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Study on Fiscal and Tax Incentive Policies for China's Wind Power

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In recent years, wind power has gained rapidly development in both speed and scale in China. During the four years from 2006 to 2009, the annual cumulative growth of installed wind power capacity was above 100% averagely, but compared with the total energy consumption in China, the wind power composed only a minor share. Currently, China has brought forward the objectives of increasing the share of non-fossil energy to 15% till 2020 and the GDP per capita carbon dioxide emission down by 40%-50% as compared with 2005. To realize this objective, in 2020, the development of China's wind power is expected to reach 150,000 mw. Therefore, massive reasonable development and utilization of wind power will become an important strategic task.

China's wind power resources mainly gather in the three northern areas (Northeast China, North China, and Northwest China). The state planned seven wind power bases of 10 million kw at the end of 2008, among which, six were located in remote backward areas of North China, without any superior industry. The development of wind power will become the main way for these areas to develop economy and expand employment. However, the VAT transition policies implemented as of 1 January 2009 allowed enterprises to deduct the input tax included in newly purchased machines and equipments, which reduced the local tax payments of wind farms remarkably. Meanwhile, since the development of wind power belongs to infrastructure project, the preferential enterprise income tax policy of three-year exemption and three-year half reduction accessible reduces the interests available for local government from the development of wind resource in the early stage. In order to benefit from the wind power development, some areas even require wind power development enterprises mandatorily to introduce wind turbine or spare parts manufacturers while developing wind farms locally. This practice has, on the one hand, aroused the local protectionism in wind turbine selection; on the other hand, formed the manufacturing of wind turbines bloomed almost everywhere, and caused the waste of investment and overcapacity. Therefore, in order to develop the wind resource better, research on wind power-related fiscal and tax policies is in urgent need. The constitution of reasonable and effective wind power-related fiscal and tax policies will offer policy guarantee to the massive development of wind power in the future.

1 Contents and Major Impact of VAT Transition

1.1 Background and contents of VAT transition reform

1.1.1 Background of VAT transition reform

VAT is a tax on the value added to a product or service, which belongs to service charge (or turnover tax). China's VAT is collected on the value added of entities and individuals selling goods or rendering processing, repairing, or assembling services, and importing or exporting goods, and by the tax credit method adopted universally in the world, namely, calculating the output tax at the specified tax rate on the basis on the sales of goods or services, and then deducting the VAT paid for acquiring the said goods or services, that is, the input tax, the difference is the tax paid for the value added.

Pursuant to the manner of input tax deduction, VAT can be classified into production, revenue, and consumption three types. The production type will not deduct the VAT of fixed assets; the consumption type allows deducting the VAT of fixed assets once for all; while the income type is the tax levied on the current added value of fixed assets. Currently, a majority of countries in the world adopt the consumption-type VAT.

China adopted the production-type VAT when implementing the VAT in its 1994 tax reform, which was helpful to guarantee the fiscal revenue, but since the production-type VAT does not allow the deduction of the input tax of fixed assets, it has obvious shortages as follows:

(1) Double taxation: since the production-type VAT does not allow the deduction of VAT of fixed assets like machines and equipments purchased, thus, the value added of products actually include the depreciation of fixed assets, which increases the value added of products, and then enters the next stage, and forms the double taxation;

(2) Unequal tax burden of sector and enterprises: since the VAT of fixed assets like machines and equipments purchased is not allowed to be deducted, the tax burden of sectors and enterprises with majority of fixed assets purchased, such as capital-intensive enterprises, is obviously higher than those sectors and enterprises with less fixed assets purchased, such as the labor-intensive enterprises;

(3) Impact on technological progress and adjustment of economic structure: the production-type VAT has made the tax burden of enterprises heavier, which influences the investment enthusiasm of enterprises, especially the investment enthusiasm of enterprises to capital-intensive and technology-intensive industries and infrastructure industries, and further influences the application of new technologies and adjustment of economic structure;

(4) Weakening the competitiveness of products in the world: under the production-type VAT, the VAT on purchase of fixed assets has been incorporated in the cost of products as part of depreciation, which will increase the price (in particular, when the export rebate policies have not been fully implemented), and weaken the competitiveness of these products in the international markets).

Given the aforesaid problems of the production-type VAT, in order to eliminate

the double taxation weakness of the original production-type VAT, reduce the tax burden of enterprises when investing in equipments, and further encourage investment and domestic demand expansion, and boost the technological progress of enterprises, adjustment of industrial structure, and transformation of economic growth manner, China also began to try the VAT transition reform. The pilot reform of conversion of production-type VAT to consumption-type VAT in the eight sectors in the three provinces and one city in Northeast China was initiated in July 2004; three years later, in July 2007, the scope of pilot VAT transition reform was expanded to six provinces and 26 cities in Central China; in 2008, the scope of pilot transition reform was expanded further, including the five leagues in east of Inner Mongolia and serious earthquake-hit areas in Wenchuan (excluding specific sectors whose development is restricted by the country). Since the aforesaid series of trial has accumulated abundant experience for the nationwide popularity of the reform, together with the prime macro control task of growth maintenance set aiming at the changes in domestic and foreign economic situation and for the purpose of withstanding the adverse impact of the international economic environment after the global financial crisis in 2008, the state decided to carry out the VAT transition reform across the country as of 1 January 2009.

1.1.2 Major contents of VAT transition reform

Major contents of the VAT transition reform are as follows:

(1) Under the premise of maintaining the prevailing VAT rate, to allow all general VAT payers to deduct the VAT on purchase of newly purchased equipments across the country (regardless of area and sector); and VAT on purchase that has not been fully deducted will be carried forward to the next period for further deduction. In order to prevent tax loophole, cars, motorcycles, and yachts with few relation with the technological update of enterprises and which are usually mixed as the consumption tax on personal consumption are excluded from the aforesaid scope of equipments.

(2) as a supporting measure of the transition reform, the VAT-free policies regarding imported equipments and VAT refund policies for domestic equipments purchased by foreign-invested enterprises will be cancelled accordingly;

(3) to reduce the VAT rate of small-scale taxpayers to 3%; and

(4) to restore the VAT of mineral products to 17%.

