

Overview of the discussion on the problem of local governmental debt

- how to ask the question.
- there are different ways of classifying local governmental finance. Different ways of cutting the debt also draws our attention to different kinds of problems.

Two ways to ask the question:

Why do they have debt? (Jean Oi/Zhao Shukai's question)

(how you ask the question has a big impact on whether you focus on proximate causes or systemic causes.)

Jean Oi and Zhao Shukai listed all the reasons that local officials borrow money and then are unable to return it. For instance, “look at rising costs, look at reasons why revenues are declining, look at why funds are borrowed and not paid back.”

Rising costs

- increasing expenditures: increasing wage bill and inflated bureaucracy – some because of central regulations requiring townships to take in new college graduates, some because they have to absorb surplus educated labor in their locality, some because of patronage.
- Targets from above: meeting educational standards, developing agriculture, investing in basic infrastructure
- Justin Lin and his colleagues point out targets can be justifications for increasing wage bills since higher levels cannot observe exactly how much it really costs to implement their policies → goes back to an information problem.

Declining revenues

- tax-for-fee reform
- rise in tax noncompliance, especially after Beijing's announcement that agricultural tax will be abolished within 5 years (Oi and Zhao, 21)

Unreturnable loans

- borrowing to cover tax noncompliance
- borrowing to service debt
- borrowing to cover collapse of rural credit associations and TVEs
- borrowing to create a continued illusion of high tax revenues and rapid economic development for political advancements

To recap, Jean Oi and Zhao Shukai's approach focuses on proximate causes/factors that are specific to the things that have been affecting rural China in recent years.

Why don't they have good fiscal management? (Lili Tsai's question)

She identifies the necessary conditions for good fiscal management (of local governments) and which ones are missing. In other words, conditions that local governments need to incentivize to pursue good fiscal management.

- Must either reduce their bailout expectations (of both officials and villagers) or reduce their access to credit.
- So why do they have high bailout expectations? Tsai argues that high bailout expectations result from strong clientist institutions – personal social and kinship networks of village officials, villages which have produced higher-level officials, villages which have been “adopted” by higher-level bureaus in an informal system designed to foster patron-client ties, ties to former sent-down youth, etc. Clientist institutions are encouraged and fueled by a system where almost all higher-level transfers are in the form of *ad hoc* discretionary funds. Local officials can be bailed out by multiple offices at multiple levels of the government (unlike the two-level central-local bailout game in other decentralized systems).
- Why do they have such an easy access to credit? Lack of incentive and capability for higher levels to monitor central government regulations prohibiting borrowing to cover budget deficits (Tsai argues at the village level exacerbated by institution of village elections which increases local autonomy by decreasing top-down control but without increasing bottom-up accountability); lack of institutionalized and systematic auditing of local governments by higher-level governments; horizontal control of local bank branches by local governments.
- Note: villages may also have preferences for fiscal indiscipline. If villagers know that they will not have to pay the costs of fiscal mismanagement in the form of raised taxes – because Beijing will not allow ‘peasant burden’ to be increased – then of course, they either don't care if officials borrow money to embezzle it or invest it in useless projects that help them get promoted, or they may actively prefer officials to borrow money for public projects and not pay them back, thereby getting public projects for free.

Different ways of categorizing local finance

Formal vs. informal finance, interaction between informal and formal institutions

Why don't higher levels of government stop local governments from over-borrowing or running deficits? Long-running system of informal finance

- inability of state to obtain accurate information about local revenue capacities lead to evolution of local informal finance – a longstanding norm of allowing local governments to create informal mechanisms for completing state mandated tasks.
- During the Maoist period, the state could not get accurate data on grain

production. So a cheap way to minimize the amount of grain hidden locally was to increase the expenditure responsibilities of local governments without allowing them sufficient budgetary funding to cover these expenditures.

