

The Hierarchical Discrepancy in Chinese Government Behaviors and the Weakness in Policy Execution

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Abstract

This paper puts forward a hypothesis suggesting a hierarchical discrepancy between Chinese central government and the local governments, which argues that, in the progress of policy making and implementation, the central government is an encompassing group, whose policy making stems from the historical responsibilities it carries, while the local governments, though politically obedient to the central government, and competing in economy with each other, usually take local economic growth into account during policy execution. By developing a double-task principal-agent model between central government and local governments, this paper comes to a conclusion that the incentive incompatibility, in the discipline contract between central government and local governments, is likely the root cause of the weakness in policy execution.

Keywords: Central Government, Local Governments, Hierarchical Discrepancy, Incentive Incompatibility, Policy Execution

1. Introduction

Theoretically, a high degree of administration system enjoys high efficiency in policy making and implementation. China is a society with a high degree of administration, but Chinese government is incompetent in policy implementation, which interests the worldwide academia. The weakness of Chinese government in policy implementation is resulted from the interaction of multiple factors, including subjective and objective factors, systemic and conceptual factors [1]. Intuitively, the poor execution is attributed to the huge

inefficient and excessive costs during the implementation of public policy, which consumes inappropriate and unnecessary public resources [2], and thus closely links to government financial resources [3]. However, it is thought-provoking to notice that, without effective external restriction, the weakness of Chinese government in policy implementation indicates the huge internal friction of power in the administrative system. It is heuristic to explain the relationship between the central government and the local governments, as a multi-stage bargaining process, during which, the local governments, in line with different governmental relationships and policy features, would take completely different strategies in policy implementation, consequently weakening the execution [4]. But this explanation can not further explain the reason why the local governments prefer to handle their relationships with the central government before deciding on a strategy for policy execution. Therefore, this paper has averted the focus reasonably onto the inside of the administrative system, seeking the root of the problem by analyzing the behavior characteristics of the central government and local governments.

2. Hierarchical Discrepancies in Government Behavior Characteristics

Before China's open and reform, the central government and local governments maintained a simple relationship of "mandator-executor", the former was the policy-maker and the latter executors. The local governments simply acted as the royal subordinate to the central government, faithfully implementing the policies made by the central government [5]. After the open and reform, in order to fully

motivate the initiative of local governments, the central government start to carry out the decentralization progress [6], accordingly local governments began to beware of their own interests. And local governments are empowered to make decision in a certain extent, which aroused their potential motive to deviate from central government's policy [7]. Consequently, from then on, obvious hierarchical discrepancy of the behavior characteristics between the central government and local government has emerged.

2.1. The Central Government: An Encompassing Interest Group

The central government's behavior has dual characters: on one hand, it could either boost economic growth, on the other, it could trigger economic declines [8]. Yang(1998) describes it as "North Paradox". The central government's behaviors, however, are not unreasonable as the "maximization of monopoly rent" is always the consistent ideological line of the government. All the behaviors of the government always take the consolidation of its dominant position as the starting point and ending point.

Nevertheless, rebuttal to "North Paradox" has come forward. To explain the sustainable economic growth in China after open and reform, Yao reckons that "the economic growth during the past 25 years in China is largely due to policy release", its political base derives from the following belief, "a powerful nation must be an encompassing nation, this is also true for a ruling party", and that "the Communist Party of China has walked through the transition process from a single class basis to an encompassing group." If the central government, as Yao said, is an encompassing group, then it will not have its own special interests, and will always make policy in line with its ruling concepts, standing in the center of the policy progress.

2.2. Local Governments: Followers to central government and Competitors to each other

Local governments are playing a dual role during the policy progress. Politically, local governments are undoubtedly obedient to the central government. As a ruling party, the Communist Party of China is capable to ensure policies and laws made by the central government are implemented faithfully by local governments. But meanwhile, due to the

unbalanced development of China's economy in different areas, the central government sticks to the principles and is flexible as well in making policies, usually leaving some room for local governments at all levels to take their initiatives.

