6. Beyond governance for economic growth: understanding incentive distortions in the Chinese bureaucracy

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It has been commonly argued that an important institutional setup driving the rapid economic growth in China over the past three decades has been the alignment of local government incentives to promote markets and productive enterprises (Xu 2011). There are two dimensions to these local government incentives. One dimension relates to the fiscal (budgetary) system in which local governments are given both considerable leeway to develop business-friendly policies and the rights to retain substantial portions of the fiscal revenues. There have been changes in the past two decades in terms of the relative freedom and the shares allotted to local governments from total tax revenues. Yet in the main, local governments have been fiscally rewarded by increasing their local tax revenue base. The other dimension relates to the personnel system in which the career advancement of local officials depends on meeting performance targets (mostly in the form of tangible GDP growth figures) set by higher-level governments. Working within a highly centralized personnel system, local officials are strongly motivated to meet or exceed economic growth targets so that they can advance rapidly through the party-state personnel hierarchy.

More recently, as scholars and policy makers began to ponder prospects for the next stage of development, many have started to pinpoint inherent weaknesses in the current fiscal and personnel systems in China. Many of the selfsame features that have favored economic growth have begun to show their negative impacts on other finer governance issues – environmental protection, the struggle against corruption, widening income gaps, and widespread social unrest (Liu and Tang 2011; Wang, Zheng, and Zhao 2011). In their relentless effort to finance infrastructure projects, for example, local governments have accumulated enormous debts, many of which are likely to face eventual default, threatening China's overall fiscal stability. Relying on revenues generated from converting agricultural lands to commercial and residential uses, local officials have helped fuel real estate bubbles nationwide, resulting in an over-supply of housing stocks in many cities. While cross-jurisdictional competition has promoted innovation and economic efficiency, it has also led to highly uneven patterns of social and economic development, widening the gaps between the prosperous coastal regions and the inner provinces. When arising simultaneously, these worrisome phenomena have undoubtedly created tremendous challenges to China's governing regime. In view of these emerging governance conundrums (Miao et al. 2014), a key research and policy question is how to systematically identify the types of incentive distortions created by the current administrative systems, and more importantly, what strategies can be developed to alleviate these distortions.

To address this question, this chapter draws on four in-depth case studies, including three counties and one township, to highlight the dominant incentive distortions in the fiscal and personnel systems of the Chinese government in the post-1994 era and their variations across

Table 6.1 *Profiles of the four cases*

County	W County in Neimenggu	Mo County in Henan	Central County in Henan	J Town in Zhejiang
Sources	周庆智 2004	何慧丽/赵晓峰/魏程琳 2011	冯军旗 2010	张丙宣 2011
Study Period	1994–2000	2008–2009	1978–2009	2000–2009
Geographical Features	Northern Region Population: 0.47 million Size: 11,882 km^2	Central Region	Central Region Population: 0.8 million Size: 1,000 km^2	Coastal Region
Economic Development Levels	Very Low Economic Base: agriculture and animal husbandry Fiscal revenue (1999): 57 million A "national-level poverty-stricken county"	Low Economic Base: agriculturally related business Fiscal revenue (2008): 180 million Strived to develop its secondary industry	High Economic Base: animal husbandry and cotton production Fiscal revenue (1999): 200 million Owned the biggest high-quality cotton production base in China	Very High Economic Base: manufacturing and tertiary industry Fiscal revenue (2008): 140 million External investment was the main driver of local economy
Main Research Methods	In-depth interviews Archival investigation Analytical observation	In-depth interviews Archival investigation Analytical observation	In-depth interviews Archival investigation Participant observation	In-depth interviews Archival investigation Analytical observation
Study Focus	How the structure of government's power distribution influenced the ways local officials fulfilled stipulated goals	How the government handled fiscal deficits due to the elimination of agricultural tax in 2006	Trajectories of local cadres' political careers	The logic behind government's gamesmanship behavior (distorting directives from higher-level authorities)

socioeconomic contexts. Although these four case studies were originally written for different scholarly purposes, they all provide extensive details about the operations of their respective local governments, the patterns of communication among local officials, and their interactions with higher-level governments. Specifically, W County is located in the Inner Mongolia Autonomous Region in northern China. Recognized as one of the "national-level poverty-stricken counties" in China, W County is 1,182 square kilometers in size, with a population of 0.47 million. Mo County and Central County are both located in Henan Province. Mo County's economy was based primarily on agriculturally related businesses, akin to other inland counties in China's central region; Central County's economy relied mainly on animal husbandry and cotton production due to its mild, warm-temperate climate, and peripherally supplemented by emerging industrial development. Geographically, Mo County is fairly large and multicultural; it consists of five towns and 11 townships, typical of China's less-developed region. Central County is relatively small compared with other counties in Henan Province. It covers an area of 1,000 square kilometers and has a population of 0.8 million, mirroring the majority of China's subnational governments at the county level with a medium level of economic development. Finally, J Town is situated in Zhejiang Province on the southeastern coast of China, which is a prosperous region with a relatively high level of economic development and ample financial resources. In 2008, J Town collected an annual fiscal revenue of 1.4 hundred million, which was almost equivalent to the total revenues that Mo County generated in the same year. Table 6.1 provides a summary of the four jurisdictions' key socioeconomic features.

Based on a comparison of these four cases, we identified not only the key incentive distortions rooted in the current fiscal and personnel systems but also their variations across regions at different levels of economic development. In the rest of this chapter, we first outline the theoretical and historical backgrounds of the study, which is followed by patterns identified in the four cases. We conclude by examining theoretical lessons and practical implications.

THEORETICAL AND HISTORICAL BACKGROUNDS

Many scholars contend that a relatively decentralized fiscal arrangement has been conducive to China's economic growth at a record-setting rate since 1978 (e.g., Lin and Liu 2000; Xu 2011). Among existing theories on China's intergovernmental fiscal system, the one on market-preserving federalism (or what is more generally called the second generation of fiscal federalism) advocated by Barry Weingast (1995, 2009) is perhaps the most influential to date.[1] Since the early 1990s, Weingast and his colleagues have argued that China in the reform era represents an exemplary case of market-preserving federalism, which is characterized by (F1) a delineated scope of authority between different levels of governments; (F2) subnational autonomy; (F3) common market; (F4) hard budget constraints; and (F5) institutionalized authority allocations (Qian and Weingast 1997; Weingast 1995).

In theory, this set of characteristics matters as a whole because they mutually support each other in promoting economic development and the general welfare of the entire country. By encouraging inter-jurisdictional competition, market-preserving federalism motivates local officials to maintain a healthy local economy and efficient provision of public goods in order to ensure stable revenues for their respective local governments. Likewise, when facing hard budgetary constraints, local officials are expected to act prudently since they bear the negative fiscal consequences for failing to manage the local economy properly. Additionally, institutional safeguards must be in place against the national government from unilaterally and arbitrarily intruding on pre-designated local autonomy, which in turn provides credible incentives for "government officials at all levels to encourage market growth" (Xu 2011, 1105). As each level of government is also subject to budgetary constraints and competitive pressure, market-preserving federalism limits "the exercise of corruption, predation, and rent-seeking" (Weingast 2009, 282), making it difficult for officials to dole out favors to cronies. Lastly, market-preserving federalism supports a common market that facilitates efficient economic transactions.

