

China's Fiscal Policy in the Post-Crisis Period

(paper prepared for Macro Economy Research Conference funded by Nomura Foundation)

Dr. Ding Ning Ning,
Senior Research Fellow
Research Department of Social Development
Development Research Center of the State Council
P. R. China
(DRC)

16 November 2010
Kensington Terrace, Hotel Okura
Tokyo

I. Reasons for the tangible results achieved by China's Expansionary fiscal policy

1. The reasons can be narrowed down to two points:

First, the efforts to expand fiscal input was greater;

Second, the monetary policy gave an active response to fiscal policy.

I. Reasons for the tangible results achieved by China's Expansionary fiscal policy

First, the efforts to expand fiscal input was greater

In China, the investment by central financing is generally used as the key capital, and played an important guiding role of investment.

In the short span of two years and three months, a total sum of 1180 billion Yuan of investment by central treasury for major construction projects had all been granted and scheduled.

I. Reasons for the tangible results achieved by China's Expansionary fiscal policy

Second, the monetary policy gave an active response to fiscal policy.

Chinese banks have sufficient funds reserves, when banks in the world face funding shortage. The reasons are two:

First, during the commercialization process of the state-owned banks in previous years, the government had replenished necessary capital for them;

Second, the saving habits of Chinese people brought sufficient cash flow to the major banks.

I. Reasons for the tangible results achieved by China's Expansionary fiscal policy

2. Compared with the Western countries, China is at different stage of the development.

The government has a much greater room for maneuvering in the areas such as public infrastructure, public service and private consumption.

I. Reasons for the tangible results achieved by China's Expansionary fiscal policy

a. In the area of public infrastructure

(Take as an example investment for railway construction)

In the eastern region of China the population is dense, the large-sized cities are close to each other and residents' income has witnessed a swift increase. These conditions are favorable for the development of high-speed railway and capital recovery.

During the 12th Five-Year Plan period, the projects for the construction of high-speed railway and intercity passenger lines would be launched one after another, the intensity of investment will not only be maintained, and would be enhanced.

I. Reasons for the tangible results achieved by China's Expansionary fiscal policy

b. The area of public service

(Take as example to increase the budget input for agriculture, rural areas and farmers)

At present, rural population accounts for about 60% of the total population in China with per capita income less than 1/3 of urban residents.

After the occurrence of international financial crisis, the Chinese government has made additional allocation of funds in the budget for agriculture, rural areas and farmers.

I. Reasons for the tangible results achieved by China's Expansionary fiscal policy

c. The area of private consumption

(Take as an example the policy of promoting industrial products to the countryside and trading-in old durable consumer goods for new ones)

In order to quickly reverse the sluggish demand of consumer market caused by export decline, the Chinese government has implemented the expansionary fiscal policy in the area of private consumption and got good result.

II. Challenges facing China's fiscal policy in the post-crisis period

1. The uncertainty of world economic performance in the post-crisis period

- After experiencing pains triggered by the financial crisis, people in the world desire for stability and hope the global economy could quickly resume its shape as that before the crisis.
- But people might not be that optimistic if they observe carefully the reasons leading to the financial crisis, the present policies adopted by various developed countries and the actual performance of the world economy.

II. Challenges facing China's fiscal policy in the post-crisis period

a. The developed countries are in a dilemma in dealing with the crisis

If they adopt the expansionary fiscal policy to bolster the fragile economic performance, the governments' debt will expand to the edge of danger; but if they pursue a tight financial policy to reduce the debt level, it would bring harm to the weak economic recovery.

Under such a dilemma, the developed countries have no way out but to prolong the periods for the implementation of the expansionary monetary policy so as to avoid a double dip of the economy, and will inevitably lead to serious inflation.

II. Challenges facing China's fiscal policy in the post-crisis period

b. A gloomy picture for global investment, trade and employment

In October 2010, the report issued by UNCTAD shows that after four quarters of slow recovery, the global FDI dropped again in the second quarter of 2010, looming a gloomy picture.

The WTO report estimated, It would take at least more than two years for the total world trade to resume the level prior to the outbreak of the international financial crisis.

The report by ILO predicts that the unemployment rate for youth in the world would increase to 13.1% in 2010.

II. Challenges facing China's fiscal policy in the post-crisis period

c. Trade protectionism has added uncertainty to the recovery of world economy

The outbreak of the international financial crisis will accelerate the devaluation speed due to the prompt increase of the amount of US dollars issued.

