The Perils of Fiscal Centralization: Delegation of Tax Collection, Local Elites, and State Capacity

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Version: Jan. 4. 2022

Abstract

Fiscal centralization is essential for state building and state capacity, but decentralization is often praised for improving public service delivery. We highlight an important tradeoff in (de)centralization by focusing on the incentive structure of local elites, who assist the state in maintaining local stability in an environment of weak institutions. We argue that the delegation of tax collection under fiscal decentralization facilitates the implementation of unpopular policies by offering fiscal and political incentives to local elites and mitigates the credible commitment problem between the government and local elites. We exploit a centralization reform in China that abolishes agricultural taxation, inadvertently removing the delegation of tax collection from local elites. Based on a village-level panel dataset, we demonstrate that the tax reform led to tax noncompliance and rising social unrest. We further show that worsening local governance occurred because of disincentives of village elites to carry out state-preferred yet unpopular policies.

1. Introduction

Insufficient state capacity is an impediment to many developing countries, crippling well-intended policies and resulting in a vicious cycle of political instability and economic underdevelopment. In search of solutions for better state capacity, recent scholarship turns attention to political elites' incentives for engaging in state building.[1] In particular, scholars maintain that successful state building requires fiscal centralization, which remedies the political and economic fragmentation that weakens state capacity.[2]

The emphasis on fiscal centralization as the cornerstone of state capacity challenges the notion that fiscal *decentralization* enhances the delivery of public services and promotes economic growth (World Bank 2004).[3] Indeed, scholars have warned about the unintended consequences of decentralization. For example, some studies raise the concern that decentralization leads to local elite capture and regional inequality in public goods provision.[4] In addition, recent studies show that (re)centralization could improve citizens' ability to organize and demand the delivery of public goods and enhance public service.[5]

We contribute to this debate by highlighting an important limitation of fiscal centralization—elite coordination and cooperation at various levels of government to implement unpopular policies and maintain local political stability. Despite the importance of fiscal centralization for the standardization of taxation and public service delivery, centralization reforms could undermine the interest of elite intermediaries, who play a vital role in extending the reach of the state at the

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[1] See, for example, Beramendi, Dincecco, and Rogers (2019), Besley and Person (2009), Dincecco (2011), and Garfias (2018, 2019).

[2] Dincecco (2017) offers an excellent synthesis of this line of reasoning.

[3] See Wibbels (2006) for helpful reviews on decentralization and the delivery of public goods and services.

[4] See Bardhan (2002) for an overview of decentralization and governance. For evidence of elite capture under decentralization, see Bardhan and Mookherjee (2000) and Mattingly (2016).

[5] See, for example, Acemoglu, Robinson, and Torvik (2020) and Malesky, Nguyen, and Tran (2014).

last mile of state capacity (Gerring et al. 2011; Soifer 2015). Scholars have shown that local elites and street-level bureaucrats facilitate or resist policy implementation in environments with weak formal institutions in rural and peripheral areas.[6]

To investigate the ways through which fiscal centralization impedes local elites' incentives to assist the state in implementing unpopular policies and maintaining local political stability, we propose a theoretical framework and offer supporting empirical evidence. Our arguments build on insights from theories of bureaucracy and delegation in a principal–agent framework and highlight the commitment problem facing higher-level governments (the principal). To facilitate implementation of unpopular policies, higher-level governments may *implicitly* delegate some informal authority to local elites in the form of discretionary policy enforcement. Notwithstanding, delegation is not credible *ex ante*—should undesirable outcomes arise during the process of policy implementation, governments could deny and even renege on delegation, scapegoating local elites.

Delegation of tax collection offers both fiscal and political incentives to local elites and alleviates the commitment problem. First, delegation of state tax collection offers fiscal autonomy and legitimacy to local elites for their rent-seeking activities. Second, delegation of tax collection offers leverage to local elites in their strategic interaction with higher-level governments and local residents. Specifically, local elites could punish a reneging government by exerting less effort in future tax collection, mitigating the credible commitment problem. Meanwhile, local elites could use tax collection as a leverage to incentivize local residents to comply with other unpopular state policies. Fiscal centralization inadvertently removes the delegation of tax collection, thus

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[6] See discussion in Baldwin (2013), Hassan (2020), Koter (2013), and Mattingly (2020) for the role of local elites in assisting the state. For the resistance of local elites, see the studies emphasizes a weak state and strong society (Lange 2004; Mamdani 1996; Migdal 2001; Shue 1988).

undermining local elites' incentives to facilitate the reach of the state and maintain local political stability.

Recently scholars have noticed the tension between fiscal centralization and elite coordination. Based on historical developments in Mexico, Garfias and Sellars (2021a) highlight the possibility that state building through centralization could undermine local elites' incentives to maintain political stability. We study China to provide evidence in a contemporary setting, exploiting a unique agricultural tax reform in rural China from 2001 to 2005. This agricultural tax reform reduced and eventually abolished agricultural taxes owing to the central government—the primary tax burden on peasants imposed by the state throughout China's history. The tax reform is part of a broad shift toward recentralization by the Chinese government since the mid-1990s, taking away power over economic resources from village and township cadres (Oi et al. 2012). We show that rural governance, measured by tax compliance and local political stability, declined after the agricultural tax reform. Our empirical strategy relies on a unique village-level panel dataset covering the period before and after the tax reform (2000-2007) and the exogenous timing of the removal of tax collection delegation in our identification strategy. More importantly, our data consists of detailed measures that allow us to link village elites' efforts and local policy outcomes.

Our findings are robust to a host of potential temporal and cross-sectional explanations that could lead to rising social unrest and tax noncompliance, such as changes in the Chinese central government's management of social stability, the level of public spending, the ad hoc tax burden, prior local stability, the strength of informal institutions, and rural land expropriation. We also provide direct evidence for our proposed mechanism, demonstrating that village cadres exert significantly less effort in collecting taxes and maintaining local stability. We find that the tax reform reduces their fiscal autonomy and undermines the legitimacy of village cadres.

Our paper is relevant to two strands of literature. First, our studies connect important debates in state building and fiscal centralization vis-à-vis recentralization. We cast new light on this debate by focusing on an important but overlooked consequence of (de)centralization reform—implementation of state preferred yet unpopular policies. Although the state could use public spending or coercive apparatuses to maintain local stability, local elites play a critical role in preempting the outburst of mass contention against the state. Our paper specifies the ways through which fiscal centralization could undermine local elites' incentives to become the agent of the state and implement unpopular policies. Moreover, our study complements recent scholarship highlighting the reason that state's centralization reform could backfire—it undermines elite coordination (Garfias and Sellars 2021a). Hence, we highlight an important tradeoff between public service delivery and elite coordination across levels of government in the centralization–decentralization reforms.

Second, our paper sheds light on the political consequences of agricultural tax reform and rural governance in China. Previous scholarship primarily emphasizes the *fiscal* consequences of this reform, suggesting that it strengthens the central government's control of revenue collection and public spending at the expense of local governments (Kennedy 2007, 2013; Oi et al. 2012; Smith 2010; Takeuchi 2014). To our knowledge, this paper represents the first attempt to investigate the non-fiscal consequences of the reform (i.e., political stability) and provide microlevel panel data on the village cadres' and residents' behavioral responses to the tax reform.

Moving forward, we present a theoretical framework based on the principal–agent models in Section 2. In our framework we highlight the ways tax collection resolves the credible commitment problem in strategic interaction between local government and village elites. Section 3 contextualizes our argument in rural China. In Section 4 we show consistent evidence that tax

reduction since 2001 has undermined the state's desired outcomes—tax compliance and political order. In Section 5 we provide supporting evidence for our arguments by evaluating the impact of tax reduction on village elites' efforts to assist in implementing state policies. Finally, Section 6 concludes with implications and discuss why the Chinese central government initiated this tax reform in spite of its detrimental effects on elite coordination.

2. Implementation of Unpopular Policies, Local Elites, and Delegation of Tax Collection

In this section we first illustrate the tension between higher-level governments and local elites during the process of implementing unpopular policies. We then discuss the ways through which the delegation of tax collection incentivizes local elites to achieve unpopular but desired state policy outcomes. Our theoretical framework is most applicable to political environments with weak formal institutions and state reliance on local elites for policy implementation (e.g., rural and peripheral regions).

2.1. The Set Up

Our theoretical framework builds on insights from theories of bureaucracy and delegation in a principal–agent model,[7] allowing us to specify the choice set and payoff behind strategic interactions between lowest-level government officials and village elites. In our theoretical framework, we are primarily concerned with the strategic interaction between lowest-level governments and local elites, which differs from the focus on interaction between local elites and peasants in the model proposed by Garfias and Sellars (2021a).[8] In our framework, the lowest-

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[7] For a review of the formal models of bureaucracy and delegation, see Bendor, Glazer, and Hammond (2001) and Gailmard and Patty (2012).

[8] The strategic decisions by local elites and peasants were determined by elite loyalties to the central government, peasants' incentives to rebel, and central government strength to punish defecting elites in Garfias and Sellars (2021a).

level government constitutes the principal, and local elites are the agents. The principal has the resources and institutional power to make policy decisions but is ill-informed; agents have better information and the social network necessary to implement policies because they are socially embedded but lack sufficient power and resources to make policy.

