Nomura Institute of
Capital Markets Research

Comments on Dr. Ding Ningning's Paper "China's Fiscal Policy in the Post-Crisis Period"

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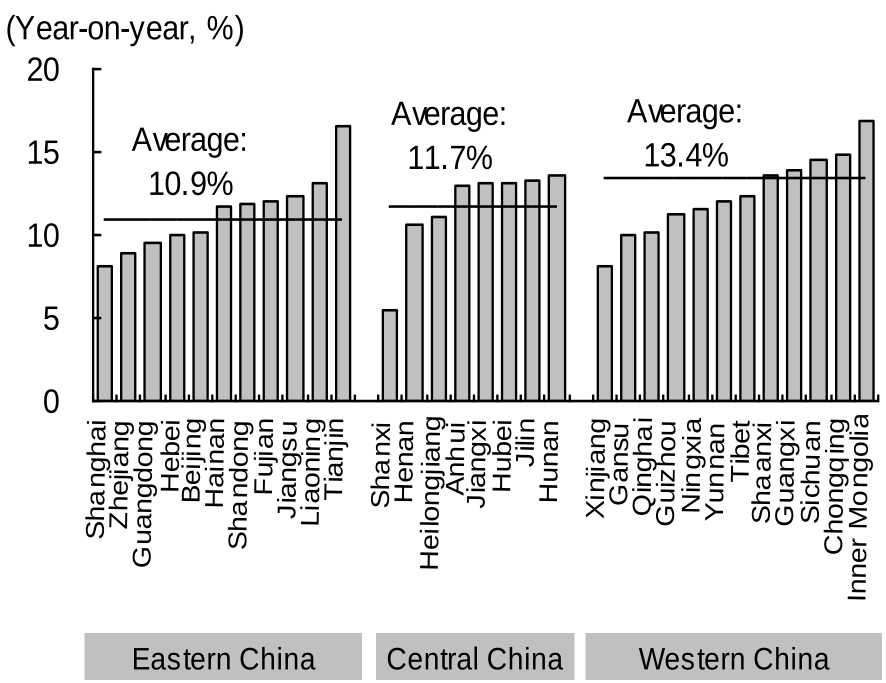
November 16, 2010

Faster Economic Growth in the Inland Areas than in the Coastal Areas

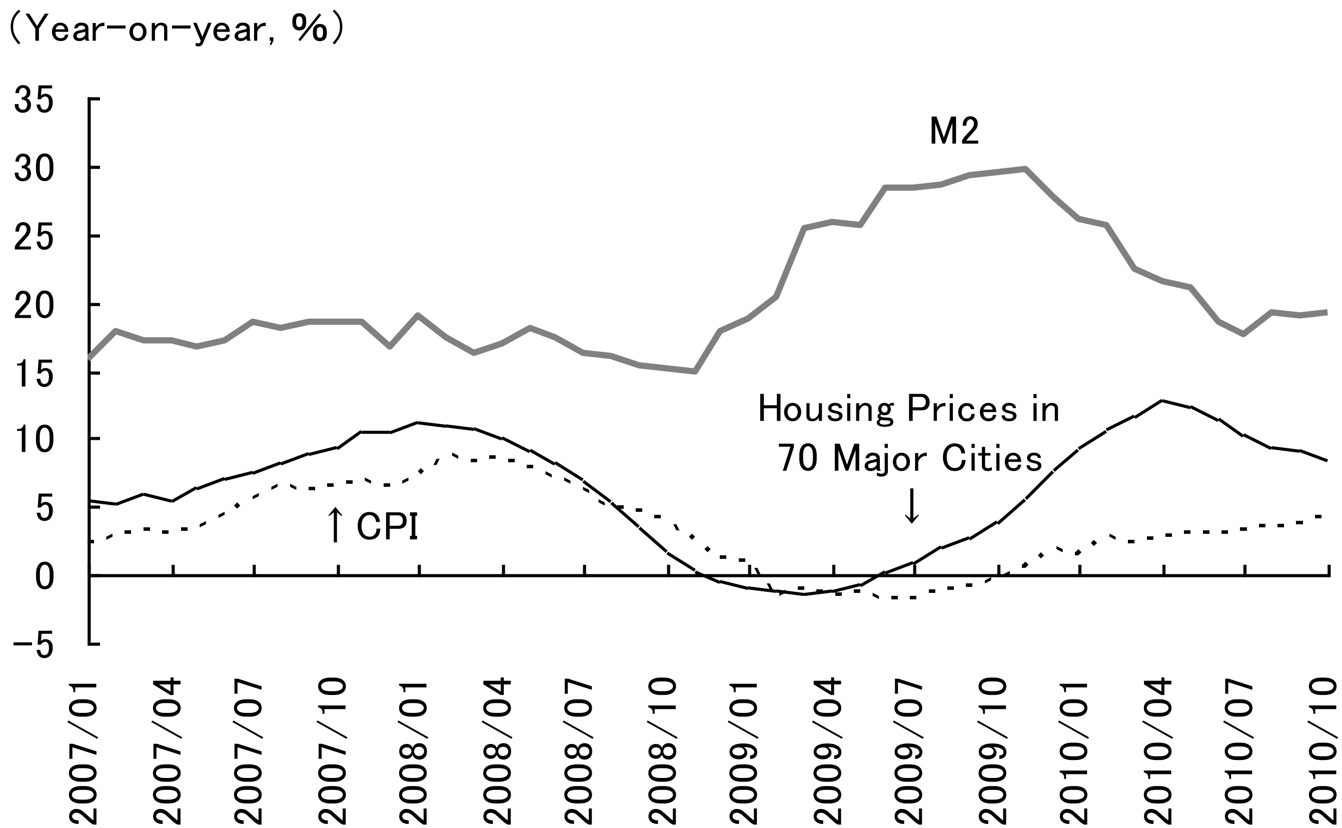
Central and Western China Outpace
Eastern China in Real GDP Growth (2009)



