A SINO-AMERICAN COMPARISON OF BUDGET AND ACCOUNTING COVERAGE

James L. Chan

INTRODUCTION

A central purpose of comparative international government accounting research (CIGAR) is to describe and explain the similarities and differences in the government accounting - including budgetary - practices of countries. To the extent such differences are due to the nature of their political and economic systems, variability in the environmental factors will help to explain these differences. During the Twentieth Century, the public sector environment of accounting in many countries underwent radical changes. Nowhere have changes been more profound than in China and Russia. The October Revolution in Russia created a vastly enlarged public sector for the Soviet Union and World War II expanded the Soviet empire into Eastern Europe. The next global expansion took place in 1949 when a half billion people came under communist rule in China. In spite of the significance of such a vast expansion, the Western English-language literature is sparse on socialist government accounting. By the time the first CIGAR conference was held in 1987, demoralization was emerging in Eastern Europe and market reform was well underway hi China. In this context, Alicja Jaruga and Lu Ting-gang reported on how reforms began to affect public sector accounting in Poland and China, respectively (Chan and Jones, 1988). Since then, Jaruga and Novak (1995) continued to monitor developments in Poland, while the author began to seriously study Chinese public sector accounting a few years ago.

China merits further research from the CIGAR perspective for several reasons. First, in part due to the language barrier, Chinese government accounting publications are not easily accessible to most Western scholars, resulting in a vast void in our knowledge about China. Second, China could be a fertile ground for a country study in many ways. For example, one could trace the extent of foreign and ideological influences (Chan, 1995); one could compare government accounting during the socialist era with its role in the emerging market economy (Chan, 1996). There are still other possibilities in studying this complex and dynamic nation that is engaged in perhaps the largest economic and institutional experiment in human history. The present study was motivated by the alarming observation (e.g. Wang, 1994) that the budget of the Chinese central government had dropped precipitously to a level that threatened its ability to effectively govern the country and conduct macroeconomic policy. Chinese policy makers, apparently sharing a similar concern, soon launched a campaign to restore the vitality of public finance. In support of this policy initiative, some analysts (Yu and Wang, 1996) noted the relatively small amount of the Chinese central government's revenues in comparison with those of some developing and developed nations. Critics (Long, 1997) questioned the validity of such comparisons on the grounds that governments under different political and economic systems performed different functions.

This paper focuses on the issue of the coverage of the central government's budget. It too inquires into whether a public budget covers all public institutions and activities. In the course of research, even what is "public" or "government" becomes problematic. In the United States, for example, there exist many off-budget entities (OBEs) that are in some sense public or at least quasi-public. The definition becomes even more murky when an entire public sector is being transformed hi China. Since definitions are ultimately tautological, it would be more fruitful to identify entities that are excluded from the budget.

The paper is structured as follows: Section I points out the economic and political significance, as well as the analytical significance of budget coverage. Section II will describe the transformation of the Chinese state budget during the reform period. Section III illustrates how the American federal government applies the unified budget principle; it will identify exceptions to the rule and draw some Sino-American comparisons. A brief concluding section identifies possibilities for further research.

THE IMPORTANCE OF BUDGET COVERAGE

Economic and Political Significance

A public budget allocates the government's resources and is its instrument of control. Thus the budget status of-an entity - be it a whole sector of the economy, an organization, a program - has both real and symbolic significance. Being in the budget gives it - and its beneficiaries - an authoritative claim on future resources. For example, large Chinese state enterprises rely on government subsidies to make up for their losses even though reformers advocate the separation of business and politics. Americans - and probably people in other countries as well - compete for shares of government budgets to secure tangible economic benefits - money, jobs and services. Not only do they want their programs in the budget, they seek to keep their shares of the budget for as long as possible through multi-year appropriations and entitlement programs (Schick, 1995; Wildavsky and Caiden, 1997).

The power of the budget carries with it the ability to control. For instance, American local governments receive billions of dollars in grants and contracts from the federal government, but they complain about the conditions and red tape -otherwise termed accountability provisions - that are attached to the federal money. Receiving Federal aid subjects the recipients to federal policy influence and control. Similarly, when local governments in China were required to send most of their taxes to Beijing and await their allocations, they were almost totally beholden to the central government. Once local officials were able to levy and keep tax revenues and generate substantial off-budget resources, their economic and political power grew, leading to greater independence. Thus the budget is a two-edge sword: it provides resources but requires reciprocity.

A public budget also conveys information thereby making government more transparent. When a government entity or program is moved out of the budget, or incompletely reported therein, it becomes part of Leonard (1986) calls "the quiet side of public spending." Even if there exists only a modest level of financial discipline in a country, it is more likely to affect the on-budget resources more than off-budget resources. In other words, the budget is the first line of defense for the public treasury. To the extent bureaucrats maximize their budgets as assumed by William Niskanen (Chan and Rubin, 1987), they are still subject to the control measures. In other words, a budget creates accountability, which is enforced by the accounting system. Accountability is weakened when resources go off the public budget or are left out of the books of the state. That would allow public officials to use resources at will. The absence of disclosure creates the temptation to abuse power. As a counter measure, American government accounting standards require all funds - regardless of their budget status - be brought under accounting control (NCGA Statement 1 as codified in GASB, 1996). Accounting - including financial reporting and auditing - constitutes the second line of defense for the public treasury.