Since the open and reform and with the deep-going of reform of "streamlining of administration and decentralizing of power", the independent economic role of local governments at all levels has been constantly enhanced, and more competition among local governments for local economic developments has been occurred. It's understandable that the real competition among local governments is the competition among local officials for career promotions. We assume that a local official of outstanding performance gets promoted in the performance appraisal by superior level of government. Then, to comply with the policy legislated by the central government, the local officials naturally devote themselves to local economic growth, or local GDP growth, or rather, their personal interests. It's easy for us to observe that, while the policy by the central government is in favor of the local economic growth, the local government will advertisedly "say it and do it". The typical examples are the policy of the household contracted responsibility system and the policy of SOE reform "by laying stress on major enterprises and setting free the small". If the policy is not in favor of the local economic growth, or in other words, not in line with the personal interests of the chief local officials, the local government will "just say it and not do it". The typical examples are government institutional reforms, and real estate industry control. If some behavior, not supported by or prohibited clearly by the central government, is in favor of the local economic growth, the local government will "do it without saying it". The typical example is the preferential policy for attracting investments, such as tax exemption and land price deduction. If some behavior, clearly prohibited by central government, is in favor of the local economic growth, the local government will leave the policy on the shelf "without saying it". The typical examples are the illegal use of lands, and the construction of houses with limited property rights. To sum up, the policies made by central government will be implemented faithfully by local governments on condition that it is in favor of the development of local economy, or the

political interests of the chief local officials.

3. The double-task Principal-Agent Model between Central Government and Local Governments

The behavior discrepancy between the central government and local governments has made the governments fall into a game relationship during the policy progress. The realization of the policy purpose could be explained through the principal-agent theory. This paper assumes that the central government acts as a principal while local government an agent, and they take the discipline of “Subordination of the lower levels to the higher” as their contract. In the policy progress, they have different preference and objective functions. The central government, who has strong political preferences, inclines to the consistency of the policy, while the local government, who has strong economic preferences, inclines to the local economic performance. By establishing a discipline contract, the central government imposes restraints upon the behaviors of local governments, in hopes of realization of the economic growth in different areas on the premise of policy consistency. However, due to the huge development differences across the country, incentive incompatibility often arises between the policy purpose of central and local governments. This paper develops a double-task principal-agent model between the central and local governments [9], so as to discuss how the preference discrepancy and the relative price change cause local governments’ efforts to deviate from the reform target of central government.

During the policy progress, the central government issues documents to its subordinates along administrative architecture, accordingly the discipline contract relationship with local governments is being formed. It is assumed that in the policy progress a local government, entrusted by the central government, takes up two tasks: political and economic task. The former aims to maintain the policy integrity, while the latter aims at the economic growth during the policy implementation. During the policy progress, the central government sticks to the principles and is flexible as well in making policies, usually leaving some room for local governments at all levels to make detailed rules, supplementary clauses and normative

explanations in accordance with their actual situations. Thus, the local governments have option of those two tasks mentioned above, which is necessary, and the freedom assumption for the tasks is true.

Suppose the central government is risk neutral and the local governments are risk averse. Especially, we make this assumption that the utility function for local governments is $-exp(-rw)$, in which r is a constant, standing for absolute risk measurement, and $r > 0$; w is the actual monetary income. Vector of local governments’ efforts is $\vec{a} = (a_1, a_2)$, in which, \vec{a} is a continuous two-dimensional variable for the efforts, stands for the sum measurement of all the actions a local government takes to fulfill the two tasks, a_1 is the economic efforts, and a_2 is the political efforts. The effort cost $C(a)$ is a convex function, and is assumed to enable the monetization of measurements. In order to simplify the model, we suppose $C(\cdot)$ is a quadratic form and could be written as $C(a) = aC(a)^T$, in which C is a positive-semidefinite symmetric matrix

$$C = \begin{bmatrix} c_{11} & c_{12} \\ c_{12} & c_{22} \end{bmatrix}$$

and its invertible matrix is also a symmetric one. The output of efforts is displayed by monetized variables, and $\vec{x} = (x_1, x_2)$ is defined as output vector. The level of efforts affects the mean value of the random output, that is, $x_i = a_i + \varepsilon_i$, $i=1,2$, in which, x_i is the total output gained through the economic efforts by a local government, including disposable income, local GDP, fiscal income growth, etc.; x_2 is the total output gained through the political efforts, including public security, legal system construction, social harmony, democratic election, compulsory education, public health, social security system, disaster prevention and deduction, environmental protection, family planning, etc.; ε_1 largely depends on the uncertain factors affecting the economic growth; ε_2 largely depends on the uncertain factors affecting the social stability. The random vector $\varepsilon(\varepsilon_1, \varepsilon_2)$ is subject to a normal distribution in which the mean value is 0 and the variance is