To achieve desirable outcomes, the principal (the lowest-level government) faces two choices in the strategic interaction with the agent (local elites)—control or delegation. The control strategy entails the principal taking full control of policy implementation by relying on the agent for accurate information on local affairs; however, this strategy is not in the principal's best interest because the agent may falsify information that prevents the principal from making the best decision. Even if the agent reveals truthful information, controlling policy implementation comes at a high transaction cost to the principal when managing multiple agents. Finally, the principal's taking policy into her own hands is potentially dangerous because she has to bear full responsibility for potential negative outcomes.

Meanwhile, the agent has two choices in strategic interaction with the principal—exerting effort or shirking. Specifically, the agent could exert effort by persuading local residents to comply with unpopular government policies. The success of the agent's efforts lies in moral authority as well as social embeddedness in the community (Bhavnani and Lee 2018; Hassan 2020; Tsai 2007); however, government policies are not always popular among local residents, making the agent's efforts very costly.

Alternatively, the agent could choose shirking, relegating the task of policy enforcement to the principal. Although the agent's shirking is likely to lead to failures in policy implementation, these undesirable outcomes hurt the principal more than the agent. Specifically, lowest-level government officials aim to seek promotion within the bureaucratic system, and failures in policy

implementation would dent their promotion prospects. By contrast, local elites, who are mostly immobile, do not seek promotion outside their localities. The lack of immobility is one of the key conditions for moral standing to offer benefits and impose constraints upon local elites (Tsai 2007). Finally, with the imperfect information resulting from information asymmetry, government officials often cannot distinguish the sources of policy implementation failure emanating from lack of effort from other factors beyond the agents' control.

2.2. The Commitment Problem in Delegation of Policy Implementation

Fundamentally, the principal's ultimate goal is to "get as close as it can to its most preferred outcome, and by extension, to induce the agent to deploy its expertise as much as possible in the principal's interest" (Gailmard 2014:9). Hence, the standard principal–agent framework suggests that the principal should choose delegation over control. In an environment of weak institutions, delegation manifests mainly in discretionary policy enforcement, allowing the agent to selectively withhold law enforcement in some areas in order to achieve the broader objective (Holland 2016). For example, local elites with the power of discretionary policy enforcement may ignore local residents' minor legal infractions in some areas in exchange for compliance in other areas; or local elites may use coercion to carry out government policies Scholars have documented the engagement of village cadres in selective policy implementation in China (Obrien and Li 1999), in which they often use a mix of coercion and concession to ensure policy compliance from villagers (Hurst et al. 2014; Ong 2018).

The delegation with discretionary policy enforcement, however, engenders a credible commitment problem (Gailmard and Patty 2012). Specific to an environment with weak rule of law, delegation of power for discretionary policy enforcement is not institutionalized. Instead, delegation of power by the principal is implicit as long as the agent assists the principal in

accomplishing tasks. Precisely because delegation of power is implicit, the principal may renege on and even deny delegation when the process of policy implementation generates undesirable outcomes, scapegoating the agent.

In fact, the Chinese central government often blames village cadres' actions instead of policy design when undesirable outcomes emerge during implementation of unpopular policies, such as the One Child Policy, environmental policies, and tax collection (Bernstein and Lü 2003; Mattingly 2020; Ran 2017; Takeuchi 2014). Scholars have shown that the decentralization of policy implementation and state media bias induce Chinese citizens to credit the central government for good policy outcomes while blaming local governments for adverse outcomes (Cai 2008; Lü 2014; O'Brien and Li 2006).

Without safeguarding the commitment from the principal, agents have no strong incentive to use their information and social network to assist the state *ex ante*. Although contracting could help alleviate the credible commitment problem (Dixit 1995; Myerson 2015), the effectiveness of the contract requires an objective and impartial third party to monitor and enforce contracts. This type of third party is often absent in developing countries where rule of law is limited.

2.3. How Does the Delegation of Tax Collection Alleviate the Commitment Problem?

In light of the commitment problem in the interaction between the principal and the agent, the delegation of tax collection offers *incentives* as well as *tools* to the agent and alleviates the commitment problem. Fiscally, tax collection generates legitimate channels for rent-seeking by local elites and enhances their fiscal autonomy. Politically, tax collection empowers local elites in their strategic interaction with both higher-level government officials and villagers.

Models of bureaucracy stresses that effectiveness of delegation requires embedded incentives for the agent to use local knowledge and social networking to achieve the policy outcomes desired

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by the principal (Dessein 2002). Fiscal incentives are a common tool used to motivate the agent. Specifically, we contend that fiscal autonomy (i.e., control of revenue collection and spending) instead of material benefits (e.g., salaries and benefits) for the agent is the more important form of fiscal incentives. Although a higher salary enhances the economic well-being of the agent, delegation of tax collection offers fiscal autonomy in generating and distributing fiscal revenues that empower the agent. For instance, local elites could legitimately engage in rent-seeking through collecting other associated fees as part of the mandated agricultural taxation from the state. In addition, fiscal decentralization offers an opportunity for agents to distribute public spending at their discretion.

In the case of China, fiscal incentives have long been used to tie the incentives of local elites to the state. Historically, the central government purposely allowed local bureaucrats to keep extra, unmonitored taxes in order to ensure bureaucratic compliance during the Qing Dynasty (Ma and Rubin 2019). In contemporary China village cadres were entitled to a share of associated fees to finance village projects, incentivizing them to assist in collecting the state's agricultural taxes. The scheme of revenue-sharing and fiscal contracting was the basis of local state corporatism because they incentivized county, township, and village governments to promote economic growth in rural China in the 1980s (Oi 1992).

Meanwhile, delegation of tax collection engenders tools to the agent by offering leverage against both *higher-level governments* and *local residents*. In the event of scapegoating by the government, local elites could exert less effort in future tax collection. Because tax revenues are relayed to higher-level governments, lower tax revenue hurts the principal more than the agent. Relying on the agent's continuous efforts in collecting taxes, the principal is less likely to renege

on the delegation of power at will.[9] Although the principal could also use career incentives (e.g., replacing existing agents with new ones) to motivate the agent, this strategy faces three limitations. First, local elites are not often state employees, making discipline by the state difficult. Second, new agents are unlikely to possess the information and social network needed to deal with complex relationships among local residents. Third and most importantly, a new agent faces exactly the same commitment problem as the previous agent in their repeated interaction with the principal. Hence, replacing existing agents is unlikely to yield better policy outcomes.

In addition, local elites could use tax collection as bargaining leverage with local residents for compliance in other policy dimensions. Tax assessment and compliance are two fundamental challenges facing the state in an environment with weak institution, particularly in rural and peripheral areas. Instead of strictly following tax codes, tax assessment and payment are often "negotiated" between tax collectors and households in order to improve tax compliance. Consequently, local elites could incentivize some villagers to pay less tax in exchange for compliance in other policy dimensions. This dynamic has been documented in China and elsewhere.[10] Moreover, the process of tax collection also offers important information to the agent about local residents, thus enhancing the agent's bargaining leverage. That is, delegation of tax collection enhances the "legibility" of the state, which is one of the foundations of state capacity (Lee and Zhang 2017; Scott 1998).

In sum, the delegation of tax collection offers both incentives and tools alleviates the credible commitment problem through offers of fiscal and political payoffs to local elites. When the state initiates a fiscal centralization reform by abolishing local taxes and using governmental transfers

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[9] Note that local governments could still renege, particularly those officials who have high career mobility, because leverage hinges on repeated interaction between the principal and the agent.
[10] Tian and Zhao (2008) and Wu (2007) offer insightful case studies of tax negotiation in rural China. See Brautigam, Fjeldstad and Moore (2008) for issues involving tax collection in developing countries.

to finance the delivery of public services, it effectively withdraws the delegation of tax collection from local elites. Consequently, local elites no longer have sufficient political power and incentives to assist the state in achieving desirable outcomes from unpopular policies. In the next two sections, we provide empirical evidence to support this claim through the analysis of an agricultural tax reform in China.

3. Agricultural Taxation and Local Elites in China

Before we present our empirical evidence, we contextualize our argument in rural China. We briefly discuss the evolution of agricultural taxation in China, then detail the structure of rural governance that shapes village elites' incentives to assist the state in achieving unpopular policy outcomes.

3.1. Evolution of Agricultural Taxation in China

Agricultural taxation had been a major source of state revenue throughout China's history. After the founding of the People's Republic of China in 1949, agricultural taxes and later mandatory grain procurement fueled China's early industrialization (Oi 1989). Since China's economic opening and industrialization in 1978, however, the share of agricultural tax in government revenues has radically declined. By 2002 agricultural tax accounted for only 2.6% of total government revenue (Wang and Shen 2014).

The tax burden of Chinese peasants falls into two categories: formal and ad hoc. The former consists of the agricultural tax (农业税, or *nongyeshui*) and associated fees (三提五统, or *santi wutong*) authorized by the central government. The household tax assessment is based on estimated agricultural production, and the agricultural tax is part of county and township government revenues. Meanwhile, associated fees are a type of subtax on the agricultural tax that remains in the hands of township and village to finance local public goods. Chinese peasants are

also subject to an ad hoc tax burden in the form of fundraising for village public goods projects, administrative fees, and even illegal fees and fines. Supplementing the budgetary shortfall of local governments, it is legitimized by local governments' ordinances and policies but not by the central government's tax policies.

