Chapter 2
Some Basic Works

Constructing China's public finance index system is no doubt a new job and there is no existing path to follow. We have to start from scratch for many things.

The following interrelated issues obviously have the significance of laying foundations.

2.1 Atypical Market Economy

The very first proposition is that on which institutional context that China's construction of public finance should base.

Looks like this proposition has been solved for long. The word Public Finance went into our vision during the process of China's market-oriented reform after all. Since we have established the reform objective of socialist market economic system, and entered a new phase in the way of leading to a perfect socialist market economic system; it is an obvious choice to constructing the public finance construction indicator system under the context of socialist market economic system.

However, when executing the screening of indictors and trying to express the overall framework based on their intrinsic links, we realized that the knowledge of institutional context has to be deepened rather than staying in the general level.

The socialist market economy is not simply a replica of so-called standardized market economic model after all (Dapei and Xiaoge 1996). Compared to the so-called typical market economy which is represented by the U.S. and European countries, there are many differences in the market economy that China is constructing and finally completed (Yining 2003). A large developing country, institutional transition country and ancient civilization country are the fundamental national conditions of China. Adhere to the principle that fitting general rules of market economy with China's fundamental national condition is the successful experience of more than 30 years of opening up and reforming, as well as the only way to improving socialist economy. Noting the above mentioned facts, and in

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order to constructing public finance construction indicator system on the basis of profound understanding and highlighting China's fundamental national conditions, we name China's socialist market economy as "Atypical market economy" (Peiyong 2005).

Fundamentally speaking, public finance is not entirely exotic. China's public finance construction indicator system in the context of "Atypical market economy" should also be rooted in China's national conditions, drawing all human society civilization achievements with great courage and a product of organically integrating both. Therefore, the complete set of public finance concepts, rules and institutional arrangements that are adapted to typical market economic countries could be used as one of the models for China's public finance construction; however, not be copied or transplanted. It is inevitable to be acclimatized and made it "half-cooked rice", or even be departed from the established direction by doing so.

We decided that China's national conditions as well as the taxation system and its general characteristics in market economy are the basic clue of China's public finance construction that we can follow, as well as the fundamental point of us constructing China's public finance construction indicator system.

2.2 Essential Feature of Public Finances

The second proposition is how to summarize or refine the essential characteristics of public finances?

Public finance is a concept that has not reached a broad consensus and been clearly proofed in China so far although the discussions around it has been going on for more than 30 years. Because of this, regarding the understanding and interpretation of public finance, there are people who literally looking at the wordings, and people who has restricted understanding and stays on the surface phenomenon, also people who confuse it with other related concepts. The discussion, disputes and controversies are absolutely necessary and should be continued in a long term. Promotions in practical level shall not hesitant because of the divergent theories. Constructions of China's public finance construction indicator system apparently has to start from summarizing or refining the essential characteristics of public finance.

Logically speaking, there must be some special meanings that are different from the concept of conventional "finance" by putting the words "public" and "finance" together to form "public finance". Therefore, amongst the ongoing discussions about public finance, there is one topic that one cannot walk around is what exactly are the differences between "public finance" and conventional "finance".

Based on the same logic, "public finance" is obviously transformed from the conventional "finance". One can also say, "Public finance" is a new concept formed based on the conventional "finance" (Shangxi 2000b). The question is, if the difference is manifestation of "public", there must be cone kind of "non-public" characteristics in the conventional "finance", or at least lack of "public" characteristics in certain area.

In fact, regardless of the degree of subjective perception, from the day that the concept of "public finance" is raised and treated as reform objective, one important work that costs us lots of energy is to find the differences between "public finance" and the conventional "finance". And there were some dramatic experiences when summarizing the "non-public" characteristics of the conventional "finance".

Initially, there were many people, including some of us (e.g. Tifu 1999; Peiyong 2000b), treated the "non-public" as production and construction expenditures, and therefore explained public finance construction as financial expenditures quitting the fields of production and constructions. However, with the moving of time and progressing of practices, people quickly noted that it is in line with the market-oriented reform by financing mainly public service area and reducing production and construction expenditures correspondingly. However, reducing is not quitting. What needs to be reduced is restricted to the expenditures in the competitive field. The public services that government needs to fulfill have to include production or providing public facilities and infrastructures in any social form and economic systems. The productions or supply of public facilities and infrastructures are certainly part of production and construction expenditures and certainly do not exclude the nature of public.[1] Therefore, it is absolutely necessary to reduce the financial investments in production and construction areas, however, it is not the substance of public finance to let financial expenditures quitting production and construction fields or even make it the direction of financial expenditure structure adjustment.

