BUDGET ACCOUNTING IN CHINA: CONTINUITY AND CHANGE

James L. Chan

ABSTRACT

Under the orthodox socialist model, governmental accounting in China became budget accounting. Given the close link between accounting and budgeting, major changes in the Chinese economic system in general, and in public finances in particular, are bringing about some potentially fundamental changes to the Chinese government accounting system. The promulgation of a new budget law in 1994 has quickened the pace of reform. This paper analyzes the key reform provisions of the law and explores their implications for accounting and the need for new standards to strengthen accountability and financial control. It proposes that governmental accounting has a mission and scope broader than the state budget, which no longer covers most of the economic activities and financial transactions of the Chinese public sector. This requires a new accounting framework that includes but is not limited to budgetary control. The building blocks and likely controversies for such a framework are described.

Table 1. An Overview of the Chinese Economy

<table>
<thead>
<tr>
<th>Year</th>
<th>GNP (Billions 1987 constant yuan)</th>
<th>Annual Growth Percent</th>
<th>Inflation Percent</th>
<th>Central Level Budget Deficit (Billions yuan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979</td>
<td>544.70</td>
<td></td>
<td>2.00</td>
<td>17.06</td>
</tr>
<tr>
<td>1980</td>
<td>587.20</td>
<td>7.80</td>
<td>6.00</td>
<td>12.75</td>
</tr>
<tr>
<td>1981</td>
<td>613.60</td>
<td>4.50</td>
<td>2.40</td>
<td>2.55</td>
</tr>
<tr>
<td>1982</td>
<td>667.00</td>
<td>8.70</td>
<td>1.90</td>
<td>2.93</td>
</tr>
<tr>
<td>1983</td>
<td>735.70</td>
<td>10.30</td>
<td>1.50</td>
<td>4.35</td>
</tr>
<tr>
<td>1984</td>
<td>842.70</td>
<td>14.54</td>
<td>2.80</td>
<td>4.45</td>
</tr>
<tr>
<td>1985</td>
<td>944.90</td>
<td>12.13</td>
<td>8.80</td>
<td>-2.16</td>
</tr>
<tr>
<td>1986</td>
<td>1020.80</td>
<td>8.03</td>
<td>6.00</td>
<td>7.05</td>
</tr>
<tr>
<td>1987</td>
<td>1130.10</td>
<td>10.71</td>
<td>7.30</td>
<td>7.96</td>
</tr>
<tr>
<td>1988</td>
<td>1252.40</td>
<td>10.82</td>
<td>18.50</td>
<td>7.86</td>
</tr>
<tr>
<td>1989</td>
<td>1305.20</td>
<td>4.22</td>
<td>17.80</td>
<td>9.23</td>
</tr>
<tr>
<td>1990</td>
<td>1379.90</td>
<td>5.72</td>
<td>1.60</td>
<td>13.96</td>
</tr>
<tr>
<td>1991</td>
<td>1475.10</td>
<td>6.90</td>
<td>3.00</td>
<td>20.27</td>
</tr>
<tr>
<td>1992</td>
<td>1677.50</td>
<td>13.72</td>
<td>5.60</td>
<td>23.75</td>
</tr>
<tr>
<td>1993</td>
<td>1902.30</td>
<td>13.40</td>
<td>14.50</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Lieberthal (1995), column (2) derived from the author from (1).

With almost 1,200 million people, China has 22 percent of the world population. Among them are 1,800,000 accountants working in the almost 500,000 administrative agencies and public service institutions in the public sector, and many more are in state enterprises. The changing nature of their work is the subject of this paper.

The rapid and sustained growth of the Chinese economy produced by economic
reform since 1979 (Table 1) ironically has resulted in a weaker public sector beset with fiscal woes. As recently as the early 1980s a World Bank report (Dernberger 1991, 532) was able to state: “The principal instrument of financial control over the [Chinese] economy is the state budget, through which about 30 percent of GDP flows.” In 1994 government revenues accounted for only about 12 percent of GDP in 1994, a decline of 15.8 percent from the 1979 level. Falling revenues and rising expenditures led to a 480 percent rise in the central government budget deficit, from 11.5 billion yuan in 1990 to 66.7 billion yuan in 1995. In 1995 the central government issued 153 billion yuan of debt (2.9% of GDP), almost a sevenfold increase since 1990. The central government’s ratio of debt issues to expenditures rose from 21 percent in 1990 to 52.8 percent in 1995 (Gao 1995, 3). Deficit financing seems to have become the norm. Clearly, managing the public finances of China is an enormous challenge, but it is critical to the government’s capacity to influence the course of the economy and sustain the pace of reform (Wang 1994).

In pursuit of economic reform, China has initiated a series of steps to change its public budgeting system. A new budget law, promulgated in April 1994, has been in effect since January 1, 1995. As governmental accounting in China is heavily influenced by budget concepts and practices—indeed it is commonly called “budget accounting”—efforts are currently underway to formulate a new set of accounting standards. The dynamic changes in the budgeting system have created a great deal of uncertainty, as well as opportunity, for reforming Chinese governmental accounting. A purpose of this paper is to explore governmental accounting standards issues that call for input from the changes introduced in the new budget law.

Section I describes the symbiotic relationship between public budgeting and governmental accounting in China. Section II documents the structure and process of Chinese public budgeting. Section III analyzes the 1994 Budget Law, focusing on changes that have significant accounting implications. The concluding Sections IV and V identify issues expected to be addressed in budget accounting standards.

I. TRADITIONAL BUDGET ACCOUNTING

A. A Taxonomy of Chinese Accounting

In recent years accounting in China has undergone major reforms as a result of its conversion from a centrally planned economy to what it calls a socialist market economy. A new set of accounting standards has been implemented for business enterprises operating in both the private sector and the public sector (PRC Ministry of Finance 1992). Next on the reform agenda is budget accounting. What is budget accounting?

The Domain of Budget Accounting

The term “budget accounting” is a reflection of China’s official ideology of socialism. China’s constitution adopted in 1982 (Lieberthal 1995; Zheng 1992) contains the following relevant provisions:

Article 6. The basis of the socialist economic system of the People’s Republic of China is socialist public ownership of the means of production, namely, ownership by the
Article 7. The state economy is the sector of socialist economy under ownership by the whole people; it is the leading force in the national economy. The state ensures the consolidation and growth of the state economy.