A key weakness in Weingast and his colleagues' arguments, however, was that they were mostly based on the institutional setting and data from the early 1980s through 1994. During that period, the Chinese central government set in place a decentralized tax-sharing system with local governments. This began with the central government signing "intergovernmental fiscal revenue-sharing contracts" with subordinate governments (Oi 1992), by which the central, provincial, and sub-provincial governments agreed to share annual fiscal revenues based on specific contractual agreements. These contracts helped motivate provincial and local governments to promote economic development and infrastructure investment, which in turn, attracted businesses and provided taxable revenues to the local government. Between 1981 and 1992, the first ten years of China's economic bloom, "Chinese provinces on average retained 89 percent of additional tax revenue generated within the province and that 68 percent of all provinces faced a marginal retention rate of 100 percent" (Weingast 2009, 284).

Since the early 1990s, however, the central government started to realize the need to overhaul the fiscal contract system. Although the system doubtlessly yielded sufficient incentives for local governments to foster economic growth in their respective jurisdictions (Ong 2012b), the central government itself ironically faced a severe tax revenue reduction (Shen, Jin, and Zou 2012). Many local authorities, for example, adopted a variety of quasi tax-exemption programs to attract outside businesses and investment, resulting in an erosion of tax revenues to the national government. Statistics showed that the central government's fiscal revenue as a percentage of GNP plummeted dramatically from 31.6 percent in 1978 to 14.1 percent in 1993 (Tsang and Cheng 1994). Faced with these issues, the central government launched a revised version of the tax-sharing system in 1994, titled "tax assignment system." Premised on maintaining local authorities' incentives to promote economic growth, the system helped restore the central government's fiscal power, as indicated by the statistics that the aggregate share of subnational governments' tax revenues accounted for merely 40 percent, as compared to 70 percent in previous years, of national tax revenues (World Bank 2002).[2] According to this system, taxes collected by local governments fall into three categories: central taxes, local taxes, and shared taxes. In addition to the central taxes, which are fixed categories partitioned exclusively for the central government, shared tax revenues also go disproportionately to the central government. The value-added tax, for example, is shared roughly under the adjusted scheme of a three to one split between the central and the local government (Zhang 2006).

While strengthening the revenue sources of the central government, this revised system has also created its own problems. First, the new system lacks legal stability, meaning that no legal document explicitly stipulates the specific amounts (proportions) of local tax revenues that go to the central government. This leaves room for higher-level authorities, especially the central government, to modify and adjust the shared amounts decidedly in their favor (姚洋/杨雷 2003). Assuming the dual roles of being both "principal" for their subordinates and "agent" for their superior entities, in addition, governments at each subnational level are inclined to act strategically and often opportunistically (Williamson 1985). A higher-level government, for instance, may funnel most of its spending targets down the administrative hierarchy while intercepting the subordinate governments' revenue sources by adjusting the retention rate of the local tax revenues (Gao 2010). As a result, "the cascade of bureaucratic pressure falls most heavily on the lowest rank in the state hierarchy" (Lee and Zhang 2013, 1484), meaning that lowest-level officials, who are unable to push responsibilities any further down, are put in charge of many underfunded mandates.

In addition to various forms of fiscal pressure, local government officials also face overwhelming pressure from the hierarchical personnel system, which serves as the central government's "trump card" to help ensure political loyalty and policy compliance from local cadres (Li and Walder 2001). The Chinese personnel system is based on the principle of personnel subcontracting, that is, a "one-level-down management system," in which the promotion, transfer, and turnover of subordinate officials are entirely decided by those at a higher level of authority. This system is designed to guarantee that higher-level officials have strong leverage over lower-level officials by assigning them specific performance targets. A common practice is for lower-level leaders to sign annual performance contracts with the government immediately above them. Accordingly, they are "held accountable for the accomplishment of the established targets. At the year-end evaluation, all organizations that have signed performance contracts are ranked by their actual performance achievements. Reward and penalty decisions are then made based on the results of the ranking" (Gao 2010, 58S). Using clearly defined targets for evaluation purposes, the performance-based contract not only encourages local officials to meet demands from higher authorities, it also creates a competitive environment, often referred to as a "promotion tournament," which instills a sense of urgency for them to accomplish their stated goals (周黎安 2007). The underlying rationale is that the earlier a local official gets promoted, the more opportunities he or she will have to climb the administrative ladder.

Since Weingast's original study was unable to foresee at the time that (1) China would fiscally deviate from several of the key characteristics of market-preserving federalism in subsequent years, and (2) China's personnel management system plays a pivotal role in shaping incentives for local administrations/officials, some scholars have pointed out the necessity to examine the joint effects of the current fiscal and personnel systems to fully understand the drivers of China's economic growth and to account for their related problems. Tsui and Wang (2004, 75), for instance, credited the success of China's fiscal decentralization to its "vertical-control paradigm," by which higher-level administrations maintain tight control on "the appointment, evaluation, promotion, and dismissal of local cadres." Working under the target responsibility system (TRS), local officials are incentivized to act in alignment with the key priorities of the central government. Similarly, Cai and Treisman (2006, 525) suggested that career concerns are the major driving force for local (especially provincial-level) officials to both implement nationwide market reforms and pursue regional economic growth. By itself, a fiscally decentralized system would be insufficient to motivate local officials to focus on economic growth given that: (1) tax bases between the central and local governments often overlapped, and (2) "a complicated system of compensatory transfers made it hard to tell what the net retention rates actually were" (also Li and Zhou 2005; Yao and Zhang 2015).

Notwithstanding these scholarly efforts, several limitations of the current literature can be identified. First of all, most of the quantitative studies on bureaucratic incentives in China have focused on the relationships between the central and provincial governments prior to 1994. There are case studies at the sub-provincial level, but they: (1) are mostly single-case studies (e.g., Göbel 2011), or (2) examine behavioral responses of local officials who reside in villages that are geographically and economically similar to each other (O'Brien and Li 1999), making it difficult to generalize the findings. Moreover, some recent articles published in English (e.g., Heberer and Trappel 2013) implicitly attribute the behaviors of local officials exclusively to personnel incentives, treating fiscal factors merely as a backdrop. In the Chinese literature, admittedly, there are discussions about general features of both fiscal and personnel systems, but they normally lack any systematic scrutiny of the impacts of socioeconomic differences across regions. Our study, therefore, helps to fill a gap in both the Chinese and English literature by undertaking a small-N comparative case study of the key patterns of incentive distortions in post-1994 China across diverse contexts. Overall, the experiences of these four cases show that China in the post-1994 era has not even remotely begun to match most of the necessary conditions for market-preserving federalism as suggested by Weingast. To further China's development, one must consider feasible ways to adjust its fiscal and personnel systems so that intergovernmental relations can resemble more closely the ideal conditions of market-preserving federalism and that local officials are motivated to tackle finer governance issues.

In the next section, we detail how the four cases illustrate incentive distortions deriving from China's fiscal and personnel management regimes, and how local administrations vary in both their levels of transparency in the promotion-based tournament and their degrees of bargaining power over fiscal autonomy.

