

Beijing, local leaders fight over taxes

by Cho Wen-pin

Over Nov. 11-14, the Communist Party of China held its third Central Committee plenum, a meeting hailed by its propaganda machine as kicking off the second phase of economic reforms. Prior to the plenum, Beijing had announced that dramatic policies would be implemented to restore to itself some control over the nation's credit, but intensive resistance from the provinces, where free trade, slave labor, and speculation dominate, led to a series of compromises at the plenum. The fight is expected to continue over the measures the committee adopted, which include:

Banking: To make the People's Bank of China more independent in monetary policy, it will establish a reserve ratio on deposits and lending rates to protect the value of the yuan; create a floating exchange rate based on market forces, and transform the yuan into a convertible currency; and encourage the development of commercial banks with floating interest rates on loans and deposits. The reformed central bank is said to be modeled on the German Bundesbank, as are the new policy banks on construction, trade, and agriculture set up under the guidance of executive committees modeled on Japan's Ministry of International Trade and Industry.

Taxation: The systems of local and government taxation will be separated (the central government takes in the revenues and then redistributes them to the provinces, taking into account underdeveloped economic regions), and will create an indirect taxation system based primarily on a valued-added tax.

A two-tier tax system

The tax overhaul envisions introducing a two-tier tax system at the central and local levels. It envisions a change from the current system of fiscal contractual responsibility, to a tax assignment system on the basis of a rational division of powers of taxation between central and local authorities.

Since the policy banks, especially the construction bank, don't generate Hamiltonian-type credits, government funds to invest in infrastructure come only out of tax revenues. Beijing's arguments for tax reform, which gives the central government stronger financial authority, are to gain "macro control" over the economy, to cut the government's soaring deficit. Twelve days prior to the meeting, it was reported by *Wen Wei Po*, Beijing's mouthpiece in Hong Kong, that from Jan. 1, this new package will accelerate taxation restructuring. To stop news leaks on the policy fights, some reporters

were arrested before the meeting on national security grounds.

After the meeting, on Nov. 17, Finance Minister Liu Zhongli told the press that the new tax system will be introduced gradually, so that regional interests will not be immediately affected. He assured everyone that in working out the reform plan, the central government has taken fully into account the realities of businesses and the interests of localities, according to the official news agency Xinhua. The next day, Jin Xin, the commissioner of the State Tax Administration, admitted that China will have trouble implementing the new regulations. "Public awareness of the need to pay taxes is poor compared to that in developed countries," he said. "In the past, we did not have the custom [of paying taxes], or the appropriate income level in China. . . . We must raise the awareness of our people."

These statements from top officials suggest that the tax reform proposal has been sharply challenged by the coastal provinces, such as Guangdong, Deng's best mousetrap, which is run by corrupt officials who often sell out their constituents' interests to speculators and investors in slave labor. As the November issue of the Hong Kong magazine *Tangtai* pointed out, "The local government questions the wisdom of the central authorities' judgment." Vice Prime Minister Zhu Rongji, who started to consolidate the central government's power with the 16-point program announced four months ago, has seen his effort weakened by Beijing's concessions on the tax issue to the southern provincial leaders.

In a sense, the southern China provincial leaders are embracing ideas like those of the American Confederacy in the last century—ideas that caused a catastrophe. (This is not to suggest that northern China today is analogous to the pro-Union states in the U.S. Civil War.)

Americans and "economists" like free enterprise madman Milton Friedman support the idea. He was in China before the plenum and was received by President Jiang Zemin, who also met Lawrence Klein. Friedman told the *Far East Economic Review* that he endorses a "bottom-up" approach to reforming the economy; he believes that China's central government has given too much support to industry. To Friedman, it seems that only Beijing's control of economic policies—not its lack of moral commitment to raise people's standard of living, to develop the nation-state, to develop each sovereign individual's creativity, and to safeguard human rights—causes corruption, financial chaos, and inefficiency.

Many economists in China who think like Friedman are advising decisionmakers to push "deepening reform"—a Chinese version of "shock therapy." Just as during Mao Zedong's "Great Leap Forward" in the late 1950s, which cost China over 30 million lives, this descent into a warlord economy, if not soon reversed, is a prelude to the disintegration of China and civil war.