$$\Sigma = \begin{bmatrix} \sigma_1^2 & 0 \\ 0 & \sigma_2^2 \end{bmatrix}.$$

Suppose the discipline contract between central

and local governments is in a linear form, in which the central government demands an unconditional obedience from local governments and provides them with

$$\exp(-rw_e) = \int_{-\infty}^{+\infty} \exp\left(-r\left(\alpha + \beta a^T - \frac{1}{2}eCe^T\right) - \frac{1}{2}(x-a)\Sigma^{-1}(x-a)^T\right) \frac{dx}{2\pi(\det \Sigma)^{1/2}}$$

(1)

Use the moment to generate the function, and it makes

$$w_e = \alpha + \beta a^T - \frac{1}{2}aCa^T - \frac{1}{2}r\beta\Sigma\beta^T$$

(2)

The final item in the formula (2) is the risk cost. Make the optimization of a in the formula (2), we could get the optimized response by a local government against a linear contract, in which the incentive and restraint should be

$$\beta = aC$$

(3)

According to formulas (2) and (3), the local government's certainty equivalent wealth

$$\int_{-\infty}^{+\infty} (b - s(x_1, x_2)) \exp\left(-\frac{1}{2}(x-a)\Sigma^{-1}(x-a)^T\right) \frac{dx}{2\pi(\det \Sigma)^{1/2}} = b - \beta a^T - \alpha$$

(5)

Thus, the optimization problem of the central

$$\begin{aligned} & \text{Max}_{\beta, a} b - \beta a^T - \alpha \\ & \text{s.t. } \beta = aC \end{aligned}$$

The above restraint is tight at the optimization, so when it is substituted into the target function,

$$\text{Max}_{\beta} b - \frac{1}{2}r\beta\Sigma\beta^T - \frac{1}{2}\beta C^{-1}\beta^T$$

Solve this formula, we could get the suboptimal solution under situation with

$$\beta^{SB} = (r\Sigma C + E)^{-1} b'$$

in which, $b' = (b_1, b_2)^T = \left(\frac{\partial b}{\partial a_1} \quad \frac{\partial b}{\partial a_2} \right)$

is the effect vector of social output which

$$\beta^{SB} = \begin{bmatrix} \beta_1^* \\ \beta_2^* \end{bmatrix} = \frac{1}{|\chi|} \begin{bmatrix} (1 + rC_{22}\sigma_2^2)b_1 - rb_2C_{12}\sigma_2^2 \\ (1 + rC_{11}\sigma_1^2)b_2 - rb_1C_{12}\sigma_1^2 \end{bmatrix}$$

(8)

in which,

$$|\chi| = (1 + rC_{11}\sigma_1^2)(1 + rC_{22}\sigma_2^2) - r^2C_{12}^2\sigma_1^2\sigma_2^2$$

(9)

4. The Incentive Incompatibility and the Weakness of Policy Execution

The double-task principal-agent model

corresponding financial supports as necessary. Make $S(x_1, x_2) = \alpha + \beta_1 x_2 + \beta_2 x_1$, then the certainty equivalent wealth of the local government w_e will satisfy

should be

$$w_e = \alpha - \frac{1}{2}r\beta\Sigma\beta^T + \frac{1}{2}\beta C^{-1}\beta^T$$

Use $b = (b_1, b_2)$ to represent the total expected social return generated through the policy implementation by the local governments, then the expected return gained by the central government from the total output should be

government is

$$w_e = \alpha + \beta a^T - \frac{1}{2}aCa^T - \frac{1}{2}r\beta\Sigma\beta^T \geq 0$$

a simplified optimization problem could be gained as

(6)

incomplete information

(7)

corresponds to the economic and political efforts made by a local government. Expand the formula (7), we could get

between the central government and local governments proves that, the more incompatible the central government's incentive appears, the more serious the local

governments will deviate from the policy purpose, and the lower the performance of the policy will become.

How great importance the local government attaches into the central policies depends on the consistency degree of the policy purposes between the central government and local governments. Hereby, two situations will be discussed to analyze the different incentive effects could be done to local governments' both efforts by the externality of a political market and the relative price change.

