CSCanada
Canadian Social Science
Vol. 20, No. 5, 2024, pp. 105-111
DOI:10.3968/13558

ISSN 1712-8056[Print]
ISSN 1923-6697[Online]
www.cscanada.net
www.cscanada.org

# An Empirical Study on the Relationship Between Local Penalty Intensity and Regional Differences Under Fiscal Pressure: A Case Study of Food Enterprises in Prefecture-Level Cities in China (2017-2022)

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Received 3 July 2024; accepted 10 September 2024
Published online 26 October 2024

## Abstract

In recent years, with the slowdown of China's economic growth, fiscal pressure on some local governments has intensified. As a potential effective measure to offset financial deficits, local governments have increased incentives to boost penalty revenues to alleviate fiscal pressure, leading to a frequent occurrence of 'excessive fines for minor violations' in the food sector, contrary to the central government's intention to support enterprises. The level of regional development, as a key regional characteristic variable, is assumed to have a certain correlation with the revenue from food forfeiture. Based on the panel data of 27 prefecture-level cities from 2017 to 2022, this paper employs the moderating effect model and the lagged regression model to investigate the relationship and mechanisms between the regional development level and the local penalty strength of food violation enterprises and the influence mechanism, and verify the lagged effect of the regional development level on the penalty strength. The study shows that: regional food confiscation revenue and the level of regional development is indeed negatively correlated, there is a certain degree of lag, regional financial self-management ability has a significant moderating effect on this effect. The results and conclusions can assist the central government in identifying key areas for remediation, reducing costs, and providing policy recommendations for more effective supervision.

**Key words:** Regional development level; Penalty level; Moderating effect; Lagged effect; Supervision; Efficiency

Zhao, J. H., & Sun, J. (2024). An Empirical Study on the Relationship Between Local Penalty Intensity and Regional Differences Under Fiscal Pressure: A Case Study of Food Enterprises in Prefecture-Level Cities in China (2017-2022). *Canadian Social Science, 20*(5), 105-111. Available from: http://www.cscanada.net/index.php/css/article/view/13558
DOI: http://dx.doi.org/10.3968/13558

## INTRODUCTION

Over the past few years, China's economic growth has slowed down, and small and medium-sized enterprises (SMEs) have experienced increased cost pressures and operational difficulties. China's economic recovery and small and medium-sized enterprises, with the intention of further increasing the relief efforts to reduce the burden on enterprises, to help them tide over the difficult times, the General Office of the State Council of China issued a "notice on further increasing the relief efforts to help small and medium-sized enterprises", which proposes to encourage local arrangements for small and medium-sized enterprises to relieve the funds, tax reductions and fee reductions. Against this background, there are still some local governments where administrative penalties are "excessive and inappropriate", with the ratio of the amount of the fine to the amount of illegal income reaching 100 to 200 times, and in some cases, exceeding 3,000 times.

Although the amount of punishment in most cases does meet the requirements of relevant laws and regulations, but with the advancement of the rule of law in China, the phenomenon of violation of the law should be less and less, but according to the statistics of the Southern Weekend, in 2021, in the 111 prefectural-level cities that have published the data, More than 80 cities' forfeiture income are growing, and even 15 cities compared to the 2020 growth rate of more than 100%, raising concerns that some local law enforcement agencies in China have incentives to increase confiscate revenues.

The background of global war and trade restrictions has not only brought a huge impact on small and medium-sized enterprises across China, but also on their local tax revenues, so this raises the conjecture: whether the tax revenues brought by economic shocks have exacerbated the financial pressure on Chinese localities, thus making it more likely that localities can reduce the gap between the fiscal balance of payments and the scale of confiscated revenues through non-tax revenues.

"Excessive penalties for small faults" phenomenon exacerbates the economic pressure on small and medium-sized enterprises (SMES), is not conducive to the recovery of the Chinese economy, but also may be the promotion of its rule of law, the confidence of more market players to participate in the market, the burden of market players, but also erosion of the policy effect of tax cuts and tariff reductions, undermining the rule of law of doing business, and may lead to the undermining of the vitality of the market players. Behind it may bring the deterioration of the whole business. If there are no laws and regulations on the boundaries of law enforcement, resulting in the abuse of power at the local level, or fines are regarded as a channel of income, it may cause great pressure on China's small, medium and micro enterprises, and thus the open business formed after the reform and opening up. Law enforcement should be reasonable and fair, and market regulators should promptly rectify the phenomenon of "chaotic law enforcement", maintain good market order, and create a favorable environment for the survival of small and medium-sized private enterprises.