1.2 Major impact of VAT transition reform

1.2.1 Impact of VAT transition reform on enterprises and sectors

As far as enterprises are concerned, the VAT transition will influence their tax burden directly. Generally speaking, after the VAT transition, the VAT on purchase of fixed assets like machines and equipments by enterprises can be deducted from the VAT on sales, which will directly reduce the VAT paid by enterprises, but given the difference between domestic and foreign-funded enterprises in original VAT policies enjoyed, the impact of the VAT transition on them also vary.

As to domestic-funded enterprises, while the VAT burden is reduced, the burden brought by urban maintenance and construction tax and educational surtax is also lightened. Even considering that the enterprise income tax paid by enterprises will increase due to the decrease of accumulated depreciation after the VAT transition (machines and equipments as the entry value of fixed assets will no longer include the VAT on purchase), the comprehensive result is the decrease in the tax burden of enterprises.

In respect of foreign-funded enterprises, since after the VAT transition reform, the VAT on importation of self-use equipments in foreign-invested projects that the country encourages to develop is restored; moreover, the policy that VAT on home-made equipments purchased by foreign-invested enterprises within total investment will be fully refunded becomes null and void. As compared with the original VAT policies, they have not benefited from the VAT transition reform. Therefore, the VAT transition reform, in fact, has actually narrowed the gap between domestic and foreign-funded enterprises in VAT policies and burden.

In the case of sectors, the impact of VAT transition on tax burden of sectors varies for the difference in fixed asset investment of sectors, namely, the faster the wear and tear of fixed assets and the shorter the depreciation period, the more the newly added fixed asset investment due to changes in tax system, and the lower the return of fixed assets, the bigger of the impact of changes in tax system on the tax burden of sectors. Concretely speaking, capital-intensive industries with huge investment in fixed assets, such as the power and heat production and supply industry, equipment manufacturing, petrochemical industry, building material industry, food& beverage industry, and hi-tech industry, will benefit a lot from it, especially those with tremendous new equipments purchased.

1.2.2 Impact of VAT transition reform on fiscal revenue

With regard to fiscal revenue, the implementation of the VAT transition reform will definitely lead to the reduction of fiscal revenue. Besides reducing the VAT revenue directly, it also directly cuts down the revenue from the urban maintenance and construction tax and the educational surtax. Though the revenue from enterprise income tax is also increased, the comprehensive result is the decrease in fiscal revenue. According to relevant measurement, the implementation of VAT transition reform will reduce the 2009 VAT revenue by around RMB120 billion, urban maintenance and construction tax by around RMB6.0 billion, and educational surtax by around RMB3.6 billion; meanwhile, increase the enterprise income tax by about RMB6.3 billion. After the offsetting of increase and decrease, the tax burden of enterprises will be reduced by about RMB123.3 billion.

Since the hierarchical tax-division system prevails in finance of China, the central and local governments divide fiscal revenue by tax, where the central tax, local tax, and central& local shared tax are set (See Table 1). Among others, VAT and enterprise income tax belong to the central& local shared tax. The central and local governments have 75% and 25% stake in VAT, and 60% and 40% stake in the enterprise income tax. The urban maintenance and construction tax and educational surtax are local tax

revenue. Thus, VAT transition has different impact on central and local fiscal revenue. Generally speaking, the central finance will undertake the main decrease caused by the VAT transition; while the local finance just shoulders a small portion of the decrease. But when it comes to local government, the extent of influence on tax revenue will vary due to the scale of local VAT revenue, that is, the bigger the original VAT revenue of local government, the bigger the impact of transition on local tax revenue, especially those local governments taking VAT as the main source of local fiscal revenue.

Table 1 Classification of central and local tax

Type of tax	Scope of taxation	Remarks
Central tax	Tariff, consumption tax and VAT withheld by customs, consumption tax, vehicle purchase tax, tonnage tax, individual income tax (interest tax), enterprise income tax (some industries and enterprises), business tax (some industries), and urban maintenance and construction tax (some industries).	The enterprise income tax belonging to the central tax is the income tax paid by the railway transportation, state post, ICBC, ABC, BOC, CCB, China Development Bank, Agricultural Development Bank of China, Import- Export Bank of China, and ocean petroleum& natural gas enterprises; business tax and urban and rural maintenance and construction tax are the part collectively paid by railway departments, head offices of banks, and head offices of insurance companies.
Local tax	Business tax (excluding some industries), urban maintenance and construction tax (excluding some industries), urban land use tax, house property tax, urban real estate tax, farmland occupation tax, land VAT, deed tax, stamp tax, vehicle and vessel tax, stamp tax, tobacco leaf tax, fixed asset investment regulation tax.	The agricultural and animal husbandry tax, forestry and agricultural special products tax, slaughter tax, and banquet tax originally belonging to local tax have been abolished; the vehicle and vessel tax and vehicle and vessel usage license plate tax have been merged; the fixed asset investment regulation tax will not longer be levied currently.
Central& local shared tax	VAT (central 75%, local 5%), stamp tax on securities trading (central 97 % , local 3 %), resource tax (ocean petroleum resource tax belongs to the central finance), enterprise income tax (excluding few industries or enterprises) and individual income tax (central 60%,	Income tax above the base in 2001 will be shared.

	local 40%).	
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Source: *Decision on the Implementation of the Tax Division Fiscal Management System* (SC (93) No.085), *Circular of the State Council on Issuing the Income Tax Revenue Sharing Reform Plan* (SC [2001] No.37).

Though in the short run, the VAT transition will reduce the central and local tax revenue concurrently, in the long run, its positive impact on social economy and the development of various sectors is huge. The VAT transition reform may alleviate the burden of enterprises, and enhance the investment enthusiasm of enterprise, and in the long run, can even stimulate investment and pull the domestic demand, as well as encourage the development of hi-tech industries, improve the production benefit and competitiveness of enterprises, and promote the technological update and renovation, also favor the structure transformation of China's economy, and further drive the faster development of economy, and finally fuel the increase of tax revenue.

