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Modern Legal Regulation of Inter-Budget VAT Distribution in the People's Republic of China

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Abstract. The work presents a comprehensive study of legal regulation of inter-budgetary VAT distribution in the People's Republic of China in the context of the country's socio-economic development. Particular attention is paid to the analysis of financial decentralization and the distribution of income from value-added taxation at the municipal district level and the distribution of budget revenues in the provinces of the People's Republic of China. Decentralized distribution of value added tax has a great impact on innovative development in the context of an imbalance in budget expenditures. The author makes a conclusion that one of the key factors for the success of Chinese reforms is the stimulation of provincial and local authorities to develop the economy by combining the expansion of budgetary powers with the administrative and disciplinary control methods. The harmonization of central functions and the separation of financial and legal powers between different levels of government allows Chinese authorities to focus on the following targets: (1) concentration of financial resources; (2) balanced regional development; (3) motivation of local authorities through decentralization; (4) effectiveness of financial control. The inter-budgetary distribution of VAT in China is one of the significant financial and legal instruments of effective socio-economic policy. Modern legal regulation of inter-budgetary VAT distribution in the PRC is aimed at supporting industrial policy and expanding production capital based on the gradual transfer of the tax burden from production to consumption while maintaining stable budget revenues from value-added taxation.

Keywords: inter-budgetary distribution of VAT; budget revenues in the provinces; legal regulation of value-added taxation; budget allocation.

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Introduction

Value added taxation is one of the significant components of multidimensional financial and legal regulation, which is used in the interests of state's social development. Therefore, the Chinese institution of inter-budgetary VAT allocation should be considered inextricably in the context of financial management and budget allocation at various levels of governance based on the general logic of socio-economic development of the country.

The main dimension and one of the goals of the development of tax reform in modern China is to improve the local taxation system.¹ The difficulty of reform lies in contradicting financial interests, which reveals many negative consequences when mobilizing local authorities and the industrial incentives of the population. Previously, most financial and tax decisions were "gradual reforms" or "step-by-step reforms" that allowed for a smooth course of change.

¹ The outline of the 14th five-year plan for economic and social development and long-range objectives through the year 2035 of the People's Republic of China. The outline is a set of development goals aimed at strengthening the Chinese economy in the period 2021–2025. Adopted by the fifth plenum of the 19th Central Committee of the Communist Party of China, which was held from October 26 to October 29, 2020. National Development and Reform Commission. <https://en.ndrc.gov.cn/policies/202203/P020220315511326748336.pdf>

The application of budget revenue sharing system used by governments, which contributes to the effectiveness of the center and local authorities, has provided it with an important place in the national management strategy. In fact, this is one of the conditions for China's economic growth.

The shared distribution of tax revenues between different budgets is a complex combination of tax distribution contracts between different levels of government. Decentralization contracts contain various sets of economic incentives and obligations that influence the behavior of local authorities in the areas of taxation, borrowing, land transfer, investment attraction, industrial policy, public investment, transfer payments, budget management, ecology, and prioritization of economic growth.²

The division of responsibility for tax revenues and expenditures between all levels of government is an important component of the country's financial management system. The results of agreements on inter-budgetary distribution are reflected in contracts on the distribution of tax payments, which are dispositive agreements on their joint use. For this reason, we can say that in China, moderate centralization of income is combined with a broad decentralization of spending.

From a methodological perspective, the legal regulation of inter-budgetary VAT allocation has an important interdisciplinary quality and can be studied not only in a financial and legal context, but also in combination with public administration, political science, sociology, and other disciplines.

In the empirical research, it should be considered in comparison with macroeconomic data on budget revenues and expenditures, as well as on the results of economic activity.

Theoretically, the inter-budgetary allocation of VAT can be combined with the theory of fiscal decentralization, the theory of economic growth, the theory of contracts and the theory of incentives.

1. Formation and Development of Legal Regulation of Budget Allocation of VAT in China

The specifics of the Chinese economic management system is its ability to create and improve financial and legal regulation institutions. After the creation of the PRC, the country's financial management system enters a period of continuous change, when budget policy priorities are built on the basis of "decentralization" and "centralization" alternately. Inter-budgetary relations in the period of 1949–1978 demonstrated the distribution of financial resources coordinated by the center among lower-level budgets in accordance with the directive established expenditure levels. At the same time, tax payments, which play a secondary role, are not subject to distribution, but deductions from the income of state-owned enterprises.