The Chinese fiscal system has experienced a cyclical wave of centralization-decentralization since 1949. In 1994 the Chinese central government began another wave of recentralization of fiscal revenue collection but kept public spending largely decentralized. Agricultural taxation became an important revenue source for county and township governments to finance local public goods after the 1994 tax-sharing reform (Wong and Bird 2008). The disparity in revenue collection and public spending obligations generated enormous stress among local governments, resulting in inequality in the peasant tax burden and the delivery of regional public services across China (Bernstein and Lü 2003; World Bank 2002).

The Chinese central government initiated the 2001 agricultural reform in order to address the inequality in public service delivery by further centralizing tax collection and public spending. The agricultural tax reform was part of the "Taxes for Fees" reform in 2000, fundamentally changing the nature of rural taxation and public service delivery in China (Oi et al. 2012). This tax reform centralized public service delivery through intergovernmental transfers from above and abolished formal taxes (i.e., agricultural tax and associated fees) previously authorized by the central government. The remaining tax burden after the reform stems from ad hoc taxes and administrative fees imposed by local governments.

The design of the agricultural tax reform was a top-down process. Despite mounting social unrest in rural China in the 1990s, the Central Government reacted tepidly to the peasants' burden even when it became a national policy issue (Göbel 2010). Eventually, elite competition in the

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central government, not bottom-up pressure, became the main driver of this policy (Li 2007). Importantly, the Chinese central government did not impose new taxes but used intergovernmental transfers to fill the township and county governments' budgetary shortfall resulting from tax abolition. Consequently, the reform relieved the pressure on the county and township governments to rely on agricultural taxes and fees to finance local public spending. By the end of 2002, another twenty provinces joined the policy experiment to reduce peasants' tax burden. Finally, the National People's Congress formally abolished the agricultural tax and fees for the entire country as of January 1, 2016.

3.2. Rural Governance and Village Elites in China

The formal organizational structure of the Chinese government is a nested hierarchy of political power, comprising four levels: province, municipalities–prefectures, counties–districts, and townships, the lowest level of the governmental system representing the formal state apparatus. Meanwhile, nearly one million villages are nested in townships in rural China, but their governing structure differs radically from the higher-level governmental structure. Since the enactment of the Organic Law of Village Committees (1987, amended 1998), the village committee, whose members are elected by villagers, serves as the main governing body in each village. Although village elections have granted villagers some political power, township governments and village-level party organizations remain important players in shaping rural governance (O'Brien and Han 2009).

In rural China the last mile of state capacity hinges on cooperation and coordination between township officials and village cadres. We consider township officials the principal in our theoretical framework; village cadres, the agent. Although township officials have resources and institutionalized political power to make policy decisions, the implementation of these policies

relies on cooperation from village cadres. Serving as dual political brokers for both the state and peasants (Chen and Liu 2020; Duara 1988), many village elites come from families or clans with extensive political power in the village; and they play an important role in facilitating or undermining the state's policy implementation. In particular, village elites play an important role in mediating conflict arising from unpopular policies, such as tax collection (Duara 1988; Oi 1989), the One Child Policy (Mattingly 2020), and land expropriation (Cai 2003; Chen 2015; Mattingly 2016).

4. Empirical Evidence

In this section, we first discuss our data and the identification strategy. We then report the main results, showing that the removal of the delegation of tax collection undermined the implementation of unpopular policies, leading to greater tax noncompliance and social unrest in rural China. We further evaluate a number of potential alternative explanations to the decline of rural governance, and demonstrate that the main finding was driven chiefly by tax reduction but not by other potential channels.

4.1. Data

Our data are based on the *Rural Survey of Land, Migration, and Local Governance*, carried out by the Center for Chinese Agricultural Policy at the China Academy of Sciences. The survey involved a multistage stratified sampling procedure. First, the researchers who conducted the survey divided the entire country into six regions, in each of which randomly selecting one province, resulting in the selection of Fujian (Southeast), Hebei (North Central), Jilin (Northeast), Jiangsu (East/Central Coast), Shaanxi (Northwest), and Sichuan (Southwest). They then sorted all counties in each province into five quintiles based on their gross industrial output per capita. One county was then randomly selected from each stratum. Next, researchers randomly selected two

townships in each county based on per capita rural net income (one above the median and one below). Following the same procedure of township selection, they randomly selected two villages in each township for a total of 120 villages in the panel. Data collection in several villages was disrupted because of flooding in 2005 and the Sichuan earthquake in 2008. Hence, the data analyzed in this paper are based only on a balanced panel of 113 villages in 53 townships for which data are available for 2000, 2004, and 2007. Figure A1 in the Appendix shows the diverse geographical locations of the counties where these villages are located

The village-level panel data are particularly suited for our empirical investigation for two reasons. First, they were designed and collected by academic researchers, not governmental agencies, overcoming potential bias in government statistics. Second, the data are comprehensive, offering fine-grained measures of key concepts specific to our argument before and after the tax reduction. For instance, the survey includes an extensive set of objective questions on local governance, ranging from details on the tax burden from formal and ad hoc sources, tax noncompliance, and social unrest (i.e., petitions and incidents). More importantly, the researchers recorded valuable answers to questions that allow us to measure the behavior changes of township bureaucrats and village cadres after the tax reform.

Tax collection and political stability maintenance are often considered unpopular policies, and our main dependent variables entails three measures: tax noncompliance, mass petition, and mass incident. The measure of tax noncompliance is the percentage of households in a village where citizens refused to pay their nonagricultural taxes and fees on time. We use two indicators for social unrest—mass petitions and mass incidents. Mass petitions occur when two or more individuals collectively submit a petition claim. Mass incidents are large-scale acts of disobedience that include but are not limited to protests, demonstrations, physical clashes, obstruction of

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government business, and other forms of gatherings that disrupt social stability. The variables of mass petition and mass protest are coded 1 for the occurrence of these events, and zero otherwise.

4.2. Identification Strategy

As discussed in the previous section, the agricultural tax reform gradually rolled out to the entire country between 2001 and 2006. We are mainly interested in the impact from the abolition of agricultural taxes, which effectively removes the delegation of tax collection from local elites. In our panel data, no villages experienced tax abolition in 2000, and 43.36% experienced it (i.e., 95% or more tax burden reduction) in 2004; finally, 100% were "treated" in 2007. The pattern of treatment assignment presents opportunities and challenges in our identification strategy. In what below, we demonstrate that the typical difference-in-differences (DID) estimation is likely to be biased, and we adopt the within-village fixed effects model by using the timing of treatment assignment instead of the size of tax reduction as our main independent variable.

Naturally, the gradual rollout of tax reform leads to the use of DID strategy to identify the effects of tax abolition. The key treatment is the amount of tax reduction (i.e., intensity of the treatment), which serves as the proxy for the degree of removing the delegation of tax collection. The motivation is that the greater the tax reduction after the reform, the more that was at stake for local elites. The treatment is based on the following calculation: $Tax\_Reduction_{it} = Tax\_Burden_{it} - Tax\_Burden_{i,2000}$. The DID specification follows:

$$Y_{it} = \beta_1 Tax\_Reduction_{it} + \delta X_{it} + v_i + \delta_t + \varepsilon_{it} \quad (1)$$

In Equation (1), Y_{it} is the indicator of local governance for village i at year t discussed in Section 4.1. X_{it} is a vector of control variables for village characteristics, and both village (v_i) and year (δ_t) fixed effects are included in the model.

Unfortunately, Equation (1) is likely to lead to biased estimates for the treatment. One particular concern is that the intensity of the treatment (i.e., amount of tax reduction) correlates with pretreatment village characteristics. Although the difference in prereform tax burdens partly resulted from the variation in arable land per capita in various villages, it also reflects local elites' efforts in tax collection prior to the reform; in other words, the prior low tax burden could result from the initial lack of efforts by village elites in tax collection. Figure A2 in Appendix – 1 confirms our concern: a strong positive correlation exists between village cadres' effort and the size of tax burden per capita in 2000 prior to the reform.[11] Hence, Equation (1) would generate biased estimates because the size of the tax reduction is partly shaped by the level of the prereform tax collection efforts, which is endogenous to a host of observed and unobserved factors specific to the villages noted above.

To address the endogeneity issue, we exploit the *timing* of reform implementation instead of the *amount* of tax reform because the former was exogenous to village characteristics—the gradual rollout of tax reduction was determined by the central and provincial governments, not by the villages. Once a province decided to adopt tax abolition, it often implemented policies across the entire province or in some prefectures instead of selecting specific villages. Hence, we use the timing of tax abolition to capture the intensity of removing tax collection delegation over time in the following village fixed effect model:

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[11] In our data we assess village cadres' efforts in various tasks by asking them to rank the top five of their 34 most time-consuming tasks. Approximately 26.55% of the village cadres did not list tax collection as one of the top five tasks at all in 2000, but 48.67% of the village cadres listed tax collection as the most important tasks in 2000.

$$Y_{it} = \beta_1 Tax\ Abolition_{it} + \delta X_{it} + v_i + \varepsilon_{it} \quad (2)$$

In Equation (2), *Tax Abolition*, an indicator for the treatment of tax abolition, is coded 1 when a village experienced complete tax abolition, and zero otherwise.[12] To minimize post-treatment biases, we include only three control variables: *(Log) Village Population*, *(Log) Arable-land per capita*, and *(Log) Villager Net Income per capita*. Finally, we use clustered standard errors at the village level in this model. The model specified in Equation (2) is superior to that in Equation (1): it alleviates potential estimation bias resulting from the prereform variation in local elites' efforts in tax collection. For the remainder of the paper, we rely on Equation (2) for most of the empirical analysis.