2 Impact of VAT Transition on Wind Power Development Enterprises

Same as other enterprises, wind power development enterprises will also sustain the impact of VAT transition on their tax burden. Since wind power industry has huge investment in fixed assets, and has no fuel or raw materials as input tax for deduction, the impact of VAT transition on enterprises' tax burden will be even bigger. Similarly, given the VAT policy difference between domestic and foreign-funded wind power enterprises before the transition, next, this paper will primarily analyze the domestic enterprises.

For domestic-funded enterprises, after the VAT transition, wind power enterprises may deduct the input tax of wind power equipments within the deduction period year after year, which will reduce the VAT, urban maintenance and construction tax, and educational surtax paid, also increase the cash inflow and pretax profits of enterprises, and further improve the profitability of enterprises.

Next, we will take a 50 mw wind power project invested after the VAT transition as an example to analyze the impact of VAT transition. Assume the cost of the project is RMB90.00 million, and the unit equipment investment (tax inclusive) is RMB7,650/kW; the annual power hour is 2,200 (assume the power hours have been sold out totally), the tariff (tax inclusive) is RMB0.58/kWh; the salvage rate and depreciation period of fixed assets are 5% and 20 years respectively. See the Table below for the tax payment of the enterprise within the project period.

Table 2 Impact of VAT transition on tax burden of domestic-funded wind power projects

Unit: RMB10,000

Item	Before transition	After transition	Comparison of tax payable before and after transition
VAT input tax	0	5557.69	-
Annual VAT output tax	927.01	927.01	-
VAT paid annually from Year 1-6	463.50	0	-2781 (the first 6 years)
VAT paid annually after Year 7	463.50	463.50	0
Urban maintenance and construction tax and educational surtax paid annually from Year 1-6	74.16	0	-445 (the first 6 years)
Urban maintenance and construction tax and educational surtax paid annually after Year 7	74.16	74.16	0
Newly increased enterprise income tax from Year 1-6	-	66	99 (the first 6 years)

due to depreciation			
Newly increased enterprise income tax after Year 7 due to depreciation	-	66	924 (the last 14 years)
Total	-	-	-2203 (20 years)

Note: the impact of time value has not been considered in calculation.

According to the Table above, after the transition, the enterprise can receive VAT input tax of RMB55,576,900; its annual VAT output tax is RMB9,270,100. It does not need to pay the VAT within 6 years ($RMB55,576,900 / RMB9,270,100 = 6$), namely, the deduction period when the enterprise does not need to pay the VAT is 6 years¹. While after Year 7, it has to pay the VAT normally. According to current preferential policy of immediate 50% VAT refund upon collection, it shall pay VAT up to RMB4,635,000² annually. Since before the transition, it can enjoy the preferential policy of immediate 50% VAT refund upon collection for 6 years, namely, it can receive preferential tax of RMB27.81 million; thus, though the enterprise may deduct RMB5,576,900 after the transition, the comprehensive result is that it actually pays VAT RMB27.81 million less actually.

Meanwhile, the VAT un-payment in the first 6 years also makes the enterprise pay the urban maintenance and construction tax and the educational surtax (at the tax rate of 8%) less by RMB4.45 million³. Besides, the annual profit increased due to the decrease in fixed asset deduction after the VAT transition is RMB2.64 million. Calculate the enterprise income tax at the tax rate of 25%, the annually increased enterprise income tax amounts to RMB0.66 million, totaling RM3.96 million in the first 6 years; if considering the impact of the policy of “three-year exemption and three-year halved collection” of enterprise income tax, the actual increase in enterprise income tax in the first 6 years is RMB0.99 million⁴; while the enterprise income tax increased in the last 14 years is RMB9.24 million. To sum up, during the project period (20 years), the VAT transition has alleviated the tax burden of the enterprise by RMB22.03 million.

¹The deduction period that enterprises do not pay VAT varies due to the impact of unit equipment investment, on-grid power tariff, and power sold annually, which generally is about 5-9 years.

²After the VAT transition, since the output tax of enterprises has been fully deducted in the first 6 years, the benefit brought by the policy of 50% of immediate VAT refund upon collection has not been enjoyed during this period.

³According to the policy of immediate 50% of VAT refund upon collection, the urban maintenance and construction tax and educational surtax will not be refunded when the VAT is refunded immediately after collected.

⁴According to the provisions of the *Enterprise Income Tax Law* and the *Provisional Regulations of the Enterprise Income Tax Law*, as for income received by enterprise from investment in and operation of key public infrastructure projects supported by the state, namely, (approved after 1 January 2008) port, airport, railway, urban public traffic, power, water conservancy projects specified in the *Catalogue of Public Infrastructure Projects Eligible for Preferential Enterprise Income Tax*, the enterprises will be exempted from the enterprise income tax from Year 1 to Year 3 since the year of tax payment when the first operating income is received from the project, and pay half of the enterprise income tax from Year 4 to Year 6 (the policy of “three-year exemption and three-year halved collection of enterprise income tax”). According to the provisions of the *Catalogue of Public Infrastructure Projects Eligible for Preferential Enterprise Income Tax*, newly established wind power projects approved by competent government investment authorities are eligible for the policy of “three-year exemption and three-year halved collection of enterprise income tax.”

While if further consider the impact of decrease in fund outflow for tax payment on the reduction of fund demand and financial expenses, the VAT transition can increase the cash inflows and pretax profit of the enterprise, and finally improve the overall benefit and profitability of domestic-funded wind power projects remarkably.

Besides, it is worth noting that after the VAT transition, the actual VAT burden of wind power enterprises has dropped from 8.5% to 5.5%, down by 3 percentage points. Comparatively speaking, since the coal VAT rises from 13% to 17%, the actual VAT burden of thermal power enterprises has decreased from 7% around to 2%, down by 5 percentage points. Therefore, as to wind power enterprises, firstly, the actual burden after the VAT transition is still higher than thermal power enterprises; secondly, the enterprise tax burden reduced after the transition reform is also less than thermal power enterprises.

3 Impact of VAT Transition on Local Fiscal Revenue

3.1 Impact of wind power projects on local fiscal revenue

Pursuant to the impact of aforesaid VAT transition on wind power project (take the 50 MW wind power project as an example), in the first 6 years of the project, there is no need for the enterprise to pay any VAT, urban maintenance and construction tax, and educational surtax. More specifically, the decrease in VAT and the urban maintenance and construction tax& educational surtax is RMB27.81 million and RMB4.45 million respectively; while throughout the project period (20 years), the increase in enterprise income tax reaches RMB13.20 million.