Figure 1. The Functions and Organizations of the Chinese Government

Article 15. The state practices economy on the basis of socialist public ownership. It ensures the proportionate and coordinated growth of the national economy through overall balancing by economic planning and the supplementary role of regulation by the market....

Article 16. State enterprises have decision-making power with regard to operation and management within the limits prescribed by law, on condition that they submit to unified leadership by the state and fulfill all their obligations under the state plan....

Article 17. Collective economic organizations have decision-making power in conducting independent economic activities, on condition that they accept the guidance of the state plan and abide by the relevant laws....

Under these constitutional provisions, the Chinese state possesses both ownership and management functions (Figure 1). It owns national resources and business enterprises either wholly or partially. It is also responsible for managing the society and the
economy. This second function is carried out through (a) state-operated enterprises and public service institutions, and (b) government administrative agencies, which implement public policies. As the right-hand side of Figure 1 indicates, budgetary control by the state is stringent for government agencies, moderate for goods/service producing organizations in the public sector, and minimal for enterprises in which the government has ownership.

A Sino-American Comparison

To avoid the need for repeated definitions, a few key terms should be introduced at this point. Table 2 provides a comparison between Chinese and American public sector organizations. In China, it is customary to refer to organizations as “units” (or danwei). The implication is that, no matter how large an organization is, it is still a component (unit) of a larger entity—the state. The Chinese state is administered by a cabinet (called the State Council) under the formal oversight of the National People’s Congress, with a similar setup at four to five levels of local government. There exists a formal separation between the parallel structures of the state and the ruling Communist Party. However, the party determines China’s national policy, and party members occupy virtually all policy-making positions and most managerial positions (Lieberthal 1995).

In the context of the Chinese state, there are three major categories of units: administrative units, institutions, and enterprises. Administrative units (xingzhen danwei) make and implement public policies. They correspond to all types of governmental bodies in the American context, including governing boards and oversight bodies. Nonprofit organizations that render services are called institutional units or simply institutions (shiye). They correspond to government-owned educational institutions, health care providers, and social service agencies. American public authorities and government corporations also perform functions similar to some Chinese “institutions.” In keeping with its socialist character, the Chinese state also owns or operates a large number of diverse business enterprises or simply enterprises (qiye), ranging from manufacturing concerns to trading companies and financial institutions. American counterparts to these are few in number, but would include the Tennessee Valley Authority for generating electricity, or local utilities and airports.

The diversity of Chinese public sector functions is reflected in Chinese public sector accounting. Conceptually, the Chinese public sector may be thought of as a decentralized firm with three types of responsibility centers: cost centers, breakeven centers, and profit centers. These correspond roughly to the administrative units, institutional units, and public enterprises in the Chinese context. As state enterprises and the emerging private enterprises are required to follow the same set of accounting principles, the term “enterprise accounting” is commonly used to refer to state enterprise accounting. From the perspective of theory and practice, in a broad sense, Chinese budget accounting encompasses what would be termed “governmental accounting” and “nonprofit accounting” in the United States.
Table 2. A Comparison Between Chinese and American Public Sector Organizations

<table>
<thead>
<tr>
<th>China</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative Units</td>
<td>Government Bodies:</td>
</tr>
<tr>
<td></td>
<td>▪ Administrative</td>
</tr>
<tr>
<td></td>
<td>▪ Legislative</td>
</tr>
<tr>
<td></td>
<td>▪ Judiciary</td>
</tr>
<tr>
<td></td>
<td>▪ Regulatory agencies</td>
</tr>
<tr>
<td>Institutional Units (Services)</td>
<td>Government-owned or affiliated</td>
</tr>
<tr>
<td></td>
<td>▪ Universities and colleges</td>
</tr>
<tr>
<td></td>
<td>▪ Elementary and secondary schools</td>
</tr>
<tr>
<td></td>
<td>▪ Hospitals and other health care providers</td>
</tr>
<tr>
<td></td>
<td>▪ Social service agencies</td>
</tr>
<tr>
<td></td>
<td>▪ Public authorities (e.g., housing)</td>
</tr>
<tr>
<td></td>
<td>▪ Government corporations (e.g., Postal Service)</td>
</tr>
<tr>
<td>Public Enterprises (Production)</td>
<td>Federal government corporations (e.g., Tennessee Valley Authority)</td>
</tr>
<tr>
<td></td>
<td>Local government enterprises (e.g., airports, utilities)</td>
</tr>
</tbody>
</table>

As a consequence of the state budget being a tool for central economic planning in a socialist country, Chinese governmental accounting is officially known as budget accounting. The influence of the budget is so strong that accounting as such does not have an independent identity. Accounting is considered only as a tool for monitoring and controlling budget execution. Furthermore, the term “governmental accounting” is often associated with the era prior to the establishment of the People’s Republic of China in 1949 (Chan 1995). However, this ideological interpretation of the term has lost some of its validity as China moves toward a market economy.

B. Public Financial Management Process

The leading role of the budget is reflected in the design of the Chinese public financial management process. After the budget is prepared, it is reviewed and approved after any modifications are made. Budget execution follows, accompanied by the recording of financial transactions and activities. At the end of the fiscal year, the books are closed and annual accounts are prepared and audited (Figure 2).

![Figure 2. The Public Financial Management Process in China](image)

In comparison with the American system, there are a few noteworthy differences. First, an annual state budget is articulated with the five-year national development plans currently in effect. Second, the preparation of the state budget involves the combination
of several levels of sub-national governments, eventually merging with the central government budget to form the state budget (detailed in the next section). Third, while legislative bodies (People’s Congresses at each level of government) have the formal authority of budget approval and oversight, the budget process is dominated by the executive branch, especially the Ministry of Finance and finance bureaus at lower levels of governments. Fourth, legislative monitoring of budget execution occurs within the fiscal year. Fifth, the “final accounts” (i.e., after the books are closed) are subject to the approval of legislative bodies.

As Chinese government accounting is currently in effect an adjunct to the state budget, it would not be possible to have a full understanding of it without comprehending the Chinese public budget structure and process in some detail. This is done in the next section.

