

## Introduction

Why do some tax systems succeed and others fail? In this book, I explore this fundamental question in the field of political economy by studying rural taxation in China. In particular, I examine the motivations and consequences for the Chinese Communist Party's (CCP) introduction of rural tax reforms, asking why the central government adopted the reforms, why local governments implemented them despite potentially negative consequences, and what this analysis contributes to our understanding of authoritarian politics in the world. Few places are better than the Chinese countryside to explore these questions. China's geographic and chronological variation during the political, economic, and social transition of the post-Mao market-oriented reform represents ideal conditions to examine the implementation and enforcement of taxation.

Rural taxation was regressive throughout China's long history, but it worsened in the 1990s. Over the past decades, especially in the 1990s, Chinese villagers were forced to pay a variety of taxes and fees, leading many to complain – and some to protest – that local exactions took up an increasing proportion of their incomes. Students of China's rural issues were stunned by the well-documented cases reported by two sensational Chinese books published at the beginning of this century: *Telling the Premier the Truth*, by Li Changping (2002), a former township party secretary in Jianli County of Hubei Province;<sup>1</sup> and *An Investigation of Chinese Farmers*, by Chen Guidi and Wu Chuntao (2004), writers from Anhui and Hunan Provinces, respectively. Li described, on the basis of his experience as party secretary of poor townships, the difficult livelihood of the villagers and the tense relationship between villagers

<sup>1</sup> *Xiang* is translated as “township” and *zhen* is translated as “town.” In this book, I follow this rule to note a specific township or town. When indicating *xiang* or *zhen* as a general administrative level, I use “township.”

and local officials in agricultural areas. For example, in Qipan Township of Jianli County in 1999, when Li started serving as party secretary, villagers paid 14 million yuan in taxes and other forms of levies – although only 6 million yuan was considered legitimate – while the total agricultural revenue of the town was less than 10 million yuan (Li C. 2002, 2).<sup>2</sup> Chen and Wu (2004) reported in detail, on the basis of several cases in Anhui, how local officials often employed violent methods to collect taxes and fees and how villagers in agricultural areas, in desperate conditions of poverty, resisted them. Concerned that these signs of discontent would become a source of political instability, the central government initiated a series of rural tax reforms in 2000.

My own experience in two villages at the beginning of my field research in December 2004 confirmed that the Chinese countryside was a good place to explore the issue of taxation. Highland Park Village of Zhejiang Province was, at the time, one of the richest villages in China.<sup>3</sup> The village government had plenty of fiscal revenue to provide public goods.<sup>4</sup> The village cadre I interviewed proudly told me that in 2003 the village government constructed five clean public flush toilets (Interviewee 104).<sup>5</sup> As the village had several factories, 80 percent of its fiscal revenue came from the corporate tax and 20 percent came from the animal husbandry tax. The agricultural tax had been abolished in this village in 1999, before a series of rural tax reforms started in the rest of the nation. Since then, the village government was paying subsidies to villagers who farmed, because no one would be engaged in farming otherwise. Under China's household responsibility system, the village government had to distribute a certain area of land for villagers to farm, regardless of their desire to do so.

Although Long Bridge Village neighbors Highland Park Village, its taxation situation was very different. In 2003, a large part of the revenue of Long Bridge Village still came from the agricultural tax, representing 60 percent of fiscal revenue, while only 30 percent came from the corporate tax (Interviewee 105). The villagers who farmed still had to pay the agricultural tax without receiving any subsidies (Interviewees 106–108). The village did not have flush toilets and villagers were dissatisfied with taxation and the provision of public goods. One of the villagers described: “Last year [in 2003], we not only had to pay the agricultural tax (*nongye shui*) but also had to provide ‘compulsory labor’ (*yiwu gong*) for repairing an irrigation canal because the village government had not

<sup>2</sup> By “legitimate,” I mean the items stipulated by law.

<sup>3</sup> To keep the anonymity of my interviewees, I use fictitious names to describe the localities where I conducted interviews.

