Chapter 4
Policy Implications and Suggestions

Based on the results from policy simulations, this report makes two policy suggestions as follows:

1. Reduce the growth rate of the government fiscal revenue moderately;
2. Transfer the decreased part of the government fiscal revenue to all residents or to the low-income residents in the urban and rural areas. This policy of income redistribution not only could improve income distribution between the sectors of government and residents, but also could narrow the income gap among residents.

Simulations of these policy hypotheses indicate that they could not only promote economic growth and narrow the income gap among residents but also increase the resident consumption and lower the share of investment in GDP. What's more, they could reduce exports and expand imports, stimulate domestic demand and narrow trade surplus. In one word, these policies of income redistribution have desirable effects on the Chinese economy.

However, though the conclusions are based on the policy simulations, it is reasonable to conclude that it is necessary as well as feasible to carry out the above policy at present conditions.

So far, we have made a policy suggestion on increasing the resident income of low and lower-middle income cohorts and on narrowing the income gap among residents. We are confident that such a policy would be supported by the majority of the Chinese people, since the resident income gap is already very large and the Gini coefficient had reached 0.474 in 2012 according to the National Bureau of Statistics.

There are some issues open to further discussion: (1) Is the growth rate of the government fiscal revenue too high in China? (2) Does the share of the Chinese government revenue in GDP grow too fast that it is necessary to slow it down?

Our research team holds such positions:

1. To appropriately slow the growth rate of the government fiscal revenue, and to curb the share of government revenue in GDP is the key measure to deepen the reform of economic system, maintain a balance between the government and

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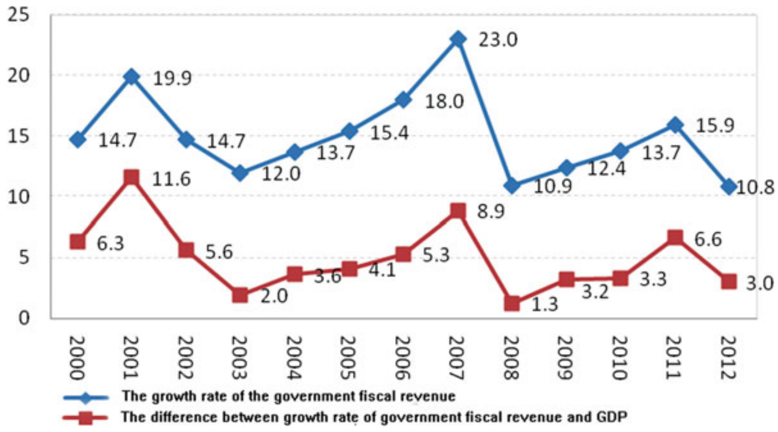

Fig. 4.1 The growth rate of the government fiscal revenue in real term in China, 2000–2012 (Source: CEIC Data)

market, and promote the transformation of economic development. Obviously, the growth of government fiscal revenue and the share of government revenue in GDP are closely related. Only under the condition that the share of government revenue in GDP is too large compared with a normal level, it is necessary to reduce the actual growth rate of government fiscal revenue in order to make it consistent with economic growth.

Since 2000, the growth rate of the government fiscal revenue in China has continued to go up faster than economic growth. Meanwhile, the financial base increase substantially, and the revenue of the government budget increased to 11.72 trillion Yuan in 2012 from 1.34 trillion Yuan in 2000, an increase of 8.75 times with an average annual nominal growth rate reaching up to 19.8 % which was about 9.8 percentage points much higher than the growth rate of GDP over the same period. After inflation adjustment, the growth rate of the government fiscal revenue in real term in China is approximately 15.0 % on average in the period 2000–2012, which is about 5 percentage points higher than the growth rate of GDP over the same period (Fig. 4.1).

As the government fiscal revenue has been growing over-rapidly for many years, the share of government fiscal revenue in GDP has been growing rapidly, too. This share increased to 22.6 % in 2012 from 13.5 % in 2000, an increase of 0.75 percentage points on average per year.

