

Exclusive

China's fiscal policy: some considerations

Writing exclusively for *Emerging Markets*, China's finance minister **Xie Xuren** explains how a proactive fiscal policy has helped the country face the global financial crisis while boosting economic development



Over the past year, the world economy has undergone the most severe challenge since the Great Depression in the last century. In response to the international financial crisis, the Chinese government has adjusted macroeconomic policies in a timely and resolute manner, implemented proactive fiscal policy and moderately easy monetary policy, and formulated a stimulus package to expand domestic demand and promote economic growth in its endeavour to maintain stable and relatively fast development.

The proactive fiscal policy, which is an important component of the Chinese gov-

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ernment's macroeconomic policies for fighting the international financial crisis, is composed of the following five parts.

- First, expanding government investment with focus on the key programmes. Of the total 4 trillion RMB in the two-year investment plan, 1.18 trillion RMB comes from the central government. In the end of 2008 the central government allocated additional 104 billion RMB to the government-subsidized housing programme and the post-disaster reconstruction programme, and in 2009 the central government arranges 908 billion RMB for public investment with an increase of 487.5 billion RMB. In 2010, an additional 588.5 billion RMB is expected to be allocated from the central government. Such investment will be mainly used in projects concerning people's well-being, infrastructure, eco-environment, post-disaster reconstruction and consumption demand boosting so as to accelerate economic growth.

- Second, promoting fee-and-tax reform, and conducting structural tax reduction. The central government has fully launched the consumption-based VAT system and started

the fee-and-tax reform for refined oil products. The exemption and reduction policies that were launched in 2008 are maintained to relieve financial burden on enterprises and households and enhance corporate investment and household consumption capacity. It is estimated that the tax burden of enterprises and households will be reduced by around 550 billion RMB in 2009.

- Third, increasing the income level of low-income groups and forcefully expanding consumption demand. The government has further increased subsidies to farmers, raised the minimum purchasing prices of grains and increased the basic cost of living allowances for urban and rural residents so that the people will be able to spend more. At the same time, China increased fiscal input, and offered subsidies for the purchasing of home appliances, agricultural machinery, automobiles and motorcycles by farmers and subsidies for automobiles and home appliance replacement. Thus, the role of consumption demand in driving up economic growth is further reinforced.

- Fourth, further optimizing fiscal expenditure structure and safeguarding and improving the people's livelihood. As support to development and reform in rural areas, in 2009 the central government's allocation to the programmes related to agriculture, rural areas and farmers totals at 716.1 billion RMB, a year-on-year increase of 20.2%. To effectively safeguard and improve the people's livelihood, in 2009 the central government allocates a total of 728.5 billion RMB to the undertakings directly related to people's well-being such as education, health care, social security, employment, government-subsidized housing and culture, up by 29.4% year-on-year.

- Fifth, strongly supporting innovation in science and technology, energy conservation and emissions reduction, and promoting economic restructuring and transformation of the development pattern. The government increases spending on science and technology, accelerates fund alignment to major science and technology projects, explores fiscal and taxation policies favouring industrial restructuring and revitalization plans, encourages enterprises to upgrade technologies and make scientific and technological innovations, and promotes perfection and escalation of the industrial structure. The government also strengthens energy conservation and environmental protection, reins in excess capacity and supports the development of new industries of strategic significance, so that the Chinese economy will be put on a

more sustainable development.

The proactive fiscal policy and other macro regulation measures have on the whole proven to be effective and fruitful. In the first half of this year, China's GDP increased year-on-year by 7.1% despite the serious contraction of external demand. This shows China's macroeconomic policy and stimulus package for coping with the international financial crisis are effective and China's economic growth is contributing to the recovery of the world economy.

