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Reforming the Budgeting Process in China

by

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Despite many reforms implemented in China's public financial management over the past ten years, China's public budget still exhibits a glaring lack of accountability, most evident in the gap between the adopted budget and the final budget. This article examines the role played by public budgeting in ensuring good governance, and establishes a framework for how the legislature ensures accountability in the public budgeting process. The existing problems in the Chinese public budgeting process are analysed, and suggestions are made for reforming the budgeting process based on the outlined framework.

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1. Introduction

The public budget, serving as a reflection of the collective public interest and as a legal constraint on government spending, is an effective tool in ensuring good governance and public interest. Within the first 30 years after the establishment of the People's Republic of China in 1949 – a period that was dominated by a planned economy – even though the Chinese government had a budget, this role of the public budget was nowhere to be found. The most important financial management tools at the time were mandatory plans, executive orders and rigid administrative control over state-owned enterprises. In that era, the public budget played a subsidiary role to the planned economy.

Since 1978 when China adopted the policy of "reform and opening", the planned economy was gradually being dismantled and its commanding role in determining resource allocation was also being eroded. While the government's role in economic planning has been on the decline, its role in the provision of public goods and services to the general public, however, has taken on more prominence. The change in the role of government has also raised awareness about the role the budget plays in resource allocation and public management. This led to a series of budgetary reforms in China. The reforms started with the Chinese Budgetary Law, a brand new law specifically on the budget, which was passed in 1994.[1] In 2000, a departmental budget reform was begun to increase the government's control over the budget and budgetary transparency. In 2001, a centralised treasury management system was instituted. The aim was to provide a system that allows for sharing of fiscal information in the areas of budget formulation, economic and revenue forecasting, disbursement, cash management, and state asset and debt management. A State Procurement Law was passed in 2002, with full implementation beginning in January 2003. The law was intended to make procurement more centralised and transparent, and to reduce corruption. In 2005, another reform was implemented to institute a new classification system for revenue and expenditure in the budget. This series of budgetary reforms was aimed at establishing a mechanism for controlling and promoting the more efficient use of public funds. Since the implementation of various reforms, some positive – albeit limited – results have been achieved in setting up a basic infrastructure for a modern budget system, process and rules (Wong, 2007). Departments directly affiliated with the government have annually submitted their departmental budgets to the legislative body, something they were not required to do in the past. Budget classification has become more detailed and more in line with international practice, thus bringing some transparency to the budget. There has also been some improvement in the comprehensiveness of the budget by decreasing the number of funds that are beyond the normal budgetary process.

Despite all the achievements, the limitation of these reforms has become ever more evident. The most serious issue with all the reforms so far is that they have not turned the budget into a legally binding document on the government in terms of revenue collection and spending. This lack of any budgetary legal authority is evident in several aspects: there is a consistently wide gap between the original budget approved by the Chinese legislature (the National People's Congress) and the final budget; substantial additions and subtractions are made by the government to the original budget figures without the approval of the legislative body, and funds are used for purposes other than those approved by the legislature; there is also rampant corruption and misuse of public funds for personal benefit. Such evidence clearly demonstrates the inadequacy in controlling government spending and the fact that budgetary reform has a long way to go in China before the public budget can play a role in society as intended. This article presents a framework for furthering budgeting reform in China that will enhance the role of the public budget in managing a modern society.

The article is divided into three sections. In Section 2, the importance of the public budget is discussed along with the role played by the legislature in the budgeting process in terms of accountability. In Section 3, problems in current Chinese budgeting practice are discussed, and then the reasons for the budgetary problems are analysed. In Section 4, recommendations are presented on how to build a framework to improve Chinese budgeting practice.

2. Public budgeting, process and legislative role

In this section, we provide a general theoretical framework for the public budgeting process, which will be used later to analyse the budgetary issues in China. We first examine the role of public budgeting and the role of the legislature in public budgeting. Second, we discuss how the role of the legislature is fulfilled in the budgeting process. Third, we review the literature on the worldwide trend in legislative budget activism.