² Lu, B. (2014). Building modern interstate financial relations. *Journal of Renmin University of China*, 28(5), 11–19.

Relative stabilization was achieved in the 1980s through an active search for forms and methods of budget management at various levels of government.³ The central government and the provinces apply a wide range of individual co-financing agreements, rules for the “general distribution of budget revenues,” “fixed settlements,” “fixed subsidies” and implement a system of income and expense sharing.

Guided by the financial arrangements between the central and regional authorities, each province, city, district and county also define its own rules for the allocation of funds. In conditions of relative decentralization, the governing bureaucracy is able to respond more productively to the specific needs of entrepreneurs and the public.⁴

Contractual schemes that allow creating and maintaining material incentives for the development of local economies, division of labor and industrial specialization expanded the institutional possibilities for developing the internal potential of the Chinese economy. However, the objective circumstances of further development required effective management of the state center for the Chinese economy to enter foreign commodity markets.

The transition to an export-oriented development model under state patronage in 1993 led to the development of an appropriate fiscal system that takes more account of the realities of international trade and market relations. In addition, socio-economic development calls for the centralized mobilization of financial resources necessary for the successful provision of public services by the State.

Inter-budgetary relations in the PRC are regulated by the Budget Law⁵ adopted in 1994, which establishes a five-tier system of budgetary authority in accordance with the administrative-territorial division of the country: (1) the central budget; (2) budgets of provinces, autonomous regions, and municipalities subordinate to the center; (3) budgets of cities comprising districts and autonomous prefectures; (4) budgets of districts; (5) budgets of counties.

Due to the fact that direct relations have been established between provincial and district budgets, in many cases we can talk about a four-level or even three-level budget hierarchy. Moreover, districts are often given separate budgetary powers and accounting and administrative functions of lower-level counties.

Since 1994, in order to streamline financial relations between different levels of government, maximize the role of financial functions and expand the control capabilities of the state, the contractual system of inter-budgetary relations has been complemented by a unified fiscal system and the distribution of taxes in the interests of provinces and municipalities. Central, local, and distributable taxes are allocated.

³ Chen, C., & Wu, H. (2008). Fiscal structures and regional economic growth: Evidence from China's fiscal contract system. *Journal of Developing Areas*, 41(2), 119–135.

⁴ Oates, W. E. (1999). An Essay on Fiscal Federalism. *Journal of Economic Literature*, 37(3), 1120–1149.

⁵ Budget Law of the People's Republic of China. <http://www.lawinfochina.com/display.aspx?id=18189&lib=law>

The central budget begins receiving the largest share of tax payments, which gradually increases from 32% in 1993 to 50% in 2003. This implies an active distributive role for the central budget, on which most of China's provinces largely depend.⁶ Initially, VAT is divided in the ratio of 75/25 between the center and the lower levels of government. At the same time, the remaining business taxes belong to local authorities, and income tax is divided depending on the territorial affiliation of individuals.

The redistribution of VAT revenues itself can be considered a financial and legal innovation to a certain extent, since early local governments, encouraging production and innovation, focused on receiving subsidies rather than working with the tax base.

The next step was aimed at streamlining fiscal relations between the state center and municipalities, when in 2002 the State Council of the People's Republic of China issued a "Notification of opinions on issues related to improving the financial management system below the provincial level." It is accompanied by the standardization of financial management within provinces. The State Council requires all levels of government to adjust the method of tax distribution in accordance with the actual situation in each region and municipality, abandoning the practice of dividing tax revenues depending on the affiliation of taxpayer enterprises.

Since the central government does not define uniform and clear rules for the division of tax payments between lower levels of government within the provinces, which adjust the conditions of financial management independently, the methods of tax distribution between provinces vary.⁷

An important change in the fiscal distribution is the instructions of the Ministry of Finance of the People's Republic of China, entered in force in 2005, in the interests of districts and municipalities in the form of an "Opinion on effective relief of financial difficulties of districts and municipalities." Fulfilling the requirement for financial support for hard-to-reach areas, provincial financial authorities are increasing the share of tax distribution in relation to counties and municipalities, with the subsequent expansion of the powers of counties to manage the economy.