Notably the estimation based on Equation (2) could still face two concerns for biases from two sources: selection for treatment and unobserved time-varying factors. First, the early adoption of tax abolition in a village may still be driven by the government's concerns to address various taxation-related grievances. To evaluate this concern, we adopt two strategies. First, we estimate the correlations between village characteristics in 2000 and the assignment of tax abolition treatment in 2004. Table A1 in the Online Appendix shows that we find no correlations between prereform village characteristics and the tax abolition treatment assignment in 2004. In particular, the analysis shows that tax noncompliance as well as the numbers of mass petitions and protests in 2000 have almost precise estimates of zero correlation with the tax abolition treatment in 2004.

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[12] Notably the estimate of our tax abolition treatment could be underestimated instead of overestimated because although some village did not receive the tax abolition treatment in 2004, they experienced some form of tax reduction. In other words, the control group in 2004 has been partially treated to some extent. We could adopt an alternative model specification using *Tax Cut* as an indicator for the tax reduction treatment. In our robustness checks, our alternative model specification using *Tax Cut* yields similar estimation results (Table A2). We also consider a model specification combining both treatments of *Tax Abolition* and *Tax Cut*, and the substantive interpretations remain consistent with the main results above (Table A3).

Hence, we are confident that the treatment assignment was not endogenous to *observed* taxation-related grievance.

One remaining concern is that treatment assignment is endogenous to *unobserved* time-varying village characteristics. In our main analysis, we already include village fixed effects to account for unobserved time-invariant and village-specific characteristics. Our second strategy to address the selection bias entails pairing our main results with a subsample analysis restricted to the 2004-2007 panel. The motivation of this subsample analysis is that although early adoption of the tax abolition could be subject to selection bias, all villages received the treatment in 2007 because the National People's Congress passed the legislation to formally abolish the tax for the entire country. Consequently, the analysis of the 2004–2007 panel eliminates the concerns of selection bias because of the mandatory treatment for the all villages. As shown in our discussion of main results below, the estimates of our treatment variables are comparable between the analysis of the full sample (2000–2007) and that of the restricted sample (2004–2007).

Notably, our model specification does not include year fixed effects, hence the estimation could be subject to bias in time-varying trends that drive our outcome of interests. Note that because our key treatment variable is about the timing of reform implementation and we have a short year panel, *Tax Abolition* is highly correlated with the year indicators (correlation: 0.81). Thus, the inclusion of year fixed effects could generate significant multicollinearity leading to an imprecise estimate of our key treatment variables. Furthermore, recent studies have shown that two-way fixed effects models could be biased because of heterogeneous treatment effect (de Chaisemartin and D'Haultfœuille 2020; Imai and Kim 2021).[13] Hence, we do not include year

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[13] Because of the treatment structure and short time periods in our panel data, we are unable to use recent innovations for causal inference in TSCS data developed by Chaisemartin and D'Haultfœuille (2020) and Imai and Kim (2021).

fixed effect in Equation (2). Instead, we consider a number of time-varying factors in our estimation models before and after the tax reform, and we report these results in our Section 4.4 when we explore a host of alternative explanations.

4.3. Main Results

We first report the effects of the tax abolition policy on formal tax burden based on Equation (2) in Table 1. Column 1 in Table 1 shows that the *Tax Abolition* treatment reduces the total formal tax burden by 67.61 RMB per capita. Substantively, the savings from the agricultural tax reform amounted to 3.23% of villagers' personal income in 2000. Columns 3 and 5 evaluate the impact of tax abolition on two disaggregated formal tax burdens—agricultural tax and associated fees— and show that the treatment has a larger impact on the agricultural tax that would be transferred to higher-level governments. To evaluate the potential selection bias for treatment assignment, we restrict the analysis to the subsample of 2004–2007; and the estimates of *Tax Abolition* treatment remain negative and statistically significant in Columns 2, 4, and 6.[14] Hence, the 2004–2007 subsample analysis suggests that the main analysis is unlikely to be subject to selection bias.

TABLE 1 ABOUT HERE

Next, we evaluate the impact of tax abolition on our main dependent variable of interest— local governance. Table 2 reports regression results, showing that tax abolition positively correlates with tax noncompliance and numbers of mass petitions and mass incidents. Substantively, Column 1 suggests that tax abolition increases tax noncompliance by 8.95 percentage points. Meanwhile, Columns 3 and 5 suggest that tax abolition increases mass petitions

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[14] The estimates are smaller in the subsample analysis because the control group (untreated villages in 2004) has also experienced some form of tax reduction.

and mass incidents by 21.3 percentage points and 15 percentage points, respectively. Substantively, our results indicate that the tax abolition led to a drastic increase in political instability from 2000. Finally, the estimates of our *Tax Abolition* in the analysis of subsample (2004–2007) are comparable with those in the main analysis, suggesting that the treatment effects are unlikely driven by selection bias.

TABLE 2 ABOUT HERE

Taken together, the main results reported in Tables 1–2 suggest a seemingly surprising finding—although the tax abolition significantly reduced peasants' tax burden, local governance in rural China deteriorated. Specifically, peasants are more likely to engage in tax noncompliance and stage mass petitions and mass protests. Nonetheless, the finding is consistent with our theoretical framework, in which we suggest that removing the delegation of tax collection—through tax abolition, for example—undermines local elites' incentives to assist the state in achieving unpopular policy outcomes. Before we present direct evidence for this mechanism in Section 5, we first evaluate the robustness of the main finding by exploring a number of alternative explanations to the deteriorating rural governance observed in our data.

4.4. Addressing Alternative Explanations

The main results reported in Table 2 could be driven by a number of confounders, particularly those time-varying factors that shape tax noncompliance and social unrest in rural China. We found that these alternative explanations—although playing important roles in shaping local governance in rural China—do not bias our estimated impact of tax abolition on the rise of tax noncompliance and social unrest.

Changes in the Political Environment. The rise of defiant villagers could be the result of changing domestic political environments following a 2003 change in central leadership. The new Hu–Wen administration appeared more accommodating of petitioners to expose policy failures in the previous administration and emboldened peasants to challenge local governments (Li, Liu, and O'Brien 2012; O'Brien and Li 2006). Mass protests could also serve as a monitoring device to alert higher-level leaders of local power abuses (Lorentzen 2013).

We agree that the policy shift by the central government played an important role in shaping contentious politics in rural China, but the common policy shock from the central government cannot explain cross-sectional variations among villages observed in our data. We further address this concern by incorporating villagers' public opinion data in the analysis.[15] Specifically, we generated a village-level aggregated measure on villagers' trust in the Chinese central government for both 2004 and 2007, which ranges between 0 and 1.[16] Figure A3 in Appendix – 1 illustrates positive correlations between the aggregated trust in the central government and numbers of mass petition and mass incident. In other words, this pattern corroborates the notion that the central government signals greater accommodation to villagers' demand, leading to higher trust in the central government and villagers emboldened to stage petitions and protests.

We then replicate our main analysis by including this measure of trust in the Chinese central government in the model. Table A4 in the Appendix shows that the estimates of tax abolition remain positive and statistically significant for mass petition and mass incident. The magnitudes of the estimates show small changes after we include the variable on trust in the central government.

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[15] The research team administrated public opinion survey to 16~20 randomly selected villagers in 2004 and 2007. Unfortunately, no public opinion survey was not conducted in 2000 prior to the tax reform.

[16] The original survey question on trust in the Chinese central government involved a 5-point scale. We recoded this variable 1 if a villager responded that he or she trusted or very much trusted the central government, and zero otherwise.

Hence, our main results of social unrest are not driven by changes in the overall political environment.

Pre-reform Unstable Villages. Another concern about the main results is that the patterns are driven largely by villages that experienced higher social unrest prior to the reform. Hence, the observed effects could result from pre-reform factors driving more defiance to government policy implementation from the outset. To evaluate this claim, we divide the sample by village tax noncompliance in 2000 in the analysis. The higher the tax noncompliance rate in 2000, the more likely that village cadres had weak control over local affairs prior to the tax reform, resulting in more protests and petitions after the tax reduction. The estimates of *Tax Abolition* still positively correlate with numbers of mass petitions and mass incidents across various quantiles of prereform instability (Columns 1–6, Table A5).

Alternatively, we exclude villages experiencing mass petitions and incidents in 2000 in our panel analysis. Our analyses still show strong positive correlations between tax abolition and mass petitions and incidents after excluding these previously unstable villages (Table A6). Hence, our results indicate that the tax reform led to a decline in local governance in many previously stable villages.