- Local governments could only hide so much without getting caught, so at least this way, most of what they managed to hide would have to go into funding public projects which were generally more easily observable than grain production.
- *In other words, the state's rule on local revenue retention were made to be broken.* The state asked for more surplus than they really expected.
- Local norms developed making informal finance acceptable: local officials were allowed to hide grain from the state, illegally borrow loans, and use funds for unsanctioned purposes as long as they were used for carrying out state tasks.
- In sum, the state's strategy was: *set unachievable formal targets for surplus extraction and public services provision but allow local officials to establish informal institutions for trying to meet these targets.*
three advantages: (1) the state could pursue ambitious development plans while minimizing the resources spent on monitoring local officials.
(2) the state is relieved of pressure to invest in constructing formal institutions for information transmissions and income redistribution
(3) it allows the state to avoid blame from farmers that would occur if state followed "draconian route of Stalin to extract maximum amounts of grain at any cost." (Oi and Zhao)

Conclusion of Tsai's paper:

1. Grassroots democratic reforms, which should have militated against the diversion of public funds away from public services, have increased the autonomy of local officials without strengthening their accountability to citizens. (p. 33)
2. It may be more useful to examine local democratic reforms in terms of decentralization rather than through the lens of the "democratization" paradigm
3. By focusing on the interaction between formal and informal institutions, we see that in places with extensive informal clientelist norms and networks, decentralization may be a very bad idea. (34).
4. In places where Party institutions of control are still strong, the state can counteract these incentives by controlling personnel appointments, including party norms of discipline, and enforcing state regulations against local governmental borrowing. In places where clientelist norms and networks are weak, Party institutions of control may not need to be strong since village officials have far lower bailout expectations and are more likely to manage public funds carefully.
5. In the end, it may be that the most important challenge facing the state with respect to local governance is not getting decentralization right and devolving

power to local levels – but successfully deploying power at higher levels to replace informal institutions at the local level with formal ones.

Seminar Discussion

The debate: on whether and why that informal mode of local financing described in Lili’s paper is a bad thing. Why called it “fiscal mismanagement”? Can we look at the Chinese system and say it is just a very resilient system? In that view, decentralization is good, the more autonomous the local governments are, the better chances for informal institutions to sprout. Decentralization in fiscal terms is a good thing in Weller’s view. Let the local informal associations come up with their way of public goods delivery.

- the disciplinary problem consciousness (embedded in poli-sci vs. cultural anthropology) affects a scholar’s assessment of whether informal local finance is a good or bad thing. Are informal institutions necessarily bad? Should informal ones be replaced by formal ones to achieve better accountability as Lili argued?
- the discourse of modernity and efficiency and formal institutions underlie the negative assessment of the informal local finance → back to the 西方问题意识/中国问题 controversy. But does the critique of Western modernity and rationality necessarily lead us to the romantic celebration of the “ traditional”?

Lili’s response to Rob Weller: A feasible approach is to allow there to be local autonomy at the level where social network is the thickest. But at the level where social network thins out, you need formal institutions to monitor and to contribute their share to the locale. I am not simply arguing for a top-down recentralizing approach. The advantage of reinserting formal institutions into the picture is that oftentimes, the state brings in its own resources and techno support that informal institutions lack and don’t have the resources to provide.

Methodology: Since clientelist ties are the linchpin of this research project, Weller asked: how do we know that those villages which did not get informal subsidies/loans have fewer clientelist ties with higher levels of government (an underlying assumption in Lili’s paper)? It was suggested that Lili incorporate into her interviews of local officials questions that further probe the nature of the clientelist relationship between village leaders and township authorities: (1) class mate relationships; (2) marital ties; (3) military ties; (4) cadre background variables. It was also suggested that interviews with township authorities incorporate ways of figuring out their thought processes (i.e., how did they pick subsidy winners?) Kate Hartford wondered if there may be reasons other than clientelism (such as that they may have calculatedly picked economic winners – those places that can make the most of the \$) that affected the decision making of township authorities in favor of certain villages against others.