II. CONVENTIONAL BUDGET ACCOUNTING

The State Budget of China consists of the budget of the central government and the combination of provincial budgets (formally called the local government budget). These budgets are termed “overall budgets” (jon yushuan) to distinguish them from “unit budgets” (danwei yushuan). Logically, the budget accounting system is structured in terms of “overall budget accounting” and “unit budget accounting.”

A. Overall and Unit Budgets

As Figure 3 shows, there are five levels in the budgeting system corresponding to the five levels of government in China—central, provincial, city/county, town, and village.2 (Below the provincial level there is a distinction between urban areas [i.e., cities] and rural areas. The hierarchy of county, towns and villages applies to the rural areas; large cities usually contain several counties. A few major cities, such as Beijing and Shanghai, report directly to the Center and are regarded as provinces for purposes of financial management.)

Starting from the bottom rung of the hierarchy of the Chinese government, the overall budget of a village is made up of the unit budgets of all institutions and the unit budgets of all administrative agencies at the village. (In contrast to the pre-reform period, the budgets of government-owned public enterprises are not included in the overall budget of government at all levels.) Likewise, all unit budgets of a level are reviewed and approved at their respective level. This horizontal aggregation of the budget preparation process is repeated at each of the village, town, city/county, and provincial levels, as well as at the central government level.

The overall budgets of all villages in a town are submitted to the town, the next higher level of government, where they are reviewed, modified, and eventually approved. Plus, the town level of government has its own administrative agencies and institutions, and the unit budgets of these town-level organizations are also prepared, reviewed, and approved at the town level. At this point, the town overall budget is formed by merging the approved town-level unit budgets as well as the approved overall budgets of the town’s subordinate governments (namely the villages). This vertical integration process of successive review, approval and submission is repeated upward: villages → towns →
counties/cities → provinces and eventually to the Center.

Figure 3. Budget Structure and Preparation in China

At the central government level, the overall budgets of all the provinces (collectively termed the "Local Government Overall Budget") are merged with the Central Government Overall Budget to constitute the State Budget. Thus China has a unified public budget. (In contrast, the Budget of the United States Government does not encompass those of 50 states and the over 80,000 local governments. Nor is it a common practice for the budget of an American state, i.e., the equivalence of a Chinese province, government to include the budgets of the local governments in its jurisdiction.)

As we have seen, unit budgets are the building blocks of an overall budget in the Chinese public budgeting system. The system classifies units, administrative agencies, and institutions in terms of their dependency for the state’s budgetary support. Organizations that depend completely on the higher-level government’s budget support are termed “full budget management units.” Some institutions (e.g., hospitals and
educational institutions) are permitted to charge fees for their services on a regular basis. They may nevertheless ask for subsidies to cover some of their costs. These are called “differential budget management units.” Finally, organizations expected to cover all their costs from their own revenues—self-supporting operations—are descriptively called “self-receipt self-payment budget management units” (Tang 1992, 148-149).

The highly integrative nature of the Chinese budgeting system requires the support of an equally integrative accounting system. There are nationwide uniform charts of accounts for revenues and expenditures. Not only do the unit budgets have to tie with the overall budgets, a unit budget for a multilevel organization is supported by an accounting system at each level. Elaborate systems, procedures, and forms are designed to process a vast number of upward remittances and downward allocations of funds, transfers, and grants. These are described in Chinese-language textbooks (e.g., Shi and Jiang 1993). What follows is a distillation of a few important concepts underlying the current system.

B. Characteristics of the Chinese Budget Accounting System

“Budgeting dictates accounting.” This is probably the simplest way to sum up the way government accounting is practiced in China today. The budget laws enacted are elaborated by rules and regulations issued by the Ministry of Finance. The Bureau of Budget Management in the Ministry of Finance develops accounting rules and procedures that conform to and support the budget rules and procedures. The advantages of this system are (a) it ensures consistency between budgeting and accounting and (b) it enjoys the enforcement power of the state. These advantages could, paradoxically, turn out to be obstacles to introducing changes to the accounting system. After being appended to the budget for so long, Chinese government accounting has a weak conceptual and institutional base to launch a major reform. Nevertheless, incremental progress can still be achieved by attempting to understand the characteristics and rationale of the current system.

Accounting as a Budget Tool

As indicated earlier, parallel to the system of overall budgets and unit budgets is a system of “overall budget accounting” and “unit budget accounting.” The overall budget accounting systems are operated by the Ministry of Finance and the finance bureaus at each subordinate level of government. They track the execution of overall budgets—that is, receipts and payments. Reports are prepared on the tenth day of each month; in addition, monthly, quarterly, and annual statements are submitted. These statements basically report the amounts of the various sources and uses of funds. The primary objective of the accounting system is to prevent spending in excess of appropriations, and to ensure the collection of revenues.

Each of the administrative units or institutions (“units”) has its own accounting office. The hierarchical structure of these accounting offices resembles their reporting relationships to their oversight government agency. There can be as many as two levels of accounting offices below the supervisory accounting office. Unless one actually sees the piles of forms and rows of desks in an office, it is hard to imagine the sheer size of the Chinese financial bureaucracy. Perhaps one statistic captures it: there are almost two
million accounting functionaries toiling their trade.

What are a few significant features of the Chinese government accounting system as it is practiced today? The next section attempts to answer this question by describing some of its characteristics.

**Characteristics**

Chinese budget accounting is currently characterized by its faithfulness to the prevailing national policy, a high degree of uniformity and broad coverage (Shi and Jiang 1993, 10-15).

Budget accounting in China keenly reflects the prevailing political ideology and public policy. In an officially socialist country like China, the government budget is an integral part of its economic development plan to achieve certain national goals in keeping with the direction determined by the Chinese Communist Party. Upon its adoption by the National People’s Congress, the budget becomes law. Budget accounting fulfills its budget enforcement function by dutifully tracking the flow of budgetary resources.

This view of Chinese budget accounting may miss a larger point: the state budget no longer plays the role it used to assume. When the government played an exclusive or at least dominant role in determining the course of the Chinese economy, the state budget was an instrument of proactive macroeconomic planning and management. Budget accounting, observed Shi and Jiang (1993, 11), “is really about planning and control.”