According to current tax division fiscal management system, VAT is split into 75% and 25% between the central and local finance; while the enterprise income tax is shared between central and local finance by 60% and 40%. The urban maintenance and construction tax and educational surtax revenue belongs to local tax revenue, thus the VAT revenue loss of local government during the wind power project period is RMB6,952,500. The loss on urban maintenance and construction tax and educational surtax is RMB4.45 million; while the increase in enterprise income tax revenue is RMB5.28 million. Comprehensively speaking, the local government has lost tax revenue of RMB6122,500 during the project period. If considering the calculation of the first 6 years, the annual average tax revenue loss is RMB1834,400.

Considering the high financial expenses prior to the operation of the wind power project, in the early stage, the project will make low project or even a loss in the early stage. Relevant calculation indicates that prior to the VAT transition, the income tax of domestic-funded wind power projects in the first 9 years of operation period in fact is 0, which indicates that the local government probably cannot receive any of the aforesaid tax revenues during the 6 years after the transition.

Table 3 Impact of domestic-funded wind power projects on fiscal revenue of local governments due to VAT transition Unit: RMB10,000

Item	Before transition	After transition	Comparison of impact on fiscal revenue
VAT revenue in the first 6 years	695.25	0	-695.25
Urban maintenance and construction tax and educational surtax revenue in the first 6 years	444.96	0	-445
Increased enterprise income tax paid	-	528	528
Total	-	-	-612.25

Note: take the aforesaid 50mw wind power project as an example.

3.2 Case study

The research team conducted survey to the wind power development of one county in Northeast China. Next, relevant survey data will be taken to analyze the

concrete impact of the VAT transition on the fiscal revenue of local government.

According to the survey data of the selected County, its 2009 local fiscal revenue was RMB0.15 billion. The installed capacity of newly added wind farms from 2010 to 2012 is 2,300 MW. If all the newly added wind farms projects are funded domestically, and relevant indicators are the same as the aforesaid 50 MW foreign-funded wind power project, after the VAT transition, the newly added 2,300 mw wind power project will reduce the fiscal revenue of the county by RMB282 million. If only consider the first 6 years, the annual fiscal revenue loss is RMB84,382,400, up to 56.25% of local fiscal revenue of the same level.

According to the aforesaid analysis, wind power development projects have significant impact on local fiscal revenue due to the VAT transition, especially when calculated by domestic-funded wind power projects. If the local fiscal revenue decrease caused by local wind power equipment manufacturers due to the VAT transition reform, in 2010, the decrease in VAT, urban maintenance and construction tax, and educational surtax of wind power equipment manufacturers will reach RMB23.02 million. The impact on local fiscal revenue will be even bigger.

Table 4 Impact of VAT transition on fiscal revenue of the county

Unit: RMB 100 million

	Impact of transition on fiscal revenue	Annual average impact on fiscal revenue in the first 6 years	Weight in 2009 local fiscal revenue of the same level (%)
Newly added 2,300 mw foreign-funded wind power projects	1.28	0.21	14.23
Newly added 2,300 mw domestic-funded wind power projects	2.82	0.84	56.25

3.3 Conclusions

On the whole, since the VAT input tax which is not allowed deduction becomes deductible after the transition, the local governments will lost the tax revenue of this part of input tax. But the current implementation of the policy of immediate 50% wind power VAT refund upon collection will reduce the impact on tax revenue. Meanwhile, the low VAT revenue will lead to the loss of urban maintenance and construction tax and educational surtax. Enterprise income tax, through after the transition, will increase local tax revenue, the actual increase will not be as much as expected due to the impact of the preferential enterprise income tax policy of the “three-year exemption and three-year halved collection” in preliminary stage of

projects. Therefore, the main revenue loss of local governments includes the VAT (part attributable to local finance), urban maintenance and construction tax, and educational surtax.

Generally speaking, in 2009, China's newly increased installed wind power capacity reached 12,020 MW⁵. If calculate the local fiscal revenue loss according to relevant data of the aforesaid 50 mw foreign-funded wind power projects (annual tax revenue loss of RMB464,000 in the first 6 years), the annual local fiscal revenue loss due to the VAT transition of wind power projects across the country amounts to RMB112 million. While if calculate in accordance with relevant date of domestic-funded wind power projects (annual tax revenue loss of RMB1,834,400 in the first 6 years), the annual local fiscal revenue loss due to the VAT transition of wind power projects across the country amounts to RMB441 million. But in the case of wind power bases in the underdeveloped three north regions (Northeast China, North China, Northwest China), since the fiscal revenue of local governments is minor, the impact of VAT transition on local fiscal revenue is huge. Meanwhile, wind power development enterprises, after the full deduction of the input tax of wind power equipments, will seldom have any input tax deduction of other projects, thus local governments, after the completion of the deduction period, can receive stable tax revenue. Therefore, the impact of VAT transition on the fiscal revenue of local governments also reflects in the unbalance or fluctuation of local fiscal revenue in early stage of wind power projects.

⁵ China Ranked First in the World by Newly Added Installed Wind Power Capacity in 2009, CHINA5E.com.

4 Suggestions on Polices for Perfecting Fiscal and Tax Policies to Promote Local Wind Power Development

4.1 Necessity to perfect the wind power-related fiscal and tax policies

The conversion of VAT from production type to consumption type has objectively alleviated the tax burden wind power development enterprises. In the long run, it will play an active role to increase the investments of wind power enterprises. Since wind power enterprises are featured with fixed asset investment in wind power equipments, after the transition, they do not need to pay any tax within the deduction period, which causes the local fiscal revenue loss. Especially for the remote and less developed three north regions, in view of the weak tolerance of finance to reduction, the impact on their fiscal revenue is even bigger, which will also cause encumbrance to local budget arrangement and the expectation on economic development. This, to a great extent, frustrated the enthusiasm of local governments where wind farms are located to support the wind power development. Yet, local governments of these areas in order to benefit from the wind power development, compulsorily required wind power development enterprises to introduce wind turbine or part manufacturing enterprises while developing wind farms locally, which has, on the one hand, formed the local protectionism in wind turbine selection; on the other hand, also created the overheated situation of excessive wind turbine manufacturers, and caused the waste of investment. Therefore, disputes on wind turbine overproduction aroused in the second half of 2009. Besides, the phenomenon of various levies on wind power development enterprises also emerged, which actually increased the burden of wind power development enterprises.

