

EC2374

Economy of Modern China

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Topic 4 Government & Macro Management

from direct control to regulation & service

- the economic role of government
- the role of government in China
- dynamics of China's fiscal management
- future challenges

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the economic role of government

- to provide public goods
 - physical infrastructure
 - education
 - social welfare: may include healthcare, unemployment insurance, retirement pensions & public housing
- to minimize economic fluctuation
 - control inflation
 - government spending
 - money supply

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the economic role of government

- to ensure market competition
 - formulate laws such as anti-trust legislation
- to conduct industrial policy
 - establish and maintain control of certain large corporations
 - encourage the development of certain industries
 - encourage technology innovation

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the role of government in China

- under central planning
 - to provide public goods (?)
government played the dominant role
infrastructure, education, welfare
considerable gap between urban & rural areas
 - to minimize economic fluctuation (?)
price control
central planning & material balancing
money demand and supply play no significant role
state banks

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the role of government in China

- under central planning
 - to ensure market competition (?)
market play no significant role in resource allocation
competition for resources, but not through by price/profit
 - to conduct industrial policy (?)
SOEs under direct government administration
Govt investment to develop certain industries
no effective economic policy for technology innovation

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the role of government in China

- during transition

- public goods provision

- overall importance reduced significantly

- growing participation & contribution by non-state parties

- gap between urban & rural remain

- significant improvement in infrastructure

- education: primary education vs. tertiary education

- social welfare, and healthcare, housing

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the role of government in China

- during transition

- to minimize economic fluctuation

- increasing economic fluctuations from various reforms

- more market instruments & less administrative measures

- fiscal management & fiscal policy increasingly used

- monetary policy began to play a role

- effectiveness uncertain

- establish a legal environment

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the role of government in China

- during transition
 - to ensure market competition
 - entry of non-state firms: TVEs & FIEs
 - participate in international trade & WTO
 - create level playing field for all firms
 - laws/regulations prohibit local market protection

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the role of government in China

- during transition
 - to conduct industrial policy
 - maintain control of large SOEs with strategic importance
 - policies for S&T and other innovative activities
 - increase spending on government-funded research institutions
 - direct government investment in certain industries
 - international cooperation

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China's fiscal management

- under central planning
 - very limited role of fiscal policy
 - conservative fiscal policy (& monetary policy)

economy highly centralized

direct allocation of resources to fulfill production plan.

SOEs remit profit to the government & receive investment

there were no personal or business tax

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China's fiscal management

- fiscal reform 1978-1993
 - initial steps: decentralization & incentives
 - 1st, both central & local authorities are made responsible for collecting certain items of revenue & covering certain items of expenditure;
 - 2nd, there were attempts to change from profit delivery to tax payment in 1985;
 - 3rd, the contract systems in enterprises were transplanted & put into practice in 1988.

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China's fiscal management

- fiscal reform 1978-1993

- fiscal contract system, 1988:

- definite revenue quotas: local authorities turned over definite revenue quotas to the central authority

- contracting of increased revenue quotas: local authorities pay an increasing amount of revenues at an average annual rate

- contracting of increased amount of revenue: local authorities raise increasing revenue and share with the central

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China's fiscal management

- fiscal reform 1978-1993

- an evaluation: advantages

- strong incentive for local authorities to promote development

- decentralize decision-making power responsibility

- enable local authorities for economic development

- gain support from local authorities to other reforms

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China's fiscal management

- fiscal reform 1978-1993
 - an evaluation: adverse effects
 - erosion of central government's fiscal capacity
 - local protectionism hinder domestic market integration
 - uneven fiscal burden across regions
 - does not solve the SOE incentive problem
 - central & local authorities share revenues but not losses

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China's fiscal management

- second wave of fiscal reform 1994~present
 - dividing administrative scope & expenditures between the central & local authorities

central: national security, diplomatic & central administration, national economic objectives, regional development coordination, and regulations.

local: local administration & local development

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China's fiscal management

- second wave of fiscal reform 1994~present

- new taxation

central: tariffs; consumption tax; VAT & income tax of centrally administrated enterprises, central bank profits

local: income tax of local businesses and individuals, land-use taxes, urban maintenance and construction taxes; property taxes, and vehicle and vessel use taxes

central-local shared: VAT; resource taxes, and securities exchange taxes

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China's fiscal management

- second wave of fiscal reform 1994~present

- Tax collection

created a new central government taxation authority

under the old system: tax revenues were collected by local tax bureaus. Localities then transferred funds to the central government

under the new system: the central government first collected the bulk of revenues and then shared them with local authorities

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China's fiscal management

- second wave of fiscal reform 1994~present

- an evaluations: advantages

clarify central-local sharing in revenue & financial responsibilities

strengthen the Central's ability in macro-management

maintain strong local incentives for development

standardize & simplify the taxation system

reverse the decline of overall government revenue

earlier decentralization lead to a double decline

the trend have been reversed

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China's fiscal management

- second wave of fiscal reform 1994~present
 - an evaluations: advantages
 - to create a level playing field
 - unify tax rate for firms of different ownerships
 - eliminate contract negotiation between firms & local governments
 - merge industrial & commerce tax into VAT: equal tax burden.
 - centralized administration to eliminate unauthorized local tax relieves
 - to simplify administration process
 - transparent: less negotiation.
 - administration less costly.
 - more emphasis on assessment, collection, and audit

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China's fiscal management

- second wave of fiscal reform 1994~present

- an evaluations: advantages

restructure central-local relation in favor of the central

increase share of central budgetary revenue.