<sup>4</sup> The village level is included in my study as a part of the rural governmental structure (even though it is *not* an *official* governmental organization) because officials and villagers both perceive the village level to be part of the local government structure for taxation, the provision of public goods, and the implementation of various policies.

<sup>5</sup> Interviewees are cited by number throughout the book. The list of the interviewees is provided in Appendix A.

## Introduction

3

repaired it. The village cadres are not helpful. Village elections are useless. The cadres are the same as the officials for the emperor during the imperial period. They are not serving us” (Interviewee 106). In short, in this interviewee’s eyes, village cadres did not represent villagers’ interests.

The comparison of the two villages was interesting. In richer Highland Park Village, residents did not have to pay the agricultural tax but received subsidies, whereas in poorer Long Bridge Village, residents still paid this tax. Clearly, China’s rural financial burdens were regressive. Research on the agricultural tax and other sources of financial burdens in rural areas indeed identifies their regressive character (e.g., X. Li 2003; Lin, Tao, and Liu 2007; Lin et al. 2002a, 2002b). Thus, one of the central questions this book poses is why regressive taxation emerged in the Chinese countryside.

Following decollectivization and subsequent post-Mao reforms, in the 1980s local governments in rural China – including all levels from province to village – gained political authority for tax revenue sources, while the central government lost major fiscal revenue with the decline of state-owned enterprises (Oksenberg and Tong 1991; Wong 1991).<sup>6</sup> However, when the tax-sharing system (*fenshuizhi*) was adopted in 1994, the central government gained back its authority over rural taxation, while local governments – especially at the county (*xian*) and township (*xiang* and *zhen*) levels – lost their revenue sources of easily collected taxes as well as their rights to keep a significant portion of the taxes collected in their locality (Wang 1995; Wang and Hu 2001; White 1998; Zhan 2009a). Local governments – especially at the county and township levels – became increasingly dependent on exactions from local residents to cover budgetary needs. These exactions – informal and sometimes illegal – became a source of villagers’ resentment and caused an increase in protests in the Chinese countryside (Bernstein and Lü 2003).

Concerned that these protests would become a source of political instability, the central government initiated the tax-for-fee (*feigaishui*) reform in 2000 and the gradual abolition of the agricultural tax in 2002 (Chen 2003; Li C. 2006; L. Li 2006, 2007; Li and Wu 2005; Oi 2004; Yep 2004).<sup>7</sup> A series of tax reforms beginning in 2000 not only alleviated the villagers’ financial burden but also created a new set of problems: local fiscal crises (Chen 2007; Chen and Chen 2004; Huang 2005; Kennedy 2006; Li and Dong 2004; Oi and Zhao 2007; Xiang 2004; Zhao 2010). In areas that relied heavily on the agricultural tax and other ad hoc fees, government officials at the county and township levels

<sup>6</sup> Constitutionally, the structure of China’s local governments consists of four levels in rural areas: province (*sheng*), prefecture (municipality or city: *shi*), county (*xian*), and township (*xiang* and *zhen*). Among the four levels, governments at the county and township levels are especially influential on the administration of rural governance, whereas the governments at the provincial and prefectural levels are more influential on the administration of urban governance.

<sup>7</sup> The tax-for-fee reform started with Anhui Province as a test province in 2000 and spread to the whole nation in 2002. Thus, in this book I take 2000 as the year when a series of rural tax reforms started.

found themselves with inadequate revenues and limited incentives to provide public goods. What does the recent experience of rural tax reforms reveal about the evolving logic of power in China's authoritarian regime? And does this experience shed light on the future possibility of China's democratization?

