Comments on “China’s Fiscal Policy in the Post-Crisis World” by Dr. Ding Ningning

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Overview

- Interesting and useful paper
- Provides description of China’s expansionary fiscal policy
- Highlights challenges facing China’s fiscal policy in the post-crisis world
- Focuses on major concerns for fiscal policy going forward

Post-crisis fiscal policy

- Massive fiscal stimulus launched in November 2008 played a key role in the China’s economic recovery
- Challenge for all countries post-crisis: exit strategy
  - Which policies are phased out? When?
  - Which policies are retained?
  - How do policies affect the medium and long-run budget situation?

Challenges*

- Exports and investment has powered the country and will continue to do so in the future
  - But more sustainable growth in the post-global crisis period is likely to require a more balanced economic structure in which domestic demand and consumption play a bigger role
  - Growth driven primarily by investment can eventually lead to a deterioration in the quality of investments and excess capacity

*Source for comments: Asian Development Bank Briefs, No. 3, August 2010

Rebalancing

- Fiscal policy is a powerful tool for rebalancing
  - Should not be used only to temporarily boost aggregate demand
  - Should be used to promote structural reform which alters household and firm behavior in a way that raises domestic demand and adjusts the output mix toward the domestic market on a sustained basis
  - Shifting composition of public spending from investment to public services would raise the disposable income of households, reduce precautionary savings, and encourage consumption

Rebalancing

- A recent IMF staff study shows that a sustained 1% of GDP increase in China's public spending on health, education and pensions could result in a permanent increase in household consumption of more than 1% of GDP

- Social spending is being increased but public expenditure on education, health, and social security combined amounts to only 6% of GDP compared to 28% in OECD countries

Policy directions for rebalancing

- Financial reform
  - Greater availability of consumer credit
    - Provide boost to private consumption, especially of durable goods
    - Foster consumption by diluting the precautionary savings motive, for example, by increasing the availability of private health and retirement insurance
  - Design specific lending products to target rural consumption needs
    - Facilitate access to financial services and products in rural areas (given weakness of rural consumption)

Tax reform

- Could be a case for reexamining the structure of taxation to boost household income by shifting the tax burden away from labor income, and toward property and capital gains taxes

Policy directions for rebalancing

- Introduce property taxation
  - Could provide a significant source of stable tax revenue for local governments
  - Would mitigate local governments' heavy reliance on land sales for their revenues
  - Should be levied on all property owners based on value of their properties

Policy directions for rebalancing

- Cut back spending on infrastructure to make room for necessary social protection outlays?
  - Probably not since the country has infrastructure needs in the medium term, especially in the interior provinces
  - Thus, strengthening social protection and social safety nets or building low-income housing, is likely to require a moderate easing of the fiscal stance in the medium term
  - But this will increase deficit…

Policy directions for rebalancing

- Transfers to local governments
  - Should be predictable in magnitude or timing
    - If not, constrains the capacity of local governments to provide public services
  - Could transfer a larger share of tax revenues from the center to local areas
    - Increase share of VAT to local governments

Policy directions for rebalancing

- Central government, while maintaining the existing decentralized scheme for the provision of social services, could increase its share in their financing
  - Use redistributive and equalizing mechanisms for central government transfers to support poorer provinces
  - Otherwise, large inter-provincial disparities in social public spending per person would remain, constraining consumption in poorer provinces

Conclusion

- Primary role of fiscal policy should be to foster structural change rather than temporarily stimulate aggregate demand
- China is moving in this direction
  - The structure of public spending is being shifted away from physical infrastructure and toward actions that will improve human capital and also boost consumption