2.1. The roles of public budgeting and the legislature in public budgeting

Public finance is a political system by which a society decides the kind and level of resources that should be collected as well as the kind and level of public goods and services that should be provided, and ensures that the resources are used as intended. The outcome of this decision process is the government budget. The budget is the single most important policy vehicle for government. It is an instrument that reflects government priorities and citizens' preferences (Rubin, 2006).

One of the most fundamental principles of public finance is the separation of the ownership of, decision making on, and management of public funds. Public funds belong to all taxpayers (collectively the entire society); the decision making on how the funds should be used resides with the legislative body elected by the taxpayers; and the management of the public funds is carried out by the government. The reason for the separation of ownership and decision making is that direct decision making by taxpayers on every issue is practically impossible and simply too costly; and the reason for the separation of decision making and management is to avoid the opportunism in a fiduciary relation, so that those who decide how the funds should be used and those who actually use them are not the same people. This separation of ownership from management, however, also introduces the principal-agent relationship and all the issues related to this relationship. Accountability becomes the paramount issue in terms of protecting the principals' interest. Therefore, prerequisites for the safeguard of the public interest are that the legislative body – considered in this case to be the guardian of the taxpayers' purse – has the final decision-making authority in a budget before it can be executed by the government, and that a budget so approved by the legislature is legally binding on the government. In this sense, the budget is a legal contract between the government and the legislature about what the government should do in the new fiscal year (Wildavsky and Caiden, 2004), and the budget is a powerful tool of accountability for citizens to know how the government spends their money (Rubin, 2006; Lee, Johnson and Joyce, 2008). Henceforth, in theory at least, the legislature constitutes the most important element of external accountability to society in public financial management.

While the rationale for legislative involvement in public budgeting is clearly established, the next question is: what does the legislature need in order to fulfill its responsibility? Literature on legislative budgeting has identified three key elements in the institutional arrangements of the legislature that will make this possible: legal authority, organisational structure and capacity.

- Legal authority: for the legislature to have any real power in the budgeting process, the constitution or other statute should clearly state that the legislature has the authority to amend the budget submitted by the government and set the parameters of the amendment power, such as whether the legislature can revise the spending up or down.
- Organisational structure: to make the legislative budgeting process efficient and effective, a committee structure also needs to be in place. The most generic format of this committee structure has two components: a central committee component, with a budget or finance committee responsible for overall budgetary matters; and a subcommittee component, with multiple subcommittees responsible for various policy areas. This allows the legislature to have both control over the overall budget process and more specific in-depth inquiry into various government programmes.
- Capacity: the legislature also needs to have the capacity to analyse the government's budget. This capacity is dependent on three factors: time, information and expertise. First, the legislature needs a sufficient amount of time to review and analyse the government's budget proposal, especially at the central government level where the budget tends to be large and complicated. Second, the legislature also needs to have the necessary information on the cost of government programmes. The legislature can collect such information in two ways, either by itself or through some institutional arrangement with the government for sharing information. Third, the legislature also needs its own staff with substantial knowledge in specific programmes to review the government budget. Legislators simply do not have the time needed to review the entire budget by themselves. If any one of these three factors is absent, then a substantive review of the government budget is unlikely.

According to a report of the National Democratic Institute for International Affairs (Gustafson, 2003), most legislatures have between two and four months to deliberate on and pass the annual budget; most legislatures that are active in the budget process have strong and active committee systems, including vesting principal responsibility in a budget or finance committee or sharing power with multiple committees; and adequate staff and technical expertise are also critical for legislatures to fulfill their constitutional responsibilities. Stapenhurst (2004) also discusses five reasons why the legislature is not active in some countries, and two of the reasons are the absence of legislative budget research capacity and of specialised budget committees.

2.2. The budgeting process

The budgeting process should thus reflect the nature of public budgeting and the role played by the legislative body in terms of its decision-making and oversight authority.