The role of the state budget in a socialist market economy is less certain and clear. It certainly retains its managerial function with regard to the core of government (i.e., the administrative agencies). The Chinese government, like all governments, conducts monetary policy. It is in the area of fiscal policy where issues have arisen: To what extent should the state budget subsidize failing state enterprises? How should the central government and local governments divide (or share) service responsibilities and their financing? What activities and revenues should be “on budget” or “off budget”? While budget accounting, per se, is not concerned with such policy questions, the answers to these questions nevertheless determine what is to be accounted for.

Chinese budget accounting is highly uniform. The uniformity is a consequence of the central government’s authority to prescribe the laws and regulations and the existence of an elaborate administrative apparatus to enforce them. (The Audit Administration is part of the State Council and the Auditor General reports to the Prime Minister.) The regulations determine such details as the charts of accounts for all the administrative units and institutions at all levels of government throughout China. The accounting procedures and the form and content of accounting reports are also mostly centrally determined. The implementation and enforcement of these uniform policies and procedures is facilitated by a large network of local chapters of the Chinese Budget Accounting Society, which was established in 1990 under the auspices of the Ministry of Finance. The society publishes the monthly journal *Budget Accounting*, which disseminates policy pronouncements on a timely basis. Since 1992 budget accounting has also been recognized as a specialty at par with enterprise accounting in the national accounting professional qualification examination.

Normatively, Chinese budget accounting is encompassing in its scope. Until recently
it used to encompass not only government administrative agency accounting, public institution accounting, but state enterprise accounting as well. As a consequence of economic reform, state enterprise accounting has been separated from budget accounting, even though standards are still set by the government through a unit of the Ministry of Finance. Currently there is a debate on whether institutional accounting should be disassociated from budget accounting (Lee 1996). That is not likely to occur so long as state-sponsored institutions rely on state budgets for financial support to any significant extent. Even if institutional accounting became a separate system for purposes of standard setting, the standards would still be determined by government. Nevertheless, it is interesting to notice how a diminished public purse has raised questions about the applicability of accounting rules designed for the state’s budgetary control. It is too early to expect any consensus on this critical issue. The conservative forces are strong. “To simply equate governmental accounting under capitalism and budget accounting under socialism,” protest two Chinese experts (Shi and Jiang 1993, 13), “degrades the status and functions of Chinese budget accounting. This is both very partial and unjust.”

While the foregoing may be an accurate normative account of how budget accounting in China is supposed to work, the way in which public finance is conducted in China nowadays compels a review of the traditional precepts. We therefore turn to a major milestone in the form of a recent budget law.

III. THE 1994 BUDGET LAW

In 1994 the People’s Republic of China promulgated a new budget law to be effective on January 1, 1995. This law replaced the 1991 “State Budget Management Regulations” then in effect. While the new law codifies and reaffirms most of the current practice, several reform measures were introduced. These will be emphasized in the following analysis.

A. Scope

The 1994 Budget Law provides the legal basis for all phases of the Chinese public financial management process outlined in Section I. After laying out general principles, the law in 10 chapters and 79 articles deals with; the jurisdiction of budgetary control; budgetary revenues and expenditures; budget preparation; budget review and approval; budget execution; budget adjustments; final accounts; oversight and legal responsibilities.

In this section, the budget law will be analyzed in terms of institutional alignment and substantive policies. (An unofficial translation of the budget law is available from the author.)

B. Institutional Structure

The formal hierarchical structure described in Figure 3 is maintained by the 1994 Budget Law. There are however some changes. Perhaps the most important is the adjustment of the relationship between the central and local governments through the system of separate revenues. The other major change concerns the role of the People’s Congress in the budgetary process.
Traditionally public budgeting in China is regarded largely as part of an administrative function. Budget submission to the People’s Congress, as the Chinese legislative body or parliament is called, is a legal formality; approval by an overwhelming majority is routine. While there is no reason to expect a drastic change in this basic situation, the new budget law does give considerable formal authority to the People’s Congress at each level of government throughout the process.

In particular, the People’s Congress or its standing committee at each level of government is empowered by the budget law to (1) review and approve the draft budget submitted by the administrative branch; (2) review and approve requests for budget adjustments; (3) receive reports of budget execution at least twice a year; and (4) review and approve draft final accounts. It is not clear whether these formal powers will be fully exercised by the People’s Representatives (as Chinese legislators are called).

Much of the 1994 Budget Law is devoted to a detailed prescription of the vertical relationship between lower- and high-level governments, especially between the center and sub-national governments. In particular, the State Planning Commission and the Ministry of Finance at the national level wield considerable power over the local government sector through policy directives as well as through a vast network of finance bureaus throughout the country. Unlike the American system where the administration receives budget appropriations from Congress, Chinese government agencies receive their appropriations from finance bureaus at the same level of government. Financial transactions are handled through branches of the Treasury run by the People’s Bank of China. The hierarchical nature of the institutional setup enables the Center to exercise what a 1983 World Bank report labeled as “centralized financial surveillance and control” (Dernberger 1991, 537).

Whereas the budget law meticulously lays out the institutional structure and the process for preparing various documents, one has to search through the documents for insights about the Chinese government’s current budget policy. The result of such an effort is presented in the next section.

C. Budget Policy

Budget policy refers to a government’s decisions about resource allocation and the means of financing public expenditures. The 1994 Budget Law enunciated a few general principles and formally endorsed the system of shared revenues and the system of dual budgeting.

General Policies

The budget law affirms several budget policies:

First, local governments are not allowed to run deficits or issue bonds (Article 28). The central government is not permitted to run deficits either in its “public budget.” However, the central government is permitted to borrow funds for capital projects as appropriate (Article 27).

Second, budget decisions should be guided by “the principle of economy and saving.” A balance should be struck between overall well-being and priorities, such as “government public expenditures” (Article 30) and the development of poor regions
Third, budgeted revenue should maintain “an appropriate relationship with the growth rate of the Gross National Product” (Article 29).

Fourth, the budget for a particular year should be based on the results of the previous year and current projections (Article 25), with one to three percent of the budget reserved for unforeseen requirements (Article 32).

In addition, the 1994 Budget Law reaffirms two recent initiatives: (a) establishing a system of separate revenues for the Center and local governments (Article 8), and (b) setting up a “dual budgeting” system. These relatively new ideas are discussed in the following subsections.

**Separate Revenue System**

The realignment of the service functions and fiscal base of the Center and local governments has been a key concern in Chinese public finance in recent years. The 1994 Budget Law gave new force to the concept of “separate revenues” (fensui) for each level of government.