Public Spending. Withdrawing the delegation of tax collection could undermine public spending, which in turn could result in mass discontent. We evaluate the impact of tax abolition on village public spending, and find no significant effect (Column 1, Table A7). The estimate is negative but far from statistically significant. We then include village public spending in our estimation. As shown in Columns 2–4, estimates of *Tax Abolition* remain positive and statistically significant in the analysis of tax noncompliance and social unrest.

Meanwhile, unequal distribution of public spending in villages could be the culprit in rising social unrest. Specifically, those with power and influence could prioritize public goods provision to themselves, given the larger share of public spending earmarked for intergovernmental transfers. Indeed, our survey shows that the numbers of mass petitions and protests related to issues concerning public spending had risen slightly since 2000.[17] To alleviate this concern, we excluded public spending-related mass petitions and protests from our analysis but still found positive correlations between tax reduction and mass petitions and protests (Table A8).

Ad Hoc Fees. Substitutional effects could be another potential explanation for the surprising negative impact of agricultural tax reform: local governments may increase the ad hoc tax burden to meet the shortfall in government revenue. Thus, the *de facto* tax burden remains unchanged. In our data, we find some evidence that the collection of ad hoc taxes and fees had increased after the tax abolition as reported in Column 1, Table A9; however, the estimate of tax abolition is small, indicating only a 16.90RMB increase in the informal tax burden, far smaller than the 103RMB formal tax burden prior to tax abolition. Furthermore, models including ad hoc fees suggest that the rise of ad hoc taxation after tax reform does not contribute to the rise of social unrest. Hence, the magnitude of the ad hoc tax burden is too small to generate mass discontent after the tax reform.

Bureaucratic Infrastructure. In addition to the loss of fiscal revenue, tax reduction may also undermine bureaucratic capacity. For example, tax reduction may weaken the operation of the grassroots Chinese Communist Party (CCP), which facilitates tax collection in rural China (Koss 2018). Table A10, however, shows that CCP party membership actually increased after the tax

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[17] We define issues concerning public spending as those related to public goods and infrastructure or village finance. No mass petitions or protests related to public spending occurred in 2000, but the number of mass petitions related to public spending rose to 7 in 2004 and 8 in 2007. The number of mass protests rose to 1 in 2004 and 3 in 2007; however, the share of public spending-related mass petitions and protests did not rise from 2004 to 2007.

abolition; furthermore, party membership has little impact on mass petitions and incidents before and after the tax cut.

Informal Institution. Informal institutions like lineage networks and semiautonomous civic associations play an important role in raising funds to finance rural public goods provision in China (Tsai 2007), but their effects on conflict resolution are mixed. Some scholars argue that informal institutions may help mediate conflicts between the government and citizens (Lu and Tao 2017), others that informal institutions lead to elite capture in rural China, weakening citizen welfare (Mattingly 2016). Informal institutions evolve slowly because accumulating social capital takes time. Hence, the likelihood that the tax reduction policy could have an immediate impact on the structure and influence of informal institutions is limited.[18] In Table A11, we include its interaction with tax abolition treatment in the model.[19] Our analysis shows that estimates of interaction terms have different signs, and they are not statistically significant. Hence, the decline of state capacity in rural China has little to do with the role of informal institutions.

Land Expropriation. One could argue that the loss of revenue resulting from agricultural reform led to intensified land expropriation, causing greater social conflict. In particular, land expropriation by local governments has been a primary source of conflict in China (Göbel and Ong 2014). Local governments often seize land from villages in order to promote economic growth and raise fiscal revenues (Chen and Kung 2016).

Although a key catalyst for rural unrest in China, land expropriation may be only a necessary but not sufficient condition for the rise of social unrest observed in our data for three reasons. First,

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[18] Our village survey includes some questions on informal institutions. We use a variable indicating cooperative intermedia association that serves as the ally of the state with the following two conditions: 1) whether at least one of the organizers of these associations is a village cadre; 2) whether these associations have the autonomy to make decisions in infrastructure investment (e.g., building temples or churches).
[19] The measure of informal institution is not time-varying for the entire time period, so we cannot include this variable in a village fixed effects model. Alternatively, we use an interaction term between the treatment and informal institution variables to overcome this issue.

scholars have found that local governments have primarily relied on strengthening the enforcement of VAT taxes instead of land expropriation to compensate for a loss of revenue from agricultural tax reform (Chen 2017). Second, many villages experienced land expropriation long before the agricultural reform. Hence, land expropriation cannot explain why social unrests, especially that unrelated to land expropriation, become more prevalent after the tax abolition but not before. Third, village cadres play a critical role in mediating between local governments and land developers and villagers to resolve land expropriation related conflicts (Cai 2003; Guo 2011). Hence, the occurrence of land conflict directly results from village elites' effort.

To further evaluate the potential confounding effect from land expropriation, we conduct two additional tests. First, we control for the size of land expropriation in the current year[20] in our main analysis. Although we found a positive correlation between the size of land expropriation on mass petition and mass protest, the estimates of *Tax Abolition* remain positive and statistically significant, and the size of estimates is comparable to the main results (Table A12). Second, we disaggregate our data by land expropriation frequency in these villages and estimate the impact of land expropriation. As shown in Columns 1–2, Table A13, we still find that tax abolition positively correlates with mass incidents in 59 villages never experiencing land expropriation from 2000 to 2007—hence, land expropriation cannot explain the rise of social unrest in these villages. Columns 3–8 further show that tax abolition positively correlates with a greater number of mass incidents, regardless of how many times the village has experienced land expropriation; however, estimates are less precise because of small sample size.

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[20] The substantive effects remain unchanged if we use the size of the last three years' land expropriation, because the timing of social unrest could lag behind the timing of land expropriation.

5. The Mechanism: Behavioral Responses by Township Officials and Village Elites

To this point we have shown that agricultural tax reform, which removed tax collection delegation, had led to rising tax noncompliance and social unrest in rural China. The findings remain robust after we address a number of potential explanations. In this section, we offer direct evidence for the mechanism proposed in our theoretical model—withdrawing tax collection delegation undermined village elites' incentives to assist the state in achieving desirable outcomes—tax collection and local stability. We first evaluate the behavioral responses of village cadres (agents) and township officials (principals). We then show that tax abolition has a negative impact on village cadres' fiscal autonomy and legitimacy, suggesting that they experience greater difficulty persuading villagers to comply with state policies.

Efforts through Job Priority. Village cadres' efforts are critical for implementing unpopular policies and maintaining local stability largely because they have the knowledge and social network township officials lack. Given that both village cadres and township officials operate in a multitask environment, they must prioritize some tasks over others as a result of their time and resource constraints. One unique feature of our data is that it consists of a battery of survey questions asking village cadres and township officials to name their top five job priorities from a list of 34 tasks, among them, tax collection, managing petitions, and maintaining stability. Based on the survey responses, we created binary variables indicating whether tax collection, social stability, and petitions were mentioned among the top five tasks, respectively, by both village cadres and township officials.

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We found evidence suggesting that village cadres engaged in efforts to shirk tasks involving local stability; consequently, township officials had to exert greater effort.[21] Figure 1 shows that village cadres were less likely to indicate tax collection and stability maintenance as one of the top five task priorities from 2000 to 2007. Township officials report that they exert much greater effort in maintaining local stability to fill the gap; however, they have neither the knowledge nor the social network of village cadres. Hence their efforts yielded little fruitful outcome.

FIGURE 1 ABOUT HERE

Given the importance of maintaining social stability as a "veto policy target" under China's cadre responsibility system,[22] we expect past incidence of social unrest would incentivize village cadres to exert greater effort. Nonetheless, we found that the social unrest prompted township officials to exert more effort but not village cadres when we evaluate their impact on job priority of township officials and village cadres. Specifically, we aggregated the numbers of mass petitions and mass incidents for the three-year period prior to 2004 and 2007[23] and estimate their effects on village cadres' and township cadres' self-reported job priorities in either petition or social stability. We find consistent evidence that rising social unrest positively correlates with township cadres' job priorities in these two areas (Table 3, Columns 1–4); however, we find little evidence that

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[21] One could argue that changes in the efforts of village cadres could result from de facto elites no longer running for positions in the village governing body. Evaluating the personal characteristics of village party secretaries and village heads before and after the tax reform, we find little difference (Table A14).

[22] In the case of China, higher-level governments often use strategies to incentivize lower-level governments to carry out certain tasks. One of the most important tools is the so-called "veto policy target," which means that failing to fulfill this policy target would immediately hurt the careers of local politicians during the annual cadre evaluation (Edin 2003). This kind of "veto policy target" tends to direct local politicians' time and effort toward tasks like birth control and social stability (Obrien and Li 1999).

[23] The analysis is based only on job priority indicators reported in 2004 and 2007 because we have no data on social conflict prior to 2000.

social unrest has any impact on village cadres' self-reported job priorities in these two areas except for the number of mass incidents during the previous three years (Table 3, Columns 5–8). More importantly, designating petitions or social stability as veto policy targets fails to incentivize village cadres to prioritize the state's achieving these desirable outcomes.