#### THE ARGUMENT

Although many factors contribute to the explanation of rural tax reforms in China, the argument here places particular emphasis on taxation and state building under authoritarian rule. It fits in the tradition of Margaret Levi's claim: "The history of state revenue production is the history of the evolution of the state" (1988, 1). Previous studies on taxation by political economists and economic historians have suggested that solely relying on the repressive apparatus to collect taxes is inefficient and some institutional mechanism through which taxpayers are willing to cooperate with tax collectors (i.e., the state) is necessary for efficient taxation (e.g., Brewer 1989; Gehlbach 2005; Hoffman and Norberg 1994b; Hoffman and Rosenthal 1997; Mathias and O'Brien 1976; Tilly 1990). Once the state succeeds in establishing efficient taxation based on taxpayers' cooperation, it can invest revenue in building infrastructure to foster further economic development – including the formation of institutions such as wealth-enhancing property rights regimes (Greif 2006; Hoffman and Rosenthal 1997; North 1981, 1990; North and Thomas 1973; North and Weingast 1989). By contrast, if the state fails to establish an institutional mechanism through which it gains taxpayers' cooperation, it not only struggles with collecting tax revenue but also has to expend resources on the repressive apparatus and to create bureaucracies for monitoring coerced compliance by the economic sectors under their control, instead of investing in infrastructure for economic development (Hoffman and Rosenthal 1997, 53).

Empirical findings from preindustrial Europe support this argument. For example, democratic Holland and Britain successfully raised tax revenue while autocratic France and Spain failed miserably to do the same. The British government, because its parliament assured citizens that new impositions would be spent on public goods, created and collected taxes with relative ease (Sacks 1994). Meanwhile, the French government, because it could not credibly commit to similar intentions, ran up sizable deficits on high interest loans (Norberg 1994).

The fact that the most recent rural tax reforms in China were introduced to abolish the agricultural tax suggests that the Chinese state failed to establish a legitimate institution to raise fiscal revenues in order to meet financial needs in its rural areas. In truth, many of the problems confronting rural local governments, which gave the central government an incentive to implement the tax reforms, would not have appeared if villagers had been confident that their money was being spent on public goods. Knowing this, they would have been

## Introduction

5

willing to pay taxes. Why did the state fail to establish a tax system that might give villagers an incentive to pay in rural China?

The major arguments in this book concern the political economy of rural tax reforms between the central government and local governments in contemporary China. I hypothesize that the central government leadership in Beijing designed and constructed the political and economic framework of reforms so that the CCP could maintain authoritarian rule while remaining committed to the post-Mao market-oriented reform. In this book, I discuss how China is ruled by examining the central government's strategies of keeping power, focusing on the intrastate relationship between the central government and local governments. Ultimately, I argue that the central government uses the local government as a scapegoat for problems that the central government has actually created.

Having experienced the disaster of the Great Leap Famine (1958–60) and the Cultural Revolution (1966–76), the CCP leadership reached a consensus that reverting to the planned economy was not a viable option (Baum 1994; Fewsmith 1994; Pye 1986; Thaxton 2008; Yang 1996). Once the post-Mao market-oriented reform started, the central government found it difficult to collect sufficient revenue to finance the expenditures of local governments. This was attributable to reduced revenue from inefficient state-owned enterprises, which had been the major revenue source for the central government under the Maoist planned economy (Naughton 2007, chapter 13; Steinfeld 1998, chapter 3). This difficulty gave the central government a strong incentive for the fiscal reform in 1994, called the tax-sharing system (*fenshuizhi*), which increased the central share of fiscal revenue and significantly decreased the share that local governments could claim (Zhan 2006). Having lost a major revenue source by the introduction of the tax-sharing system, local governments increasingly relied on exactions from local residents in rural areas. Reflecting tensions caused by increased financial burdens, villagers started to express their grievances with greater frequency and intensity in the 1990s. Organized demonstrations, protests, and even riots began to occur on a growing scale and with sporadic but increasing violence. In response, China's authoritarian regime introduced (or revamped old) participatory channels designed to give political voice – albeit a limited, controlled voice – to villagers, hoping to ease rural discontent and reduce the likelihood of political instability (Bernstein and Lü 2003; O'Brien and Li 2006; Unger 2002).