In the past local governments remitted local tax revenues in amounts predetermined by the central government and in turn awaited the Center’s budgetary support. Now, four criteria have been established to guide fiscal relations between the different government levels: (a) Budgetary support should be commensurate with the level of management responsibility, (b) Budgetary support should be consistent with service burden, (c) Budgetary support to and demand for remittance from a region should be based on its fiscal capacity, (d) Budgetary allocation should be sensitive to the needs of national minorities³ (Shi and Jiang 1993, 123-126).

After experimenting with several ways of sharing revenues, China’s new alignment of revenues and expenditure between the central government and local governments is as follows:

The central government is assigned custom duties, consumption taxes, and certain other revenue sources. These revenue sources support: (a) national defense and foreign policy; (b) the central government’s administrative costs; (c) large-scale construction projects and infrastructure development; (d) scientific and technical projects of national significance; and (e) major higher education institutions.

Local governments are designated business operation taxes, real estate taxes, and individual income taxes, as well as some other revenue sources. These revenue sources support: (a) social welfare programs; (b) cultural, educational scientific, public health and sports expenditures; and (c) local government administrative costs.

In addition, company income taxes, natural resource taxes, and value-added taxes are shared between the central government and local governments.

The delineation of separate and shared taxes has the potential of significantly altering the relationship between the Center and local governments. It accommodates the desire for greater fiscal and decision autonomy on the part of local governments, especially the prosperous ones in the coastal region. At the same time, the system also reduces the Center’s reliance on upward remittances by lower-level governments. As the system is still being implemented, it is too early to reach any firm conclusion as to its long-term impact. What is clear at this point is that the concept and practice of a tightly knit state...
budget based on the principle of successive combination is being weakened.

**Dual Budgeting System**

Since 1949 China began using what might be called a “single budget system” which made no formal distinction between operating and capital expenditures. Beginning in 1992 government budgets in China were required to separate expenditures into recurring expenditures and development expenditures (Shi and Jiang 1993, 143-146). This system, commonly translated as “dual budgeting,” was initially discussed in terms of separate operating budgets and capital budgets (see Figure 4). However, as will be explained later, dual budgets would soon become multiple budgets.

The single budget system has the advantage of a simple structure and relatively easy preparation. It succinctly presents an overview of budget receipts and expenditures. Such a budget, however, does not clearly recognize or differentiate the nature of each type of government receipts and expenditures. Nor can it help policymakers trace the causes of budget deficits or identify funding sources for solving the deficit problem. Since economic reform began in China in 1979, there have been many structural changes in the economic system and in public finances. The single budget system was judged to be inadequate for meeting the needs of economic reform.

The adoption of the dual budgeting system has been justified on the following grounds: (a) the recurring versus development classification better reflects the functions of a socialist country; (b) it improves the transparency of the budget, thereby facilitating budget deficit control and the planning of borrowing; (c) it tightens budget restraints, thus raising the effective utilization of budgetary resources (Shi and Jiang 1993, 144-145). Each of these reasons is briefly examined.

*Functional classification of the budget.* As a socialist country, the Chinese government has two basic functions: social management, and the direct conduct and
indirect regulation of the national economy. Accordingly, Chinese public finance also has two functions. The first function is to use the sovereign power of the state to redistribute income and to raise the people’s standard of living by ensuring the normal working of the government and development of various social service institutions. The second function is based on the collective ownership of economic resources. Here the objective is to expand the production of goods directly or through the development of productive capacity or macroeconomic regulation.

Accordingly, the dual budgeting system associates recurring expenditures needed to support the normal functioning of the state and social development with revenue sources derived from the exercise of the sovereign power of the state. On the other hand, the investment-oriented funds for expanding productive capacity should come from the retained earnings of state enterprises established under the principle of collective ownership. The intent is to establish a stable and balanced relationship between recurring expenditures and developmental expenditures. The recurring budget is prepared ahead of the development budget. It is insisted that the recurring budget be balanced and expenditures be rigorously controlled. Projected surplus in the recurring budget is transferred to the development budget. The guiding principle for the development budget is that spending depends on the availability of funding; or in the form of a slogan, putting food on the table ahead of development. Clearly, the philosophy is to put more emphasis on current consumption.

**Increased budgetary transparency.** The separate disclosure of recurring expenditures and development expenditures is also expected to help control the budget deficit and determine the size of borrowing. The magnitudes of these two types of spending can point to the extent to which the two national functions described earlier are being carried out, and the relative weight given to each one. When a deficit arises, one can ascertain whether it is an operating deficit or if it can be traced to other causes. Similarly, the reasons for government borrowing and the uses of borrowed funds are to be clearly disclosed.

**Increased effectiveness in resource utilization.** Under the dual budget system, the recurring budget is placed under severe constraints. Recurring expenditures can only be financed by recurring revenues. Local governments are prohibited from incurring deficits in the recurring budget, and are encouraged to use it to subsidize development expenditures to the extent possible. The central government is allowed judicious borrowing. The side benefit of the dual budget system is to put all public debt under central management and greater control. The preparation of a development budget is intended to sensitize policymakers to the concept of return on investment and the capacity to service debt.

The application of the principle stated earlier led to the following assignment of financing sources: (a) Recurring budget revenues are derived mainly from various taxes, including enterprise income taxes. These are used to finance operating or recurring expenditures, which are expenditures for running the government, and paying for social development and social security. These are classified in terms of nonproductive capital construction, agriculture, forestry, irrigation, culture, science, public health, industry and commerce, relief and social welfare, administrative expenses, the cost of the judicial
system, police, national defense and foreign affairs, subsidies, and others. (b) Development budget revenues come primarily from transfers from the recurring budget, receipts from specific projects (e.g., tax for urban renewal, fees for developing water supplies), and borrowing from domestic or overseas sources. It should be noted that the concept of “developmental expenditures” is quite broad. Examples include infrastructure construction costs, research and development expenditures, new product testing, geological exploration, urban renewal, and aid to underdeveloped regions.