TABLE 3 ABOUT HERE

Fiscal Autonomy. Our theoretical framework suggests that fiscal autonomy is one of the key mechanisms for delegation of tax collection to incentivize local elites to assist the state in achieving desirable outcomes. We formally evaluate this claim by using several indicators to measure fiscal autonomy. Columns 1–2, Table 4 first report that the wages of village cadres, that is, party secretaries and heads, substantially increased after the tax reform; however, their salary increase primarily derived from intergovernmental transfers after the tax abolition (Columns 3–4, Table 4). In other words, village cadres' financial well-being relies on governmental transfers but not rent-seeking opportunities at the local level. Furthermore, we find a strong correlation between tax abolition and intergovernmental transfers to village revenues for public spending (Column 5). The estimate of *Tax Abolition* indicates a substantial 75.8% increase in intergovernmental transfers. Given that intergovernmental transfers are tied to specific public projects, village cadres have fewer opportunities to exert their influence in the distribution of public spending. Finally, we found a strong negative relationship between tax abolition and the ability of villages to raise revenues by themselves (Column 6). After tax abolition the amount of fundraising by village cadres declined by 95.2%. Taken together, these results provide strong evidence that tax reduction undermines village cadres' fiscal autonomy, in turn undermining their incentives to assist the state.

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6. Conclusion

The strength of state capacity hinges on the state's ability to carry out unpopular policies at the grassroots level. In an environment with weak institutions, state capacity relies on cooperation from local elites. We argue that the delegation of tax collection offers both incentives and tools to local elites to assist the state in implementing unpopular policies. Hence, our paper highlights a critical tradeoff in reforms of centralization–decentralization, enticing cooperation and coordination from local elites, which is critical for state capacity (Berwick and Christia 2018). Although fiscal centralization may improve public service delivery, fiscal decentralization with delegation of tax collection strengthens the last mile of state capacity by incentivizing local elites to assist the state. One key implication from our finding is that the success of centralization–decentralization reforms depends on whether a reform is embedded with mechanisms to mitigate these tradeoffs, which could veer off "the narrow corridor," given the tussles between the State and Society (Acemoglu and Robinson 2020).

In addition, our study suggests that weakening the political power of village cadres inevitably have profound impacts on rural governance. Recent scholarship has shown that local elites have little incentive to become village cadres because this job offers fewer rewards while generating tremendous costs during the process of conflict resolution (He and Yuan 2021). Because of lack of cooperation from local elites, local governments were forced to seek alternative assistance to carry out unpopular policies, leading to the rise of outsourcing violence and repression through thugs or other private actors for land expropriation in rural China (Hurst et al. 2014; Ong 2018).

Although some may view tax reform through centralization of the delivery of public goods as an indicator of China's strengthening state capacity, the last mile of state capacity is weakened because of the gap between the intent of the state and actual outcomes. The edifice of state capacity may one day collapse because of corrosion at the very base of the foundation.

Given the detrimental consequences of centralization, why the Chinese central government initiated this reform in the first place is puzzling. Scholars have contended that whether the state initiates a centralization reform hinges on the existence of prior state-like infrastructure or perceived threat of rebellion (Gerring et al. 2011; Garfias and Sellars 2021b). In the case of China, the Chinese central government was indeed concerned about potential negative consequences arising from this centralization reform and tried to alleviate this issue with a drastic increase in fiscal compensation to village party secretaries and village heads. Nonetheless, fiscal compensation cannot resolve the credible commitment problem between the higher-level government and local elites, which remains the most crucial wedge for elite coordination and compliance (Berwick and Christia 2018).

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Panel A: Village Cadre's Job Priority Ranking
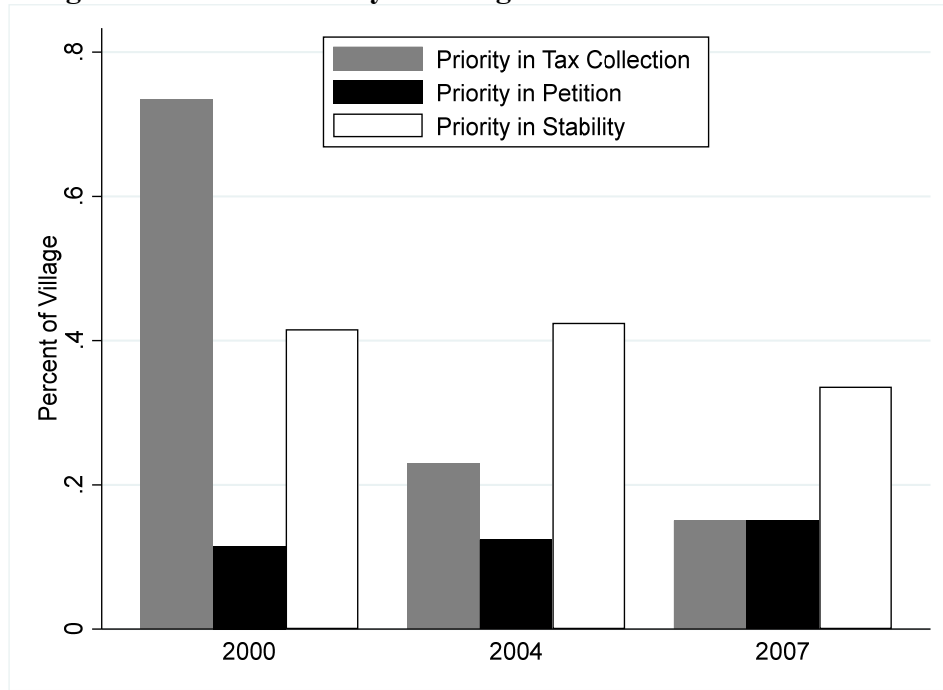
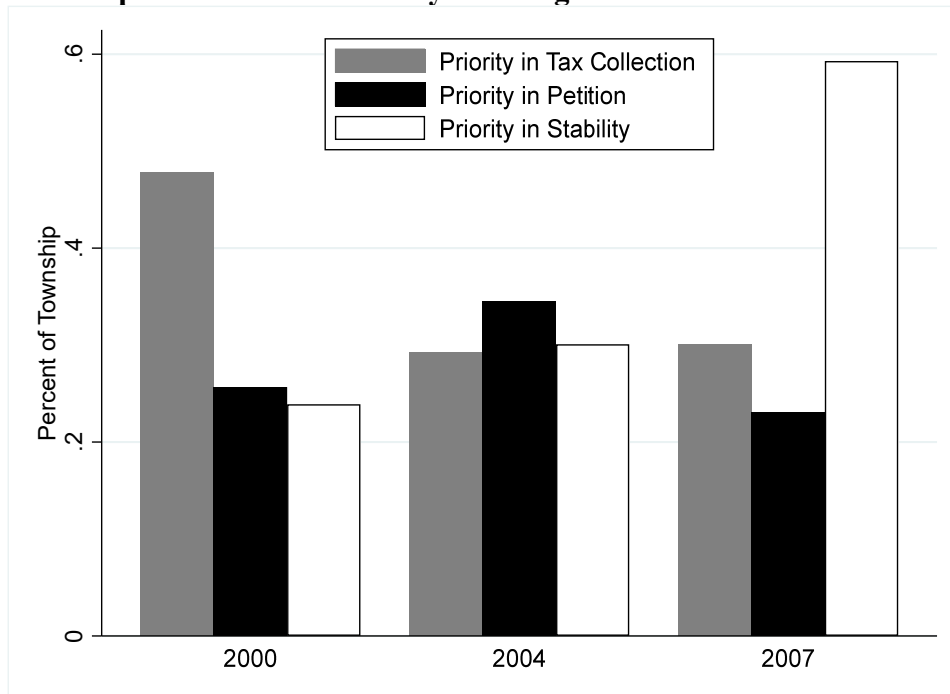**Panel B: Township Official's Job Priority Ranking**

FIGURE 1: BEHAVIORAL CHANGES BY VILLAGE CADRES AND TOWNSHIP OFFICIALS

Note: The figure is based on the data from *Rural Survey of Land, Migration, and Local Governance*. It plots the percentage of villages and townships reported tax collection, managing petition, and managing stability as one of the top-five tasks out of 34 tasks.