The budgeting process can generally be divided into four stages: preparation, review and adoption, execution, and financial reporting and auditing. What follows is a brief discussion of each stage to see how the legislature exercises its control and oversight authority on the government in the public budgeting process.

2.2.1. The preparation stage

For practical reasons, it is widely acknowledged by budgeting experts and researchers that the initial preparation of a budget for a new fiscal year is best left to the government. The government is at the front line of providing goods and service and thus has a more intimate knowledge of the cost; and the government has more time and the whole bureaucracy to put the budget together. There are very few countries in which the legislature has the ability to put together a budget from scratch on its own without much help from the government.

In budget preparation, on the revenue side, the government forecasts revenue collection from every revenue source, and should detail in the budget proposal what it expects to collect from all sources. On the spending side, the government should also forecast spending for every single programme, large and small. The budget should detail spending for each agency as well as each office within each agency: number of positions, salaries and other administrative costs. The purpose of this level of detail in the information presented is to make it possible for the legislature to review and oversee government spending.

2.2.2. The review and adoption stage

Once the budget is prepared and submitted to the legislature, the legislative budgeting process begins. In this stage, the legislature will do a number of things to exercise its decision-making power: review the executive budget, gather more budget information from the government, seek public input about the budget through public hearings, revise the budget based on the legislative priorities, and finally pass the budget. The revisions to the budget include adding new legislative programmes, or adding to or subtracting from current spending for a particular programme proposed by the government. This ability to revise the budget lies at the heart of legislative oversight and decision-making power.

2.2.3. The execution stage

During the execution stage, the legislature exerts its oversight power over the government mainly in two ways: periodic reporting and revision to the adopted budget.

Once the budget is passed, it is legally binding on the government. The government will execute the budget and cannot make any changes to the budget without legislative approval. However, changes to the adopted budget are inevitable over the course of the fiscal year. These changes happen due to both revenue and spending. On the revenue side, as revenue collection is dependent on the underlying economic activity, the actual revenue collection will be different from projections. When there is a revenue shortfall, a deficit results, thus necessitating spending cuts or a revenue increase, if there is a balanced budget requirement. When actual revenue exceeds projected revenue, a budget surplus results, which can either lead to a spending increase or to savings by being put into a reserve for future use. All these actions that will result in changes to the adopted budget will require the approval of the legislature. On the spending side, as the spending figure in the adopted budget is also a projection of what the government plans to do in the future, the actual spending can also be somewhat different from the projected spending. First, the government may have to spend more on a certain programme due to a legal requirement, such as more spending for welfare programmes during an economic downturn. Second, the government may find that it needs more money for some spending item but less money for others – for example, more money for travel but less money for office equipment. Changes therefore need to be made to the adopted budget by adding to or subtracting from certain programmes, or by a transfer of funds between programmes or within a programme. Again, all these changes will require specific legislative approval in order to take place.

A prerequisite for such legislative changes to the adopted budget over the course of the year is a periodic financial report from the government. Such periodic reporting (monthly, quarterly, and semi-annually) covers actual revenue collection and spending, as well as comparison with projected revenue and spending up to that point. Only in this way can the legislature and the public know if the budget is executed according to the plan and if any legislative actions are needed to deal with an emerging deficit or surplus.

Because of the inevitable changes, the final budget will certainly be different from the adopted budget. While such changes are inevitable, there are ways to minimise the size of the variance. First, the government can do a better job in forecasting both revenue and spending. This entails using advanced scientific models in projecting the economic growth, revenue growth and spending growth. Second, there should be a sizeable reserve fund to cover unanticipated fiscal events and thus avoid reduction in existing programmes to eliminate the deficit. If budget preparation is solid from the start, absent serious disruption to the economy, any changes to the adopted budget should be relatively small.