Under the background that China's economic system reform is still under way, and the macro policy environment for development of new energy industry is not stable, sufficient attention shall be attached to the impact of various policy changes on development of the wind power industry, which is in the early stage of development; and flexible measures shall be taken to create sound policy environment for the development of the wind power industry. Therefore, in order to mobilize the enthusiasm of the remote and less developed areas in the three north regions to develop the wind power, and promote the sound and orderly development of China's wind power industry, it is necessary to perfect existing wind power-related fiscal and tax policies under new VAT policy environment, and design and draft reasonable and effective fiscal and tax incentive policies.

4.2 Schemes for perfecting wind power-related fiscal and tax policies

Major impacts of VAT transition on local fiscal revenue and wind power development are as follows: the VAT transition generally will cause certain loss to local fiscal revenue; and within certain period time, local governments cannot relevant tax revenue including VAT, which will make local fiscal revenue become unsteady and uneven, and further influence the enthusiasm of local government to develop wind power or trigger some behavior distortions.

Aiming at the aforesaid problems, the main thinking to perfect the wind

power-related fiscal and tax policies is as follows: to make up the fiscal revenue loss of local government within certain period of time by adjusting the VAT system, adjusting the central and local appropriation relation, drafting financial subsidy or transfer payment, and collecting local wind resource tax, so that ensure the stability of their fiscal revenue, and promote the virtuous circle of local fiscal revenue.

Based on the aforesaid thinking, this paper brings forward the following schemes for perfecting the wind power-related fiscal and tax policies:

Scheme 1: Return the part of VAT attributable to the central finance to local finance

(1) Contents of and analysis on Scheme 1

Main contents of Scheme 1: return the part of VAT in wind power project attributable to the central revenue to local finance, in part or in whole, within certain period of time, which, actually, increases the 25% portion of local finance in VAT of wind power projects to make up the decrease in local fiscal revenue due to the VAT transition within the input tax deduction period.

Since newly invested wind power projects after the VAT transition have no VAT revenue in the preliminary stage of projects, the return of part of VAT attributable to the central revenue will not increase the local fiscal revenue. But since wind power development in different wind farm development areas proceeds by stage, prior to the VAT transition reform, some areas have had some wind power projects or wind power enterprises under operation. As to these wind power projects prior to the VAT transition reform (“old wind power projects”, the same below), their VAT payment is not subject to the impact of the VAT transition, and will actually form and pay certain VAT revenue annually. If the VAT revenue paid by these wind power development enterprises and apportioned to the central revenue to local revenue within certain period of time, it can solve the problem that local newly built wind power projects can receive no tax revenue.

According to relevant statistical data, till the end of 2008, China’s cumulative installed wind power capacity had reached 12,200mw. If the annual average power hour is 2,200 (assuming that they have been sold out totally), and the average on-grid power tariff (tax inclusive) is RMB0.56/kWh⁶, assume the deductible VAT input tax of wind power projects is 0⁷, the annual VAT payable of the wind power projects prior to the VAT transition is RMB1,092 million, among which, RMB819 million belongs to the central revenue.

According to the final account figures of the 2009 central fiscal revenue, the domestic VAT revenue of the central finance is RMB1,391.596 billion⁸. If return the RMB737 million VAT revenue of wind power projects prior to the VAT transition

⁶In accordance with the provisions of the *Circular on Perfecting the Wind Power On-grid Tariff Policies* (NDRC Price [2009] No.1906), the country is divided into four wind resource zones by the wind resource situation and engineering construction conditions, whereupon the benchmark wind power on-grid tariff is determined. The benchmark wind power tariff of the four resource zones is RMB 0.51/ kwh, RMB0.54/ kwh, RMB0.58/ kwh, and RMB0.61/ kwh respectively.

⁷Under the circumstance of no permission of input tax deduction in wind power equipments, wind power projects almost have no fuel and raw materials for input tax deduction during the operation period.

⁸ Final Statement of Central Fiscal Revenue in 2009, website of the Ministry of Finance.

reform to local finance, the VAT revenue reduced from the central finance accounts for 0.05% of domestic VAT revenue, which has minor impact on the central fiscal revenue.

Scheme 2: VAT exemption policy for the sales of wind power equipments

(1) Contents and analysis of Scheme 2

Main contents of Scheme 2: With VAT exemption policy for the sales of wind power equipments, the wind power development enterprises cannot obtain the input tax deduction for wind power equipments, so they will have to pay wind power VAT as the foreign-funded enterprises before VAT transition. This can resolve the problem that the wind power enterprises may not pay VAT during certain period after VAT transition reform.

The implementation of VAT exemption policy for wind power equipments will further have different influence on the wind power equipment manufacturer, wind power development enterprise and local financial revenue.

First, with respect to wind power equipment manufacturer, the implementation of this policy will increase the tax burden.

Scheme 3: VAT prepayment of wind power development enterprises

(1) Contents and analysis of Scheme 3.

Main contents of Scheme 3: during the period of VAT exemption due to VAT transition, wind power development enterprises will prepay certain amount of VAT, which will be offset in the subsequent years. VAT transition results in local financial loss, and another main problem for the influence on local financial revenue is that the payment of VAT income results in income unbalance during the service life of wind power development project. Therefore, prepayment of certain amount of VAT by wind power development enterprises will achieve relative balance of VAT paid by the enterprises during the service life of project, and the income fluctuation of local governments will be reduced.

Specifically speaking, it is possible to consider that the new wind power development enterprises, during certain period of the project implementation (based on the years of VAT exemption for wind power development enterprises), may prepay every year 50% of VAT income for subsequent year when VAT is to be paid, so that the tax payment can be relatively balanced during the service life of wind power project. Assuming the China-funded 50 thousand kW wind power project, VAT will not be paid during the first six years, and from the seventh year, it is required to pay the VAT RMB 4.635 million, accounting for 8.5% of sales revenue (RMB 54.53 million). Therefore, it is possible to specify that the wind power development enterprises shall prepay 4% VAT of the annual sales revenue. After the prepayment period of VAT is over, the prepaid VAT will be offset in subsequent years.

