

A Literature Review of Local Government Competition

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Abstract: Since the reform and opening up, China's economy has developed rapidly, and local government competition has always been a key perspective to analyze China's economic development. In order to better understand local government competition, it is necessary to conduct an in-depth literature review on its related theories. This paper summarizes the theoretical origin, theoretical evolution and definition of local government competition by combing the relevant literature of local government competition in order to understand Chinese economic issues better.

Keywords: Local government competition, Theoretical evolution, Economic development.

1. Introduction

Competition among local governments is not only an important perspective for understanding the behavior of local governments in Chinese, but also an important perspective for understanding Chinese economic growth. Therefore, the academic circles have turned their research focus to local governments as the main body of behavior. The theory of local government competition originated from the theory of fiscal decentralization in the West. After it was put forward in the 1970s, it was widely used in the research of local economic development and public services, and evolved into "competition for economic growth" and "market protection". Theories such as "type federalism" have deepened the understanding of local government competition in developing countries. At the same time, the development of this series of theories also provides a valuable theoretical reference for solving the problems of Chinese economic development. In order to clarify the development context and research status of local government competition theory, and to gain a deeper understanding of local government competition, this paper summarizes the relevant literature on local government competition, sorts out the theoretical evolution of local government competition and the application of local government competition theory in Chinese.

The structure of this article is as follows: the second part expounds the origin, evolution and definition of local government competition theory. The third part discusses the application of local government competition theory in Chinese. The fourth part is the summary.

2. The Origin, Evolution and Definition of Local Government Competition Theory

Abroad, the earliest discourse on local government competition can be traced back to Adam Smith's elaboration on institutional competition. Adam Smith (1972) mentioned in "The Wealth of Nations": "Land can be moved, but capital is easy to move...The owner of capital is likely to be a citizen of the world, and he is not necessarily attached to a specific country. If a country In order to tax heavily, he will search his property in many ways, and he will leave it alone. And he will transfer his capital to other countries, where it is more convenient to conduct business at will, and enjoy wealth more easily." It can be seen from Adam Smith's exposition that he

analyzed the impact of factor mobility on institutional competition from the perspective of people's responses to capital taxes of different levels. His exposition opened the precedent for institutional competition in the sense of economics, and at the same time organically linked public goods such as taxation with government competition. After Adam Smith, Tiebout made a clearer discussion about local government competition. Tiebout (1956) put forward two hypotheses. The first is that local public goods should show the crowding of consumption, that is, the increase in your consumption means the reduction of my consumption. The second is that the residents have sufficient mobility between different regions. On the basis of the above two theoretical assumptions, Tiebout believes that when there is a competitive relationship between local governments, that is, residents can move freely between regions that provide local public goods. If there are enough areas, residents can show their real preference for public goods through their choice of residence. When residents are dissatisfied with the quality and quantity of public goods provided by the local government, residents can adopt the method of "voting with their feet" to leave this area and choose to live in areas where the quality and quantity of public goods meet their preferences. The direct result of this is that the residents of each region can be satisfied with the public goods of the region through free flow, thus reaching the Pareto optimal state.

In China, the theoretical research on local government competition has undergone three changes. At the beginning, some scholars absorbed the western "traditional federalism" thought, which is the most important theoretical basis for the study of local government competition. This theory demonstrates the significance of local government competition for the improvement of public services, and also reflects the advantages of decentralization over centralization. In the discussion of the dynamic mechanism of local government competition in fiscal federalism, the explanation of the dynamic mechanism of local government competition mainly includes three aspects. First of all, based on the mobility of capital, resources, technology, talents and other factors, enterprises and residents can put pressure on the government by "voting with their feet", so that the government can compete between regions, and use "financial and tax competition" and "institutional competition" ways, competing to provide public goods and productive infrastructure in a more efficient manner. But this theory has some flaws. It cannot explain the phenomenon of local

governments in developing countries, nor can it explain the decentralization reform in my country since the 1990s.

