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CHINA'S PUBLIC FINANCE

Chief Editor Lou Jiwei



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Preface

Public finance is not only an important topic in the study of theories of finance, it is also closely related to the reform and development of finance in practice. When China started to reform its economic system some three decades ago, the concept of public finance was put forward to serve the establishment of a new financial operating model that could fulfill the requirements of the emerging socialist market economy.

The major functions of public finance are those of fiscal revenue, financial expenditure and the regulation and control of finance.

“Public finance administration” refers to actions the government takes concerning the material resources, such as decision and plan making, organizing, coordinating and supervising. It is vital to adhere to such principles for public administration as justice, fairness, openness, standardization and transparency, which run through the whole course of financial operation. So, effective administration of public finance can ensure the smooth functioning of public finance.

Establishing and improving the system of public finance is of great political, economic and social significance. Done properly, it can promote the healthy development of the socialist market economy and guarantee the fundamental interests of the people. Moreover, it also represents the advanced culture and philosophy of financial administration.

Fiscal Revenue

Fiscal revenue is the money collected by the government to perform its functions of managing the economy and society. It is an essential task of public finance to build up steady, balanced and powerful state finances to ensure the construction of a society in which everyone lives a comfortable life.

Fiscal revenue can be classified into various kinds according to different criteria. If classified in accordance with structure and the characteristics of different types of money collected, fiscal revenue in China can be divided into three parts: tax, government charges and other income, with tax as the major source of national income.

Section 1 Classification of Fiscal Revenue

I. Tax Revenue

Tax is a form of revenue that the government compulsorily collects in accordance with set standards to perform its functions. Tax has three features: (1) compulsory: Taxes are compulsorily collected by the government in accordance with the law. As long as one has taxable income or engages in a taxable activity one has to pay taxes in full in accordance with stipulations of the tax

law. Therefore, the revenue from tax is stable in quantity. (2) Non-compensatory: The government has no duty to repay the taxpayer or give him/her anything in return. (3) Fixed rates: The government collects taxes in accordance with fixed rates as laid down in relevant laws. Unless an adjustment is made in the laws, the government has no right to adjust the tax rates.

The three features of tax make it a superior type of revenue. Taxes are not only a stable source of revenue for the government, they also give expression to the principles advocated in modern society, such as the equity principle, the financial ability principle and the principle of rule of law. Thus, taxes are used worldwide as the most important source of revenue for governments to implement their policies.

II. Government Charges

Government charges are the money a government gets from granting franchises or providing direct services. As a major subsidiary type of revenue, government charges are distinct from taxes in that taxes are collected by the government from the public to provide public services while government charges are fees paid by individuals or corporations for special services the government offers them. Government charges can be divided into two types: levies and statutory fees.

Levies are the money charged by the government for special services or franchises, for example, water charges, school tuition fees, parking charges, bus fares, park ticket fares. There are three kinds of government levies: direct charges for the use of communal facilities and consumption of products or services provided by the government; special public utility charges, which refer to those charged for the building, rebuilding or repair of communal facilities; and franchise charges for the grant of franchises to run such facilities as recreational centers or to erect buildings.

Statutory fees are compensation fees for the special activities or services provided by the government when it is performing social and economic administration functions. These fees can be divided into two types: administrative fees charged by administrative organs of the government, e.g., license fee, passport fee, trademark registration fee and commodity inspection fee, and judicial fees charged by judicial organs, e.g., fines and charges for legal services.

III. Other Income

Under the modern enterprise system, the state can both collect taxes in accordance with the law and share profit and interest as an assets owner from state-owned enterprises (including enterprises in which the state holds shares).

This kind of income includes fines, public property income and miscellaneous income. Fines come in the form of both money and goods. Public property income includes that from selling or renting public property, such as products of state-owned mountains and forests, housing belonging to government departments and other public properties. Miscellaneous income includes donations from international organizations and repayment of international loans.

