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Disgruntled cadres: How tax reduction undermines rural governance

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Abstract

Tax reduction is supposed to garner popular support, yet rural unrest sharply increased following the Chinese government's agricultural tax reform aiming to reduce peasants' tax burden. We argue that the tax reduction could undermine village elites' economic and political incentives to assist the state in implementing unpopular policies and achieving desirable outcomes. We exploit the exogenous timing of the agricultural tax reform that abolished the agriculture tax and estimate its impact through a rare national representative village-level panel dataset. We demonstrate that the tax reform led to tax noncompliance and rising social unrest. We further show that local governance worsened because village elites were disincentivized from carrying out state-preferred yet unpopular policies.

1 | INTRODUCTION

Tax cuts have been widely used by governments in democratic and nondemocratic regimes to bolster popular support. Emboldened by rising fiscal capacity, the Chinese central government initiated an agricultural tax reform to reduce peasants' tax burden in 2001, and eventually abolished the agricultural tax altogether in 2006. After all, this tax accounted for only 2.6% of total government revenue in 2002, but the process of its collection had become a source of social unrest in rural China.[1] The olive branch extended by the Chinese government encountered a surprising reaction in rural China—social unrest accelerated after the tax reform. For instance, the number of mass protests was only in double digits from 1992 through 2005 but rose immediately to 117 incidents in 2006 and 219 in 2007, skyrocketing to 784 in 2012.[2] The actual number of mass protests is likely to be even higher given the lack of media freedom in China.

The rise of social unrest in rural China following the 2001 agricultural tax reform is puzzling for several reasons. First, conventional wisdom suggests that *raising* taxes generates tension

between the state and society. If tax burdens were the culprit in rural social unrest, the *rise* of social discontent was at odds with the *abolition* of rural taxation. Second, the tax reform is part of China's revenue recentralization efforts since 1994, which aimed to strip village and township cadres of their economic power. The recentralization of revenue has led to predatory behaviors in collecting ad hoc taxes and fees, potentially causing rural unrest. Nonetheless, our survey of national villages found that the informal tax burden was generally lower than the previous formal tax burden.[3] Third, scholars have identified land disputes as a primary cause of rural conflict in China,[4] but the uptick in rural unrest preceded the booming real estate market and land expropriation by local governments starting in 2007. Additionally, our data indicates that the increase in social unrest happened in villages that had not undergone any land expropriation.[5] Forth, the Chinese government has rolled out several social policies to expand public spending in rural areas since 2000s, most of which were funded by intergovernmental transfers.[6] Hence, under-provision of public services resulting from the tax reduction cannot adequately explain the rise of rural unrest.

We argue that an overlooked factor that can explain this puzzle is the incentives for village elites to maintain local political stability and help implement unpopular policies. Local elites play a vital role in extending the reach of the state in the *last mile* of state capacity. The cooperation of local elites and street-level bureaucrats, or lack thereof, has a profound impact on policy implementation in environments with weak formal institutions in rural and peripheral areas.

Tax reduction undermines both economic and political incentives for village elites to implement unpopular policies and maintain local stability. First, tax reduction weakens the fiscal autonomy and legitimacy of village elites in their rent-seeking activities and second, minimizes their leverage in their strategic interaction with higher-level governments and local residents. Specifically, village elites can no longer use tax collection as leverage to incentivize local residents to comply with other unpopular state policies and may be unable to mitigate a potential scapegoating problem arising from problematic policy implementation.

To corroborate our arguments, we analyze a village-level panel dataset covering the period before and after the agricultural tax reform in China and exploit the exogenous timing of the removal of tax collection delegation in our identification strategy. Unlike aggregated government data, our data comprise detailed measures that allow us to link village elites' efforts and local policy outcomes, thus providing direct evidence to the microfoundation of our argument.

We show that the tax abolition has had a significant negative impact on rural governance measured by tax compliance and local political stability. 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. Importantly, we provide direct evidence for our proposed mechanism, demonstrating that village cadres exert significantly less effort in collecting taxes and maintaining local stability because of the decline in their fiscal autonomy and legitimacy.