BUREAUCRATIC INCENTIVES AND INCENTIVE DISTORTIONS

Bureaucratic incentives are a commonly referenced term with context-specific meaning touching primarily on the behavioral aspect of individuals or collectivities in a bureaucratic system. In their words, for example, Meier and Morton (2015, 96) asserted that bureaucratic incentives are "the key variable in determining bureaucratic decision-making" and in making sense of organizational performance. When explaining China's spectacular economic development and relatively stable social conditions over the past decades in spite of the nation's widening income gap and deteriorating environmental quality, scholars led by Naughton (2017, 10) similarly lauded the arrangement under which "a set of bureaucratic incentives that reward officials for growth (of GDP and revenue)" are put forth and decisively implemented. They believe that these incentives help the central authority of China solicit political allegiance and desirable actions from local governments and officials, overcome the principal–agent problem inherent in a gigantic hierarchy, and maintain sufficient flexibility in priority shifts and personnel churning (e.g., Jiang 2018; Kung and Chen 2011; Li 1998; 周雪光 2013).

That being said, scholars often supplement the adoption of bureaucratic incentives with a cautionary tale. For instance, high-powered incentives must be used gingerly, because their elicited bureaucratic outcomes may be lopsided toward favoring one or two salient objectives at the expense of others (e.g., Acemoglu, Kremer, and Mian 2008). This concern is not expressed in a vacuum but partly reflects the Chinese bureaucratic reality. As Naughton (2017, 10) observed, "China's system of incentives for local bureaucrats to encourage growth is extremely unusual and seems to exist only in China. It is a blunt but powerful instrument, encouraging growth and indirectly promoting investment and high-profile development projects." Imaginably, the ramifications resulting from the use of these aggressive, one-dimensional incentives are immense and far-reaching. Table 6.2 provides a summary of the incentive distortions reported in the four cases.

Table 6.2 Major types of incentive distortions

	W County	Mo County	Central County	J Town
Bureaucratic Entrepreneurship	No specific examples	Developed tournaments to encourage official efforts in attracting businesses Granted preferential treatments to new external investments, regardless of environmental and societal consequences and their business viability Imposed unreasonable tax and fee burden on existing enterprises	No specific examples	Disfavored foreign enterprises to avoid granting tax exemption status as mandated by the central government since 2004
Reliance on Extra-budgetary Revenues	Underfunded agencies raised extra budgetary revenues by imposing administrative charges and fees, and engaged in, sometimes illegal, profit-making activities	No specific examples	No specific examples	No specific examples
Excessive Borrowing	No specific examples	Engaged in excessive borrowing to fund public projects and administrative expenses, often without intention for repayment	No specific examples	Subordinate governments engaged in excessive borrowing, subsequently forcing the township government to repay loans over extended periods of time
Making the Numbers Regardless of Outcomes	Resorted to data fabrication and creative accounting to meet performance targets	Focused on meeting economic performance indicators, as those for other policy areas such as environmental protection played a much smaller role in calculating the total performance score	Resorted to data fabrication to meet hard GDP targets	Focused on meeting economic performance indicators, as those for other policy areas such as environmental protection played a much smaller role in calculating the total score Used court orders and police force to confine potential petitioners to their hometowns in order to meet the one-veto target of stability maintenance

	W County	Mo County	Central County	J Town
Short-sightedness	Offered extensive preferential treatments to attract outside investors Failed to devote sufficient resources to implement long-term social development programs	No specific examples	Brought in speculative industrial projects without considering environmental consequences	Offered extensive preferential treatments to attract outside (domestic) investors Blocked neighboring jurisdiction's efforts to attract investors from their own jurisdiction
Variations in Bargaining Powers	With limited power to negotiate for more favorable revenue sharing contracts, officials sought fiscal transfers by dishonest tactics	No specific examples	No specific examples	Negotiated with higher-level authorities, leading to adjustments of fiscal revenue-sharing contracts in the township's favor
Variations in Levels of Transparency	Viewed performance contracts as a formality, but focused on developing networking skills and social ties as a way to enhance chances for promotion	No specific examples	Networking skills and social skills were important, but reaching the assigned GDP target growth was key for promotion	Used relatively clear and well-specified awards systems to encourage officials to attract external investment. Promotion opportunities favored award recipients

BUREAUCRATIC ENTREPRENEURSHIP

Local governments are transformed into market-driven players whose primary goal is short-term profit maximization. Instead of focusing on the provision of public goods and services, local governments swing for the fences to attract external investments. Given their administrative power, local authorities can also easily become rent-seeking bureaucracies, cutting the quality and quantity of public services and siphoning off local enterprises' profits through taxes and fees (Chan 2004; Frye and Shleifer 1996). In the long run, however, such behaviors will seriously undermine market efficiency and quell outside entrepreneurs' enthusiasm for investing, which in turn will accelerate local bureaucracies' greed in relation to local businesses and lock them into a vicious cycle (Chen, Hillman, and Gu 2002; 周黎安 2008).

The Mo County government, for example, had several bureaucratic incentive schemes for attracting outside investors. One such scheme involved a tournament for attracting the most investments within one hundred days as a way to boost its economic growth performance. The aim of the scheme was to capture at least 100 new investment projects, each of which should be valued at no less than five million RMB. Those who acquired a qualified investment would be immediately awarded 1 percent of the investment's value; those who introduced investment worth between a hundred million and two hundred million RMB would be awarded 150,000 RMB; those who introduced investments worth more than two hundred million would be awarded 300,000 RMB.

Given Mo County is located in an underdeveloped region, it is hardly attractive for business investments. To attract sizable outside investments, local officials relied heavily on preferential policies, including such incentives as free land, free electricity, and free water. Some enterprises were given permission to extract groundwater for free, regardless of the potential impact on the groundwater basins. These policies have created many unintended problems. First, they escalated the conflicts between the government and local farmers and residents. As the government was offering lands to these investors at low prices, it could only provide very low compensations to current farmers and residents, thus causing strong resistance from them. As a result, the number of land-related conflicts has increased dramatically in recent years. In 2009 alone, residents initiated 18 petitions to higher-level authorities, even though this means of citizen appeal was actively discouraged by all levels of government. Second, many of these projects turned out to be established only for reporting performance. As a cadre in Mo County mentioned:

> To accomplish our mission of developing the industrial areas in our county, we tried our best to appeal to the businessmen. In some cases, we even provided them with capital. As a result, many manufacturing facilities were built, but have not been put into production. As far as I can tell, only a quarter of the enterprises in our industrial areas are actually in operation. (何慧丽/赵晓峰/魏程琳 2011, 55)

Although the overarching intent underlying the incentives is for local governments to foster economic growth, some local governments may succumb to short-term fiscal pressure by extracting whatever they can from existing enterprises within their jurisdictions. Mo County's budgeting system was, for example, not at all investor-friendly. Using the principle of "using expenditures to determine revenues," the county government estimated the annual expenditure first and then used it as the "target" for tax and fee collection. All governmental departments were required to collect targeted amounts of taxes and fees. Not surprisingly, larger companies were seen as the main targets; officials often imposed unreasonable tax and fee burdens on these larger companies, thus undermining the jurisdiction's long-term business environment.