In short, budget coverage has both economic consequences and political significance.

Analytical Significance

Budget coverage also has significance for social commentators and professional analysts. The size of the budget is often used as a surrogate measure of the size of government. In the West, liberals want the government to be bigger to do more good; conservative's want governments to be smaller to do less harm. They all turn to the government's budget for evidence to justify their positions. Unfortunately, there do not exist generally accepted criteria on what a government budget should cover. Analysts and politicians alike are fixated on budget deficits, but with only a few notable exceptions (e.g. Eisner, 1986), most people do not take the trouble to probe the assumptions behind the numbers. After reviewing two hundred years of budget deficit debates among economists, legal scholar Daniel Shaviro (1997, jack inside cover) concludes that budget deficits do not matter because "the deficit is an accurate measure with little economic content."

If the budget data and analytical problems in the U.S. are non-trivial (Ellwood, 1985 and Meyers, 1994), they are severe in China. There, fundamental structural changes modify the scope and composition of the state budget. It is very difficult, even without the structural changes to interpret public finance data in statistical compilations. Definitions are often so brief that ft is hard to tell what the numbers purport to measure. Besides, some practices (e.g. the inclusion of debt proceeds as budget receipts) are at variance with international norms.

The analytical problems are compounded in the international context (Easterly, Rodriguez and Schmidt-Hebbel, 1994), where the temptation to compare is almost irresistible. Unfortunately international comparisons are fraught with difficulties that arise from (1) varying scopes of government functions, (2) a lack of a common yardstick and fluctuating exchange rates; (3) differing definitions of revenues and expenditures; and (4) the reliability of GNP measures. The exclusions of certain receipts and expenditures from the state budget is only one of the adjustments required to make public finance statistics meaningful for international comparisons (Long, 1997). Unfortunately inadequate information about public sector functions makes such adjustments difficult if not impossible. Even after the boundary line of the public sector is drawn, there remains the fundamental issue of how to measure the public sector. There is no international consensus on whether it should be measured by the amounts of resources it uses, spends, owns, controls or produces (Gemmel, 1993, pp. 2-3).

This paper adopts a positive approach to studying budget coverage. There is no presumption as to what the budget should encompass in terms of sectors of the economy, institutions, programs, etc. Rather, it compares the scope of the budgets of two national governments and inquires into the nature and the reasons for exclusions from those budgets.

It is argued that the coverage of a government budget in a country at any point in time reflects the extent to which government plans and controls that nation's political, economic and social institutions. Consider two extreme scenarios. In a pure communist state, the private sector does not exist and the state owns all the means of production and runs the economy and controls the society. In that case, the state budget is all-inclusive. At the other extreme is the laissez faire capitalist state, in which the state plays the irreducible internal governmental function of maintaining law and order and external function of providing for national defense. Here the state budget would minimally cover the core governmental functions, and would likely be very small relative to the size of the economy - around 3% of GNP according to economist Milton Friedman. These scenarios are obviously unrealistic but they serve as benchmarks for judging real-world budgets.

BUDGET COVERAGE IN CHINA

During the last fifty years, especially the last twenty years, China radically transformed its economy while maintaining essentially the same political system. How has this historical event affected its state budget and its coverage? The first part is answered in general terms in an earlier paper (Chan, 1996). This section addresses the changing boundary line of the Chinese State budget.

The Evolving Circles

The coverage of the state budget in China kept on changing in keeping with economic reform and the alignment of central-local fiscal relationships between central and local governments. In the early years of the People's Republic of China, the classical socialist budget model prevailed. At that time, the state budget was all encompassing, both vertically and horizontally. Vertically, it included the central government and all local governments. Horizontally, at each level of the government structure, the budget covers governmental institutions and their auxiliary enterprises. Such a highly integrated budgeting system corresponded to China's institutional structure as a unitary state with a centrally planned economy. The theory was that these organizations were owned by the people, and since the state represented the people, the state owned these organizations (Tang, Chow and Cooper, 1992, p. 140).

Horizontal Relationships

Market reforms have profoundly altered the horizontal relationships between the Chinese State and its economic institutions. In particular, the income tax reform introduced in 1984 changed the nature of their budgetary transactions. Prior to that time, all state enterprises were required to remit their profits to the state treasury and were in turn allocated funds for operations. Under the new system, the state budget receives income taxes from these state enterprises, which are permitted to retain after-tax income. In the event of a loss, the government is reluctant to let unprofitable large state enterprises fail and the state budget subsidizes unprofitable enterprises in order to maintain production and employment, and promote social stability.

The budgetary relationships between the state budget and the state-owned or supervised service institutions depend on the extent to which the latter receive government subsidies. Some were completely self-sufficient and require no state subsidies. Some were partially subsidized; still others were fully subsidized (Chan, 1996). The trend is for service producing organizations to become market-oriented and charge for their services, thus becoming increasingly independently of the state budget.