The calculation of urban construction tax and education surcharge is based on VAT amount. Since VAT for the wind power project is prepaid in the initial period, prepayment may not be implemented, but these taxes shall be paid normally according to the VAT amount to be paid in subsequent years.

(2) Advantages and disadvantages of Scheme 3.

Advantages of this Scheme lie in:

First, it can resolve the problem that local government cannot obtain the VAT income during certain period after VAT transition;

Second, it does not need the adjustment of VAT system;

Third, it does not require the adjustment of central and local financial relations;

Fourth, it will increase central and local financial burden.

Disadvantages of this Scheme lie in:

First, it cannot resolve the financial revenue loss of local government after VAT transition. The VAT prepayment system for wind power development enterprise can only make the local government obtain some VAT income, but the tax income loss of local government due to VAT transition reform cannot be made up;

Second, it will increase the burden of wind power development enterprise. VAT prepayment by wind power development enterprise requires the enterprise to take the time value cost of fund due to VAT prepayment on one hand, and occupies the fund of the enterprise on the other hand, and therefore increases the fund burden of wind power development enterprise;

Third, there are certain legal obstacles with respect to tax system because the VAT prepayment in this Scheme is effected in the initial period without tax obligation, which is fundamentally different from the current tax prepayment system. If VAT prepayment system is implemented, there is certain conflict with the tax obligation of taxpayer in VAT, and therefore provisional VAT regulations shall be revised.

Scheme 4: Transfer payment of central and provincial finance

(1) Contents and analysis of Scheme 4.

Main contents of Scheme 4: tax income loss due to VAT transition by central and provincial finance on local government in the wind power development zone may be compensated to certain extent by means of financial subsidy or transfer payment.

Specifically speaking, certain fund can be arranged from the central finance budget (or shared with provincial finance) for transfer payment in the region of wind power development enterprise, to compensate for financial revenue loss of local government.

The relevant system details concerning transfer payment are:

First, with regard to transfer payment region, it is recommended to limit it to “northwest, northeast and north-China regions”. Since there is sufficient financial strength in the economically developed regions, the influence of wind power project due to VAT transition is relatively low compared with that in “northwest, northeast and north-China regions”, and therefore the range for transfer payment shall be directed to “northwest, northeast and north-China regions”, excluding other economically developed regions;

Second, the fund for transfer payment is about RMB one billion. As for the fund size in every region with transfer payment, local financial revenue amount to be compensated for wind power investment per kW may be determined by central finance according to the calculation of relevant wind power development projects, and based on defining the remote and underdeveloped “northwest, northeast and

north-China regions” resulting in local financial revenue loss and large influence due to VAT transition, the fund amount to be compensated is calculated according to the scale of wind power investment in different regions.

Block diagram 1: Estimation on the fund size in transfer payment of
wind power

From the above analysis, it can be known that during the 2010-2015 period, the local financial revenue loss due to new wind power projects is RMB 367 million-2.202 billion every year, and totally RMB 7.707 billion in six years.

According to the wind power development planning in China, during 2010-2015, the new installed capacity “northwest, northeast and north-China regions” accounts for about 82% of total installed capacity in China. Therefore, the total financial revenue reduction in “northwest, northeast and north-China regions” during the 2010-2015 period will be RMB 6.343 billion and annual average compensation of financial revenue loss will be RMB 1.057 billion.

Third, from the fund source of transfer payment, it may be arranged from central financial budget or from central and local financial budget. In 2009, central financial revenue in China was RMB 3.336415 trillion, and the dedicated funds from central finance for energy saving and emission reduction constantly increase, reaching RMB 27.0 billion, 30.0 billion and 50.0 billion in 2008, 2009 and 2010 respectively, therefore the fund for transfer payment may be completely arranged from central financial budget. But to alleviate central financial burden, it is also possible that the central government shares the burden with provincial government for the region of wind power development enterprise, and central government shall take the major part. For the amortization ratio, considering that the burden shall be consistent with the profit, that is, referring to central and local payment percentage of current VAT, it is recommended that central government shall take 75% financial burden and provincial government shall take 25%. Based on this requirement, the central government shall take the compensation about RMB 964 million per year, and provincial finance shall take the compensation of RMB 311 million per year. Specifically for each of “northwest, northeast and north-China regions”, based on the percentage of newly installed capacity of every province in total installed capacity of “northwest, northeast and north-China regions”, the provinces shall take the fund burden within RMB 10 million - 100 million.

Fourth, it is recommended to define the implementation period of dedicated fund as about 6 years. Similarly, considering that new projects basically will have passed the “tax-free period” after six years, they can generate the VAT income, and therefore it is required to choose six years as the implementation period for transfer payment.

(2) Advantages and disadvantages of Scheme 4.

The advantages of this Scheme lie in:

First, it can resolve the problem that local government cannot obtain the VAT income and will suffer income loss during certain period after VAT transition;

Second, it does not need the adjustment of VAT system;

Third, it will increase the burden of wind power development enterprise.

The disadvantages of this Scheme lie in:

First, it will increase the central and local financial burden (to be shared by central and provincial finance);

Second, since there is difference in each of “northwest, northeast and north-China regions” with respect to wind power development, it will be difficult to determine the scale of subsidy or transfer payment for a specific region, and there might be the problem that financial subsidy cannot meet regional demand.

Scheme 5: Collection of wind energy resource development fee or compensation fee

(1) Contents and analysis of Scheme 5.

Main contents of Scheme 5: wind energy resource development fee or compensation fee will be imposed on the wind power development enterprises at certain percentage. Theoretically, wind energy belongs to national resource as mine resource and water resource. According to the rule of paid use of national resources, the wind power enterprises shall pay corresponding expenses for the development and use of wind energy resources. Collecting wind energy compensation fee from the wind power development enterprises and putting income under centralized management of local government may compensate for the reduction of financial revenue of local government.