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TABLE 1 THE IMPACTS OF TAX ABOLITION ON TAX BURDEN

	TOTAL TAX BRUDEN PER CAPITA		AGRICULTURAL TAX BURDEN PER CAPITA		ASSOCIATED FEES PER CAPITA	
	(1)	(2)	(3)	(4)	(5)	(6)
Tax Abolition	-67.608***	-51.112***	-43.094***	-33.753***	-16.704***	-8.057***
	(7.129)	(6.007)	(4.230)	(4.100)	(2.813)	(1.760)
Data Coverage (2000, 2004, 2007)	YES	NO	YES	NO	YES	NO
Data Coverage (2004, 2007)	NO	YES	NO	YES	NO	YES
Village Characteristics	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES
Number of Observations	339	226	339	226	339	226

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *Village Income per capita.* Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE 2 THE IMPACTS OF TAX ABOLITION ON LOCAL GOVERNANCE

	% OF TAX-NONCOMPLIANCE HOUSEHOLD		MASS PETITION		MASS INCIDENT	
	(1)	(2)	(3)	(4)	(5)	(6)
Tax Abolition	8.947**	6.842	0.213***	0.187**	0.150***	0.148**
	(3.573)	(4.233)	(0.067)	(0.079)	(0.042)	(0.059)
Data Coverage (2000, 2004, 2007)	YES	NO	YES	NO	YES	NO
Data Coverage (2004, 2007)	NO	YES	NO	YES	NO	YES
Village Characteristics	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES
Number of Observations	339	226	339	226	339	226

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE 3 THE IMPACTS OF MASS INCIDENT ON VILLAGE AND TOWNSHIP BEHAVIORS

	TOWNSHIP JOB PRIORITY ON PETITION		TOWNSHIP JOB PRIORITY ON STABILITY		VILLAGE JOB PRIORITY ON PETITION		VILLAGE JOB PRIORITY ON STABILITY	
	FE	FE	FE	FE	FE	FE	FE	FE
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
# of Mass Petition (Last 3 years)	0.095*				-0.002			
	(0.057)				(0.024)			
(Log) # of People Participated in Mass Petition (Last 3 years)		0.023				-0.009		
		(0.053)				(0.020)		
# of Mass incident (Last 3 years)			0.314*				0.133*	
			(0.180)				(0.073)	
(Log) # of People Participated in Mass incident (Last 3 years)				0.110*				0.040
				(0.057)				(0.026)
Designated Veto Policy Target to Village					0.010	0.007	-0.014	-0.023
					(0.103)	(0.103)	(0.100)	(0.099)
Township Characteristics	YES	YES	YES	YES	NO	NO	NO	NO
Township FE	YES	YES	YES	YES	NO	NO	NO	NO
Village Characteristics	NO	NO	NO	NO	YES	YES	YES	YES
Village FE	NO	NO	NO	NO	YES	YES	YES	YES
Year FE	YES	YES	YES	YES	YES	YES	YES	YES
Number of Township/Village	53	53	53	53	113	113	113	113
Number of Observations	106	106	106	106	226	226	226	226

Note: The dependent variables are binary indicator of whether a specific task was ranked as one of the top-5 tasks by village cadres or township cadres. Standard errors clustered by village or township are reported in parentheses for village and township analysis, respectively. Village control variables include *(Log) Village Population, (Log) Arable-land Per Capita,* and *(Log) Village Income per capita*. Township control variables include *(Log) Township Population, (Log) Net Income per capita,* and *Numbers of Township TVE*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE 4 THE IMPACTS ON VILLAGE FISCAL AUTONOMY

	ANNUAL WAGE (LOG)		% OF INTERGOVERNMENTAL TRANSFERS IN THE WAGE		TRANSFERS RECEIVED IN VILLAGE REVENUE (LOG)	VILLAGE SELF-RASIED REVENUE (LOG)
	V-SEC	V-HEAD	V-SEC	V-HEAD		
	(1)	(2)	(3)	(4)	(5)	(6)
Tax Abolition	0.347***	0.387***	12.216*	12.036*	0.758***	-0.952***
	(0.049)	(0.048)	(6.325)	(6.445)	(0.170)	(0.208)
Village Characteristics	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES
Number of Observations	336	333	338	336	337	339

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land Per Capita,* and *(Log) Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

The Perils of Fiscal Centralization: Delegation of Tax Collection, Local Elites, and State Capacity

(1/4/2022)

APPENDIX – 1 FIGURES

APPENDIX – 2 ADDITIONAL TABLES

Figure A1: Geographical Locations of the Sampled Counties

FIGURE A2: TAX BURDEN AND VILLAGE ELITES' EFFORTS PRIOR TO THE AGRICULTURAL TAX REFORM

Note: The figure is based on the data from *Rural Survey of Land, Migration, and Local Governance*. It plots the average tax burden per capita and village cadres' efforts in tax collection in 2000. The Job Priority in Tax Collection is self-reported top-five tasks out of 34 tasks that village cadres spend most of the time during that year. It is coded when tax collection was reported as: 5 for Top 1 Task; 4 for Top 2 Task; 3 for Top 3 Task; 2 for Top 4 Task; 1 for Top 5 Task; and 0 for not named in one of the top 5 task.
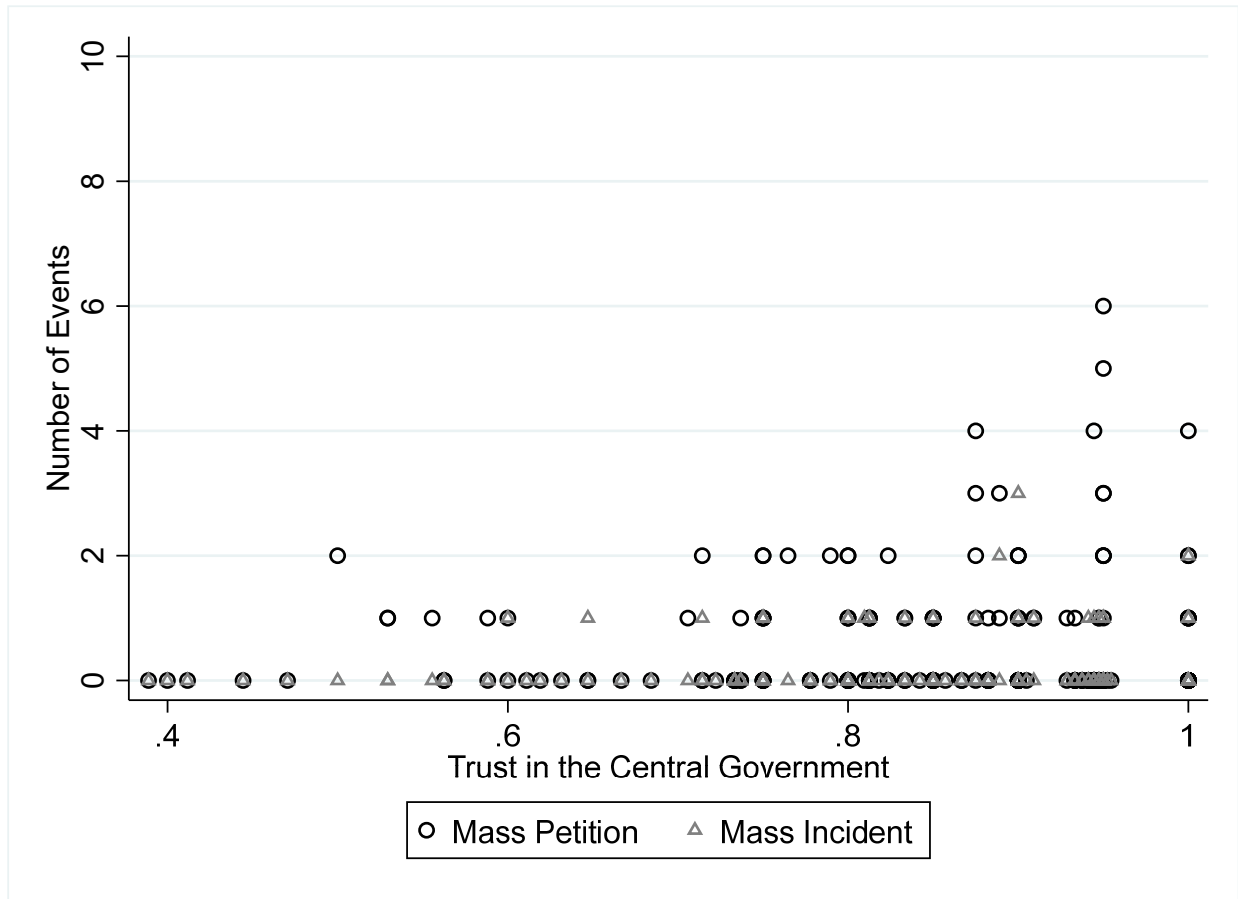
FIGURE A3: TRUST IN CHINESE CENTRAL GOVERNMENT AND MASS PEITTION/INCIDENT

Note: The figure is based on 2004 and 2007 public opinion data of randomly selected villagers in *Rural Survey of Land, Migration, and Local Governance*. Unfortunately, the public opinion survey was not conducted in 2000. This figure plots aggregated village-level trust in the Chinese Central Government and the number of mass petitions and incidents in both 2004 and 2007. The original survey question was in a 5-point scale, and we recoded the variable one if a villager responded that he/she trust or very trust the Chinese central government, and zero otherwise. We then aggregate the village-level measure by averaging the villagers' responses within a village. Hence, the variable *Trust in the Central Government* ranges from 0 to 1, where a higher number indicates greater trust in the central government.