These developments have led to a paradigm shift in the China's governance structure (Chan, 1996, pp. 170-171). Instead of the former rigid hierarchical structure, Chinese institutions at each level (central, provincial, municipal, etc.) are gradually reconfigured as a series of concentric circles. At the core are the policy making and administrative units of the state. State owned enterprises and institutions surround the inner most circle, and are in turn encircled by quasi-state organizations. Finally, the new emerging private sector envelopes the public sector. In this arrangement, the state budget loses its power of planning and control toward the outer circles of the institutional structure, as they reduce their dependency on the state budget.

Vertical Relationships

Vertical relationships link between the Center and local governments. Structurally the state budget has a central government component and a local government component. The local budget component results from successive consolidations of budgets from village governments upward to provincial governments. The state budget is therefore a symbol of the primacy of the central authority. In recent years, while the symbol has been maintained, there has been a major realignment of the fiscal relationships between the Center and local governments. Until the early 1990s, local governments were essentially the fiscal agents of the Center: they mostly collected taxes and sent the money to the central government and looked to the Central government for their budgetary allocations. Later, local governments obtained more taxing authority under the new system of separate and joint taxation. In 'this system, some taxes are the exclusive jurisdiction of the central government; some are exclusively local taxes, while others are subject to joint jurisdiction. The formal structure tells only half of the story, however. The other half is local collection and control over the non-tax revenues and other sources of financing, especially borrowing for investment projects. In principle, the larger and the more strategic the project, the greater is central control. In practice, local governments exercise considerable discretion over many investment projects. The growing economic strength of the provinces, especially those in the coastal region, during the almost 20-year reform period have led some analysts to characterize China as evolving into a system of de facto fiscal federalism (Huang, 1997).

In summary, the coverage of the Chinese government budget results from two types of tension: (1) the tension between the centrifugal pull of the Center and local officials' desire for greater autonomy, and (2) the tension between the political authorities and the managers of economic enterprises. During the period of economic reform and governance reconfiguration, the "master budget" of the Chinese State has loosened up. Chinese policy makers now face a dilemma: can a smaller state budget exert great economic influence in a market economy, and exercise effective control in a decentralized governance structure? Only the future can tell.

Budget Coverage Policy

At the level of national budget policy, China seeks to strike a delicate balance between contending forces mentioned above. The Budget Law in effect since January 1, 1995 enunciated a number of basic principles:

First, the state budget should correspond to the government structure. That is, within the hierarchy of five levels of government, the budget of a government at a given level covers not only itself, but also the combined budgets of all the governmental units reporting to it at the next lower level. The legislature (i.e. the people's congress) at a level of government will review and approve the budget proposals of the government at the same level, but will only review (and presumably cannot modify or disapprove) the combined budgets of the lower level governments.

Second, a public budget should include government agencies and other institutions accountable to them. Thus, the Central Government budget covers the various national ministries and departments, and all the units reporting directly to them. These ministries and departments include not only administrative agencies of the state, armed forces, but also political parties and civic associations. The direct reporting units refer to their business enterprises as well as service institutions. The same principle operates at the lower levels of government.

Third, under the system of separate taxation between the Center and local governments, each government includes in its budget its own exclusive tax revenue sources and its share of joint taxation, as well as inter-governmental transfers.

Fourth, off-budget resources are allowed, but should be effectively managed. This last point will be discussed in detail in the next section.

To what extent have these principles departed from the high degree of political and economic integration discussed previously? In theory, the 1994 Budget Law has retained the form of a "state budget", but the system of separate taxation between the Central Government and local governments has effectively redefined their fiscal relations. In the face of rising prosperity of the coastal provinces, the Center strains to hold them accountable. Local officials have the institutional incentive to pursue economic development agendas, but not at the risk of jeopardizing their career advancement in the hierarchy of the party and government (Huang, 1997).

Managers have been given more operating responsibilities and decision-making authority. But the issue of how much autonomy state enterprises should have - and conversely, how much the state should interfere or intervene - remains a hotly debated issue in China today. The government has an interest - both from an ownership and macroeconomic perspective - in the performance of state enterprises, many of which are unprofitable partly because of the burdens (e.g. underemployed workers, social welfare benefits) they are not allowed to unload. Despite of the enactment of a bankruptcy law, the Chinese government is influenced by the "too big to fail" doctrine, which has compelled even governments in some Western capitalist countries to bail out large *private* corporations. Thus, despite the nominal change in the organization's name and titles of its managers, state enterprises remain inside the enlarged socialist market economy. The government's businesses, when they falter and fail, remain the business of government.

In conclusion, the Chinese State budget has lost some of potency as an instrument for economy-wide resource allocation, but has kept its significance as a symbol of the integrity of the Chinese public sector.

Off-budget Resources

The structural problem of the Chinese economy and government are manifested by the issue of "off-budget resources" (OBR). Designating something as on or off budget is not merely a technocratic exercise, but is a significant public policy decision. Indeed OBR has been declared a "cancer" (Ting, 1996, p. 3) and a "hot bed of [official] corruption" (Jiang, 1996, p. 3).

A Brief Semantic Analysis

The term "off-budget resources" is translated from the Chinese phrase *yusuan-wai zhejing,* which literally means "financial resources outside of the budget." Huang (1996, p. 47) call it extra-budgetary or quasi-budgetary revenues. The "extra-budgetary" characterisation stresses the additional and supplementary nature of these resources with respect to the on-budget tax revenues. The "quasi-budgetary" label carries the implication that such resources are not truly government revenue. There is some validity hi both characterisations.