There are also many people (e.g. Xin 1999, 2004a) treated the planned economy finance as a typical representative of "non-public", and tried to reveal the meaning of public finance construction from institutional differences between planned economy finance and market economy finance, and therefore identified public finance as the product of market economy or the financial model that adapts to market economy, even made public finance equivalent as western finance.[2] However, taking it from here and overlooking the overall development history of finance, in the financial expenditure model led by production and construction expenditures during planned economy era, many items that can be categorized into production and construction expenditures, including urban infrastructure and social welfare facilities, are typical public expenditures themselves, not to mention there are many public government expenditure projects including water conservancy, roads and bridges, relief spending, sacrifice and even military spending in thousands of years of pre-market economy in human history. Therefore, equalizing market economy finance and public finance, while categorizing all non-market economy finance as non-public finance, is not able to explain the financial system

[1]Many people criticize public finances, it is also based on, seize it.

[2]Its representative explained that public finance is the provision of the public in a market economy country. Assign activity or distribution of goods or services co-relations, government revenue and expenditure patterns or financial operation mechanism model to meet public needs, which is a type of financial and market economy and a market economy prevailing financial system and financial system.

and its running patterns in pre-market economy, not able to explain public expenditures projects in planned economy, also is not able to clarify the motivation and pattern of government who acts as social administrator as well as other action objects.

There are also people who applied subjective simplification to public finance, and prominently showing as two poles, one is regarding public finance as a new category and a new subject which is different from the conventional finance, the other one is regarding it as a fashioner concept with no difference from the conventional finance in contents. The former makes public finance against conventional finance areas and financial subjects, it tries to explain it as a new area and new subject, and furthermore comes out with new names such as "public finance study", "public finance specialization" and "public finance direction". The latter replaces all the places that use "finance" as "public finance" without giving it any substantial meanings, and furthermore comes out with new sayings such as "public finance budget", "public finance revenue", "public finance expenditure" and "public finance policy". There are even people advocate renaming Ministry of Finance to Ministry of Public Finance, renaming the Department (Bureau) of Finance to Department (Bureau) of Public Finance.[3] Follow the clues and one can understand that it is difficult to justify whether regarding it as a new subject or a replica of old concept. For example, according to the logic of the former, as the minimum requirements for a new area or subject, public finance should have new connotation, denotation, research subjects or methods that is different from the conventional, which does not occur on public finances. The connotation, denotation, research subjects and methods has no difference from conventional finance. Another example, according to the logic of the latter, replacement of the concept of public finance and conventional finance is just an act of fashionable or superfluous with no actual meanings (Gong 1999). One just need to turn on the word replacement function, all the public finance work can be completed instantaneously by renaming. This is certainly not the truth. Therefore, although the above mentioned are two extremes, neither of them touch the substance of public finances. They are misreading of public finance to a certain extent.

There is new saying about public finance in recent years in the midst of the tide of focusing on improving people's livelihood. Some people equalized public finance with livelihood finance, even regarded whether finances are used for people's livelihood as the distinction between public and non-public. We should admit that we used to put big amount of financial investment in production and construction but neglected improvement of people's livelihood in the era of planned economy. During the process of transaction to market economy from planned economy, we committed the mistakes such as "drained the child together with bath water" and pushed many people's livelihood items to the market. Therefore, there are a lot of financial debts accumulated in the field of people's livelihood along the

[3]There were even more sayings that have been seen on media, such as "public finances to pay for teacher education", "public finance helps countryside children to continue their education", etc.

way. It is absolutely necessary right now to increase financial inputs to people's livelihood and emphasis on the urgency of improving it. However, one must notice that to improve people's livelihood id not the only function of finance. In addition, typical public matters such as national defense, foreign affairs, environmental protection and social management are all public matters that finance must be responsible for. The current preferential policies for people's livelihood only means that this field is the bottle neck as compared to other fields and needs to be focus on. It does not mean that the responsibilities of finance are only to improve people's livelihood, it does not mean neither that only people's livelihood matters are of the nature of public. Therefore, going from one extreme to another, mistreated the current compensatory moves to improve people's livelihood as the entire contents of public finances is obviously one-sided and not the essence of public finances.

