CHINA'S FISCAL POLICY IN 2023:
TREADING WATER

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Executive Summary

1. The 2023 budget is a ‘continuity’ budget that offers a moderate stimulus using the familiar tools of tax and fee cuts to support enterprises and special project bonds (SPBs) to boost investment in infrastructure.

2. The ‘headline’ deficit of 3% of GDP is slightly larger than last year’s 2.8%. The consolidated deficit including all government accounts will be RMB10.9 trillion, and at 8.5% of GDP, it is also 0.2% of GDP larger than that in 2022. The quota for the issuance of SPBs to support infrastructure investment is RMB3.8 trillion, also slightly larger than the RMB3.65trn last year.

3. For the 2023 budget, there are neither big spending programmes like the planned RMB1.2 trillion VAT credit refund, nor the calling up of RMB1.65 trillion in extraordinary remittance from the People’s Bank and several central government enterprises and institutions. The approach is much more conservative.

4. This cautiousness stems from an “extraordinarily difficult” year in 2022, when economic disruptions, deep housing slump and massive tax and fee cuts and refunding past VAT credits converged to batter government finances. General government revenues fell to 16.8% of gross domestic product (GDP), a level last seen in 2005, before huge social spending programmes were introduced.

5. In 2023, the zero-COVID disruptions and the massive VAT credit refund have been cleared, and the housing market is also showing signs of revival. However, a revival of property sales will not provide much immediate help to the budget in 2023, given the typical 6-12 month lag between land sales and payments.

6. The transitory problems aside, the government faces three huge, interrelated problems that require urgent attention: an aggregate fiscal gap, a worsening crisis in local government finance and a looming local government debt crisis.

7. Since 2015 government revenues have declined by more than 5% of GDP after several tax and fee cuts. With revenue growth lagging behind economic and expenditure growth, a widening aggregate fiscal gap has emerged and reducing the fiscal space for policymakers.

8. In 2022 severe financial problems led to widespread complaints of wage arrears, cancelled bonuses and performance pay to public employees, excess fines and fees levied on businesses and residents, curtailed bus services, and even heating during the harsh winter months. In its review, the National People's Congress noted the "relatively prominent" funding gap at the grassroots level.

9. The government has relied heavily on infrastructure investment to boost GDP growth. To provide funding, local governments were allocated quotas for SPBs of RMB3.75 trillion in 2020, RMB3.65 trillion in 2021 and RMB4.15 trillion in 2022.

10. In three years local government debt had surged 65% to RMB35.1 trillion by year-end 2022. At 125% of consolidated fiscal capacity (general revenues + transfers + government fund revenues), it crossed one of the redlines for financial risks, set at 120%.