For reasons that are not clear to an outside observer, the original recurring (operating) and development (capital) binary classification has been replaced by a fourfold classification to be effective in 1997 in connection with China’s Ninth Five Year Plan. The new categories are: government public budget, state-owned property management budget, financing budget, and social security budget (Yang 1995, 16). It appears that the “government public budget” is synonymous with the recurring or operating budget, which is financed largely by taxes. The “state-owned property management budget” is for capital expenditures to be financed by earnings derived from using public property. The financing budget accounts for debt issuance and debt service, as well as other credit activities. Finally, the social security budget is a conglomeration of retirement funds and unemployment insurance funds; no specific revenue sources are identified except “financing through administrative measures” (Yang 1995, 16).

The new classification system represents a significant departure from the original conception of dual budgeting. The current literature is not clear about the exact demarcation of the boundaries of these categories. The rationale for the new system has also not been fully explained. What is predictable, based on the American experience, is that the multiple budgets will give rise to a proliferation of deficit (or surplus) numbers for different components of the budget. This could lead to confusion and debates on the size of “the deficit.”

Further Developments

After the budget law was promulgated in April 1994, China began an effort to create a body of accounting standards in support of implementing the law and to provide guidance for the development of accounting systems. In September 1994, the Bureau of Budget Management of the Ministry of Finance convened an “International Symposium on Governmental Accounting and Treasury Management.” This symposium was noteworthy in several respects. First, the term “governmental accounting” reemerged as part of the official lexicon, signifying at least a willingness to reconsider the relationship between budget accounting and governmental accounting standards. Second, as evidence of its desire to harmonize accounting standards with international norms, a half dozen experts from other countries were invited to share their experiences.

For the last several years, a small group of Chinese budget accounting experts has been functioning as a de facto standards advisory board to the Ministry of Finance, which has the legal authority to promulgate accounting. The following sections offer a perspective on developing governmental accounting standards in China.

IV. A PERSPECTIVE ON DEVELOPING GOVERNMENTAL ACCOUNTING STANDARDS IN CHINA
A. Scope and Objectives

The ambiguous identity of Chinese governmental accounting is due to the transformation of the public sector in China. When the state was the sole owner of all property and a major producer of goods and services in the socialist economy, governmental accounting was all encompassing. It was further labeled as budget accounting to emphasize the role of the budget in planning and controlling the economy and society. However, as state enterprises became privatized completely or partially in the emerging market economy, their accounting began to form a separate identity, as evidenced by a high degree of conceptual development and professional expansion. The global reach of Chinese business enterprises and their association with foreign firms (e.g., joint ventures) has also motivated the articulation of Chinese accounting with international standards. There exist now a separate accounting law and a body of standards for business enterprises, developed with extensive international consultation and technical advice (PRC Ministry of Finance 1992).

Next came the increased fiscal autonomy of state-owned or affiliated institutions that produce a vast array of public services. As more of these institutions are expected to be self-supporting from user charges—off-budget funds—they take on the character of business enterprises. A natural byproduct of this trend is the accounting for these institutions to become further removed from the domain of budget accounting. Indeed, a set of institutional accounting standards has recently been promulgated, and its coverage under the budget accounting umbrella is being debated (Lee 1996).

Consequently, the scope of governmental accounting has been effectively reduced substantially to essentially the core governmental entities and functions. As such, “budget accounting” is ironically an apt description of the accounting for the uniquely governmental entities and activities. In China, as is the case throughout the world, the budget is universally a public policy statement and a tool for planning and controlling governmental activities. We may have therefore found something common to governmental accounting in all political and economic systems; in so far as accounting for purely governmental functions is concerned, the objective of accounting everywhere is to facilitate budgetary control.

However, the scope of governmental accounting need not be the same as the public budget. As the statistics cited at the beginning of this paper suggest, the coverage of the Chinese state budget has diminished rather substantially in the last twenty years. Paradoxically, the scope of accounting has to expand to compensate for the shrinking coverage of the public budget.

This issue of the relationship between budgeting and accounting may be illustrated by off-budget funds. A serious problem in Chinese public finance is the growing proportion of so-called off-budget funds. As a percentage of budget receipts, off-budget funds stayed at 25 percent or less in the 1950s and 1960s. It jumped to 75 percent by the early 1980s and was almost equal to budget receipts by 1990 (Wang 1994, 42).

Off-budget funds by definition are not subject to the same degree of scrutiny and control as on-budget funds. Is it bad policy to allow off-budget funds? Not necessarily. Off-budget funds might be viewed as a deliberate move to allow or even encourage fiscal autonomy so as to reduce the dependency on the state budget. Managers have the
incentive to market their services and please fee-paying customers. An entrepreneurial spirit serves as an antidote to fight bureaucratic indifference. Within the public sector, a fee-supported market economy now competes with the budget-supported bureaucracy.

The problem is that in the absence of (the enforcement of) clear public policy regarding when and how much to charge for services, the public may be faced with a proliferation of authorized and unauthorized fees. Reduced fiscal discipline invites mismanagement and corruption. At best there are a “second budget” and two sets of books. At worst, no books are kept for off-budget money, in spite of requirements to account for both on-budget and off-budget funds. From the point of view of public accountability, weaker budgetary control has to be reinforced by a stronger accounting system.

Liberating governmental accounting from the conceptual and institutional constraints of budgeting has a number of advantages. First, as discussed earlier, it prevents resources from escaping financial accountability. Second, it becomes possible to introduce additional concepts and measures in the public financial management system. This second point will be elaborated in the next section.

B. Measurement Focus and Basis of Accounting

Like governmental accounting in many other countries, budget accounting in China uses the cash basis of accounting, keeping track of cash receipts and disbursements. The basic accounting equation is:

\[
\text{Fund sources - Fund applications = Fund balances}
\]