The difficulties that are encountered in the process of differentiating public finance and conventional finance actually reflect the particularity of China's public finance, which is a product that rooted in China's reform practices. Thus, for the definition of essence of public finance, one must get out the boundary of pure academic thinking but extend to the special historical background of institutional transition, and complete it with systematic summary and profound grasp of reform history.

Realizing that public finance is a flag indicating direction of reform and formed in the historical background of China's institutional transition, one can obtain the judgment that the first object of public finance reform is definitely conventional financial system operation pattern. And furthermore, the non-public feature of conventional finance has to be found from its taxation system.

By connecting China's finance system operation pattern before reform and the economic and social background that it rooted in, one can summarize the financial operation pattern under conventional system as follows: Financial revenues are mainly from state sector; financial expenditures are mainly invested in state sector; fiscal policy tends to discriminate between state and non-state sectors. Take the situation in 1978 for example, 86.8% of national financial revenue were from state sectors, and 85.6% of national expenditures were used in state sector. Such kind of financial income and expenditure pattern of "do one's own things with one's own wealth" clearly reflected the distinct orientation of fiscal policy, which was to develop and grow state-owned economy but to weaken and even eradicate private economy.

The reason why financial operation pattern was like mentioned above is related to the dual economic and social systems during that period of time. As an important part of a dual economic and social system, financial system had to be constructed on the basis of dual systems, which is to implement different rules for different forms of ownership as well as between urban and rural. Therefore, doing one's own things with one's own wealth and engaging discriminate systems between self-owned and others became the only choice of fiscal and taxation systems during that period of time.

Furthermore, due to the dualism of the taxation, its coverage is selective but not comprehensive. The financial benefits it provides is definitely biased but not equal.

Therefore, there formed the situation that different areas, different companies and different residents have different financial coverage due to difference in coverage, despite belonged to the same nation, living on the same land and governing by the same government.

If the ranges of coverage and thus caused differences in financial benefits are used as the evaluation standard, the salient features of the dual finance systems in traditional system can be summarized as following three points:

First, the state-owned financial system which is bounded by ownership, and the revenue and expenditure activities under traditional system are mainly completed inside state-owned sectors. As for the non-state-owned sectors, they are either outside the coverage of finance system or on the edge of covered zones. Even if there are financial revenue and expenditure activities that involves non-state-owned departments, especially financial expenditure, they are normally of small amounts and shares. Or they are arranged in a limited specific field, for a special project, in a special place or for a special purpose.

Second, the municipal finance. Fiscal income and expenditure activities in traditional system are normally done inside urban area. As for the broader rural areas are either outside or on the border of financial coverage. Even there are some financial activities, especially expenditure activities, cover the rural area, they are normally of small amounts and shares. Or they are arranged in a limited specific field, for a special project, in a special place or for a special purpose.

Third, production and construction finance. Categorized by the nature, fiscal expenditure activities in the traditional system are mainly in the fields of production and construction, which is to say, production and constructions expenditures lead overall fiscal expenditure.[4] Non-production and non-construction expenditure projects, which are mainly expenditures of public service nature represented by improving people's livelihood, are always placed in subordinate positions or at the periphery. They are not only of small scales and shares, also are the first ones to be cut in the fiscal difficult years.[5]

Selective instead of complete financial coverage, un-equalize instead of fair financial package, focused on production and construction instead of overall public service fields, such a fiscal and taxation system and the financial operation pattern as the result, are clearly not public, or at least its nature of public is discounted. In fact, what stated-owned finance, urban finance as well as production and construction finance highlighted are exactly the non-public characteristics of traditional fiscal and taxation system. In other words, the non-public characteristics of

[4]Expenditure projects in this category mainly include three expenditures, which are capital expenditures, additional business flow capital, realising potential and transformation as well as science and technology; additional working capital for state-owned companies, geological exploration expenditures, capitals to support rural production, and operating expenses for transportation and commercial sectors.

[5]Because of this, people called China's fiscal system as "production and construction finance" in that period of time, and called typical market economy state finance which tends to pubic service expenses as "food finance".

traditional fiscal and taxation system is epitomized in its relative narrow coverage, or is epitomized in not able to completely cover all areas, enterprises and residents, not able to treat all areas, enterprises and residents fairly, not able to bear the responsibilities of providing comprehensive pubic service system.