The adoption of new rules for inter-budgetary allocation leads to a gradual decrease in the share of tax revenues at the provincial level and a simultaneous increase at the level of counties, municipalities and counties. At the same time, the total share of subnational budgets remained high, amounting to 54.1% in 2014. Since expenditures still remained decentralized, and their predominant share was carried out by local budgets (in 2014 – 85.1%), they are also provided by increasing transfers from the state budget.

⁶ Shen, Ch., Lin I., & Zou, H. (2012). Fiscal decentralization in China: History, impact, challenges and next steps. *Annals of Economics and Finance*, 13(1), 1–51.

⁷ Zhou, L.-A., & Wu, M. (2015). Tax sharing rates among sub-provincial governments in China: Facts and explanation. *Journal of Financial Research*, 424(10), 64–80.

The government's decision to increase transfers was made while limiting the attempts of provinces and municipalities to overcome the budget gap on their own by setting fees for a variety of public services. The importance of the problem was evidenced by the fact that the total debt of county budgets in the mid-2000s was several times higher than their budget revenues.⁸

It can be assumed that the adoption of measures in the field of financial regulation to reduce China's dependence on international trade was caused by the aggravation of foreign trade relations with the United States. These measures had a long-term perspective and were primarily aimed at improving business conditions and increasing the competitiveness of Chinese manufacturers, both in foreign markets and in the domestic market of China. In addition, the issues of motivation of public managers at all levels of government were taken into account. As a result, we can observe that China has been progressively implementing financial policy measures aimed at decentralizing budget revenues and reducing the tax burden in the field of value-added taxation.

In 2016, the State Council of the People's Republic of China issued a "Notification on the adjustment of the Transition Plan to the division of central and local value-added tax revenues after the pilot implementation of the reform and increased fees in the camps," according to which the value-added tax is temporarily distributed between the central and local levels in a 50/50 ratio.

Adopted by the State Council of the People's Republic of China in 2019, the "Plan to promote the reform of the division of central and local revenues after the implementation of more extensive tax and fee cuts" aimed at a new ratio of the distribution of value-added tax between the central and local levels of government. It was set at a 55/50 ratio to "encourage local areas to cultivate and expand tax sources in economic development, strengthen the 'blood-forming' function of local finance, and create an environment for active, competitive development and practical prosperity."

Improving the conditions for increasing business activity was facilitated not only by the adoption of parity proportions of VAT distribution on an ongoing basis, which made a significant contribution to strengthening the tax base of local budgets, but also by reducing tax rates to 6%, 9%, 13% in 2019, which reduced the tax burden by 2.1 trillion yuan that year, and increased the financial capabilities of Chinese manufacturers. In 2021, the Chinese economy accounted for 18.4% of global GDP (\$17734 billion).

In 2022, the State Council of the People's Republic of China issued "Guidelines for further advancing the reform of the tax system below the provincial level," which set forth conditions for tax distribution between provinces and lower levels of government based on proportionality.

It should be noted that, while calling on local governments to improve the distribution of taxes in counties and counties to reduce differences in financing

⁸ Ong, L. (2006). The political economy of township government debt, township enterprises and rural financial institutions in China. *China Quarterly*, 186, 377–400.

conditions, the Chinese state does not introduce uniform rules within the regional distribution of taxes. There are still large differences in the distribution of taxes between budgets within provinces in different regions of the country. The difference in the distribution of taxes increases as the level of government decreases, which leads to a different intensity of tax incentives for local economic development and business activities.

Value added tax accounts for the largest share of the country's tax revenues. In 2022, of the total revenues of the PRC budget in the amount of 20370.3 billion yuan, VAT payments on domestic transactions amounted to 4871.7 billion yuan (23.91%). Therefore, it is no coincidence that the nature of the inter-budgetary distribution of VAT directly affects the greater interest of the lower levels of government in increasing their share of value-added tax.