2.2.4. The financial reporting and auditing stage

Once the fiscal year ends, the government should present a comprehensive report on the results of its financial operation over the past year. To show its accountability to the public and the legislature, the government should not only report the final revenue and spending figures, but also compare them to their counterparts in the adopted budget and provide explanation on any major discrepancies between the two. This comparison should be for both revenue (breaking down into all major revenue sources) and expenditure (breaking down into all the major programmes or government departments). The purpose of this comparison is to hold government accountable to the budget adopted at the beginning of the fiscal year. In addition, the government should also provide a comprehensive account of its assets and liabilities, and whether the assets and liabilities have increased or decreased after one year's financial operation. This provides a long-term perspective on the fiscal health of the government. To be credible, this comprehensive financial report also needs to be independently audited by an agency outside the government. The legislature should also conduct its own audit of government spending to see if it is what it is said to be.

In this ideal budgeting framework, government action is constantly subject to legislative oversight and control through the budgeting mechanism. The legal authority for the public budget imposes firm constraint on government financial discretion so that the outcome reflects the collective wish of the majority of taxpayers.

2.3. The worldwide trend

Despite the theoretical underpinning of the importance of the legislative role in the public budgeting process, the legislature has not been playing as active a role as expected until more recently (Schick, 2002; Posner and Park, 2007). One important reason for the relative hands-off approach by the legislature is the growth in the size of the state and of the complexity of its structures, financing mechanisms and expenditure agendas, which makes it increasingly difficult for the legislature to get a full picture of the government and to assess individual proposals for both spending and revenue.

This situation, however, has started to change over the last 20 to 30 years. A survey by the OECD (1998) found that there is a growing number of countries in which the legislature plays an increasingly active role in budget processes – by creating special budget committees with expertise in budgets and supported by legislative staff, by obtaining better information from the government on spending proposals and implementation, and also by becoming more active on the monitoring and audit side. Fölscher (2006) also found that more than a quarter of countries have revised their constitutions over the previous 15 years to give the legislature more powers.

Among developed countries, the best example of this trend can be seen in the United States. In 1974, the Congress passed the Congressional Budget Act of 1974. It established the Congressional Budget Office (CBO), a nonpartisan budget staff office to help the Congress in budgetary matters. Over the years, the CBO has grown into a very authoritative source of budget information, allowing the Congress to put together a budget on its own. In France, the National Assembly initiated a wide-ranging budget reform, including a reclassification of the budget, in order to support legislative oversight and an expansion of powers to amend expenditures (Stapenhurst, 2004).

In developing and transition countries, too, there is a trend toward legislative budget activism. In most Latin American countries, the government used to dominate the budget process, and legislatures largely served as "rubber stamps". As Santiso (2004) points out, the financial reform in many Latin American countries occurred in two rounds. In the first round, Latin American countries undertook efforts to upgrade their public finance management and financial information systems to improve efficiency within the government. However, little attention was paid to the issue of accountability in budget management beyond the executive branch. In the 1990s, many Latin American countries introduced constitutional reforms to clarify and expand the power of the legislature with regard to the public budget (Petrei, 1998). For example, in Argentina, the Congress has the right to modify the total spending and debt amounts, and to make decisions that involve changes to the purposes for which the funds are to be used. If Congress increases the budget proposed by the executive branch, it must indicate the financing sources.

Recent changes in African practices concerning budgets and legislatures reflect similar trends. Legislatures have become more vocal in their oversight roles, holding members of the executive publicly to account through strengthened committees. South Africa and Uganda have passed acts on financial administration or the budget which give more influence to the legislature during the budget formulation and approval processes (Stapenhurst, 2004). In Eastern Europe, a notable example reflecting this trend is Poland. In 1997, a new constitution gave the Polish House of Representatives broad power to increase or decrease spending and revenues in the executive's budget. The only limitation is that the changes may not increase the budget deficit (or decrease the surplus) proposed by the executive (Gustafson, 2003). To increase the legislature's budgeting capacity, a research analysis unit was established in 1991 with six employees. By 1995, the number of staff had increased to 12, and the unit also contracted with the academic world to provide analytical services, thus substantially increasing the legislature's ability to undertake in-depth analysis of the government budget (Stapenhurst, 2004).