Definition

Off budget resources have co-existed with the state budget since early days of the People's Republic of China (PRC) when the socialist doctrine reigned supreme. "Off-budget resources," according to the State Council (1996, p. 3), "refer to the various financial resources which are excluded from state budgetary control and which are collected or otherwise obtained to be spent by state organs, institutional units and civic associations in the course of carrying out, or acting as agents of the state in carrying out, governmental functions." In other words, public policy sanctioned the accumulation of some resources outside of the state budgets.

Off-budget resources were allowed to exist in several situations. First, local governments were sometimes allowed to keep the surcharge taxes, assessments and fees. Second, administrative units and service institutions were often authorized to collect and retain fees for their own use. Finally, state enterprises were permitted to keep their after-tax earnings in different funds for specific purposes, e.g. new product development, major renovations and repairs, and employee welfare benefits and bonuses (Public Fiscal Science Research Institute, August 1995, p. 43; Xu and Zhu, 1990, p. 10).

The Magnitude of Off-budget Resources

If OBR are legitimate, why have they become a major issue? One problem is that they have become too large in both absolute and relative terms. In the PRC's first decades, when Soviet-style socialist central planning was earnestly practiced, the amounts of off-budget resources were less than 10% of on-budget resources in the 1950s. As soon as economic reform started in 197S, OBR abruptly rose to one-third of on-budget amounts, and virtually doubled every five years until 1993. In that year, a new system for enterprise financial management was implemented. Under the new system, after-tax profits are no longer allocated into various special funds, which were previously deemed off-budget resources (Table 1).

The OBR numbers in Table 1 refer to what may be called *legitimate* OBR, i.e. their *origin* can be traced to the policy adopted long before reform started. That policy however, cannot be credited or blamed for the *magnitude* of OBR during the reform period (explanations will be suggested in a later section). These reported OBR numbers represent the lower bound of total OBR in China because of the existence of *illegitimate* OBR. These are OBR of dubious legality and are kept off the books. Alternatively, if they are accounted for, they are not recorded in the official accounts. Judging from the persistent complaints about "two sets of books" and "little treasuries" by the top Chinese official in charge of the economy (Zhu, 1995), it seems reasonable to infer that they are a sizeable amount.

Table 1. The Growth of Off-Budget Resources (Amounts in Billions of Yuan)

	Off-budget	**Oil-budget**	**Off/On**
1980	55.7	108.5	51%
1985	153.0	186.6	82%
1990	270.9	331.3	82%
1992	385.5	415.3	93%
1993	143.3	508.8	28%

Source: Excerpted from Table 8 "State Fiscal Receipts and National off-budget Resources - Receipts," Expert Group on China's Reform and Economic Development Report, 1978-1994 (1995), pp. 274-275.

Categories of OBR

In spite of the loud condemnations of fiscal misconduct, actually the amounts of OBR in the hands of local governments, and of administrative agencies and service institutions were relatively small - 2% and 23%, respectively - of the total in 1992. In that year, most of the total OBR was in the form of retained after-tax earnings of state enterprises (Table 2).

Table 2. Off-budget Resources by Type (Amounts in Billions of Yuan)

	1980	**1985**	**1990**	**1992**
Local Govt	4.1	4.4	6.1	9.1
Admin. & Inst	7.4	23.3	57.7	88.5
State Enterprises	44.2	125.3	207.1	287.9
Total	55.7	153.0	270.9	385.5

Source: Excerpted from Table 8 "Slate Fiscal Receipts and National Off-budget Resources - Receipts," Expert Group on China's Reform and Economic Development Report, 1978-1994 (1995), pp. 274-275.

Table 3 shows what these off-budget resources were used for. Approximately 40% of the off-budget resources were invested in fixed assets, and another 20% in construction projects. Thus, slightly more than half was used for capital expenditures. Another 10-15% was used for employee welfare benefits and bonuses. The rest was basically for the operations of administrative agencies and service institutions. As was remarked earlier, these official statistics do not purport to disclose the wasteful and illegitimate spending financed by fees and assessments, which are often unaccounted for.

Table 3. Expenditure of Off-Budget Resources

Expenditure Categories	**1985**	**1990**	**1992**
Total amount in Billions of Yuans	137.5	270.7	365.0
Investment in fixed assets	42%	34%	37%
Major repair expenditures	11	11	14
Minor construction expenditures	-	-	-
Road repair expenditures	5	5	5
Urban renewal expenditures	2	1	1
Remittance to the national energy source and transportation major construction funds	9	7	4
Welfare benefit expenditures	7	9	7
Bonus expenditures	7	4	3
Science and technology expenditures	1	1	1
Supplemental revolving funds expenditures	1	2	1
Service institution expenditures	4	6	7
Administrative expenditures	1	1	1
Other	12	20	19

Source: Derived from data in Table 9 "State Fiscal Expenditures and National Off-budget Resources - Expenditures," Expert Group on China's Reform and Economic Development Report, 1978-1994 (1995), pp. 276-277.

