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Analysis of the Relationship between Local Fiscal Autonomy Reform and the Efficiency of Public Service Provision

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ABSTRACT

This paper discusses the complex relationship between the reform of local fiscal autonomy and the efficiency of public service supply in China. The article first combs the historical process and current characteristics of China's fiscal decentralization reform, and points out that the current local fiscal autonomy is limited and the regional differences are significant. Theoretical analysis reveals that fiscal autonomy affects the efficiency of public service supply through the four mechanisms of resource acquisition, incentives and constraints, information advantage and innovation drive, and is regulated by China's unique "political championship", the central assessment system and other factors. The results show that appropriate fiscal autonomy helps to improve the matching degree of public services and local demand, stimulate supply innovation and improve the efficiency of financial resources; But at the same time, it may also lead to challenges such as widening regional gap, short-term tendency of public services and debt risk. The article further analyzes the institutional constraints of China's unitary structure, multi-objective governance system and regional capacity differences. Finally, this paper proposes a systematic reform path: building a clear fiscal relationship with rights and responsibilities, improving the incentive and restraint mechanism, promoting the innovation of supply mode and strengthening the supporting system, emphasizing the balance between maintaining the central control ability and giving local appropriate autonomy, so as to achieve the dual goals of improving the efficiency of public service supply and equalization of basic public services.

KEYWORDS

Fiscal autonomy; Efficiency of public service supply; Central-local fiscal relations; Institutional constraints; Reform path

1 Introduction

Since the reform and opening up, China has gradually promoted the reform of the financial relationship between the central and local governments while its economy is developing at a high speed [1]. As an important part of the national governance system, local government plays a key role in the supply of public services [2]. As an important embodiment of local governance ability, fiscal autonomy directly affects the efficiency and quality of public service supply [3]. In recent years, as China's economic and social transformation has entered the deep water, how to improve the efficiency of public service supply by optimizing local fiscal autonomy has become an important topic worthy of in-depth study [4-5]. This paper aims to analyze the impact mechanism, practical challenges and optimization path of local fiscal autonomy reform on the efficiency of public service supply in combination with China's national conditions, as shown in Figure 1.

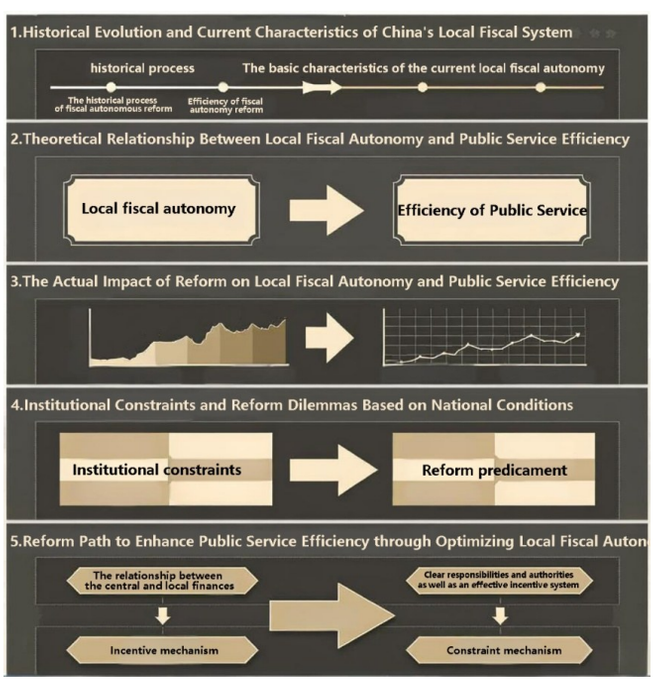


Figure 1 Graphical Abstract

2 Historical Evolution and Current Characteristics of China's Local Fiscal System

2.1 The Historical Process of Fiscal Decentralization Reform

China's local fiscal system reform has gone through multiple stages: the 'separate cooking and eating' system in the 1980s initiated the initial exploration of fiscal decentralization [6]; the tax-sharing system reform in 1994 established the basic framework for the division of taxation between the central and local governments [7]; in recent years, with the advancement of reforms such as the conversion from business tax to value-added tax and the division of powers and expenditure responsibilities between the central and local governments, the connotation of local fiscal autonomy has been continuously changing [8].

