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Author/s:

Wong, C

Title:

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Date:

2021-09-07

Citation:

Wong, C. (2021). What's up with China's fiscal policy? The puzzle of recent budget data. East Asian Institute, NUS.

Persistent Link:

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What Is up with China's Fiscal Policy? The Puzzle of Recent Budget Data

By Christine WONG

China's budget data for the first seven months of 2021 sprang some surprises.¹ First, the budget nearly perfectly balances, with ordinary budget revenues amounting to RMB13.77 trillion and expenditures to RMB13.79 trillion. **If this trend were to hold for the year, it would mark the first time since 1985 that the government's general budget has been in or near balance.**² MOF (Ministry of Finance)-reported expenditures were 3.3% higher than that for the same period in 2020. Due to the disruptions of the COVID-19 pandemic last year, a better comparison is with the pre-COVID budget of 2019, against which the 2021 expenditures were 1% *lower* for the same period, with a deep 12.5% cut in central government spending and a small 1% increase in local government spending (Table 1).³

Another useful and perhaps more pertinent comparison is with the budget approved by the National People's Congress in March 2021. This budget came at a time when economic recovery was still nascent and the government set a modest GDP (gross domestic product) growth target of "no less than 6%".⁴ The budget was even more cautious in setting revenue growth at 3.8% and expenditure growth at 4.5% over 2019, both significantly below historical trends that had averaged 6.7% and 9.3% for revenues and expenditures per annum for the 2013-

¹ Released on 20 August by the MOF at http://gks.mof.gov.cn/tongjishuju/202108/t20210819_3746445.htm, accessed 28 August 2021.

² In 1985 there was a small surplus of RMB100 million. NBS data.

³ Figures used for 2019 are for seven months of the total for the year, rather than the first seven months.

⁴ <https://www.cnbc.com/2021/03/05/china-sets-2021-gdp-growth-target-of-over-6percent.html>, accessed 4 March 2021.

2019 period, respectively.⁵ Warning of a difficult fiscal environment ahead in 2021, Finance Minister Liu Kun emphasised that while “meeting people’s basic living needs” remains a priority, the budget must “ensure social expenditures are commensurate with economic development and fiscal capacity so as to ensure that policies do not become divorced from reality, and that we are not spending beyond our means”.⁶ The approved budget projected a general budget deficit of RMB5.2 trillion, to be offset by bringing in RMB1.63 trillion from other fiscal resources – the government fund and the state capital operating budgets, the budget stabilisation fund and other reserves, to produce a reported (“headline”) deficit of RMB3.57 trillion that is used in public discourse.⁷

TABLE 1 PUTTING THE FISCAL OUTTURNS OF THE FIRST SEVEN MONTHS OF 2021 IN CONTEXT*

(unit: RMB Bn)	2021 (Jan-July)	Projected for full-year 2021	Compared to 2019	Compared to 2020	Compared to approved budget
Revenue	13,771.6	23,608.5	24.0%	29.1%	19.4%
central	6,465.8	11,084.2	24.1%	33.9%	23.9%
local	7,305.8	12,524.2	23.9%	25.1%	15.8%
Expenditure	13,792.8	23,644.8	-1.0%	-3.7%	-5.3%
central	1,792.7	3,073.2	-12.5%	-12.4%	-12.2%
local	12,000.1	20,571.6	1.0%	-2.3%	-4.1%
General Budget balance (RMB Bn)		-36.3	-4,849.2	-9,168.8	-5,197.0
<i>As per cent GDP</i>		0.0	-4.9	-9.0	-4.8

* Comparisons are for full-year figures except where indicated.

Source: http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/202103/t20210314_3670203.htm accessed 14 March 2021; http://gks.mof.gov.cn/tongjishuju/202108/t20210819_3746445.htm, accessed 28 August 2021; and MOF final accounts for 2019.