Section 2 Current Tax System in China

The tax system in China has experienced three stages of development since the founding of the People's Republic of China in 1949. The first stage was from 1949 to 1978, and during this period the tax system was constantly adjusted to suit the planned economy. The second stage was from 1979 to 1993, during which period the old tax system was adjusted and amended to suit the

new planned commodity economy. And the third stage started in 1994. In this stage, the old tax system has been undergoing thorough reform to establish a new one in accordance with the requirements of the socialist market economy.

I. The Tax System Reform of 1994

This reform set the framework of the current tax system in China.

1. Reform of the Turnover Tax System

In the light of the turnover tax system widely adopted in other countries, value-added tax is levied in all the links of production and circulation. On this basis, excise tax is imposed on a small variety of products, and business tax is levied on labor services, transfer of intangible assets and sale of immovable property. The turnover tax system after the reform consists of value-added tax, excise tax and business tax, which are uniformly applied to both domestic and foreign-funded enterprises. The product tax imposed on domestic enterprises and the industrial and commercial consolidated tax imposed on foreign enterprises and foreign-invested enterprises have been repealed.

2. Reform of the Income Tax System

A consolidated domestic enterprise income tax system has been established through uniting the income taxes of state-owned, collective and private businesses. A consolidated individual income tax system has also been introduced through uniting the individual income regulatory tax, and income taxes levied on foreigners and private business owners.

3. Reform of Other Industrial and Commercial Tax Systems

This reform is characterized by three aspects: the scope of the

levy of resources tax has been enlarged; land value-added tax has been introduced to combat exorbitant profits in the real-estate business; and some other taxes have been adjusted; for example, market trading tax, livestock trading tax and special oil consumption tax have been repealed. The special excise tax has been merged into excise tax, and the salt tax is included in the resource tax. The collection of the animal slaughter tax and feast tax has been delegated to the local governments.

4. Reform of Agricultural Tax System

Taxes on farm and forest produce, livestock and aquatic products which originally belonged to the categories of special farm and forest produce tax, product tax and industrial and commercial consolidated tax, respectively, have been amalgamated. The scope of taxation has been enlarged, and the tax rates of some products have been somewhat reduced. The types of taxes have been reduced from 37 to 24. This reform can be considered to be the beginning of building a simplified and highly efficient tax system.

II. Adjustment and Improvement of the Tax System Since 1994

To improve the new tax system and solidify the achievements of the reform in 1994, China has made some adjustments to the tax system in accordance with the development of the economy as a whole, and the emergence of new situations and problems.

1. Changes in the Turnover Tax System

Turnover tax is a general term referring to all kinds of taxes levied on commodities, including value-added tax, excise tax, business tax, etc., in the current tax system of China.

(1) Adjustment of value-added tax system

To implement the state industrial policies, the government

has reduced the value-added tax rates of farm produce and agricultural machinery, and made clear the kinds and range of farm produce on which value-added tax is to be levied. The VAT on waste materials purchased by common value-added tax payers can be reduced by 10 percent. The criterion of common commercial taxpayer has been redefined, and the rate of value-added tax imposed on small commercial taxpayers has been reduced. The deductibility rate of income VAT for farm produce the common taxpayer purchases from farmers has been raised from 10 percent to 13 percent. The taxable threshold of value-added tax on goods sold and taxable services has been raised appropriately.

(2) Adjustment of the excise tax system

Excise taxes are imposed, to fulfill the requirements of the government finance or to achieve the regulatory purpose, on some products (mainly consumer goods) after value-added tax is levied. Eleven major types of products (e.g., cigarettes, alcoholic drinks and cars) are liable to excise tax. On April 1, 2006, the Ministry of Finance and the State Taxation Administration issued a joint notice adjusting the current excise tax items, excise tax rates and related policies. This was the largest adjustment in excise tax since the reform of 1994. Six new items, including processed oil, disposable wooden chopsticks and wooden floorboards, have been added to the list of taxable items. Some consumer goods that were regarded high-grade and luxury have become popular products. In consideration of the fact that body and hair care products, such as shower cream and shampoo, have become commodities of popular need, the "body and hair care products" have been eliminated from the list. In addition, the government has reduced the tax rate on automobile tires from 10 percent to 3 percent.

