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Central versus local states: Which matters more in affecting China's urban growth?

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ABSTRACT

To date, many geography studies have identified GDP, population, FDI, and transportation factors as key drivers of urban growth in China. The political science literature has demonstrated that China's urban growth is also driven by powerful economic and fiscal incentives for local governments, as well as by the political incentives of local leaders who control land use in their jurisdictions. These parallel but distinct research traditions limit a comprehensive understanding that can result in partial and potentially misleading conclusions of urbanization in China. This paper presents a spatially explicit study that incorporates both political science and geographic perspectives to understand the relative importance of hierarchal administrative governments in affecting urban growth. We use multi-level modeling approach to examine how socio-economic and policy factors – represented here by fiscal transfers – at different administrative levels affect growth in "urban hotspot counties" across three time periods (1995–2000, 2000–2005, and 2005–2008). Our results show that counties that are more dependent on fiscal transfers from the central government convert less cultivated land to urban use, controlling for other factors. We also find that local governments are becoming more powerful in shaping urban land development as a result of local economic, fiscal, and political incentives, as well as through the practical management and control of capital, land, and human resources. By incorporating fiscal transfers in our analysis, our study examines a factor in the urban development of China that had previously been neglected and provides an improved understanding of the underlying processes and pathways involved in urban growth in China.
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Introduction

Studies of urbanization in China can be divided into two broad categories: spatially explicit studies and non-spatial studies. In the former category, researchers focus on monitoring, analyzing, and modeling the temporal–spatial patterns of urban growth mostly with the use of remote sensing images, geographic information, and socio-economic variables from statistical yearbooks (Liu et al., 2012a; Schneider and Woodcock, 2008; Seto and Fragkias, 2005). These geographical studies have identified GDP, population, FDI, and transportation factors as key drivers of urban growth in China (Deng et al., 2008; Fragkias and Seto, 2007; Long et al., 2007; Seto and Kaufmann, 2003; Wu and Zhang, 2012). In the latter category, the processes of urban growth are examined from the perspective of institutions, governance, and the power of states mostly with the use of in situ field investigations, participatory observations, interviews, governmental and archival documents, and analyses of official policies (Lin and Ho, 2005; Perlstein, 2012; Wallace, 2009; Wu, 2002; Zhang and Gao, 2008; Zhang, 2002). The political science literature has demonstrated that the urban growth is driven by powerful economic and fiscal incentives for local governments, as well as the political incentives of local leaders who control land use in their jurisdictions (Lichtenberg and Ding, 2009; Lin, 2009; Liu et al., 2012b; Zhang and Gao, 2008; Zhang, 2002).

These parallel but distinct research traditions limit a comprehensive understanding of urbanization in China because the approaches and insights have remained separate rather than informing each other. Importantly, without considering the roles played by institutions and governance in affecting urban growth in China, any spatially explicit analysis of the drivers of urban growth will result in partial and potentially misleading conclusions and will ultimately fail to effectively guide sustainable urban development. In addition, the underlying processes and pathways of urban drivers may not be revealed. We therefore argue that the incorporation of policy variables to spatially explicit urbanization

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studies will provide a more comprehensive framework for better understanding urban growth patterns and processes in China.

Given the aforementioned context, previous studies mostly interpret China's urbanization as driven by either macro-level factors (such as GDP, population, and FDI) or non-spatial institutional factors separately. This leads to uncertainty as to whether all the spatially variant factors outside these identified drivers have been taken into account, which in turn leads to the key research questions in this paper: If some important factors have been missed, to what extent do they control urban growth in China? Does the inclusion of these policy or fiscal factors in a spatially explicit model of urban growth alter the established relationships of the standard drivers? Furthermore, as perhaps indicated by intergovernmental fiscal transfers, to what degree does the central government affect local decisions and urban growth at the local level? Is it central or local states that matters more in shaping local landscape? How important is the central–local relationship? How do these factors vary over time and across space in China? To date, spatially explicit studies of the hierarchical governments' roles in affecting urban growth and empirically modeling the relationship between intergovernmental fiscal transfers and urban growth in China remain underexplored, especially at the national level and in a systematic manner on the consistent and comparable longitudinal data. In order to fill in this knowledge gap, the primary purpose of this paper is to examine the degree to which the central government, local government, and central–local relationship affect urban growth in China by combining both political science and geographic perspectives.

