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FISCAL GOVERNANCE AND STATE CAPACITY IN CHINA



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Abstract: this article examines China's fiscal governance system and its contribution to state capacity. It analyzes the multi-tier government structure, four parallel budgets, taxation, state-owned assets, and central–local fiscal relations. Particular attention is given to the 1994 tax-sharing reform, local expenditure pressures, land finance, and the fiscal risks associated with intergovernmental imbalances.

Keywords: *fiscal governance; state capacity; China; budget; taxation; state-owned enterprises; local government; land finance*

Xitoyda fiskal boshqaruv va davlat salohiyati

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Annotatsiya: maqolada Xitoyning fiskal boshqaruv tizimi va uning davlat salohiyatini shakllantirishdagi o'rni tahlil qilinadi. Tadqiqotda hukumatlararo fiskal munosabatlar, to'rt parallel budjet, soliq tizimi, davlat korxonalari va davlat aktivlari ko'rib chiqiladi. Shuningdek, 1994-yilgi soliq islohoti, mahalliy budjet bosimi va yer moliyalashtirishining imkoniyatlari hamda xatarlari baholanadi.

Kalit so'zlar: *fiskal boshqaruv; davlat salohiyati; Xitoy; budjet; soliq tizimi; davlat korxonalari; mahalliy hukumat; yer moliyalashtirishi.*

Фискальное управление и государственный потенциал в Китае

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Аннотация: в статье анализируется система фискального управления Китая и ее роль в формировании государственного потенциала. Рассматриваются межбюджетные отношения, четыре параллельных бюджета, налоговая система, государственные предприятия и государственные активы. Особое внимание уделяется реформе распределения налогов 1994 года, бюджетному давлению на местном уровне и рискам зависимости от земельных доходов.

Ключевые слова: *фискальное управление; государственный потенциал; Китай; бюджет; налоговая система;*

государственные предприятия; местное управление; земельные доходы.

Fiscal governance refers to the institutional arrangements governing government revenue collection, budget allocation, expenditure supervision and intergovernmental fiscal coordination. State capacity denotes the ability of the state to mobilize resources, implement national strategies, deliver public services and stabilize macroeconomic activity. Fiscal institutions are therefore a central mechanism through which state capacity is exercised.

China provides an important case for examining this relationship because its fiscal system combines a multi-tier governmental hierarchy, several interconnected budget accounts, a tax-sharing arrangement, substantial state ownership and extensive intergovernmental transfers. The central research question is how these institutional arrangements contribute to the mobilization and allocation of fiscal resources while creating pressures at the subnational level.

The article aims to explain the institutional relationship between fiscal governance and state capacity in China, with particular attention to budget architecture, taxation, state-owned assets and central–local fiscal relations. It also identifies structural tensions associated with local expenditure responsibilities, land finance and fiscal sustainability.

The study uses a qualitative institutional analysis supported by descriptive analysis of official fiscal and economic indicators presented in the source material. The analytical approach combines institutional comparison, historical analysis and interpretation of aggregate fiscal data.

The empirical scope covers China's fiscal and intergovernmental arrangements, with particular attention to developments from the reform era to the most recent data reported in the manuscript. The analysis considers the four budget accounts, tax composition, government expenditure responsibilities, state-owned assets and central–local revenue and expenditure shares.

The study is descriptive and explanatory rather than causal. The available material does not provide an original econometric identification strategy; therefore, numerical relationships are interpreted as institutional and descriptive evidence rather than as causal estimates.

Five-Tier Government Hierarchy

We start with administrative setup, because every fiscal transfer, fund appropriation and policy implementation is built upon this vertical governance system. According to the 2024 official data released by the Ministry of Civil Affairs and China Statistical Yearbook, China adopts a five-level hierarchical government system:

- Central Government: 1 top administrative body, taking charge of national strategy, cross-regional major projects, national defense, foreign affairs and unified fiscal institutional design;
- Provincial-level governments: 34 in total, including provinces, municipalities directly under the Central Government, autonomous regions and special administrative regions,

• responsible for coordinating regional development and transferring funds to lower-level governments;
• Prefecture-level governments: 333 prefecture-level cities and autonomous prefectures, acting as the middle hub connecting provinces and counties;
• County-level authorities: 2,846 counties, county-level cities and urban districts, the core provider of daily public services;

Township governments: 38,712 townships and towns, the most grassroots governance unit directly contacting residents.

This multi-layer structure creates a long vertical fiscal chain. Central fiscal revenue needs to go through multiple rounds of transfer payments to reach county and township governments, which inevitably brings challenges in fund efficiency and supervision, and also explains why expenditure responsibilities are heavily concentrated at grassroots levels—we will elaborate on this later.