2.2 Basic Characteristics of Current Local Fiscal Autonomy

Under China's current system, local fiscal autonomy exhibits the following characteristics [9]: First, local fiscal revenue autonomy is relatively limited, with a weak local tax system and high dependence on central transfer payments. Second, local fiscal expenditure autonomy is constrained by central policy guidance, leading to phenomena such as "countermeasures for top-down policies." Third, the authority of local governments in debt management is gradually being standardized under central control. Fourth, budget management autonomy has been enhanced with the revision of the Budget Law, but there remain numerous constraints during implementation.

2.3 Institutional Framework of Public Service Supply System

China's public service supply system exhibits characteristics of multi-level and multi-channel provision: basic public services such as education, healthcare, and social security are primarily the responsibility of local governments, though their standards and policies are guided by the central government [10]. The methods of public service supply are gradually diversifying, with innovative approaches such as government-purchased services and Public-Private Partnership (PPP) models continuously emerging. A public service performance evaluation system is being progressively established, but there remains a need for improvement in the setting of evaluation indicators and the evaluation mechanism itself.

3 Theoretical Relationship Between Local Fiscal Autonomy and the Efficiency of Public Service Provision

Fiscal autonomy affects the ability and stability of local governments to raise funds for public services, which determines the level of resource security for public services. Different fiscal decentralization arrangements form different incentives for local governments' behavior, which affect their enthusiasm and mode choice in providing public services [11]. Local governments have information advantages in understanding local public service needs, and enhanced fiscal autonomy can promote them to more accurately match resources and needs. Appropriate fiscal autonomy can stimulate local governments to innovate public service supply mode and improve service efficiency.

Under China's unique political and economic system, the impact of fiscal autonomy on the provision of public services is further moderated and constrained by the following factors: First, the pressure of the "political tournament" faced by local governments may lead to a bias in public service investment toward "visible achievement" areas. Under incentive mechanisms that prioritize economic growth and short-term performance, local governments often tend to allocate fiscal resources to infrastructure projects and urban image initiatives that can quickly enhance visible political achievements. Second, the guiding role of the central policy assessment system has a dual effect on strengthening or weakening local preferences in public service provision. When the central government incorporates public welfare, satisfaction with public services, and other related indicators into the key criteria for evaluating local officials, it significantly incentivizes local governments to adjust their fiscal expenditure structure and increase investment in these areas. Conversely, if the assessment focus shifts toward other objectives such as economic growth, it may weaken the motivation for local governments to provide balanced public services. This top-down policy orientation and evaluation framework serves as a critical institutional variable shaping local fiscal behavior. Third, the vast disparities in fiscal capacity across regions profoundly constrain the actual effectiveness of fiscal autonomy. Developed eastern coastal regions, with their strong financial resources, can ensure relatively high-quality public service provision even under greater fiscal autonomy. Fourth, the boundaries between local governments, the market, and society remain in a state of dynamic adjustment, influencing the choice of public service provision models. With the deepening of "streamlining administration, delegating power, and improving regulation" reforms and the transformation of government functions, local governments are gradually shifting from being "direct producers" to playing the roles of "coordinators" and "regulators" in public service provision.

These factors are intertwined and collectively shape the behavior of local governments in public service provision in China. This issue is not merely a technical matter of fiscal resource allocation but a systematic governance challenge embedded within a specific context of political incentives, central-local relations, regional development disparities, and government-market interactions.

4 Empirical Impact of Reform on Local Fiscal Autonomy on the Efficiency of Public Service Supply

Some studies show that the enhancement of fiscal autonomy helps local governments adjust the structure of public service investment according to local actual needs and improve the pertinence of resource allocation [12]. After the expansion of fiscal autonomy, some regions have explored a variety of new modes of public service supply, such as the "run once at most" reform in Zhejiang and the innovation of government purchase of services in Guangdong [13]. The combination of fiscal autonomy and budget management reform can promote local governments to pay more attention to the output benefit of public service input.

One of the risks is the widening gap in public services between regions [14]. The difference in fiscal autonomy may exacerbate the imbalance of fiscal capacity among regions, leading to the widening gap in the level of public service supply. Secondly, the combination of the tenure system of local officials and fiscal autonomy may lead to public service investment biased towards short-term effective projects, while ignoring the construction of long-term basic services. In addition, the enhancement of fiscal autonomy may weaken the ability of the central government to coordinate regional public services and increase the difficulty of realizing the equalization of basic public services. Finally, some local governments rely too much on debt financing, and debt servicing pressure may squeeze public service expenditure and increase the negative impact of local government debt risk on public services.