At the same time, reflecting the importance of maintaining political and social stability and an unwillingness to relinquish power, the CCP leadership has retained authoritarian rule instead of being committed to political reforms for establishing a democratic regime based on representative institutions. Political reforms advanced to a certain extent during the post-Mao period; however, the condition of maintaining authoritarian rule limited the CCP leadership's available means to improve the quality of rural governance through effective

taxation and the provision of public goods. Note that I do not claim that the CCP's effort to maintain authoritarian rule is the only factor that explains rural tax reforms in contemporary China and (the lack of) the provision of public goods, nor do I claim that if China's political regime is democratized then all the problems concerning taxation and the provision of public goods in the Chinese countryside will be solved. Many factors have contributed to these issues. However, I do argue that the CCP's commitment to maintaining authoritarian rule while advancing market-oriented reform played a crucial and hitherto poorly understood (or misunderstood) role in shaping the consequences of rural tax reforms beginning in 2000.

This argument also has a practical implication for public policy: that is, taxation may give an authoritarian ruling party a possible rational interest to initiate democratization. While there has been a consensus that China's democratization will be elite-led – not mass-oriented – *if* the political regime becomes more democratic (e.g., Baum 1996; Gilley 2004), the issue of how and why the elite may lead democratization remains largely unresolved. On the one hand, because of the rural tax reforms beginning in 2000, the CCP succeeded in defusing popular dissatisfaction over rural taxation without extending popular franchise in the countryside. Perhaps because of this success, the CCP leadership might be less likely to embrace further democratic reforms. On the other hand, this success was achieved at the expense of local governments' administrative capacity and popular legitimacy. The central government managed to rechannel the blame for the lack of public goods on local governments and (perhaps) enhance its own authority. However, blaming the local authorities did not necessarily strengthen the central government's hand. Local people knew that the central government and its clients had appointed the local cadres that plundered from them. Theoretically, democracy may give the regime a way to successfully collect the taxes it needs for financial stability, as well as provide funds needed to provide public goods. In previous studies, some have argued that democracy should be embraced in order to defuse unrest, whereas others have argued that its justification should derive from its normative value (e.g., Barber 1984; Bobbio 1987; Cunningham 1987; Dahl 1989; Dominguez and Shifter 2003; Held 1993; Pateman 1970; Powell 1982; Sartori 1987; Shapiro 1996). I argue instead that democracy is needed – or desirable – for the economic reason of efficient taxation. To prove my argument generally and rigorously would go far beyond the evidence this book can muster. Instead I offer analyses using simple game-theoretic models, supported by interview data, about taxation, political participation and popular resistance, and authoritarian rule based on what has been observed in the Chinese countryside.

#### RESEARCH DESIGN AND METHODOLOGY

The empirical analysis of this book uses both documentary sources and interviews. Documentary sources in Chinese and English include newspapers,

## Introduction

7

magazines, books, and publicly available governmental and nongovernmental reports. Publicly available academic and media sources, secondary literature, and field notes of other scholars in both Chinese and English were also consulted. I use these sources to discuss rural taxation and tax resistance in the period of 1985–2005, especially in the 1990s, and to document the growing crisis of legitimacy surrounding the issue of rural taxation and fiscal revenue. I especially use Chinese-language sources that have been little referenced in the English-language literature, which give a great wealth of data on this issue.<sup>8</sup> By extensively using Chinese-language sources, I discuss why 2005–06 was the date for abolishing the agricultural tax, whether anti-tax resistance crested when the agricultural tax was abolished, and how the situations varied between poor agricultural villages and richer industrialized villages.

Moreover, interviews with 108 individuals – local cadres and rural residents in the seven provinces of Guangdong, Guizhou, Hebei, Hubei, Hunan, Jiangxi, and Zhejiang during 2004 and 2005 – are a crucial part of the data I use in this book for ascertaining the motivations behind local cadres' and rural residents' behavior. The interviews are not representative, and I reference other studies and reports when discussing the information I obtained from the interviews. I use the interviews to discuss rural tax reform in contemporary China, focusing on how the central government ruled rural areas, while bringing in the established (both Chinese-language and English-language) literature to show how the literature differs from my findings or supports them. In particular, my interviews with local cadres reveal how they saw the central government and how they understood the central government's strategy of ruling the countryside and engaging in rural governance.<sup>9</sup> My interviews with local cadres and villagers show how they viewed the dilemma posed by the central government's dominant power in rural governance.