Meanwhile, it is apparent that, though positive signs of recovery have emerged, the world economy still lacks a firm foundation for solid recovery. With many uncertainties ahead, the process towards all-round recovery will be slow and tortuous. The stabilization and recovery of the Chinese economy is not yet steady, solid and balanced. China will continue to take maintaining steady and relatively fast economic development as our primary task; unswervingly follow the proactive fiscal policy and moderately easy monetary policy; fully implement and continuously enrich and improve the stimulus package; and make our policies more targeted, effective and sustainable. Economic growth policies in China will not only focus on guarding against and fending off various potential risks, including inflation, but will also focus on securing long-term development and seeking the fundamental solution to the

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institutional and structural problems that constrain the sound development of China's economy. China will continue to actively push forward the economic restructuring and transformation of the development pattern in a bid to balance growth speed with economic structure, quality and efficiency and reinforce the economic sustainability in an all-round way.

The future and destiny of all countries are more closely interconnected than at any time in history. Tackling the international financial crisis and promoting the healthy recovery of the world economy remain the top priorities for all countries. I believe that, as long as the international community makes concerted efforts, unswervingly stimulates economic growth, strengthens macroeconomic policy coordination and actively promotes the balanced development of the world economy, the world will definitely be able to triumph over the international financial crisis and usher in a more prosperous world economy tomorrow.

Doubts raised on Iran sanctions

By Gareth Smyth

Punitive measures against Iran might not work well, analysts said this week after Iranian and US officials met face-to-face in Geneva and the US House of Representatives threatened Tehran with petrol sanctions.

Proponents of further sanctions argue they should be applied if Iran fails to suspend its nuclear programme as demanded by three UN security council resolutions.

Many say Iran is particularly vulnerable to measures impeding petrol imports due to its heavy domestic consumption encouraged by cheap, subsidised fuel.

But Djavad Salehi-Isfahani, a research fellow at Harvard, told *Emerging Markets* that imports had halved since petrol rationing was introduced by Ahmadinejad in 2007, when they accounted for 40% of consumption.

"Imports fell from 200,000 barrels per day to less than 100,000 in 2007," he said.

Economists suggest petrol sanctions would be inflationary. Heydar Pourian, editor of the Tehran-based *Iran Economics* monthly, told *Emerging Markets* they could also reduce economic growth by 0.5-0.75%.

Salehi-Isfahani argued that petrol sanctions could be "generally positive" for the Iranian economy, despite any inflationary effect.

"Iranians will learn to live with world energy prices, something that other people – for example, in Istanbul – have learned to do," he said. "This would also help the government politically to accelerate its programme to reduce gasoline subsidies."

The ration sells at 12 cents a litre. Government subsidies of petrol are part of energy subsidies that amount to over 10% of Iran's GDP – and overall subsidies, including everyday items like bread and medicines, have been estimated at \$50-\$90 billion, or 15-30% of the GDP.

Iran's parliament rejected a plan drawn up by Ahmadinejad last year to phase out subsidies in favour of benefits targeted at the poor. "Opposition was largely on the grounds that it could be inflationary," Pourian said.

The political and economic challenges facing Ahmadinejad have been complicated by unrest following June's disputed presidential election. Iran's reformists continue to allege fraud and the supreme leader, Ayatollah Ali Khamenei, has been drawn into the factional fray.

Salehi-Isfahani said the "political emergency" gave Ahmadinejad greater leeway with the conservative-controlled parliament, which might lead him to step up withdrawals from the Oil Stabilisation Fund. The OSF collects windfall oil revenues ostensibly for investment, especially in the private sector, but successive governments have used it for current spending.

The level of oil revenue invested has therefore been insufficient for the economy to meet an 8% economic growth target set by the new Five-Year plan covering 2010-15. Hence, unemployment has risen officially to 12.5%.

The IMF projects 1.5% growth this year and 2.2% in 2010, down from 7.8% in 2007 and 2.5% in 2008.

Salehi-Isfahani said short-term politics remained focused on issues of redistribution rather than investment to foster growth.

"The predominant belief among the president's supporters [among the Iranian public] is that the government is super rich and that since Ahmadinejad is an honest leader, then money should trickle down to them."

Salehi-Isfahani argued there was also a danger the government would move towards greater control of the economy. The post-election unrest had raised its fears that liberal economic policies had fostered the growth of a restive middle class whose ranks were swollen by expanded higher education and reduced poverty, he said.