Source: Based on data from the National Bureau of Statistics of China.

- Coastal areas (Eastern China) more adversely affected by the slowdown in the global economy
- Inland areas (Central and Western China) benefit more from the fiscal stimulation program centering on the construction of infrastructure
- Should help reduce regional disparities over the long term, which in turn should boost consumption

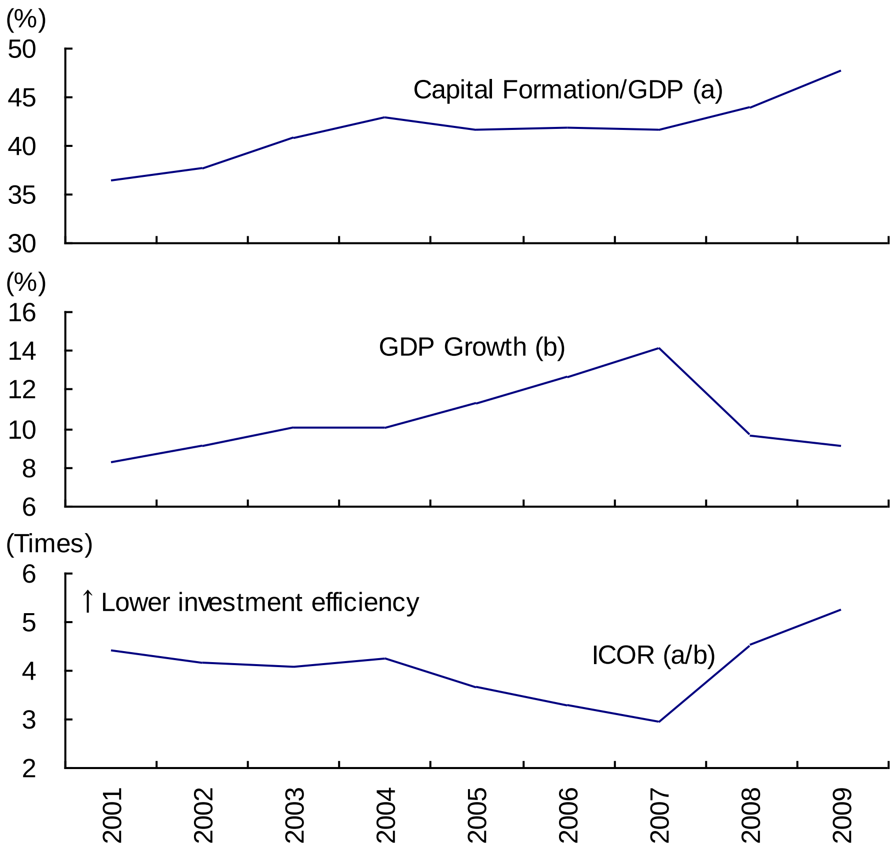
Monetary Easing as the Major Source of Overheating



Source: Based on data from the National Bureau of Statistics of China.