2. Distribution of Budget Revenues in the Provinces of China

Since the founding of the New China, inter-budgetary distribution of taxes has become an effective management tool, the use of which by a higher level of government motivates lower-level administrations to fully develop their local economy by concluding a tax-sharing agreement and sharing part of the tax resources.

An important feature of such contracts, starting in 1988, has been the consolidation of provincial obligations in them, setting a certain share of income growth to be allocated to the central budget, as well as setting the growth rate of contributions to the central budget.

Individually defined conditions for the extraction and deduction of revenues not only motivate provinces to increase their own revenues and revenues of the central budget, but also determine the chaotic nature of the distribution of budget revenues between provinces. At the same time, objective development imbalances are growing due to the fact that the coastal regions, which have the best initial opportunities to attract investment and conduct export-oriented business, are noticeably ahead of the rest of the provinces.

At the same time, the provinces themselves transfer most of the VAT to the districts if they are able to agree on the conditions for the districts, which are developed using such financial and legal forms of government as "direct provincial administration of districts," "expansion of power and strengthening of districts," "preferential fiscal compensation policies."

The province acts as a coordinator of financial relations between different levels of government and has high flexibility in tax revenue negotiations. Within the province, the district and county levels of government receive the majority, while the smallest part remains at the disposal of the province.

The methods of allocating budget revenues in the province can be roughly divided into three categories:

(1) “Systematic allocation of the total amount.” Since 2001, five provinces (Jiangsu, Fujian, Zhejiang, Liaoning, and Hubei) have consistently implemented this model.

(2) “Sharing + classification points.” Twenty two provinces provide for the division of income from the same type of tax by affiliation and provide for a certain share of sharing.

(3) “The distribution of the total amount depending on the affiliation of the taxpayer enterprise.” Four provinces continue to use this distribution model (Jiangxi, Guizhou, Tibet, Xinjiang).

It is important that the policy of allocating tax and non-tax budget revenues to provinces within each of these categories follows its own logic, and the unification of approaches in inter-budgetary regulation takes place within comparable regional groups.

In turn, local governments at all levels, below the provincial level, do not want to achieve uniformity by suppressing the energy of economic development in developed areas. This position conflicts with the task of balancing budget revenues per capita between regions when a higher-level budget allocates financial subsidies to districts.

The research has shown that there is a direct correlation between local economic development and regional imbalances, as well as a cyclical relationship between fiscal decentralization and the degree of local imbalance in per capita income.⁹

The inter-budgetary distribution of income from value added tax follows the rule of interconnection, which consists in the fact that the higher the concentration of budget revenues at one level of government, the greater the degree of imbalance in budget revenues per capita in the areas under its jurisdiction.

Despite the constant changes in the conditions of budget allocation, tax decentralization intensifies the efforts of local authorities to expand the tax base and increase tax revenues accordingly.

Such work is carried out on the basis of the Budget Law of the People’s Republic of China, the evolution of which since its adoption in 1994 has led to the fact that the central budget and provincial budgets are organically interconnected by the system of budget revenue distribution and the transfer system. In particular, Articles 20 and 21 of the Budget Law of the People’s Republic of China specifically highlight the principle of revenue sharing between the central budget and provincial budgets.

The leading role in specifying the rules of such distribution belongs to the representative and executive state authorities of the People’s Republic of China.

The National People’s Congress (NPC), which convenes annually, reviews the draft state and provincial budgets and reports on their implementation. The NPC Standing Committee oversees the execution of budgets. In addition, it checks the

⁹ Sacchi, A., & Salotti, S. (2014). The effects of fiscal decentralization on household income inequality: Some empirical evidence. *Spatial Economic Analysis*, 9(2), 202–222.

resolutions, orders and other normative legal acts of the State Council of the People's Republic of China, as well as the People's Congress and their standing committees of lower levels of government for compliance with the Constitution of the People's Republic of China and the laws of the State (Art. 12 of the Budget Law of the People's Republic of China).

The State Council of the People's Republic of China prepares the draft central budget, organizes the execution of the central and provincial budgets, oversees the execution of budgets, and may amend or annul unlawful acts of provincial-level executive authorities regarding budget execution (Art. 14 of the Budget Law of the People's Republic of China).