Semistructured interviews were conducted with both local cadres (county, township, and village) and rural residents. Table 0.1 shows the structure of the pool of interviews. Among the seven provinces where I conducted interviews, a majority of interviewees were from Hebei, Hunan, and Jiangxi, where I stayed longer than the other provinces. The regional variation in political-economic conditions helped me examine how economic levels and other socioeconomic and geographic factors *across* and *within* each province influenced political participation and rural taxation. For example, in two of the five townships

<sup>8</sup> *Taxation without Representation in Contemporary Rural China* by Bernstein and Lü (2003) is the best work in English-language literature on rural taxation and tax resistance in China in the 1990s.

<sup>9</sup> In this way, I see rural tax reform and rural governance from the local cadres' eyes. Thus, I do not directly observe or argue the central government's real intention, which is difficult to determine because the central government's (and any organization's) decision making is collective and each policy outcome often does not meet each policy maker's original intention. On the issue of the gap between the state's or policy maker's intention and the policy outcome, see the book by James Scott (1998).



TABLE 0.1. *Composition of the Informant Pool*

	Local Cadres				Villagers	Total
	Prefecture	County	Township	Village		
Guangdong	—	—	—	1	2	3
Guizhou	—	—	1	—	7	8
Hebei (Baoding)	—	—	—	2	12	14
Hebei (Zhangjiakou)	—	1	8	5	5	19
Hubei	3	1	—	1	2	7
Hunan	—	1	5	17	3	26
Jiangxi	—	—	6	6	13	25
Zhejiang	—	1	—	2	3	6
Total	3	4	20	34	47	108

in Hunan Province where I conducted field research, one consisted of mostly agricultural villages while the other consisted of mostly industrialized villages. The observed variation was useful for discerning which variables influenced local cadres’ and villagers’ behavior. Being on the ground helped me see how less quantifiable historical and cultural variables influenced political and economic outcomes.

All interview questions were open-ended: respondents answered questions in as many or as few words as they deemed necessary.<sup>10</sup> The questions focused on: (1) conditions of local finance, including sources of revenue and a breakdown of expenditures; (2) decision-making processes of local governance; and (3) execution of village elections.<sup>11</sup> I also gathered basic geographic and demographic information on each locality. During the course of the interviews, I met with local cadres first and then moved to rural residents, so that I could confirm with villagers the information local cadres provided.

My interviews provided me with a nonrepresentative sample based on the snowball sampling method – which means that I was introduced to the respondents rather than employing a random sample. With this method, the sample was suggestive and provided rich details and analyses of how local cadres and villagers saw the rural tax reforms and responded to the policy change. Interviews were arranged through my friends and through the local cadres that I knew. Most of the interviewees were eager to share their experiences with me, although several apparently told me what they had been instructed by

<sup>10</sup> In this sense, my interview method is different from the structured interview methods that follow the same questionnaire in every interview (e.g., Guthrie 1999). Instead my interviews are similar to those conducted by William Hurst, which “allowed interviewees to discuss issues and ideas that concerned them” (2009, 9). My interviews are similar to the interview strategy taken by David Wank (1999).

<sup>11</sup> Interview questions are provided in Appendix B.



## Introduction

9

higher authorities to tell me. Just as Kevin O'Brien (1994a, 362) found that his interviewees (i.e., National People's Congress delegates) expressed "personal standpoints and preferences that enabled them to transcend informal pressures and formal demands to reshape their own roles," so also I found in my interviews; local cadres expressed their own views about the reality of rural politics in their locality, transcending formal and informal constraints about what they should tell me about local governance. In most of the interviews it was not possible to tape record responses, so I translated and transcribed answers in every instance as soon as possible after the interviews.

The semistructured interviews were supplemented with what Thomas Gold (1989) called "guerrilla interviewing" – that is, informal conversations with local cadres in a dining room of the local government, chatting with villagers in informal settings, and so forth. Although guerrilla interviewing is not systematic, many previous studies have established that it is a good way to authenticate what is happening on the ground (e.g., Hurst 2009; Kelliher 1992). For example, a town official spoke of informal and quasi-illegal ways of financing his local government when I chatted with him while eating lunch, but he referred only to formal ways of financing when I formally interviewed him in his office. Informants used for guerrilla interviewing only are not included in the 108 interviewees listed in Appendix A. However, when an informant with whom I formally interviewed showed me more reliable information during guerrilla interviewing than during systematic interviewing, I replaced the information from their systematic interview with the information from the guerrilla interview. For example, in the aforementioned case of a town official, I took the information about quasi-illegal financing he gave me when eating lunch, instead of the information about formal ways of financing he gave me during the systematic interview in his office.