Block diagram 2: Resource tax in China

Resource tax in China has been levied since 1984, with the objective to adjust the differential income in resource development and promote the reasonable development and use of resources. The current “Provisional regulations of resource tax” requires that resource tax shall be imposed on mineral products including crude oil, natural gas and coal and salts with the quantity-based method. Since the amount of the original resource tax is relatively low, the government raises the resource tax amount on fossil energies such as crude oil, natural and coal, as well as on nonferrous metals. Since 2007, the government has made active preparation for resource tax reform, including expanding the range of taxation, changing the tax calculation from “quantity-based collection” into “quantity-based and price-based collection”, and increasing the tax rate and so on. According to “Regulation on resource tax reform of crude oil and natural gas in Xinjiang” (Finance and Tax [2010] No. 54), resource tax reform was carried out first in Xinjiang. Since June 1, 2010, the resource tax is levied on crude oil and natural gas in Xinjiang with the quantity-based method at the rate of 5%.

Table: Current resource tax item and amount sheet

Tax item		Tax amount
Crude oil		RMB 14-30/ton
Natural gas		RMB 7-15/km ³
Coal		RMB 0.3-5/ton
Crude ore of other nonmetallic ore		RMB 0.5-20/ton or m ³
Crude ore of ferrous metal ore		RMB 2-30/ton
Crude ore of nonferrous metal ore		RMB 0.4-30/ton
Salt	Solid salt	RMB 10-60/ton
	Liquid salt	RMB 2-10/ton

Block diagram 3: Resource charge in China

1. Mineral resource compensation fee

On February 27, 1994, the State Council issued No. 150 decree "Regulation on the collection and management of mineral resource compensation fees", which requires that mineral resource compensation fee shall be paid for the mining of mineral resources in the People's Republic of China and other managed sea areas. Mineral resource compensation fee is levied with the objective to guarantee and promote the prospecting, reasonable development and protection of mineral resources, and maintain the national property interest on mineral resources. The compensation fee is collected on mineral products at the rate of the sales income on the mineral products, and the collection ratio shall be distinguished and set within 0.5-4% according to the categories of mineral products, and the compensation fee shall also be collected by geological and mineral department and finance department in combination with mining recovery ratio of mineral products.

2. Mining area use fee

Mining area use fee is collected on the Chinese and foreign enterprises and the enterprises for onshore oil exploration with Sino-foreign cooperation according to the "Regulations on the payment of mining area use fee for the exploration of marine oil resources" and "Provisional regulations on mining area use fee for onshore oil exploration through Sino-foreign cooperation". Mining area use fee is collected based on calendar year for every oil field and gas field or total production output of natural gas and the mining area use fee ratio, by setting the collection threshold, and the use fee will be imposed on the surplus part at the progressive fee rate. According to current regulation, the enterprises with the mining area use fee in the above two regulations will not pay the resource tax temporarily, and will not pay mineral resource compensation fee.

3. Other fees

In addition to mineral resource compensation fee and mining area use fee, the fees to be paid by mineral resource enterprises also include prospecting right use fee, mining right use fee, mining registration fee and survey registration fee and so on.

With regard to the system design, the compensation fee will be levied according to the power generation capacity on the wind energy resources developed and used by wind power development enterprise. Therefore, compensation fee for wind energy resource development may be collected by year according to the power generation capacity of

wind power enterprises, and a collection standard is set for electricity of every kWh. Similar to the development and use of other resources, the collection period for wind energy resource compensation fee shall be throughout the service life of wind power project. But it is also possible to set a certain years to compensate for local government income, that is, to determine the charging period according to the time that the local government cannot obtain VAT income from the new wind power project.

For the collection criteria of wind energy resource compensation fee, it can be known from the previous analysis that the VAT transition will result in the local financial revenue loss of about RMB 1.8344 million (based on the six-year period) from the China-funded 50 thousand kW wind power projects. While the power production per year of a 50 thousand kW wind power project is 110 million kWh (2,200 hours for power generation per year), then wind energy resource compensation fee of RMB 0.017/kWh is required to compensate for the above financial revenue loss.

(2) Advantages and disadvantages of Scheme 5.

Advantages of this Scheme lie in:

First, it does not require the adjustment of VAT system;

Second, it does not require the adjustment of central and local financial relations;

Third, it can stably make local government obtain the income with certain scale to compensate for the “no tax” situation for wind power enterprises during certain period and financial revenue loss of local government due to VAT transition.

Disadvantages of this Scheme lie in:

First, there is controversy in the theoretical basis for the system. From the background that the collection criteria for resource tax is raised to promote resource saving and effective utilization during recent years, it can be seen that according to the rule of paid use of national resources and the rule of benefiting, the compensation fee is collected for wind energy resources in the wind resource land. But the current mineral resource compensation fee and water resource fee are collected to promote the saving and utilization of these resources with the restriction approaches, while the development and utilization of renewable energy resources, such as wind energy and solar energy, are encouraged by the national government. There is certain difference with respect to the policy orientation for two kinds of resources. Therefore, the theoretical basis for the collection system on wind energy resource is insufficient according to the rule of paid use of national resources.

Second, it might increase the burden of wind power development enterprise and incur certain resistance. Since current policy of categorized power tariff was issued in July, 2009, the expense of this part was not considered when determining the power tariff, and therefore wind energy resource compensation fee is shouldered by the wind power development enterprises if wind power price cannot be adjusted or wind resource compensation fee is included into the renewable energy power price addition;

Third, it might increase the burden on the consumers. If wind energy resource compensation fee is included into the renewable energy power price addition, the consumers will finally take this burden, which will not affect the wind power

development enterprises, but the power tariff rise will incur certain resistance from the society and enterprises.

4.3 Scheme evaluation and recommendation

For the five Schemes in the above design, this article makes the evaluation with the following six standards, (1) whether it can resolve the problem of financial revenue loss and “zero tax” problem for the wind power development projects in the remote and underdeveloped “northwest, northeast and north-China regions”; (2) whether it will increase the burden of wind power development enterprises; (3) whether VAT system adjustment is required; (4) whether the adjustment of central and local financial relations is involved; (5) whether new taxation system is required; (6) whether the wind power equipment manufacturing industry or interested parties will be affected.