Attitude Toward Off-budget Resources

Off-budget resources have led an uneasy co-existence with the state budget. On the one hand, there is a grudging acknowledgment that these are "mobile resources" (Hubei, 1995) that compensate for the rigid control inherent in the state budget. A group of researchers at the Public Finance Scientific Research Institute (August 1995, p. 44) put it this way:

"It should be recognized that the continuous growth of off-budget resources is the expected results of reforming a highly centralized planned economy to effect administrative separation of powers. This has produced certain positive effects. Within a particular historical period, it has mobilized the initiatives of government agencies in managing their own finances. Because of this, different regions, department and units can judge their particular circumstances and flexibly proceed with their production, construction and development of service enterprises. This has also solved the problem of

the all-embracing reaches of the state budget, thus enabling some service institutions to gradually move to business-like management."

In other words, off-budget resources both reflect and foster decentralization, delegation of authority and an entrepreneurial spirit. These are elements of economic reform in progress in China since the late 1970s. If off-budget resources have these positive features, why has the Chinese government repeatedly tried to bring them under control? For example, in 1983, the Chinese Ministry of Finance issued tentative regulations on managing off-budget resources. Notwithstanding this regulation, off-budget resources (OBR) almost quadrupled between 1983 and 1992, suggesting the earlier measure had not been effective.

Explaining OBR

In order to understand why off-budget resources grew so rapidly during the reform period, one should examine the dynamics behind the three types of OBR identified previously. First, the growth of state enterprise OBR is accounted for by the robustness of the Chinese economy in general (Overholt, 1993) and by a new relationship between the state and state-owned enterprises. A variety of incentive schemes were tried to stimulate the performance of these enterprises, including the use of tax policy (Cong, 1994). In 1993, new rules governing enterprise management and accounting were promulgated to virtually disconnect state enterprises from the state budget. The state enterprise OBR was formally transferred over - at least on paper - from the gray area of overlapping jurisdiction to the exclusive control of state enterprises. Suddenly almost 300 billion yuans of OBR vanished from the OBR receipts. That move was significant in terms of the amount - the off-budget/on-budget percentage dropped from 90% to 30%! But it also had a profound ideological significance: the state budget gave up its claim to the retained profit of state enterprises.

Second, local fiscal autonomy in conjunction with market reform helps to explain the increase of OBR associated with provincial and local governments. It is not enough for policy to permit OBR to exist, there had to be an economic base to generate OBR and the incentive to tap into the base. By 1994, a system of separate taxation was officially promulgated. One issue was how to treat the OBR in the custody of finance bureaus at the local level. Do these resources belong to the central government? Are local government officials merely the fiscal agents of the Center? Currently OBR are being identified and centralized in special bank accounts. It is anticipated that approximately 15 billion yuans of local government OBR will be returned to local governments. This development would be consistent with the devolution of service responsibility and fiscal resources. A logical extension of this concept is to place the local finance bureaus' OBR in the budgets of local governments.

By 1996, when the State Council issued its Decision on tightening the management of OBR, the main target was the OBR in the hands of administrative agencies *and* service institutions (such as hospitals and educational institutions). The following summary shows the remarkable growth of this class of OBR in recent years (amounts in billions of yuan):

1980	1985	1990	1991	1992	1993	1994
7	23	58	70	89	131	166

Unfortunately, official statistics do not separate OBR at administrative agencies charged with carrying out governmental functions, and OBR at public service institutions. This distinction is crucial because these two types of organizations are different in terms of their governmental function, the nature of services and means of financing (Table 4).

Table 4. Comparing Government Agencies and Public Service Institutions

	Government Agencies	**Public Service institutions**
Function	Governmental	Quasi-governmental service
Nature of goods	More like public goods	More like private goods
Sources of financing	Mostly taxes, with supplemental assessments and fees	Combination of user fees and taxes as subsidies

The term "government agencies" (or department, bureaus, offices, etc.) is used for xinjen danwei instead of "administrative agencies" because the Chinese concept of government agencies encompasses all organs of the states (i.e. executive agencies, legislative bodies and the courts), the armed forces and political parties; all of which are involved in exercising the sovereign power of the state. Their "products" are consumed by the whole society and, as such, should be financed mostly by taxes to prevent the ability to pay to dictate the distribution of such services. Sometimes governments impose assessments to pool resources for financing common-goods projects, or charge fees for regulatory services. But these should be supplemental to taxes as the main financing source. When such supplemental revenues grow to the point of complementing the tax revenues, it is fair to ask whether the government has become a business, and government officials have become businessmen.

Under the socialist principle, the Chinese public sector includes a vast network of public service institutions. Prior to market reforms, they used to provide services - e.g. health care, education - mostly free of charge. The extent to which these institutions are "governmental" in nature depends, in part, on ownership, control and financing. However, since they produce private goods, it is technically possible for them to charge for services rendered to specific individual customers. The extent to which they do so is a function of political ideology: public financing under socialism, and private payment in a market economy. As the burden shifts to customers, the state budget is relieved of the financial responsibility, and resources go off the state budget.

Off-budget resources were officially permitted in China to generate resources to *supplement* the state budget. However, officials did not have the necessity and incentive to take advantage of this provision prior to economic reform in the late 1970s. Economic reform in China has been credited with the delegation of authority, fostering individual initiatives and professional management. When the state budget is insufficient to meet spending requirements, government officials resort to revenue diversification and enhancement devices to make up for the difference. Some of the earlier free government services now require fees. Since government agencies are often monopolies, they can charge amounts higher than competitive prices, and keep them off the official budget. The growth of this type of off-budget resources is a by-product of market reform.