Visual Evidence of Economic Growth Supported by Fiscal Input

Now let's turn to the comparison photos on screen, which serve as intuitive evidence of how fiscal governance releases state capacity and drives urban and national development.

The first group is Shanghai Lujiazui photos: the 1987 black-and-white panorama shows low-rise old buildings along the Huangpu River, with almost no modern high-rises; the 1994 photo captures the Oriental Pearl Tower under construction; the latest full-color picture presents a world-class financial cluster with dozens of skyscrapers. The second group records old Beijing street scenes from 35 years ago: narrow roads filled with bicycles, small minivan taxis and few private cars, in sharp contrast with today's Beijing landmarks—the Bird's Nest National Stadium, CCTV Headquarters, National Centre for the Performing Arts and Financial Street.

All these landmark urban facilities, transport infrastructure, cultural venues and financial hubs are funded by combined fiscal resources from central and local governments, plus investment from state-owned enterprises. Urbanization, infrastructure upgrading and public cultural construction would never be possible without the resource mobilization capacity of China's fiscal system.

GDP Growth: Quantified Achievement of Fiscal-Driven Development

We can further quantify decades of economic take-off with GDP data. In 2024, China's gross domestic product reached 135 trillion yuan. Compared with the baseline year 1978:

Nominal GDP expanded 366.7 times due to economic expansion and price growth;

After eliminating inflation factors, real GDP grew 49.4 times;

The average annual real GDP growth rate over more than 40 years hit 8.8%, ranking top among major global economies.

We follow the standard national income accounting identity: GDP = Consumption + Investment + Net Export. Among the three driving forces, public investment financed by fiscal budgets and SOE capital expenditure plays a counter-cyclical

stabilizing role. During economic downturns, governments expand infrastructure fiscal spending to hedge insufficient private demand; during expansion periods, fiscal investment guides industrial upgrading and high-tech layout, which is a typical manifestation of China's strong fiscal state capacity.

The long-term GDP growth rate table from 1978 to 2024 further reflects the economic cycle. High-speed growth above 10% prevailed from the 1990s to 2007, followed by a gradual shift to medium-high growth after the global financial crisis, corresponding to the transformation of fiscal policy from simply pursuing scale expansion to focusing on high-quality development.

- **China's Government Administrative Structure and Economic Development**
- **Five-Tier Government Hierarchy**
- **Fiscal Inputs and Economic Development**
- **China's Expenditure Structure and Four Parallel Budgets**

The most distinctive institutional innovation of China's fiscal governance is the four parallel independent budget system, a design rarely seen in Western countries that only operate a single general public budget. The four budgets cover all government disposable resources, each with independent revenue sources, exclusive expenditure scopes and separate supervision mechanisms. Let's analyze each budget in detail with institutional logic and data characteristics.

General Public Budget (GPB) – Core Basic Budget

This is the most standardized, transparent and mature budget, regarded as the backbone of national fiscal operation.

Revenue composition: Over 85% comes from various taxes, with the rest from administrative fees, penalties and other general fiscal income;

Expenditure coverage: All mandatory basic public services that governments must guarantee, including social security and employment, compulsory education,

healthcare, national defense, public security, agriculture, forestry and water conservancy, science and technology, environmental protection, national debt interest payments, foreign affairs and disaster emergency management.

From the proportion tables on Slide 16 and 17, we can clearly observe the clear division of fiscal responsibilities between central and local governments:

Central government expenditure features high shares of national defense, national debt interest, central-level scientific research and foreign affairs. National defense spending is almost entirely borne by the central government, which matches its national security authority;

Local governments undertake the overwhelming majority of people's livelihood expenditures: education, medical care, pension and employment support, rural infrastructure and urban community construction account for the largest proportion of local fiscal outlays.

This division naturally creates a structural imbalance: central government collects

large-scale tax revenue but bears limited daily livelihood expenditure, while local governments face heavy spending pressure with insufficient tax revenue, laying the groundwork for transfer payment mechanisms and land finance supplements.

Government Fund Budget (GFB) – The Budget for Urbanization

The dominant revenue source of this budget is state-owned land-use right transfer income, widely known as "land finance" in academic research. The core institutional rule is earmarked revenue for earmarked expenditure—all land transfer proceeds cannot be diverted to general public service spending arbitrarily.