Similarly, since 2004, J Town and its subordinate government units have disfavored foreign enterprises as a result of a major policy change at the national level that provided foreign enterprises with different types of tax exemptions. As a result of this policy, these local government units prioritized their goals of attracting domestic enterprises that generated high levels of local taxes. Among them, real estate companies became favorites among the local officials.

RELIANCE ON EXTRA-BUDGETARY REVENUES

In areas that are economically disadvantaged yet insufficiently destitute to qualify for significant subsidies, large companies are scarce, and the local government is forced to shoulder spending programs arbitrarily imposed by higher-level governments. An easy way, then, to maximize the "residual" revenues beyond the threshold stipulated by higher-level government(s) is by levying various administrative charges (Hurst et al. 2014). Many local governments have resorted to inconsistent charges, fund-raising quotas, and unreasonable fines as tools for raising revenues. Budgeted fiscal allocations in the W County government, for example, covered only a small fraction of its administrative costs, making it heavily dependent on extra-budgetary revenues, such as administrative charges, fines, and other profit-seeking opportunities. As estimated by the Head of the Animal Husbandry Bureau, which provided crucial agricultural services in this rural county, the total administrative costs for the Bureau were approximately 40 million per year, whereas the budgeted allocation was less than two million. The budgeted amount could barely cover the costs of the telephone bills, let alone all the other bills.

To partially fill in this budgetary gap, the Bureau leased out some of its offices to commercial enterprises. While it was illegal to use that kind of income to support the bureau's general operations, the bureau chief frankly acknowledged the practice, claiming that there was no other way to meet the operational expenses (周庆智 2004, 191). The auditing agency from the superior government came to investigate, but the bureau continued the practice after the county government intervened on its behalf.

EXCESSIVE BORROWING

According to the statistics provided by China's National Audit Office (2014), borrowing by provinces, counties, and townships reached 17.9 trillion Yuan ($2.96 trillion) in June 2013.[3] Bloomberg's analysis (Panckhurst 2013) further indicates that local governments indeed possess few incentives to repay the debt unless it becomes a regional or systemic problem. Even if it does reach this level, as argued by Bardhan (2002, 202), local governments would not be affected because "upper tier governments will have difficulty ignoring the political pressure that will be generated in favor of bailing them out." For instance, J Town spent almost ten years (1994–2004) helping its subordinate villages pay off their bank loans. Although the specific amounts of debt were unknown from the case, the long duration suggested that it was a pervasive problem.

Given that borrowing is virtually risk-free, local governments tend to employ this method as a way of eschewing the inadequacies of intergovernmental transfers or hiding their fiscal mismanagement, which ironically distorts the initial purpose of the budgetary incentives (e.g., Wang 2017). In 2007, for instance, all six newly built roads in Mo County were financed by bank loans, totaling around 60 million. The total annual revenue for the county at the time was approximately 137 million, whereas the total expenditure teetered around 630 million, resulting in an enormous gap of approximately 500 million. Such huge gaps can never be filled entirely by administrative charges and tax levies. For many financially strapped local governments, getting loans from banks has become the de-facto procedure for dealing with financial shortfalls.

MAKING THE NUMBERS REGARDLESS OF OUTCOMES

Although the "desired outcomes" for a local government are naturally multifaceted, using quantitative indicators is a convenient method for higher-level officials to measure their subordinates' performance. GDP growth, given its measurability (Eisenhardt 1989), is heavily valued in the current target-based measurement system. As GDP growth and related economic performance indicators account for the largest portion of the performance evaluation system, local (especially the county level) officials are encouraged to utilize their administrative power to promote industrial development projects, even if their jurisdictions are ill suited for these projects or if these projects pose a great threat to the environment.

For the target-based measurement system in Mo County, economic goals accounted for 40 points on a 70-point scale, while environmental protection accounted for only two points. In J Town, economic performance served as the base value in the grading rubric of the target-based measurement system, whereas performance on other policy areas (e.g., social affairs, environmental protection) had only a marginal effect on the total score. The formula for calculating the final score was quite complicated, but worth explaining. For example, the completion of economic tasks equaled 200 points, while taking appropriate measures in lowering local factories' carbon dioxide emissions equaled 300 points in total. One might be pleased to see that environmental protection had been placed as a top priority in J Town government's agenda. However, this was not exactly the case. In fact, points gained from the completion of economic tasks were 100 percent transferred into the total score, whereas points gained from other measured aspects were transferred into the total score merely as coefficients. For example, if J Town received 150 points in its completion of economic tasks and 250 points in its work on environmental protection, the total score for J Town = 150 * 1.25 = 187.5.[4] This score would be even lower than that for a certain county that obtained 0 from environmental protection but 190 points from economic tasks. Furthermore, as the performance evaluations of non-economic accomplishments usually did not vary much across jurisdictions, the total score and relative rankings were indeed determined mainly by economic performance.

In recent years, some non-economic performance targets have become increasingly important for local officials, but those targets may not be directly beneficial to the residents. For example, stability maintenance has become a major performance target for local officials. In 2009, J Town was assigned the task of guaranteeing "zero Beijing petitions" on the National Day that celebrated the 60th anniversary of the People's Republic. This goal, as mentioned in the performance contract, was subject to the one-strike veto rule, meaning that if local cadres failed to ensure that no one in their jurisdiction petitioned the central government on that day, all other accomplishments would be negated, and all chances for bonuses, promotions, and eligibility to compete for honors would be denied. Given this performance target, local officials pressured the local judicial branch to issue subpoenas to potential petitioners, reminding them of the legal consequences of leaving their homes without authorization. In addition, they threatened the use of police force and blocked off "key villages" to make sure that these potential petitioners did not even have a chance to leave their hometowns (张丙宣 2011, 177).[5]

In W County, fabricating numbers was a means frequently used by local officials to satisfy auditors sent from higher-level governments. Creative accounting, such as using the appropriated budget for the subsequent year to fill the gap for the current year, was also commonly used. In Central County, a former party secretary complained to the interviewer that performance fabrication was ultimately caused by higher-level governments that imposed unrealistic growth targets on their subordinate units. In his words:

> When you are handed a 100 million GDP target, how can you ever achieve it, unless you ask each shoe repairer to be responsible for 1 million? At my time, many cadres got promoted by fabricating performance…Since I was a peasant before, I know their difficulties. Even under this tremendous burden, I insisted on not taking a cow from them, nor robbing their grains. At that time, I was like sitting at the mouth of a volcano every day. Therefore, I insisted on not being a party secretary anymore. (冯军旗 2010, 150)

During the time of the case investigation, performance fabrication continued unabated. A leading official in the county admitted that township and village officials often burned trash in the industrial area when county officials came for inspection as evidence of industrial development. Alternatively, when there were site visits, the local officials would turn the machines on, but once visitors had left, production would also be over (冯军旗 2010, 144).

SHORT-SIGHTEDNESS

Meeting measurable targets is critical for a local official's prospect for promotion, and the promotion tournament is time-sensitive. Local officials must accumulate sufficient "achievements" in the shortest time possible to stay competitive in the tournament. Given this urgency, local officials tend to be less concerned about long-term social development projects such as those related to science, culture, and health. According to 周黎安 (2007), local governments' total spending on these areas in 2005 was less than that in 1998, although GDP itself experienced a threefold increase. Under the guise of creating market competition and lessening the effects of government monopolies, many local governments sought to commercialize the supply of educational and healthcare resources (Su, Walker, and Xue 2013), making it increasingly inaccessible to disadvantaged populations. Additionally, given that the opportunities to advance in a given period are fixed, local officials compete with one another in zero-sum games: one official's promotion reduces the likelihood that his or her peers will be promoted. Some local officials thus resorted to local protectionism as a method for reducing competition in this political tournament.

