; 12th Five-Year Plan; fiscal reform; poverty alleviation; decentralization

1. Introduction: 1994 fiscal reform’s implications for decentralization

The fiscal reform in 1994 at least in the short term has been seen to result in centralization or recentralization after the large extent of decentralization during the earlier reform period. As a result, the Chinese central State’s fiscal power has been greatly strengthened vis-à-vis the local (difang) in terms of the division of taxes. ‘Tax sharing’ (fenshuizhi) divided the taxes into the central taxes, local taxes and shared taxes. Through the tax system reform, income sources stabilized, tax sources concentrated, types of taxes with higher potential increased – though most of these are classified as central State’s fixed revenue or shared revenue of the central and local governments (and among the taxes, the largest one is the enterprise value added tax which is designated as a shared tax, of which 75% goes to central and 25% to local). On the contrary, local sources of revenue are almost all those small and medium taxes with unstable and scattered tax bases, those which are difficult to collect and administer, or with high cost of collection. Through such divisions, the proportion of central government revenue increased rapidly, turning the central-to-local ratio from 3:7 to 6:4. During the following decade, this level was maintained, but the central-to-local ratio of public expenditure over the same period remained at the 3:7 level. The 1994 reform represented the second phase of reform-era China’s fiscal decentralization. From the year 1978, when reform began, until today, public expenditure decentralization has been consistent throughout, but decentralization of revenue has experienced two stages:

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