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China's Macroeconomic Outlook

Quarterly Forecast and Analysis Report, March 2015

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Preface

This report is a partial result of the "China Quarterly Macroeconomic Model (CQMM)," a project of the Center for Macroeconomic Research (CMR) at Xiamen University. The CMR is one of the Key Research Institutes of Humanities and Social Sciences of the Ministry of Education of China. The research is funded by the Key Project of the National Social Science Fund of China (13&ZD029), the Key Projects of Philosophy and Social Sciences Research of the Ministry of Education of China (Grant No. 14JZD011), the Major Project for Humanities and Social Sciences Key Research Institutes of the Ministry of Education of China (14JJD790007, 13JJD790026, 13JJD790025), the Youth Project of the National Social Science Foundation of China (13CJL017, 11CJY073), and the Postdoctoral Science Foundation of China (2014 M560526).

Since the launch of CQMM 9 years ago, 17 forecast reports with policy simulations and 9 essay collection books on China's macroeconomic analysis have been published. This is the 18th forecast report, which is a summary of forecast results released at the "China Macroeconomic Advanced Forum (Spring 2015), CQMM Press Conference for Economic Projections for 2015–2016." The forum was jointly organized by the Center for Macroeconomic Research, Xiamen University, and the Economic Information Daily, Xinhua News Agency, in Beijing on March 1, 2015.

Xiamen, China

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Chapter 1
Introduction

The real growth rate of China's gross domestic product (GDP) was 7.4 % in 2014, 0.3 percentage points lower than that of the previous year, the lowest growth rate since 2000. The corresponding consumer price index (CPI) rose by 2 %, but the producer price index (PPI) fell by 1.9 %. Moreover, the investment growth rate fell sharply, leading to the decline in GDP growth.

Although the investment growth rate fell sharply, the growth rate of the private fixed investment was higher than that of the total social fixed asset investment, and investment in the tertiary industry has been gradually expanding. The growth rate of the annual profit of the equipment and high-tech manufacturing industry was strong, and the pace of industrial transformation and upgrading improved. The economy gestates new development space in difficult times. In 2015, we expect investment demand in the modern manufacturing and tertiary industry, except for real estate, to expand further. Therefore, the monetary policy for 2015 should guarantee new credit resources to further meet the needs of emerging industrial expansion and private investment. The government should reform the financial sector and solve the long-standing problem of financing the private investment, which is difficult and expensive. At the same time, fiscal policy should focus on reducing the tax burden on enterprises and ensure the steady growth of private investment. Crucially, government management should reduce administration and decentralize further; carry out negative list management, reducing the burden on enterprises and entrepreneurs; and reduce all kinds of investment and business costs. By comprehensively deepening reforms, adjusting policies, and improving government management, China's economic growth potential could be motivated.

Looking forward to 2015, the US economy will maintain steady recovery, and its growth rate will reach 3.6 %. Following the political upheaval in Greece, the political uncertainty in the eurozone could expand further. Although it has launched a new round of quantitative easing, its economic recovery would be "fragile and unbalanced," with the growth rate likely to be as low as 1.0 %. The euro is expected to maintain its weakening trend in 2015; China's RMB is also expected to face

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modest weakening. Considering the downward pressure faced by the Chinese economy as well as the continuing decline in prices in 2015, the Central Bank of China is expected to cut its interest rate by 25 basis points in the first quarter of 2015 and the annual M2 growth rate is expected to rebound to 12.5 %.

The China Quarterly Macroeconomic Model (CQMM) uses the aforementioned assumptions on exogenous variables and predicts that in 2015, the economy would continue to face downward pressure, although its growth rate would exceed 7.0 % and annual GDP would grow to 7.14 %. China's inflation rate continues to fall, and its CPI will rise by 1.74 %, 0.26 percentage points lower than that in 2014; its PPI is expected to be −2.15 %. As regards imports and exports, China's total exports in USD at current prices will grow by 8.02 %, 1.94 percentage points higher than that of 2014. The growth rate of total imports will rise to 7.57 %, a significant increase by 7 % over total imports of 2014. Influenced by a weaker real estate market and undigested excess production capacity in the manufacturing sector, the growth rate of urban fixed asset investment in 2015 is expected to fall to 10.65 %, 4.57 percentage points lower than that in 2014. The total retail sales of social consumer goods will grow by 11.80 %, 0.32 percentage points lower compared with the previous year.

In 2015, China will complete its 12th five-year plan, and so it is the key year to comprehensively deepen reforms and promote the rule of law and the year in which China's economy will enter a new stage of development under the new normal. Maintaining the economic growth rate at over 7 % and a stable employment situation would help the Chinese government achieve the plan's targets and create favorable conditions to speed up the implementation of its comprehensively deepening reforms.

China's fiscal revenue increased by only 8.6 % in 2014; this was the lowest growth in 23 years. However, from the point of tax revenue structure, the growth rate of indirect taxes, mainly comprising turnover taxes such as value-added tax, business tax, consumption tax, and tariff, showed a reducing trend, whereas, thanks to the people's increasing income, increasing automobile sales, and the expansion and high growth of the state-controlled land transfer tax and property tax base, the growth rate of direct taxes maintained a rapid growth. Furthermore, the ratio of direct taxes to indirect taxes in the tax revenue increased considerably, rising from 0.48 in 2010 to 0.59 in 2014.

"The Decision on Major Issues Concerning Comprehensively Deepening Reforms" (henceforth, the "Decision") points out that gradually raising the proportion of direct taxes is an important part of deepening the tax system reforms and improving the tax institution. The current fall in indirect taxes is mainly due to the decline in economic growth, fall in investment, and reduction in production capacity. Meanwhile, the marginal tax effect of individual production or consumption activities does not change. In other words, the fall in indirect taxes is due to the narrowing tax base and not the declining marginal tax rate, and it is transient, a temporary adjustment that would change along with the growth rate of the economy. The increasing weight of direct taxes due to the difference

between the growth rates of direct and indirect taxes is not the same as that caused by institutional tax adjustments.

For a long time, China's tax structure has been based more on indirect taxes because it enables the tax burden to be easily transferred from producers to consumers. Actually, this causes consumers to bear most of the tax burden, reducing their disposable income and thereby inhibiting the growth of consumption. In addition, indirect taxes are unfair over extended time periods. Levying more categories of taxes, which is directly related to personal income level, benefits the income distribution adjustment between enterprises and residents, narrows down the income gap, and promotes residents' consumption.

Reducing the proportion of indirect taxes while raising that of direct taxes could bring down indirect taxes in the short run. However, in the long run, it can help achieve economic transformation and upgrading, promote enterprise investment, boost economic growth, drive the sustainable growth of tax revenue, and avoid the risk that the growth rate of tax maintains a decrease caused by passive adjustments. At the same time, under the current price system based on taxes, as designed in China, reducing the marginal rate of indirect taxes will drive prices down, raise the residents' real purchasing power, promote consumption, fuel economic growth, and improve the demand structure.

Finally, a comparison with other countries or regions in the world shows that the proportion of direct taxes in China is now low—it is lower than that of not only the developed and high-income countries but also the same-income (above-average countries), middle-income, and low-income countries. Thus, there is more room for increasing direct taxes in China.

From the above analysis and using the CQMM, our research group simulates the macroeconomic effect of improving the proportion of direct and indirect taxation to the world's average level (0.63:1) for the period 2012–2014. The policy simulation is designed as follows: The first scenario requires the government to maintain the tax amount, reduce indirect taxes, and increase direct taxes simultaneously and finally to adjust the proportion of direct and indirect taxes to a new scale. Under the second scenario, the government should reduce the indirect taxes, keeping the direct taxes unchanged, and adjust the direct and indirect taxes to a new scale under the falling total tax situation. In this scenario, the simulation includes both the tax structure adjustment and macroeconomic effect of cutting the total tax. Simulation results show that the tax structure adjustment, especially that of reducing the proportion of indirect taxes while reducing the total tax burden on the national economy, strongly promotes investment, expands consumption, and improves the economy's growth rate.

We believe that at this stage, moderately reducing indirect tax and then the total tax burden on the national economy is not only feasible but also necessary. This can even be considered one of the important ideas to motivate China's economic growth potential in the next stage.

From the above analysis, the research team makes the following policy suggestions:

1. In 2015, an important option in financial system reform is to cut the total tax burden. The government should actively reduce the total tax burden on the national economy by adjusting the marginal tax rates and cutting indirect taxes. Although progress in this direction is visible in fiscal and taxation reforms over the past few years, the ratio of fiscal revenue or that of the general government revenue to GDP remains at a high level, and the ratio of nontax revenue even reveals a contrarian rise. During the transformation of this development stage, macroeconomic decision-making authorities should consider the overall situation in which the market plays a decisive role in the allocation of resources, fully consider the reasonable proportion of fiscal revenue and the general government revenue in GDP, and make a determined effort and smooth away any obstacle. Institutional across-the-board tax cuts can be expected to benefit people, reduce the burden on enterprises, motivate social economic activity, and promote market entities to innovate independently and thereby improve the efficiency of resource utilization, reengineer economic growth potential, stabilize investment, and boost consumption.
2. The government should speed up the policy of replacing business tax with value-added tax (VAT). It should extend VAT to construction, real estate, finance and insurance, living service industries, and other fields. The tax rate should be simplified, providing reasonable standards to the average taxpayer and a suitable tax environment for the development of the service economy. The government should sharply reduce the VAT rates in line with the above analysis, perfect the consumption tax system, and adjust the scope of consumption tax, thereby transferring the consumption tax from production or the import link to retail or the wholesale link and from the taxes included in the calculated prices to taxes not included in the calculated prices. The authorities should break up the original distribution pattern by which consumption tax is fully owned by the central government and reserve a part of consumption tax to supply the local financial resources. At the same time, they should reform the existing real estate tax, build a real estate tax system with link tax, promote the reform of personal income tax, pay close attention to construct a personal income tax system combining comprehensiveness and classification, and enable the timely levy of inheritance tax. The government should promote the reform of resource taxes and add water and other natural resources to the scope of resource tax step by step, combining characteristics of the related resources and the nature of resource tax.
3. The government should improve the structure of fiscal expenditure, compress all administrative expenses, and increase the service efficiency of government funds. It should further cut competitive industrial spending and strengthen its support in the field of basic public services that simultaneously has a strong demand for but seriously lacks investment. At the same time, the authorities should strive to maintain an open, just, and fair market order and release entrepreneurship, innovation potential, and vitality of the market entity.
4. The government should promote the administrative power and responsibility list system and strengthen power supervision. Setting up a power list system is not simply combining administrative power but accurately defining the boundary

of power and then solving the decentralization problem between the government, market, society, and the government hierarchy or departments. According to this, the government should reengineer the organization system and business process and enhance the level of governance. Thus, it should also develop the responsibility list and perfect investigation of the responsibility of illegal administration. Specific to offside, absence, and dislocation behaviors during the execution of power, the executants of power should finally be held accountable for their actions. At the same time, the government should continue to improve and revise the market access negative list, carry out enterprise-independent investment decision making, reduce the examination and approval in advance, strengthen supervision during and after processes, and perfect the market regulation system.

Promoting the reform of fiscal and taxation systems and optimizing the tax structure are not meant to cut tax for the sake of tax cuts but to encourage production and consumption and meanwhile go Dutch and avoid crossing subsidies on resource usage and consumption. At the same time, the government should improve the local tax system and make property behavior items such as the real estate tax, consumption tax, resource tax, and deed tax important local tax sources. It should motivate financial power and the responsibilities to match each other and achieve the organic unification of market effects and government in the allocation of resources and thereby strengthen the growth potential. From international experience, for a better and more efficient allocation of resources and a more conducive way to improve the quality of life, common people should participate in public management and supervise government behaviors; this is a more conducive way to cultivate local autonomy, autonomous management, and civil consciousness.

Chapter 2
A Review of China's Economy in 2014

2.1 Economic Growth Continued to Fall, but the Proportion of the Tertiary Industry Continued to Improve

In 2014, China's real GDP grew by 7.4 %, a decrease of 0.3 percentage points from the previous year and the lowest since 2000 (Fig. 2.1). *The main reason for this economic slowdown was the continued deceleration of the secondary industry*. The industrial growth rate was 8.3 %, a decrease of 1.4 percentage points from the previous year. The main factors behind the continued slowdown of the secondary industry were excess production capacity and excessive investment in the real estate industry. Because of the long-term accumulation of excess capacity, adjusting the industrial structure and de-stocking the real estate industry took some time, and in 2015, these two industries are still expected to exert a downward pressure on economic growth.

In 2014, the nominal investment in fixed assets (excluding farmers' investment) grew by 15.7 %, a decrease of 3.9 percentage points from the previous year. The contribution of annual capital formation to GDP growth reduced to 38.3 %, a decrease of 16.1 percentage points from the previous year (Fig. 2.2).[1] *The continued economic slowdown is bound to hinder urban and rural residents' income growth*. In 2014, the per capita disposable income of urban residents grew by 6.8 %, a decrease of 0.2 percentage points from the previous year; the per capita net income of rural residents grew by 9.2 %, a decrease of 0.1 percentage points from the previous year. The residents' consumption structure gradually changed with their increasing income level, showing a fall in material consumption growth but a rise in

[1] The statistical bureau has not yet announced this data. However, based on a routine conference of the Commerce Department on January 21, 2015, Shen Danyang, the press spokesperson, said that in 2014, the contribution of foreign trade to economic growth was about 10.5 %. On this basis, we estimated that the rate of contribution of gross capital formation on economic growth sharply declined to 38.3 %, the lowest recorded since 2000. See http://finance.ifeng.com/a/20150122/13449424_0.shtml

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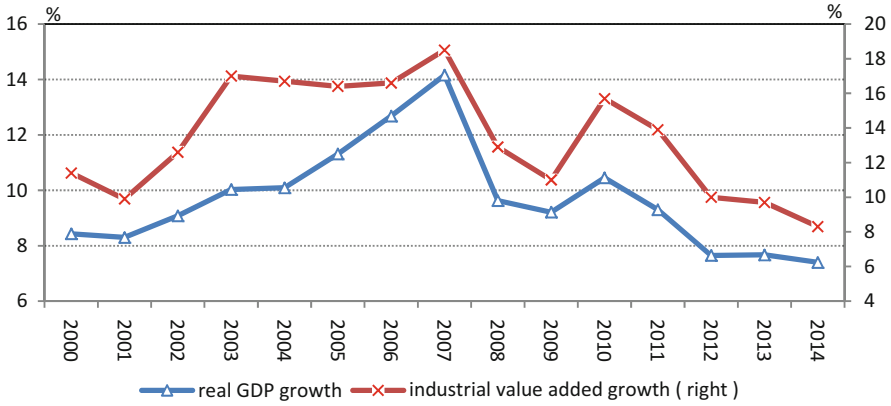

Fig. 2.1 Growth rate changes in China's GDP and industrial added value (Data source: CEIC)

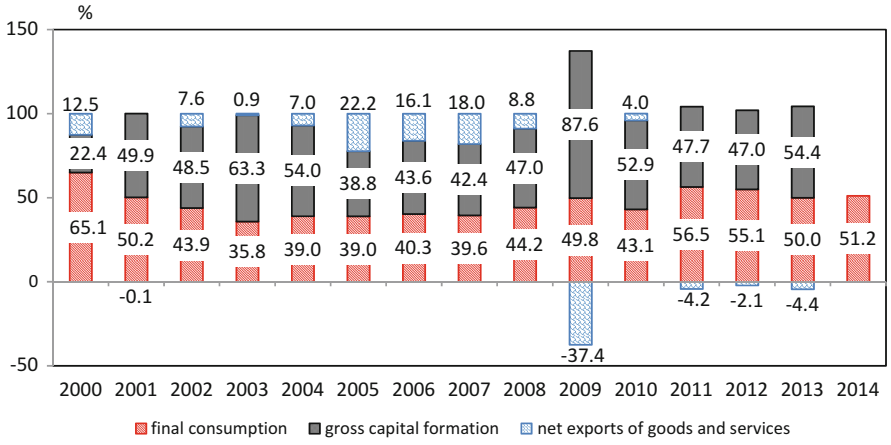

Fig. 2.2 Changes in contribution rate of GDP growth based on the expenditure accounting approach (Data source: CEIC)

proportion of service consumption. Following the government's anti-corruption move and restrictions on the "three public expenditures," the growth rate of the government's public service spending in general apparently slowed down. The total retail sales of consumption goods grew nominally, by 12.0 %, a decrease of 1.1 percentage points from the previous year.[2] The contribution of final consumption to

[2]The present total volume of retail sales contains only the domestic "material consumption amount" and "food and beverage service income" and does not include the overall residents' consumption project, especially service consumption, which grew rapidly in recent years. In tourism, for example, since 2008, the number of domestic tourists grew by 13.8 % on average per year, reaching 3.26 billion persons in 2013. The number of outbound tourists grew by 16.5 % on average per year, reaching 98.19 million people in 2013. Tourism revenue reached around 3.25 trillion

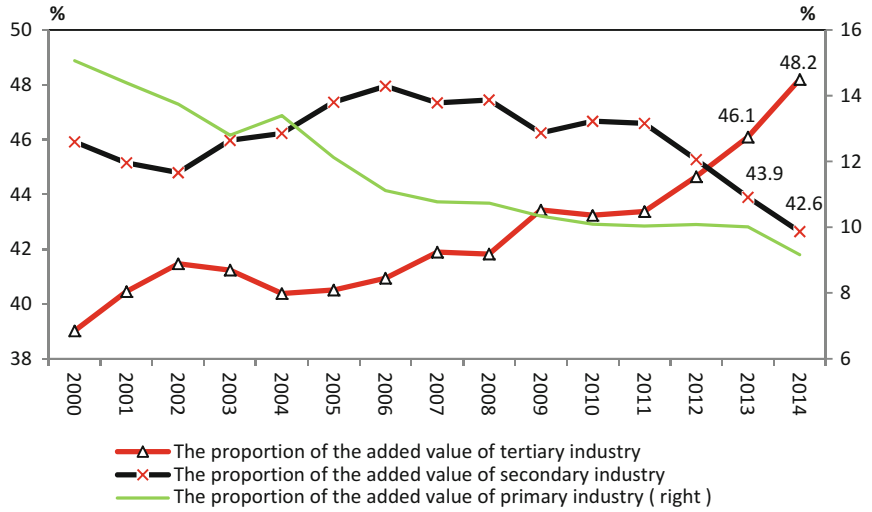

Fig. 2.3 Changes in proportion of added value of three industries in GDP (Data source: CEIC)

economic growth was 51.2 %, a slight increase of 1.2 percentage points from the previous year. Slow recovery of the external market continues to inhibit China's export growth: the total exports in USD grew by 6.1 %, a decrease of 1.7 percentage points from the previous year. Influenced by the decline in staple commodity prices and the slowing down of domestic demand, China's imports grew by only 0.4 %, a sharp decrease of 6.9 percentage points from the previous year. The contribution rate of net goods and services exports to economic growth sharply increased from –4.4 to 10.5 %.

From the point of industrial structure, the tertiary industry's share in GDP increased by 2.1 percentage points in 2014, reaching 48.2 %, 5.6 percentage points higher than the share of the secondary industry (Fig. 2.3). The tertiary industry's share continued to rise, ensuring stability of the employment situation for the whole year to a certain extent. Although the economic growth of China continued to decline, 13.22 million new jobs were generated for urban residents, exceeding the target of 10 million new jobs set in early 2014.[3]

USD in 2014, an increase of 11 % over the previous year. The number of domestic tourists was 3.6 billion persons, an increase by 10 % over the previous year. The number of outbound tourists hit the 100-million-person mark for the first time, reaching 109 million persons. The number of inbound tourists was 128 million persons, a decrease of 1 % from the previous year.

[3] The change in China's population age structure eased the pressure on employment to a certain extent. By the end of 2012, persons aged 15–59 years (including those below 60 years), the working-age population, totaled 937 million people; this was 3.45 million persons less than the previous year. By the end of 2013, the working-age population further reduced to 920 million persons; this again dropped to 916 million people by the end of 2014, a decrease of 3.71 million persons from the end of the previous year.

2.2 Fixed Asset Investment Growth Fell Sharply, but the Investment Structure Started to Improve

In 2014, the manufacturing industry has continued its fall since 2010. Meanwhile, the years of fever in the real estate market started to cool. The beginning of the second quarter saw a drop in real estate sales growth and rise in real estate inventory. A substantial part of the urban real estate market showed a "decreasing housing price and decreasing sales volume" trend, directly inhibiting the growth of investment in the real estate industry.[4] The manufacturing and real estate investment growth showed a sharp fall, leading to a corresponding sharp decline in growth of the total social fixed asset investment (Fig. 2.4). The full-year growth in manufacturing investment in 2014 was only 13.1 %, a decrease of 5.5 percentage points from the previous year; this accounted for 33.3 % of the total investment, a decrease of 0.6 percentage points from the previous year. Real estate investment grew by 11.1 %, a sharp decrease of 9.1 percentage points from the previous year; this accounted for 24.6 % of the total investment, a decrease of 1 percentage point from the previous year. In order to stabilize investment, infrastructure construction investment continued to maintain rapid growth; its annual growth reached 19.8 %,[5] a fall by just 1.5 percentage points from the previous year. This accounted for 22.3 % of the total investment, an increase of 0.8 percentage points over the previous year.

Fig. 2.4 Changes in growth rate of investment in fixed assets by industry (Data source: CEIC)

[4] In 2014, by area, the national sales of commercial housing fell by 7.6 % from the previous year; the national commercial housing sales fell by 6.3 % from the previous year; and the month-to-month drop in number of newly built commercial houses sharply increased from 4 in March to 69 in September in the country's 70 large- and medium-sized cities and was 66 by the end of the year.

[5] This included transportation, warehousing and postal services, water conservancy, environment and public facilities management, electricity, heating power, gas and water production, and the supply industry.