Table 1 shows that revenues had outperformed the budgeted level by nearly 20% through the first seven months of 2021. This makes the *underperformance* on spending, against a conservative budget, all the more puzzling. **At the current pace, the government is on track to underspend the budget by RMB1.3 trillion, or more than 5%, making fiscal policy tighter than planned even as economic growth appears to be softening.** It also makes China an outlier among major economies in the world, all of which are running unprecedentedly loose fiscal policies to mitigate the economic damage of the pandemic.

Budget outcomes for the first seven months show deep cuts in most of the major expenditures reported, compared to 2019 levels. These include a 36% decline in environmental protection expenditures, one of the government’s key policy priorities (Table 2). Only three categories significantly increased during the first seven months: health, social security and employment (SSE), and debt service. The 20% increase in health expenditures is likely due to the massive vaccination drive and the repeated rounds of COVID-19 testing. The spike in SSE spending should be discounted as it is mostly or wholly due to an accounting change that has shifted

⁵ http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/202103/t20210314_3670203.htm, accessed 14 March 2021; calculations from CEIC data.

⁶ http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/202103/t20210314_3670203.htm, accessed 14 March 2021. The term 民生支出 is translated as “social expenditure” in this note.

⁷ For details, see Christine Wong, China’s Post-COVID Goldilocks Budget – How Big Should It Be?, EAI Commentary No. 27, 18 March 2021.

some expenditure for public employee pensions from the category of general services to SSE.⁸ Indirect confirmation for this interpretation is found in the 2019 final accounts, where SSE was one of the few categories of expenditure that exceeded budgeted levels, and the overspend of RMB64 billion for public employee pensions was more than the excess of RMB33.7 billion for the whole category.⁹ For 2021, a check on the Ministry of Civil Affairs website also found no significant increases in the number of recipients of social assistance.

TABLE 2 STRUCTURE OF BUDGET EXPENDITURES (2021)*

(unit: RMB Bn)	2021(i-vii)	Projected for 2021	Compared to 2019	Compared to 2020
Total Expenditure	13,792.8	23644.8	-1.0%	-3.7%
Education	2085.2	3574.6	2.7%	-1.6%
Social security and employment	2156.6	3697.0	25.8%	13.5%
Health	1166	1998.9	19.9%	4.1%
Environmental protection	274.6	470.7	-36.3%	-25.5%
Urban and rural community affairs	1084.9	1859.8	-25.3%	-6.6%
Agriculture, forestry and water	1104.4	1893.3	-17.2%	-20.8%
Transport and shipping	619	1061.1	-10.2%	-13.0%
Debt service	608.2	1042.6	23.5%	6.1%

* Comparisons are for full-year figures except where indicated.

Source: http://gks.mof.gov.cn/tongjishuju/202108/t20210819_3746445.htm, accessed 28 August 2021.

To be sure, there is still plenty of time during 2021 to make up for the shortfall in spending – perhaps with a year-end burst of spending, but the trend continues with what was set last year in the implementation of the 2020 budget. When the economy bounced back more quickly than expected from the second quarter onwards, revenue collections improved and exceeded the budget by 1.5% for the year, but expenditures were 0.9% less than budgeted. Along with underspending across the other budgets – the government funds, state capital operating budget and social security fund – the consolidated fiscal deficit in 2020 was RMB2.5 trillion, or 21%, smaller than that approved in May.¹⁰

The question is whether this fiscal policy tightening is the result of a deliberate choice. In a report on fiscal policy implementation for the first half of 2021 (issued on 27 August), the MOF Research Small Group cited prominently the deficit of RMB3.57 trillion and general budget expenditures of more than RMB25 trillion as key to maintaining an appropriate and sustainable level of fiscal support for achieving policy priorities and managing financial risks.¹¹ It discussed at length the need for optimising expenditures under a tight budget constraint, by prioritising and safeguarding key areas of social spending on education, health, housing and

⁸ The change stems from the creation in 2015 of the public employee pension scheme to replace the payment of pensions from the current operating budgets of government agencies and public institutions to a funded scheme similar to the Urban Employee Pension Scheme. As a result of this change, the share of SSE devoted to public employee pension-related expenditures had risen from around 22% in 2015 to 33% in 2019.