Therefore, scholars such as Yingyi Qian put forward the "market protection federalism" based on the practice of China's decentralization reform. This theory believes that, on the one hand, the central government delegates economic management authority to local governments to have relatively independent economic decision-making power; on the other hand, in the reform of fiscal decentralization with fiscal responsibility as the content, the central government delegates the budget decision-making power to the local governments. The higher the fiscal revenue generated by the local government, the more it will be retained, so that the local government has sufficient incentives to protect the market and promote local economic growth. But this theory only pays attention to the positive effects of decentralization, while ignoring the negative effects of decentralization. Therefore, more advanced theoretical research on local government competition is needed, so the "promotion tournament" theory proposed by Li'an Zhou came into being. Zhou (2007) believed that the promotion tournament based on economic growth combined the Chinese government system and economic structure. The unique nature provides a governance method with Chinese characteristics to motivate local officials to promote local economic development when government officials have huge administrative power and discretionary power. However, this theory has also been questioned. Tao(2010) believes that the official governance mechanism based on GDP growth means the denial or weakening of the authority space of the central government, which contradicts the reality of political centralization in China. And in some empirical studies, the significance of political relations to official promotion is far greater than that of economic growth. Although it is difficult to explain the rapid economic growth of our country, compared with traditional federalism and market protection federalism, this theory also has certain progressive significance, and can effectively explain the economic problems of local government competition in developing countries such as China.

Government competition is divided into two types, namely horizontal competition and vertical competition. Horizontal intergovernmental competition refers to the game strategy selection between local governments at the same level around the relevant interests of their respective localities. The scope of competition includes funds, talents, public goods supply, investment attraction, expenditure and taxation. Zhang (2017) believes that the ultimate goal of horizontal government tax competition is to maximize the inflow of economic factors, attract investment, and promote regional economic growth. Horizontal competition among local governments is generally regarded as an important driving force for economic development since China's reform and opening up. With the deepening of regional economic integration in China, the competition among local governments in economic development has become increasingly fierce. On the one hand, this kind of competition constitutes a powerful driving force for the sustainable development of the regional economy, but on the other hand, local protectionism and redundant construction caused by disorderly competition will also damage the overall interests of the country and regional public interests. It can be seen from this that the competition between local governments has both good and bad sides. Therefore, realizing orderly competition among local

governments and promoting the sound development of local economies is an important issue and a big problem for China's economy. Vertical competition mainly refers to the competition between the central government and local governments as well as the competition between local and lower levels of government.

3. The Application of Local Government Competition Theory

Since the reform and opening up, factor input has been the main driving force of China's economic growth. Especially since the early 1990s, the proportion of capital output in the composition of economic growth has continued to rise. Capital is particularly important for regional economic growth and official promotion, and the competition for GDP growth among regions has also been transformed into competition for capital. At the same time, many literatures using the theory of local government competition to analyze China's economic problems have emerged in the academic circle.

Yang et al. (2020) analyzed the connection between local government tax competition, FDI, and green development efficiency from the perspective of local government competition. They believe that FDI has become the object of competition for local governments because it can bring funds and advanced management concepts and technologies, and competition for tax cuts is the main means for local governments to compete for FDI. However, tax competition among local governments will lead local governments to loosen the punishment for environmental polluting enterprises, which in turn will increase the discharge of industrial wastewater and waste gas, causing pollution to the environment. In addition, the empirical results show that local government tax competition has an inhibitory effect on the improvement of green development efficiency, FDI has a promoting effect on the improvement of green development efficiency, and the combined effect of tax competition and FDI hinders the improvement of green development efficiency. Therefore, the government should improve the assessment system, standardize the tax competition behavior of local governments, and introduce high-quality and high-efficiency foreign capital to promote the efficiency of green development.

From the perspective of local government competition, Li and Mao (2018) systematically investigated the impact mechanism and effect of local government tax competition and industrial structure adjustment on China's regional green development. In the local "competition for growth", tax competition policy and industrial structure adjustment policy are important means of local government competition. Therefore, local governments can improve regional industrial structure by strengthening local tax competition and the migration of factors in different departments and regions. Adaptive adjustments to industrial and industrial policies will have a significant impact on the green development of local and adjacent areas. Empirical analysis shows that local government tax competition and industrial structure industrialization will directly have a negative impact on local green development, and tax competition and industrialization development in adjacent areas will also directly inhibit local green development through the negative incentives of "competition to the bottom".