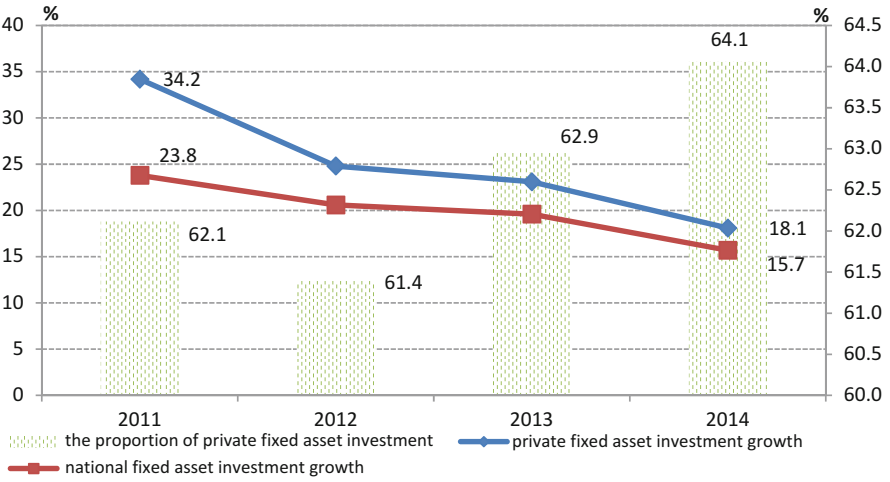

Fig. 2.5 Changes in growth rate and proportion of investment in private fixed assets (Data source: CEIC)

In terms of investment source, to begin with, in 2014, investment in domestic enterprises grew by 16.3 %, a decrease of 4.2 percentage points from the previous year. Among this, the state-owned and state-holding enterprises investment grew by 13.0 %, a decrease of 2.6 percentage points from the previous year, and private investment grew by 18.1 %, a decrease of 5 percentage points from the previous year. Although private investment growth still showed a decline, since 2012, the private fixed investment growth was always faster than the total fixed asset investment growth (see Fig. 2.5). In 2014, the proportion of private investment in the total fixed assets investment increased to 64.1 %, an increase of 1.2 % over the previous year. Private investment is the main source of growth of investment in fixed assets for stable economic growth. As the market environment changed, the economic restructure and the structure of private investment gradually started to adjust: the proportion of investment in the primary and tertiary industry increased, and the structure of investment in the secondary industry also started to adjust. Among this, investment in mining grew by 2.3 %, a decrease of 9 % from the previous year, and 18.1 % lower than in 2012; investment in manufacturing grew by 16.8 %, a fall by 4.6 % from the previous year and 10.4 % lower than in 2012.

Second, in 2014, investment from enterprises located in Hong Kong, Macao, and Taiwan grew by 8.7 %, an increase of 1.7 percentage points over the previous year; this accounted for 2.4 % of the total investment in fixed assets, an increase of 0.1 percentage points over the previous year. Finally, investment from foreign enterprises fell by 0.3 %, a decrease of 4.8 percentage points from the previous year.

In terms of project source, investment from central government projects grew by 10.8 %, a decrease of 1.6 percentage points from the previous year. Affected by the decline in local debt scale and land-transferring fee growth, the local projects investment rose only by 15.9 %, a decrease of 4.2 percentage points from the previous year.

In terms of capital source, in 2014, the source of investment funds mainly comprised domestic loans and self-raised enterprise funds. Among this, investment from the national budget funds grew by 14.1 %, a decrease of 2.9 percentage points from the previous year; this accounted for 5 % of the total investment, the same as the previous year. Investment from domestic loans grew by 8.6 %, a decrease of 5.8 percentage points from the previous year[6]; this accounted for 12 % of the total investment, the same as the previous year. Investment from self-raised funds grew by 16.4 %, a decrease of 6.4 percentage points from the previous year; this accounted for 70 % of the total investment, an increase of 3 % over the previous year and 9 % higher than that of 2010. Out of all self-raised funds, company investments from their own capital accounted for 27.7 %, a decrease of 2.58 percentage points from the previous year.[7] The growth of foreign capital investment shrank by 6.3 %, a decrease of 2.6 percentage points from the previous year; this accounted for 1 % of the total investment, the same as the previous year.

In conclusion, we consider the following prospects: (1) In 2015, thanks to excess production capacity and inventory accumulation, the growth in manufacturing and real estate investment will continue to decline. Infrastructure investment should moderately expand in order to stabilize investment. (2) Despite decline in the total social fixed asset investment growth, the proportion of private investment continues to improve; private investment is constantly moving from the secondary industry with excess capacity to the primary and tertiary industry, and there is good momentum of structural adjustment in the manufacturing industry. This shows that under the harsh post-recession market environment, market participants should make a determined effort to adjust inventory and optimize increment, and the private investment structure should gradually optimize under severe market pressure. (3) In 2014, to a certain extent, the large supply of credit slowed down investment growth; the large increase in proportion of investment of self-raised enterprise funds meant that the demand for enterprise investment was expanding. In this background, in 2015, monetary policy should continue to ensure the supply of bank credit resources and the reduction in financing cost. Meanwhile, fiscal policy should focus on lightening the tax burden of enterprises to promote a steady rise in private investment. More importantly, the government should further streamline its administration and delegate power to lower levels, implement negative list management, ease the burden of enterprises and entrepreneurs, and reduce all sorts of investment and entrepreneurship costs. By comprehensively deepening reforms, adjusting policies, and improving its management, the government can reinvent China's economic growth potential.

[6] In 2014, the RMB loans newly increased by 9.78 trillion yuan, against 9.59 trillion yuan in 2009.

[7] In 2008, the proportion of self-raised funds at the disposal of enterprises was 52.1 %. This continued to decline sharply thereafter. It was 43.1 % in 2009, 39.2 % in 2010, 37 % in 2011, and 33.9 % in 2012. The sharp decline in proportion of self-raised funds at the disposal of enterprises illustrated the broadening of the investment channels.

2.3 The Industrial Profit Growth Declined Sharply, and Eliminating Backward Production Capacity Achieved Certain Progress

In 2014, the profit of the industrial enterprises abovementioned grew by 3.3 %, a decrease of 8.9 percentage points from the previous year. Among this, the mining industry's profits fell by 23 %, a decrease of 2.0 percentage points from the previous year; the profit of goods manufacturing industry, represented by food, textiles and garment, tobacco, and so on, grew by 5 %, an increase of 0.2 percentage points over the previous year. The profit of equipment manufacturing and high-tech manufacturing industries grew strongly, 0.9 % and 12.7 %, an increase of 4.1 % and 6.7 %, respectively, over the previous year's results (Fig. 2.6).

In 2014, the elimination of backward production capacity in industries with excess capacity continued to progress: the elimination of backward steel by 35.67 million tons, cement by 81.25 million tons, and plate glass by 35.67 million weight boxes accounted for 3.1 %, 3.3 %, and 4.5 % of the total output, respectively (Fig. 2.7).

To some extent, this shows that China's manufacturing industry is adapting to the change of market environment through structural adjustments and the development of equipment manufacturing and high-technology manufacturing industries with accelerated high added value, eliminating backward production capacity, continuing to make progress in industries with excess capacity, and

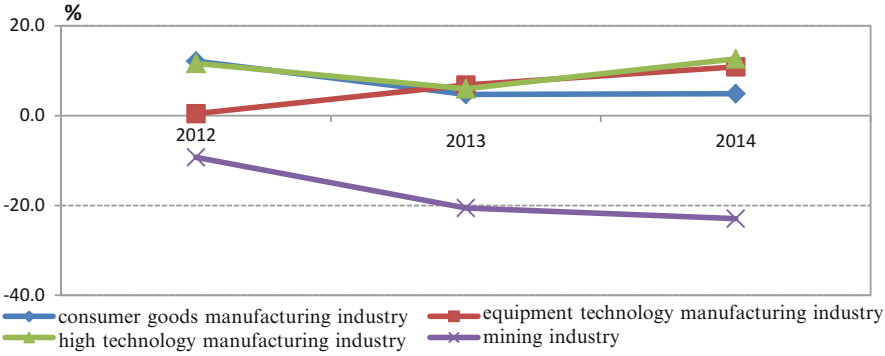

Fig. 2.6 Changes in profit growth rate of part of the above industrial enterprises (In this paper, the equipment manufacturing industry includes general equipment manufacturing, special equipment manufacturing, automobile manufacturing, electrical machinery and equipment manufacturing, fabricated metal products, and other industries; the high-technology industry includes pharmaceutical manufacturing; railway, shipbuilding, aerospace, and other transport equipment manufacturing; computer, communications, and other electronic equipment manufacturing; instrument manufacturing; and other industries) (Data source: CEIC)

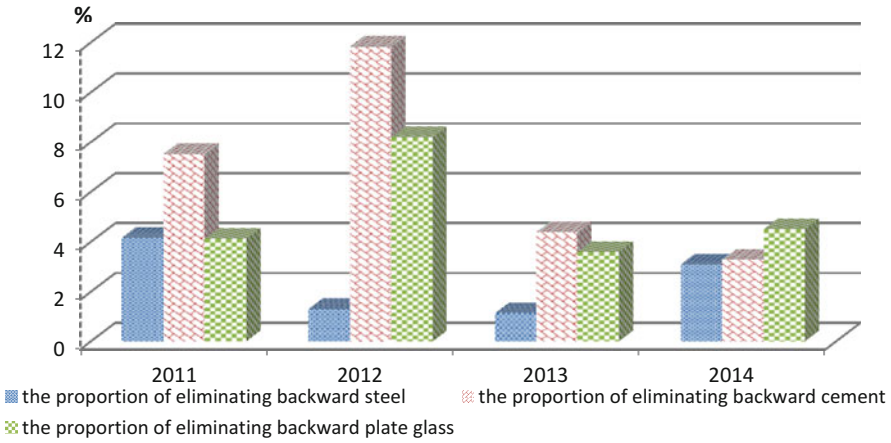

Fig. 2.7 The ratio of quantity of some industries' backward production capacity in industrial production (Data source: Wind Information)

upgrading the industrial structure. The new economic development space is showing signs of positive results.[8]

2.4 Import and Export Growth Fell Sharply, but the Trade Structure Continued to Improve

In 2014, the global economic recovery was weak. The major economies moved separately, and China's goods trade import and export growth fell further. Affected by weak domestic demand and the decline in prices of oil and other staple commodities, the decline in import growth was larger than the decline in export growth, and the surplus in commodity trade increased sharply. China's annual total exports in USD grew by only 6.1 %, a decrease of 1.7 percentage points from the previous year, and its total imports rose by only 0.4 %, a sharp decrease of 6.9 percentage points from the previous year (Fig. 2.8).[9] Commodity trade surplus expanded significantly to 382.46 billion USD, an increase of 122.71 billion USD over the previous year. The services trade deficit continued to maintain its previous expending trend, with the annual deficit widening to 198 billion USD.[10]

[8] In addition, new types of business such as electronic commerce and mobile communications and strategic emerging industries that mainly depended on new energy, biological medicine, and environmental protection technology also develop quickly.

[9] According to Shen Danyang, the spokesman of the Commerce Department, "after stripping out the factor of arbitrage raising high base in 2013, real national import and export grew by 6.1 % year-on-year, the export growth was 8.7 %, import growth was 3.3 %." http://www.mofcom.gov.cn/xwfbh/20150121.shtml

[10] Among them, in 2014, tourism, transportation, and patent fee exploitation increased to 113.6 billion, 57.9 billion, and 21.9 billion USD, that is, 4.7, 1.3, and 1.6 times higher than 2011, respectively.

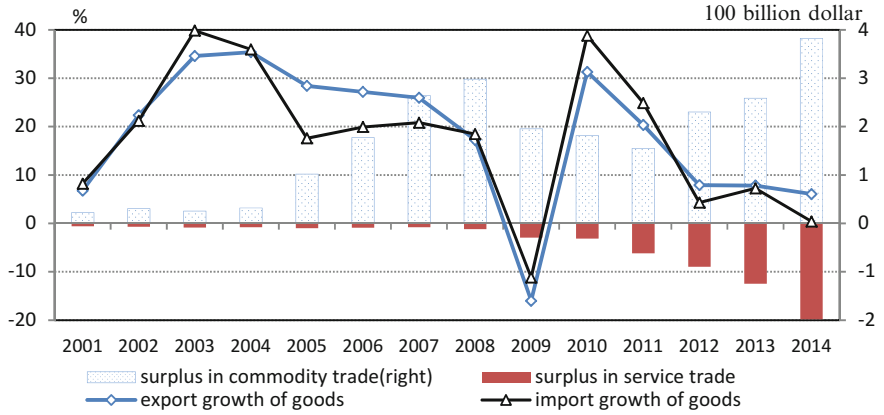

Fig. 2.8 Changes in import and export growth and trade surplus scale (Data source: CEIC)

China's commodity trade surplus and services trade deficit expanded in opposite directions, partly reflecting the changes in the country's current consumer demand structure, the imbalance in industrial structure, and the international competitive differences between different industries, and showed the direction of industrial structure adjustment. In 2014, China newly added 21.7 billion USD in foreign exchange reserves, taking its foreign exchange reserves balance to 3.84 trillion USD by the end of the year. The central parity exchange rate was 6.1190 yuan to the dollar, indicating a depreciation of 0.36 % in RMB compared with that at the end of the previous year.[11] The central parity exchange rate was 7.4556 yuan to the euro, an appreciation by 11.44 %.

In 2014, the actual use of foreign capital was 119.56 billion USD, an increase of 1.7 % from the previous year.[12] Among this, the manufacturing industry accounted for 33.4 %, a decrease of 5.34 % from the previous year and 15.52 % lower than that in 2007. The real estate industry accounted for 28.96 %, an increase of 4.47 % over the previous year and 8.5 % higher than that of 2007. The financial industry accounted for 3.5 %, an increase of 1.52 % over the previous year and 7.29 % lower than in 2007. The information transmission, computer services, and software industry accounted for 2.3 %, a decrease of 0.15 % over the previous year but 0.53 % higher than in 2007. After the international financial crisis, foreign investment also started to adjust the investment structure, turning from manufacturing to the tertiary industry and from labor-intensive to technology-intensive industry.

[11] Since March 2014, the USD central parity rate against the yuan has been continuously rising; the RMB depreciated by 1.8 % from a year earlier until early June. From June to August, the depreciation rate maintained the range of 0.8–1.8 %. In early September, the depreciation range of the RMB constantly narrowed, showing a depreciation of 0.35 % at the end of the year compared with that at the beginning of the year. Computing the RMB exchange rate based on the annual average value, the average exchange rate of the USD to yuan was 6.142 in 2014, and the RMB appreciated by about 0.86 %. The nominal and real effective exchange rate of RMB maintained the trend of appreciation; the range of appreciation was larger than the range in 2013.

[12] In 2014, China became the world's largest recipient of foreign investment, surpassing the USA.

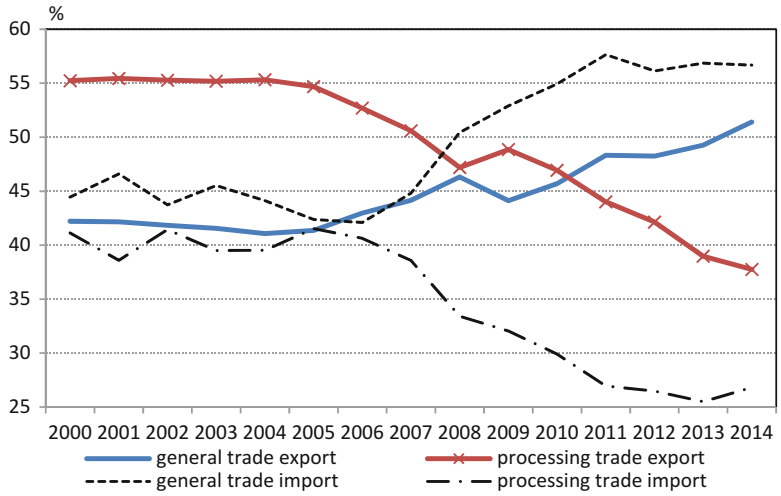

Fig. 2.9 Changes in proportion of general trade and processing trade import and export (Data source: CEIC)

In terms of trade structure, the proportion of general trade continued to improve, whereas that of processing trade continued to fall. In 2014, general trade exports grew by 10.7 %, accounting for 51.4 % of total exports, a 2.2 % increase over the previous year. Processing trade export grew by 2.7 %, accounting for 37.7 % of total exports, a 1.2 % decrease from the previous year. The general trade import growth fell from 8.6 to 0.2 %, accounting for 56.7 % of total imports. The growth of processing trade imports increased from 3.3 to 5.7 %, accounting for 26.8 % of total imports (Fig. 2.9).

In terms of regional structure, in 2014, China's growth of exports to Asia and the USA (in USD) improved sharply, by 10.4 % and 9.9 %, respectively, an increase of 3.8 % and 6.9 %, respectively, over the previous year. Following the slowdown of the EU recovery and euro depreciation, exports to the EU increased by 4.9 %, an increase of only 1 % over the previous year (Figs. 2.10 and 2.12). Compared with 2013, China's exports to Asia and the USA accounted for 52.8 and 16.1 %, an increase of 0.4 % and 0.1 %, respectively; its exports to the EU accounted for 15.2 %, a decrease of 0.7 %. On the import side, China's growth of imports from Asia and the USA fell by −3 and 3 %, a decrease of 8.5 % and 10.4 %, respectively; its growth of imports from the EU increased significantly to 15.4 %, an increase of 8 %. The proportion of China's imports from Asia decreased by 0.4 %, reaching 55.6 %; that from the USA increased by 0.5 %, reaching 9 %; and that from the EU rose to 13 %, an increase of 2 % (Figs. 2.11 and 2.13).

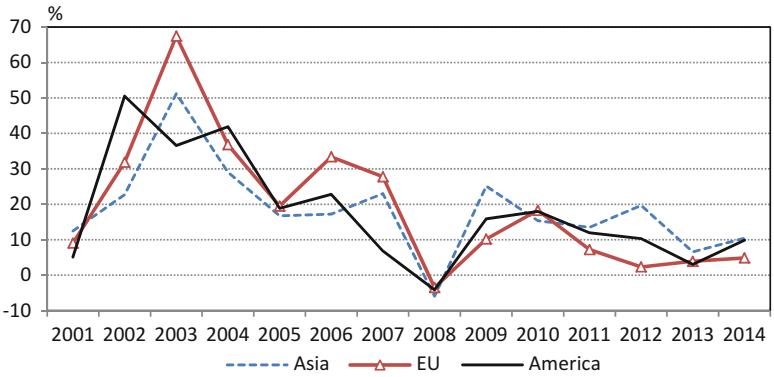

Fig. 2.10 Changes in China's export growth in main areas (Data source: CEIC)

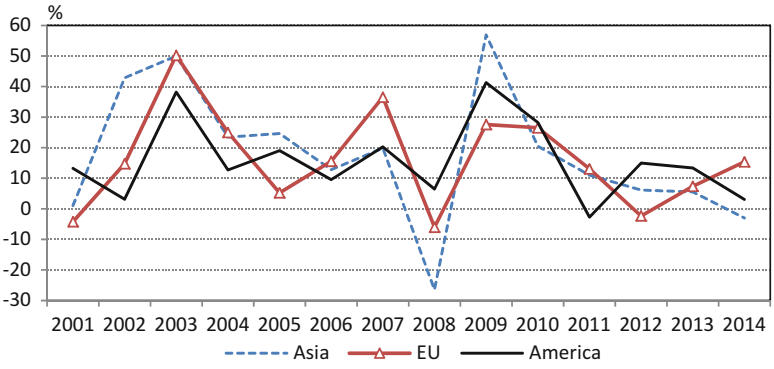

Fig. 2.11 Changes in China's import growth in main areas (Data source: CEIC)

2.5 Resident Real Income Growth was Slowing and the Growth of Total Retail Sales of Consumer Goods Continued to Fall Back

In 2014, the Chinese residents' per capita disposable income grew by 8.0 % in real terms, a decrease of 0.1 % from the previous year. By permanent residence, the per capita disposable income of urban residents grew by 6.8 % in real terms, a decrease of 0.2 % from the previous year; the per capita net income of rural residents grew by 9.2 %, a decrease of 0.1 % from the previous year (Fig. 2.14). The economic slowdown continued to inhibit the growth of the urban and rural residents' real income.