Our paper is relevant to an emerging literature in which public administration and bureaucratic incentives in developing countries are studied (Bertelli et al., 2020; Pepinsky et al., 2017). Local elites often play a crucial role in implementing policies and maintaining political stability in countries with weak formal institutions (Baldwin, 2013; Hassan, 2020; Koter, 2013; Mattingly, 2020). Local elites, however, are not always keen to become agents of the state (de Kadt and Larreguy, 2018; Mattingly, 2016). In fact, they could resist the state's penetration in weak states (Lange, 2004; Migdal, 2001; Shue, 1988). Our paper highlights one important condition

for retaining cooptation of local elites—the delegation of tax collection—which provides both economic and political incentives.

Second, our paper sheds light on the political consequences of agricultural tax reform and rural governance in China. We join recent scholarship focusing on the incentive instructive for local cadres (Oi et al., 2012; Smith, 2010; Takeuchi, 2014; Wang, 2017). The major departure of this paper is twofold. Firstly, we provide a theoretical framework based on a principle-agent framework to specify the incentive structure of village cadres to assist the state to implement unpopular policies. Secondly, we evaluate several competing explanations and offer microlevel evidence through a panel data analysis on the behavioral responses of village cadres and residents to the tax reform. Our findings challenge the common belief solely attributes post-reform rural unrest to ad hoc taxes, land expropriation, and promotion incentives. Instead, we demonstrate that village cadres are disincentivized to act as mediators between the state and society.

2 | LOCAL ELITES AND IMPLEMENTATION OF UNPOPULAR POLICIES

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 manner in which tax reduction disincentivizes local elites to achieve unpopular but desired state policy outcomes. Our framework is most applicable to the political environment in which the state relies on local agents to carry out policy implementation.

2.1 | The set up

Our theoretical framework draws on bureaucracy and delegation theories in a principal-agent model.[7] The lowest-level government serves as the principal, while local elites act as agents. The principal holds the institutional power and resources for policy decisions, but is ill-informed. Agents have better information and social networks to implement policies, but lack the power and resources to make policy decisions.

The lowest-level government, as the principal, must choose between delegation and control when interacting with local elites as agents to achieve desired outcomes. Delegation involves giving the agent discretionary power to selectively enforce policies. Control strategy involves the principal taking full responsibility for policy implementation, but it comes with a high transaction cost and the risk of receiving falsified information from the agent. Taking policy into their own hands is also not ideal since the principal would be solely accountable for any failed policy implementation.

In strategic interaction with the principal, the agent has two choices: exerting effort or shirking. The former involves persuading local residents to comply with unpopular government policies, relying on moral authority and social embeddedness (Bhavnani & Lee, 2018; Hassan, 2020; Tsai, 2007). However, this approach can be costly since not all policies are popular. Alternatively, the agent could choose to shirk and leave policy enforcement to the principal. This can be problematic as higher-level government officials may not be able to distinguish between lack of effort and other factors beyond the agent's control due to imperfect information resulting from information asymmetry.

2.2 | How tax reduction disincentivizes local elites from policy implementation

The principal's main objective is to reach their preferred outcome and motivate the agent to use their expertise in the principal's best interest. Therefore, the standard principal-agent framework prefers delegation over control and provides an incentive structure that supports implementing unpopular policies (Gailmard, 2014). Delegation with discretionary policy enforcement creates a credible commitment problem, especially in environments with weak rule of law (Gailmard & Patty, 2012). Delegating power for discretionary policy enforcement is implicit and not institutionalized, making the agent a scapegoat when the policy implementation results in undesirable outcomes.

We propose that delegating tax collection provides the agent with *incentives* and *tools* while also mitigating the problem of scapegoating. Economically, tax collection generates legitimate opportunities for local elites to engage in rent-seeking activities and enhance their fiscal autonomy. Politically, the collection of state taxes legitimizes authority to local elites, offering them leverage when interacting with higher-level government officials and villagers.

Bureaucracy models stress the importance of providing incentives for the agent to use their local knowledge and social networking skills to achieve the policy outcomes desired by the principal. Fiscal incentives are a common tool used to motivate the agent. Fiscal autonomy, which involves control over revenue collection and spending, is more effective than material benefits such as salaries and benefits. While a higher salary benefits the agent economically, fiscal autonomy provides the agent with the power to generate and distribute fiscal revenues. For example, local elites can engage in rent-seeking by collecting associated fees in addition to state taxation, all done within the bounds of legitimacy.