In J Town, for example, local officials competed for investment projects that were worth more than five million, and they sought to raid potential investors from other jurisdictions by offering them such benefits as preferential tax incentives and exemptions from environmental regulations. Officials in other towns were known to have taken countermeasures against such raids, for example, by placing security guards near fancy office buildings to monitor, report, and prevent the entrance of unauthorized persons.

In Central County, officials hastily decided to establish several large-scale paper mills in 1995 upon hearing stories about their profitability, without carefully considering the local geographic conditions and environmental consequences. These paper mills discharged large amounts of alkaline water and caused massive livestock death, eventually leading to orders from a higher-level government to shut them all down. Likewise, in W County, local officials were enthusiastic about attracting external investments on which their achievements were predominately measured. Excessive preferential policy terms were thus often offered to attract investors. As local cadres' attention was fully committed to this single subject, other equally important issues in local governance, albeit less likely to be assessed and recognized by their administrative superiors, were largely ignored. One example was a program, titled "Bring technology to the village," tasked by the central government. Since the county government was not provided with extra funds for administering the program, it lacked the motivation to support it. The program resulted in no more than the county government sending some old computers, refrigerators, and electronic books/brochures to the villages.

VARIATIONS IN BARGAINING POWERS

In general, local governments in China do not have the power to either adjust local tax rates or expand taxable categories (Lin, Tao, and Liu 2006). Specifically, local tax revenues depend mostly on value-added taxes, sales taxes, and corporate income taxes, all of which are subject to fixed and centrally mandated rates. Total tax revenues thus depend heavily on the absolute size of the underlying tax base. Since larger tax bases (i.e., more profitable enterprises) are more likely to stay in economically prosperous regions where the residents' purchasing power is stronger and the local infrastructure is better, collecting adequate tax revenues tends to be easier for local jurisdictions that depend less on transfers from higher-level governments. More fiscal self-sufficiency, consequently, provides local jurisdictions with more bargaining powers when they negotiate with higher-level authorities. Located in an economically advanced region, the J Town government is a case in point. It undertook an eight-month-long negotiation with its higher-level authorities concerning the fiscal revenue-sharing contracts in 2007. As a result, the H District government made significant concessions to J Town concerning the property tax sharing formula[6] and promised to pay for a number of underfunded projects, demonstrating the significant bargaining power of local governments in an economically advanced region.

In contrast, local governments in economically less-developed regions lack bargaining power and are obliged to accept the tax-sharing contract imposed by higher-level governments, resulting in an ever-increasing financial imbalance between revenue sources and expenditure mandates (Fedelino and Minassian 2006; Shen, Jin, and Zou 2012). Several factors are relevant. First, local residents in less-developed regions are politically and economically vulnerable, meaning that their tax contributions to the local government are quite limited (Park et al. 1996). Second, a shortage of funds reduces both the local officials' opportunities to receive higher education and the likelihood that professional staff and college graduates will transfer to the area (Wong 2009).[7] A lack of local talent further restricts the local government's ability to maximize the benefits of established projects, ironically turning their subsistence into new sources of financial burdens. As a result, local governments in these regions are limited both in bargaining power with their administrative superiors and in their abilities to seize opportunities for economic development. These dire conditions further motivate the local governments to behave recklessly.

Both located in less-developed regions, Mo and W Counties are two examples. In 2008, Mo County retained only 180 million in tax revenues after higher-level governments took a significant portion. Yet over 200 million was required to cover just the payroll, not to mention other overhead costs for multiple social programs. Faced with a similar financial situation, W County addressed its financial challenges by encouraging its agencies to engage in profit-making activities and in generating "extra-budgetary revenues" through various types of fines and administrative charges. In 2003, W County's value-added tax was approximately three million, and other kinds of taxes totaled seven million. Nonetheless, extra-budgetary revenues generated by government-affiliated organizations, under the guise of "administrative charges and fines," reached 17 million! When faced with underfunded administrative projects, severe fiscal shortages, and a lack of negotiating powers with higher-level authorities, these local governments are likely to become bureaucratic entrepreneurs. Another common strategy was to lobby for added appropriations from higher authorities, sometimes in a dishonest fashion. Rather than bargaining with its administrative superiors concerning tax retention rates, W County often used the following two approaches. One approach was "fake matching": whenever a matching grant was available, the county would apply for it. However, once the money was granted, the county would fail to provide the stipulated matching funds or would use the grants for other purposes. The other approach was for the county to encourage its agencies to destroy or trash usable equipment in order to justify requests for additional fiscal appropriations.

VARIATIONS IN LEVELS OF TRANSPARENCY

As Cai and Treisman (2005) pointed out, Chinese local officials' promotion prospects vary based on the economic and cultural conditions of their geographic regions. Local officials' efforts are likely to go unrewarded in underdeveloped areas due to fiscal imbalances and the region's unattractiveness to outside investors. As compared with those in more developed regions, officials in less-developed regions face more difficulties in promoting economic development and consequently have grimmer prospects for career advancement.

Paradoxically, the marginal benefits local officials in underdeveloped areas derive from promotion tend to be significantly larger than those for officials in economically advanced areas. Since employment and investment opportunities in less-developed regions are minimal, local officials in these regions highly value their governmental positions, which come with steady pay. A small promotion may significantly improve one's financial situation and monthly pension payments after retirement. Given its being less reliant on easily documented economic performance indicators and its high stake among officials, the promotion-based incentive system in less-developed regions tends to be subject to a certain level of opacity. In these regions, one's informal networks and interpersonal connections play a more critical role in deciding whether or not one will be promoted.

Based on multiple interviews with local officials in W County, the most underdeveloped among the four cases, 周庆智 (2004, 132) found that when they were asked to present their contracts in which their assigned annual tasks were spelled out, some of them searched in vain through dusty piles of paper. Shockingly, quite a few officials had no idea where they put them. Perhaps, due to W County's inherent economic disadvantages and the resulting difficulty for local officials to complete assigned tasks, higher-level officials never took the contract seriously. As a result, county officials viewed their performance contracts as a formality and saw factors such as networking skills and social ties as more significant for their promotion potential.[8] As opined by a retired official in W County, it was common for cadres with no outstanding achievements to get promoted. Put differently, a key reason why a local official would fail to get promoted might be that he failed to form a "close" relationship with the key personnel, namely the party secretary.

In Central County, which is in the mid-level of development among the four cases, although to some extent networking skills and social ties played a role in advancing local officials' careers,[9] the majority of the promoted officials between 1998 and 2008 were those who had exceeded their assigned GDP growth targets. Moreover, many local officials may have changed their promotion philosophy, evidenced by the fact that their children have a more extensive array of employment and investment choices than they did. Based on Feng's investigation (冯军旗 2010), most of these children are now living and working in Beijing and Shanghai. Many local officials believe that larger cities provide more career opportunities. Even if their kids do not choose to pursue a government career, other career paths are equally promising. A positive impact of this trend may be that future bureaucratic incentive systems are moving toward greater transparency, beginning from the economically advanced jurisdictions, as climbing the hierarchical ladder is gradually losing its unique appeal for individuals in these areas.