As the per capita income levels rose, the Chinese residents' consumption structure was undergoing new changes, with the growth of material consumption slowing

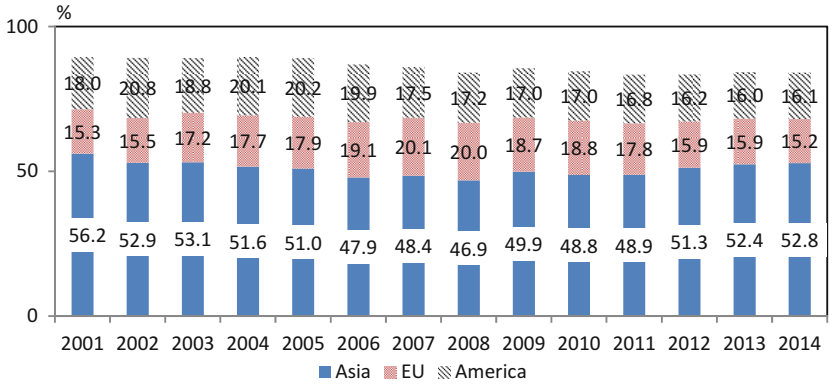

Fig. 2.12 Changes in China's export composition (by region) (Data source: CEIC)

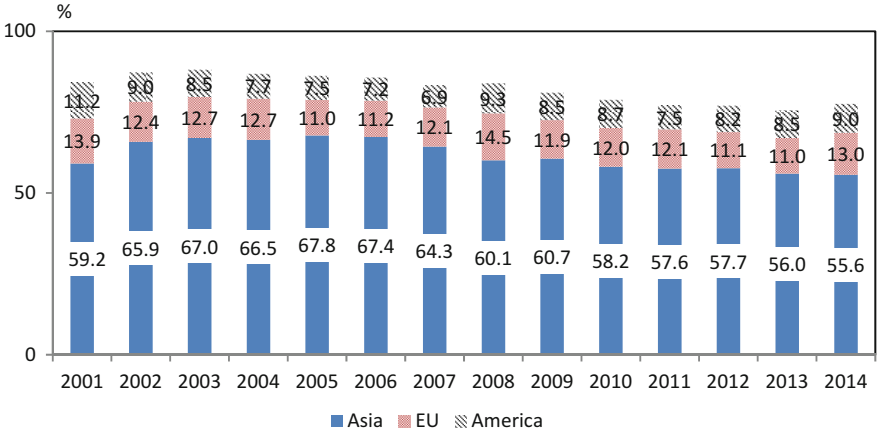

Fig. 2.13 Changes in China's import composition (by region) (Data source: CEIC)

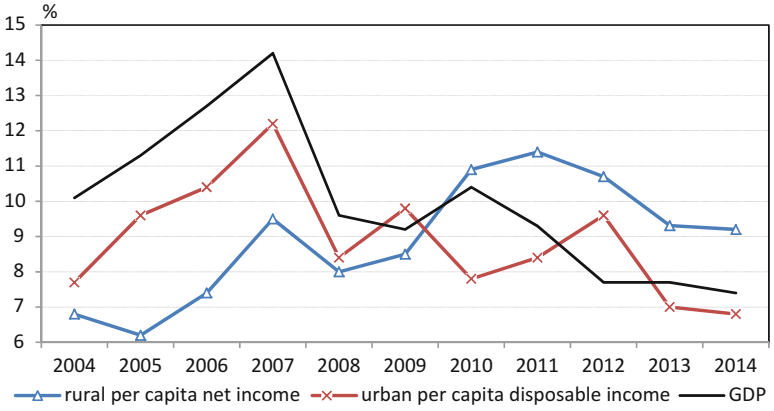

Fig. 2.14 Changes in real growth rate of per capita disposable income in urban areas and net income in rural areas (Data source: CEIC)

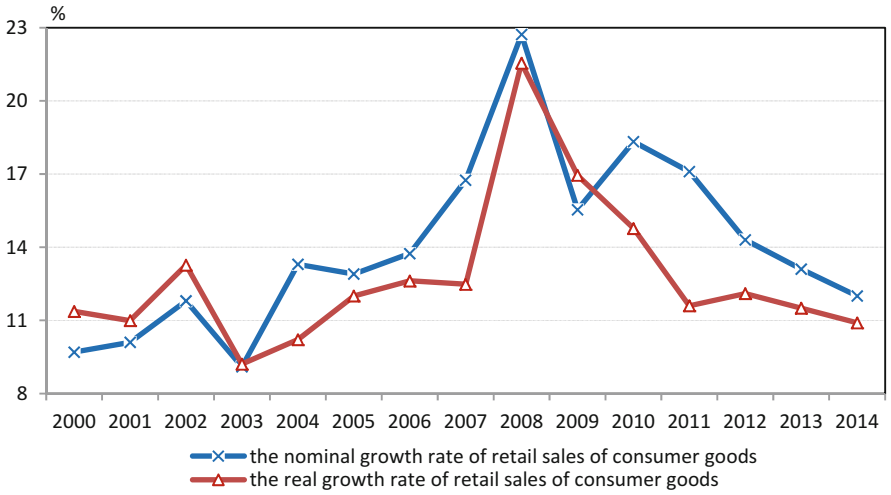

Fig. 2.15 Changes in real growth rate of consumer good retail sales (Data source: CEIC)

down and proportion of service consumption rising. Influenced by the government's anti-corruption move and restrictions on the three public expenditures, the growth rate of the government's public service spending in general apparently fell. The total retail sales of consumption goods maintained the falling trend since 2010 and then nominally grew by 12.0 %, a decrease of 1.1 percentage points from the previous year; meanwhile the real growth was 10.9 %, a decrease of 1.6 % from the previous year (Fig. 2.15).

2.6 Price Index Continued the Trend of "Double Down," and the Structural Deflation was Increasing

In 2014, the CPI was 2 %, a decrease of 0.6 % from the previous year, and the PPI fell by 1.9 %, the same as the previous year (Fig. 2.16). Since 2011, China's CPI and PPI continued the "double down" trend, but the growth of CPI remained positive, whereas that of PPI continued the negative trend.[13] The consumer market and intermediate product market faced different downward pressures on the price, and China's deflation revealed obvious structural characteristics.

In terms of CPI, eight types of consumer goods maintained their positive increase, although the rate of increase dropped. The decreasing price of staple commodities such as food and oil was the main reason for the decrease of CPI; the enlarging demand on services, clothing, traffic, communication, entertainment, education,

[13] This situation is usually defined as disinflation, rather than deflation.

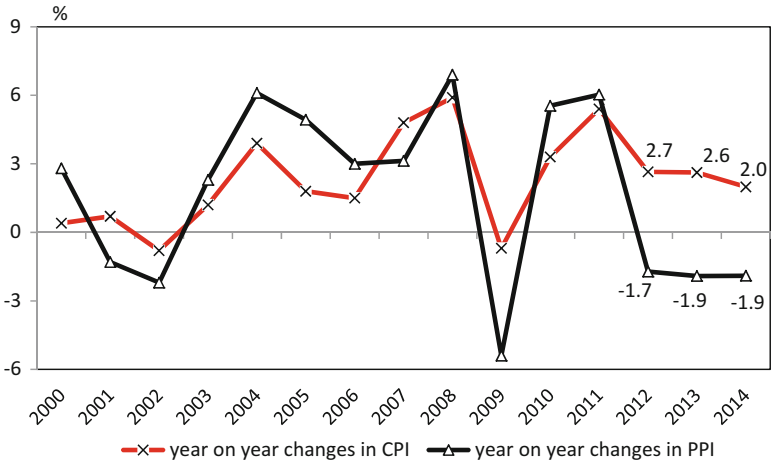

Fig. 2.16 Year-on-year changes in CPI and PPI (Data source: CEIC)

and culture promoted the increase of CPI.[14] In terms of PPI, excess production capacity and the 2014 slump in oil prices were the main reasons for the drop.

2.7 The Monetary Policy Targeted Eased, and Financing Costs Remained High

In 2014, under the premise of adhering to the "total amount control, structural adjustment" through measures such as targeted reserve requirement ratio (RRR) cuts and loan and deposit benchmark interest rate cuts and enlarging the rising ceiling of deposit interest rates, the Central Bank of China implemented a prudent monetary policy.[15] The annual broad money (M2) balance was 122.84 trillion yuan, indicating a growth of 12.2 %,[16] a decrease of 1.4 % from the previous year

[14] At the end of 2014, the consumer confidence index, customer satisfaction index, and consumer expectations index grew by 3.5 %, 5.4 %, and 2.3 % respectively. From the resident survey data, in 2014, the urban per capita disposable income increased by 2381.6 yuan over the previous year, and the per capita consumption expenditure increased by 1945.4 yuan; the marginal propensity to consume was 81.7 %, an increase of 10.6 % over the previous year.

[15] In the first half of 2014, the central bank implemented the targeted RRR cuts twice. By creating medium-term lending facilities (MLF) and pledged supplementary lending (PSL) and using other tools, the central bank guided financial institutions to raise their credit availability in some fields such as agriculture, small microenterprises, and shantytown transformation. Since the second half, the central bank reduced the base point of positive repo rate four times, to 60 points; cut the benchmark interest rate for loans and deposits by 40 and 25 base points, respectively, in late November; and expanded the upper limit of deposit interest rates to 1.2 times of the benchmark interest rate.

[16] By the end of 2014, the M2 balance reached 122.84 trillion yuan, about twice the GDP at the beginning of year.

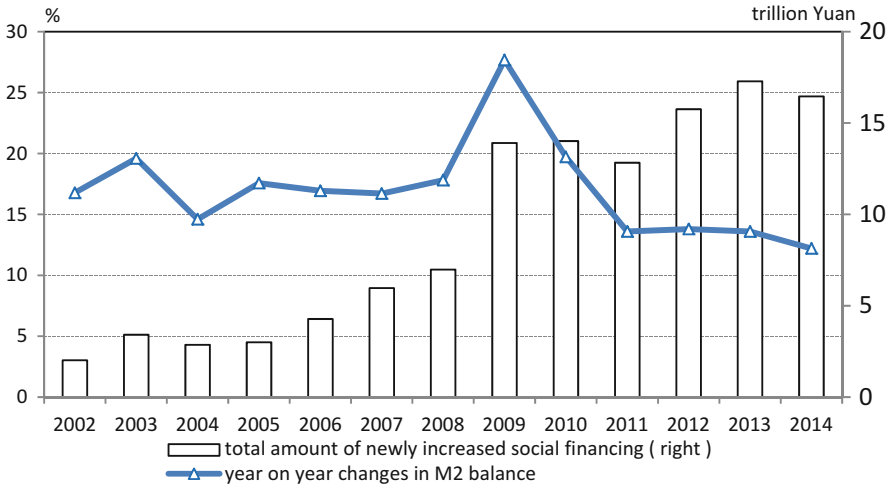

Fig. 2.17 Total amounts of newly increased social financing and year-on-year changes in M2 balance (Data source: CEIC)

(Fig. 2.17). M2 newly increased by 12.18 trillion yuan, a decrease of 1.05 trillion yuan from the previous year. The narrow money (M1) balance grew by 3.2 %, a decrease of 6.1 % from the previous year. Currency in circulation (M0) grew by 2.9 %, a decrease of 4.3 percentage points from the previous year.

In 2014, the scale of social financing was 16.46 trillion yuan, 859.8 billion yuan less than the previous year (Fig. 2.17).[17] The newly increased RMB loans amounted to 9.78 trillion yuan, an increase of 890 billion yuan over the previous year, accounting for 59.4 % of the scale of social financing for the same period, 8.1 % higher than the previous year. From the newly increased RMB loans, 66 % was used to finance nonfinancial companies and other departments,[18] and 28 % was used to finance the real estate sector. In 2014, the general loan-weighted average interest rate of financial institutions on nonfinancial institutions and other departments was as high as around 7 %.

In order to stabilize investment in 2015, monetary policy should cut the interest rates and continue the measures of targeted RRR cuts. The central bank should maintain a modest currency devaluation.

[17] In 2014, the regulators' supervision of service specification restrained the expansion of commercial banks' off-balance sheet business and restricted the expansion of the social financing scale. Trust loans accounted for 3.1 % of total social financing, a decrease of 7.5 % over the previous year.

[18] By the end of 2014, the loan balance of small microenterprises was 15.46 trillion yuan, an increase of 15.5 % from the previous year. The growth rate was 1.3 % higher than the previous year; this was 6.1 % and 4.8 % higher than that of large- and medium-sized enterprise, respectively, the previous year.

2.8 Fiscal Revenue Growth Was Falling, but the Fiscal Expenditure Structure Continued to Improve

In 2014, China's fiscal revenue grew by 8.6 %, a decrease of 1.6 % from the previous year. Fiscal expenditure grew by 8.2 %, a decrease of 3.1 % from the previous year (Fig. 2.18). The financial deficit was 113.12 billion yuan, accounting for 1.8 % of GDP.

In terms of fiscal revenue, the decline in corporate profit growth directly inhibited the increase of tax revenue. The annual tax revenue grew by 7.8 %, a decrease of 2.1 % from the previous year; the ratio of tax revenue to financial revenue was 84.9 %, a decrease of 0.6 % from the previous year. Meanwhile, the growth of nontax revenue showed an increase, growing by 13.5 %, an increase of 1.2 % from the previous year. The transfer income of state-owned land use right grew by 3.3 % in 2014, a decrease of 41.4 % from the previous year, but accounting only for 30 % of the fiscal revenue. On the tax revenue side, following the decline in corporate profit, the corporate income tax revenue grew by 9.8 % in 2014, a decrease of 4.3 % from the previous year; corporate income tax accounted for 20.7 % of all tax revenue, an increase of 0.4 % over the previous year. The growth of value-added tax revenue was by 7.1 %, a decrease of 2.0 % from the previous year; this accounted for 25.6 % of all tax revenue, a decrease of 0.2 % from the previous year. The business tax revenue grew by 3.2 %, a decrease of 6.2 % from the previous year; this accounted for 14.9 % of all tax revenue, a decrease of 0.7 % from the previous year.

In 2015, following the decline in real estate investment growth, the local government land leasing income is expected to be hard to grow rapidly. Under the slowdown of tax revenue growth, the local government should more strictly and effectively control nontax revenue growth and ease the burden on enterprises and residents, reduce the interference of market operation, and improve the market's economic vitality.

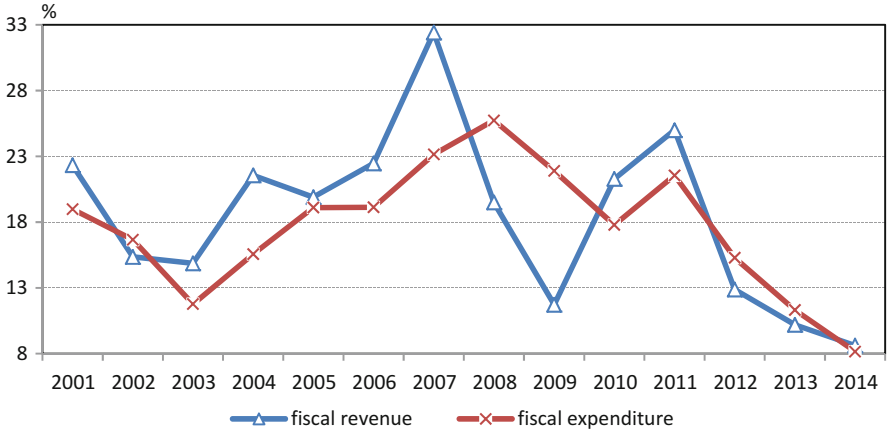

Fig. 2.18 Changes in nominal growth of financial revenue and expenditure (Data source: CEIC)

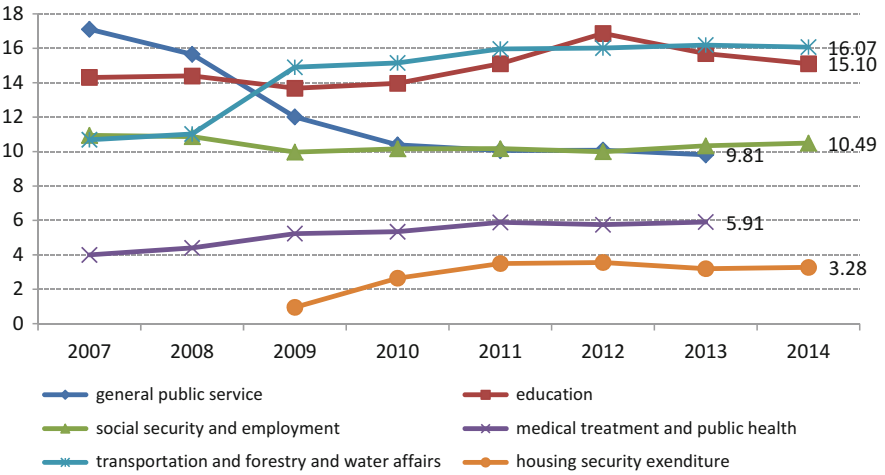

Fig. 2.19 Changes in public financial revenue and expenditure composition (Data source: CEIC)

On the side of fiscal spending (Fig. 2.19), education spending grew by 4.1 %, an increase of 0.5 % over the previous year. This accounted for 15.1 % of fiscal expenditure, a decrease of 0.6 % from the previous year.[19] Social insurance and employment expenditure grew by 9.8 %, a decrease of 5.3 % from the previous year; this accounted for 10.5 % of fiscal expenditure, an increase of 0.2 % over the previous year. The expenditure on transportation and agriculture and forestry and water affairs grew by 7.4 %, a decrease of 5.2 % from the previous year; this accounted for 16.0 % of fiscal expenditure, a decrease of 0.1 % from the previous year. The expenditure on housing security grew by 10.9 %, an increase of 10.9 % over the previous year; this accounted for 3.3 % of fiscal expenditure, an increase of 0.1 % over the previous year.[20]

In conclusion, we propose the following:

1. In 2014, a significant decline in investment growth led to a continuous drop in GDP growth. The annual real GDP grew by 7.4 %, a decrease of 0.3 % from the previous year. We expect excess production capacity and inventory accumulation in the real estate industry to inhibit investment growth in 2015 as well. Although investment in infrastructure will continue to grow faster, total social fixed assets investment growth will continue to fall and GDP growth will continue to decline.
2. In 2014, the CPI was 2 % and PPI −1.9 %. Following the economic slowdown, the price level is expected to maintain a downward trend in 2015. Although the CPI continues to decline, it will maintain a positive rise. Because excess capac-

[19] In 2014, the proportion of education spending on GDP was 3.6 %; this was still below the level of 4 % established in 1993.

[20] For the first 11 months of 2014, the general public service spending cumulatively rose 2.0 %, a decrease of 9.1 % from the previous year for the same period; this accounted for 9.3 % of the total financial expenditure, a decrease of 0.8 % from the previous year.

ity still needs to be digested, the PPI will continue to maintain a negative growth, although the fall will be somewhat less. Structural deflation is expected to continue.

3. Following the economic slowdown, the growth of urban and rural resident income will be restricted. Therefore, although the residents' propensity to consume is relatively stable, the promoting effect of consumption on economic growth in the near future will be limited.
4. Although investment growth dropped dramatically in 2014, the growth of private fixed investment has been faster than that of fixed asset investment of the whole society since 2012, and investment in the tertiary industry is gradually expanding. In terms of capital source, the proportion of investment from self-raised funds in the total investment increased significantly. In terms of industry, the profit from equipment manufacturing and high-tech manufacturing industries grew strongly, the pace of industrial transformation and upgrading accelerated, and investment demand is expected to expand further. Investment demand in the tertiary industry, except in the modern manufacturing and real estate industry, is expected to expand further in 2015. Macro-policy should guarantee that the newly increased credit resources further meet the needs of emerging industrial expansion and private investment demand. Furthermore, the government should reform the financial field and effectively resolve the long-standing problem of "financing difficulty, financing expensive" in private investment. While steadily promoting interest rate marketization, it should also speed up opening up the financial field and improve the capital market.
5. In 2014, the scale of social financing fell dramatically due to both demand and supply effects. On the supply side, the supervisory regulation on banks' off-balance sheet activity was strengthened, making it difficult for banks to expand their off-balance sheet activity. On the demand side, the decline in corporate profit growth inhibited the demand of enterprises for investment funds. However, newly increased RMB loans amounted to almost 10 trillion yuan, and to some extent, this showed that banks still had the strong willingness and ability to provide credit and enterprises the strong demand for investment funds. Monetary policy should take strong measures in 2015 to guarantee that credit resources entered the real economy, especially to meet the needs of private investment, and thus realize the stable growth of investment.

Chapter 3
Forecast of China's Economy During 2015–2016

3.1 Assumptions of Exogenous Variables

3.1.1 Economic Growth Rates of the USA and the Eurozone

We expect the US financial situation to continue to improve through 2015. At the same time, driven by factors such as drop of the jobless rate and low oil prices, the growth of domestic demand in the US economy could overcome the adverse impact of the strong dollar and continue to recover steadily. On January 22, 2015, the International Monetary Fund (IMF) predicted that the USA will grow by 3.6 % in 2015 and that the growth rate will reach 3.3 % in 2016.

To overcome the pressure of deflation and boost the economy of the eurozone, the European central bank announced its quantitative easing (QE) policy on January 22, 2015. However, due to geopolitical reasons, the progress of structural reform is slow. The Greek political upheaval has further expanded the eurozone's political uncertainty, leading to the recovery being "weak and not balanced." We expect a 1.0 % economic growth for the eurozone in 2015, which is lower than the IMF forecast in January (1.2 %). For 2016, as the IMF forecast, the growth could be 1.4 % (Fig. 3.1).

3.1.2 Major Exchange Rates

In 2014, at the spot exchange rate, the RMB depreciated by 2.5 % against the dollar, and the median price depreciated by 0.36 % annually for the first time. In January 2015, the official PMI fell lower than 50, creating a new lowest in 19 months, indicating a slowdown of China's economic growth. As the China-US economic trend indicates, overall, the dollar is on an appreciation cycle now, but the possibility that

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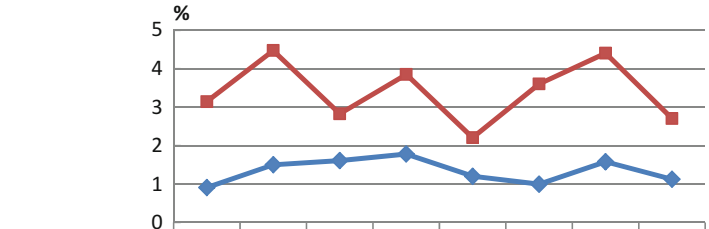


	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
EU17GDP_C	0.91	1.50	1.61	1.78	1.20	1.00	1.58	1.12
USGDP_C	3.14	4.47	2.83	3.85	2.21	3.60	4.40	2.70

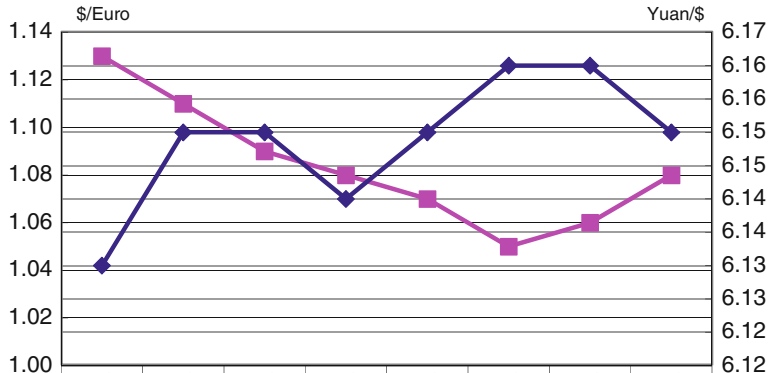
Fig. 3.1 Assumptions of growth in the USA and the eurozone (Note: EU17GDP_C denotes growth in the eurozone, while USGDP_C denotes growth in the USA)

the RMB appreciates by phases cannot be ruled out. We expect the exchange rate to fall from 6.13 yuan to 6.14 yuan (median) to the dollar in the year 2015; in 2016, it may fall slightly to 6.16 yuan and then return to 6.15 yuan (see Fig. 3.2).

Faced with the eurozone's economic growth and low inflation or even deflationary pressure, the European central bank launched the European version of QE—the purchase of 60 billion euros per month until September 2016 or until the eurozone inflation reduces to 2 %. Starting from March 1 this year, the QE will continue 19 months, bring in a total of 1.14 trillion euros, and newly add 950 billion euros. Given that the USA may raise its interest rates in the second quarter, the dollar would continue to be strong and the euro would further weaken; thus, we expect the euro to fall against the dollar to $1.08 by the end of 2015, to the lowest level of $1.05 by the second quarter of 2016, and to then get back to $1.08, affected by the expectation of QE exiting in September 2016 (Fig. 3.2).