However, things have changed today after more than 30 years of reform and opening up.

On financial revenue side, the structure of tax revenue sources was already 20–80 model in 2007, which is, tax revenue contributions of state-owned entities has dropped from 86.8% in 1978 to 19.2%, even taking into account of contribution of collective economic units (1.6%) to calculate both pure and partial state-owned economic entities, it was only 20.8%. At the same time, enterprises with a variety of ownership including joint-share enterprises, private enterprises and foreign invest enterprises, together with payments from other sources, accounted for 79.2%. Moreover, the growth rate of the share of contribution from the latter is becoming stronger and stronger. Therefore, we can say that fiscal revenue pattern in China is more diversified, it is changing from "taking one's own wealth" to "taking everyone's wealth".

On the expenditure side, shares of capital expenditures dropped from 40.2% in 1978 to 11.33% in 2006. If the non-recurring infrastructure investments arranged by issuing long term construction bonds were excluded (60 billion), the actual share of capital expenditures was less than 10%. At the same time, other investments specially for state-owned economic entities were declined substantially as well. For example, additional enterprise working capital investments (0.04%), innovation funds and technology promotion expenses (4.5%) dropped 5.86 and 11% respectively as compared to 1978. In contrast, shares of social security expenditures for the entire society including pension subsidies, basic allowance for laid-off workers in State-owned enterprises, subsistence allowances for urban residents, pensions and social welfare expenditures, education, science and health expenditures, and subsidies policy expenditure increased to 11.25%, 18.69% and 3.58% respectively.[6] Therefore, we can say that the pattern of China's financial expenditure is also diversified and changing from "Do one's own business" to "do everyone's business".

On fiscal policy side, discrimination has already become an outdated concept in China nowadays. Instead, civilization package, non-discriminatory package and equalization became familiar terms. No matter it is tax burden or arrangements of fiscal expenditures, all areas, enterprises and residents are treated equally, moreover, all areas, enterprises and residents enjoying roughly the same basic public service has become a broad consensus and being deepened on financial practices level gradually.

[6]New classification of fiscal revenue and expenditure was implemented in 2007. Due to differences between old and new system, there is no data available so far that is compatible with data in 1978. Therefore, data of 2006 are used here.

From "taking one's own wealth" to "taking everyone's wealth", from "do one's own business" to "do everyone's business", from discrimination between one's own and others' to civilization package in whole society, changes of financial operation pattern are clearly happened in the context of institutional transitions. In other words, it happened during the process of China's dual structure economic society system and fiscal system transiting to uni-structure.

Using coverage and thus formed fiscal treatment differences as scales of assessment, the prominent changes of China's fiscal and taxation system can be summarized in three points as shown below:

First, from state-owned finance to a variety of ownership finance. Financial coverage is no longer separated by ownership, instead, it broke the limitation of state-owned sectors, and extended to a variety of ownerships including state-owned and non-state-owned.[7] In other words, the foothold of financial revenue and expenditure activities has extended from focusing on the needs of state-owned departments to the public needs of the whole society.

Second, from urban finance to integrated urban-rural finance. Financial coverage is no longer separated between urban and rural, Instead, it broke the limitation of urban area, and extended to all the territories of China including urban and rural, as well as all the community members.[8] In other words, the foothold of financial revenue and expenditure activities has extended from enterprises and residents in the cities to all the enterprises and residents including urban and rural.

Third, from production and construction finance to public service finance. Financial expenses are on longer focused on production and construction matters, it extends to all the public service matters including infrastructure construction, social administration, economic regulation and improving residents' livelihood and so on.[9] In other words, financial expenses gradually expanded from focusing only on production and construction to every field of public service.

Up to here, it can be seen that alone with the transition process of economic and social system, changes of China's fiscal and taxation system are mainly embodied in its expanding coverage. Expanding coverage gradually and implementing non-discriminatory treatments step by step undoubtedly are the signs of its nature of public keeps increasing and becoming more manifest. Therefore, jumping from "state-owned finance plus urban finance plus production/construction finance" to "variety of ownership finance plus urban-rural integrated finance plus public service finance" is the major changes of China's fiscal and taxation regime in the past 30 years, it is also the basic footprint of transiting from non-public to public.