⁹ There was a shortfall of RMB34.5 billion in fiscal subsidies to the basic residents' pension scheme and urban employees' pension scheme, and an underspend of RMB19.5 billion for *dibao* (minimum living standard guarantee programme) compared to budget. See http://yss.mof.gov.cn/2019qgczjs/202007/t20200731_3559718.htm, accessed 11 August 2020.

¹⁰ See fn 7.

¹¹ http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/202108/t20210827_3748539.htm, accessed 27 August 2021.

social security and employment. These themes were echoed in recent statements by the Finance Minister and other top officials in support of the 14th Five-Year Plan and the goal of common prosperity, where the scale of budget expenditure and fiscal deficit are often reiterated but no new spending is announced.¹²

I have argued in several recent papers that inadequate financing at the local, especially county, level, is increasingly crimping the delivery of services and thwarting the implementation of national goals.¹³ Since 2015, fiscal stress has grown steeply for local governments under a combination of slowing revenue growth and growing “hard” expenditure mandates. The COVID pandemic has added greatly to the stress. With uneven economic recovery across provinces, the fiscal pain, as evidenced by slow growth in budget expenditures, is regionally unbalanced as well. Calculations by Luo Zhiheng of Yuekai Macro found that through the first half of 2021, only nine of the 31 provinces had average growth of 4% or more per annum in nominal budget expenditures over the past two years. Over the two-year period, 15 provinces had zero or negative expenditure growth, three had average growth of 0.3-0.5% and four had average growth of 1-2%.¹⁴

Anecdotal reports confirm that local governments are facing pressures to cut spending. There have been scattered reports of teachers not receiving their full pay in the past few years, but a recent report cites examples of civil servants and teachers even being asked to repay their first quarter performance bonuses. The report also claims that plummeting revenues have led local governments in Henan, Jiangxi and Guangdong provinces to suspend bonus pay for all civil servants and teachers indefinitely.¹⁵

The causes of inadequate local finance amid abundant overall revenue growth are complex and tightly linked to China’s sprawling, decentralised administrative structure. The tension between top-down policymaking and bottom-up policy implementation has grown exponentially as the budget has grown in size and reach. Despite the rapid growth in central transfers since 2000 and concerted efforts to improve targeting, the mechanism of level-by-level transmission of central transfers through the administrative hierarchy continues to hamper efficient and predictable outcomes.

In the meantime, tight budgets are slowing down the improvement of public services. Social spending (education + health + SSE) as a share of GDP had fallen from 8.5% in 2016 to 7.6% in 2019. Even though education spending in 2021 (January-July) grew 2.7% over 2019, it was 1.6% below the 2020 level. At the current rate, government spending on education for the full

¹² http://www.mof.gov.cn/zhengwuxinxi/caizhengxinwen/202107/t20210730_3741888.htm, accessed 1 August 2021; and http://www.scio.gov.cn/xwfbh/xwfbfh/wqfbh/44687/45235/wz45237/Document/1701754/1701754.htm?mc_cid=bab4c5f044&mc_eid=70bc029764, accessed 9 April 2021.