The emergence of the market economy has relaxed the ideological prohibition against transactions outside of the budget. Market reform has also led to debates and redefinition of the functions and scope of government. It has also encouraged entrepreneurial activities of government officials, thus creating the problem of “three chaos” - chaos in selective assessments, fees and fines. All of these are associated with the emergence of a new social norm of demanding fees for services.

Freed from the ideological constraint, government officials began to behave rationally as utility maximizing individuals, as public choice theory predicts. “They desire to maximize their budgets in general, and discretionary budgets in particular. Since on-budget resources are subject to greater control, government officials prefer off-budget resources instead. Government officials maximize off-budget resources when (a) it can be done legally, or (b) the benefits exceed the costs. Recent policies attempt to thwart such tendencies by putting some OBR on the budget and declassify others.

In short, the policy that initially permitted the collection of revenues for own use and the exclusion of such revenues from *the* budget opens the door for off-budget resources. However, under the regime of central planning and control, the norm was to rely on the common-pool budget for financing virtually all needs. Furthermore it was politically incorrect for the government to raise resources through market mechanisms. When the inhibition against market transactions was lifted in 1978, local governments and public officials seized the legal loophole to tap resources from the burgeoning market. This led to the mistaken charge that off-budget resources are the product of market reform, which however, is indeed responsible for the *growth* of off-budget resources.

In the next section, we will see that the boundary issues also exist for the federal budget of the United States, but “off-budget” has a very different meaning in the American context.

COVERAGE OF THE U.S. GOVERNMENT BUDGET AND SINO-AMERICAN COMPARISONS

As in China, the scope of government budgets in the United States is also shaped by political ideology and economic forces. The line between the private and public sector is relatively clear - at least more clear than in China - and it is a settled principle that public (government) budgets do not cover private sector entities. (The secondary issue of commercial activities of government will be addressed later.) Federalism is also a firmly established constitutional order so that the budgetary separation between the federal government and state governments (including local governments therein) is uncontroversial. (While an American *state* corresponds to a Chinese *province* in the jurisdictional hierarchy of government, they are significantly different). With these basic boundary lines so clearly set, defining the budgetary contour of the American federal government became a matter of applying a settled principle.

Federal-Local Relations

The United States was conceived as a federal system. A consequence of federalism is that, despite then fiscal interrelationship - with 15% of federal outlays in assistance to state and local governments - there does not exist a national budget for the United States. The Federal Government administers its tax laws and directly collects revenues from throughout the United States. Each one of the 50 states has separate taxation, budgeting and financing systems (Aronson and Hilley, 1986; Sbragia, 1996). The approximately 80,000 local governments, being the legal creatures of the states, are subject to state laws, including finance-related laws and regulations on budgeting and accounting matters. Quite simply, unlike China, the United States does not have a national budgeting system. There exists the Budget of the United States Government, commonly called the federal budget; but it is not a budget of the United States. The diversity of state financial practices is itself an area of research. The large and complex federal budget is also a substantive area of scholarship (e.g. Schick, 1995; Cogan, Muris and Schick, 1994; Wildavsky and Caiden, 1997). In this section, we shall compare the scope of the budgets of the two national governments, with the understanding that the Chinese Central Government's budget concepts and structures are replicated at lower levels of government, while that is not the case in the United States.

Criteria for Federal Budget Boundary

The twin principles of capitalism and federalism limit the federal budget to covering the activities of the United States Government The budget coverage issue was carefully studied thirty years ago by the President's Commission on [Federal] Budget Concepts. Believing that the federal budget should be a "more useful fiscal policy statement," the President's Commission on Budget Concepts enunciated the principle of a unified budget, one that would "as a general rule, be comprehensive of the full range of Federal activities" (1967, p. 25). The commission went on to argue that "[b]orderline agencies and transactions should be included in the budget unless there are exceptionally persuasive reasons for exclusion"(p. 25).

It should be noted that the American federal government's unified budget is far less all-encompassing than the Chinese socialist state budget. The commission was unifying what were then three disparate federal budgets: (1) the administrative budget for operating federal government agencies; (2) the credit budget for federal loans and loan guarantees; and (3) the consolidated cash budget used by the Treasury. The commission subsumed all these budgets as components of a unified framework so that the attention of policy makers and the public alike would be directed to one single federal budget surplus or deficit figure.

In drawing the outer boundary of the whole federal government, the commission (1967, p. 25) decided the budget status of borderline cases by asking several questions:

- Who owns the agency?
- Who supplies its capital?
- Who selects its managers?
- Do the Congress and the President directly control the agency's programs and budget?

While the answer to any one of these questions is not inconclusive and multiple considerations have to be weighed, these questions framed the coverage decisions in terms of *ownership, financing and control.*

Applying the Criteria

This section looks at how the boundary criteria have been applied in practice.