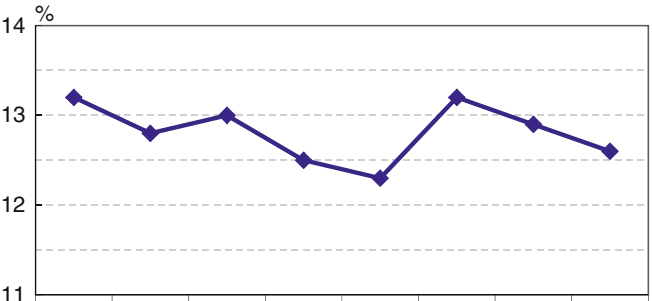
3.1.3 The Growth Rate of Broad Money Supply (M2)

In 2015, the Chinese economy could face a downward pressure and its prices may continue to fall. Thus, the velocity of China's monetary policy could slow down, and, as an important channel of currency, its foreign exchange might step into low-growth stages, the monetary policy transmission mechanism might possibly fail, and, while insisting on a steady tone, the central bank might maintain the preset of directional loose fine-tuning. After the central bank's announcement of reducing quasi on February 5, 2015, reducing quasi is likely to continue to drop one to two times a year and connect with the cut interest rates to stabilize growth. Given the expectation of the Federal Reserve raising interest rates in the second quarter of this year, the first half, especially the first quarter of the first half year, is a better time



	2015 Q1	2015 Q2	2015 Q3	2015 Q4	2016 Q1	2016 Q2	2016 Q3	2016 Q4
USDEURO	1.13	1.11	1.09	1.08	1.07	1.05	1.06	1.08
ER_W	6.13	6.15	6.15	6.14	6.15	6.16	6.16	6.15

Fig. 3.2 Assumptions of major exchange rates (Note: ER_W denotes the exchange rate of the RMB against the USD, and USDEURO denotes the exchange rate of the USD against the euro)



	2015Q 1	2015Q 2	2015Q 3	2015Q 4	2016Q 1	2016Q 2	2016Q 3	2016Q 4
M2	13.2	12.8	13	12.5	12.3	13.2	12.9	12.6

Fig. 3.3 Assumption of the growth rate of M2

window for monetary easing. Thus, the central bank is expected to cut interest rates by 25 basis points in the first quarter of 2015, the year the M2 growth rate is expected to rebound to 12.5 %. It will maintain this level basically in 2016, and the annual M2 growth rate will be 12.6 % (Fig. 3.3).

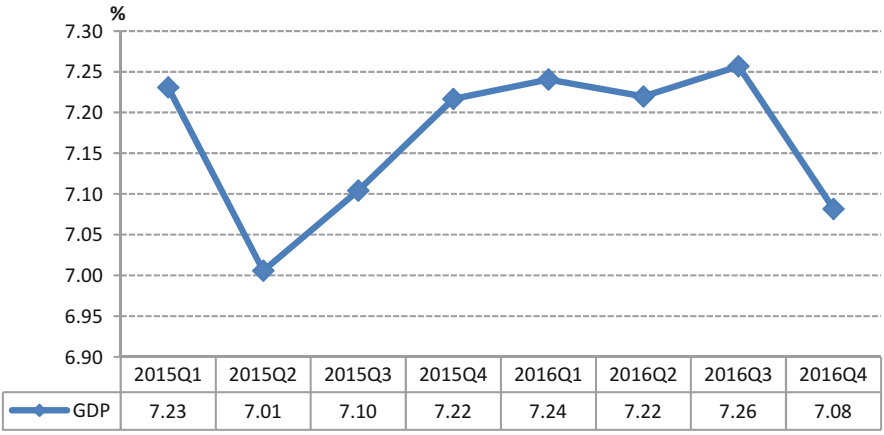
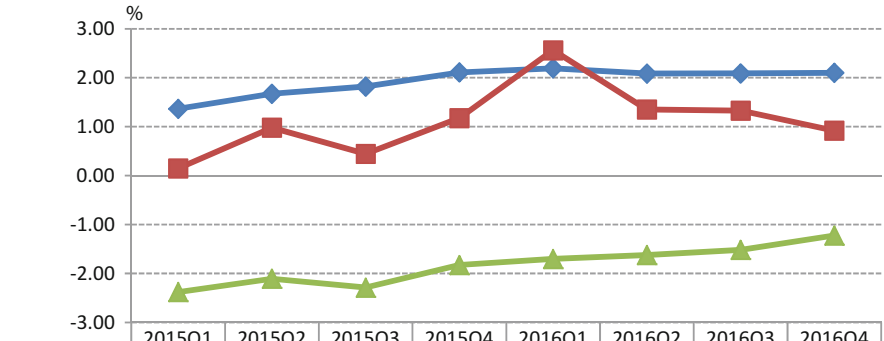


Fig. 3.4 Forecast of GDP growth rate (year-on-year basis)

3.2 Forecasts of China's Major Macroeconomic Indicators for 2015–2016

3.2.1 Forecast of GDP Growth

Assuming the above exogenous variables, the predictions based on CQMMs show that in 2015, China's GDP growth rate will continue to fall to 7.14, 0.26 % lower than that in 2014. By 2016, the GDP growth rate will rise slightly to 7.20 %. Subsequently it will fall but then reverse in a late recovery over the next two years. The main reason for this is that manufacturing still faces inventory pressure, the commercial housing construction area is also historically high, and the growth rate of investment will continue to fall. Under the influence of slow resident real income growth rate and the economic downturn, the final consumption support to the economy wanes. However, external market recovery will ease the pressure on the economic downturn to a certain extent. In 2016, the dividend of the comprehensively deepened reform of the system will gradually appear, and improvement in the external economic environment will improve China's economic growth to a certain extent. From the quarterly year-on-year growth rate shown in Fig. 3.4, we find that following the negative growth of the export in the first quarter of 2014 and a low base, the year-on-year growth rate of exports will rebound significantly. China's economic growth rate is expected to fall to 7.23 % in the first quarter of 2015. Then, from the base effect of the same period last year, the growth rate will further slow down to 7.01 % in the second quarter; following the export and investment recovery, the economy will then rebound to 7.10 % in the third quarter and continue to uplink to 7.22 % in the fourth quarter.



	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
CPI	1.37	1.67	1.82	2.11	2.19	2.09	2.09	2.10
P_GDP	0.15	0.98	0.45	1.18	2.56	1.35	1.33	0.92
PPI	-2.38	-2.11	-2.29	-1.83	-1.70	-1.62	-1.52	-1.22

Fig. 3.5 Forecasts of major price indices (year-on-year basis) (Note: CPI, P_GDP, and PPI denote consumer price index, GDP deflator, and producer price index, respectively)

3.2.2 Forecasts of Major Price Indices

The CQMM predicts that the CPI will rise by 1.74 % in 2015, a decrease of 0.26 % from 2014. By 2016, the CPI is expected to rise slightly to 2.12 %. By quarters (Fig. 3.5), because of weak demand, the CPI could fall to 1.37 % in the first quarter of 2015, and, following the rebound of consumption, could rise moderately to 1.67 % in the second quarter, further rise to 1.82 % in the third quarter, and continue to rise to 2.11 % in the fourth quarter.

The PPI in the next two years will continue to maintain a negative trend, but the decline is expected to gradually narrow. The PPI is expected to fall to −2.15 % in 2015 and could further narrow to 1.52 % in 2016. By quarters (Fig. 3.5), the PPI may fall to −2.38 % in the first quarter of 2015 and then recover to 2.11 % in the second quarter; the decline tends to narrow until the fourth quarter, when it will recover to −1.83 %. In 2016, as the pressure of backward production capacity drops and the enterprise management situation improves, the index will continue to rise, reaching −1.22 % in the fourth quarter.

In 2015, the GDP deflator (P_GDP) could rise to 0.70 % and further improve to 1.52 % in 2016. By quarters, it could rise to 0.15 % in the first quarter of 2015, continue to rise to 0.98 % in the second quarter, and, after an apparent fall, rebound until the fourth quarter to 1.18 %. In 2016, the index could show a tendency of low after high and then fall to 0.92 % by the fourth quarter (Fig. 3.5).

Overall, the Chinese economy is facing a downward pressure in 2015, but the economic growth rate is expected to be over 7.0 % and the full-year GDP growth rate is expected to be around 7.14 %. Inflation in China continues to drop beyond the current low level, and the CPI is expected to rise by 1.74 % through the year. We predict that under the gradually appearing effects of China's comprehensively

deepened reform policy and the world economic recovery, the country's GDP growth rate will recover in 2016; the CPI growth rate will also increase.

3.2.3 Forecasts of Growth Rates of Other Major Macroeconomic Indicators

3.2.3.1 Export, Import, and Reserve Growth

The CQMM predicts that in 2015, the speedy relief of the US economic recovery and eurozone economic crisis will promote China's imports and exports to a certain extent. In 2015, based on the present price levels, China's total exports are expected to grow by 8.02, 1.94 % higher than that of 2014. The country's import growth will rise to 7.57 %, a significant increase of 7 % from 2014 (see Table 3.1). By quarters, China's year-on-year export growth in the first and second quarters of 2015 soars, respectively, to 11.49 % and 11.41 % from the previous year, falls slightly in the third quarter to 8.12 %, and reaches 9.62 % in the fourth quarter. The year-on-year growth in imports in the first quarter of 2015 could reach 4.89 %, rebound quarter by quarter, and rise to 10.45 % in the fourth quarter. Because of the increase in export growth rate, China's foreign exchange reserves could grow by 4.05 % in 2015. In 2016, following recovery of the external market demand, China's imports and exports will continue to grow steadily. At the current USD prices, the export growth rate is expected to reach 7.75 % and import growth rate expected to reach 6.11 %. China's foreign exchange reserves may grow by 3.09 % in 2016 (Table 3.1, Fig. 3.6).

3.2.3.2 The Growth Rate of Total Fixed Capital

The CQMM predicts that in 2015 (Fig. 3.7), on account of the weak real estate market and undigested excess production capacity and based on current prices, the urban fixed asset investment growth rate will be 10.65, 4.57 % lower than that in 2014. In 2016, following the recovery in manufacturing and a new round of urbanization, the demand for urban investment will increase further and the growth rate of urban fixed asset investment will rebound to 12.96 %. By quarters, the growth rate of urban fixed asset investment (present price) will slightly fall to 8.34 % in the first quarter of 2015 but gradually rise to 12.08 % by the fourth quarter. In 2016, except for the second quarter, it will be maintained at more than 13 %.

Table 3.1 Forecast of growth rates of exports and imports and foreign exchange reverse in 2015–2016 (Unit: %)

Time	Exports				Imports				Foreign Exchange Reserves
	At constant price	At current price	General trade at current price	Processing trade at current price	At constant price	At current price	General trade at current price	Processing trade at current price	At current price
2015	**10.12**	**8.02**	**7.09**	**10.02**	**8.89**	**7.57**	**7.80**	**12.67**	**4.05**
Q1	11.49	12.62	9.26	11.60	4.94	4.89	−1.49	21.15	−0.20
Q2	11.41	10.92	9.22	13.39	10.62	7.78	8.23	16.25	−1.34
Q3	8.12	4.61	4.84	7.94	10.08	7.17	10.75	8.34	1.89
Q4	9.62	4.70	5.33	7.54	9.96	10.45	14.41	6.39	4.05
2016	**9.68**	**7.75**	**8.48**	**7.32**	**8.16**	**6.11**	**8.41**	**3.65**	**3.09**
Q1	9.39	7.52	8.11	8.17	8.57	6.92	10.05	3.48	3.49
Q2	8.99	6.54	6.97	6.65	8.03	5.39	7.69	2.84	3.48
Q3	10.57	8.91	9.88	7.78	8.32	6.19	7.95	4.46	3.28
Q4	9.73	7.99	8.92	6.74	7.73	5.96	8.05	3.80	3.09

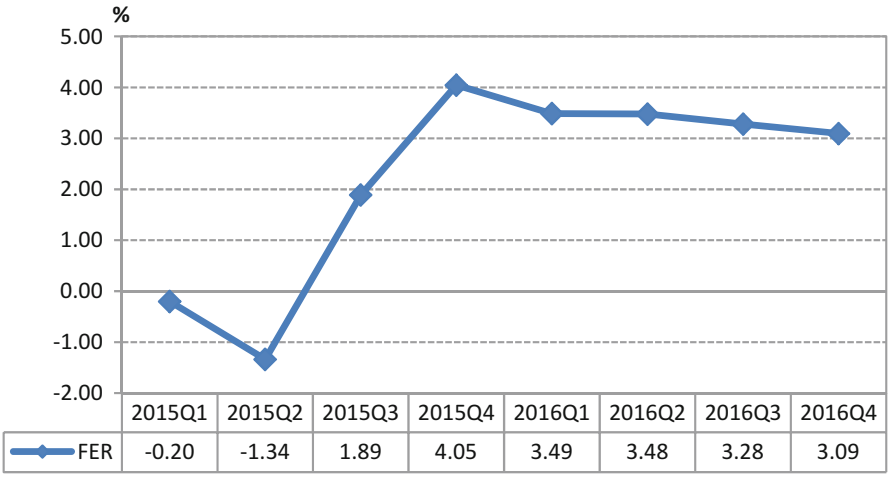


Fig. 3.6 The growth rate of reserves (year-on-year basis)

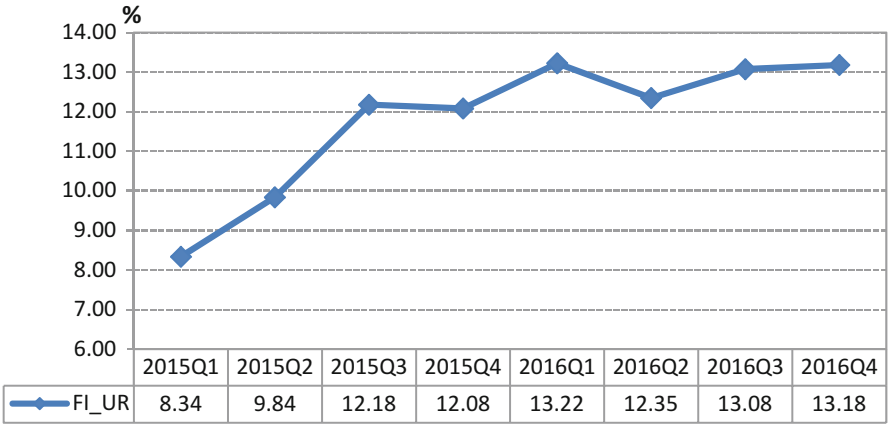
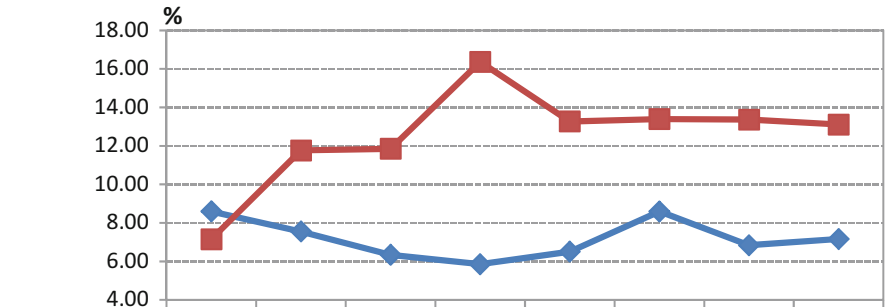


Fig. 3.7 The growth rate of total fixed capital formation (year-on-year basis) (Note: FI_UR denotes the growth rate of urban fixed capital formation at current prices)

3.2.3.3 The Growth Rate of Consumption

According to the CQMM prediction, in 2015, with the prices kept constant, the total consumption of residents will grow by 7.06 %, a decrease of 0.21 % from 2014; it would then rise slightly to 7.26 % in 2016 and maintain stability. In 2015, at the present price level, the total retail sales of social consumer goods will grow by 11.80 %, a decrease of 0.32 % from 2014, and rise slightly to 13.28 % in 2016.

By quarters, the growth rate of total residents' consumption (at constant prices) will peak to 8.60 % in the first quarter of 2015, then fall back quarter by quarter, and finally reach 5.86 % by the fourth quarter. In 2016, it will basically remain



	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1	2016Q2	2016Q3	2016Q4
CON_D_C	8.60	7.55	6.34	5.86	6.51	8.60	6.84	7.16
RETAIL	7.16	11.76	11.85	16.37	13.27	13.39	13.36	13.11

Fig. 3.8 The growth rate of consumption (year-on-year basis) (Note: CON_D_C denotes the growth rate of resident consumption at constant price and Retail denotes the growth rate of retail consumer goods sales at current prices)

stable and reach the annual peak of 8.60 % by the second quarter and then fall back to 7.16 % by the fourth quarter. The growth of total retail sales of social consumer goods (present price) will improve every quarter of 2015, and driven by base effects of the previous year's fourth quarter, it will rise to 16.37 %. In 2016, the increase will be relatively stable and will remain between 13.1 and 13.4 % each quarter (Fig. 3.8).

In conclusion, we present the CQMM predictions as follows:

1. In 2015, it is the final year of the 12th five-year plan and the year the Chinese economy moves toward the new normal, the real estate market will continue to adjust, real estate investment and manufacturing will remain at the low end, and infrastructure investment will continue to play the role of palm of steady growth. Simultaneously, a transformation between the old and new mechanisms on account of various promotional reforms will produce a certain degree of uncertainty in economic growth. The expected economic growth rate of China in 2015 is 7.14 %, a slight decrease of 0.23 % from 2014, and the country's CPI is expected to rise by 1.74 %. If the economic growth rate stays over 7 % and the employment situation is basically stable, it will create favorable conditions for the Chinese government to achieve the goal of the 12th five-year plan and enter a new stage of development and to speed up the implementation of its comprehensively deepening reforms.
2. In 2015, it is the key year to comprehensively deepen China's reforms. Carrying out comprehensively deepening reform measures will optimize the allocation of resources, recycle the potential of economic growth, and stimulate the vitality of economic development. By accelerating the administrative examination and approval system reform, finance and tax reform, and financial reform and formulating the industry and regional planning policies intensively, the system will release further bonuses. The promotion of China's (Shanghai) reform

experience of free trade area can be copied, and the government's widely implemented negative listing management technique will further widen the space of private investment, improve the proportion of private investment, improve the quality and efficiency of economic growth, gradually enlarge the residents' income and consumption, and promote the economic growth transformation mode. The GDP growth rate is expected to increase by about 0.06 % in 2016 over the previous year.

3. In 2015, the eurozone will continue its weak economic growth, but the strong recovery of the US economy might promote the steady rise of China's imports and exports. Furthermore, at current prices, the total exports of China are expected to grow by 8.02 %, an increase of 1.94 % over the previous year. The growth rate of China's total imports could rise to 7.57 %, a significant increase by 7 % over the previous year, and, consequently, its trade surplus could further narrow down.
4. Following the decline in economic growth, all kinds of hidden risks would tend toward innovation, all kinds of risks that resolve high leverage and bubbles into the main characteristics will continue for a period of time, real estate investment will become weak, and the pressure of the manufacturing industry's liquidation could inhibit the growth of investment in fixed assets. However, with China's "One Belt and One Road" policy, its new strategy for urbanization, construction, and the rapid development of the equipment manufacturing industry, emerging areas such as high-tech industry will continue to promote the fast growth of investment in fixed assets. The expected growth of urban fixed asset investment in 2015 is 10.65 %, at current prices, down 4.57 % from the previous year. At the same time, the comprehensively deepening reforms in investment, trade, finance, services, state-owned enterprises, and so on, especially the system mechanism innovation, will also open up new investment options and attract social capital to participate in investment. The growth rate of urban fixed asset investment is expected to rise to 12.96 % in 2016.

Chapter 4
Policy Simulations

4.1 Background Analysis of Policy Simulations

Following the continued decline in economic growth, China's fiscal revenue growth fell to 8.6 % in 2004, the lowest growth rate in 23 years. However, the fiscal revenue share of GDP did not fall[1] but showed a slight increase of 0.1 percentage points over the previous year. *The generalized government revenue as a share of GDP remained high at 37.2 %.*

The reasons are as follows. First, from the fiscal revenue structure, the economic slowdown affected the tax revenue growth, which fell significantly. Its proportion of fiscal revenue declined from 88.1 % in 2010 to 84.9 % in 2014. At the same time, the growth of nontax revenue increased significantly, its proportion reaching 15.1 % of fiscal revenue (see Table 4.1). Nontax revenue had become an important means for local governments to make up for declining tax revenue. Second, by structure of tax revenue, the growth of indirect taxes slowed down primarily in VAT, business taxes, consumption taxes, customs duties, and other turnover taxes. Because of the growth of income and automobile consumption and the tax base for real estate tax and other taxes related to the state-owned land expansion and their high growth, the growth of direct taxes remained high. In fact, since 2011, the growth of direct taxes has been higher than that of indirect taxes in China. In 2014, the growth rate of direct taxes was 9.7 %, which was higher than that of indirect taxes by 3 %. Affected by these, the ratio of direct to indirect taxes increased substantially, from 0.48 in 2010 to 0.59 in 2014 (Fig. 4.1).

The *Decision* pointed out that the gradually increasing proportion of direct taxes is important to deepen China's tax reform and improve the tax system. In the past three years, following the significantly higher growth of direct taxes compared to indirect taxes, the proportion of direct taxes increased rapidly. This seems to satisfy

[1] See the footnote of Table 4.1 for related estimation instructions.

Center for Macroeconomic Research of Xiamen University,
China's Macroeconomic Outlook, Current Chinese Economic Report Series,
DOI 10.1007/978-3-662-47473-0_4

Table 4.1 Changes in fiscal revenue indicators from 2010 to 2014 (in billion yuan)

Items	2010	2011	2012	2013	2014
Fiscal revenue	8310.15	10387.44	11725.35	12920.96	14035.00
Tax revenue	7321.08	8973.84	10061.43	11053.07	11915.80
Nontax revenue	989.07	1413.60	1663.92	1867.89	2119.20
Tax-to-revenue ratio (%)	88.1	86.4	85.8	85.5	84.9
Nontax-to-revenue ratio (%)	11.9	13.6	14.2	14.5	15.1
Governmental fund revenue	3678.50	4136.31	3753.49	5226.88	5409.30
State-owned capital management: revenue	55.87	76.50	149.59	171.34	190.00[a]
Social insurance fund: revenue	1707.07	2575.77	3141.10	3599.36	4029.20[a]
GDP	40151.28	47310.4	51947.01	58801.9	63646.3
Fiscal revenue-to-GDP ratio (%)	20.7	22.0	22.6	22.0	22.1
Government revenue	13751.59	17176.02	18769.54	21918.53	23663.50
Government revenue-to-GDP ratio (%)	34.2	36.3	36.1	37.3	37.2

Notes: 1. The government revenue defined here mainly consists of four parts: fiscal revenue, government fund revenue, the state-owned capital operating income, and social insurance funds. 2. The data table marked with [a]is estimated by the authors. Among them, the state-owned capital operating income is obtained as follows: the 2014 central state-owned capital operating income plus the difference between the average state capital operating income and average central state capital income for 2011–2013. The social insurance fund income is obtained as follows: the national social security fund plus the growth rate of the difference between the social insurance fund revenue and national social security fund revenue for 2011–2013

the requirements of the Decision for the reform of the tax system. However, the rise in proportion of direct taxes due to the difference in growth rates between direct and indirect taxes is different from that due to tax adjustments.[2] The former is unstable, because once the economic situation changes, the proportion of direct taxes may subsequently reverse. The declining share of indirect taxes due to economic slowdown is not the result of declining marginal tax rate, but the result of declining tax base. It only meets the Decision's requirement in a statistical sense and is not the reform result of perfecting the tax system and adjusting the economic structure that the Decision raises. The marginal tax effect of individual production or consumption behavior has not changed.