In recent years, China has paid more and more attention to food safety issues, but the problem of excessive income from food safety sampling and confiscation occurs frequently in various regions. If China's central government conducts a regional census, it will be costly and inefficient. So, it is meaningful to investigate the common characteristics of regions where small violations receive disproportionately severe penalties. By focusing on these regions and examining the correlation between these characteristics and the severity of food safety inspection penalties, we aim to hypothesize and prove the significance of this relationship.

And the level of regional development, as a key feature of the region, will undoubtedly play an inescapable role in this problem. According to the study of Meng Tianguang and Su Zheng (2015), prefecture-level cities will take a smaller scale of non-tax revenue than neighboring prefecture-level cities to attract investment, and the higher the per capita GDP of the region, the smaller the scale of non-tax revenue, although this is the opposite of the conclusions of the article he cited (Bai, Zhang, and Zhang, 2009), but it also inspires us to pay attention to the level of development of the region and its confiscation of the scale of revenue and punishment. The level of development of the region and the size of its confiscation revenue and the severity of its penalties are significantly correlated with each other.

## 1. EMPIRICAL LITERATURE AND THEORETICAL ISSUES

The growth of local penalty and confiscatory income has been a matter of great concern. Some literature suggests that the rapid growth of local penalty and confiscatory income in China mainly stems from the distortion of the local fiscal expenditure structure at all levels in China. (Zhao and Jia, 2016); There is also literature that found that under the fiscal system of the time (2005), nearly half of China's county and township expenditures depended on fees and fines, and thus fees and fines became an important source of revenue to maintain local funding expenditures (2005). Many scholars have also studied China's penalty and confiscatory income management system and found that it allows penalty and confiscatory income to be used for the expenses and welfare of law enforcement agencies, which has led to the linkage between the interests of law enforcement agencies and law enforcement behavior, and to the growth of penalty and confiscatory income (Wang, Zhou, and An, 2007; Yang and Li, 2007; Chen, 2013). It can be seen that in many places there may indeed be incentives for penalty and confiscatory income, in which case fines are no longer a punishment for violations, but may be a kind of "subsidy" for the government itself.

In the past decade, many articles have demonstrated the impact of taxation on non-tax revenues. Some literature adopts an unconstrained cointegration test and concludes that there exists a kind of equilibrium relationship between non-tax revenues and non-tax revenue use, tax revenues and gross domestic product (Chen and Liu, 2012). Besides, there is also a lot of literature that argues that fiscal pressures, tax competition (Li, et al., 2018), and tax reductions (Zhao, et al., 2021) affect the changes of local non-tax revenues; while many scholars have made a lot of progress through research on specific tax reforms, such as value-added tax sharing (Xi, et al., 2017), income tax sharing (Xu, et al., 2020), the abolition of agricultural tax (Xie, et al., 2017), and the reform of the camp to the increase (Liu, et al., 2018), etc., and found that these tax reforms ultimately have the pressure on the local finances, and this situation is mainly more prominent in the less developed regions of the central and western regions of China, and the non-tax revenues will be expanded with the gap between fiscal revenue and expenditures, which will affect the changes in local non-tax revenues. With the expansion of the fiscal gap and improve (Liu, Liang, and Wu, 2022), at the same time, the relationship between the level of regional development and forfeited revenue is also the focus of this paper.

In summary, the existing research results on penalty and confiscatory income to make a more perfect, proved that the tax, the increase in expenditure and other financial pressures brought about by the correlation with the growth of non-tax revenues, as well as there is indeed a means of penalty and confiscatory income to alleviate the financial pressures of incentives; however, based on the purpose of our research, the current research is still unable to meet our needs. First, the correlation between the level of regional development and the growth of penalty and confiscatory income is still unclear, and the existing literature often pays less attention to or draws opposite conclusions; second, the existing literature pays less attention to the local tax and financial pressure in the preceding years, which has a lag in time, and is not able to meet our needs; third, the existing literature has used the data for the total amount of penalty and confiscatory income or non-tax revenues, which has not been refined to the specific categories, and cannot visually reflect the changes in the intensity of the penalties. The data used in the literature are mostly the total amount of penalty and confiscatory income or non-tax revenue, which are not broken down into specific categories, and cannot reflect the changes in the intensity of punishment.