In China, delegation of tax collection to local elites has included economic incentives. Historically, imperial governments allowed local bureaucrats to retain extra taxes without oversight to ensure their compliance (Ma & Rubin, 2019). In modern times, village cadres were given a portion of associated fees for village projects, incentivizing them to assist in collecting the state's agricultural taxes. This revenue-sharing and fiscal contracting scheme formed the basis of local state corporatism in rural China in the 1980s (Oi, 1992).

Meanwhile, delegation of tax collection offers leverage to the agent against both *higher-level governments* and *local residents*. To begin, local elites face the risk of scapegoating when policy implementation generates undesirable outcomes. For instance, Chinese central government often attributes undesirable outcomes to the actions of village cadres rather than policy design.[8] Furthermore decentralization of policy implementation and state media bias can cause Chinese citizens to credit the central government for positive policy outcomes and hold local governments responsible for negative outcomes.[9]

When the state blames local elites for negative outcomes resulting from unpopular policies, it undermines their institutional source of power and reduces their incentives to implement these policies. However, if tax collection is delegated and institutionalized, local elites can retaliate against the government by exerting less effort in future tax collection. This would hurt the principal more than the agent because tax revenue is relayed to higher-level governments. Therefore, the principal is less likely to scapegoat local elites when tax collection is institutionalized and relies on their continuous effort.

Importantly, delegating tax collection strengthens the institutional power of local elites, giving them leverage to use tax collection as a bargaining tool for compliance in other policy areas in their dealing with peasants. In areas with weak institutions, such as rural and peripheral

regions, tax assessment and compliance are often negotiated rather than strictly enforced. This provides an opportunity for local elites to incentivize some villagers to pay less tax in exchange for compliance in other policy areas. This phenomenon has been observed in China and other places.[10]

When the state initiates a tax reform by abolishing local taxes, it would take away the political and fiscal benefits that local elites had been receiving, undermining their incentives to support the state in implementing unpopular policies. A detailed case study in Wang (2017) demonstrated this effect, as some village cadres even switched sides and supported petitions after the abolition of agricultural tax.

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 was a significant source of state revenue in China's history, and it fueled the country's early industrialization. However, since the economic opening in 1978, the contribution of agricultural tax to government revenues has drastically declined. In 2002, it accounted for only 2.6% of the total government revenue (Wang & Shen, 2014).

Chinese peasants face two types of taxes: formal and ad hoc. The former consists of the agricultural tax (*nongyeshui*) and associated fees (*santi wutong*) authorized by the central government. The assessment is based on estimated agricultural production, and revenue goes to the county and township governments. Associated fees are subtaxes that stay in the hands of the village and township governments to finance local public goods. The ad hoc tax burden includes fundraising for village public goods projects, administrative fees, and illegal fees and fines. This tax burden supplements the budgetary shortfall of local governments and is legitimized by local policies but not by the central government's tax policies.

In 1994 the Chinese central government began a wave of revenue recentralization and spending discentralization. Agricultural taxation became an important revenue source for county and township governments to finance local public goods after the 1994 tax-sharing reform (Wong & 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 & Lü, 2003; World Bank, 2002).

The Chinese central government initiated the 2001 agricultural tax reform aiming to address the inequality in public service delivery through intergovernmental transfers.[11] The agricultural tax reform was part of the "Taxes for Fees" reform experiment in Anhui province in 2000, fundamentally changing the nature of rural taxation and public service delivery in China (Oi et al., 2012). The reform centralized public service delivery and abolished formal taxes like the agricultural tax and associated fees. The remaining tax burden after the reform stems from ad hoc taxes and administrative fees imposed by local governments. By the end of 2002, another 20 provinces joined the policy experiment. Finally, the National People's Congress formally abolished the agricultural tax and fees for the entire country in 2006.

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. The village committee, composed of members elected by villagers, serves as the main governing body in each village since the enactment of the Organic Law of Village Committees in 1987 (amended in 1998). 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 & Han, 2009).