Because the tax structure is mainly based on indirect taxes, the tax burden can easily be transferred from producers to consumers and hence consumers actually

[2] Structural tax cuts over the past few years, such as "replacing business tax with VAT," tax cuts for micro- and small businesses, and property tax pilot. Although the tax system was fine-tuning, overall, it did not substantially adjust the indirect tax-based tax system. The decline in indirect taxes share, especially the low growth of VAT and business tax, was mainly due to the real economy shrinking and service trade slowdown.

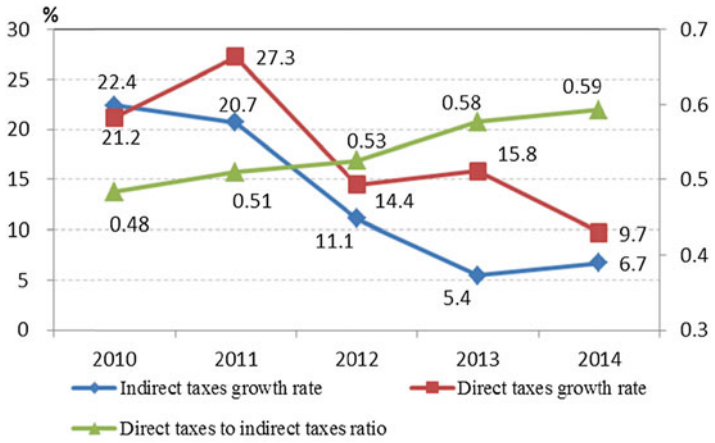


Fig. 4.1 The 2010–2014 growth rate and ratio changes of direct and indirect taxes (Data source: CEIC, Notes: 1. Indirect taxes are of 10 types: VAT, business tax, consumption tax, customs duties, excise duty and VAT of imported products, urban maintenance and construction tax, resource tax, stamp duty, tobacco tax, and tonnage tax. Direct taxes are of nine types: property tax, corporate income tax, personal income tax, urban land use tax, land value increment tax, travel tax, deed tax, cultivated land usage tax, and vehicle purchase tax. 2. The city maintenance and construction tax for 2014 is extrapolated by its proportion of VAT, sales tax, and excise tax for 2010–2013. The resource tax, stamp duty, tobacco tax, property tax, travel tax, vehicle purchase tax, tonnage tax, and other small taxes are extrapolated by their growth rate in 2013)

bear most of the tax burden. This reduces the consumers' disposable income and thereby inhibits the growth of consumption. In addition, indirect taxes do not have vertical equity features. Therefore, by reducing the proportion of indirect taxes, increasing the proportion of direct taxes, and levying more taxes directly related to the level of personal income, taxes can help balance the income distribution between businesses and residents, narrow down the income gap between all income classes, and promote consumer spending.

Finally, compared to other countries, the current ratio of direct taxes in China is still low. The proportion of direct taxes in China is lower than that in not only the developed high-income countries but also the same-income (upper-middle income), middle-income, and lower-middle-income countries (Table 4.2). Thus, there is large room for increasing the share of direct taxes in China.

In our view, we should focus on the Decision's requirements.[3] We should also adjust the indirect marginal tax rates, lower the indirect taxes initiatively, and reduce the total tax burden of the national economy. This could lead to the following advantages:

[3] The *Decision* requires that "We should advance VAT reform and simplify rate levels, and adjust the scope and rate of the consumption tax. Energy and pollution-intensive products and some high-end consumer products will be subject to a consumption tax. We should establish an individual income tax system in which taxable income is defined in both comprehensive and categorized ways. We should accelerate property-tax legislation and related reform at an appropriate time and change the current environmental-protection fee into an environment tax."

Table 4.2 Changes of the ratio of indirect tax to direct taxes in some countries and regions from 2007 to 2012

Country	2007	2008	2009	2010	2011	2012
Australia	2.63	2.72	2.65	2.35	2.49	2.68
Brazil	1.23	1.15	1.15	1.06	1.13	1.13
India	1.11	1.12	1.43	1.24	1.24	1.10
Japan	1.74	1.49	1.17	1.23	1.29	1.36
Peru	1.04	0.96	0.89	0.89	1.05	1.11
The USA	16.57	14.71	11.96	12.65	12.86	13.01
The eurozone	0.91	0.88	0.82	0.76	0.78	0.76
OECD countries	1.12	1.06	0.90	0.81	0.88	0.85
High-income countries	1.00	1.01	0.91	0.84	0.82	0.82
Middle-income countries	0.59	0.67	0.65	0.62	0.61	0.57
Upper-middle-income countries	0.64	0.65	0.67	0.58	0.53	0.55
Lower-middle-income countries	0.49	0.57	0.59	0.54	0.57	
The world average	**0.63**	**0.68**	**0.65**	**0.63**	**0.63**	**0.62**
China a	0.56	0.47	0.41	0.36	0.39	
China b	**0.44**	**0.49**	**0.49**	**0.48**	**0.51**	**0.52**

Notes: 1. Except for the data of China b that is obtained from CEIC database, the remaining data are obtained from WDI 2014. 2. The specific algorithm is (taxes on income, profits and capital gains + other taxes)/(taxes on goods and services + taxes on international trade). Among them, the other taxes include taxes on wages and labor, confiscation of property, income tax, and other revenues that have not been categorized

1. The increase in proportion of direct taxes will be stable and not a temporary adjustment based on economic growth.
2. Although it could bring about short-term reduction in indirect taxes, in the long term, it is conducive to economic transformation and upgrading. By promoting business investment, it can stimulate economic growth, bring about sustainable tax revenue growth, and avoid the risk of passive adjustments that can lead to continued decline of tax revenue growth rate.
3. Under the "tax price" system designed in China, it could reduce the indirect taxes' marginal rate, bring down the price level, increase the household purchasing power, promote residual consumption, stimulate economic growth, and improve the demand structure.

4.2 Scenario Design of Policy Simulations

Further to the above analysis, we use the CQMM to simulate macroeconomic effects and increase the ratio of direct taxes to indirect taxes to the world average (0.63) from 2012 to 2014. This helps us to verify the aforementioned qualitative judgment and give policy recommendations. Our policy simulation design is as follows:

1. Lower the indirect tax revenues from 2012 and gradually adjust the 2014 Chinese ratio of direct and indirect taxes in Fig. 4.1 to the world average (0.63).

2. To achieve our hypothesis goal, we design the following two scenarios:

   Scenario 1: Keeping the total tax burden on the national economy unchanged, we adjust the ratio of direct and indirect taxes to the new scale by lowering the indirect taxes and raising the direct taxes. Therefore, the average annual decline in indirect taxes from 2010 to 2014 is 118.65 billion yuan, and the increase of direct taxes is the same amount each year. After adjustments, the ratios of China's direct taxes to indirect taxes for 2102, 2013, and 2014 were 0.55, 0.60, and 0.63, respectively. Considering the tax feedbacks on endogenous macroeconomic variables, the actual ratio of the simulation results may vary. In this scenario, the simulation adjusts only the structure of direct taxes and indirect taxes and does not reduce the overall national economy macroeconomic effects of tax burden.

   Scenario 2: Keeping the direct taxes unchanged, we reduce the indirect taxes. The direct and indirect taxes will adjust to the new scale, reducing the overall tax burden on the national economy. While the average annual decline from 2012 to 2014 in indirect taxes is 318.24 billion yuan, after adjustment, the ratios of China's direct taxes to indirect taxes for 2012, 2013, and 2014 will be 0.55, 0.60, and 0.63, respectively. Similarly, considering the tax feedbacks on the endogenous macroeconomic variables, the actual ratio of the simulation results may vary. Under this scenario, the simulation incorporates both the tax structure adjustment of direct and indirect taxes and the overall national economy macroeconomic effects of reducing the tax burden.

The economic logic behind these policy simulations is as follows. Under Scenario 1, on the one hand, the decline of indirect taxes would reduce fiscal revenue, which would in turn reduce fiscal expenditure and dampen GDP growth. On the other hand, the decline in indirect taxes would reduce business costs, expand production and sales, and lead to increased profits, expand the investment needs of self-financed business capital. Furthermore, the decline in indirect taxes would lower the price level and promote consumption, both of which stimulate economic growth and lead to the sustained growth of tax income. In contrast, increasing the direct taxes would reduce corporate income and self-raised enterprise investment. On the other hand, it would reduce the disposable income and lead to a decline in residual consumption. Macroeconomic changes occur as a result of both tax strategies together. Under Scenario 2, the decline of indirect taxes is based on exogenous assumptions, and so direct taxes are endogenous on the changes of economic growth.

4.3 The Result of Policy Simulations

4.3.1 The Simulation Result of Scenario 1

First, the tax structure adjustment in 2012 led to a slight reduction in economic growth; this was slightly lower than the reference value by 0.02 percentage points. However, in the next two years, thanks to the acceleration of urban fixed investment growth and the rise in residual consumption, the GDP growth rate was higher than

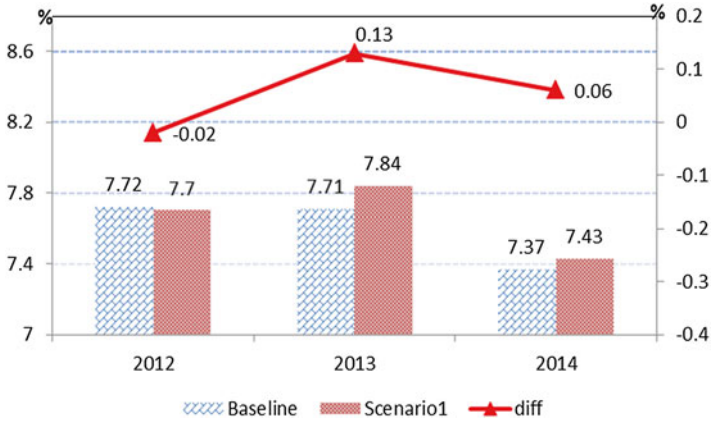


Fig. 4.2 Changes in GDP growth rate (Note: Baseline denotes benchmark simulation; Scenario 1 denotes the simulation result of Scenario 1; diff denotes the simulation result difference between Scenario 1 and Baseline)

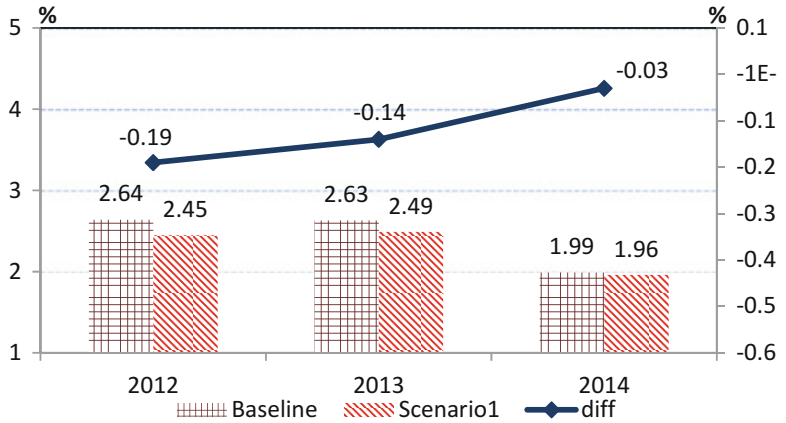


Fig. 4.3 Changes in price level (Note: Baseline denotes benchmark simulation; Scenario 1 denotes the simulation result of Scenario 1; diff denotes the simulation result difference between Scenario 1 and Baseline)

the reference value by 0.13 and 0.06 percentage points, respectively, in 2013 and 2014 (Fig. 4.2). Thus, a reduction in indirect taxes and rise in direct taxes, although it has a slightly negative impact on economic growth in the short term, can promote economic growth in the long term.

Second, a reduction in indirect taxes would decrease the price level slightly and increase resident consumption. In 2012, the CPI was about 2.45, 0.19 percentage points less than the reference value. This then dropped and was less than the reference value by 0.14 and 0.03 percentage points in 2013 and 2014, respectively (Fig. 4.3).

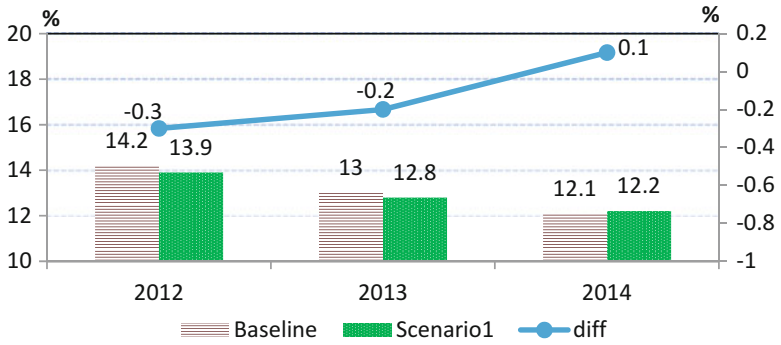


Fig. 4.4 Changes in growth of total social retail sales (Note: Baseline denotes benchmark simulation; Scenario 1 denotes the simulation result of Scenario 1; diff denotes the simulation result difference between Scenario 1 and Baseline)

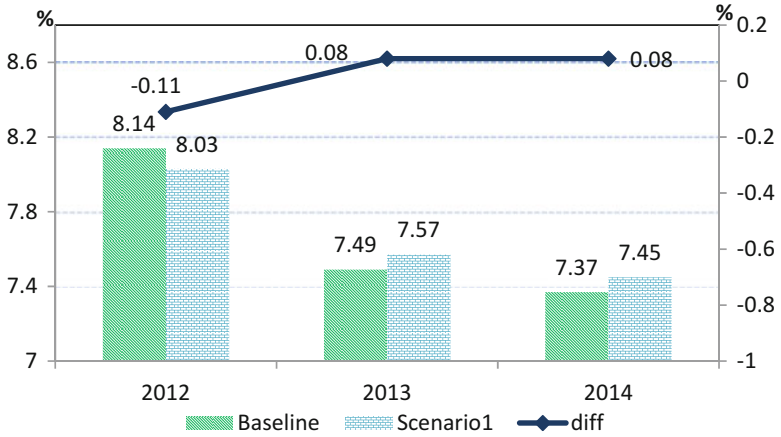


Fig. 4.5 Changes in residual consumption growth at comparable prices (Note: Baseline denotes benchmark simulation; Scenario 1 denotes the simulation result of Scenario 1; diff denotes the simulation result difference between Scenario 1 and Baseline)

Following the rise in direct taxes and dilution of price declines, the nominal growth rate of total retail sales was less than the reference value by 0.3 and 0.2 percentage points in 2012 and 2013, respectively. However, with the rise in economic growth, the nominal growth rate of total retail sales in 2014 was higher than the reference value by 0.1 percentage point (Fig. 4.4). After excluding the price factor, the growth rate of residual consumption, except when it was less than the reference value by 0.11 percentage points in 2012, was higher than the reference value by 0.08 percentage points both in 2013 and 2014 (Fig. 4.5). This suggests that for residual consumption, the incentive effect of decline in price level due to reduction in indirect taxes is greater than the inhibition of increasing direct taxes. Tax restructuring would improve the fairness of the tax burden and raise resident consumption.

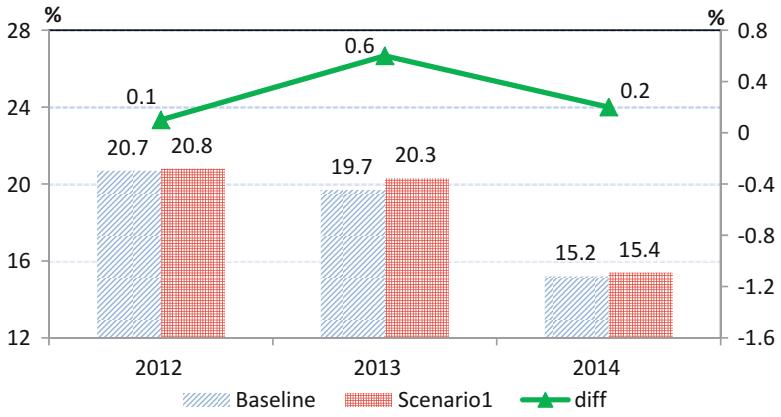


Fig. 4.6 Changes in urban fixed asset investment growth (Note: Baseline denotes benchmark simulation; Scenario 1 denotes the simulation result of Scenario 1; diff denotes the simulation result difference between Scenario 1 and Baseline)

Third, urban fixed asset investment is expected to increase rapidly. Because the total amount of tax has remained unchanged, changes in the ratio of direct and indirect taxes would have little effect on government-led investment, but would have a positive impact on the investment of self-financed enterprise capital, which promotes the overall urban investment growth. The urban fixed asset investment growth for 2012, 2013, and 2014, compared with the reference value, increased by 0.1, 0.6, and 0.2 percentage points, respectively (Fig. 4.6). Among them, self-finance business investment growth improved by 0.1, 0.8, and 0.2 percentage points, respectively, compared with the reference value. This shows that China's current tax system based on indirect taxes indeed inhibits the expansion of private investment. Against the current background of weak business investment will, a reduction in burden of companies would improve the business investment will and effectively promote the growth of investment.

Fourth, the total demand structure is slightly inclined toward investment. After adjustment of the tax structure, the absolute amount of both household consumption and investment would increase, but in view of the ratio of investment and consumption, it would decrease slightly, because investment grew faster than consumption. Compared with the reference value, the ratio of household consumption for 2012, 2013, and 2014 decreased by 0.03, 0.05, and 0.05 percentage points, respectively (Fig. 4.7); therefore, the investment share increased slightly by 0.03, 0.12, and 0.13 percentage points, respectively, compared with the reference values (Fig. 4.8).

Finally, the growth rate of direct taxes increased at first and then decreased, while the growth of indirect taxes was in the opposite direction. In 2012, the reduction in indirect taxes led to a fall in indirect taxes growth rate by 2.05 percentage points compared with the reference value. However, as the economic growth accelerated, the lagged growth effect of indirect taxes gradually increased. Coupled with the base effect of the previous year, although the indirect taxes continued to decline by

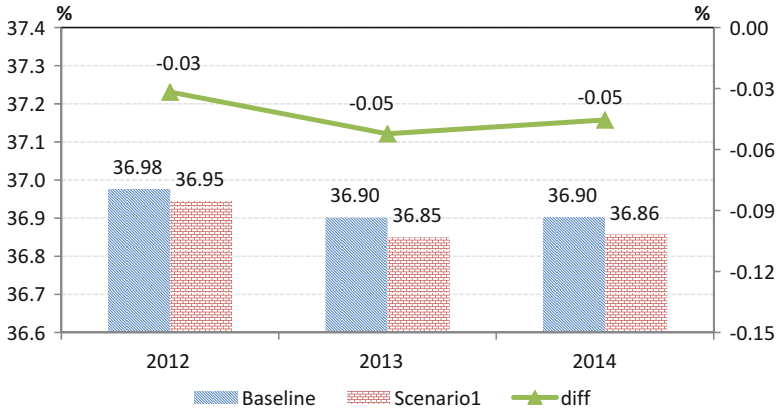


Fig. 4.7 Changes in the division of residual consumption (Note: Baseline denotes benchmark simulation; Scenario 1 denotes the simulation result of Scenario 1; diff denotes the simulation result difference between Scenario 1 and Baseline)

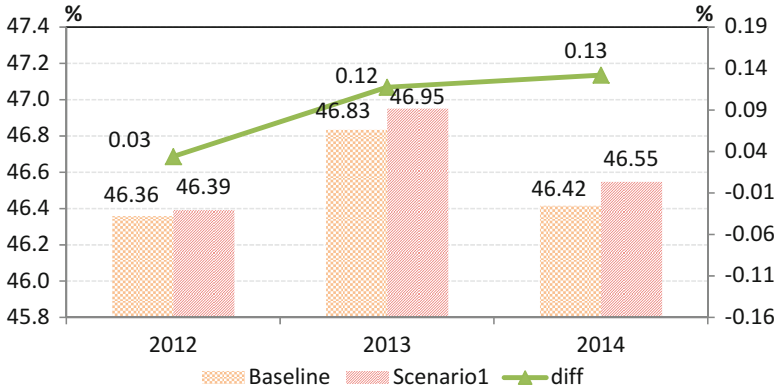


Fig. 4.8 Changes in the division of gross capital formation (Note: Baseline denotes benchmark simulation; Scenario 1 denotes the simulation result of Scenario 1; diff denotes the simulation result difference between Scenario 1 and Baseline)

118.65 billion yuan a year, the year-on-year growth appeared to rise, increasing by 0.11 and 0.15 percentage points in 2013 and 2014, respectively (Fig. 4.9a), compared with the reference value; direct taxes showed the opposite trend. In 2012, an increase in direct taxes substantially raised the year-on-year growth rate, which was 3.4 percentage points higher than the reference value. In 2013 and 2014, this slightly decreased by 0.5 and 0.2 percentage points, respectively (Fig. 4.9b), suggesting that the increasing effect of economic growth on direct taxes is stronger than that on indirect taxes. Thus, the ratios of direct taxes to indirect taxes in the final simulation results for 2012, 2013, and 2014 were 0.55, 0.61, and 0.62, respectively, close to the initial target. The total tax revenue growth remained unchanged.