Wang and Liu (2016) used the theory of local government

competition to analyze the impact of local government fiscal expenditure competition on economic growth. From the perspective of political promotion, they pointed out that based on the purpose of promotion, local officials have sufficient motivation to support the development of local enterprises and promote economic growth. Instead of cooperating from the perspective of overall development, they are keen on local protection, infrastructure construction to promote local economic development and gain advantages in competition. This kind of vicious competition based on fiscal expenditure will lead to waste of resources, relatively insufficient supply of public goods and services, and irrational expenditure structure represented by insufficient social expenditure on people's livelihood. In addition, under the promotion incentives of local officials, local governments compete for capital, which leads to unreasonable investment structure and economic overheating, thereby causing economic fluctuations. Obviously, fiscal competition among local governments is not conducive to the sustainable development of local economies, nor to the improvement of social welfare.

Jia and Liang (2020) explained the impact and mechanism of local government fiscal revenue and expenditure competition on residents' income distribution based on the theory of local government competition. He pointed out that the income gap among residents in China is getting bigger and bigger, and one of the important reasons is the competition between local governments. Under the promotion incentives centered on GDP growth, competition has intensified the economic spending of local governments on public infrastructure, while neglecting education and social security and people's livelihood expenditures has also prompted them to rely more on transfer payment income to finance for expansion expenditures, in order to transfer more expenditure costs to the central and other jurisdictional governments through public pool channels. In addition, use business tax to obtain self-owned income, and avoid the rapid increase in income such as corporate income tax and value-added tax that have a relatively large adverse impact on the economy. The empirical results also prove that such an income-expenditure competition strategy tends to increase the income distribution gap among residents, which is not conducive to fair distribution. Unfair income distribution is an important factor that restricts China's economic development and affects the realization of the goal of common prosperity. Therefore, how to effectively narrow the income distribution gap among residents has become a major issue that the Chinese government and academic circles need to solve urgently.

Institutional competition refers to the competition among local governments in terms of rules and institutional innovations, involving institutional innovations around investment promotion and market segmentation strategies adopted by local governments to protect local markets. Feng and Pan (2009) analyzed the characteristics, advantages and disadvantages of institutional competition from the current situation of local government institutional competition in China based on the perspective of local government competition. They believe that this kind of institutional innovation by local governments is to cultivate new institutional factors in areas other than the original institutional stock, which not only maintains the stock interests of the relevant institutional subjects and reduces the resistance to change, but also enhances institutional innovation by acknowledging the incremental interests of the relevant institutional subjects to reach the marginal

equilibrium of the system. There is no doubt that successful institutional innovation can indeed drive local economic development, but this kind of blind institutional competition does not consider the actual situation of local economic development, but blindly imitates the development model of other regions, which will hinder local economic development.

The above scholars have used the theory of local government competition to conduct theoretical analysis and empirical research on China's green development, economic growth, and income distribution, which is of great significance for promoting sustainable regional development and achieving the goal of common prosperity.

4. Conclusion

After so many years of development, the theory of local government competition has formed a theoretical system with a relatively clear framework and relatively rich content details. Using the theory of local government competition to deeply analyze the practical problems in the system transition process of a big country like China is itself an attempt of theoretical innovation. However, most of the current literature expounds the negative impact of local government competition on economic development and the environment. In fact, the relationship between local governments is not all competition, but also cooperation. Such healthy competition can promote efficiency. Therefore, with regard to the application of local government competition theory, future research directions can focus on the positive effects of competition. In addition, most of the research on local government competition is based on the micro level, such as environmental pollution, the inflow of capital and other elements, but there are relatively few studies on the macro level. The Third Plenary Session of the 18th Central Committee of the Communist Party of China included "the modernization of the national governance system and governance capabilities" into the reform goals. It also emphasized the promotion of the modernization of the national governance system and governance capabilities. These all reflect to pay close attention to realistic presentation of national capacity building issues. However, the research on local government competition has not linked it with national capacity to discuss, and there is a lack of research on the impact of local government competition on national capacity through empirical methods. Therefore, another future research direction of local government competition theory is to use empirical evidence to analyze the impact of local government competition on national capabilities.

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