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[7]A prominent example is the establishment of urban residents subsistence allowances system, there used to be a very popular media language saying: "capitalism or socialism, everyone can receive their urban subsistence allowances."

[8]Financial management once had a statement about this: "Public finance covers rural" and "let the sun of public finance shine on rural."

[9]Especially the financial expenses on peoples' livelihood matters including education, healthcare, social security, housing and environmental protection were greatly enhanced.

Things do not end here. A more profound change appeared in China's fiscal and taxation system with continuous expansion of financial coverage.

In the context of "state-owned finance plus urban finance plus production/construction finance", finance revenue and expenditure activities affect mainly state-owned sectors, urban areas and are carried out around production and construction matters. Moreover, when looks further, it can be seen that in that specific period of time and under the specific circumstances, state-owned sectors were mainly located in cities, also production and construction expenses were operated in the closed system of state-owned sectors. Therefore, from the ownership perspective, these three levels are highly overlapped, financial revenue and expenses are expressed as revenue and expenses within state-owned sectors themselves. Since it their own business and own choice, even there are certain regulations, its operation can stay within state-owned sectors and no need to be publicize and no need to be adapted to common regulation and concept of the entire society.

However, in the context of "multi ownership finance plus urban-rural integrated finance plus public service finance", financial revenue and expenditure activities affect sectors with various ownership including state-owned and non-state-owned sectors, affect all territories of China including urban and rural areas and all members of society, also happen around entire public service matters that are focus on meeting social public needs. Under such circumstances, financial revenue and expenses has already out of state-owned sectors and become the revenue and expenses of entire society. Once financial revenue and expenses are operated in the entire society, once the vital interests of entire social member us affected, as a public matter and public choice, it has to be incorporate into public track and based on the common rules and philosophy of the entire society.

It is very important to realize this. It tells us that the nature of public can be used to summarize the essential characteristics of public finance. The process of going public can be used to summarize the process and direction of China financial reform and development, and implementing substance of China's public finance construction on financial system reform that highlights the nature of public.

In other words, the nature of public is the soul of China's public finance construction, only by holding this, the construction of China's public finance indicator system will not fall into the paradoxical stereotypes.

2.3 Ideological Foundation

China's public finance construction index system has to be constructed on certain ideological foundation. Clearly identify the sources of these ideas and thereby gain strong support is the third proposition that we have to face.

We believe that the reason why targeting China's financial reform and development as public finance construction during the process of market reform is due to support of public finance ideas that are adapted to market economy system. The

sources of China's public finance ideas can be identified from the interconnection between theory and practice, ideals and realities.

On theoretical level, main clues that go into our vision include welfare economics, institutional economics and other related ideas and methods in addition to Marxism economics as guidelines, it includes also over 20 years of researches of Chinese financial economists on public finance construction. On practical level, main clues that go into our vision include typical practices of market economy countries, and experiences of institutional transition countries, as well as practices of over 20 years of China's fiscal and taxation reform. We can see that it is by the support of these theories and practices that China's public finance construction can achieve such a process so far. Such theories and practices and the close integration between them can be an important ideological foundations of China's public finance construction index system.

Look further, no matter it is the past, present or future, China's public finance construction naturally has to sustenance in the ideal pursue of us on China's fiscal reform and development. These pursuing of ideals come from our own and everyone in academia, government and other related fields. Based on abstract and put these pursuing into practice are exactly the tasks of China's public finance construction index system. However, transiting from fiscal system of planned economy system to that of market economy, one has to start from the reality. Drawing fiscal system blueprint that is in line with "better well-off society for the benefit of over one billion people" has to be rooted in real national situation. What we should do is one thing, what we can do is another thing. Realizing integration of theory and practice based on profound grasp of the reality is the only way to effectively promote public finance construction. We believe that such integration of theory and practice can be another important ideological foundation of China's public finance construction index system.