Lower Efficiency of Investment

Rising Investment Pushing up ICOR



Source: Based on *China Statistical Yearbook*.

- Rising capital formation as a percentage of GDP since 2008 has not been matched by faster GDP growth and the incremental capital-output ratio (ICOR) has risen as a result

- State-owned companies (notorious for low efficiency) have received the lion's share of public works projects.

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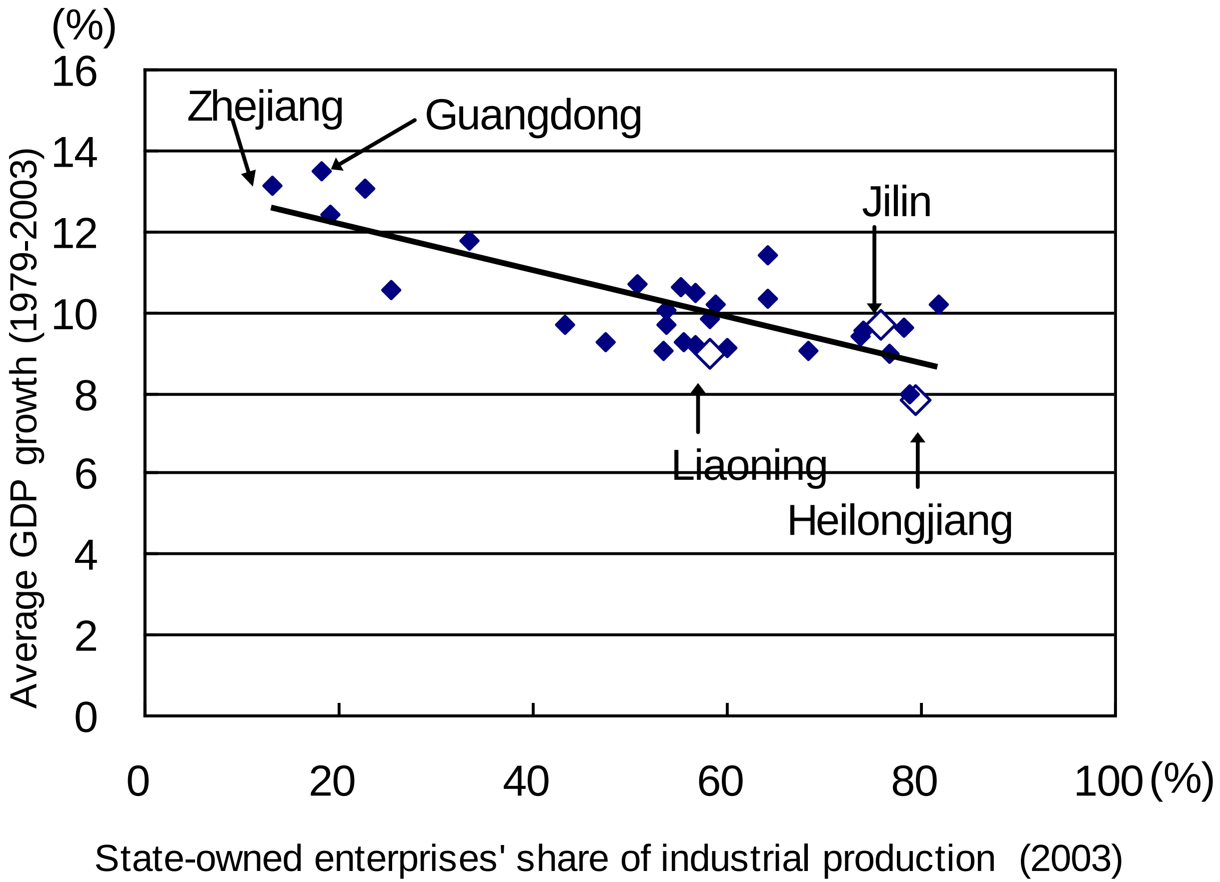
Negative Correlation between Provincial Growth and SOE's Share of Production



Source: Based on *China Statistical Yearbook*.