3. Current issues with Chinese budgets

Although, on the surface, the overall public budgeting process in China looks somewhat similar to the framework discussed above, it deviates from it by a wide margin in substance. The most important result of this deviation is the huge discrepancy between the adopted budget and the final budget. In this section, we first present some evidence of this discrepancy, and then we analyse the budgeting process to search for reasons behind the discrepancy.

3.1. Existing problems

The most serious issue in China's budget that is easily observable is the huge gap between the adopted budget and the final budget. Such discrepancy is evident in both revenue and spending.

3.1.1. Revenue

In terms of revenue, since 2000 the Chinese central and local governments have consistently underestimated revenue growth by a substantial margin, as can be seen in Table 1.

Table 1. **Revenue growth estimates (per cent)**

	Budgeted growth	Actual growth	Actual versus budgeted growth
2000	8.4	16.9	201.20
2001	10.3	22.2	215.53
2002	7.7	15.4	200.00
2003	8.4	14.7	175.00
2004	7.0	21.4	305.70
2005	11.0	19.8	180.00
2006	12.0	22.4	186.67

Source: Ma, Caichen (2007), *Government Budget*, Northeast Publishing House, China.

While underestimation of revenue by itself is not a major concern (and one may even argue that this is a result of unprecedented economic growth over this period), consistent underestimation over many years indicates either very poor budgeting and forecasting skills, or a deliberate underestimation of revenue collection. Even though consistent underestimation of revenue collection by itself is not a major concern (again it can be argued that more conservative estimation of revenue is conducive to the long-term fiscal health of the government), it poses a serious problem for the integrity of the budget if the resulting surpluses fall outside the purview of the public budget. Unfortunately, this happens to be the case in China. The governments at all levels never explain how the surplus is treated, and there is every indication that such a surplus is spent in the year to boost spending beyond what is budgeted. It has been estimated that the correlation between a revenue surplus and additional government spending is as high as 95% (Sun and Tan, 2007). Such additional government spending is completely free from any legislative review and approval, and is thus utterly at the discretion of the government itself.

3.1.2. Spending

Deviation from the spending budget also runs deep and wide. This is shown in two main aspects: the budget office that allocates funds and the agencies that use the funds.

In China, the main agency that controls budget allocation at the central level is the Ministry of Finance (MoF). Since China's National Audit Office started auditing government agencies, it discovered year after year that the MoF either allocated more than the budgeted amount or did not allocate the fund set in the budget. For example, in 2006, the National Audit Office found that the MoF allocated to government departments an additional CNY 81.75 billion (Yuan renminbi) above the budgeted amount that had been approved at the beginning of the year, accounting for 12.5% of the approved budgeted amount (Li, 2007). Such additional allocation could be a result of the additional revenue mentioned above. From 2004 to 2006, the MoF was to allocate CNY 5.5 billion as subsidies to employees laid off from state-owned enterprises. In reality, it allocated CNY 285 million, accounting for only 5.2% of the budgeted amount (Li, 2007). These and many other changes from the approved budget were executed without any involvement of the Chinese legislative body.

The auditing of government agencies' budget execution also uncovered similar disregard of the budget. For example:

- In 2005, the National Audit Office found that the use of CNY 5.5 billion was in violation of the budget approved at the beginning of the year. Nine departments requested and received CNY 176 million over the budgeted amount (Li, 2006).
- In 2006, the use of CNY 35 billion was in violation of the budget, and 95% of that amount was due to mismanagement, such as transfer of allocations from their originally intended programmes (Li, 2007).
- In 2007, close to CNY 30 billion was misused, and mismanagement accounted for 98% of that amount (Li, 2008).

What is hidden in these audits and almost impossible to quantify is the level of corruption and waste of public funds. The amount of public funds used on official entertainment (such as banquets, gifts for the purpose of official bribes, international travelling for pleasure) is incalculable. These funds are spent purely for the government officials' personal benefit without any regard for public interest.