In rural China the last mile of state capacity hinges on cooperation and coordination between township officials and village cadres. Many village elites come from families or clans with significant political power in the village, serving as dual political brokers for both the state and peasants. They play a crucial role in facilitating or undermining the implementation of state policies, especially in mediating conflict arising from unpopular policies such as tax collection (Chen & Liu, 2020; Duara, 1988), 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 tax reduction undermined the implementation of unpopular policies, leading to greater tax noncompliance and social unrest in rural China. We evaluate a number of potential alternative explanations, and demonstrate that the main finding was driven chiefly by tax reduction but not by other potential channels.

4.1 | Data

Our data are from the *Rural Survey of Land, Migration, and Local Governance* by the Center for Chinese Agricultural Policy at the China Academy of Sciences. The survey followed a multi-stage stratified sampling procedure, which randomly selected one province from each of the six regions in China and one county from each of the five quintiles based on gross industrial output per capita. Researchers then selected two townships and two villages in each county based on per capita rural net income. To this end, we analyzed a balanced panel of 113 villages in 53 townships with available data for 2000, 2004, and 2007. Figure A2 in the Appendix displays the locations of these villages across China.

The village-level panel data are ideal for our analysis for two reasons. Firstly, they were collected by academic researchers, mitigating potential bias in government data. Secondly, the data are detailed, providing precise measures of crucial concepts related to our argument before and after the tax reduction. The survey comprises an extensive set of objective questions on local governance, including formal and ad hoc tax burden, tax noncompliance, and social unrest (petitions and incidents). Crucially, the survey enables us to measure the behavior changes of township bureaucrats and village cadres following the tax reform.

To assess the effectiveness of local elites in assisting the state, we focus on two main tasks: tax collecting and maintaining political order. Our main dependent variables entail three measures:
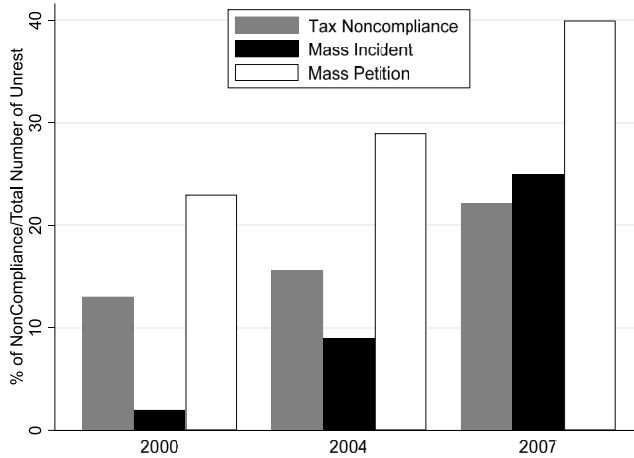
FIGURE 1 Behavioral Changes in village cadres and township officials. The figure is based on the data from *Rural survey of Land, Migration, and Local Governance.*

tax noncompliance, mass petition,[12] and mass incident.[13] Tax noncompliance is the percentage of households in a village that didn't pay their nonagricultural taxes and fees on time, while mass petition and mass incident are coded one if they occur and 0 otherwise. Our data from 2000 to 2007 shows an increasing trend in tax noncompliance, mass petition, and mass protests (Figure 1).

4.2 | Identification strategy

We are interested in the impact of the abolition of agricultural taxes, which removed the economic and political benefits of tax collection from rural cadres. We exploit the gradual roll out of the agricultural tax reform across the country between 2001 and 2006 in our identification strategy. In our sample, no villages experienced tax abolition in 2000, while 43.36% of the villages in our sample experienced it (i.e., 95% or more tax burden reduction) in 2004. Finally, all villages in our sample experienced tax abolition in 2007.

To address the endogeneity issue due to pretreatment unobservable characteristics,[14] we exploit the exogenous *timing* of reform implementation because the timing was determined by the central and provincial governments, not by the villages. Hence, we use the timing of tax abolition to capture the impact of tax reduction in the following village fixed effects model:

$$Y_{it} = \beta_1 Tax\ Abolition_{it} + \delta X_{it} + \upsilon_i + \varepsilon_{it} \tag{1}$$

In Equation (1) $Tax\ Abolition_{it}$ is coded 1 when a village i experienced complete tax abolition at year t and zero otherwise.[15] To minimize posttreatment biases, we include only three control variables: *(Log) Village Population*, *(Log) Arable Land per Capita*, and *(Log) Villager Net Income per Capita*. We also include village fixed effects in the model to capture unobserved time-invariant and village-specific characteristics. Finally, we use clustered standard errors at the village level in this model.