(3). Adjustment of the business tax system

The business tax rate of recreational venues, such as night clubs and ball rooms, has been unified to 20 percent since 2001. Business tax is not levied on such business incomes as dividends

got equity investments in intangible assets or real property, and income from transfer of shares. The taxable threshold of business tax paid on a transaction basis has been raised slightly.

2. Improvement of the income tax system

Aiming at reducing the gap in pre-tax deduction between domestic and foreign-invested enterprises, the taxable salary standard of domestic enterprises is being gradually raised, as is the deduction rate for special donations by domestic enterprises. The application of the preferential policy allowing the outlay on R&D to be deducted for taxable receipts has been extended to all kinds of industrial enterprises. Since the macroeconomic situation has changed, individual income tax has started to be re-levied on individual deposit interests. To solve the problem of cascading taxation of individual businesses and partnerships (which used to pay both enterprise and individual income tax), and to promote the development of individual and private businesses, sole proprietorships and partnerships are not required to pay enterprise income tax, although their owners still have to pay individual income tax.

Section 3 The Current Financial Administration System — Revenue-sharing Scheme

Since the People's Republic was founded, China's finance system has undergone several changes and adopted several forms. Generally speaking, during the period 1949-1978 the finance system was characterized by "unified revenue and expenditure"; during the period 1979-1993 it was changed into "separate revenue and expenditure"; and in 1994 the revenue-sharing scheme was adopted.

I. Basic Content of the Revenue-sharing Scheme

1. Division of Revenue

Revenue is classified into fixed income of the central government, fixed income of the local governments, and income shared between the central and local governments.

The fixed income of the central government includes tariffs, excise tax and value-added tax the customs collect, other excise tax, income tax paid by enterprises directly under the central government, income tax of local banks, foreign-invested banks and non-bank monetary enterprises, money turned in by the railways, head offices of banks and head offices of insurance companies (including business tax, income tax, profits and urban maintenance and construction tax), and profits turned in by enterprises directly under the central government.

The fixed income of local governments includes business tax (not including that paid by the railways, head offices of banks and head offices of insurance companies), income tax of local enterprises (not including the income tax paid by local banks, foreign-invested banks and non-bank monetary enterprises mentioned above), profits turned in by local enterprises, individual income tax, urban land-use tax, tax on fixed assets investment to rationalize such investment, urban maintenance and construction tax (not including that part paid by the railways, head offices of banks and head offices of insurance companies), house property tax, vehicle- and vessel-use tax, stamp tax, animal slaughter tax, farming and animal husbandry tax, special farm produce tax, cultivated-land-use tax, deed tax, inheritance and gift tax, land value-added tax, and income from leasing of state-owned land.

The income shared between the central and local governments includes value-added tax, resources tax and security exchange stamp tax. Of the income from value-added tax, 75 percent goes to the central government, and 25 percent to the local governments. Income from different categories of resources tax is shared

differently, with the local governments getting most categories of income from resources tax, while the central government getting that from the offshore oil resources tax. The security exchange stamp tax is divided 50-50 between the central and local governments.

2. Division of Expenditure

The expenditure of the central finance includes expenditure on national defense and armed police forces, administration costs and service expenditure of the central government, expenditure on key construction projects, and expenditure on adjusting the structure of the economy, coordinating the development of different regions and performing macro control. The major expenditure of local governments includes local administration costs and service expenditure, expenditure on basic construction and technology innovation, expenditure on supporting farming, on city maintenance and construction, expenditure on price subsidies, etc.

3. Local Tax Authorities and Central Tax Authorities

In accordance with the revenue-sharing scheme, two sets of tax authorities — local and central — have been established to be in charge of tax collection, respectively. The State Administration for Taxation and the customs are in charge of the collection of taxes that go to the fixed income revenue of the central government and the income shared between the central and local governments. The local taxation authorities are in charge of the collection of taxes that go to the fixed income revenue of the local governments.

II. Perfection of the Revenue-sharing Scheme

Since 1995, on the basis of stabilizing the revenue-sharing scheme, the Chinese government has taken the following meas-