Government Corporations

Federal government corporations are in the federal budget because in general (1) they are owned in whole or in part by the federal government, (2) the federal government provides the financing, (3) their boards of directors are appointed by the federal government, and (3) their annual budgets are subject to presidential review and/or congressional approval. While they are akin to state-owned enterprises or service institutions in China, they are much fewer in number – only forty-five active ones according to a study by the U.S. General Accounting Office (1988). Moreover, U.S. Government corporations hardly match Chinese state-owned enterprises (SOE) in terms of the resources they command or the liabilities they bear. Regulated by the [U.S.] Government Corporation Control Act, they are required to prepare projected financial position and income statements for listing in the budget documents. However, their impact on the budget totals is presented on a net basis in terms of projected net incomes (which belongs to the U.S. Government) or net losses (which may require subsidy). As an example, while the U.S. Postal Service had $50 billions in gross outlays in 1993, only $1.4 billions of net outlays was included in the unified budget (Schick, 1995, p. 16). On a technical note, the Postal Service was given the statutory designation of “off-budget” to insulate it from deficit reduction measures. But this does not mean its financial results are not included in the unified budget totals.

Government-Sponsored Enterprises

There are a dozen federally chartered financial institutions which borrow money in capital markets for lending to farmers, homeowners and college students. These government-sponsored enterprises (GSEs) are excluded from the federal governments on the grounds that, in spite of the public policy objectives they serve and the federal agency oversight they are placed under, they are owned by non-federal entities, they borrow capital in their own name and are run by boards of directors not appointed by the government. Furthermore, their budgets are not subject to presidential review or congressional approval. Nevertheless, despite the federal government’s disclaimer of liability and its lack of equity investment in these institutions, the capital market regards GSE obligations as implicitly guaranteed by the federal government. This creates a risk exposure to the federal government and has led to calls for greater budgetary discipline (Eisenbeis, 1996). Therefore the federal budget document contains information about the financial performance of GSEs, but the federal government’s economic subsidies to GSEs are not recorded in the budget nor controlled through the federal budget process.

Recently a group of financial experts suggested that such subsidies be recorded in the federal budget in a way similar to other federal credit subsidies (OMB, 1996, p. 124).

The case for or against including federal subsidies to GSEs in the federal budget is not clear cut. The argument against inclusion relies on the private ownership of GSEs and the fact that their policies and operations are determined by boards of directors elected mostly by private owners. Others argue that GSEs were established by the federal government to achieve public policy objectives to making credit available in situations where private lenders deem unprofitable. The market perception of implicit federal government is based on the assumption that the federal government will probably bail out weak or failed GSEs in order to ensure the flow of credit to target populations (OMB, 1996, p. 124). When the "too important to fail" argument is added to "too big to fail" doctrine, the federal government faces the persistent thorny issue of whether to "book" the estimated costs of federal subsidies to GSEs.

The issue of dealing with quasi-public enterprises is particularly relevant to China. The narrow technical issues relate to (1) the measurement of budgetary implications of government subsidies to unprofitable state enterprises, and financial exposure in risky investments and lending, and (2) the budget presentation of the government's large and growing investments in private sector firms at home and abroad. It is clear from this brief discussion of American GSEs that the complex nature of these entities does not lend itself to clearcut solutions. It is part of the broader policy issues of the restructuring of state-owned and quasi-public institutions to improve their performance (Zhang, 1995; Tseng, et. al 1995; Broadman, 1996; Muir and Saba, 1995; King and Zhang, 1992; The World Bank, 1988).

Trust Funds, Especially Social Security

The President's Commission on Budget Concepts (1967) recommended the federal budget should cover federally owned funds (now commonly called federal funds) as well as trust funds. Most of the federal government's trust funds are actually earmarked taxes or fees to finance specific programs, e.g. the interstate highway system and civil aviation. Indeed, the commission (1967, p. 26) alerted: "There has never been a question of the Federal Government's responsibility for determining the size and shape of the major trust fund programs or for altering or redirecting these programs by appropriate changes in legislation." The trust funds are clearly under the policy direction and budgetary control of the federal government. In reaction to the practice of excluding the trust funds from the administrative budget, the commission recommended that they be brought into the unified budget.

The largest trust funds are the Old Age Survivors Insurance and Disability Insurance trust funds, together known as the social security program. Social security is the federal government's social insurance program financed by payroll taxes (Weaver, 1990; Steuerle and Bakija, 1994; Diamond, Lindeman and Young, 1996). Following the budget concept commission's recommendation, social security is *in* the federal budget. However, in 1985 Congress declared social security as "off-budget" to prevent the resources of the social security trust funds from being used for deficit reduction (U.S. Senate Committee on the Budget, 1991). Consequently, the receipts and outlays of social security are excluded from the budget totals and from deficit calculations for reaching deficit reduction targets required by budget laws (Chan, 1999). Because of this legal requirement, social security transactions are separately identified in the budget, and on-budget and off-budget amounts are added together. As Table 5 shows, the current cash surplus of the social security trust funds offset the general fund cash deficits, resulting in a small federal budget deficit on a unified basis. The U.S. Treasury borrows the cash balance of the social security trust funds and "pays" interest via bookkeeping entries. These practices have led to the twin charges that the federal government diverts social security money and hides its true deficit.