In accordance with Article 21 of the Budget Law of the People's Republic of China, the distribution of income between budgets of different levels, the consolidation of expenditure obligations, as well as issues of inter-budget transfers are under the jurisdiction of the State Council of the People's Republic of China.

3. Features of Financial Decentralization and Distribution of Income from Value-Added Taxation at the Municipal District Level

Chinese managers perceive the concepts of development and stability as eternal problems of "motivation" and "balance." In the context of tax allocation, this means the need not only to provide additional financial incentives to individual budgets, but also to ensure a balance of interests for each of them.

The administrative division of China at the county level includes two types: municipal districts and counties. Between these two types the Constitution of the People's Republic of China provides for three levels of administrative and territorial hierarchy: provinces, counties and volosts, between which there are significant differences in terms of governance structure and degree of financial independence.

However, there are actually five levels of territorial government in the country: provinces, districts, counties, parishes, and villages.

Some territorial units may be part of different levels of administrative division:

- provincial level – provinces, autonomous regions of regional significance, cities of central subordination, and special administrative regions;
- district level – districts, cities of provincial subordination, urban and autonomous districts, aimags;¹⁰
- county level – counties, urban and autonomous counties, khoshuns,¹¹ autonomous khoshuns, districts subordinate to the city and separate national districts of urban significance;

¹⁰ An aimag is an administrative-territorial unit in the Inner Mongolia Autonomous Region (China). They correspond to the district in their administrative functions.

¹¹ Hoshong is an administrative-territorial unit in the Inner Mongolia Autonomous Region (China). According to their administrative functions, they correspond to the county.

- volost level – volosts, towns, volosts of national importance, districts of county subordination, somon¹² and national somons;¹³
- village level – villages and neighborhoods.

One can observe how the concept of a decentralized distribution of budget rights of the “dumbbell” type is gradually developing and strengthening, where most of the spending powers are concentrated at the central and local levels, and the provinces are mainly responsible for managing a balanced adjustment of financial resources.¹⁴

In this case, the adjustment of tax positions at various levels of government consists in dividing tax revenues and possibly supplementing them with separate payments. The short-term effect of such measures is to facilitate the transformation of government functions and ways of economic growth. The long-term effect is to strengthen central governance and eliminate hidden dangers caused by future economic growth and excessive expansion of provincial power.

After the reform of the budget allocation of taxes, a differentiated approach is developing in determining the model of fiscal management for each specific district. Depending on the existing economic conditions and socio-economic organization, the following types of districts are distinguished:

- (1) An ordinary district with direct provincial administration;
- (2) A district with expanded financial powers under the direct control of the Ministry of Finance, which, as a result of the transformations, has moved from the model of a “district under the direct control of the province” to greater independence in the distribution of income and expenses, transfer payments and capital exchange. The district with expanded financial powers carries out its fiscal activities not under management, but only in contact with the provincial level of government according to the principle: “Less taxes – more transfers”;
- (3) Further expansion of financial powers makes it possible to switch to a model of socio-economic management based on the principle of “Fewer transfers – more taxes”;
- (4) A large district is a grain producer. In order to mobilize producers in large grain production areas, the central government has provided preferential transfer payments to large grain-producing districts, and the provincial authorities are providing full support from the general budget revenues. As a result, the model of fiscal management of such a district is based on the principle of “Transfers + taxes.”

A comparison of the financial positions of the districts allows us to draw a conclusion about the impact of the economic status of the district on the share

¹² Somon is an administrative-territorial unit of the People's Republic of China at the volost level, present only in Inner Mongolia. As of 2025, there are 181 somons in Inner Mongolia.

¹³ National Somon is a somon dominated by national minorities (China). As of 2025, there is one national somon in the country – the Evenki National Somon in Khoshun Chen-Barga-Qi urban district of Hulun-Buir Autonomous Region of Inner Mongolia, where 2.6 thousand people live.