The measures taken by the Chinese government are only to control RMB not to appreciate at a too fast speed.

Under the backdrop of economic globalization, the excessive appreciation of RMB will not only bring harm to China's export businessmen, but also to contractors and investors from developed countries as well as to raw material suppliers beyond China.

II. Challenges facing China's fiscal policy in the post-crisis period

2. China will not witness major changes to its economic growth

In the wake of the Asian financial crisis occurred in the last century, doubts about China's economic growth have prevailed in the world and even Chinese officials from the planning departments are also influenced by these sentiments.

They have claimed more than once that China has entered the phase of "stable" growth, but the actual economic growth always goes beyond the expectations of the planning departments.

II. Challenges facing China's fiscal policy in the post-crisis period

a. Long-term factors affecting China's economic growth

Capital

Saving of residents, Foreign direct investment

Labor (The challenge of the aging society)

Compulsory education promote improvement of the labor quality

Resources (lower than the average level of the world)

Trade ability, foreign exchange reserve

Technological progress

Learning ability

.

II. Challenges facing China's fiscal policy in the post-crisis period

b. Impact of the international financial crisis on China's economy

The direct impact of the international financial crisis on China's banking sector is not that great.

The major impact of international financial crisis on China's economy focused on reduced demand for Chinese export due to the economic recession and shrinking market of the developed countries.

Thanks to the dependence of China's economic growth on foreign resources, China will not retreat from the present stance of trade liberalization.

II. Challenges facing China's fiscal policy in the post-crisis period

c. China is able to maintain high economic growth

In addition to the high deposit rate by Chinese residents and the large size of labor force, the people might have neglected the following facts:

China's technological progress in the course of swift industrialization and urbanization

The improvement of efficiency brought about by the reallocation of labor resources between urban and rural areas

II. Challenges facing China's fiscal policy in the post-crisis period

3. The sustainability of the financial ability of the Chinese government

The sustainability of financial ability is governed by three factors: deficit, debt level and the ability to raise income.

Generally speaking, people in the world have no doubt about China's fiscal deficits, but they are suspicious of China's debt issue.

The estimation made by various international institutions shows that the maximum debt level of the Chinese government is still less than 60% of GDP.

II. Challenges facing China's fiscal policy in the post-crisis period

3. The sustainability of the financial ability of the Chinese government

There is still much room for Chinese government to increase fiscal revenue due to the sound economic growth momentum.

Chinese government has, according to internationally-accepted standard, the ability to further implement the expansionary fiscal policy to boom the economic development.

III. Major concern for China's fiscal policy in the post-crisis period

1. Pushing forward the tax reform continuously

In 2008 when the international financial crisis broke out, China realized the unification of income tax for both the foreign firms and domestic firms.

In 2009, China accomplished the transformation of production-type value-added tax toward consumption-type value-added tax.

In May 2010, a pilot project of resource tax reform, changing from “levied by weight” to “levied by price” , was carried out in Xinjiang.

Chinese government will promote the reform of property tax and personal income tax, to narrow the income gap among residents and increasing government fiscal revenue.

III. Major concern for China's fiscal policy in the post-crisis period

2. Rebuilding the government budget system

Over the past 30 years, with the swift development of economy, the difference related to inter-regional and urban-rural economic development has been quickly enlarged, causing much difficulty to the government in providing equal public service and building a social security system.

From the long-term point of view, only by establishing a three-tiered budget system based on public budget and supplemented by social security budget and state-owned capital budget could we better deal with the various economic contradictions and social issues emerged in the course of industrialization and urbanization in China.

III. Major concern for China's fiscal policy in the post-crisis period

3. Fiscal policy should focus on Restructuring and institutional building

It is difficult to withdraw from the “proactive” fiscal policy to the “prudent” one in a reckless manner.

- a. Emphasis should be laid on Economic restructuring and industrial upgrading.**
- b. To speed up the institutional building in the field of social policies.**

III. Major concern for China's fiscal policy in the post-crisis period

4. Control debts scale, and strengthen risk prevention

In face of the uncertain economic performance in the world, it is necessary for China to look ahead and make advance preparations so as to cope with any incidence that might occur in the future.

Chinese government should keep its debt size within a reasonable and appropriate limit and adopt effective measures to clear up the implicit debt of local governments and various kinds of policy-based financial bonds.

China's Fiscal Policy in the Post-Crisis Period

The end

Thank you for your attention!

Any comments and criticism is welcomed.

16 November 2010

Kensington Terrace, Hotel Okura

Tokyo