3.2. Reasons for budgetary problems

The main reason for all these problems is that the Chinese legislature, the National People's Congress (NPC), lacks substantive budgeting authority, due to many of the factors mentioned earlier.

- The NPC does not have the authority to amend a budget submitted by the government. As discussed earlier, the ability to revise a budget is the key to whether the legislative body has the final decision-making authority regarding a budget to safeguard the public purse. Even though the Chinese Constitution and the Budgetary Law bestow on the NPC the authority to review and approve the initial budget and the final budget, they do not elaborate on what this authority entails or whether the NPC can revise the budget. Therefore, legally it is not guaranteed that the NPC can revise a budget. As a matter of fact, since the establishment of the People's Republic of China, central and local government budgets have hardly ever been revised.
- The overall budgetary approval process also makes it impossible for the legislative review to be of any significance. This is because the budget year starts on 1 January whereas the NPC does not convene until early March, and later for people's congresses at the local level. By the time the budget is approved by the NPC, almost three months of the budget year have already elapsed. In other words, the government operates without a budget for

almost one-quarter of the fiscal year. At the local level, this kind of "budgetary vacuum" can last as long as half a year. The Budgetary Law stipulates that, during the period of "budgetary vacuum", the government can operate on the basis of last year's budget up to that point and then operate under the new budget when it is approved. In reality, such stipulation has very little effect in constraining government spending without any specific regulation and oversight. The "budgetary vacuum" severely diminishes the authority of legislative review and the legality of the budget in constraining government spending.

- The initial budget submitted by the government to the NPC is not comprehensive and lacks details. As a result, the NPC does not have enough information to evaluate the government budget. There are three problems with this information disadvantage. First, the government has a total monopoly on budgetary information. In a principal-agent relationship, the agent has a strong motive to use the information advantage for personal benefit. The NPC has no way of evaluating the accuracy of the information provided by the government, and its ability to review the government's budget is thus completely controlled by the government. Second, the information contained in the budget is incomplete. The budget contains only part of government spending. Some extrabudgetary revenue and spending are not included in the budget submitted to the NPC and are thus outside public purview and oversight. Gao (1999) estimated the size of extrabudgetary funds to be 11-12% of Chinese GDP. Third, even for the part submitted to the NPC for review, the budgetary information is too general to be of any use. The information includes some verbal description and some summary tables on revenue and spending. Such a lack of detailed information makes it impossible to evaluate the overall budget, departmental budgets and individual projects, in terms of efficiency and effectiveness in resource allocation. Therefore, even if the Budgetary Law requires that changes to the budget be approved through the legislative process, the lack of detailed budget information renders this requirement all but meaningless in both theory and practice.
- The legislative committee does not have sufficient time and capacity to review the budget. The Finance and Economics Committee (FEC), a legislative committee within the NPC, is responsible for budgetary issues, among many other finance and economic issues.[2] The FEC consists of 32 NPC members, with only a handful responsible for budgetary matters. A subcommittee under the FEC, called the Budgetary Work Committee (BWC), consisting of about 20 staff members, is the primary unit within the NPC that is responsible for reviewing the government budget and monitoring budget execution.[3] According to the Chinese Budgetary Law, the government has to submit the budget proposal to the FEC for review a month before the convening of the NPC conference. However, given the size and complexity of the budgets, and the small size of BWC staff, a thorough review of the budget proposals is unlikely with just one month's lead time.
- The legislature as a whole does not have time to review the budget. The NPC convenes for 15 days every year. Of the 15 days, only one day is allocated to budget review. At the local level, only a few hours are typically reserved for budget review. To review and make sense of an entire central government's budget in just one day makes it a very hollow process. Not only does the NPC lack the information to evaluate the budget, it also does not even have the time to evaluate the very limited information available to it. As a comparison, the United States Congress needs about eight months to pass a federal

government budget, and a state legislature needs about five to six months to pass a state government budget.