Table 5. Comparison of On-, Off-budget and Total Deficits
(Amounts in billions of U.S. Dollars)

Fiscal Year	On-budget Deficit (-)	Off-budget Surplus or Deficit (-)	Total Deficit (-)
1970	-9	6	-3
1975	-55	2	-53
1980	-73	-1	-74
1985	-222	9	-212
1990	-278	57	-221
1991	-322	52	-269
1992	-340	50	-290
1993	-300	45	-255
1994	-259	56	-203
1995	-226	62	-164
1996	-174	67	-107
1997	-103	81	-22
1998	-106	96	-10
1999 (Estimated)	-96	105	9.5

Source: Excerpts from Table 21-1 Comparison of Total, On-budget, Off-budget Transactions, Analytical Perspectives, *Budget of the United Slates Government*, Fiscal Year 1999, p. 353.

At the heart of the confusion and controversy is whether social security payroll deductions are fundamentally (a) earmarked special taxes or (b) individual retirement contributions. The term "trust fund" hardly helps the matter because it reinforces the perception that the federal government is merely acting as a trustee for the beneficiaries. The logical conclusion of this line of reasoning is that the off-budget status is not just a statutory technicality, but that the resources in the trust funds do not belong to the federal government Few would carry the argument so far, but federal accounting standards, after long and contentious deliberations, have declined to recognize future benefits as the federal government's long-term liabilities (Chan, 1998).

Federal Reserve System

The Federal Reserve System, being the central bank of the United States, is unquestionably a federal government operation. It is responsible to Congress for executing monetary policy and reports the results of its operations to Congress annually. Its board of governors are appointed by the President subject to the advice and consent of the Senate. As an independent agency, its budget is included in the federal budget but is not subject to the President's review or approval. Its excess profits, turned over to the U.S. Treasury, is scored as a federal budget receipt. The system's revenues and expenditures, however, are not included in the federal budget in gross terms. The budget concepts commission (1967, p. 28) explained this method as follows:

... Inclusion of the Federal Reserve banks in the Federal budget might jeopardize the vital flexibility and independence of the monetary authorities. Moreover, projections of System operations for a forward period - as would be required if included in the budget - do not appear feasible at the present time. The nature and economic significance of Federal Reserve bank "receipts" and "expenditures" are different from those of most other government programs and activities.

One can understand the strategic reason for not revealing the Federal Reserve System's future plans through budget disclosure. The budget concepts commission did not concern itself with historical reporting of the Federal Reserve System. To my knowledge, no one has argued that historical reporting would jeopardize the system's flexibility and independence. It appears that federal accounting simply follows this budget policy and excludes the Federal Reserve System from the Consolidated Financial Statements of the United States Government (U.S. Treasury, 1998).

In summary, whether a federal program or agency is included in the federal budget depends on a combination of factors indicating ownership, financing and direct budgetary control. The unified budget concept requires that the federal budget includes virtually all organizations and programs m the executive, legislative and judicial branch of the federal government, as well federal government corporations. The monetary authority of the United States is excluded for special reasons.

Off-setting Receipts

It is of some interest to note that the off-budget administrative agency fees in China are called *off-setting receipts* in the American federal government. Often federal agencies are authorized by law to collect and spend taxes and fees related to the services they render. These revenues are on the budget in a nominal sense, because budget-scoring rules allow them to be used to off-set these agencies' appropriations (U.S. Office of Management and Budget, 1997; Cogan, Muris and Schick, 1994, pp. 81-87). In this way, the federal government outlay comes closer to reflecting the cost of government to taxpayers. However, accountants tend to prefer the gross method - treating earmarked taxes and user fees as revenues -which reveals the total revenues and total expenditures of the government.

CONCLUSION

"A full discussion of issues involved in delineating the outer boundaries of the Federal Government," stated the Report of the President's Commission on Budget

Concepts (1967, p. 25), “could easily carry into quite esoteric matters of philosophy and political theory.” That is because this seemingly technical issue brings to the fore such fundamental questions as: What is government? What does the government do? What does it own? What does it control? The commission found its task easy once it settled on the basic principle of a unified or comprehensive budget for the federal government and solved a few borderline cases by resolving doubts in favor of inclusion. The ease with which the Commission disposed of the issue was helped by the clearer delineation of institutional structure in the United States. The fundamental constitutional principles of federalism and private property have long been settled.

In contrast; the first principles of economics and politics are far from being a settled matter in China. China revised its constitution four times, reflecting the convulsive political and economic transformations in the last fifty years (Chan, 1997). It is still articulating what constitutes a socialist market economy with Chinese characteristics. One of those characteristics must be me ability to contain the contradictions of socialist planning and a free market. Similarly the Chinese State budget exhibits the paradox of political control and economic decontrol. As a political document, it displays central authority; as an economic document, it reveals the draining of resources away from the Center to the provinces and from the public to the private sector. This uneasy tension and the attendant ambiguity is reflected in the shifting coverage of the state budget.

It is clear from this study that a major challenge of comparative international government accounting research lies in dealing with the “incomparables.” Incompatibility is often traceable, as in this inquiry, to differences in institutional structure. If one were to peel away the institutional veneer, would there be more comparability - or universality - in human behavior? We have already seen some indirect evidence that budget (resource) maximization is shared by Chinese as well as American public officials. Are there other common traits? It is hoped that future CIGAR research will try to uncover such similarities as well as differences.

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