

**REFORMING CHINA'S INTER-  
GOVERNMENTAL FISCAL SYSTEM  
UNDER THE "NEW NORMAL"**

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## **Executive Summary**

1. Local fiscal condition is critical for China's economic growth under the "new normal". By the end of 2014, outstanding local government debt reached over RMB15.4 trillion, amounting to about 203% of local fiscal revenue in China.
2. There is a mismatch between local government's fiscal capacity and its expenditure responsibility in the current fiscal system. To finance their expenditure responsibilities, local governments rely on intergovernmental fiscal transfers, local municipal bonds, land transfer revenue and bank loans.
3. The current intergovernmental fiscal system has three concerns. First is the large and rapidly rising local government debt. Second is the increasing urbanisation aggravated by an ageing population which will increase local government's social expenditure significantly. Third is the deceleration of economic growth leading to a slowdown in fiscal revenue.
4. Central and local government policies were released for reforming the intergovernmental fiscal system. The amendment of the budget law has been approved and local fiscal capacity is expected to be improved.
5. New government guidelines released in late 2014 highlight the regulation of the issuance and management of local government bonds and local industrial policies.
6. Reforms to the intergovernmental fiscal system involved several aspects. First, intergovernmental fiscal transfers and budgetary local municipal bonds have increased considerably.
7. Second, Public Private Partnership and mixed-ownership reforms have been initiated to help reduce the debt burden of local governments. Third, the Ministry of Finance has endorsed the issuance of RMB3.2 trillion local municipal bonds to clear local government debts in 2015.

8. Remaining issues for reforming the intergovernmental fiscal system include further reforms of the tax sharing system and adjustment of performance evaluation system for local officials. The various on-going pilot programmes are still at their early stages and need to be assessed and modified in the next reform.