## 2. HYPOTHESIS

Indicators of the level of regional development such as GDP per capita can often reflect the profitability of local enterprises, as well as the local consumption level, which on the one hand may affect the level of penalty and confiscatory income by affecting the local tax revenues in the form of fiscal pressures, i.e., in this case the local penalty and confiscatory income may be used as a means to alleviate the fiscal pressures; on the other hand, the level of regional development is affected by the administrative efficiency. On the other hand, the level of regional development is affected by administrative efficiency, which may reflect the local administrative law enforcement, so whether the more underdeveloped the region, the more likely to have a higher proportion of penalty and confiscatory income, which is the second reason for selecting the level of regional development as the core variable. In addition, GDP per capita, as a more objective, transparent and real-time updated data, can be used as a reference indicator to help complete the decision-making on the allocation of inspector resources.

In summary, this paper hypothesizes that local food penalties vary with the level of development of the region, and that relatively underdeveloped regions may have greater incentives to attenuate economic shocks through confiscation revenues, a process that may be moderated by the ability of local finances to take care of themselves. At the same time, it is important to note that the impact of many economic variables is not immediate, but rather requires some time delay to manifest itself, such as the time required to budget for sources of revenue and administrative priorities in some localities where increased fiscal pressures have been detected. Due to the financial pressure shock brought about by the changes in the level of development of the region may not be immediately on the food confiscation revenue, this regional pressure brought about by the incentive of confiscation revenue may take a period of time to be reflected. In this regard, hypotheses 1 and 2 are formulated.

Hypothesis 1: The more underdeveloped the region, the greater the tendency to increase food forfeiture revenues under fiscal pressure, and this negative correlation is moderated by the fiscal self-management capacity of each region.

Hypothesis 2: There is a significant lag in this effect of regional development level on food confiscation revenue.

## 3. METHODOLOGY

### 3.1 Model Specification

#### 3.1.1 Regulatory Effect Model

In order to verify the theoretical hypotheses proposed in the previous section, this paper constructed the following mediation effect model for mediation effect.

$$fines_{it} = \alpha_0 + \alpha_1 pergdp_{it} + \alpha_2 ability_{it} + \alpha_3 pergdp_{it} * ability_{it} + \alpha_4 proportion_{it} + \varepsilon_{it}$$

where i and t denote prefecture-level cities and years, denotes the food penalty intensity; denotes the regional developed level; denotes the regional financial self-care ability denotes the interaction term between the regional developed level and the financial self-care ability; proportionit denotes the proportion of food consumption; denotes the random perturbation term.

#### 3.1.2 Lagging Regress Model

In this paper, we regress per capita gdp one period lagged and develop the following lagged regression model.

$$fines_{it} = \beta_0 + \beta_1 pergdp_{it-1} + \beta_2 proportion_{it} + \varepsilon_{it}$$

where pergdpt-1 denotes the regional level at one period lag, and the rest of the variables have the same meaning as the variables in model (1).

### 3.2 Sample Selection and Data Sources

China's exists a regional imbalance, the eastern region is more developed, while the central and western regions are relatively underdeveloped, in order to ensure the randomness of the sample, the project team took samples

from China's central, eastern and western regions, respectively, three provinces, and three cities from each province to conduct the relevant data survey. Considering the severe global economic situation in the current period, this paper focuses on the data of the six years from 2017-2022. Changes in food safety sampling penalties are measured by the logarithm of the food confiscation revenue in each region, the regional development level is expressed by the logarithm of per capita GDP, and the difference in the financial self-management ability of each region has a moderating effect on the correlation between the regional development level and the penalties, and is expressed by the logarithm of the difference between regional financial expenditures and regional tax revenues. Considering that differences in the proportion of food consumption in each region may also affect food confiscation revenues, their logarithmic form is introduced into the model as a control variable.