Notably, the estimation based on Equation (1) could still present two concerns for bias 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 higher-level government's priority 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 no correlations between prereform village characteristics and the tax abolition treatment assignment in 2004. Hence, we are confident that the treatment assignment was not endogenous to *observed* taxation-related grievance.

One remaining concern is the selection bias due to *unobserved* time-varying village 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 behind this subsample analysis is that although early adoption of the tax abolition might be subject to selection bias, all villages received the treatment in 2007 because the National People's Congress passed legislation to formally abolish the tax for the entire country. Consequently, analysis of the 2004–2007 panel mitigates the concerns of selection bias because of the mandatory treatment for all villages.

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 interest. Because our key treatment variable is about the timing of reform implementation and we have only a 3-year panel, *Tax Abolition* is highly correlated with the year indicators (correlation: 0.81). Thus, the inclusion of year fixed effects generates 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 the heterogeneous treatment effect (de Chaisemartin and D'Haultfœuille, 2020; Imai & Kim, 2021). Hence, we do not include year fixed effects in Equation (1). 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 Section 4.4.

4.3 | Main results

We first report the effects of tax abolition on the formal tax burden in Table 1, where Column 1 shows that the *Tax Abolition* treatment reduces the total formal tax burden by 67.61 yuan 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

TABLE 1 Impact of tax abolition on tax burden.

	Total tax burden 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 Impact of tax abolition on local governance.

	% of tax-noncompliant households		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.

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.[16] Hence, the 2004–2007 subsample analysis suggests that the main analysis is unlikely to be subject to selection bias.

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 the occurrence of mass petitions and mass incidents. Substantively, Column 1 suggests that tax abolition increases tax noncompliance by 8.95% points. Meanwhile, Columns 3 and 5 suggest that tax abolition increases the likelihood of mass petitions and mass incidents by 21.3% points and 15% points, respectively. Again, 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.

Taken together, the main results reported in Tables 1–2 suggest that although the tax abolition reduced peasants' tax burden, tax noncompliance and social unrest ensued. This surprising finding is consistent with our theoretical framework, in which we suggest that tax reduction 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 findings by exploring a number of alternative explanations.

4.4 | Addressing alternative explanations

The main results reported in Table 2 could be driven by a number of confounders, particularly time-varying factors leading to rising 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.

4.4.1 | Changes in peasant behaviors

The rise of defiant villagers may be due to a change in central leadership in 2003. The new administration led by Hu and Wen appeared more receptive to petitioners exposing policy failures,

potentially incentivizing villagers to challenge local governments (Li et al., 2012; Lorentzen, 2013; O'Brien & Li, 2006).

While we acknowledge the impact of the policy shift by the central government on peasant incentives and behaviors in rural China, it cannot fully account for the cross-sectional variations among villages observed in our data. We further evaluate this potential explanation by incorporating villagers' trust in central and township government in the analysis,[17] which should explain the patterns of local governance if peasant behaviors were driven by central government policies. Based on our data, we generated a village-level aggregated measure of villagers' trust in the Chinese central and township government for both 2004 and 2007, which ranges between 0 and 1.[18] Table A4 in the Appendix shows that the estimates of tax abolition remain positive and statistically significant for models of mass petition and mass incident, while the estimates of both trust variables are statistically insignificant.

4.4.2 | Prereform trends

Another concern about the main results is that the patterns are driven largely by prereform trends, such as weak local elites and unstable villages. For instance, Wang (2017) suggested rising fragmented local elites may lead to greater instability. Hence, tax noncompliance and social unrest would have increased even without the tax abolition. To evaluate this claim, we divide the sample by the degree of weak local elites proxied by tax noncompliance in 2000 before the reform. The estimates of *Tax Abolition* still positively correlate with models of mass petition and mass incident across various quantiles of prereform tax noncompliance, especially villages with less fragmented elites and high tax compliances (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).

4.4.3 | Public spending

Tax reduction 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. In addition, we exclude public spending-related mass petitions and protests from our analysis but still find positive correlations between tax reduction and mass petitions and protests because our main finding is not driven by concerns of public spending (Table A8).