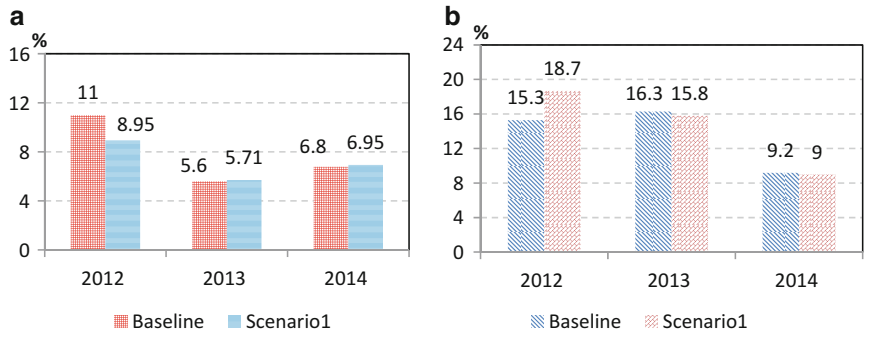


Fig. 4.9 Changes in classified tax growth rate. (**a**) Change of direct tax growth. (**b**) Change of indirect tax growth (Note: Baseline denotes benchmark simulation; Scenario 1 denotes the simulation result of Scenario 1; diff denotes the simulation result difference between Scenario 1 and Baseline)

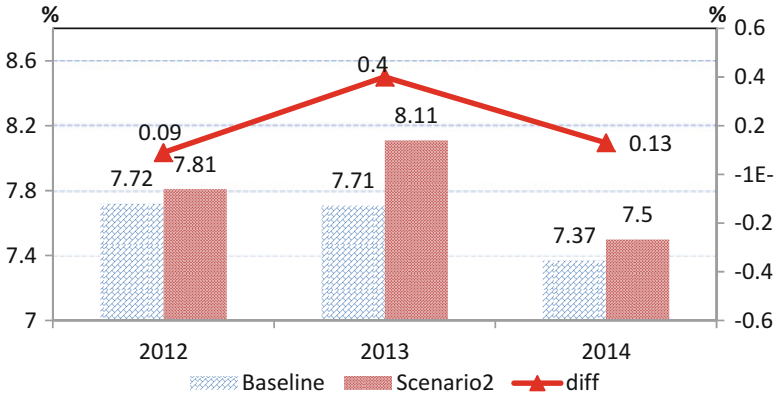


Fig. 4.10 Changes in GDP growth rate (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

4.3.2 The Simulation Results of Scenario 2

Scenario 2 assumes that direct taxes are kept constant, indirect taxes go down, and the change in proportion of direct and indirect taxes is due to the decrease in indirect taxes. Therefore, the difference between the two scenarios is not only with regard to change in proportion of the two kinds of taxes but also decrease in total taxes of the national economy. The policy simulation results indicate the following:

First, there are strong promotional effects on economic growth. In 2012, 2013, and 2014, the growth rate of GDP increased by 0.09, 0.40, and 0.13 percentage points, respectively, compared with the reference values (Fig. 4.10), obviously higher than the deviation from the reference values in Scenario 1 (Fig. 4.2). This

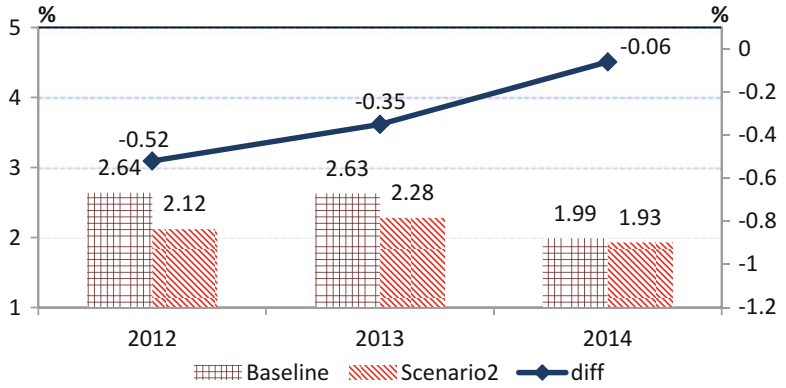


Fig. 4.11 Changes in CPI (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

shows that the direct and indirect tax structure adjustments are stronger with tax-reducing effects than without tax-reducing effects for promoting economic growth. Tax reduction has extra promotional effects on economic growth.

Second, the decline range of price level is higher. Moreover, since the direct tax is constant, the growth rate of residents' consumption in comparable prices increases further. In 2012, 2013, and 2014, the CPI decreases by 0.52, 0.35, and 0.06 percentage points, respectively, compared with the base values (Fig. 4.11).

The relatively higher decline range of price leads a higher decline range of nominal growth rate of the social consumption goods' total retail sales. In 2012, the nominal growth rate of social consumption goods' total retail sales decreased by 0.6 percentage points compared with the base values; however, it increases rapidly later, by 0.3 percentage points, compared with the base values until 2014 (Fig. 4.12). The growth rate of residents' consumption in comparable prices obviously accelerates without an increase in direct taxes. It increased by 0.06, 0.31, and 0.16 percentage points in 2012, 2013, and 2014, respectively, compared with the base values (Fig. 4.13); the growth rate is obviously higher than the simulation results in Scenario 1 (Fig. 4.5).

Third, because of decrease in the national economy's overall tax, the increase in growth rate of urban fixed asset investment is more significant. The growth rate of urban fixed assets investment increased by 0.5, 1.7, and 0.5 percentage points in 2012, 2013, and 2014, respectively, compared with the base values (Fig. 4.14).

Fourth, as with Scenario 1, although the residents' consumption increases in absolute value, its proportion in aggregate demand structure appears to slightly shrink because of faster increase in investment, but the range of shrinkage is less than that in Scenario 1. The ratio of residents' consumption over GDP decreases by 0.01, 0.04, and 0.03 percentage points in 2012, 2013, and 2014, respectively, compared with the base values (Fig. 4.15); the decline range each year is lower than the results in Scenario 1 and the investment proportion increases further. The

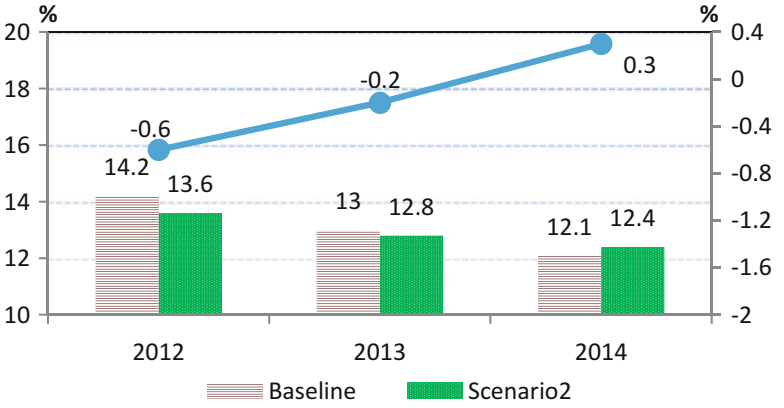


Fig. 4.12 Changes in growth rate of total social consumption goods' retail sales (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

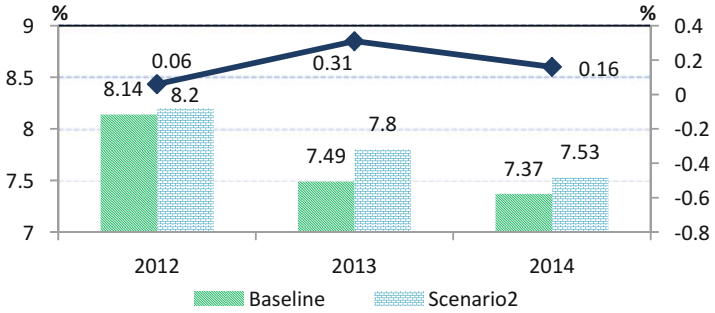


Fig. 4.13 Changes in growth rate of residents' consumption in comparable prices (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

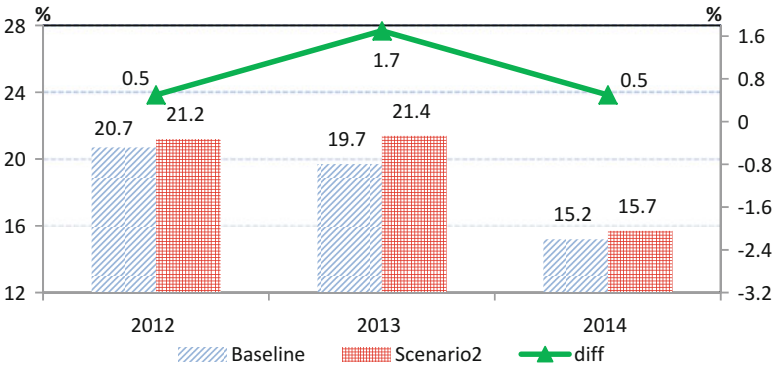


Fig. 4.14 Changes in growth rate of urban fixed asset investment (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

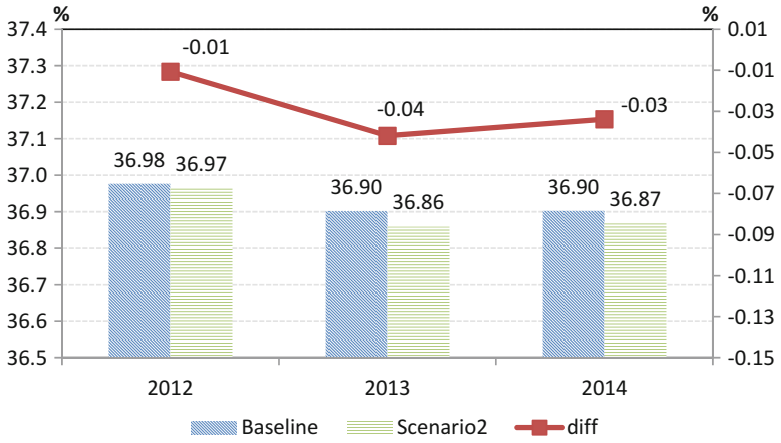


Fig. 4.15 Changes in proportion of residents' consumption (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

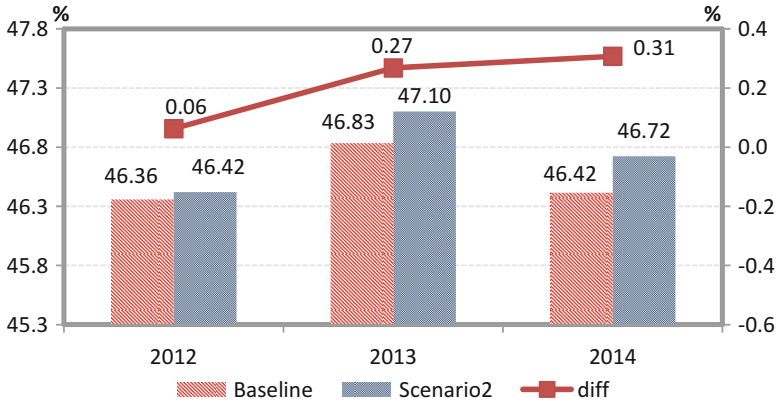


Fig. 4.16 Changes in proportion of gross capital formation (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

ratio of gross capital formation over GDP increases by 0.06, 0.27, and 0.31 percentage points in 2012, 2013, and 2014, respectively, compared with the base values (Fig. 4.16).

Finally, as with Scenario 1, following the recovery of economic growth, although a certain fixed amount of indirect taxes decreases each year, the growth rate of indirect taxes increased by 0.3 and 0.38 percentage points in 2013 and 2014, respectively, compared with the base values (Fig. 4.17a), but in 2012 there appears a relatively larger decline range, with a 5.31 percentage points decrease

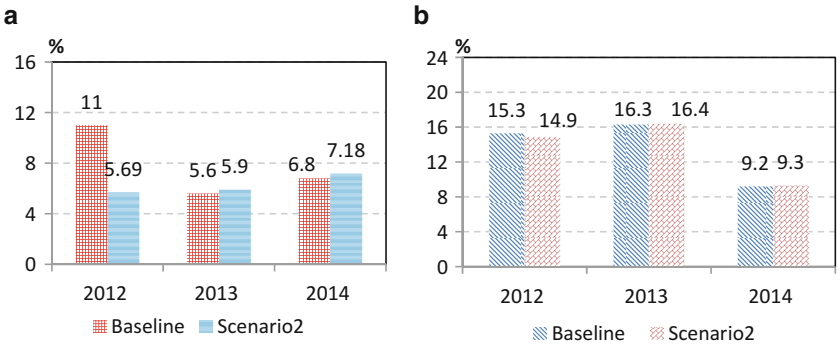


Fig. 4.17 Changes in growth rate of classified taxes. (**a**) Changes in growth rate of indirect taxes. (**b**) Changes in growth rate of direct taxes (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

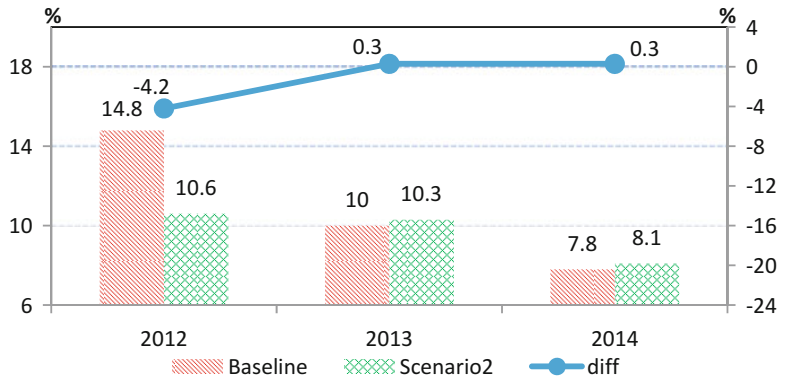


Fig. 4.18 Changes in growth rate of gross tax revenue (Note: Baseline denotes basic simulation; Scenario 2 denotes the simulation results in Scenario 2; diff denotes the difference between the simulation results in Scenario 2 and the basic simulation results)

compared with the base values. The growth rate of direct tax is basically stable (Fig. 4.17b). In 2012, the growth rate goes down by 0.4 percentage points compared with the base values, but it increases by 0.1 percentage points in the following two years. The ratio of direct taxes to indirect taxes in the final simulation results is 0.55, 0.61, and 0.62 for 2012, 2013, and 2014, respectively, the same simulation results in Scenario 1.

In terms of gross tax revenue, affected by the large decline range of indirect taxes, the growth rate of gross tax revenue in 2012 decreased by 4.2 percentage points from the base values and then increased by 0.3 percentage points over the base values in both 2013 and 2014 (Fig. 4.18). Reducing the tax not only does not decrease the long-term growth rate of gross tax revenue, but, through the

optimization of tax structure, maintains the sustainable long-term growth of the gross tax revenue.

In summary, the results of policy simulation are as follows:

1. The tax structure adjustment of reducing indirect taxes and increasing direct taxes helps in decreasing the price level; improves consumption; promotes investment, especially private self-financed investment; and finally boosts economic growth. This clearly illustrates that the current tax structure of China, which mainly depends on indirect taxes, dampens enterprise investment and residents' consumption. For the Chinese economy, further accelerating the tax structure adjustment, decreasing the indirect tax proportion, and increasing the direct tax proportion are the policy issues that needs to be solved as soon as possible if the economy is to enter the new development stage.
2. A comparison of the two policy simulations (Scenario 1 and Scenario 2) shows that the adjustment of proportion of direct and indirect taxes with reducing tax effects (Scenario 2) has stronger effects on the economy's growth rate, residents' consumption, and investment in urban fixed assets than the adjustment without reducing tax effects (Scenario 1). This shows that while adjusting the tax structure, reducing the national economy's gross tax has better policy effects currently.
3. Reducing indirect taxes can lead to slightly adverse effects for the aggregate demand structure. While the residents' consumption increases in absolute terms, its proportion in aggregate demand decreases slightly. Benefiting from the accelerating investment, the proportion of gross capital formation will increase. However, since the growth rate of residents' consumption keeps stable and even appears to increase—this structure change mainly reflects that the decrease in indirect taxes promotes investment, rather than depresses consumption—as a whole, its effects on the economic growth is positive.
4. Although reducing the indirect taxes could cause the growth rate of the gross tax revenue to fall in the short term, the growth rate of residents' consumption and private investment will increase. Moreover, the long-term recovery of the economic growth rate ensures that the growth rate of the gross tax revenue does not persistently decline; it also assures the long-term sustainable growth of tax revenue.

From the policy simulation of the CQMM and analysis of the current Chinese economic issues, we consider a current moderate decrease in indirect taxes and a subsequent moderate reduction in the national economy's gross tax not only feasible but also necessary. We might even say that this is one of the key possibilities to recreate the Chinese economy's potential growth in the next stage.

First, the policy simulation results show that a decrease in indirect taxes will not produce serious negative effects whether the gross tax revenue keeps constant or moderately decreases but helps to stimulate the growth of residents' consumption and private investment instead and therefore boosts the economic growth. This shows that reducing indirect taxes has a positive effect on the macroeconomy and deserves to be given a try.

Second, the Chinese policy practices in the last three years show that the easing monetary policy is too weak to attract social investment and promote economic growth because of serious transmission barriers. The structural contradiction is the major sticking point of the current Chinese economy. This makes the monetary policy, which is good at gross controlling, especially inflation controlling, difficult to work. In comparison, fiscal policy is better for structure adjustment. Fiscal policy is nothing more than reducing tax and increasing spending; the increase in spending is limited to the tax revenue and government debts, and tax reduction is relatively uncontrolled. Moreover, the theory of the supply-side economist and policy practices of US President Reagan have already shown that reducing taxes is not equal to reducing fiscal revenue.

Third, from the perspective of implementing the government's fully covered budget, a decrease of fiscal revenue is not equal to a decrease of government revenue. Government revenue includes the government's fund revenue, social insurance revenue, and state-owned capital operating revenue. The Decision requires that the profit-delivering proportion of state-owned enterprises increases by 30 % percent. Based on calculations using the current data, in 2013, the gross profit of the central enterprises was 1.62 trillion yuan, the net profit was 1.17 trillion, and the profit after tax and deducting 10 % statutory reserves about 1.05 trillion yuan.[4] In 2013, the profit revenue of central state-owned capital operation was about 103.96 billion yuan and the turning-over proportion was about 9.88 %, which is still a bit far from the target value. Therefore, following the Decision's requirement, gradually improving the real profit turning-over proportion of the state-owned enterprises in the future 5 years would help in some degree to offset the possible decrease in fiscal revenue growth rate due to reducing taxes.[5]

Fourth, the government's revenue-expenditure condition can be improved by further optimizing the fiscal spending structure, transforming the government function, specifying the boundary of government's responsibility and obligation, improving the capital utilizing efficiency, compressing the government's administration expenditure, and guaranteeing livelihood expenditures. In 2014, following the high pressure of anti-corruption, although the growth rate of fiscal revenue decreased, the growth rate of fiscal expenditure, especially the general public service expenditure, decreased faster. There was not lack of compression of the past extravagant waste spending.[6]

[4] The after-tax revenue still needs to deduct the unrecovered deficit at the beginning of the year. Since complete corresponding statistics are unavailable, we do not consider it, and the real average turning-over proportion may be a bit higher.

[5] Only some state-owned financial enterprises turn over their profits to the government currently. The four state-owned commercial banks are the most profitable state-owned enterprises in China currently. In the first half-year of 2014, 16 listed banks achieved a net profit of 6907.81 trillion yuan; this covered about 51.63 % of the net profit of 2558 listed enterprises, with the four state-owned banks covering up to 35.34 %. However, in 2013, all the state-owned financial enterprises turned over profits of only 117 million yuan.

[6] The general public service spending rose by 2.0 % cumulatively in the first 11 months of 2014, falling by 9.1 % year on year. This accounted for 9.3 % of the total financial expenditure, a decrease of 0.8 % from the previous year.

Finally, fiscal deficit still has some space. In 2014, the fiscal deficit in China was about 1.35 trillion yuan, an increase by 150 billion yuan from 2013; the deficit ratio was about 2.1 %, which is still lower than the international deficit warning line of 3 %. If indeed necessary, the government can moderately increase the deficit rate and release the space for reducing the tax and increasing spending.

Chapter 5
Policy Implications and Suggestions

The year 2015 is important for implementing a series of reforms and advancing the rule of law. It is the last year of the country's 12th five-year plan, and the economy is stepping into a new stage of development under the new normal. China's economy will continue in the downward direction following the fallout from the global financial crisis. The domestic economy is still under restructuring, and the positive effects of the comprehensive deepening reforms has not percolated completely. However, the Chinese economy has explored a new development space. Tough market conditions in China after the international financial crisis prompt the Chinese companies to make a determined effort to adjust the structure change the ideas and ways of development. After China became an upper-middle-income economy, the service-oriented economy opens up a new demand area for economic development. Since the global financial crisis, the government has put forward massive investment stimulus plans and micro-stimulus policies; the authorities should have an in-depth understanding and grasp of the characteristics of China's economy under the "new normal." All these together have brought the Chinese economy the necessary conditions and foundation to step into a new stage of development.

The new stage of development for the Chinese economy is a transitional phase from the upper-middle-income levels to a modern developed economy. Obviously, in the new stage of development, the pattern and experience of economic development of the past is no longer applicable. The new stage of development and the new task of development call for new developmental ideas.

The new developmental ideas are based on the implementation of the resolutions made in the Third and Fourth Plenary Session of the 18th Central Committee. The basic direction is to implement all the measures of the comprehensive deepening reforms and let the market decide the allocation of resources.

To let the market really decide the allocation of resources, we must consider seriously how to better play the role of government in the new situation.

Of course, the government needs to maintain an appropriate infrastructure investment growth to stabilize the economy. However, to stabilize the economic growth

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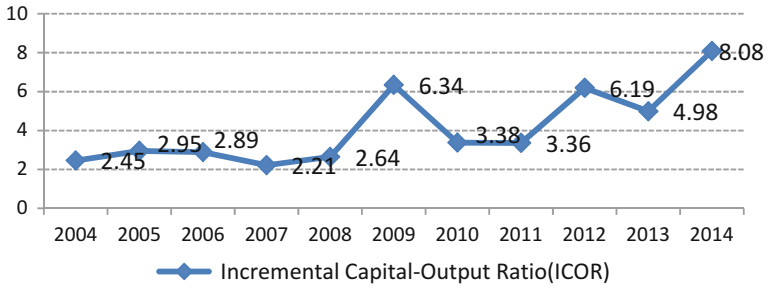

Fig. 5.1 China's incremental capital-output ratio (Note: Incremental capital-output ratio (I/△GDP), that is, the ratio of investment to incremental output. ICOR is used to measure the amount of investment needed to measure per unit of output growth. In general, the higher the ICOR of an economy, the lower are its investment efficiency and productivity. Data source: calculated according to CEIC)

and to expand, government investment can only be a supplementary measure for periodic use compared to social investment. Since 2008, one of the side effects of the large-scale investment stimulus plan and micro-stimulus policy is further raising the incremental capital-output ratio (ICOR) of the national economy (Fig. 5.1), reducing the efficiency of investment.