Specifically, land sales revenue is mainly used for four purposes: compensation for farmers whose land is expropriated, housing demolition resettlement compensation, preliminary land development costs and urban infrastructure construction. Over the past three decades, this budget has provided massive capital for China's rapid urbanization: urban roads, subways, municipal pipelines, public parks and industrial park supporting facilities all rely heavily on land transfer funds.

transfer income, local governments will face obvious funding gaps, which is one core challenge of current intergovernmental fiscal relations.

State Capital Operating Budget (SCOB) – Budget for State-Owned Capital

Its primary revenue comes from dividends and after-tax profit distribution of state-owned enterprises. At present, this budget system is only fully implemented at

The current ruling party selects the elements of tradition that serve its purposes, namely minben, meritocracy, and datong, and mutes those that do not. But the ease of the selection indicates how much shared grammar was available to begin with.

Placed side by side, the traditional and contemporary versions of the ideal order reveal the continuity clearly.

Corresponding expenditure items mainly include capital injection into loss-making or strategic SOEs, industrial transformation subsidies and investment in national strategic emerging industries. This budget is an important channel for the state to adjust industrial layout through state-owned capital, reflecting the unique institutional advantage of state ownership.

Social Security Fund Budget (SSB) – Independent Budget for People's Livelihood Security

Revenue mainly consists of social insurance contributions paid jointly by enterprises and individual employees, with small supplementary fiscal subsidies from the general public budget. This budget operates completely independently from other fiscal funds, and all income can only be used for pension, medical, unemployment, work injury and maternity insurance benefit payments.

Separating social security funds into an independent budget effectively prevents the occupation of security funds by other fiscal expenditures, forming a special protection mechanism for residents' basic living standards.

Comprehensive Summary of Four-Budget Institutional Logic

Many scholars question whether China's macro tax burden is too low or high if we only calculate the general public budget tax-to-GDP ratio. But the four parallel budgets tell us a complete story: besides general tax revenue, the government can mobilize large-scale resources via land transfer income, SOE profit dividends and social security contributions. Therefore, the actual resource control capacity of the Chinese government is far stronger than what the simple tax-GDP ratio suggests, which constitutes the institutional foundation of China's powerful state capacity.

General Public Budget

Government Fund Budget

State Capital Operating Budget

Social Security Fund Budget

Institutional Logic of the Four Budgets

Revenue and Taxation System

Revenue is the source of all fiscal expenditure, and taxation is the core component of government revenue. China currently implements a tax system with 18 separate tax categories, showing an obvious structural feature: indirect taxes dominate, while direct taxes and property taxes account for a relatively small share. We will break down the tax structure, long-term evolution and tax burden distribution respectively.

Three Major Tax Categories and Their Proportions

Turnover taxes (indirect taxes): Value-Added Tax (VAT), Consumption Tax. Together they take up approximately 65% of total national tax revenue. Among them, VAT alone contributes nearly 38% of all tax receipts in 2024, firmly standing as the single largest tax source. Indirect taxes are levied on production and circulation links, which are easy to collect and stable in revenue, matching China's industrial and manufacturing-based economic structure.

Income taxes: Corporate Income Tax (CIT) plus Individual Income Tax (IIT), accounting for around 30% of total tax revenue. CIT contributes about 23% of tax income, while individual income tax only accounts for less than 14%. The low proportion of personal income tax is a prominent feature of China's tax structure, different from Western welfare countries where personal income tax serves as the primary tax source.

Property taxes: Including House Property Tax, Land Appreciation Tax, Urban and Township Land Use Tax, Deed Tax and Farmland Occupation Tax. Combined, all property-related taxes only make up roughly 5% of total tax revenue. Residential housing property tax is only piloted in Shanghai and Chongqing, without nationwide popularization, leading to insufficient adjustment function of property taxation on wealth distribution.

Long-Term Evolution of Tax Structure (1985–2024) The historical proportion table clearly records two critical institutional turning points:

First, the 1994 tax-sharing reform. Before 1994, Business Tax occupied a high proportion of local tax revenue; after the reform, VAT was unified nationwide, and its revenue share surged rapidly, becoming the core tax of central and local shared revenue.

Second, the full "replacing business tax

with VAT" reform completed in 2016.

After that, Business Tax was completely abolished, simplifying the indirect tax system and eliminating double taxation in service industries, which greatly boosted the development of the tertiary sector.

Corporate income tax's proportion has shown a steady upward trend over the past 40 years, reflecting the continuous expansion of enterprise operating income alongside economic growth.