Fiscal transfers and cultivated to urban land conversion

Conceptual framework for the relationship between fiscal transfers and cultivated to urban land conversion

Local governments operate under budget constraints. The expenditures of local governments often exceed their budgetary revenues. Faced with this difficulty, local governments finance expenditures through revenues accrued by the selling and transferring of land use rights (Fock and Wong, 2008; Oi and Zhao, 2007; Wong, 2007, 2012), while also utilizing transfer payments from higher levels of government. In this way, fiscal transfers can theoretically substitute for land use change at the local level, by providing the funds required of local governments to pay for their essential operations. Intergovernmental fiscal transfers account for a large share of local budgets, revealing the dependency of local economies on the central government in the post Tax Sharing System (TSS, *fenshuizhi*) environment. To some degree, fiscal transfers also represent the policy preferences of the central government. Therefore, investigating the relationship between fiscal transfers and cultivated to urban land conversion (hereafter land conversion) can improve our understanding of the interactions between and the relative importance of central and local governments in affecting China's urban growth.

Public finance reform and intergovernmental fiscal transfers

When the planned economy dominated the Chinese economy, the central government could manipulate prices in the economy to ensure that excess profits would be concentrated in a few firms; revenues would then be extracted from those excesses. With marketization came the destruction of the government's ability to collect revenue in this fashion as firms could sell goods at market prices outside of the plan rather than accept the substantially lower plan prices for their goods (Naughton, 1992). In 1988, the government created fiscal contracts with firms and provincial-level units to try to replace revenue lost due to marketization (Wong and Bird, 2008). This fiscal contracting system (*caizheng baogan*) put local governments on a self-financing basis for the first time and continued to erode the fiscal position of the central government (Wong, 1991; Wong and Bird, 2008; Wong et al., 1996).

The continuation of the central government's fiscal decline was finally put to a halt by the 1994 fiscal reform, which brought revenues that were commensurate with its political power to the center. The 1994 fiscal reform reversed the trend of the earlier reform era of a weakening central state by reestablishing control of the fiscal system to the central government from localities.

The most important component of the 1994 fiscal reform was the creation of the TSS. The TSS "fundamentally changed the way revenues are shared between the central and provincial governments, by shifting from a negotiated system of general revenue sharing to a mix of tax assignments and tax sharing" (Wong and Bird, 2008). The TSS divided all taxes into central, local and shared tax.[1] Most critically, 75% of the value-added tax (VAT), which accounted for almost half of all government tax revenue, were shifted to the central government with the remaining 25% for the local government (Wong and Bird, 2008). The TSS was a dramatic change. Prior to the TSS reform, local governments sent transfers to fund the central government. After the reform, local governments depended on transfers from the central government to pay for the operations, salaries, and facilities of local governments (Oi and Zhao, 2007). The 1994 fiscal reform changed the power of different levels of government – it strengthened the central government by claiming for itself a substantially larger share of revenues from the provinces (Li, 2010; Wong, 2000; Zhang, 1999). The expenditure assignment did not recentralize in accordance with the revenue; and the main responsibilities for public goods and services remained concentrated in local governments (Lin and Yi, 2011; Lin, 2009; Man and Hong, 2011).

Fiscal transfers data

Fiscal transfers data were obtained from *All China Prefecture City County Fiscal Statistical Data* (*Quanguo Di Shi Xian Caizheng Tongji Ziliao*), which are produced by the Ministry of Finance of China. We categorized the fiscal transfers data into internal revenues, tax rebates, and net fiscal transfers considering the availability and consistency of data at the county level over time. Internal revenues comprise taxes collected by local governments. The difference between internal revenues and total revenues equals the total fiscal transfers from central government to local states. Deducting tax rebates from total fiscal transfers yields net fiscal transfers. We developed indexes, such as total and net fiscal transfers as percentages of total revenue, to measure the dependency of local economies on fiscal transfers from the central government.

Between 1999 and 2004, Tibet had the largest fraction of total fiscal transfers as a percentage of total revenue, at 84.2%, and Fujian had the smallest percentage, at 35.6%. During this same period, Tibet also had the largest share of net fiscal transfers, at 79.2%, while Jiangsu had the smallest at 18.7% (Fig. 1). That a larger fraction of fiscal transfers went to less developed provinces reflects the national policy to develop western regions and revitalize the old industrial base of northeast China.

At the county level, there was a geographic gradient in the total and net fiscal transfers as percentages of total revenue. In general, the amount of total and net fiscal transfers is highest in the west

[1] The TSS divided all taxes into three categories: central, such as tariff and consumption tax; local, such as business tax, urban maintenance and construction tax, housing property tax, and fixed asset investment tax; and shared, such as value-added tax (VAT), and corporate and personal income tax.

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