Local tax revenues, total fiscal expenditures, the share of food consumption, and GDP per capita by region were obtained from data published in China's national Statistical Yearbook 2017-2022. Data on food safety confiscation revenues by region are relatively difficult to find, and in this paper, we find the city's final revenue statement for each year from the information disclosure section of each Chinese city's Market Supervision Administration website, with specific data in the column on food.

### 3.3 Variable Interpretation

Explanatory variable $pergdp_{it}$: represents the economic level of each region and is expressed as the logarithm of the per capita GDP of each region. Considering the impact of population on the total economic volume of the region, it is more reasonable to use the logarithm of regional GDP per capita.

The explanatory variable $fines_{it}$: indicates the magnitude of penalties for food safety violations in each region of China, and is expressed as the logarithm of the revenue from food safety sampling and confiscation.

Regulatory variable $ability_{it}$: represents the fiscal balance of each region, the difference between the total fiscal expenditures of each region minus the tax revenues of each region, reflecting the ability of each region to take care of its own finances. That is,

$ability_{it}$=ln(regional fiscal $expenditure_{it}$ - regional tax $revenue_{it}$ ).

Control variable : denotes the proportion of food consumption, expressed as the logarithm of the proportion of food consumption in each region.

**Table 1**
**Variable Definition and Measure**

| Variable type | Variable symbol | Variable name | Variable Measurement |
|---|---|---|---|
| Explanatory variable | fines | Food Penalty Levels | Food confiscation revenue is taken as the natural logarithm |
| Core explanatory variables | pergdp | Level of regional development | GDP per capita in natural logarithms |
| Moderator variable | ability | Regional self-management | The difference between fiscal expenditures and tax revenues is taken as a natural logarithm. |
| Control variable | proportion | Share of food consumption | The share of food consumption is taken as the natural logarithm |

## 4. EMPIRICAL RESULTS AND ANALYSIS

### 4.1 Descriptive Statistical Analysis

Table 2 shows the results of descriptive statistics of the variables, including food punishment (fines) of the mean value of 5.947956, the difference is 1.256757, due to the unit of millions of dollars and logarithmic processing, can be seen that the overall level of confiscation of the region is higher, and there are large differences in the scale of punishment for food violations between different regions. Regional developed level (pergdp) of the minimum value of 0.8586616, the maximum value of 2.923162, it can be seen that there are significant differences in the level of development of the region. The difference of regional self-care ability (ability) is 1.030395, and the extreme difference is 4.84399, which shows that the local self-care ability has a big difference in different regions. The mean value of the proportion of food consumption is -1.215557, and it can be known that the mean value of the proportion of food consumption in each region is about 30%, which is relatively high in the whole, and it has an impact on the income from food forfeiture.

**Table 2**
**Descriptive Statistics of Variables**

| Variable | Obs | Mean | Std.dev. | Min | Max |
|---|---|---|---|---|---|
| Fines | 162 | 5.947956 | 1.256757 | 2.564949 | 9.078235 |
| Pergdp | 162 | 1.821477 | .4864988 | .8586616 | 2.923162 |
| Ability | 162 | 15.3764 | 1.030395 | 12.21783 | 17.06182 |
| Proportion | 162 | -1.215557 | .137537 | -1.52326 | -.8915981 |

*Source*: Public data on the official website of each local market supervision authority, statistical yearbook of China's National Bureau of Statistics.

### 4.2 Correlation Analysis

Table 3 shows the correlation between the variables. Observing the first column, it can be seen that the core variable pergdp is significant at the 1% level and has a strong correlation with the explanatory variables, which makes it suitable for use as the core explanatory variable. In addition, the moderating variables also have strong

correlation with the explanatory variables. The table also shows that there is no serious multicollinearity among the explanatory variables. The specific correlations will be further explored in the subsequent regression, and this test is only a test of correlation to ensure that the variables are set for the subsequent regression.

