CHINA AND INDIA:
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Public Finance and Inclusive Growth in China

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China has developed rapidly in the last 30 years. Its economy grew by more than 9% yearly on average, became a more decentralized, market based one, and integrated with the world economy. Government budget and public finance management play an increasingly important role on the core functions as supporting economic growth and stability, resource allocation for national goals, and delivery of critical public services.

1. Over view of Public Finance in China: influential

From 1999 to 2010, the ratio of total government revenue to GDP increased from 18.19% to 28.75%, total government revenue increased from 1 trillion to 11.5 trillion in terms of RMB, by more than 11 times, against the background of GDP growth by near 4.5 times.

The picture indicates that public finance became more influential.

2. Structure Change of Government Revenue and Expenditure: Public Goods Providing

On the central government level, tax income mainly came from VAT (decreased from 50 to 40%), VAT and consumption tax on import goods (increased from 18% to 26%), consumption tax (floated around 8% to 15%) and corporate income tax (increased from 10% to 20%). At the same time, personal income tax increased from 0 to 8%, and tariff decreased from 10% to 5%. However, export rebates contribute negatively from 10-20%.

On the local government level, tax income mainly came from business tax (30%), VAT (20%), corporate income tax (15%) and person income tax and city construction tax (both are less than 10%).

As for the expenditure, both central government and local government focus on providing public goods. On the central government level, the fiscal expenditure on education and medical care increased sharply by 4 and 24 time respectively from 2007 to 2008, and keep fast grow later. Interest paid for Treasury bond account for 4.57%. On the local government level, expenditure is allocated on education, public service, public security, social security, infrastructure ofor agriculture, rural and urban area, transportation, housing and power.

In the meantime, China raised the personal income tax threshold several times, equalized corporate income tax rate for both domestic and foreign corporations, and gave preferential treatment to SMEs, environment-friendly industries and service sectors for a sustainable growth.

3. Supplementary Source of Public Finance: A Main Challenge

China introduced local tax-sharing reform aiming at the shortcomings of fiscal revenue concentrated in central government and give local government more autonomous on providing local public goods. It gives overinvestment incentive to local government for local development.

Since 1995, the Budget Law has barred local governments from borrowing or issuing bonds without State Council approval. As a result, infrastructure investments are often funded with revenues from land leases and with indirect off-budget borrowings, through public utility companies, special-purpose vehicles, and urban development investment corporations.

The expansion of local government debt became obviously in 2009 against the background of stimulus package launched by central government. Local government debt jumped from 5.56 trillion to 9 trillion, increased by 61.92% annually. By the end of 2010, total local government debt amounted to 10.7 trillion RMB. The debate on the potential local government debt crisis is a hot topic now.

In fact, granting local government direct access to the bond market with municipal bond promises significant benefits. Local governments will gain access to more resources for infrastructure development and be exposed in the process to market discipline and reporting requirements. Fiscal transparency and good governance will thereby strengthen. Expanding local government borrowing will also help deepen the financial markets.