4.4.4 | Ad hoc fees

Local governments may increase the ad hoc tax burden to meet the shortfall in government revenue after the tax reform. Indeed, we find some evidence that a few villages had collected exceedingly high ad hoc tax and fees in 2007 (Figure A1); however, 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

(Columns 3–4 in Table A9). Hence, although informal tax burden could potentially generate unrest in some villages, it does not generate an estimation bias in our main results.

4.4.5 | 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 membership actually increased after the tax abolition; furthermore, party membership had little impact on mass petitions and incidents before and after the tax cut.

4.4.6 | Informal institutions

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 (Lu & Tao, 2017). Informal institutions evolve slowly because accumulating social capital takes time, hence our village fixed effects should have addressed this concern. Our village survey includes some questions on informal institutions.[19] In Table A11, we include its interaction with tax abolition treatment in the model.[20] 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.

4.4.7 | Land expropriation

One could argue that the loss of revenue resulting from agricultural tax reform led to intensified land expropriation, causing greater social conflict. Although a key catalyst for rural unrest in China, land expropriation accelerated only after 2007[21]; and our results show that the tax reform generated social unrest before 2007. In addition, local governments have primarily relied on strengthening the enforcement of value-added taxes instead of land expropriation to compensate for a loss of revenue from agricultural tax reform (Chen, 2017).

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 our main analysis. Although we find 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.

4.4.8 | Promotion incentives

Although the principal could also use career incentives (e.g., replacing existing agents with new ones) to motivate the agent, this strategy has several limitations. First, local elites are often not

state employees, making bureaucratic discipline 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 scapegoating problem as the previous agent. Hence, replacing existing agents is unlikely to yield better policy outcomes. In Table A14, we controlled for a variable evaluating whether village cadres had been promoted by township officials as a proxy for promotion incentives, and we still find that tax abolition positively correlates tax noncompliance and social unrests.

5 | THE MECHANISM: UNCOOPERATIVE VILLAGE ELITES

Why does tax reduction lead to a decline in rural governance? In this section, we offer direct evidence for the mechanism proposed in our theoretical model—it undermined village elites' incentives to assist the state in implementing unpopular policies.

5.1 | Lack of effort by village elites

Village cadres play a crucial role in enforcing unpopular policies and maintaining stability within their communities. This is mainly because they possess knowledge and social connections that township officials lack. However, village cadres operate in a multitask environment and must prioritize certain tasks over others due to time and resource constraints. To this end, we evaluate whether village cadres exert efforts in tasks deemed important by higher-level government.

One unique feature of our data is that they include a battery of survey questions inquiring village cadres to name their top five work priorities from a list of 34 tasks, among them tax collection, petition management, and stability maintenance. Using the survey results, we establish binary variables to indicate whether tax collection, social stability, and petitions were among the top five tasks mentioned by the village cadres.

We find evidence suggesting that village cadres did not exert efforts maintaining local stability.[22] Figure 2 demonstrates 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. It is not surprising to see a decrease in prioritizing tax collection given the tax reform. However, the fact that there was only a small change in managing petitions and even a slight decline in stability maintenance is inconsistent with the increasing rural unrest depicted in Figure 1. Given the importance of maintaining social stability as a "veto policy target" under China's cadre responsibility system,[23] we would have expected that past incidence of social unrest to incentivize village cadres to exert greater effort.

We conduct regression analyses to formally evaluate the correlation between local instability and village cadres' efforts. Base on our survey data, we calculate the total number of mass petitions and mass incidents for the three-year period prior to 2004 and 2007[24] and estimate their effects on village cadres' self-reported job priorities in either petition management or stability maintenance. The results show little evidence that social unrest affects village cadres' self-reported job priorities in these two areas, except for the number of mass incidents in the previous 3 years, which has some impact (Table 3). Importantly, designating petitions or social stability as veto policy targets fails to incentivize village cadres to prioritize the state's achieving these desirable outcomes.
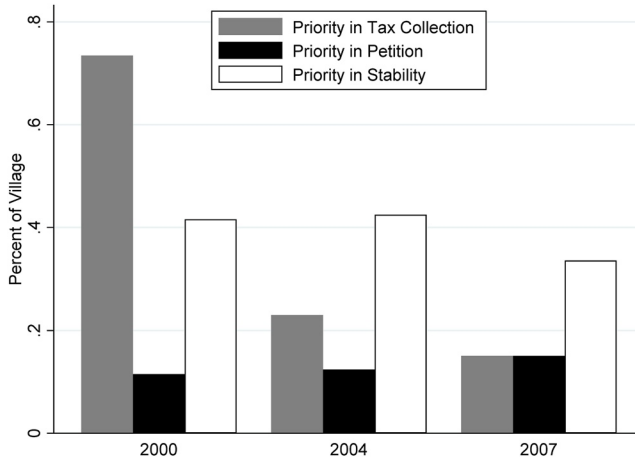
FIGURE 2 Job priority ranked by village cadres. The figure is based on the data from *Rural Survey of Land, Migration, and Local Governance*. It plots the percentage of villages reported tax collection, managing petition, and managing stability as one of the top-five tasks out of 34 tasks.