In the long run, we should start with the fundamental measures to stabilize economic growth. These measures can stimulate the economic vitality, promote the independent innovation of market players, and improve the efficiency of the use of resources. The long-term government-led economic and revenue growth rate is substantially higher than the economic growth rate for 15 years, resulting in a too large ratio of government disposable financial resources to GDP (Table 5.1), irrational tax structure, and so on.[1] The policy simulation confirms once again that in order to free up more space for the market to allocate resources, we need to reform the taxation system, adjust of the taxation structure, and reduce the national economic tax burden.

From the above analyses, our research team proposes the following policy recommendations:

1. The overall tax reduction policy should be taken as an important fiscal and taxation system reform option; it should focus on the "increases and decreases" between all tax types and reduce the indirect taxes by adjusting the marginal tax rate. This is feasible as well as necessary and urgent. The fiscal and taxation reform over the past few years is obvious to all. However, whether the ratio of fiscal revenue to GDP or the ratio of government revenue in a broader sense to GDP remained at a high level, the proportion of nontax revenue even increased contrarian. When the transformation of this development stage takes place, the

[1] In 1996–2012, the average growth rate of China's fiscal revenue is higher than economic growth rate of 5.5 %. See our research team's "China's macroeconomic forecasting and analysis – the autumn of 2013 report."

Table 5.1 Government's actual dominant fiscal resources (2008–2014)

	2008	2009	2010	2011	2012	2013	2014
Nominal GDP (Trillion Yuan)	31.40	34.09	40.15	47.31	53.41	58.80	63.65
Government Revenue/GDP (%)	29.99	31.40	34.25	36.30	35.14	37.28	37.18
General Government Revenue/GDP (%)	34.23	35.98	39.59	41.52	39.76	41.70	41.07
Government actual dominant fiscal resources /GDP (%) (1)	37.60	46.10	43.83	46.67	45.36		
Government actual dominant fiscal resources /GDP (%) (2)	38.99	49.50	42.05	51.15	50.48		

Notes: Government revenue = public finance income + governmental fund income + income of state-owned capital management budget + social insurance fund income. General government revenue = government revenue + state-owned enterprises' profits. Resources under government control/GDP (1) = (generalized government revenue + balance of local government debt increment)/GDP. Resources under government control/GDP (2) = (generalized government revenue + balance of national government debt increment)/GDP

The national government debt data of the National Audit Office updates only up to June 2013, after which there is no data

Data source: calculated by the research team

macroeconomic policy-making authorities should start from the fundamental situation in which the market plays a decisive role in the allocation of resources. They should consider the reasonable ratio of fiscal revenue, and government revenue in a broader sense, to GDP. They should make a determined effort to overcome all difficulties through an overall institutional tax reduction to help people, reduce the burden on business, stimulate social and economic vitality, promote the independent innovation of market players, improve the efficiency of resource utilization, recreate the growth potential, stabilize investment, and stimulate consumption.

2. Accelerate the replacement of business tax by VAT. Further, expand the range of the replacement to the construction and real estate sector, finance and insurance, life services, etc. Simplify taxes, determine the criteria of the general taxpayer reasonably, and build a suitable tax environment for the development of the service economy. Let VAT adapt to the operational characteristics of

manufacturing as well as services and promote the tax system to the entire country to form a unified value-added tax system of goods and services as soon as possible. Then, reduce the value-added rate significantly, exempt the tax of some low-end goods and services in the retail process to realize the goal of reducing the proportion of indirect taxes, and free up enough space for adjusting the proportion of direct taxes.

3. Improve the consumption tax system. To adjust the scope of consumption tax, the government should not only include high-energy-consuming products and high-polluting goods within the tax scope but also enlarge the tax scope of luxury goods. In addition, the government should raise the consumption tax rate of luxury and high-end consumer goods and services, such as private yachts, private planes, and certain types of battery. Consumption tax should be levied at the retail link, rather than the production link or import link, on some consumption goods such as cigarettes, white spirit, and firecrackers. In this way, the tax will clearly embody the purpose of the government not to encourage, or to limit, such consumption. The government should levy a tax that is excluded from price instead of one that is included in price. The original distribution pattern by which the consumption tax belongs totally to the central government should be amended so that the tax forms part of the local government's financial resources.
4. Reform the current real estate tax system and establish a system that can be levied at the holding link. Specifically, tax exemption based on the rule of personal nonbusiness use of real estate and taxation according to rent should be abolished and be replaced by taxation based on the value of real estate. Real estate tax currently calculated on the original value should be calculated on the market value. The government should appropriately adjust the real estate tax rate and properly determine the exemption amount.
5. Carry forward the reform of personal income tax (PIT) and adhere to the timely levy of inheritance tax. The government should establish a system that combines the comprehensive type of PIT and the categorical type of PIT, properly integrate the tax items, improve the pretax deduction system, and ensure that the taxes match the national income level and cover people's real living costs. At the same time, the government should optimize the tax rate structure, introduce the household spending declaration system, and effectively adjust the tax burden level among different social ranks, further reflecting the fairness of financial burden. As an important part of property tax, inheritance tax plays a vital role in maintaining fair market competition, narrowing down the wealth gap, and promoting the effective disposal of resources. By implementing the real estate registration system, the inheritance tax legislation can be put on the agenda as soon as the time is ripe for levying inheritance tax.
6. Improve the resource tax reform. Accelerate the reform of the resource tax that is replaced by ad valorem tax on resources like rare earth, tungsten, titanium, and nickel. Compare the tax with the clearing fee principles of the reformed coal resource tax, and clean up and regulate the relevant charges and funds.

Following the proposals made at the Third Plenary Session of the 18th Central Committee of the CPC, the government should take the features of the relevant characters of the resource tax into account and gradually expand the levying scope of resource tax to include certain natural resources such as water flows.

7. Optimize the structure of fiscal expenditure, cut down administrative expenses, and improve efficiency of utilizing government funds. The total amount of social security, medical, and educational expenditure in public fiscal expenditure gradually rose from 29.5 % in 2010 to 31.7 % in 2014.[2] The proportion of expenditure on people's livelihood improved but still remains low compared with developed countries. The expenditure on competitive fields should be cut down and efforts made to strengthen the fundamental social public service fields that have active demand but lacks in investment. At the same time, open, just, and fair market order should be emphatically maintained, and entrepreneurship and the market's innovative potential and vitality should be released.
8. Advance the administrative power list and responsibility list system and strengthen power supervision. The establishment of a power list system is not a simple combination of administrative power but a correct definition of power boundary. It solves the problem of separation of power between the government, market, and society, between the governmental levels, and between the departments to reconstruct an organizational system and business process and promote governmental management level. Responsibility lists should also be formulated, and the system of illegal administrative accountability should be completed accordingly. Besides, the omission and misplaced behaviors in power exercise should be accounted for. In the meantime, it has to continue to revise and improve the market admittance negative list, implement the enterprises' investment autonomous right, reduce prior approval, intensify pre-event and after-event supervision, and perfect the market supervision system.
9. Intensify the construction of free trade zone, accelerate the promotion of reform experience, and promote China's international trade level and status. Free trade zone is a new opportunity to open up to the outside world when China's development enters a new stage and its reform enters a hard time and abyssal region. Proactively accepting and participating in formulating a new rule system for international trade and forming high-standard free trade zone networks facing the world are conducive to overcoming external constraints, the obstructions caused by vested interests and sluggishness within the system, and driving the reforms. The spirit for more initiatives and reforms should be adopted in the future. Systems such as regulation consistency, the competitive neutrality principle of state-owned enterprises, intellectual right protection, openness of the service industry, environmental and labor rules, and uniform market admittance, which do not necessarily need to be experimented in domestic and

[2] In 2011, the EU-27's spending on health, education, and social protection together accounted for 47.8 % of the central (federal) government spending. In 2013, the US social security, Medicare, and Medicaid spending accounted for 48.0 % of federal fiscal expenditure.

foreign free trade experimental parks, should be popularized and carried out in China as soon as possible.[3]

10. Advance capital cooperation between the government and society, reform of relevant systems, and acceleration of state-level legislation. With the gradual clearness of the local debt management framework, future local governmental debt is mainly composed of general governmental debt, special governmental debt, and PPP debt. From the calculation of the Ministry of Finance, the expected financial demand for urbanization of China in 2020 is about 42 trillion yuan.[4] It can be seen that the PPP mode is given great expectation to respond to capital demand of urbanization in several decades. However, now there are no laws and regulations specifically relevant to PPP, leading to this manner difficult to be effectively boosted in a large scale. Policy guideline and detailed supporting rules should be rapidly introduced to promote PPP development and overall guide the popularization and application of PPP. Meanwhile, undertake state-level legislation and propel formulation of national franchise law. Explore new financing mode including establishing PPP fund, effectively expand financing source, and lower the transaction cost of investors.

In advancing the reform of financial and taxation system, optimizing the structure of the tax system is not to reduce tax, but to drive production and consumption and go Dutch in occupancy and consumption of resources and eliminate cross subsidization. At the same time, we need to improve the local tax system; consider the property behavior tax items such as real estate tax, consumption tax, resource tax, and deed tax as important sources of local tax; promote the matching of financial resources and the authority of office to achieve organic unification of the market playing a decisive role in resource allocation and the government playing its role better; and strengthen the growth potential. From the perspective of international experience, it is a better and more effective way to allocate resources, a more favorable way to improve living quality, a more favorable way for the public to participate in public management, a way to supervise governmental behavior, and a more favorable way to cultivate local self-government, autonomous management, and civic awareness.

[3] Li Wenpu, Chen Tingting, Li Hao (2015) From the special economic zones to the free trade zone – on the opening up promoting the third wave of reform. Southeast Acad 1. pp. 19–27.

[4] In the 2014 National Financial Work Conference on scientific research, Wang Baoan, the Vice Minister of Finance, said that China's urbanization rate was 53.6 %, which is expected to reach 60 % by 2020, and that the resulting demand for investment will be 42 trillion yuan.

Chapter 6
Comments and Discussion

6.1 Professor Liu Shucheng, Member of the Chinese Academy of Social Sciences: Ideal Path and Growth Potential of the "New Normal"

I sincerely congratulate the 18th press conference held smoothly. This conference has become an international and domestic brand. We can foresee that today's announcement will have a significant impact during the "Two Sessions." The predictions and analyses of the report were completely consistent with my view in recent years. Therefore, I extremely support the overall conclusion of this report.

Outlooking the economic trends during the period of 2015–2020, we can imagine four different scenarios: all the way down, all the way flat, returning to high growth, or just like the view of this report and mine, the economy fluctuates in the reasonable interval which follows the economic law. The economy of China has shifted gear from the previous high-speed to a medium-to-high-speed growth today, that is, "new normal." Some people take the "new normal" as economic growth all the way down, which is not right and may cause some problems. For example, it will be difficult for the urban residents to achieve the goal of doubling the income by 2020 and thus cause social problems; enterprise investment will be affected and then encumbers the goal of doubling GDP, also procrastinating the technology innovation of enterprises; revenue will be reduced, making it difficult to support public utilities like reform.

We need some countermeasures for it is inadvisable to be all the way down. We have to change the way of thinking, which means we should take the positive strategy, transforming the strategy from holding the "lower limit" to grasping the "medium limit," for the purpose of providing more space. We should also reform the operating mode of macroeconomic regulation, transforming the emergency response to global response. The "three national strategies" is a bright spot of the Central Economic Work Conference held at the end of 2014, which played an important role

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to promote the economic development in medium and long term. By taking the "three national strategies" as an engine, the economy growth will bottom out in the year of 2015, and the speeding up of the economy from 2016 to 2020 will stop from a downward trend and become stabilized and pick up moderately.

6.2 Professor Gao Peiyong, President of Strategic Finance Academy, Chinese Academy of Social Sciences: We Should Think Over Reduction of Adverse Effects as well as Prevention and Control of Risk While Pulling the Economy

We must deal with two contradictions when pulling the economy. One is about pulling the economy and reducing the side effect. The basic path of operating a fiscal policy is nothing more than reducing income or increasing expenditure. To avoid the economic structural distortions caused by the strong stimulus policy, we have to focus on the reducing income rather than the increasing expenditure. Reduction is about tax and fee, but what tax or fee should be reduced? The main categories of taxes need to be reduced to make the policy work, which means we should put tax cuts on the process of replacing the business tax with a value-added tax. The public figures suggest that the number of reduced tax from replacing the business tax with a value-added tax was 191.8 billion last year. If the policy is implemented in all industries this year, the number will be 400–500 billion. If we can reduce the value-added tax rate further more after 2016, the number will increase to 900–1000 billion. It is much larger, more direct, and more effective compared to reducing tax on small and micro-businesses. There are two parts of dropping charges: one is from nontax income of the general public budget, which is relatively normative. The other part is from the governmental fund income, which is also reported into budget but is not officially included in the scope of the National People's Congress for approval; thus, it cannot be coordinated, and in other words, it is a case dough of the government and should be cut down. The emphases of dropping charges should be put on the cleaning and reduction of the government fund income.

The other is about pulling the economy and preventing risk. Pulling the economy will certainly increase the issuance of government bonds. The deficit risks in China are immense today because there are a lot of risks out of our field of vision; for instance, the bonds are issued and repaid spontaneously by the local government. We should try to bring this part into deficit monitoring. In addition, under the current system, the local government scarcely plans to pay the debts when issuing bonds. Or it does not have enough money to repay when the bonds mature. It is mainly because the fiscal relation between central and local governments is not

normative, and the revenue and expenditure system of local fiscal is unsound. We have to give back to the local government the sound willingness and capital, which they deserve owning to repay the debts, so that they could have the debtor's personality on the aspect of issuing and repaying uniformly or spontaneously.

6.3 Professor Zhang Yansheng, General Secretary of the Academic Committee, National Development and Reform Commission: Replacing the Old with the New, the Dangers and Opportunities Coexist in Constructing the Open Economy

I am going to talk about three issues.

Firstly, we have not completed the expected targets and missions in the past three years in foreign trade and economic cooperation. What does it reveal? In my opinion, the past 35 years have passed, the new 35 years are coming, and we are paying the debts of the transition. As a matter of fact, it is a period of adjustment until 2020; therefore, the quality of adjustment will decide whether foreign trade can play the role of the engine in the coming 35 years. The sooner to exit the small countries' mode of export-oriented economy in the past 35 years, the better result can be achieved from the big countries' mode of open economy in the new 35 years. In the past, we talked too much about speed and growth. In the future, we should talk more about quality and efficiency of growth. In addition, foreign trade and economy of China need to be transformed from domestic vision to global vision. Short-term stability is important; however, the medium-term structure adjustment and long-term mode transformation are more important.

Secondly, low or negative growth of processing trade will probably continue in the next few years, and the growth of general trade will be difficult. The cultivation of the new trade structure is not in a short term but in a medium and long term. Therefore, the trade policy aimed at growth is wrong, which may delay the adjustment of structure and the transformation of economic development. The foreign enterprises are also faced with the transition from speed to quality and efficiency.

Thirdly, foreign exchange reserve declining may become a long-term trend, and double surplus change also will be a long-term trend. We can no longer expect it to maintain old normal growth, regardless of foreign trade, foreign capital, and foreign exchange. We must adapt to the coming 35 years the new normal, which is the basis of competition. Mode, principle, and policy will all change completely.

How will the finance and taxation policy affect foreign trade and economy? OEM, low-end, and simple imitation mode will exit, and middle-high-end modes and innovative mode will enter, which cannot be solved by the market or enterprises. We need fiscal and taxation policy. It must be admitted that the government should have worked better in this part. We should pay attention to this point while talking about tax cuts.

6.4 Professor Wang Luolin, Ad Hoc Consultant and Former Executive Vice President of the Chinese Academy of Social Sciences: Sufficient Attention Must Be Paid to the Promotion of the Role of the Opening up Policy to the Comprehensive Deepening Reform

The previous speeches are very enlightening. I want to make some supplement to Professor Zhang Yansheng's speech. I am thinking about an issue, which is related to the effect of international economy change on our foreign trade. Now, China's economy has been deeply involved into the international economic system. The report is well written; however, there is only one of the ten policies that is about opening to the outside world. Should it be enhanced? Opening to the outside world has played a great role in both development and reform of our economy. Reviewing the past 35 years since the Third Plenary Session of the Chinese eleventh CPC Central Committee, we had generally experienced three climaxes of reform and opening up. Suppose the current reform is the fourth one, how much impact do they have on our whole macroeconomy? Take One Belt and One Road as an instance; it has two direct effects on our economy. One is promoting the China Western Development, and the other one is helping some countries in Central Asia and West Asia to build the infrastructures and it can drive our iron and steel production at the same time. What influences will these strategies, policies, and measures of the opening to the outside world have on our macroeconomy during the current and coming period?

Professor Zhang Yansheng said that the foreign exchange reserve might not grow so substantially in the future. One reason is that I heard the central government plans to take a piece of foreign exchange reserve for outbound investment. So opening to the outside world makes China integrate into the international economic system with a greater extent. If we use it to promote the reform, could it be studied with more effort?

For decades, opening is often faster than reform because opening is easier and offends less vested interests than reform; furthermore, opening can boost reform. So we should consider opening when studying on the macroeconomy. It is difficult to calculate, but we should make efforts to achieve it, for the development of the situation is not allowed to only consider the domestic situation.

These are my suggestions

6.5 Yang Ruilong, Professor of School of Economics, Renmin University of China: Emphasizing the Bottom-Line Management While Facing New Challenges Under the Conditions of the "New Normal"

Thanks for the invitation, and congratulations to Xiamen University for hosting the macroeconomic conference report continuously.

"New normal" is, in fact, to describe a state of decline of potential economic growth rate. There is a little comfort though the economy turns down. On the one

hand, employment deterioration is not serious. On the other hand, the service industry remains robust. But the economic indicators of the second half of 2014 suggest that there are also problems with the two following factors.

Let us begin from the service industry. The PMI of nonmanufacturing industry is more mutational than the manufacturing industry. The PMI of nonmanufacturing has reached 56.7 % in October 2008 but descended to 45.4 % in November. We should not be confused by the data of more than 50 %, for it may reverse rapidly in 2015. Furthermore, China is in the postindustrial period, and the development of the third industry is heavily dependent on manufacturing and consumption. The current indices of GDP are going all the way down, manufacturing industry is relatively receding, and per capita income growth is slowing down, so the service industry lacks foundation for rising. We can suggest that the service industry may encounter serious challenges in 2015.

Then let us talk about employment. Analyzing the employee's index, the demand for employment is shrinking, especially the nonmanufacturing industry. As the employment statistics have some problems, employment quality has not been well reflected. According to the current aperture, removing the false of employment and entrepreneurship, enterprise talent reserves, and local government repression, the quality of employment has some problems. The third industry which is the construction industry that employment heavily depends on will fall back in 2015; therefore, the employment will be unavoidably under pressure.

The uncertainty of two supporting elements presents the macroeconomic policy as a dilemma. Strengthening the stimulus will aggravate the structural distortion and increase the financial risks. But it is obvious that China excessively depends on high economy growth. The unnecessary growth speed may cause economic system crisis. In addition to the decline of potential growth rate, cyclical factors are also the reasons of economic downturn. So it is a daunting problem for the macromanagement and decision-making departments to balance growth with restructuring. In order to avoid the negative effects of excessive stimulus and economic decline cliff, we should have a bottom-line management consciousness, holding the bottom line of unemployment and risk, making prearranged plans. For instance, aiming at the excessive declines of the real estate and service industry investment, we should prepare for the hedging policy and build a social safety net to hedge the impact from the macroeconomic deterioration on the economy.

6.6 Jia Kang, President of China Academy of New Supply-Side Economics and Professor of Research Institute for Fiscal Science, Ministry of Finance: The Reform of the Fiscal and Taxation Policy Should Be Done in Lots of Ways Simultaneously

The People's Bank of China has further loosened monetary policy, which makes the situation very serious. We should further explore how to regulate and control the economy in the acceptable range. The central economic work conference has made

a clear tone. The economic operation should take account of the medium-long-term general blueprint, such as modern state governance, modern market system, modern legal system, and comprehensive implementation and governance of the country by law. The Treasury should ascend some expansion aggressively as far as possible to serve the overall situation and stable market expectations and grasp the bottom line. It is possible to discuss the proper improvement of deficit rate.

In addition, the fiscal policy should clearly do something to optimize the structure adjustment. We cannot simply expect the slowdown of economy to bring structure optimization naturally. Because of imperfect competition, if the government simply reduces investment, it cannot shoulder its responsibility well. The first is to cut tax. Tax credit on enterprise innovation activities has been discussed for several years, and barriers of operation should be resolved. Responsibility should not be postponed again and again. The second is to use the available space in the financial expenditure as far as possible. We should emphasize the structure, mechanism, and performance rather than the total amount and growth. Meanwhile, we should increase effective supply selectively to support the new normal. As far as livelihood is concerned, we need a further movement on mobilizing government funds, stimulating the nongovernmental capital cooperation, and increasing investment in order to make everything go well. The third is related to redistribution, which links to reform more explicitly. Xiamen University emphasizes direct taxes, which is consistent with the policy of the Third Plenary Session. However, the difficulty is here as well. For example, the real estate tax, NPC and CPPCC have made it clear to legislate as soon as possible last year, but there is no movement so far. In addition, the personal income tax is at the bottom of the current scheme. There is no way to take the inheritance tax into the scheme of reform task if there is no policy to make officials' assets known to the public, which causes the lack of confidence to undertake the act. The distribution should be improved in this respect.

Above all, total amount, structure, redistribution, and reform should be improved collectively. Thank you!