<table>
<thead>
<tr>
<th>Year</th>
<th>Included</th>
<th>Excluded</th>
<th>Included</th>
<th>Excluded</th>
<th>Bank Overdraft</th>
</tr>
</thead>
<tbody>
<tr>
<td>1978</td>
<td>-1.01</td>
<td>-1.01</td>
<td>-0.28</td>
<td>-0.28</td>
<td></td>
</tr>
<tr>
<td>1979</td>
<td>17.06</td>
<td>20.59</td>
<td>4.27</td>
<td>5.15</td>
<td></td>
</tr>
<tr>
<td>1980</td>
<td>12.75</td>
<td>17.05</td>
<td>2.85</td>
<td>3.81</td>
<td></td>
</tr>
<tr>
<td>1981</td>
<td>2.55</td>
<td>9.86</td>
<td>0.45</td>
<td>2.07</td>
<td></td>
</tr>
<tr>
<td>1982</td>
<td>2.93</td>
<td>11.32</td>
<td>0.56</td>
<td>2.18</td>
<td></td>
</tr>
<tr>
<td>1983</td>
<td>4.35</td>
<td>12.29</td>
<td>0.75</td>
<td>2.11</td>
<td></td>
</tr>
<tr>
<td>1984</td>
<td>4.45</td>
<td>12.18</td>
<td>0.64</td>
<td>1.75</td>
<td>26.08</td>
</tr>
<tr>
<td>1985</td>
<td>-2.16</td>
<td>6.83</td>
<td>-0.25</td>
<td>0.80</td>
<td>27.51</td>
</tr>
<tr>
<td>1986</td>
<td>7.05</td>
<td>20.88</td>
<td>0.73</td>
<td>2.15</td>
<td>37.01</td>
</tr>
<tr>
<td>1987</td>
<td>7.96</td>
<td>24.92</td>
<td>0.70</td>
<td>2.20</td>
<td>51.50</td>
</tr>
<tr>
<td>1988</td>
<td>7.86</td>
<td>34.94</td>
<td>0.56</td>
<td>2.48</td>
<td>57.65</td>
</tr>
<tr>
<td>1989</td>
<td>9.23</td>
<td>37.53</td>
<td>0.58</td>
<td>2.35</td>
<td>68.46</td>
</tr>
<tr>
<td>1990</td>
<td>13.96</td>
<td>51.50</td>
<td>0.78</td>
<td>2.87</td>
<td>80.11</td>
</tr>
<tr>
<td>1991</td>
<td>20.27</td>
<td>66.41</td>
<td>1.02</td>
<td>3.34</td>
<td>106.78</td>
</tr>
<tr>
<td>1992</td>
<td>23.75</td>
<td>90.49</td>
<td>0.99</td>
<td>3.78</td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted and translated from Wang (1994).
While this system may be adequate for the purposes of budgetary control, it has led to inaccurate deficit measures and neglect of long-lived assets and long-term liabilities.

**Deficit Measurement**

The focus on current financial resources has led to the inclusion of debt proceeds along with revenues as fiscal receipts in the Chinese government’s official calculation of budget deficits. Table 3 and Figure 5 compare the official deficit numbers (also included in Table 1) with “real deficit” numbers for which debt proceeds are excluded (Wang 1994, 82, 86).

![Figure 5. Chinese Government Budget Deficits](image)

Source: Adapted and translated from Wang (1994).

Prior to 1978 when the Chinese borrowed a negligible amount, there was no discernible difference between these deficit measures. However, borrowing has escalated steeply since the mid-1980s, amounting to 66.7 billion yuan in 1992. During this period the government’s bank overdraft almost quadrupled. During the period from 1979 to
1992, cumulative deficits amounted to 416.8 billion yuan or 356 yuan per person for China’s 1.2 billion people. In explaining the 90.5 billion yuan difference between 1992 budgetary receipts and expenditures, the Chinese Finance Minister disclosed that the government had borrowed 45.5 billion yuan from domestic sources and 21.2 billion yuan from foreign sources, leaving a “hard” deficit of 23.7 billion yuan (Wang 1994, 85).

As indicated earlier, Chinese local governments are prohibited from running deficits or borrowing (presumably in part to cover the deficits). The central government, while being required to balance its operating budget, is permitted to borrow judiciously to finance capital construction projects. As discussed earlier, the dual budget system was initially proposed to create a separation of operating and capital expenditures. The new four-way classification system has thrown this separation into doubt.

Asset and Liability Recognition

In view of the decision to set governmental accounting standards, it is not surprising to find that a debate has begun in China on whether to adopt the accrual basis of accounting. Traditionalists argue that in keeping with its distinctive function of budgetary control, budget accounting should continue to use what amounts to the cash basis of accounting. Others view accrual basis as progressive reform. If the history of a similar debate in the United States is any guide, such a debate will be prolonged and exhausting. While it is impossible to forecast the outcome of a debate over the adoption of accrual-based accounting, it can be confidently predicted that if and when it were adopted, it would lead to the recognition of substantial assets and liabilities for the Chinese governments.

The case for accrual accounting can be buttressed by the decision to adopt the dual budget system. The underlying rationale for such a budget system is that there is a fundamental difference between consumption expenditures and investment expenditures. The former benefit the current period, while the latter benefit the future through the creation of capital. As assets are basically economic resources capable of producing future benefits, substantial investments in physical capital would not be recognized as assets under the cash basis of accounting. The following table shows the amounts of investments in fixed assets by state-owned units in the 1980s in billions of yuan (Beijing Review Press 1989, 99):

<table>
<thead>
<tr>
<th>Year</th>
<th>81</th>
<th>82</th>
<th>83</th>
<th>84</th>
<th>85</th>
<th>86</th>
<th>87</th>
<th>88</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yuan</td>
<td>96</td>
<td>123</td>
<td>143</td>
<td>183</td>
<td>254</td>
<td>301</td>
<td>364</td>
<td>449</td>
</tr>
</tbody>
</table>

Without using the accrual basis of accounting, there would not be accounting recognition of the Chinese government’s vast holding of public property. In recent years, the Chinese government has mounted an effort to prevent the loss and exploitation of public property. Due to practical reasons (e.g., the difficulties of the inventorying all state property) and theoretical reasons (i.e., the absence of market value in most cases), no one really knows the amount of the Chinese government’s assets.

On the other side of the balance sheet, the application of the accrual basis could be expected to reveal huge amounts of long-term liabilities, in addition to bonded debt, particularly for employee retirement benefits. This is a particularly serious issue in light
of the rapid “graying” of the Chinese population. In 1991 the number of retired persons reached 24 million or one retiree for every six workers. Retirement benefits in that year amounted to 55 billion yuan (Wang 1994, 104).

The development of accounting standards calling for the systematic recognition and measurement of all kinds of liabilities would be a major step toward getting a clear picture of the financial position of the Chinese government.