5 Institutional Constraints and Reform Dilemma based on National Conditions

Under China's unitary state structure and the principle of democratic centralism, local fiscal autonomy must be exercised under the unified leadership of the central government. This fundamental institutional feature determines that China's fiscal decentralization reform cannot move towards complete local autonomy, but must seek a balance between maintaining the central macro-control ability and giving appropriate local autonomy.

Local governments shoulder multiple functional objectives such as economic growth, social stability, public services and environmental protection at the same time. The expansion of fiscal autonomy may strengthen the incentive effect of quantitative assessment objectives such as economic growth, but relatively weaken the attention to non-quantitative objectives such as public services. There are significant differences in the level of economic development and government governance among different regions in China. The unified reform policy of fiscal autonomy may have different implementation effects in different regions, which brings challenges to the design of reform programs.

At present, China's public service supply efficiency still lacks a scientific and unified evaluation system, which makes it difficult to accurately evaluate the actual impact of the reform of fiscal autonomy on the efficiency of public service supply, thus affecting the scientific of reform decisions.

6 Reform Path for Enhancing the Efficiency of Public Service Supply through Optimization of Local Fiscal Autonomy

6.1 Construct a Fiscal Relationship with Clear Division of Responsibilities and Compatible Incentives

Refine the division of public service authority and expenditure responsibilities between the central and local governments. Clearly define the responsibility boundaries of governments at all levels in fields such as basic education, basic medical care, and social security to reduce overlapping responsibilities and shirking of duties. Establish a local tax system that matches public service responsibilities. Cultivate main local tax categories to enhance the fiscal guarantee capacity of local governments in providing public services. Optimize the transfer payment system. Strengthen general transfer payments and weaken special transfer payments to enhance the ability of local governments to coordinate and arrange funds for public services.

6.2 Improve the Incentive and Constraint Mechanisms for Public Service Supply

Reform the performance evaluation system of local governments. Increase the weight of the quantity, quality, and satisfaction of public service supply in the evaluation to form a correct policy orientation. Strengthen public participation and supervision in public service supply. Establish and improve mechanisms for expressing public service demands and evaluating public service supply, so that local governments pay more attention to the actual needs of the people. Improve the management system of local government debt. On the premise of preventing and controlling debt risks, allow local governments to raise funds through standardized channels to support the construction of public service facilities.

6.3 Promote Innovation in the Supply Methods of Public Services and Enhance Their Capacity Building

Encourage diversification of public service supply models. Under the premise of ensuring government leadership, moderately introduce market mechanisms and social forces to improve the efficiency of public service supply. Strengthen the capacity building of local governments in public service supply. Through training, exchanges, technical support and other means, enhance the public service supply capacity of local governments, especially those in less developed areas.

Promote the standardization construction of basic public services. On the basis of respecting local differences, formulate national standards and bottom lines for basic public services to ensure the equalization of basic public services.

6.4 Establish a Supporting System for Reform

Improve the legal safeguards for the reform of financial autonomy.

Define the boundaries and safeguarding mechanisms of local fiscal autonomy through laws and regulations such as budget laws and basic fiscal laws. Construct a monitoring and evaluation system for the efficiency of public service supply. Establish a scientific and reasonable evaluation index system for the efficiency of public service supply, and regularly assess the reform effects. Strengthen fiscal transparency and information disclosure. Improve the transparency of local fiscal revenue and expenditure and the input-output of public service investments to enhance social supervision.

7 Conclusion and Outlook

The relationship between local fiscal autonomy reform and the efficiency of public service supply is complex and multidimensional. Under China's special national conditions, this relationship is influenced by multiple factors such as the political system, economic level, and regional differences. Moderate fiscal autonomy helps improve the match between public services and local needs, stimulates supply innovation, but excessive autonomy may lead to widening regional disparities and a tendency toward short-termization of public services. The key to future reforms lies in seeking a balance: granting local governments fiscal autonomy commensurate with their public service responsibilities while maintaining the central government's necessary regulatory capacity; ensuring basic public service equalization while respecting regional differences; establishing effective incentive and constraint mechanisms while stimulating local initiative. Through systematic institutional design, local fiscal autonomy reform should truly become an effective way to enhance the efficiency of public service supply and increase people's well-being.

With the advancement of the modernization of the national governance system and governance capacity, China's reform of local fiscal autonomy and optimization of the public service supply system will continue to deepen. In this process, it is essential to adhere to the development philosophy centered on the people, explore innovations in combination with China's national conditions, continuously improve the socialist fiscal system with Chinese characteristics, and provide a solid institutional guarantee for meeting the people's growing needs for a better life.

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