TABLE A1 THE DETERMINANTS OF TAX ABOLITION TREATMENT

	TAX ABOLITION TREATMENT ASSIGNMENT IN 2004			
	(1)	(2)	(3)	(4)
Village Population in 2000 (Log)	0.037 (0.081)	0.040 (0.082)	0.037 (0.082)	0.037 (0.082)
Village Arable Land Per Capita in 2000 (Log)	0.087 (0.058)	0.076 (0.064)	0.085 (0.060)	0.087 (0.059)
Village Income per capita in 2000 (Log)	0.150 (0.093)	0.140 (0.097)	0.152 (0.095)	0.150 (0.094)
% of Tax-Noncompliance Household in 2000		-0.002 (0.002)		
Number of Mass Petition in 2000			-0.010 (0.029)	
Number of Mass Incident in 2000				0.028 (0.429)
Number of Observations	113	113	113	113

Note: Robust standard errors are reported in parentheses. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A2 THE IMPACTS OF TAX CUT ON TAX BURDEN AND LOCAL GOVERNANCE

	TOTAL TAX BRUDEN PER CAPITA	AGRICULTURAL TAX BURDEN PER CAPITA	ASSOCIATED FEES PER CAPITA	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)	(4)	(5)	(6)
Tax Cut	-75.578***	-46.470***	-25.955***	7.448**	0.159**	0.102***
	(6.991)	(4.279)	(3.094)	(3.269)	(0.067)	(0.029)
Village Characteristics	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES
Number of Observations	339	339	339	339	339	339

Note: *Tax_Cut* is an indicator of tax reduction, coded 1 for villages experiencing more than 50% tax burden reduction, zero otherwise. Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A3 THE IMPACTS OF TAX ABOLITION ON TAX BURDEN AND LOCAL GOVERNANCE

	TOTAL TAX BRUDEN PER CAPITA	AGRICULTURAL TAX BURDEN PER CAPITA	ASSOCIATED FEES PER CAPITA	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)	(4)	(5)	(6)
Tax Abolition	-40.459***	-26.953***	-5.023**	7.098**	0.181**	0.135***
	(5.805)	(3.592)	(2.159)	(3.426)	(0.074)	(0.049)
Tax Cut	-54.137***	-32.187***	-23.293***	3.687	0.063	0.030
	(5.273)	(3.366)	(2.989)	(2.707)	(0.074)	(0.035)
Village Characteristics	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES
Number of Observations	339	339	339	339	339	339

Note: *Tax_Abolition* is coded 1 when a village experienced complete tax abolition (i.e., 95% or more tax burden reduction), zero otherwise. *Tax_Cut* is coded 1 for villages experiencing more than 50% tax burden reduction, zero otherwise. Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A4 THE IMPACTS OF TAX ABOLITION ON LOCAL GOVERNANCE (CONTROLLING FOR TRUST IN THE CENTRAL GOVERNMENT 2004-2007)

	% OF TAX-NONCOMPLIANCE HOUSEHOLD		MASS PETITION		MASS INCIDENT	
	(1)	(2)	(3)	(4)	(5)	(6)
Tax Abolition	6.842	6.754	0.187**	0.188**	0.148***	0.138**
	(4.233)	(4.357)	(0.079)	(0.081)	(0.059)	(0.063)
Trust in the Chinese Central Government		1.717		-0.023		0.198
		(20.853)		(0.421)		(0.271)
Village Characteristics	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES
Number of Observations	226	226	226	226	226	226

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *Village Income per capita.* Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A5 THE IMPACTS OF TAX ABOLITION ON LOCAL GOVERNANCE (BY TAX NONCOMPLIANCE IN 2000)

	2000 Tax Noncompliance 4th Quartile		2000 Tax Noncompliance 3rd Quartile		2000 Tax Noncompliance 2nd Quartile		2000 Tax Noncompliance 1st Quartile	
	MASS PETITION	**MASS INCIDENT**	**MASS PETITION**	**MASS INCIDENT**	**MASS PETITION**	**MASS INCIDENT**	**MASS PETITION**	**MASS INCIDENT**
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Tax Abolition	0.374**	0.094	0.143	0.185**	0.254	0.231**	0.195**	0.093
	(0.165)	(0.097)	(0.129)	(0.087)	(0.161)	(0.096)	(0.098)	(0.081)
Village Characteristics	YES	YES	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES	YES	YES
Number of Observations	84	84	87	87	84	84	84	84

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *(Log) Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A6 THE IMPACTS OF TAX ABOLITION ON LOCAL GOVERNANCE (EXCLUDING UNSTABLE VILLAGES IN 2000)

	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)
Tax Abolition	9.847**	0.329***	0.167***
	(4.144)	(0.063)	(0.044)
Village Characteristics	YES	YES	YES
Village FE	YES	YES	YES
Number of Observations	267	267	267

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *Village Income per capita.* Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A7 THE IMPACTS OF TAX ABOLITION AND VILLAGE SPENDING

	VILLAGE PUBLIC SPENDING PER CAPITA	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)	(4)
Tax Abolition	-23.989	8.836**	0.213***	0.148***
	(29.378)	(3.603)	(0.067)	(0.041)
Village Public Spending per capita		-0.005	-0.000	-0.000
		(0.010)	(0.000)	(0.000)
Village Characteristics	YES	YES	YES	YES
Village FE	YES	YES	YES	YES
Number of Observations	339	339	339	339

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land Per Capita,* and *(Log) Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A8 THE IMPACTS OF TAX ABOLITION ON LOCAL GOVERNANCE (EXCLUDING UNRESTS RELATED TO PUBLIC SPENDING)

	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)
Tax Abolition	8.577**	0.174**	0.110***
	(3.554)	(0.069)	(0.040)
Village Characteristics	YES	YES	YES
Village FE	YES	YES	YES
Number of Observations	323	323	323

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *Village Income per capita.* Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A9 THE IMPACTS OF TAX ABOLITION AND AD HOC FEES

	AD HOC FEES PER CAPITA	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)	(4)
Tax Abolition	16.902*	8.093**	0.209***	0.146***
	(9.060)	(3.574)	(0.067)	(0.041)
Ad Hoc Fees per capita		0.051**	0.000	0.000
		(0.023)	(0.001)	(0.000)
Village Characteristics	YES	YES	YES	YES
Village FE	YES	YES	YES	YES
Number of Observations	339	339	339	339

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land Per Capita,* and *(Log) Village Income per capita*.
Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A10 THE IMPACTS OF TAX ABOLITION AND GRASSROOTS CCP PARTY PENETRATION

	PARTY MEMBERSHIP PER CAPITA	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)	(4)
Tax Abolition	0.218***	7.673**	0.220***	0.154***
	(0.051)	(3.517)	(0.066)	(0.042)
Party Membership per capita		5.848*	-0.031	-0.017
		(3.101)	(0.051)	(0.024)
Village Characteristics	YES	YES	YES	YES
Village FE	YES	YES	YES	YES
Number of Observations	339	339	339	339

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land Per Capita,* and *(Log) Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A11 THE IMPACTS OF TAX ABOLITION AND INFORMAL INSTITUTION

	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)
Tax Abolition	9.918**	0.212***	0.132**
	(3.952)	(0.075)	(0.053)
Tax Abolition × Informal Institution	-2.842	0.004	0.052
	(4.922)	(0.113)	(0.076)
Village Characteristics	YES	YES	YES
Village FE	YES	YES	YES
Number of Observations	339	339	339

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land Per Capita,* and *(Log) Village Income per capita.* Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A12 THE IMPACTS OF TAX ABOLITION AND LAND EXPROPRIATION

	% OF TAX-NONCOMPLIANCE HOUSEHOLD	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)
Tax Abolition	9.105***	0.189***	0.134***
	(3.493)	(0.065)	(0.043)
Logged Size of Land Expropriation (Current Year)	-0.460	0.068**	0.045*
	(1.491)	(0.030)	(0.027)
Village Characteristics	YES	YES	YES
Village FE	YES	YES	YES
Number of Observations	339	339	339

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land Per Capita,* and *(Log) Village Income per capita.* Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A13 LAND EXPROPRIATION FREQUENCY AND SOCIAL UNREST

	NEVER LAND EXPROPRIATION		LAND EXPROPRIATION TWICE		LAND EXPROPRIATION TWICE, INCLUDING 2000		LAND EXPROPRIATION TRHEE TIMES	
	MASS PETITION	MASS INCIDENT	MASS PETITION	MASS INCIDENT	MASS PETITION	MASS INCIDENT	MASS PETITION	MASS INCIDENT
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Tax Abolition	0.121	0.117**	0.096	0.085	-0.073	0.129	-0.328	0.263
	(0.084)	(0.047)	(0.221)	(0.112)	(0.294)	(0.104)	(0.446)	(0.312)
Village Characteristics	YES	YES	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES	YES	YES
Number of Villages	59	59	22	22	13	13	5	5
Number of Observations	177	177	66	66	39	39	15	15

Note: Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land per capita,* and *(Log) Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.

TABLE A14 THE IMPACTS ON VILLAGE CADRE CHARACTERISTICS

	YEAR OF SCHOOLING		VETERAN STATUS		SERVED IN VC		OWNED SMALL BIZ		WORKED IN TVE/TVG	
	V-SEC	V-HEAD	V-SEC	V-HEAD	V-SEC	V-HEAD	V-SEC	V-HEAD	V-SEC	V-HEAD
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Tax Abolition	0.335**	0.203	-0.010	0.020	0.002	-0.039	0.013	0.021	-0.017	-0.003
	(0.170)	(0.163)	(0.031)	(0.032)	(0.036)	(0.044)	(0.031)	(0.034)	(0.026)	(0.034)
Village Characteristics	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Village FE	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Number of Observations	289	284	290	284	295	284	293	284	295	284

Note: All the dependent variables are coded binary, with the exception of year of schooling. Standard errors clustered by village are reported in parentheses. Village control variables include *(Log) Village Population, (Log) Arable-land Per Capita,* and *(Log) Village Income per capita*. Significant at 0.1 level. ** Significant at 0.05 level. *** Significant at 0.01 level.