- The government is also not held accountable to the original budget at the end of the year. Even though the government publishes a final budget after the end of the fiscal year, it provides only very summary information and provides no comparison between the original and the final budget. It also provides no account of its total assets and liabilities. Even though a government agency, the National Audit Office, conducts audit on the government itself and has uncovered many irregularities in the government budget, the legislature does not have any involvement in *ex post* auditing, rendering it completely ineffective as an oversight mechanism and at the mercy of government bureaucracies.

As a result, the legislative approval of the budget remains largely a formality, and the budget approved does not impose any legal constraint on the government agencies, because the NPC knows very little about what is actually in the budget. The end result is that the government puts together the budget, reviews and approves the budget, and then executes the budget all by itself, with hardly any legislative or public involvement. In other words, decision-making power is not separated from the execution of the budget in China. Such concentration of budgetary power, however, does not happen by accident. It is actually enshrined in China's Budgetary Law, which emphasises the government's authority in the budgetary process. The very first article of the Budgetary Law stipulates: "This Law is enacted to strengthen the distributive and oversight functions of budget, improve state's management of budget, enhance the state's macro-management capacity, and ensure economic and social development." The first article reflects the dominant and central role played by the government (or the state) in budgeting. The law is enacted only for the government itself to better manage the public funds, without saying anything about how the public, through the NPC, should use the budget to oversee government spending.

The Budgetary Law also gives a substantial amount of discretion to the government during the execution of the budget. According to Article 53 of the Budgetary Law, budgetary amendment occurs only when total spending exceeds total revenue, or when changes are needed for the amount of debt to be raised in the original budget. That means that the changes to the budget should be reviewed and approved by the NPC only when there is a deficit. Therefore any other changes made to the budget will not require approval from the NPC, such as additional spending when there is budget surplus, and transfer of funds between different programmes. Since governments at all levels enjoyed budget surpluses year after year, the government could spend the surplus in any way it saw fit without any involvement of the NPC. While such discretion gives the government the opportunity to deal with changes more easily, it nonetheless increases the opportunity for arbitrary behaviour and corruption. If the government has this kind of discretion in budget execution, then the initial budget approval puts very little constraint on the government. Thus it is not hard to understand the huge variation between the original budget and the final budget.

4. Recommendations

Based on the previous analysis, improving the legal authority of the budget as well as accountability in the public sector requires major reforms to the budgeting process and rewriting of China's current Budgetary Law guiding the budgeting process. The fundamental reason why the budget is not adhered to and why the government changes it at will is that the budget in China is not legally binding. What follows is a list of some modest steps that can be implemented fairly easily to change the current situation. The major theme of the reforms is to impose legal authority for the budget on the government.

1. The most important reform is to amend the Budgetary Law under the principle of balance of power. It should be firmly established that the people's congresses at all levels should have the decision-making power in the budgeting process, including reviewing and approving, amending, adjusting and vetoing the budget, as well as overseeing the execution of the budget. The government can only operate under the budget approved and amended by the people's congress. There should also be provisions requiring sanctions against violation of the budget and requiring audit, by an agency independent of the government, of budget execution.
2. To help the legislature fulfill this responsibility, steps should be taken to improve the capacity of the NPC to review the budget. Such capacity involves at least three components: committee, personnel and time.
   - Within the NPC, a standing Budget Committee should be established, dedicated to government budget review and monitoring. The Budget Committee can be formed by transferring part of the responsibility out of the FEC, and the BWC out of the FEC, into the new Budget Committee. There are some advantages to this institutional set-up. First, it accords a much higher priority to the budget than under the current setup, which is an appropriate attitude given the prominent role played by the budget. Second, the new committee dedicated to the budget will lead to a more effective review and monitoring of the government budget.
   - To make it more effective, this committee should also substantially expand the size of its staff to provide the committee members with more in-depth and more technical analysis of the government budget.
   - Even though the rank-and-file members of the NPC cannot spend much time on reviewing the budget during the annual conference, the new standing Budget Committee needs to have more than a month to review the budget. The government needs to submit the budget to the new Budget Committee at least three months before the annual conference.
3. The starting date of the fiscal year should be moved to a date after the conclusion of the annual conference of the people's congress at all levels. This is one of the prerequisites for endowing the budget with legal authority.
4. The government's budgeting capacity should be increased. How well the budget is prepared will have an impact on how well it is executed. This depends on the forecasting of both expenditure and revenue. For example, revenue and spending forecasting should be based on advanced econometric models rather than on simple "guesstimates". If large discrepancies exist between the original and final budgets, they should be published and discussed so as to improve the accuracy of models for future forecasting. More precise forecasting is a prerequisite to minimize the discrepancy between the original and final budgets. The government needs to set up a professional team to do scientific forecasting of revenue and expenditure. If this cannot be accomplished within the government, then this task should be outsourced to experts outside the government. While this step is not directly linked to the legislative role, it is nonetheless important because it brings credibility to the budgeting process and makes legislative review and oversight much easier.