It is worth noting that the government fiscal revenue is only a part of the Chinese government financial resource. According to some estimates,[1] even after exclude the profits of state-owned enterprises (SOEs), the total disposable income of the Chinese government was far more than its fiscal revenue, more than 30 % of GDP

[1] Junyuan Zhang and Wenpu Li, "A Preliminary estimate of the proportion of government revenue and expenditure structure in GDP," working paper in CMR, 2012.

in 2008 and 35 % of GDP in 2010, and it keep increasing.[2] Specially, in 2010, the proportion was 40.5 % (Table 4.1). Therefore, the main cause of the imbalance in the national economy and income distribution is that the government revenue grew too fast, which also undermined the improvement of resident income as well as their consumption. In addition, because the evaluation system of local government's achievement stress on the GDP growth too much, the local governments have the incentive to promote economic growth by investment, which are the fundamental obstacles for the structural improvement of the aggregate demand. Especially, such incentives would hinder the goal of promoting domestic demand or the final consumption. For a decade, especially since 2007, the share of tax burden in GDP has continued to rise whenever the share of tax burden in GDP in the major developed countries and major developing countries has been declining in some extent (Table 4.2).

In addition, in the above policy simulation, we only focused on the adjustment of the government revenue, did not take the government expenditure into account. If the Chinese government could further optimize its fiscal expenditure on the basis of adjustment of its revenue, such as cutting the administrative costs and making more transfer payment for the social welfare especially for the rural residents, the economic structure would be improved significantly. Specially, in 2007, transfer payments from the U.S. government accounted for 40 % of GDP, and that was 60 % of GDP in Japan, which were 2.14 times and 3.27 times as much as in China respectively; And the proportion of redistribution expenditure in GDP in the United States and Japan was 12.4 and 20.7 % respectively, 3.1 and 5.2 times as much as in China respectively over the same period.[3] Both the share of transfer payment in total government spending and the proportion of the redistribution in GDP in the developed countries, such as the United States or Japan, etc., were much higher than in China.

The fact that too much government revenue were used for government dominated investment projects would inevitably lead to an excessive size of the government, interfere with the market economy and finally undermine the fundamental transformation of the pattern of the economic development. In the case of too much government consumption, it would lead to waste and corruption, and make resource allocation inefficient. Therefore, if the central and local governments could strictly

[2] Although the transfer of profits of SOEs to the public finance is rather low, and the retained profits by SOEs do not account for part of the public finance, the owner equity of SOEs should be owned by the government, just a deputy of the people as in law the equity of SOEs belong to all the people after excluding the welfare expenditure in the inner of SOEs according to the regulations. Therefore, all the profits of SOEs (excluding with the cost of employees) should belong to the whole society even these profits are the results of market competition with the other kinds of enterprises. Besides, some research pointed out that the current profits of SOEs contained much rents which should be levied by the government, and the average profits of SOEs were negative once excluding such rents from them. In other words, the current profits of SOEs were an abnormal transfer of state resource. Clearly, according to the actual source of the profits of SOEs, their profits were rather the resource revenue which belong to all the people.

[3] Pan Xie, International Comparison of the Distribution of National Income, working paper in CMR, 2011.

Table 4.1 The total disposable income of the Chinese government from 2008 to 2010 (100 million Yuan)

		Total government revenue								
Year	GDP	Public finance income	Extra-budgetary revenues	General fund revenue	Income of state-owned capital management budget	Social contribution fund	Total	The share in GDP	The profit of SOEs	The share in GDP with the profit of SOEs
2007	265,810	51321.8	6820.3	10,737	140	8,729	77748.1	29.2	16,200	35.3
2008	314,045	61330.4	6617.3	14,985	444	10,805	94181.7	30.0	13335.2	34.2
2009	340,903	68518.3	6414.7	18,351	989	12,780	107,053	31.4	15606.8	36.0
2010	401,513	83101.5	5794.4	36,785	–	17,071	142751.9	35.6	19870.6	40.5

Source: CEIC and "Finance Year Book of China"