2.4 A Brief Summary of Existing Reform Process

Getting close from nonpublic to public, use the publicize process as clue, we can roughly classify the process of China's fiscal and taxation system reform so far into four independent but also interconnected stages:

Stage One: 1978–1994

China's economic system reform started from the field of distribution. The main theme identified initially was devolution of power. Reform enthusiasms of all aspects were stimulated by devolution of power, and the vitality of national economy that was choked by traditional economic system was greatly improved. In the early stage of reform, the rights that government can release were mainly financial administration rights. The benefits that government can share were mainly shares of finance in national income distributions. By linking the overall methodology of reform with the reform tasks of taxation system itself, which is to start

from decentralization of financial power and resources, to break or change the traditional system pattern of "over centralized financial rights, unified revenue and expenditure allocation, too few classes of taxes", we have the following reform initiatives:

First, regarding the financial distribution pattern between central and local government, "separation of food supplies" were implemented. Since 1980, institutional models such as "decentralize revenue and expenditure", "differentiate classes of taxes, approval of revenue and expenditures", and "contract by increasing incomes, share of total revenues, share of total revenues plus dividend of growth, fixed amount contract, fixed amount subsidy" were implemented in different stages.

Second, regarding the distribution relationship between government and enterprises, "cut tax and share profits" were implemented. Since 1978, institutional models including corporate funding system, profits keeping system, first and second steps of tax for profits, different forms of profit and loss contract system as well as different forms of contract responsibility systems were implemented in stages.

Third, regarding tax construction system, implementation of "complex tax system" was mainly focused on. The relatively simplified tax structure has been changed since 1980 by reforms such as establishing foreign tax system and domestic enterprise income tax system, thoroughly adjusting industrial and commercial tax system, establishing personal income tax system, restoring and improving tariff system, and improving agricultural tax system, a multi-link and multi-level complex tax system with turnover tax and income tax as main body, cooperating with other taxes were established.

Fourth, providing "financial security" when coordinating with other areas of reform. By paving the way with a lot of financial expenditures, it supported the introduction of reform measures in areas such as price, wage, technology, education and other related fields.

The above-mentioned reform measures played the groundbreaking role in exchanging steady advance of reform initiatives and smooth progressing of overall reforms. However, decentralizing power and giving up profits are both in fact paid up by reducing financial income and increasing expenditures. Reforms with main tone of "devolution of power", which are mainly supported by finance, in return ran fiscal income into a difficult unbalanced situation.

On one hand, along with the implementation of various measures of "decentralizing power" and "giving up profits", the proportion of fiscal income in GDP and the proportion of central government fiscal income in nation fiscal income declined rapidly: the former have decreased from 31.1% in 1978 to 25.5% in 1980, then 22.2% in 1985, 15.7% in 1990 and 12.3% in 1993; while the latter increased first and then decrease, which was 15.% in 1978, 24.5% in 1980, 38.4% in 1985, 33.8% in 1990 and further decreased to 22.0% in 1993.

On the other hand, fiscal expenses did not drop, but rather increased dramatically because of "power devolution" and "giving up profit" measures (such as price subsidies for unbalanced agricultural product prices, and increase of special funding for increasing wages for administrative units' employees, etc.). Fiscal expenditures

increased from 112,209 million in 1978 to 464,220 million in 1993, which was an increase of 2.1 times in 15 years and an average annual increase of 21%.

At the same time, there was a lot of disordered phenomenon in the financial operation mechanism. Issues such as unauthorized tax relief, inappropriate interception of fiscal revenue, reckless spending, circulating revenues outside fiscal system and involvement of non-financial departments in fiscal allocation were relatively common.

One of the important results of rapid decreases and consistently low of the "two proportions", rapid increase of fiscal expenditures and chaos state of financial operation mechanism was not only that fiscal deficits kept increasing and debts kept expanding year after year, but also central government faced such unprecedented huge difficulties that made it hard to be responsible for macro-control.

From 1979 to 1993, there were fiscal deficits in every year except 1985, which were getting bigger and bigger. The deficit was 6.89 billion yuan in 1981, which rose to 14.69 billion yuan in 1990 and further increased to 29.335 billion yuan in 1993. If debts incomes were calculated into deficit according to common international practice, the actual deficit in 1993 were 97.858 billion yuan.

Central government restarted borrowing foreign debts which had been stopped for 20 years in 1979. It then began to borrow domestic debts in the form of Treasure Bills. Focused construction bonds, financial bonds, national construction bonds, special government bonds and hedge bonds were issued later. Fiscal income from issuing debts has reached 73.922 billion yuan in 1993.

In terms of dependent level on debts of central government (debt income/(central government level fiscal expenditure + central government debt expenditure)), it has reached a rare international level of 59.63% in 1993. It means that more than half of the central government level fiscal expenditure came from debt or loan income.