5. The budget proposal submitted by the government should be comprehensive and detailed. To make the government accountable for what it spends, the budget should be as comprehensive and detailed as possible. To be comprehensive, the budget should include all government revenue sources and spending items, both on budget and off budget. To be detailed, it should provide information on spending at all different levels. It should not only provide summary information at the programme level or department level, but also break down spending information to levels lower than the department, such as each and every office in the department, including information on the number of positions for each office, salary, office spending, travel, utilities, etc. Only with comprehensive and in-depth fiscal information can the original budget serve to hold the government accountable and can the legislature exercise its oversight authority over the government.
6. With regard to the execution of the adopted budget, the government needs to furnish information periodically (publication at least once every month) to the National People's Congress about spending and revenue figures, and compare such actual revenue and spending figures to the projected revenue and spending figures based on the originally budgeted figures. The update and the comparison will tell the legislature whether the government is executing the budget according to the plan and if the government is running a surplus or deficit as of the reporting date. This will not only hold the government accountable for its spending, but will also give the NPC, or at least its standing Budget Committee, time to prepare for necessary changes to the original budget.
7. After the fiscal year ends, the government should publish a detailed report about actual revenue and spending figures, and this report should be part of a comprehensive annual financial report that includes not only annual revenue and spending figures, but also accumulated assets and debt. This will give the public both a short-term and long-term perspective on the fiscal health of the government. It should also include a table comparing the original and final budgets, and explanations of any major differences. The legislature should also conduct its own audit of government spending, or contract with other institutions outside the government to conduct the audit.

5. Conclusion

China has made great strides in public financial management over the last 30 years since it adopted the "reform and opening" policy in 1978. The limitations of the reforms adopted so far, however, have also been clearly evident as the public sector is growing larger and the scope and level of corruption and waste are growing ever wider and higher. In one sense, the path taken so far by China is somewhat similar to the one taken by some developing countries in Latin America: initial reform was aimed at improving the efficiency of government operation without paying too much attention to government accountability. Given the importance of the role played by the legislature in the budgeting process and the worldwide trend of a more active legislature in government budgeting, it is also time for China to start implementing a second round of budgetary reform to bring more accountability into public financial management.

Notes

1. The Budgetary Law lays down four basic principles of budgetary management: *i)* each level of government should be responsible for its own budget; *ii)* the budget should be balanced; *iii)* the central government will share revenue with subnational governments; and *iv)* once the budget is approved by the legislative body at each level of government, it cannot be changed without going through the legislative process.
2. The NPC meets as a full body only once a year for two weeks. Outside this period, it is up to the NPC Standing Committee, consisting of 160 members, to meet frequently to discuss legislative matters. Under the Standing Committee, there are several specialised committees, and the FEC is one of them.
3. In addition to budget review and monitoring, the FEC is also responsible for much other legislation and regulation with regard to finance, national economy, and social and economic development.

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