¹⁴ Lu, 2014.

of its tax revenues. The budget statistics of the People's Republic of China for 2022 substantiates this statement. The share of value-added tax distribution in the expanded districts operating under the second and third models is 3.771% higher than in the regular districts. The share of value-added tax in large grain-producing districts is 1.579% higher than in ordinary districts. Provincial and municipal authorities additionally transfer 0.982% and 0.580% of value-added tax revenues, respectively, to large grain producing districts.¹⁵

A simple formal change in the status of a district does not in itself lead to noticeable improvements in its economic situation. Active day-to-day work is needed to improve business conditions for entrepreneurs and state-owned enterprises. It is especially difficult to achieve significant success in agricultural production. The results of Chinese research show that fiscal decentralization contributes to the growth of the total volume of industrial enterprises and the organization of production financed from abroad, but does not significantly affect the volume of agricultural production per capita.

It should also be borne in mind that the price of reducing the level of the regional tax burden is a decrease in tax revenues of the central government of the center, which in turn leads to a weakening of its financial capabilities.

The impact of the inter-budget division of VAT on the behavior of local authorities is due to its profitable and stimulating effect. It affects the income level of local governments, thereby affecting their activities.

In terms of value added tax, the district's share is 19.4%, which is about 1.5 times higher than the share of the municipal district (12.5%). With the exception of 75.3% distributed by the central government and 4% distributed at the provincial level, municipal government at the municipal level leaves the vast majority of value-added tax revenue to the district government.

Of particular importance to fiscal regulation at the county level is the fact that in 2019 the total GDP generated by the county economy reached 48.6 trillion yuan, or 50% of the country's GDP.¹⁶

Enterprises, in turn, have an incentive to increase the added value of products in two ways: the first is to increase the value added rate; the other is to expand the scale of production.

¹⁵ Wu, M., Zhu, L., & Shi, G. (2023). Typical facts of tax distribution by governments at the district level in China: calculation and analysis based on unique data. *Finance, Trade and Economics*, 44(04), 5–20.

¹⁶ Lu, B., Ma, G., & Hu, S. (2021). How to divide the pie: Measuring the main indicators of China's fiscal decentralization. *Institute of Finance and Taxation of Renmin University of China*, 42(8), 20–36.

4. The Impact of the Decentralized Distribution of Value-Added Tax on Innovative Development in Conditions of Budget Expenditure Imbalance

The emerging potential of the new social order largely depends on the fairness and effectiveness of financial policy, the basic foundations of which require solving problems related to the social redistribution of added value.¹⁷

Therefore, it is no coincidence that the issue of decentralized VAT distribution is highly relevant outside of China, where relevant foreign experience is closely monitored and evaluated. The decisions of the Chinese leadership take into account the results of research by European authors, which have shown that there is a direct correlation between local economic development and regional imbalances.¹⁸ Empirical evidence suggests that there is a cyclical relationship between fiscal decentralization and territorial imbalances in per capita income. Fiscal decentralization significantly increases the efficiency of government spending, but it can also increase inequality within provinces. At the same time, provincial government measures to equalize budget provision tend to mitigate the negative impact of fiscal decentralization on inequality within provinces.¹⁹

It should be taken into account that the CPC Central Committee is guided by ambitious goals of consolidating China's leading position by building up its own scientific and technical potential, advancing development based on the accelerated growth of new technological industries.²⁰

The position of the central government of the People's Republic of China is fundamentally important, which seeks not to achieve statistically positive well-being of the national economy and formally accounting indicators of the annual budgets of the state, but to systematically improve economic conditions and corresponding socio-economic development aimed at the long term. For example, the report on the execution of the central and local budgets for 2024 shows that with an increase in state budget revenues by 1.3% (21970 billion yuan) compared to 2023. Tax revenues totaled 17497 billion yuan, a decrease of 3.4%. The main reason for the decrease in tax revenues is the reduction of the tax burden on manufacturers, which in turn has led to an increase in their competitiveness and lower selling prices for their products. For this reason, the domestic value-added tax in 2024 is 3,322.25 billion yuan, which is 3.9% less than in 2023.²¹

¹⁷ Bachurin, D. G. (2019). Directions of reforming the system of legal regulation of value-added taxation. *State and Law*, 2, 71–79. (In Russian).

¹⁸ Sacchi & Salotti, 2014.