TABLE 3 Impact of mass incidents on village cadres.

	Village job priority: Petition		Village job priority: Stability	
	(1)	**(2)**	**(3)**	**(4)**
# of Mass petition (last 3 years)	−0.002			
	(0.024)			
(Log) # of people participating in Mass petitions (last 3 years)		−0.009		
		(0.020)		
# of Mass incident (last 3 years)			0.133*	
			(0.073)	
(Log) # of people participating in Mass incidents (last 3 years)				0.040
				(0.026)
Designated veto policy target to village	0.010	0.007	−0.014	−0.023
	(0.103)	(0.103)	(0.100)	(0.099)
Village characteristics	YES	YES	YES	YES
Village FE	YES	YES	YES	YES
Year FE	YES	YES	YES	YES
Number of observations	226	226	226	226

Note: The dependent variables are binary indicators of whether a specific task was ranked as one of the top five by village cadres. Standard errors clustered by village are reported in parentheses for village analysis. 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.

5.2 | The decline of fiscal autonomy

Our theoretical framework suggests that the tax reform undermine fiscal autonomy, which in turn disincentivizes local elites from assisting the state in achieving desirable outcomes. We formally

TABLE 4 Impact of tax abolition on village fiscal autonomy.

	Annual wage (Log)		% of intergovernmental transfers in the wage		Transfers received in village revenue (Log)	Village self-raised 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.

evaluate this mechanism by evaluating the impact of tax reform on fiscal autonomy. Columns 1–2 in Table 4 first report that the impact of tax reform on wages of village cadres (i.e., village party secretaries and village heads), and show a 35–39% increases in their wages; 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 that the tax abolition led to a substantial 75.8% increase in intergovernmental transfers. Given that these transfers are tied to specific public projects, village cadres have fewer opportunities to exert their influence in the distribution of public spending. Finally, we find 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.

6 | CONCLUSION

The strength of state capacity hinges on the state's ability to enforce 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 help the state implement unpopular policies. Tax reduction inadvertently undermines these incentives, resulting in disgruntled local cadres who refuse to assist the state.

Our study demonstrates that reducing the political power of village cadres undermines rural governance. Research suggests that local elites have little motivation to become village cadres due to the job's low rewards and high costs of conflict resolution (He & Yuan, 2021). As a result, local governments are forced to turn to alternative sources of support to enforce unpopular policies, such as outsourcing violence and repression through private actors or thugs for land expropriation in rural China (Hurst et al., 2014; Ong, 2018).

Our argument and findings have crucial implications beyond rural governance in China. To enforce unpopular policies, the state depends on local elites and grassroots cadres. To ensure

their cooperation, not only must the state provide both material and non-material incentives, but it also has to establish mechanisms to prevent scapegoating of grassroots cadres if the policy leads to negative consequences, which could undermine their authority.

Indeed, we observe a parallel between rising rural unrest after the abolition of agricultural tax and the urben protests against Chinese government's Zero COVID policies in late 2022.[25] In order to contain the spread of COVID, the Chinese government adopted a "Zero-COVID" approach, which involved locking down local communities and even entire cities upon the discovery of one or more COVID cases. To this end, the Chinese government relied on neighborhood community cadres and street-level bureaucrats in both rural and urban China, granting them discretionary policy enforcement power to implement the lockdown policy. These bureaucrats had significant autonomy in deciding the scope and duration of the lockdown measures. While initially successful in containing the virus from 2020 to 2021, the emergence of the highly contagious Omicron variant in 2022 proved more difficult to contain the virus through lockdowns.