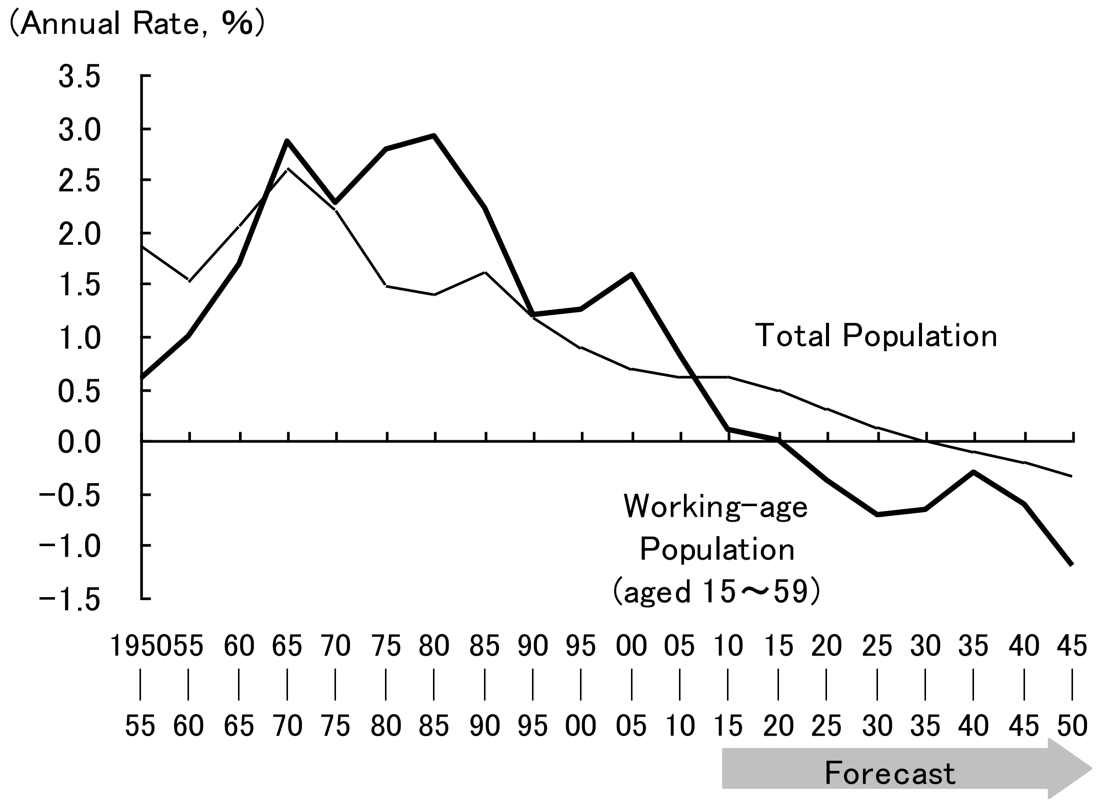
Fiscal Risk Arising from the “Intangible Debts of Local Governments”

- Borrowings by financing platform companies formed by local governments on the rise
- Amounts to nearly 20% of total bank lending
- According to China Banking Regulatory Commission, 23% of these loans have problems with their collateral or their borrowers’ ability to repay.
- Who owes those debts?
- Who bears the obligation to repay if financing platforms themselves fail to do so?
- Will those loans end up as bad debts of the banking sector?
- Will China follow in Japan’s footsteps?

Can China Maintain High Economic Growth?

- Yes, but how high and for how long
- Demographic dividend turning into demographic penalty
  - Population aging fast (slower growth in working-age population and lower savings rate)
  - Excess labor in rural areas fast diminishing
- Sustaining economic growth depends on shifting from extensive growth (based on growth in inputs) to intensive growth (based on productivity growth)
- The pace of privatization should be sped up to enhance productivity growth
- Little progress made in the privatization of large-scale state-owned enterprises
- Advantage of being a latecomer (importing technology at low cost, abundant room for industrial upgrading) to diminish over time
- Achieving harmonious society (involving more income redistribution) will lower economic growth
- Even the optimists should not expect China to grow at the current pace in the years ahead

Growth Rates of Total Population and Working-age Population in China



Note: Average over 5 years.

Source: United Nations, *World Population Prospects: The 2008 Revision*.

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Why Has the Pace of Fiscal Reform been so Slow?

- The agenda for fiscal reform looks no different from that of 10 years ago.
- Who is against fiscal reforms, particularly reforms involving income redistribution (e.g., estate tax, real estate tax, fiscal transfers, social security, and the funding of public housing)?
- Is it the rich, the state-own enterprises, or the Party?
- Will some kind of political reform be needed to speed up the reform process?