Table 5 Evaluation on the Schemes for the improvement of financial and tax policies on wind power

Evaluation criteria	Scheme 1: part of VAT income for central finance from wind power projects is returned to the local finance	Scheme 2: VAT exemption policy for the sales of wind power equipments	Scheme 3: VAT prepayment of wind power development enterprises	Scheme 4: subsidy or transfer payment by central and local finance	Scheme 5: Collection of wind energy resource development fee or compensation fee
(1) resolve the problem of local financial revenue loss and “zero tax” problem	Yes (the compensation extent differ between regions)	Yes	Cannot compensate for the income loss	Yes	Yes
(2) Increase the burden of wind power development enterprise	No increase	No increase	No increase	No increase	Possible increase
(3) Adjust VAT system	Not required	Required	Required	Required	Required
(4) Adjust the relations of central and local finance	Not involved	Not involved	Not involved	Involved	Not involved
(5) Set new collection system	Not required	Not required	Not required	Not required	Required
(6) Influence the wind power equipment manufacturing industry and interested parties	Not involved	Involved	Not involved	Not involved	Possibly involved

From the evaluation results in the above table, it is known that Scheme 1 (Part of VAT income for central finance from wind power projects is returned to the local finance), Scheme 4 (Subsidy or transfer payment by central and local finance) and Scheme 5 (Collection of wind energy resource development fee or compensation fee) are superior to Scheme 2 (VAT exemption policy for the sales of wind power equipments) and Scheme 3 (VAT prepayment of wind power development enterprises).

With regard to difficulty and operability of policy implementation, Scheme 1 (Part of VAT income for central finance from wind power projects is returned to the local finance) and Scheme 4 (Subsidy or transfer payment by central and local finance) have relatively low difficulty for implementation, while Scheme 5 (Collection of wind energy resource development fee or compensation fee) has relatively large difficulty, for which new tax collection system shall be developed. Therefore, the basic conclusion of this article is that in the near period, it is recommended to choose Scheme 1 or Scheme 4, while Scheme 5 may be used as a long-term solution for study and design.

4.4 Implementation Scheme for the policy

Recommended Scheme 1: Raise the local sharing percentage of VAT from wind power projects in “northwest, northeast and north-China regions”

This Scheme is detailed recommendation of Scheme 1: “Part of VAT income for central finance from wind power projects is returned to the local finance”.

(1) Policy purpose

Basic purpose of this Scheme: Mobilize the wind power development in remote and underdeveloped “northwest, northeast and north-China regions”, and promote the healthy and orderly development of wind power industry in China.

(2) Policy contents

Detailed contents of this policy: Raise the local sharing percentage of wind power project VAT from 25% to 100% in “northwest, northeast and north-China regions”.

(3) Scope of application

Scope of application for this policy: “Northwest, northeast and north-China regions” (economically underdeveloped regions) with new wind power projects after VAT transition, including Hebei and Inner Mongolia (north-China); Heilongjiang, Liaoning and Jilin (northeast); Shaanxi, Gansu, Qinghai, Ningxia and Xinjiang (northwest).

(4) Fund size

According to the above scope of application for this policy, it is expected that the fund size of RMB 650 million should be returned to local finance.

(5) Fund source

Fund source: VAT income of central finance from wind power projects.

(6) Policy period

The implementation period for this policy is determined as: 2010-2015 (six years).

Table 6 Recommendations on the implementation of local sharing percentage of VAT from wind power projects in “northwest, northeast and north-China regions”

Policy purpose	To mobilize the wind power development in remote and underdeveloped “northwest, northeast and north-China regions”, and promote the healthy and orderly development of wind power industry in China.
Basic contents	Raise the local sharing percentage of wind power project VAT from 25% to 100% in “northwest, northeast and north-China regions”.
Scope of application	“Northwest, northeast and north-China regions” (economically underdeveloped regions) with new wind power projects after VAT transition, including Hebei and Inner Mongolia (north-China); Heilongjiang, Liaoning and Jilin (northeast); Shaanxi, Gansu, Qinghai, Ningxia and Xinjiang (northwest).
Fund size	The fund size of RMB 650 million is expected to be returned to local finance.
Fund source	VAT income of central finance from wind power projects.
Policy period	2010-2015 (six years).

2: Transfer payment of central finance to “northwest, northeast and north-China regions”

This Scheme is the recommendation for the detailed implementation of Scheme 2 “transfer payment of central and provincial finance”.

(1) Policy purpose

Basic purpose of this Scheme is to mobilize the wind power development in remote and underdeveloped “northwest, northeast and north-China regions”, and promote the healthy and orderly development of wind power industry in China.

(2) Policy details

Detailed contents of the policy: central finance budget is arranged for transfer payment to compensate for local financial revenue loss due to VAT transition on the wind power projects in “northwest, northeast and north-China regions”.

(3) Scope of application

Scope of application of this policy is determined as: The economically underdeveloped regions of “northwest, northeast and north-China regions” with new wind power projects after VAT transition, including Hebei and Inner Mongolia (north-China); Heilongjiang, Liaoning and Jilin (northeast); Shaanxi, Gansu, Qinghai, Ningxia and Xinjiang (northwest).

(4) Fund size

According to the estimation, the fund size for transfer payment is RMB 1 billion per year.

(5) Fund source

Fund source will be arranged from central finance budget.

(6) Policy period

The implementation period for this policy is determined as: 2010-2015 (six

years).

Table 7 “northwest, northeast and north-China regions”

Policy purpose	To mobilize the wind power development in remote and underdeveloped “northwest, northeast and north-China regions”, and promote the healthy and orderly development of wind power industry in China.
Basic contents	Central finance budget is arranged for transfer payment to compensate for local financial revenue loss due to VAT transition on the wind power projects in “northwest, northeast and north-China regions”.
Scope of application	“Northwest, northeast and north-China regions” (economically underdeveloped regions) with new wind power projects after VAT transition, including Hebei and Inner Mongolia (north-China); Heilongjiang, Liaoning and Jilin (northeast); Shaanxi, Gansu, Qinghai, Ningxia and Xinjiang (northwest).
Fund size	RMB 1 billion per year.
Fund source	To be arranged from central finance budget.
Policy period	2010-2015 (six years).