Stage Two: 1994–1998

Such difficult situation soon calmed down people from the joy of enjoying fruits of reform. Aware that reform by "power devolution" is not sustainable, the decade-long fiscal reform would naturally need to go through a major adjustment, which was to transform from adjusting interests pattern to establishing new systems. The 14th CPC Congress also officially established the reform goals of the socialist economic system in Oct 1992, and the "CPC Central Committee's decision on a number of issues in establishing a socialist market economic system" was adopted in the Third Plenum of the 14th CPC Congress in November 1993. Therefore, China's tax system reform embarked on an innovative way since 1994 by focusing on establishing a tax system which is suitable for socialist market economy.

A series of major tax reform initiatives were launched by government on the very first moment in 1994:

First, a new taxation system was built by a comprehensive reform of tax system, in accordance with the principle of "unified tax law, fair tax burden, simplified tax system and reasonable power devolution", through the actions such as setting up a

turnover tax system with value-added tax as the main body and supplemented by consumption and business taxes, unifying domestic enterprise income tax, establishing unified personal income tax system, expanding the scope of resource tax, levying land value-added tax and establishing fundamental norms which is suitable for needs of socialist market economy.

Second, on the basis of central and local government reasonably determining scope of fiscal expenditures of different levels, tax was unified divided into central tax, local tax and shared tax, central and local government tax system were established, central and local tax authorities were set up separately, tax rebate and transfer system by central government to local offices was implemented, the basic framework of the tax management system was set up.

Third, in accordance with the fundamental requirements of establishing a modern enterprise system, while reducing income tax rates for state-owned enterprises, cancelling energy and transportation key construction funds and budget adjustment fund, a unified tax rate of 33% for state-owned enterprises was implemented according to national tax law, state-owned enterprises profits distribution system has gone through a comprehensive reform.

Fourth, overdraft or loan from the central bank was eliminated, all the fiscal deficits need to be compensated in the way of Treasury borrowing; therefore, the inevitable link between deficits and inflation was cut off systematically.

This is a very important turning point. Previous tax system reform initiatives were mostly elaborated around adjusting pattern of interests. Moreover, they were also planned in the background of no clear overall reform targets. The significant difference of this reform is that it broke the thinking of "devolution of power", and embarked on the way of mechanism transform and system innovation. It started from reconstruction of taxation system and its operating mechanism to adapt to the socialist market economic system; in choosing content and scope of reform, it included both appropriate adjustment of patterns of interests and establishing of new taxation system; it focused on the transformation of taxation operating mechanism, which was exactly the focus of fiscal reform in 1994.

So far, a series of positive changes in taxation fields in China that we valued and were proud of, such as, fiscal revenue stepping into track of continuous rapid growth, fundamentally reversing of continuous decreasing of the "two proportions", improving and strengthening of financial macro regulatory functions and the profit distribution between state-owned enterprises having basic norms, were all the fruits harvested from this fiscal reform. It can be said that the basic framework of fiscal system and its operating mechanism that are adapt to socialist market economic system has been initially built up through this fiscal reform.

Stage Three: 1998–2003

The fiscal reform in 1994 helped Chinese taxation system getting on the way of systematic innovation, however, it did not solve all the problems. Because it covered only government revenue and expenditures within the system after all, but did not cover those that were out of the system. Moreover, the fiscal reform focused

mainly on institutional changes of fiscal revenues which is represented by taxation system; although there are minor adjustments on fiscal expenditures, it was not focused on simultaneously. At the same time, constraints from existing interests group and motivations to increase fiscal income tied the reform to a certain extent, which made some of the practices with clear transitional or alternative tones.

With the gradual release of the results of fiscal system reform in 1994, various contradictions between government revenue/expenditure out of the system and fiscal expenditure were fully revealed and evolved into a bottleneck that affected distribution of citizen income and government revenue/expenditure process. Therefore, in the late 1990s, tax reform with the main objective as regulating government revenue/expenditure behavior and mechanism, and fiscal expenditure management system reform, has entered the heartland of Chinese fiscal system reform and thereby bring reform into reconstructing overall framework of fiscal system, which was to construct institutional framework of public finance.

On March 19, 1998, Premier Zhu Rongji said some shocking words in the first correspondent conference after being elected: "One of the existing problems is that there are more fees than taxes, many government agencies charge all kinds of fees beyond national regulations, which made people not able to bear the burden of resentment. It has to be reformed." China started the prelude of tax reform taking this as an opportunity.