In Part II (Chapters 5–7), I use simple game-theoretic formal models to make theoretical arguments that may account for the logic of the behavior of the central government, local officials, and villagers.<sup>12</sup> The formal models are abstract, stylized representations of certain aspects of rural politics in China. One of the benefits of using formal modeling is to "force one to specify all the assumptions that one is making and verify that the logical connections between these assumptions and the subsequent claims is ironclad" (Kydd 2005, 22–23). My arguments are built on the following assumption, which originates in Levi (1988, 3): all the actors are rational and strategic. Here rationality means that the actors can define their preferences based on their own interests and that their preferences are consistent. Thus, the actors calculate costs and benefits

<sup>12</sup> The title of Part II, "Analytic Narratives," is named after the title of the book written by five political economists (Robert Bates, Avner Greif, Margaret Levi, Jean-Laurent Rosenthal, and Barry Weingast). Just as they maintain, this book takes advantage of "the rich, qualitative, and descriptive materials that narratives offer," and seeks "an explicit and logically rigorous account of the events," which game-theoretic formal models offer (Bates et al. 1998, 12).

of available alternative strategies and then choose the course of action most consistent with their preferences among the set of strategies. Based on this assumption, this book develops two game-theoretic models: one about local finance, rural taxation, and the provision of public goods; and the other about village elections. In the chapters that use game-theoretic formal models, I first discuss assumptions of the model by introducing anecdotes and observations drawn from my field research and previous studies, and set out the stylized facts that pose puzzles. Then I examine theoretical explanations that may account for the puzzles in logically consistent ways. The theoretical explanations are supported by a game-theoretic analysis shown in an appendix to each chapter.

Another benefit of using formal modeling is to help us “make inferences about other sometimes difficult to observe phenomena” (Kydd 2005, 24). One cannot directly infer the actors’ preferences from the observed choices of the actors, especially when the actors make decisions strategically. For example, observed compliance might mean satisfaction with policy but might also mean a lack of ways to protest. However, the difficulty of inferring preferences from observed acts does not necessarily mean that one cannot infer actors’ preferences at all. On this issue, formal modeling can help “reason backwards from observed events to unobserved beliefs and motivations” (Kydd 2005, 24). Moreover, by casting the central government as the institution that influences local cadres’ and villagers’ behavior, I infer the central government’s preferences from the observed relationship between local cadres and villagers. In other words, I treat the central government not as a strategic player in the formal models but as a player that “governs” the model.

Thus, I assume that central leaders chose particular policies using the available information when they made decisions about what their options were and what the likely consequences would be. This assumption does not necessarily contradict conventional wisdom about policy making in post-Mao China: that it has often been a reaction to local initiatives and experiments (e.g., Kelliher 1992; Tsai 2002; Zhou 1996); that it has constantly shifted and adjusted in the manner of “crossing the river by feeling the stones” (e.g., Oi 1999; K. Tsai 2007; Whiting 2001); and that it has typically been based on incomplete and inaccurate information (e.g., Landry 2008; Manion 2004; Wang and Hu 2001). In this book, I argue that the central government myopically responded to the current, urgent problems in rural China. First, this argument implies that the central government perceived reacting to local initiatives and experiments as a possible option of its policy making. Second, it does not contradict the conventional view that the Chinese central government operates in the manner of “crossing the river by feeling the stones.” Equilibrium of the games would show potential scenarios if the central government had a long-term perspective. If the central government’s observed behavior contradicted the model’s predicted outcome, then the model would provide a good reason to suspect that the government behaved myopically. Third, the assumption that central leaders would use the *available* information to choose particular policies is consistent with