**Table 3**
**Correlation Analysis**

| | Fines | Pergdp | Ability | Propor~n |
|---|---|---|---|---|
| Fines | 1.000 | | | |
| Pergdp | 0.306*** | 1.000 | | |
| Ability | 0.588*** | 0.416*** | 1.000 | |
| Proportion | -0.045 | -0.248*** | -0.131* | 1.000 |

*Note*: Values in parentheses indicate errors, *, **, *** indicate 10%, 5%, 1% significance levels, respectively.
*Source*: Public data on the official website of each local market supervision authority, statistical yearbook of China's National Bureau of Statistics

### 4.3 Multicollinearity Analysis

Table 4 presents the results of the multicollinearity test. It is evident that the VIF (Variance Inflation Factor) values for all variables are below 10, indicating that there is no severe multicollinearity among the variables. Moreover, since the VIF values are all below 5, the variables pass the test well, suggesting that the data is suitable for further regression analysis.

**Table 4**
**Multicollinearity Analysis**

| Variable | VIF | 1/VIF |
|---|---|---|
| Pergdp | 1.27 | 0.788283 |
| Ability | 1.21 | 0.825736 |
| Proportion | 1.07 | 0.937366 |
| Mean VIF | 1.18 | |

### 4.4 Regression Analysis of Moderating Effect

Local financial self-sufficiency reflects to a certain extent the tendency to cope with economic pressures brought about by event shocks, and will have an impact on the relationship between the level of regional development and the intensity of food penalties. When the financial self-management ability is relatively strong, the local community in the face of economic pressure is more likely to take penalty and confiscatory income to non-tax revenue to cope with the risk, to a certain extent, enhance the impact of the underdeveloped region penalty and confiscatory income, not to verify this mechanism, this paper according to the model design (2) to carry out the empirical test. Introduce the product of the regulating variable ability and the explanatory variable pergdp as the interaction term, but considering the interaction term is its product, the introduction of the model has a high degree of covariance, easy to make the model bias, in order to eliminate this bias as far as possible, here the decentralized, the variables are decentralized.

Table 5 shows the results of moderated effects regression, we can see that the coefficients of the core explanatory variables and interaction terms are significant and in the same direction, indicating that the moderating effect is significant and the moderating effect can strengthen the original main effect. Firstly, it is observed that the P-value of the core variable x is 0.046, which is significant at the 5% level, and the coefficient is negative, indicating that the level of regional development is negatively correlated with the intensity of food punishment; at the same time, it is noted that the coefficient of the interaction term is also negative, and the P-value is 0.001, which is significant at the 1% level, verifying the conjecture in the hypotheses. As the local self-management capacity increases, the effect of food penalty strength is also strengthened by the level of the region.

**Table 5**
**Moderating effect Regression Results**

| | | | | | | |
|---|---|---|---|---|---|---|
| Fixed-effects (within) regression | | | | | Number of obs = | 162 |
| Group variable:city | | | | | Number of groups = | 27 |
| R-squared: | | | | | Obs per group: | |
| Within = 0.0986 | | | | | min = | 6 |
| Between= 0.0152 | | | | | avg = | 6.0 |
| Overall = 0.0053 | | | | | max = | 6 |
| | | | | | F(4,131) = | 3.58 |
| corr(u_i, Xb) = -0.5754 | | | | | Prob > F = | 0.0083 |
| **Fines** | **Coefficient** | **Std. err.** | **t** | **P>\|t\|** | **[95% conf.** | **Interval]** |
| pergdp | -.8988596 | .445448 | -2.02 | 0.046 | -1.780062 | -.0176571 |
| ability | .2508906 | .3765817 | 0.67 | 0.506 | -.4940779 | .9958591 |
| tj_c | -.8328786 | .2455562 | -3.39 | 0.001 | -1.318647 | -.3471099 |
| proportion | 1.443004 | 1.078031 | 1.34 | 0.183 | -.6895977 | 3.575606 |
| _cons | 5.65428 | 5.521663 | 1.34 | 0.183 | -.6895977 | 3.575606 |
| sigma_u | | | 1.4116297 | | | |
| sigma_e | | | .58625834 | | | |
| rho | | | .85289366 | | | |
| F test that all u_i=0: F(26,131) = 13.03 | | | Prob > F = 0.0000 | | | |

*Source*: Public data on the official website of each local market supervision authority, statistical yearbook of China's National Bureau of Statistics.