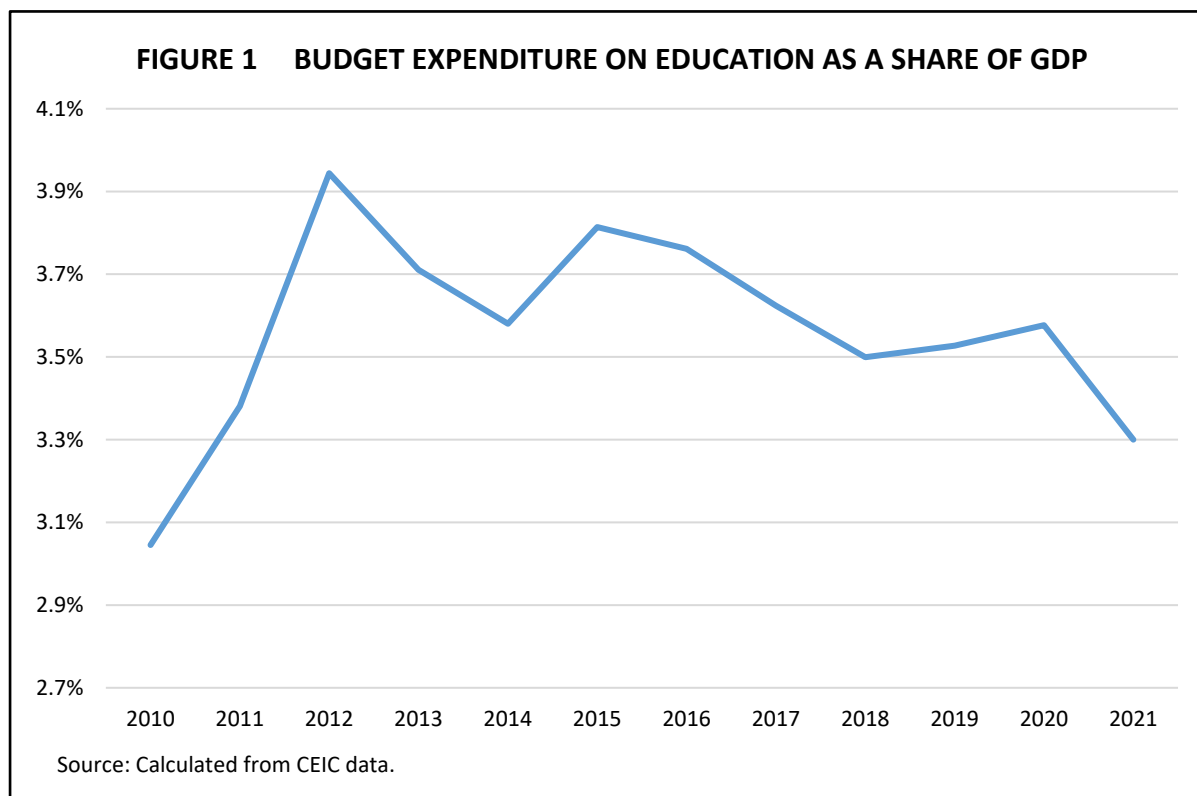
¹³ Christine Wong, “Plus ça Change: Three Decades of Fiscal Policy and Central-Local Relations in China”, *China: An International Journal*, forthcoming; “Fiscal Reform in the Xi Jinping Era and the State of Local Finance”, *EAI Background Brief*, No. 1599, 9 July 2021; China’s Post-COVID Goldilocks Budget – How Big Should It Be?, *EAI Commentary* No. 27, 18 March 2021; Christine Wong and Qian Jiwei, “COVID-19 Highlights Need To Strengthen China’s Social Safety Net (I): The Unemployment Insurance Scheme” and “COVID-19 Highlights Need To Strengthen China’s Social Safety Net (II): The Social Assistance Programmes”, *EAI Background Brief*, Nos. 1572-73, 24 December 2020.

¹⁴ https://mp.weixin.qq.com/s/6MWdvdN87R_KRcFJpId2Q, accessed 4 September 2021. Figure 14.

¹⁵ <https://www.rfa.org/english/news/china/bonuses-07122021142758.html>, accessed 30 July 2021. If true, this is a very steep pay cut since “performance bonuses” are often more than the basic salary and typically based not on the recipient’s performance but the overall fiscal health of the locality.

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year will reach only 3.3% of GDP, far below the government's target of 4% and worsening the trend of downward drift that began earlier (Figure 1).



Christine WONG is Visiting Research Professor at the East Asian Institute and the Bank of America Merrill Lynch Visiting Chair Professor in International Finance in the Schwarzman Scholars Programme at Tsinghua University.

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