The awards system utilized by the H District government, the most prosperous among the four cases, to encourage J Town officials to attract external investments adds empirical support to this conjecture. Local officials' completion of the assigned tasks was subject to various monetary awards with precise cutoffs. Specifically, different levels of awards were given to individual officials who accomplished between 130 percent and over 230 percent of the stipulated goal.[10] The recipients of these awards naturally then became the favorites for subsequent promotion. Apparently, a relatively transparent reward system for performance has been in place for officials there.

BROADER INSTITUTIONAL CONTEXT

Weingast and his colleagues have popularized the idea that China has created its own "style" of fiscal federalism with market-preserving attributes, and that China can be a model of reform for other transitioning economies (Montinola, Qian, and Weingast 1995; Qian and Weingast 1997). In a more recent article, Weingast (2009, 289) explicitly stated that "Under some circumstances, a formerly predatory government may seek reform. How is it to improve economic performance? China's successful creation of market-preserving federalism suggests one way around these problems."

This argument is by no means his first claim about China as a positive example of market-preserving federalism. Back in the mid-1990s, Montinola, Qian, and Weingast (1995) already attributed China's miraculous economic growth to its decentralized fiscal system.

Many scholars at the time raised doubts about how a nondemocratic government might maintain a credible commitment to fiscal decentralization, but Montinola, Qian, and Weingast (1995, 61) defended that a lack of democratic institutions would not hinder the success of fiscal decentralization at large: "Market-preserving federalism in no way depends on these factors [i.e., political freedom, representation, and democratization]. Instead, it depends on the political relationship among levels of government, with no reference to an explicit or constitutional basis or its promotion of individual rights and political freedom."

Their confidence that a decentralized fiscal system would continuously serve as the institutional driver of China's economic growth stemmed mainly from their belief that recentralization was no longer politically feasible in China. In their view, the Chinese people had gained economically from a variety of reforms/experimentations in multiple arenas and hence had tasted the irresistible flavor of pro-market policies and a fiscally decentralized governance structure. Even though China had not yet attained a complete version of market-preserving federalism due to the absence of an institutionalized delineation of intergovernmental fiscal authorities/responsibilities, any attempt at recentralization would potentially cause popular discontent, putting the central government's ruling legitimacy at risk. Montinola, Qian, and Weingast (1995, 60) argued that the possible factors that could potentially thwart the momentum of China's economic development included: (1) China's limited experience with market-oriented economy; (2) "the absence of centralized control over the monetary system," which could soften the budgetary constraints on local governments; and (3) over-competition between local governments under the layout of fiscal decentralization and various kinds of accompanying local protectionism.

In retrospect, however, Montinola, Qian, and Weignast (1995) had not correctly specified all the antecedents and consequences relevant to China's experience over the past twenty years. First, China can hardly be considered now as a novice in the use of markets given its additional experience during the past 20 years. Second, the problem of soft budgetary constraints for local governments persists, but a centralized monetary system has been well established[11] and has not been an effective remedy for the soft budgetary constraint problem (Ang 2009; Ong 2012b).[12] Third, trade barriers are more pervasive among governments at the township level, and this partially contradicts the prediction that township governments are most likely to face a hard budgetary constraint and are least likely to set trade barriers. Thus, a key puzzle arises as to why a governing system with experience in using markets and maintaining monetary stability still faces many incentive distortion problems.

Based on the case analysis covered earlier in the chapter, Table 6.3 provides a summary of the extent to which post-1994 China has mismatched the five necessary conditions that characterize market-preserving federalism. As can be seen in the table, the mismatch is more prevalent than what was suggested by Weingast and his colleagues. The mismatch did not create only economic problems; it also created different incentive distortions that made it more difficult for the Chinese government system to tackle finer governance issues such as those related to redistribution, social service provision, and environmental protection.

First of all, Weingast and his colleagues failed to recognize that although the central government may not announce explicitly its intention to recentralize all fiscal powers, it can do so subtly. The tax assignment system introduced in 1994 was a prominent example. In the sheep's clothing of enacting a more formal system of fiscal federalism, the tax assignment system has essentially restored predominant fiscal powers to the central government. This recentralization of fiscal powers either reduced incentives for local governments to foster economic growth

Table 6.3 Mismatching necessary conditions of market-preserving federalism

Necessary Conditions	Specific Requirements	China Since the Tax Assignment Reform in 1994
F1: Hierarchy	"A hierarchy of governments exists with each level having a delineated scope of authority" (Weingast 2009, 281)	**Fulfilled with limits**: (1) Higher-level governments maintain authority to restructure subordinate governments. (2) Higher-level governments maintain authority to readjust tax-sharing formulae. (3) Higher-level governments maintain authority to imposed unfunded and underfunded mandates on lower-level governments.
F2: Subnational Autonomy	"Subnational governments have primary both local regulation of the economy and authority over public goods and service provision" (Weingast 2009, 281)	**Compromised**: (1) The principle of personnel subcontracting ensures that higher-level officials have strong leverage over their subordinates by assigning them specific performance targets, regardless of their viability.
F3: Common Market	"The national government provides for and polices a common market that allows factor product mobility" (Weingast 2009, 281)	**Compromised**: (1) The household registration (*hukou*) system limits citizens' ability to seek residential status other than the area in which he or she was born. (2) Promotion tournaments encourage local officials to use local protectionism to increase their odds of getting promoted.
F4: Hard Budget Constraints	"All governments, especially subnational ones, face hard budget constraints" (Weingast 2009, 281)	**Compromised**: (1) A hierarchical personnel system encourages subordinate governments to unconditionally accept the service responsibilities of unfunded or underfunded mandates by superior authorities. (2) The joint-responsibility principle incentivizes higher-level administrations to pay off bank loans for their subordinate entities, thus motivating the latter to rely excessively on borrowing to implement underfunded mandates.
F5: Institutionalized Authority	"The allocation of authority is institutionalized" (Weingast 2009, 281)	**Absent**: (1) No legal document explicitly stipulates the specific amounts (proportions) of local tax revenues that go to the central government under the tax assignment system adopted since 1994, leaving room for the central government to adjust shared amounts in its favors.

or forced local officials to raise extra-budgetary revenues from local enterprises. Particularly for local governments in economically impoverished areas where tax benefits obtained from their subordinate administrative units are trivial, they have resorted to raising extra-budgetary revenues to survive. As recorded by the National Bureau of Statistics, the aggregate local fiscal incomes accounted for 53 percent of national revenues in 2017, whereas aggregate local spending consisted of 85 percent of total national spending. Moreover, the central government spent approximately 22 billion on education, while local governments spent 300 billion, which was 14 times as much as the central government. Apparently, when F1 and F5, clear and institutionalized delineation of authority across levels of government, were not safeguarded, higher-level authorities have acted opportunistically by retaining a predominant portion of financial resources, while pushing responsibilities down through the administrative hierarchy (吴晓波 2013; Zheng, De Jong, and Koppenjan 2010), regardless of whether the local units have the fiscal capacity to handle these responsibilities, thus compromising the subnational autonomy (F2) condition.