### 4.5 Regression Analysis of Lagged Effect

Taking into account the level of development of the region on the impact of food penalties may have a lag, local penalties in the previous year's per capita gdp may be included in the consideration of factors, so this paper establishes a lagged effect regression model on the lagged effect of this test.

Table 6 shows the results of the lagged one period regression on the core explanatory variables. The results show that the coefficient of regional development level on food penalties in the lagged period is significantly negative at the 5 percent level. That is, the level of regional development in the current year is negatively associated with the level of penalties in the following year, which may be related to factors such as the time taken to collect and process the data on the level of regional development, or the decision-making of local actions.

**Table 6**
**Lagged Effect Regression Results**

| | | | | | | |
|---|---|---|---|---|---|---|
| Fixed-effects (within) regression | | | | | Number of obs = | 135 |
| Group variable:city | | | | | Number of obs = | 27 |
| R-squared: | | | | | Obs per group : | |
| Within = 0.0540 | | | | | min = | 5 |
| Between= 0.0967 | | | | | avg = | 5.0 |
| Overall = 0.0651 | | | | | max = | 5 |
| | | | | | F (2,106) = | 3.0 |
| corr (u_i, xb) = -0.6610 | | | | | Prob > F = | 0.0528 |
| **Fines** | **Coefficient** | **Std. err.** | **t** | **P>\|t\|** | **[95% conf.** | **interval]** |
| pergdp | | | | | | |
| L1. | -1.063626 | .4639923 | -2.29 | 0.024 | -1.982546 | -.1427263 |
| proportion | 1.987994 | 1.318945 | 1.51 | 0.135 | -.626944 | 4.602931 |
| _cons | 10.27489 | 2.002418 | 5.13 | 0.000 | 6.304906 | 14.24488 |
| sigma_u | 1.4628194 | | | | | |
| sigma_e | .5867455 | | | | | |
| rho | .86141107 (fraction of variance due to u_i) | | | | | |
| F test that all u_i=0: F(26,106) = 17.05 | | | | | Prob > F = | 0.0000 |

*Source*: Public data on the official website of each local market supervision authority, statistical yearbook of China's National Bureau of Statistics

## 5. CONCLUSION AND POLICY IMPLICATION

### 5.1 Conclusion

Through the above theoretical as well as empirical research, this paper draws the following conclusions.

• There is a significant negative lag effect of the level of regional development on the size of its food confiscation revenue. Less developed regions have a greater incentive to increase penalty income to alleviate fiscal pressure, making them key areas for central government supervision in China. Additionally, the regional development level of the current year significantly impacts food penalty income in the following year.

• Regional fiscal self-management ability significantly moderates this effect. With recent economic difficulties for enterprises and reduced tax revenues in various regions, coupled with increased environmental and health responsibilities, fiscal self-management ability reflects the government's response to economic pressures. When fiscal self-management ability is relatively strong, local governments are more likely to increase penalty income to enhance non-tax revenues, thereby amplifying the effect of increasing penalty income in less developed regions

### 5.2 Policy Implication

• In the present time, as people's concern for food safety has increased, the problem of high revenue from food safety sampling and confiscation in various regions has arisen frequently, and it would be costly and inefficient for the State to conduct a census. The research results of this project will help the state to determine the key areas for "excessive penalties for small faults". As a result, more resources can be allocated to the less developed regions when correcting the phenomenon of "excessive penalties for small faults", so as to minimize the cost of inspections, improve the efficiency of corrections, and ensure that the fundamental attribute of local governance is for the people.

• The research for this project is in the context of local fiscal pressures, and in the event of certain events that cause shocks to the economy, it is also possible to carry out the relevant research in this paper to explore the relationship. Thus, to some extent, this paper provides a succinct research model for issues related to budget revenues and economic shocks.

• If the local always exist through penalty and confiscatory income to ease the financial pressure of incentives, may not be conducive to the local economy and the rule of law, in order to build a more open circulation of the market, to strengthen the supervision of the local administrative penalties is indispensable, especially in the current critical period of China's economic recovery and to protect the legitimate rights and interests of the local enterprises, and to maintain the market of fairness and justice.

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