¹⁹ Liu, Y., Martinez-Vazquez, J., & Wu, A. M. (2017). Fiscal decentralization, equalization, and intra-provincial inequality in China. *International Taxation and Public Finance*, 24, 248–281.

²⁰ Glazhev, S. Y. (2023). *Beyond the horizon of the end of history: A monograph* (p. 93). Prospekt. (In Russian).

²¹ Xinhua. (2025, March 13). *Report on the implementation of the central and local budgets for 2024 and the draft central and local budgets for 2025*. https://www.gov.cn/yaowen/liebiao/202503/content_7013431.htm

It should be noted that along with the decentralized distribution of VAT, among the factors that have a significant impact on innovative growth, first of all, it is necessary to take into account fair and rational taxation, expansion of financial investments, and an active state policy of industrial development.

The analysis carried out by groups of Chinese experts for the period from 1999 to 2009 proves that the distribution of value added tax has a stimulating effect on technological innovation.²²

Encouraging technological innovation allows not only to develop new products to expand the market of goods, but also to increase the VAT tax base in its territory. The higher the share of value-added tax distributed at the county level, the more likely it is that local governments will receive additional financial opportunities to encourage technological innovation.

Consequently, the authorities of the districts, which receive the right to independently build their budget policy, increase their financial resources for investments in the following areas:

First, a direct budget increase in investments in science and technology.

Secondly, the use of various financial and technological investment methods (subsidizing R&D, public procurement; compensation for the risks of innovation in the field of R&D).

Thirdly, the construction of scientific and technical infrastructure (equipment for scientific research, key laboratories, technological research centers, scientific and technical platforms for public services), which by its very nature is a quasi-public good. Investments by local authorities in the construction of scientific and technical infrastructure help to reduce the own costs of industrial enterprises for research and development, selection of innovative elements and samples.

Fourth, the implementation of technological transformations, the use of new technologies and the appropriate replacement of equipment.

Calculations by Chinese authors show that with an increase in the share of value-added tax in the budget of district B by 1%, the total number of patent applications, the total number of patent citations over three and five years, as well as the total number of patented technologies increases by 1.5%, 2.8%, 3% and 1.5%, respectively.²³

Conclusion

The most important characteristic of managing financial relations between the center and local authorities in China is politically centralized leadership and hierarchically organized local government, when the effective distribution of budget revenues

²² Fang, H., Lu, W., & Su, Y. (2020). Distribution of fiscal revenue among sub-provincial governments in China: Theory and evidence. *Academy China Journal Electronic Publications*, 4, 118–133.

²³ Lu, Ma, & Hu, 2021.

between different levels of government is based on control and motivation. One of the managerial success factors of Chinese reforms is the stimulation of provincial and local authorities to develop the economy by combining the expansion of budgetary powers with the use of administrative and disciplinary control methods.

The harmonization of centralization functions and the separation of financial and legal powers of different levels of government ultimately allows Chinese managers to focus on the tasks: (1) concentration of financial resources; (2) balanced regional development; (3) motivation of local authorities through decentralization; (4) improving the effectiveness of financial control.

China has the advantage of centralization and unification in the distribution of income and expenses. This advantage is realized through continuous theoretical and legal research on the division of central and local fiscal powers on the basis of joint taxation and responsibility for spending, which seems to be more complex, since it requires a combination of efficiency of results and equity of distribution. In financial practice, it is necessary to constantly clarify which financial resources are transferred to each level of government, and what exactly is to be paid from the relevant budget. The Chinese experience seems to be quite significant for Russia in the context of inter-budgetary relations, the development of which is hindered by the idea of mechanically applying unified approaches to calculating transfers for all regions and regulating subnational borrowing.

Inter-budgetary distribution of VAT in China acts as one of the significant financial and legal instruments of effective socio-economic policy. Value added tax, being a source of general tax revenue for district and district authorities, actually helps local authorities to gain powerful budgetary incentives for economic development. This position in the activities of the PRC authorities is becoming steadily long-term. As a result, the legal regulation of the inter-budgetary distribution of VAT is aimed at supporting industrial policy, expanding production capital based on the gradual transfer of the tax burden from production to consumption, while ensuring sustainable budget revenues from value-added taxation.

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