Facing mounting mass discontent toward the lockdown policies, the Chinese central government continued to press local cadres to enforce the unpopular policy while simultaneously blaming them for any negative consequences. The mixed signaling by the Chinse central government effectively discredited the authority of local cadres, undermining their legitimacy to enforce this unpopular policy and reducing any leverage through discretionary policy enforcement they may possess to mitigate conflict with local residents. Disgruntled local cadres become disincentivized to maintain local stability, and street protests against Zero-COVID polices in turn spread across urban China in November of 2022. The Chinese government later abandoned the Zero-COVID policy overnight without a carefully planned exit strategy. The sudden shift caused mass COVID infections across China and is likely to have long-term impacts on citizens' trust in the government's policies.

DATA AVAILABILITY STATEMENT
We will not be able to make the data public because the proprietary nature of the dataset owned by various academic institutions in China.

ENDNOTES
[1] Researchers have contended these tax burdens were the key drivers behind social unrest in rural China, both historically and contemporarily (Bernstein & Lü, 2003; Bianco, 2001; O'Brien & Li, 2006).

[2] For the overall trend of protest in the 1990s and the 2000s, see Figure 1 in Göbel and Ong (2014) and Figure 20.1 in Ong (2015), respectively.

[3] See Figure A1 for the trend of formal and informal tax burden in our sampled villages.

[4] See Pils (2005) and Sargeson (2012).

[5] See Section 4.4 for our additional analysis to account for ad hoc taxes and fees on rural unrest.

[6] For example, the New Rural Cooperative Medical Insurance (NRCMI) program has expanded healthcare coverage in rural areas since 2003 (Huang, 2014). In addition, tuition and fees for compulsory education were

abolished in 2006 (Lü, 2014). Finally, the Chinese government introduced the New Rural Pension Scheme (NRPS) in 2009, enrolling more than 300 million rural residents by 2011 (Li & Wu, 2018).

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

[8] For discussion of scapegoating local officials, see Mattingly (2020); Ran (2017); Takeuchi (2014); Wang (2017).

[9] Cai (2008); Lü (2014); O'Brien and Li (2006).

[10] Tian and Zhao (2008) and Wu (2007) offer insightful case studies of tax negotiation in rural China. See Brautigam et al. (2008) for issues involving tax collection in developing countries.

[11] See Göbel (2010) for the origins of this reform.

[12] Mass petitions occur when two or more individuals collectively submit a petition claim.

[13] Mass incidents are large-scale acts of disobedience that include but are not limited to protests, demonstrations, physical clashes, obstruction of government business, and other forms of gatherings that disrupt social stability.

[14] We could have used the amount of tax reduction as the main independent variable, but it is likely to lead to biased estimates because the preform tax burdens could be driven by a number of factors, including the initial tax collection efforts by village cadres. Figure A3 in Appendix—1 confirms our concern: a strong positive correlation exists between village cadres' effort and the size of the tax burden per capita in 2000 prior to the reform.

[15] Our tax abolition treatment may have been underestimated due to some villages experiencing partial tax reduction in 2004 despite not receiving full tax abolition treatment. To address this concern, we adopt an alternative model specification using *Tax Cut* as an indicator for the tax reduction treatment. Our robustness checks using this specification produce similar estimation results (Table A2). We also consider a model specification combining both *Tax Abolition* and *Tax Cut* treatments, and the substantive interpretation remain consistent with the main results above (Table A3).

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

[17] The research team administered a public opinion survey in 16–20 randomly selected villagers in 2004 and 2007. Unfortunately, no public opinion survey was conducted in 2000 prior to the tax reform.

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

[19] 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).

[20] 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.

[21] Figure 1 in Chen and Kung (2016) shows that land revenue drastically increased only after 2007.

[22] 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 A15).

[23] 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 (O'Brien & Li, 1999).

[24] 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.

[25] "Chinese Protests Spread Over Government's Covid Restrictions" (WSJ.com, accessed on Nov. 30, 2022).

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SUPPORTING INFORMATION

Additional supporting information can be found online in the Supporting Information section at the end of this article.