strengthen central government's bargaining power

may reduce the incentive of local government in achieving development goals such as investing in education and infrastructure

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China's fiscal management

- second wave of fiscal reform 1994~present

- an evaluations: advantages

reduce the amount of extra-budgetary-fund

decentralized management, by different agencies

earmarked for specific uses

was important element of government financing

amount to $\frac{3}{4}$ of budgetary revenue between 82-99

overall importance dropped significantly in 1993

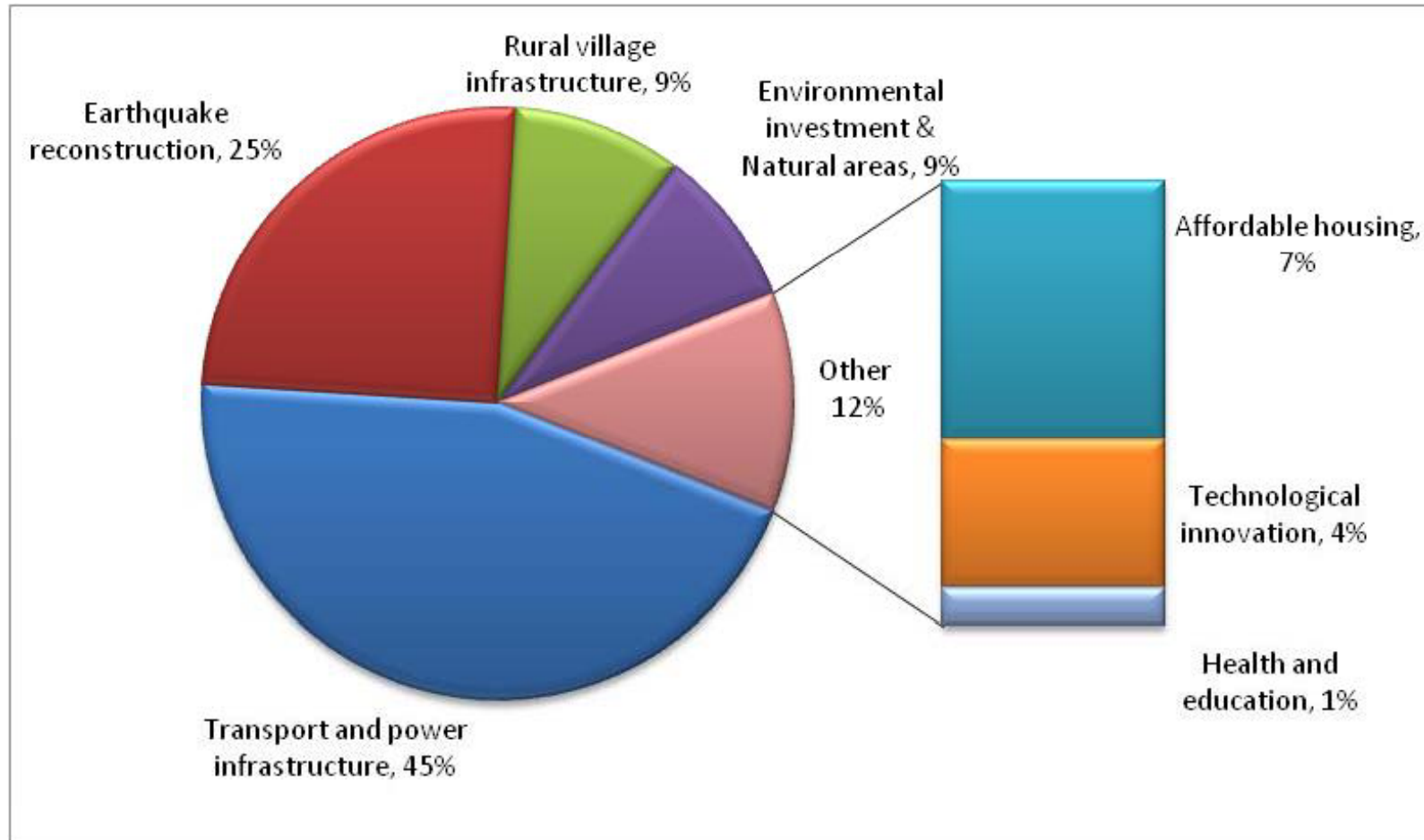
remain important for local authorities

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China's fiscal management

- remaining issues & challenges
 - increasing future spending demand
 - restoration the debt-ridden state banks
 - welfare payments to pensioners & the unemployed
 - payment to foreign debt
 - large stimulus package
 - Need to maintain a relatively low level of budgetary deficit
 - need to find ways to increase budgetary revenue
 - large SOEs
 - further reform in tax system

COMPOSITION OF RMB 4 TRILLION STIMULUS PACKAGE (MARCH 2009)



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China's fiscal management

- remaining issues & challenges
 - elements of the old system remain:
 - gradual change from old to new system
 - the central benefit only from the increase in revenue
 - certain tax exemptions remain

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China's fiscal management

- remaining issues & challenges
 - outstanding issues:
 - mismatch between local and central: rules & responsibilities.
 - growing fiscal disparity
 - no effective inter-government transfer system
 - EBF remain an important method for local governments
 - local government borrowing & “land-financing”

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China's fiscal management

- remaining issues & challenges
 - the party vs. the government in policy-making
 - central vs. local governments in economic management
 - control of resources vs. fiscal responsibility
 - direct administrative measures vs. indirect regulations in policy implementation