In fact, even before the official launch of national tax reform, different regions have tried to control unauthorized charges by government agencies. The original saying is called "fees to taxes". Its main intention is to reduce burdens on enterprises and citizens by changing various fees to unified tax. Later, with deepening of reform and broadening of vision, it was realized that the drawbacks of existing government charges are not from the charge itself. A large number of existing items which were so called government charges were neither scrutinized by People's Congress nor included in budgets; instead, they were self-regulated by department or region as self-supporting source of incomes, or included in out-of-budget income, or included in out-of-system income, and were directly put into coffers of various departments or regions. Therefore, it is essentially a non-normative source of government revenue. The purpose of "fees to taxes" is clearly not to change all the original government charges into taxes; instead, it is to include non-normative government charges into normalized track. Thus, "fees to taxes" started to get out of the routine of "adjust accordingly" but to connect to the arrangement of overall government revenues including tax revenues. In this context, "fees to taxes" were replaced by "tax and charge reform", and then was given the special significance of regulating behaviors and mechanism of government revenue.

As the "tax and charge reform" getting deeper and gradually getting effective, reform on fiscal expenditure was also in progress. Below are some of the fields that went under the radar of reform: fiscal expenditure structure gradually expands from focusing on manufacturing and construction fields to optimization and adjustment of entire public service field; promoting "department budget system" which mainly focus on regulating budgeting and classification methods and comprehensively reflecting government revenue and expenditures; implementing "centralized

treasury collect and payment system "which allows Financial Department (State Treasury) to centralized collect all government income including in- and out- of budget revenues, also allows State Treasury to centralized pay all financial expenditures from one single account; promoting "government procurement system" which gradually incorporated all the direct government expenditures into public tenders.

However, no matter it was the adjustment on financial expenditures, or changes on financial income which was represented by "taxes and charges reform", it involved only certain parts but not all of the taxation system and its operating mechanism. When the limitations of the reform gradually became more and more obvious, the following consensus were finally reached: It is important to do local adjustments, however, without re-constructing the taxation system and its operating mechanism as a whole, and incorporating the local adjustments into the overall framework, it is impossible to build up a taxation system and operating mechanism that is adapt to socialist market economy. Thus, integrating all the taxation system reform matters including revenue, expenditure, management and system into a global framework, and promoting it as a system engineering were put on the agenda. At that time, it was also found that there was no other word rather than "public finance" could command all the clues of fiscal and taxation reform, and cover all the concepts of reform matters. Therefore, taking the opportunity of national fiscal work conference which was held on 15 December 1998, the decision makers made a landmark decision, which was to build the fundamental framework of China's public finance. From that time onwards, building frameworks of public finance which was the clear target for finance and taxation system reform and development, and with the nature of overall reform arrangements, were officially entered the track of finance and taxation system reform.

Stage Four: 2003 till now

Similar to socialist market economy system, which experienced a leap process from construction to completion; finance and taxation system reform also gradually went deeper and needed to be further improved, as the system reform whose core is building fundamental framework of public finance being processed steadily. After 5 years, the Sixteenth CPC Third Plenary Session was held in October 2003, and "The Decision of CPC Central Committee on a few issues of perfecting the socialist market economy system" (Hereinafter referred to as "The Decision"). In that meeting and in the important document, based on the judgment that public finance system framework has been initially established, the strategic objective to further improve and perfect public finance system was raised. Recognizing that a complete public finance system is one of the important parts of a complete socialist market economy system, and putting improving public finance system into the same game as improving socialist market economy system, made it understandable to propose ways to further promoting building public finance from the close connection of these two. Taking this as an opportunity, China's finance and taxation system reform started again a series of operations to further improve public finance system.

We have achieved significant process in these above mentioned terms: the process of public finance to cover rural areas has begun; the finance expenditures are leaning more and more to basic livelihood issues which are represented by education, employment, healthcare, social security and housing; increasing intensity of financial transfer payment and adjusting transfer payment system accordingly; taking implementing full-caliber budget management and government revenue and expenditure classification reforms as the starting points, strengthened budget supervision management, and further promoted standardization of government revenue and expenditure behaviors and mechanisms; etc.

It can be expected that taxation system reform will get deeper and deeper and deeper together with the progressing of overall economic and social reforms.

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