Tax Burden Distribution: Enterprises Bear the Main Pressure

A key structural judgment from the tax system: over 90% of national tax revenue is ultimately borne by enterprises, while individual taxpayers only contribute around 10%. This feature brings two practical consequences:

Manufacturing, retail and service enterprises face comprehensive tax pressure in production, circulation and profit links, which is why corporate entities generally report relatively heavy fiscal burdens;

The tax system lacks sufficient direct adjustment on personal wealth and income gaps, relying more on transfer payment and social security to realize redistribution, rather than progressive personal taxation.

This structural imbalance has become an important direction of current tax reform, with policy orientations including expanding the coverage of personal income tax special additional deductions and steadily advancing property tax legislation.

Tax Categories and Their Structure

Long-Term Evolution of Taxation

Distribution of the Tax Burden

State Capacity, Fiscal Scale and State-Owned Assets

From a fiscal perspective, state capacity refers to the government's ability to extract social resources, invest in national development, regulate economic cycles and guarantee public welfare. We use two sets of authoritative aggregate data to visualize China's comprehensive state capacity: the total scale of four budgets as a share of GDP, and the full stock of nationwide state-owned assets.

Aggregate Scale of Four Parallel Budgets (2020–2023).

The table on Slide 28 calculates total revenue and expenditure of the four budgets as percentages of annual GDP:

Combined four-budget revenue accounts for 32.1% to 35.0% of GDP every year;

Total fiscal expenditure ranges from 38.0% to 43.8% of GDP.

For cross-country comparison: The revenue-to-GDP ratio of major developed welfare economies such as Northern Europe, Germany and France often reaches 45% to 50%. Measured by this standard, China's overall macro fiscal burden remains at a moderate level, with sufficient space for expanding public welfare expenditure in the future.

Aggregate Scale of the Four Budgets

State-Owned Enterprises

By the end of 2025, official data released by the State-owned Assets Supervision and Administration Commission confirms the massive scale of state-owned enterprises:

Central SOEs total assets: 123.6 trillion yuan;

Local SOEs total assets: 278.1 trillion yuan.

In 2025 alone, central SOEs delivered remarkable economic and social contributions:

Total realized profits reached 2.5 trillion yuan;

Completed fixed-asset investment of 5.1 trillion yuan, focusing on advanced manufacturing, new energy and scientific research;

Paid taxes and fees totaling 2.5 trillion yuan, becoming the largest tax contributor nationwide.

Beyond economic indicators, SOEs play a stabilizing role in the industrial chain.

They actively drive coordinated development of upstream and downstream small, medium and micro enterprises, fill market gaps in strategic industries where private capital is unwilling or unable to invest, and provide solid support for fulfilling national economic and social development goals.

According to the state-owned asset report submitted to the National People's Congress, the total book value of China's monetizable state-owned assets hits 957.8 trillion yuan, divided into three major categories:

Non-financial state-owned enterprises: Total assets 401.7 trillion yuan, net owner's equity 109.4 trillion yuan;

State-owned financial enterprises (state-owned banks, securities, insurance institutions): Total assets 487.9 trillion yuan, net equity 33.9 trillion yuan;

Administrative and institutional state-owned assets (schools, hospitals, government buildings, public infrastructure, indemnify-catory housing): Total assets 68.2 trillion yuan, net equity 55.4 trillion yuan.

The total net equity owned by all citizens nationwide reaches 198.7 trillion yuan. It is necessary to add an important note: state-owned natural resources including land, territorial sea, mineral deposits, forest and water resources are only counted by physical quantity indicators without unified monetary valuation, so they are not included in the 957.8 trillion book asset volume.

The huge stock of state-owned assets is a unique institutional advantage of China's fiscal system. It provides a powerful buffer for macroeconomic risks, supports long-term large-scale strategic investment, and fundamentally expands the boundary of national state capacity compared with economies dominated by private capital.

The vertical fiscal game between central and subnational governments is the core difficulty of fiscal governance worldwide, and China's system has distinctive characteristics shaped by the landmark 1994 tax-sharing reform. We will analyze historical evolution, revenue-expenditure structural mismatch, grassroots fiscal pressure and land finance dependence in sequence.

Historical Shift of Central-Local Revenue Shares.

Before 1994, China implemented a fiscal contract system. Local governments retained more than 70% of national fiscal revenue, while the central government held insufficient financial resources, which severely restricted its capacity to carry out

cross-regional coordination, national strategic investment and equalizing public services across regions.

The 1994 tax-sharing reform completely reshaped the revenue distribution pattern: the central government's revenue share jumped to approximately 55% immediately after the reform, and has remained stable between 45% and 47% in recent years, with subnational governments holding the remaining half of total fiscal revenue.