In addition, although Montinola, Qian, and Weingast (1995) were aware of the importance of a common market (F3), they attributed its formation almost exclusively to the elimination of local protectionism. Admittedly, within the framework of promotion-based competition in which leading officials must reach assigned targets within short time limits, local officials are motivated to comply with highly unrealistic targets or seek to falsify records if needed. As illustrated in our case analysis, local protectionism has also been a means by local officials to ward off competitors in the promotion tournament. A strong bureaucratic incentive for local protectionism, unfortunately, hinders the development of a common market environment, which is crucial for China's attempt to both "upgrade industry as a whole" (Chan 2004, 718) and to maximize public welfare by virtue of the economies of scale (Lu and Chen 2009).

Yet, as China's rate of urbanization accelerates, local protectionism becomes less a problem than the restriction of household registration in metropolitan regions. As argued by Tiebout (1956), local government competition through the "voting with your feet" mechanism may help to promote the efficient provision of local public goods that meet the needs of residents. However, for the competitive mechanism to function, production factors must be highly mobile across jurisdictional boundaries. In China, the current household registration (*hukou*) system severely limits citizens' ability to attain residential status outside their area of birth.[13] Although this system ensures the relative stability of local tax bases, such restrictions often result in local officials' willful neglect of the needs and discontentment of residents. In a deeper sense, since democratic elections might not be politically feasible at this point, a common market becomes the only leverage for citizens to "throw the rascals out" (Weingast 2009, 287). The absence of this mobility factor provides local officials with little incentive to honor citizens' rights, evidenced by J Town officials' utilization of the police forces to clamp down on local petitioners (also see: Chen 2017). Furthermore, local officials are utterly unmotivated to cater to the needs of the local residents if those needs are incompatible with key criteria for their promotion evaluation.

Moreover, Weingast (2009) has mostly neglected the pivotal role that the personnel system plays in softening local administrations' budgetary constraints (F4). Local officials in China are subject to the joint responsibility system, in which the adjacent higher-level government is jointly held accountable for the mistakes committed by their immediate subordinate administration. While this system motivates officials to closely supervise the actions of their immediate subordinates, it also creates incentives for them to hide their subordinates' mistakes when they inevitably arise. As a result, officials are motivated to protect their lower-level subordinates even when they raise revenues illegally, or to bail them out when their unit fails to meet its debt obligations. This partly explains the excessive borrowing by local governments over the past two decades despite the presence of a relatively centralized banking system. The resulting attenuation of F4 “the hard budgetary constraint” condition has created considerable threats to China’s economic stability.

As argued by Weingast (2009), well-developed market-preserving federalism also facilitates the effective functioning of intergovernmental transfers aimed at helping the disadvantaged. Yet as demonstrated in our case analysis, the current intergovernmental transfer system has faced many incentive distortion problems. For example, much of the current system aims at supporting local social service projects. Unfortunately, this system has failed to address many severe regional inequity problems as disadvantaged populations in poor regions have ironically received limited benefits from these programs (马栓友/于红霞 2003). Making matters worse, fiscal transfers travel through many layers of government before reaching their target populations. Many local governments have thus set up various schemes to siphon off transfer funds by developing “industrial improvement projects” that are a ruse to affect the transfer decisions but have little real impact on the local economy. Some have also used funds to set up representative offices in Beijing, where they can entertain officials from the central government and lobby for transfers. Although the central government has recognized W County as “poverty-stricken,” for example, its budget for entertaining higher-level officials is staggering. Based on rough estimates, the annual spending on “greeting” higher-level officials during inspections, which are golden chances to lobby for fiscal transfers, was between 700,000 and 800,000 RMB (周庆智 2004, 159).

Lastly, although the current decentralized fiscal system has motivated local government officials to support pro-market policies and to promote local economic growth, the personnel system ironically encourages local officials to adopt a short-term perspective in their economic development strategies (Xiong 2018). Specifically, given the policy preference for promoting younger cadres, local officials are forced to reach and even surpass the stipulated targets quickly so that they do not exceed the acceptable age limit at their next promotion opportunity. Under such time pressure, they may expand efforts to attract external businesses on the one hand, while trying to extract extra-budgetary revenues from local enterprises on the other. This helps explain why Mo County officials put forth preferential policies to attract sizable outside investments in the first place while switching their attitudes afterward and imposing unreasonable burdens on existing enterprises.

Notably, local officials inevitably find the promotion-based tournament less attractive as they grow older, leading to the “Age 59 phenomenon.” That is, according to statistics, the average age of Chinese officials found guilty of corruption is approximately 59. Having lost their motivation to continue to climb the administrative ladder given the mandatory retirement age of 60, local employees begin to use their remaining political power to grab as much cash and property as possible before retirement. It is interesting to note that out of the 32 local officials who were investigated or convicted over the past thirty years in Central County, 17 were the former heads of internal departments within the county. In the context of the Chinese bureaucracy, being head of an internal department usually signifies that someone has a limited chance for further promotion. As the likelihood of promotion becomes slimmer, especially during the later years of their careers, officials are more likely to think about lives after retirement and become more susceptible to corruption.

In sum, the current fiscal and personnel systems have undeniably helped promote the rapid development of China's economy. They have provided local governments/officials with strong incentives to create signs of economic prosperity within their respective jurisdictions. Many local economic success stories accumulated in the past thirty years have indeed increased the price of recentralization and anti-market policies of any kind. Yet as illustrated in our case analysis, China is still missing several critical preconditions for fully developed market-preserving federalism. Particularly when the institutionalized demarcation of intergovernmental fiscal authority is not fully in place, governments at each level are inclined to act opportunistically in the face of incentive distortions, which in the long run will create many economic and non-economic governance issues. Although Montinola, Qian, and Weingast (1995) might disagree, one may assuredly argue that well-developed market-preserving federalism ultimately depends on a stable and reliable constitutional framework.

DISCUSSION AND CONCLUSION

This study contributes to the current literature in several ways. First, it provides ample case-based evidence to illustrate the unintended consequences of China's bureaucratic incentive system. Second, it provides an initial analysis of how the identified incentive distortions may vary across socioeconomic contexts within the same country.[14] Highlighting the vital role of bargaining power in mitigating incentive distortions, the study shows the divergent paths of development in different regions. Additionally, we place the incentive distortions within the broader intergovernmental framework, emphasizing the need to develop institutional safeguards against opportunistic behaviors from all levels of government. This discussion contributes to a deeper understanding of what Weingast (2009) called the second generation of fiscal federalism by examining how personnel-related incentives may shape intergovernmental relationships, particularly during the post-tax reform era when the tax assignment system has dominated the fiscal relationship between central and local governments. Lastly, this study also examines several aspects in which China is still lacking in attaining a fully developed market-preserving federalism, more so than what Weingast and his associates have presumed.