If the central government's policy purpose is in consistent with a local government's, or, in other words, if a certain central policy meets the local needs in economic development, then local government will attach great importance to the central policy, and its subjective economic efforts will bring about objective improvement in its political service. Thus, through better coordination of political and economic goals, this local government shows less deviation from central policy purpose. In this situation, the costs of economic and political efforts are independent with each other, that is, $C_{12}=0$. Because both activities are taken under the guidance of a unified purpose, Therefore, even if a certain central policy is in favor of the local economic development, but the distinct externality of the political market will cause the decrease of the total income by the policy execution efforts, which would encourage the economic efforts and discourage the political efforts.

If the central government is not consistent with the local government in policy purpose, or in other words, a certain central policy has little effect on the local economic growth, the local government will be insouciant towards the central policy because of its economy-oriented inclination, which certainly will deviate from the political purpose. At this time, $C_{12}>0$. It is foreseeable that, when the economic motive of the local government expands, the central policy will be implemented in a passive way.

According to the possible financial compensatory program,

$$\frac{\partial \beta_1^*}{\partial b_1} = \frac{1 + rC_{22}\sigma_2^2}{|\chi|}$$

$$\frac{\partial \beta_2^*}{\partial b_1} = -\frac{rC_{12}\sigma_1^2}{|\chi|}$$

in addition, $C(a_1, a_2)$ is a strict convex function,

the level of efforts in the economic activity will not affect the margin cost due to the political efforts. The existence of the policy externality, however, will generate different incentive effects on economic and political efforts of local government.

According to the possible financial compensatory program, when $C_{12}=0$,

$$\beta_1^* = \frac{b_1}{1 + rC_{11}\sigma_1^2}$$

$$\beta_2^* = \frac{b_2}{1 + rC_{22}\sigma_2^2}$$

Thus,

$$\frac{\partial \beta_1^*}{\partial \sigma_1^2} = -\frac{b_1 r C_{11}}{(1 + r C_{11} \sigma_1^2)^2} < 0, \quad \frac{\partial \beta_2^*}{\partial \sigma_1^2} = 0$$

$$\frac{\partial \beta_2^*}{\partial \sigma_2^2} = -\frac{b_2 r C_{22}}{(1 + r C_{22} \sigma_2^2)^2} < 0, \quad ,$$

$$\frac{\partial \beta_1^*}{\partial \sigma_2^2} = 0$$

the economic efforts and political efforts are alternative to each other in the cost, therefore

$$|\chi| = (1 + rC_{11}\sigma_1^2)(1 + rC_{22}\sigma_2^2) - r^2 C_{12}^2 \sigma_1^2 \sigma_2^2$$

And $C_{12} > 0, C_{22} > 0$

Thus,

$$\frac{\partial \beta_1^*}{\partial b_1} > 0, \quad \frac{\partial \beta_2^*}{\partial b_1} < 0$$

Furthermore, the increase of the incentive in economic efforts will bring about the increase of its output x_1 , and will further result in the increase of expected social income b_1 . It could be deduced that, in the political market, the rising value of economic efforts will strengthen the incentive for economic efforts and weaken the incentive for political ones.

The model analysis as above reveals that the weakness of policy execution derives from the incentive incompatibility existed in the discipline contract between central government and local governments. It is the excessive incentive given to the economic expansion and the distinct insufficient incentive for political efforts during the policy execution that finally lead to the weakness of policy execution.

5. Conclusions

The central government is an encompassing group, whose policy making derives from the historical responsibility it carries, and always stands at the center during the policy progress. Local governments, though politically obedient to the central government, and competing in economy with each other, usually take local economic growth into consideration when making detailed rules and normative explanations to central policies. The incentive incompatibility, existed in the discipline contract between central government and local governments, is likely the root cause of the weakness in policy execution. It is the excessive incentive given to the economic expansion and the distinct insufficient incentive for political efforts during the policy progress that encourage the local governments to deviate from the policy purpose of the central government. Therefore, during the policy progress, strengthening the incentive of political efforts for local governments has become the core of policy making.

During China's process in economic system transformation and social transition, many central policies are difficult to carry out. The policy execution is often far from the expected targets, or even opposite to the origin reform intention of the central government. Typical examples are long-standing illegal land resulted from land utilization policy, and little effect in real estate market adjustment and control policies, and government institutional reform with counter effects, ect.. Certainly, it's not appropriate to simply attribute these problems to an executive deviation resulted from "local government can always find a way to cope with policies", but the policy gaming between central government and local governments indeed has been existing all along.

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