6.7 Jia Yandong, Researcher and Deputy Director of Macroeconomic Analysis Division of The Research Bureau, People's Bank of China: Development and Research of Economic Models Help to Enhance the Accuracy of Policy

Thanks for the invitation of Xiamen University, this is my first time to attend this conference. I used to be a student of Xiamen University, and it is my honor to exchange our experience in People's Bank of China with you. My job in the Research Bureau of PBC is to develop macroeconomic models. As it takes a lot of manpower and material resources to develop and maintain the models and it also costs a lot of money to buy foreign models, thus, in my understanding, it is a miracle that our university can develop models continuously in so many years.

The PBC's demand for macroeconomic models is very strong, and it has undertook the task of working out the 13th five-year development planning. Our leaders hope we can conduct policy simulation and various estimates by some scientific tools, then provide a benchmark for medium-long-term planning, and provide some policy recommendations for the short-term economic fluctuations. We also organize various business scenario analyses and predictions about the macroeconomic trend. This report is of great significance to us. Since 2000, the PBC has begun to develop various models. In addition to the large-scale econometric models, there are some special models, which construct a model library and provide support and help for the decisions. Our models emphasize the balance between financial variables and pay less attention to the government's fiscal revenue. Since fiscal policy is a theme this year, this model is a excellent supplement to ours.

Currently, we also try to release the model results by publishing papers. The leaders hope that the market expectations would be influenced through this way. We have a long way to go, and I hope, entrusted by the leaders, that we can strengthen the strategic cooperation with Xiamen University in the future. It is a strong cohesion force to combine the models together, and it can make more contributions to the development in the future.

At last, I wish our models can be improved and perfect. Thank you!

Chapter 7
A Report of the Questionnaire Survey on the Macroeconomic Situation and Policy of China in 2015

To keep abreast of the macroeconomic situation and policy trend, an annual questionnaire survey of China's macroeconomic situation and policy jointly started twice a year since the first time on August 2013, held by the Economic Information Daily, Xinhua News Agency, and the Center for Macroeconomic Research, Xiamen University (one of the Key Research Institutes of Humanities and Social Sciences of the Ministry of Education of China). This is the fourth time questionnaire survey about the study. There were 19 questions directly about China's macroeconomic situation and policy trend in the questionnaire, and we invited some domestic economists in the relevant area for this survey by e-mail in the late January of 2015 and finally got responses from 100 of them. This survey offered the latest understandings and judgments of experts concerning the main downside risk in China's current macroeconomy, macroeconomic situation of the world, trends of some major indicators about China's macroeconomy, and trends of China's macroeconomic policies in 2015. The results of this survey are presented as follows:

1. The main downside risk in China's economic development.

What is the main downside risk for China in economic development? 77 % of the experts answered that multiple crises include fiscal income growth decline and local government's debts risk accumulation caused by decreasing real estate investment growth, 68 % considered that the pace of economic recovery differed for developed countries and there still was a big uncertainty for external demand, 55 % considered that the effectiveness of the various reform measures worked slowly and short-term stimulus effect was weak, 48 % considered that the monetary policy was not smooth for transmission channel of capital cost and facing a dilemma, 28 % considered that fiscal revenue growth dropped significantly along with the stalled real economy and fiscal deficit scale would expand rapidly, 24 % considered that price level continued to fall and deflationary pressures raised further, and 18 % considered that economic growth continued to slow, which passed to the employment resulting in a large unemployment increase and migrant workers returned home.

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The results above showed that more than three quarters of the experts claimed that the main downside risk for China in economic development included fiscal income growth decline and local government's debts risk accumulation caused by decreasing real estate investment growth. More than 50 % supposed that the different pace of economic recovery for developed countries, a big uncertainty for external demand, the slow effectiveness of the various reforms, and the weak short-term stimulus would be the main downside risk for China in economic development. In addition, more than 40 % of the experts maintained that the blocked transmission channel from monetary policy to capital cost and facing a dilemma would be the main downside risk for China in economic development.

What's more, 7 % of the experts had different opinions on the main downside risk: more conservative investment and consumption because of the expected economic downturn enhancing, deficiency domestic demand that was caused by various policy or institutional factors, the too big income gap, the ineffective demand stimulus policy which needed to take moderate expansion policy stimulus, manufacturing overcapacity, the unsmooth local financing channel, investment growth of the real estate and the traditional industry falling too fast before a new investment hot spots and economic growth that was created by structure adjustment.

2. The macroeconomic situation of the world in 2015.

In accordance with the latest economic forecast of the IMF on January 20, the economic growth rate of eurozone was 1.2 % in 2014. Compared with the situation in 2014, what kind of trend will the economy of eurozone have in 2015? The survey reflected that 46 % of the experts answered that the economic growth rate of eurozone would be between 0.00 % and 0.80 % in 2015. 31 % claimed that it would be between 0.81 % and 0.99 %. 21 % of the experts thought that it would be between 1.00 % and 2.00 %. Only 2 % maintained that it would be below 0.00 %, and no one considered that the economic growth rate would be more than 2 %. In sum, more than 50 % of the experts believed that the economy of eurozone would be in recovery in 2015 and the future economic growth rate would be expected to accelerate, in which the situation would be relatively optimistic. But more than 40 % of the experts believed that the eurozone economic growth rate would show a slow downward trend in 2015.

In accordance with the latest economic forecast of the IMF on January 20, the economic growth rate of USA was about 2.4 % in 2014. Compared with the situation in 2014, what kind of trend will the economy of USA have in 2015? The survey reflected that 64 % of the experts answered that the economic growth rate of USA would be between 2.5 % and 3 % in 2015. 22 % claimed that it would be between 2.0 % and 2.4 %. 7 % of the experts thought that it would be between 3.1 % and 3.5 %. 3 % maintained that it would be more than 3.5 %. 4 % expected that it would be below 2.0 %. In sum, nearly three quarters of the experts believed that the economy of USA would be also in recovery in 2015, in which the situation would be

relatively optimistic. But more than 20 % of the experts believed that the economic growth rate of USA would show a slow downward trend in 2015.

In 2014, the main bulk stock continued downward trend since 2011, and the downward trend of the crude oil price was the most significant. American WTI crude oil spot price fell sharply, from $101.67 per barrel on July 28, 2014 to $48.36 per barrel on January 22, 2015. What kind of trend would the price of crude oil per barrel in the USA WTI have in 2015? The survey reflected that 73 % of the experts answered that the price of crude oil per barrel in the USA WTI would be between 40 and 60 dollars in 2015. 14 % claimed that it would rebound sharply between 60 and 80 dollars. 13 % of the experts thought that it would continue downward between 30 and 40 dollars. In sum, nearly three quarters of the experts believed that the crude oil prices would be between 40 and 60 dollars in 2015 which showed a trend of wide shock.

The USA would open the interest rate rise cycle which pushed the return of normal monetary policy in 2015. We conducted a questionnaire survey about when the USA would choose to raise interest rates in 2015. The survey reflected that 45 % of the experts answered that the USA would choose to raise interest rates in the second quarter of 2015. 33 % claimed that it would choose to raise interest rates in the third quarter. 16 % of the experts thought that it would choose to raise interest rates in the fourth quarter. 6 % maintained that it would choose to raise interest rates in the first quarter. In sum, nearly 80 % of the experts believed that the USA would choose to raise interest rates in the middle of 2015.

3. The forecast of some major indicators of China's macroeconomy in 2015.

With respect to the growth rate of China's GDP in 2015, the survey showed that 56 % of the experts thought that it would be "between 7.0 % and 7.2 %," 22 % expected that it would be "between 6.8 % and 7.0 %," 17 % claimed that it would be "between 7.3 % and 7.5 %," 4 % held the view that it would be "7.5 % or more," and only 1 % maintained that it would be "6.8 % or less." In sum, close to 80 % of the experts considered that the economic growth of China in 2015 would slow down continually considering the growth rate of 7.4 % in 2014.

Concerning the variation of China's CPI in 2015, the survey showed that 51 % of the experts expected it to be "between 1.6 % and 2.0 %," 32 % thought that it might be "between 2.1 % and 2.5 %," 8 % held the view that it would be "between 1.0 % and 1.5 %," 7 % chose "2.5 % or more," and 2 % claimed that it would be "1.0 % or less." In sum, more than 60 % of experts claimed that the price level would continue to decline, and the deflationary pressure would rise further considering the fact that the CPI increased by 2.0 % in 2014.

Regarding the variation of China's PPI in 2015, the survey showed that 50 % of the experts expected it to be "between −1.9 % and −1.0 %," 26 % thought that it might be "between −1.0 % and 0.0 %," 9 % held the view that it would be "0.0 % or more," 13 % chose "between −3.0 % and −2.0 %," and 2 % claimed that it would be "-3.0 % or less." 90 % of experts considered that China's PPI in 2015 would still be negative, but 85 % of experts held the view that although it would

be negative, it would rise in 2015 considering the fact that the PPI decreased by 1.9 % in 2014 than in 2013.

In regard to the USD to CNY (RMB) exchange rate in 2015, 42 % of the experts expected that it would be "between 6.1 and 6.2," 40 % considered that it would be "between 6.2 and 6.3," 12 % chose "between 6.0 and 6.1," 4 % claimed that it would be "6.3 or more," and only 2 % held the view that that it would be "6.0 or less." Up to December 2014, it was about 6.119. Hence, more than 80 % of the experts forecasted a continuous trend of depreciation of the RMB against the USD in 2015.

China's fixed investment in 2014 is about 50.2 trillion Yuan, with a year-on-year growth of 15.7 % which dropped significantly compared with it in 2013. How about the growth of China's fixed investments in 2015? The survey showed that 33 % of the experts expected the total fixed investments would increase year on year at the rate "between 15.1 % and 16.0 %," 26 % considered that it would increase at the rate "between 14.0 % and 15.0 %," 18 % chose "between 16.1 and 17.0 %," 14 % thought that the growth rate would be "14.0 % or less," and 9 % claimed that it would be "more than 17.0 %." In sum, the survey showed that 40 % of experts considered that the growth of China's fixed investments would continue to slide in 2015, more than 30 % of experts considered that the growth of China's fixed investment would be relatively steady, and nearly 30 % of experts held the view that it would rise again in 2015.

Compared with the slowdown of the economy and investment growth, the investments in real estate market in 2014 was 9.50 trillion Yuan with a year-on-year growth of 10.5 %. But the growth was slower than in 2013. How about the growth rate of China's investments in real estate market in 2015? The survey showed that 66 % of the experts expected it would be "between 8.0 % and 10.5 %," 18 % expected that it would be "between 10.6 % and 12.0 %," 15 % claimed that it would be "8.0 % or less," only 1 % maintained that it would be "between 12.1 % and 13.5 %," and no one expected that it would be "more than 13.5 %." In sum, more than 80 % of the experts considered that the investments in real estate market would slow down continually, and close to 20 % of experts held the view that it would rise in 2015.

China's total retail sales of consumer goods in 2014 were 26.24 trillion Yuan with a year-on-year growth of 12.0 %. In regard to the growth of China's total retail sales of consumer goods in 2015, the survey showed that 48 % of the experts expected that the total retail sales of consumer goods would increase year on year at the rate "between 12.1 % and 12.5 %," 27 % considered that it would increase at the rate "between 11.6 % and 12.0 %," 15 % chose "more than 12.5 %," 7 % of experts held the view that it would be "between 11.1 % and 11.5 %," and only 3 % claimed that it would be "11.0 % or less." The results reflected that more than 60 % of experts maintained that the growth of the total retail sales of consumer goods would be higher in 2015 than in 2014, and the pulling effect of consumption on economic growth would highlight gradually. Also 37 % of experts claimed that the growth of the total retail sales of consumer goods would slow down in 2015.

China's export in 2014 had a cumulative year-on-year growth of 6.1 %, and it decreased from the previous year. With respect to the situation of exports in 2015,

37 % of the experts expected that the total exports would increase year on year at the rate "between 6.1 % and 7.0 %," 36 % considered that they would increase at the rate "between 5.1 % and 6.0 %," 13 % chose "between 7.1 % and 8.0 %," 6 % held the view that it would be "between 4.1 % and 5.0 %," 6 % thought it would be "more than 8.0 %," and only 2 % claimed that it would be "4.0 % or less." In sum, the results reflected that more than half of the experts maintained that the growth of the total exports would increase to a certain degree in 2015, which would probably be benefited from the uptrend of American and European economies. Also more than 40 % of experts expected that it would continually slow down in 2015.

In regard to China's import in 2014, it had a cumulative year-on-year growth of 0.4 %, and it significantly decreased from the previous year. The survey showed that 39 % of experts expected that the total imports would increase year on year at the rate "between 0.5 % and 1.0 %," 23 % considered that they would increase at the rate "between 0.1 % and 0.4 %," 21 % chose "between 1.1 % and 3.0 %," 10 % held the view that it would be "between 3.1 % and 5.0 %," 4 % thought it would be "0 % or less," and only 3 % claimed that it would be "more than 5.0 %." The results reflected that more than 70 % of the experts maintained that the growth of the total imports would increase in 2015. Also 27 % of experts expected that it would continually slow down in 2015.

4. The macroeconomic policy measures may be taken by China in 2015.

China's broad monetary supply (M2) in 2014 had a year-on-year growth of 12.2 %, and it was lower than the target of 13 % this year. How about the growth rate of China's M2 in 2015? The survey showed that 51 % of the experts had the expectation that M2 would grow at the rate "between 12.1 % and 13.0 %," 26 % considered "between 13.1 % and 14.0 %," 16 % chose "between 11.1 % and 12.0 %," 5 % of experts maintained the views that the growth rate would be "more than 14.0 %," and only 2 % thought that it would be "11.0 or less%." The results reflected that more than 80 % of experts thought that the growth of M2 would be higher in 2015 than in 2014. It probably means that the Central Bank of China would keep a moderately loose monetary policy in 2015.

Will the Central Bank of China lower the deposit-reserve ratio in 2015? If yes, when will it happen? 37 % of experts expected that the central bank would lower the deposit-reserve ratio in the second quarter, 35 % thought that it would be "the first quarter," 16 % held the view that it would happen in the second half of 2015, and 12 % of experts maintained that it would not happen in 2015. Overall, most of the experts considered that the central bank would lower the deposit-reserve ratio in 2015[1] which signaled that the Central Bank of China would keep a moderately loose monetary policy in 2015.

Will the Central Bank of China cut the benchmark rate in 2015? If yes, when will it happen? We also put it in our questionnaire. The survey showed that 35 % of experts thought that the Central Bank of China would cut the benchmark rate in the

[1] In fact, before the end of the questionnaire recovery, the Central Bank of China had cut the bank reserve requirement ratio by 0.5 % on Feb. 5.

second quarter, 34 % of experts held the view that it would happen in the second half of 2015, 17 % chose "the first quarter," and 14 % of the experts maintained that it would not happen in 2015. The results reflected that most of the experts considered that the Central Bank would cut the benchmark rate in 2015 which provided further evidence that the Central Bank of China would keep a moderately loose monetary policy in 2015.

China's fiscal revenue in 2014 had a year-on-year growth of around 8.6 %, the lowest since 1991. How about the growth rate of China's fiscal revenue in 2015? 42 % of experts expected that it would be "between 8.1 % and 8.6 %," 35 % held the view that it would be "between 7.5 % and 8.0 %," 14 % chose "between 8.7 % and 9.2 %," and 7 % considered that it would be "7.5 % or less." Only 2 % of the experts thought that it would be "between 9.3 % and 10.0 %," and no one maintained that it would be "more than 10.0 %." Overall, more than 80 % of experts claimed that the growth rate of China's fiscal revenue would continue to decline in 2015.

Faced with the slowdown of China's economic growth, what policies and measures shall be practiced to maintain a steady economic growth? We also investigated on this issue. 86 % of experts maintained that reducing the burdens of enterprises and encouraging private enterprises to become social investment main bodies are requisite. 73 % of experts thought that the reforms on basis and monopoly industries and allowing private capital participation in the competition in monopoly industries in the form of sole proprietorship or mixed ownership are important. 60 % of experts held the view that the government should streamline administration and delegate more power to lower levels and give full play to the fundamental role of the market in resource distribution. 58 % of experts considered that encouraging investment in the infrastructure and moderate expanding of the scale of the central budget deficit are necessary. 53 % of experts believed that optimizing the structure of government expenditure and improving the efficiency of the financial fund are needful. 41 % of experts insisted on expanding opening-up in the service sector. Only 20 % of experts felt that relaxing restrictions on targeted easing monetary policy and implementing a comprehensively loose monetary policy are imperative. Overall, more than 80 % of experts believed reducing the burdens of enterprises and encouraging private enterprises to become social investment main bodies are the most important policies to maintain a steady economic growth. Close to three quarters of experts thought the reforms on basis and monopoly industries and allowing private capital participate in the competition in monopoly industries in the form of sole proprietorship or mixed ownership are important policies, this is partly reflected the importance of private enterprise and private capital on the present economic growth in our country. 60 % of experts held the view that the government should streamline administration and delegate more power to lower levels and give full play to the fundamental role of the market in resource distribution reflecting the importance of market on the economic growth at the present stage. More than half of experts held the view that encouraging investment in the infrastructure, optimizing the structure of government expenditure, and improving the efficiency of the financial fund are also crucial. This reflected that more than half of experts expected the role of fiscal policy played in maintaining a steady economic growth. More than 40 % of experts thought that

expanding opening-up in the service sector is indispensable, which reflected that service sector may become a new growth point of China's economy in the future. And most of the experts claimed that relaxing restrictions on targeted easing monetary policy and implementing a comprehensively loose monetary policy are unsuited to the situation of China's economic growth at the present stage.

Furthermore, other policies to maintain a steady economic growth were put forward by 11 % of experts. Understanding the policy and institutional factors which restrict domestic demand; encouraging high-tech industry's export; narrowing the gap between the rich and poor; moderately loose monetary policy; improving investment in society, environment, and infrastructure of big cities; promoting money to transfer from the virtual economy to real economy; combining the measures to strengthen supervision with the policies to maintain a steady economic growth; achieving fairness and efficiency balance in reform of state-owned enterprises; speeding up the readjustment of the industrial structure and seeking for industry adjustment benefits; promoting the implementations of OBAOR and other strategies; increasing investments abroad; stabilizing and developing real estate market; taking more risks of venture investment by government; and perfecting the motivation mechanism of enterprise technical progress are included.

According to the Chinese Pinyin order of their names, the 100 experts who joined this questionnaire survey were Chang Xin, Chen Changbing, Chen Gong, Chen Guifu, Chen Kunting, Chen Langnan, Chen Menggen, Chen Shoudong, Chen Yanbin, Chen Zhao, Chen Zhiyong, Dai Kuizao, Fan Conglai, Fan Ziying, Gao Bo, Gong Min, Guo Xibao, Guo Xiaohe, Guo Zhiyi, Han Zhaozhou, He Jingtong, Huang Jianzhong, Jian Xinhua, Jiang Yongmu, Jin Tao, Li Chong, Li Jianwei, Li Jun, Li Yingdong, Lin Shu, Liu Jianping, Liu Jinquan, Liu Shangxi, Liu Shiguo, Liu Shucheng, Liu Yunzhong, Liu Zhibiao, Lu Shengrong, Lu Ming, Ma Ying, Pang Jinju, Peng Shuijun, Peng Suling, Qi Yudong, Qiu Chongming, Qu Wanwen, Shen Kunrong, Shi Jinchuan, Su Jian, Sun Wei, Tang Jijun, Tian Ruzhu, Wang Changyun, Wang tongsan, Wang Cheng, Wang Guocheng, Wang Jiping, Wang Jinchao, Wang Meijin, Wang Xi, Wang Yanwu, Wang Yongqin, Wang Yuesheng, Wen Chuanhao, Wu Xinru, Wu Kangping, Xiao Xingzhi, Xu Jianguo, Xu Xianxiang, Xu Yifan, Xu Wenbin, Xu Xianchun, Yang Can, Yao Huiqin, Yi Xianrong, Yin Xingmin, Yin Heng, Yu Li, Yu Changlin, Yuan Fuhua, Zeng Jinli, Zeng Kanghua, Zeng Wuyi, Zang Xuheng, Zhang Donghui, Zhang Liqun, Zhang Long, Zhang Mingzhi, Zhang Ping, Zhang Yanqun, Zhang Yishan, Zhao Zhenquan, Zhao Zhijun, Zheng Chaoyu, Zhong Chunping, Zhou Bing, Zhou Liqun, Zhou Zejiong, Zhu Baohua, and Zhu Qigui.

The 100 experts who joined this questionnaire survey are from institutions like Ministry of Finance, China's National Bureau of Statistics, Development Research Center of the State Council, National Academy of Economic Strategy, Institute of Finance and Banking of Chinese Academy of Social Sciences, Institute of Economics of Chinese Academy of Social Sciences, Institute of World Economics and Politics of Chinese Academy of Social Sciences, Institute of Quantitative and Technical Economics of Chinese Academy of Social Sciences, Economic Information Daily, Academia Sinica, and Chung-Hua Institution for Economic

Research and universities like Anhui Finance and Economics University, Peking University, Beijing Normal University, Chongqing Technology and Business University, Dongbei University of Finance and Economics, Fudan University, East China Normal University, Huazhong University of Science and Technology, Jilin University, Jinan University, Lanzhou University, Nanjing University, Nanjing University of Finance & Economics, Nankai University, Tsinghua University, Shandong University, Shanghai University of International Business and Economics, Shanghai Jiao Tong University, Capital University of Economics and Business, Sichuan University, National Taiwan University, Tianjin University of Finance and Economics, Tianjin university of commerce, Wuhan University, Xiamen University, Xi'an Jiaotong University, Northwest University, National University of Singapore, Zhejiang University of Finance and Economics, Zhejiang University, Zhejiang University of Technology, Renmin University of China, Zhongnan University of Economics and Law, Sun Yat-sen University, Central University of Finance and Economics, etc.

Finally, we are thankful for the active participation and insights of these experts mentioned above sincerely.

Appendix

Statistic comparison of the forecast by research group with the forecast by 100 experts on major indicators of China's macroeconomy

Major indicators of China's macroeconomy in 2015	Forecast by research group (%)	The interval and ratio of forecast	
		By experts (%)	
		Interval	Ratio
The growth rate of China's GDP	7.14	7.0–7.2	56
The growth rate of China's CPI	1.74	1.6–2.0	51
The growth rate of China's PPI	−2.15	−1.9 to −1.0	50
A cumulative year-on-year nominal growth of China's total retail sales of consumer goods	11.80	11.6–12.0	27
		12.1–12.5	48
A cumulative year-on-year nominal growth of China's fixed investments	10.65	15.1–16.0	33
		14.0–15.0	26