In the final analysis, most of the incentive distortions identified in this chapter are rooted in China's predominant reliance on a vertical, single-party accountability system to shape bureaucratic behavior. This system is premised on long chains of principal–agent relations from Beijing down to the township and village level. As argued long ago by Downs (1967), a centralized control system inevitability suffers from the law of authority leakage and the law of counter control – the former referring to the inevitable distortions of information and orders as they are passed up and down a steep hierarchy, and the latter referring to the extra efforts subordinates will exert to counteract increased monitoring efforts by their superiors. In the absence of institutional guarantees preventing the central government from arbitrary interventions, the Chinese governing system may have already reached its limit in terms of using its centralized personnel system, in combination with a relatively decentralized fiscal system, as the institutionalized device for fostering economic growth. This system has created many distortions especially in relation to local officials' lack of interest in tackling other long-term and fine-grained governance issues such as environmental protection, social justice, and various social development issues. Viewed in this way, governance reform in China should not be focusing entirely on fixing problems with the vertical accountability system. In addition to delineating more clearly the respective authorities and responsibilities at different levels of government, the Chinese governing system needs more horizontal accountability mechanisms by increasing the oversight authority of the local people's congresses, introducing democratic elections of elected representatives, enhancing government transparency, protecting open media, and facilitating citizen participation in public policy making (Tang 2012; 邓穗欣 2019).

Although these institutional reforms clearly ought to be the long-term goals for governance reform in China, it is less clear how China may accomplish these goals in an orderly fashion. It is also noteworthy that market-preserving fiscal federalism is an ideal type, meaning that no country would perfectly attain all five institutional prerequisites. Different countries, including the United States, resemble market-preserving fiscal federalism only to a certain extent by partially meeting these ideal-type characteristics (Fornasari, Webb, and Zou 2000; Rodden 2002). Given China's fishbowl-like political environment, much research remains to be done to identify actionable solutions that can strike a delicate balance between maintaining the current system's positive effects on economic development and nudging it toward being more sensitive to other finer issues in governance.

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NOTES

1. On December 22, 2019, three of Weingast's many articles on China as a system of market-preserving federalism received more than 1,800 citations on Google Scholar: Weingast (1995); Qian and Weingast (1997); and Montionola, Qian, and Weingast (1995). Weingast (1995) had over 3,100 citations and has been regularly cited in the past fifteen years with around 150 citations per year.
2. As a corollary, as detailed by Lou (2008, 158–159), "between 1994 and 2005, national fiscal revenues increased from 521.8 billion to 3161.8 billion, an average annual increase of 17.8 percent. Total government revenue as a percentage of GDP increased from 12.3 percent in 1993 to 17.3 percent in 2005. Central government revenue as a percentage of total government revenue grew from 22.0 percent in 1994 to 52.3 percent in 2005, dramatically reducing the central government's reliance on local governments to turn over tax revenues."
3. While a major reason behind this humongous amount was China's stimulus package and monetary easing amid the global financial crisis between 2008 and 2010, local governments were advised to refrain from any further use of debt in the post-crisis era. Nonetheless, Xiong (2018, 1) suggested that "local governments managed to use even more debt, albeit from the less transparent shadow banking sector, to finance their investment booms."
4. The formula was specified as follows: total score = (points earned in economic task completion) * 100% * [1+ (aggregated points earned in other measured aspects/1,000)]. The maximum score for economic completion was 100, whereas the maximum total score assigned to other measured aspects was 1000. In this way, the points earned in other measured aspects were heavily discounted.

5. In J Town, the conflicts between government and local residents were caused mainly by disputes over land acquisitions (张丙宣 2011, 166). Hurst et al. (2014, 465) echoed this phenomenon by suggesting that "collective petitioning has likely become more common in wealthier areas, where land requisitions…are concentrated."
6. After several rounds of negotiation, J Town was approved to retain 6 percent, instead of 5 percent as initially determined by the H District government, of the revenue generated from property taxes (张丙宣 2011, 118–125).
7. For example, the head of the Agricultural Bureau in Mo County explained, "the budget our bureau receives each year is barely sufficient to maintain its internal operations. When we were at our wit's end, we had no other options than asking for higher-level governments' support, mainly in the form of special projects. That being said, it has become impossible for us to invest in our personnel, such as providing them training opportunities. As a result, new graduates rarely want to come to our bureau. A lack of talents further cripples our bureau's ability to develop innovative practices that warrant higher-level entities' attention, both administratively and financially. A vicious circle is thus at work" (何慧丽/赵晓峰/魏程琳 2011, 35).
8. In addition to the fact that performance contracts in W County had not been taken seriously, some specific items listed on these contracts were hardly inspiring. For example, one item was about "1–2 point penalties for local officials who do not submit their study notes on time" (周庆智 2004, 142). As the case author mentioned, performance contracts of this nature can hardly be seen as an instrument for incentivizing individuals to perform, but more of a study plan for underperforming students.
9. The case author noted, "When I was trying to figure out whether they [local officials in Central County] would be willing to accept my interviews in the afternoon, they told me that afternoon was not an option. Most likely, I would not find my interviewees in their offices. The typical schedule for local officials in Central County was as follows: they started reaching out to people for lunch at 11. During lunch, they would drink and exchange information. Afterward, they always went back home to take a nap. Another round of gathering started at night" (冯军旗 2010, 165).
10. The award system in J Town included three types of prizes: top-tier, second-tier, and third-tier. Top-tier winners were those who more than doubled the stipulated goal (accomplished 230 percent of the goal), second-tier winners were those who exceeded the stipulated goal by at least 60 percent (accomplished 160 percent of the goal), and third-tier winners were those who surpassed the stipulated goal by 30 percent (accomplished 130 percent of the goal). In 2007, top-tier winners were given a personal bonus of 100,000, second-tier winners a bonus of 60,000, and third-tier winners a bonus of 40,000.
11. This is evidenced by the fact that China's central government recentralized its banking industry in the mid-1990s. As Ong (2012a, 200) suggests, loan decisions, previously determined solely by governments at the county level, have been recentralized "at the prefectural level and above," particularly since 2000.
12. Although the centralized budgeting system in China plays a pivotal role in transferring and earmarking grants to local governments in a more reliable and transparent manner, Ang (2009, 271) bluntly pointed out that the system by itself won't be sufficient in achieving this envisioned goal. According to her analysis, it takes tremendous amounts of time for the system to "percolate to lower level governments." Hence, countermeasures can be devised by local governments during the course of this very process.
13. Although the household registration system is currently under heated debate and is highly likely to be reformed soon (e.g., Jiangxi Province drafted the reformed provincial household registration system on January 11, 2015), its negative impact is likely to continue into the foreseeable future. First, top-tier cities such as Beijing, Shanghai, Guangzhou, and Shenzhen are unlikely to ease their respective restrictions on household registrations due to their overpopulated situations. For people who already possess "*hukou*" in top-tier cities, they are unlikely to move to second-tier cities where the medical and educational resources are much inferior; but most of the migrant workers are working exactly in those top-tier cities where getting "*hukou*" is extremely difficult, regardless of whether the related policy will be reformed. For residents living in second-tier cities, nonetheless, moving to top-tier cities is not necessarily ideal either. The skyrocketing housing prices plus fierce

competition in the employment market (particularly the high-end labor market) become the major obstacle to the formation of a truly "common market."

14. The importance of regional variations has been increasingly recognized as crucial for understanding development in China. Hurst et al. (2014, 474), for example, argue, "it would be an invalid part-to-whole mapping to ascribe the virtuous set of organizational roles and relationships uncovered in some areas of one province to all of China."

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