Table 4.2 The share of tax revenue in GDP in major countries (%)

Year	The United States	Germany	France	The United Kingdom	Japan	China	Brazil	India
2001	34.3	45.0	50.0	37.8	30.3	15.1	33.9	17.1
2002	31.8	44.6	49.6	36.4	28.9	15.9	35.1	17.6
2003	31.2	44.8	49.3	35.9	28.4	16.2	34.0	18.2
2004	31.5	43.6	49.6	36.4	27.9	16.6	33.3	18.9
2005	33.0	43.8	50.6	36.9	29.3	17.2	34.4	19.1
2006	33.8	43.9	50.6	37.7	30.8	18.2	34.6	20.2
2007	33.9	43.7	49.8	37.3	31.2	19.8	34.3	21.8
2008	32.5	44.0	49.9	37.9	31.6	19.7	34.9	20.1
2009	30.9	44.9	49.2	36.6	29.6	20.2	33.9	19.2
2010	31.7	43.6	49.5	36.4	29.6	21.3	35.4	18.7

Source: CEIC Data (calculation according to the definition of the World Bank)

adhere to the principles made by the Political Bureau of the General Committee of the Communist Party of China, such as more cuts on unnecessary public consumption and the welfare of the government officers, it would even achieve the results of the policy simulation by reducing the government fiscal expenditure.

2. The government should pay more attention to adjusting the ratio of national income between the sectors of government and residents in order to increase the resident consumption.

The important content of the ongoing reform of tax system in China is to change the current tax system that is biased to indirect taxes and increase the proportion of direct taxes, in order to narrow the income gap among residents and to expand the resident consumption. The sum of the four major taxes in China, which are the value-added tax, consumption tax, business tax and tariff tax, amounted to about 4.74 trillion Yuan in 2011, accounting for 52.9 % of the total tax revenue of the Chinese government. Including the value-added tax and consumption tax on imported merchandises, the indirect tax in China was about 6.10 trillion Yuan in 2011, accounting for 68.0 % of the total tax revenue. Meanwhile the total value of corporate tax, resident income tax and property tax was about 2.39 trillion Yuan, accounting for 26.7 % of total the tax revenue. Specially, the property tax took only a proportion of 1.23 % of the total tax revenue. This structure of tax revenue was different from the one in developed countries. For example, in 2011 the total government fiscal revenue of the federal, state and local budget in the United States was 3.63 trillion dollars, almost 75 % of which was from the direct tax payment of individuals while the indirect tax such as consumption tax accounted for only about 5 %. As the indirect tax was mainly based on the production and circulation process, whose price pressure could easily be transferred to consumers, it could result in the problems that the tax burden is mainly or completely born by the final consumers whose tax burden has been already too heavy. Therefore, in general, the higher of the proportion of the indirect tax in total, which means a lower share of the direct tax, the less conducive for the government to narrow the income gap among the residents and improve their consumption.

However, there are two options to increase the proportion of direct tax. One is to adjust the tax structure by increasing the proportion of direct tax, while the indirect tax may increase, and may increase the tax burden of residents. The other one is to alleviate the tax burden of residents directly. These two options would lead to different effects on resident consumption. By analyzing the effects of these two options, it has been proved that the second option would have much greater positive effect on resident consumption. Therefore, the effect of the tax structure adjustments plays a less proactive role on boosting resident consumption. To increase the ratio of direct tax by mean of increasing the tax burden of residents, could hardly produce sufficient positive effects to compensate the negative effects owing to the rise of tax burden on the resident consumption.[4] As a result, under the condition that the proportion of government fiscal revenue in GDP, especially the total tax burden does not drop, the adjustment of tax structure would by no means effectively promote the resident consumption.

In conclusion, although the Chinese government has been implementing the structural adjustment of the tax system, the government should also reduce the tax burden on the residents gradually, in order to improve the income distribution between the government and the residents, and to expand resident consumption.

[4] Yanwu Wang, and Xi, Tian, Effect of Tax Burden and Structure on Consumption: Chinese Experience, working paper of CMR, 2012.