D. Organizing Frameworks

The Chinese budget accounting system is predicated on a hierarchy of successive aggregation of unit budgets into overall budgets (Figure 3). There exists an overall budget accounting system corresponding to each overall budget, and there exists a unit budget accounting system corresponding to each unit budget. While this hierarchical arrangement (Figure 6, Panel A) is still applicable to the core of government, that is, the administrative units, it no longer adequately describes well how economic life is organized in China today.

In the China of the foreseeable future, assuming the current policy holds, the “concentric circles” view will probably be a more accurate reflection of the macroeconomic and societal arrangement. The administrative units and the underlying Communist Party policy-making structure will continue to function as the figurative—as well as real—center for governing China. Rather than sitting on top of everything, however, the policy-making and implementing apparatus of government is surrounded by several layers of organizations. The inner-most layer consists of public enterprises and institutions wholly owned by the state and therefore directly controlled by the government through administrative directives. One layer removed from the center are the quasi-public enterprises and institutions in which the state holds partial ownership. The extent of ownership can range from a voting majority to a minority interest in a joint venture. At this level, procedural control is gradually replaced by outcome-based performance indicators, such as profit or return on investment. Management is afforded a higher degree of discretion in running these entities and are free of the 10-day, monthly, and quarterly reporting requirements imposed on administrative agencies by the budget accounting system. Here we reach the outer parameter of what may be properly called “the public sector.” In the outer rim are private sector businesses and households whose behavior is regulated by laws and state-enforced private contracts.

The concentric circle view, if accepted, would represent a kind of paradigm shift in Chinese public sector accounting. First, it acknowledges what is already going on; the state budget no longer funds or controls every single economic activity in China. The budget accounting system has to devise, in addition to the compliance measures, performance measures appropriate for each type of entity. Second, a budget would no longer be just a request for funds—a cost budget. There could be profit budgets and investment budgets. As such, a budget is also a financial plan. Third, the notion of “overall budgets” also requires reconsideration. Instead of being a monolithic pyramid structure, the public sector budget of China might be visualized as an onion. As each layer is peeled, one moves closer to the center and budgetary control increases accordingly.

In this section, I have identified only a few major conceptual issues that should
probably be addressed by any governmental accounting standards. Upon the release of those standards, there will be the opportunity to examine how those issues have been resolved.

V. CONCLUDING REMARKS

This analysis has examined the evolving relationship between public budgeting and governmental accounting in China. Accounting will always play a supporting role to the budget by monitoring budget execution. There are also reasons to believe that the mission
and role of accounting should be broader than it currently is. A fundamental objective of accounting—and financial disclosure—is to demonstrate and discharge accountability for all public funds. In this regard, public funds include both on-budget as well as off-budget resources. Given the traditional emphasis of public budgeting on receipt and disbursement of cash, accounting can provide a useful balance sheet perspective. Effective accounting for government assets—including fixed assets—can document increased infrastructure investment and can potentially prevent the loss and misuse of public property. Careful monitoring of liabilities—including but not limited to bonded debt—can aid long-range financial planning to meet future budgetary demands. These are worthy candidates for setting effective accounting standards. In the meantime, a modest step may be taken by excluding debt proceeds from receipt in calculating deficits, thereby bringing Chinese governmental accounting one step closer to this minimum international norm.

In conclusion, it seems appropriate to quote from a recent statement by the Chinese vice prime minister in charge of economic and financial affairs:

> The tasks facing public finance will be even more complex and heavy in 1996. The Central Government’s revenues for several reasons have decreased. It is also very difficult to realize the goal of reducing the budget deficit. Different regions’ finances are uneven; delaying salary payments [and other similar practices] create left-over problems to the future. Finance officers at every level of government are advised to exercise due caution in their work. You are urged to diligently implement the spirit of the fifth plenum of the Fourteenth Central Committee and meet the requirements made at the Center’s economic affairs meeting. The reform of the revenue and tax systems should be further intensified. The organizations for implementing the separate tax system should be perfected. The financial policy of appropriate tightening should be continued to be carried out. Furthermore, all legally authorized taxes should be levied, and every effort should be made to increase revenues. While local tax collection deserves concern, the collection of national taxes should also be supported. Public expenditures should be tightly controlled; extravagant and wasteful spending should be avoided. Every effort should be made to meet the goal of suppressing and shrinking the deficit. It is hoped that the above measures will create a great start and a good first step for the Ninth Five Year Plan. You are urged to vigorously enforce fiscal discipline, and launch severe attacks on the evasion of taxes and remittances [to the Center]. The practice of keeping “two sets of books” (moving on-budget receipts off the budget) is strictly prohibited. “Little treasuries” are to be found and eliminated, especially those created by the finance bureaus themselves. I hope all the finance bureaus at all levels will in the new year [1996] implement the Center’s guidelines and policy, and make a greater contribution to the revitalization of public finance, economic prosperity, price stability and the promotion of development (Zhu 1996).

**ACKNOWLEDGMENT**

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NOTES

1. Yuan is the unit of Chinese currency. One U.S. dollar is equivalent to approximately 8 yuan at the exchange rate in early 1996. In China, one hundred million is usually referred to as one yi, which is equivalent to one-tenth of one billion. Throughout this paper, Chinese financial statistics are converted to billions, unless otherwise specified. Note the discrepancy between the deficit numbers quoted and those in Table 1. The authors lacks the information to reconcile these numbers.

2. This is a general characterization. There are further divisions and exceptions. For example, major cities, such as Beijing and Shanghai, report directly to the central government and have the status of provinces for purposes of budgeting and accounting. Lieberthal (1995) is an excellent source of information of not only the formal structure of China but also how the system works in practice.

3. National minorities refer to ethnic minorities who live mostly in the border regions such as Tibet and Xinjiang. The areas populated largely by the minorities are usually given the status of autonomous regions (or counties and villages).

4. A similar system is used by the federal government in the United States. American state and local governments, however, usually have an operating budget and a capital budget. The operating budget is usually required by law to be balanced, while the capital budget is financed by debt, capital grants and, usually to be a limited extent, by current revenues.

5. The “fifth plenum of the Fourteenth Central Committee” means the fifth meeting of the Central Committee selected by the Fourteenth Party Congress of the Chinese Communist Party. Usually these meetings set forth major policy directions for the next few years and are therefore frequently cited as sources of major public policies.

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