If we further split local revenue into provincial, prefecture and county tiers, county-level governments hold roughly 27% of national total revenue, yet they bear the heaviest grassroots public service responsibilities, creating the core structural contradiction of China's fiscal system.

Severe Mismatch: Limited Local Revenue vs. Overwhelming Expenditure Responsibilities.

This is the most prominent feature of China's intergovernmental fiscal structure, supported by clear data:

Central government expenditure only accounts for 14%–15% of national total fiscal spending each year, limited to national defense, foreign affairs, national major scientific projects and cross-regional infrastructure;

All subnational governments together undertake over 85% of total fiscal expenditure, among which county-level governments alone bear nearly 60% of all outlays for compulsory education, grassroots medical care, pension subsidies, rural revitalization and community governance.

Local governments control less than half of national fiscal revenue but need to cover more than 85% of public service costs, resulting in large-scale structural funding gaps. Two major tools fill this gap:

First, massive central fiscal transfer payments, which allocate central tax revenue to underdeveloped regions and grassroots governments to equalize public service levels;

Second, government fund budget income dominated by land transfer revenue, which acts as an important supplementary funding source for local urban construction and livelihood spending.

Hidden Risks Brought by Land Finance Dependence

While land transfer income alleviates local fiscal pressure in the short run, it also breeds long-term risks: local fiscal revenue becomes highly tied to real estate market cycles. When housing and land demand shrink, land transfer revenue declines sharply, local fiscal balance deteriorates, and hidden local government debt risks accumulate. This problem has become a key research topic in current fiscal governance studies.

From the tiered expenditure proportion table of 2016–2019, we can see stable structural characteristics: county-level expenditure consistently accounts for nearly 60% of total national expenditure, fully reflecting the grassroots-oriented layout of China's public service supply, and also explaining why county-level fiscal operation faces the most prominent pressure.

Long-Term Fiscal Allocation Evolution Data The long time-series tables from 1953 to 2023 further verify the logic of

institutional changes: before the reform and opening-up, the central government controlled the vast majority of fiscal revenue and expenditure under the planned economy system; after decentralization reforms in the 1980s, local fiscal power expanded rapidly; the 1994 tax-sharing reform re-centralized major tax revenue, forming the current revenue-expenditure matching framework that we still operate under today.

The 1994 Tax-Sharing Reform

Revenue–Expenditure Mismatch

Land Finance and Fiscal Risks

The findings indicate that China's fiscal governance combines strong resource-mobilization mechanisms with significant vertical and horizontal coordination challenges. The four-budget structure broadens the range of public resources considered in fiscal governance, while state-owned capital and state-owned assets extend the state's capacity beyond conventional tax revenue.

At the same time, the institutional design creates a tension between revenue assignment and expenditure responsibility. The central government has substantial revenue-raising capacity, whereas local governments carry most routine public-service responsibilities. Transfers and land-related revenues consequently become important balancing mechanisms. Recent research likewise emphasizes the importance of evaluating local fiscal health through multiple dimensions rather than through a single budget balance.

The evidence also suggests that land finance should not be treated only as a source of development finance. It can support infrastructure and urbanization, but declining land-market activity can weaken local fiscal balances and increase debt-related pressure. Research on China's four budgets similarly shows that looking only at the headline general-budget deficit can obscure the broader fiscal position.

The article therefore contributes an institutional interpretation of state capacity: fiscal capacity depends not only on the size of tax revenue, but also on the organization of budgets, intergovernmental transfers, state ownership and the mechanisms used to coordinate national and local priorities. The relationship is consequently one of both capacity and constraint.

First, fiscal transparency should be strengthened through more integrated presentation of the four budget accounts and their inter-budget transfers. This would improve the assessment of the consolidated fiscal position and the monitoring of fiscal risks.

Second, the distribution of revenue authority and expenditure responsibility should be continuously recalibrated so that grassroots governments have adequate stable resources for basic public services. Transfer payments should remain sufficiently predictable and oriented toward equalization. Third, local governments should reduce excessive dependence on land-transfer income by strengthening sustainable tax and non-tax revenue bases and improving expenditure management. The recent literature identifies local fiscal health and debt sustainability as central dimensions of China's fiscal governance challenges.

In conclusion, China's fiscal governance system demonstrates a substantial capacity to mobilize resources and coordinate large-scale national development. However, the same institutional architecture generates challenges related to local fiscal pressure, land finance, debt accumulation and the transparency of consolidated fiscal balances. Sustainable state capacity therefore depends not only on resource mobilization, but also on improving fiscal coordination, transparency and long-term local fiscal resilience.

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