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"China: Fiscal Policies for Economic Development"
A Presentation by Xiang Huaicheng, Finance Minister of the People's Republic of China

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At a recent lecture co-sponsored by The Nixon Center and Johns Hopkins SAIS, Chinese Finance Minister Xiang Huaicheng discussed the role of state finance in China's economic development. Minister Xiang stressed that China's economic reforms are continuing, that China is a developing country, and that it is opening to the outside world.

Central Aspects of China's Economic Development

Addressing the importance of state finance to China's development, Minister Xiang highlighted three central aspects of China's economic growth. First, economic restructuring has never ceased. In fact, "we have come to a point where it is simply impossible for us to stop anymore." Economic growth is driven by reform, opening up, and technological progress. Minister Xiang stressed that the fundamental objective of this program and the establishment of a "socialist market economy" are improving people's living standards.

Minister Xiang proceeded to highlight five key areas of economic reform:

- State owned enterprises
- System of investment and finance
- Financial and fiscal programs
- Social security system
- Taxation conversion system

Minister Xiang noted that China's economic adjustments are similar to the situation in America in the 1880s. At that time, the federal government was unable to collect all the tax revenue it was entitled to collect, and excessive layers of tax regulations stifled the economy. Minister Xiang argued that social security, taxation in rural areas, and fiscal and financial reform are China's most pressing problems, and that these three reforms will help restructure the state owned sector. Referring to the redundant state workers, Xiang stated that, "We have to break this egalitarian mode of work and redistribution by creating another "big pot", so to speak. That is the "big pot" of the social security system."

China: "Just a Tiny Speck in the Global Economy"

Responding to comments that China had become a "bright star" in Asia's economy and influential in the global economy, Minister Xiang said that "we would like to decline the honor of becoming a 'big star.'" Instead, Xiang stressed that China was still a developing country with a small economy. China's economy (measured at $1.16 trillion last year) is one tenth the size of the U.S. economy. Although China has maintained high growth rates, the base is low. "Even when we grow at 10 percent, that would still mean that we would grow, in terms of the amount of increase of economic output, equal to 1 percent growth in America. Xiang stated that China's economic goal is to grow by approximately 7 percent annually and to attain a $2 trillion national economy by 2010.

Minister Xiang reaffirmed China's determination to abide by WTO and other international commitments. "I want to emphasize this to our foreign friends – China is a responsible country. We take our commitments very seriously and we honor our words."

Growing Budget Deficits

Minister Xiang then addressed China's growing fiscal deficits. In the first quarter of 2002, fiscal revenue grew by 3.4 percent, while expenditures increased by 23.9 percent. Although concerned about the issue, Minister Xiang noted that fiscal revenue had grown by more than 17 percent over the previous four years. Still, he uttered a word of caution. Instead of limiting spending, expenditures have become "reckless" - "like a flowing current in a river."

At the National People's Congress in March, Minister Xiang's budget proposal received only 80 percent of the votes – an indication that some parliamentarians are concerned with the growing deficit. Given China's healthy growth in 2001, it is hard for some parliamentarians to understand where the shortfall came from, notes the Minister. While the sluggish U.S. economy and slowing exports may be partly to blame, Minister Xiang asserted that the situation will soon improve. Xiang pointed out that the U.S. economy is healthier, that China's GDP growth is strong, that tax system reforms, including new computerized systems, will increase compliance, and he recently called public attention to the issue.

China's Economy is like a Glass of Beer

China's government has worked to increase consumer welfare, argued Minister Xiang. For example, government employees have received four payroll increases over the past four years. Over 46 million people have directly benefited from this program, more than double the population of Australia. Moreover, the series of pay raises is unprecedented in China and has doubled the average basic salary of government workers.

Asked about potential for China's rapidly growing economy to generate Japan style real estate "bubbles" or other similar problems, Minister Xiang responded that there are not many bubbles in the Chinese economy. Xiang argued that some bubbles will naturally exist in any growing economy. "It is like drinking beer – if the beer doesn't have any foam then probably the beer is not too tasty." However, controlling and managing the extent of these problems is difficult, and "really borders on art."

Andersen, Enron and Chinese Accounting Reforms

Minister Xiang then turned to the Chinese accounting system. In his view, accounting in China suffers from three problems: the absence of a unified accounting standard, different domestic agencies employ different accounting standards, and foreign and domestic entities have different standards. The first task is to unify these standards.

Prosecution of financial crimes and appropriate professional conduct are also problems. Minister Xiang stressed his commitment to eradicating fraudulent accounting practices and promoting integrity. China has established two national accounting schools, one in Shanghai and another in Beijing. Incidentally, Xiang based the idea of such accounting schools on the Arthur Andersen campus in Chicago, which he had visited before the Enron collapse. Now, "I found the [Andersen school] a very good idea, but never had I expected what would happen to Andersen." China is establishing a third national accounting school.

Minister Xiang highlighted the need to regulate financial intermediaries such as accounting firms, tax services, consulting firms, and asset management corporations. He argued that progress has been made in this area, but cautioned that "problems will be enormous" if fraudulent accounting spreads. According to Minister Xiang, "that would mean an investor would have no knowledge as to where his money had gone."

Expansionary Fiscal Policy can not be Sustained

Responding to a question from the audience, Minister Xiang examined China's recent expansionary fiscal program. Starting in 1997, China has issued special treasury bonds of approximately 100 to 150 billion yuan per year, and totaling 511 billion yuan. According to the State Statistical Bureau, the expansionary fiscal program had the following contribution to national GDP growth:

1998	1999	2000	2001
1.8 %	2.0 %	1.5 %	1.7%

Minister Xiang then stated that an expansionary fiscal policy can not be sustained into the long term. In fact, when he proposed the program in 1998, he informed the leaders that it could be conducted for only one or two years. "I would like to gradually withdraw from these expansionary fiscal policies on a year by year basis." But, Minister Xiang noted that the expansionary program can not be terminated immediately. For example, infrastructure projects require investment to start, "but if you want to discontinue infrastructure projects, you have to spend money as well." Therefore, "the withdrawal process has to be gradual."

China and the Crisis of Global Capital

Responding to a question on China's approach to entering the volatile global capital markets and the risk of financial crisis, Minister Xiang noted that every finance minister, every central bank chief, and every government leader is grappling with those questions. Moreover, international economic organizations, such as the International Monetary Fund, are seeking to improve ways to ward off financial crises and strengthen financial regulation.

Refusing to integrate into the global financial system is not a means of protection, argued Minister Xiang. "In today's world of globalization, it is simply not possible for a country to be completely on its own." Moreover, despite the perception that China was unscathed in the 1997 Asian Financial Crisis, Minister Xiang argued China's economy had been seriously hurt. During the crisis, he said, Chinese export growth fell to almost zero in 1998 after achieving a robust 20 percent growth rate in 1997. In conclusion, Minister Xiang stated that, "I believe the most effective way to prevent financial crises is first put your own house in order. Second is to strengthen the financial regulation and supervision over situations that might have an impact on your particular country. Good macroeconomic policies are also quite necessary. Of course, it is very easy for me to say this here, but it would be very difficult to actually do this."

(This **Program Brief** *was prepared by Nixon Center staff member Kelani Chan.)*

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