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THE IMPACT OF CHINA'S FISCAL POLICY ON REAL GDP GROWTH AND NET GOVERNMENT LENDING

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ВПЛИВ ФІСКАЛЬНОЇ ПОЛІТИКИ КИТАЮ НА ЗРОСТАННЯ РЕАЛЬНОГО ВВП ТА ЧИСТЕ ДЕРЖАВНЕ КРЕДИТУВАННЯ

Formulation of the problem. China's fiscal policy has played an essential role in managing economic growth, stabilizing the economy, and tackling structural challenges. Nonetheless, the impact of fiscal policy on real GDP growth and its effects on net government lending continue to be topics of considerable discussion. Expansionary fiscal strategies, including heightened government expenditure and tax reductions, have traditionally been employed to boost economic activity; however, they also bring forth worries regarding escalating public debt and the sustainability of fiscal practices. On the other hand, contractionary fiscal measures designed to decrease deficits may impede short-term growth but could foster long-term economic stability.

This research aims to examine the impact of China's fiscal policy on real GDP growth and net government lending. It specifically seeks to solve the following problems: to investigate the ways of government expenditure and taxation affect real GDP growth in China; to find the relationship between fiscal policy adjustments and net government lending; to research the connection between modifications in fiscal policy and net government lending; to research the difference in of fiscal multipliers across different economic conditions.

The results will enhance the wider discussion regarding the formulation of fiscal policy and its influence on economic results in developing countries.

Analysis of recent research and publications. J. Cimadomo estimated the ex-ante or intentional cyclical stance of fiscal policy and found out that fiscal plans might be significantly different from ex post outcomes because governments do not have complete control over their implementation [1].

I. Chugunov, M. Pasichnyi, V. Koroviy, T. Kaneva and A. Nikitishin researched the fiscal and monetary policy coordination should focus on increasing public welfare and maintaining long-term macroeconomic stability. The results showed no positive effects of general government expenditures on the GDP per capita growth. The influence of public spending on economic growth depends on institutions quality, the composition of expenditures, and fiscal architecture [2].

Weidong Chen and Xiaohui Yuan researched that financial inclusion in China has had significant progress recently and it has gradually formed a unique and sustainable development path with supporting policies and regulations as well as rapid development and application of digital technology [3].

Xiaohua Sun, Junlin Ren and Yun Wang researched the differentiated role of specific tax and ad valorem tax in alleviating the resource curse; they empirically investigated the impact of resource taxes on economic growth and resource curse using a difference-in-difference model, finding that the policy adjustment of the Chinese resource tax from a specific tax to an ad valorem tax significantly restrained the

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economic growth of pilot cities while exacerbating their susceptibility to the resource curse through two mechanisms: an output-inhibiting effect and a supply-side Giffen effect [4].

However, the impact of China's fiscal policy on real GDP growth and net government credit requires more detailed research, which determines the choice of the topic of the article.

Setting objectives. The goal of article is theoretical and analytical research of the impact of China's fiscal policy on real GDP growth and net government lending and developing recommendations regarding the future correction of fiscal policy in the context of new challenges.

Presentation of the main research material. The connection between Real GDP growth and government net lending is closely linked to the fiscal policy choices made by the government, constituting an essential aspect of macroeconomic management. This dependence is supported by theoretical rationale (see fig. 1).

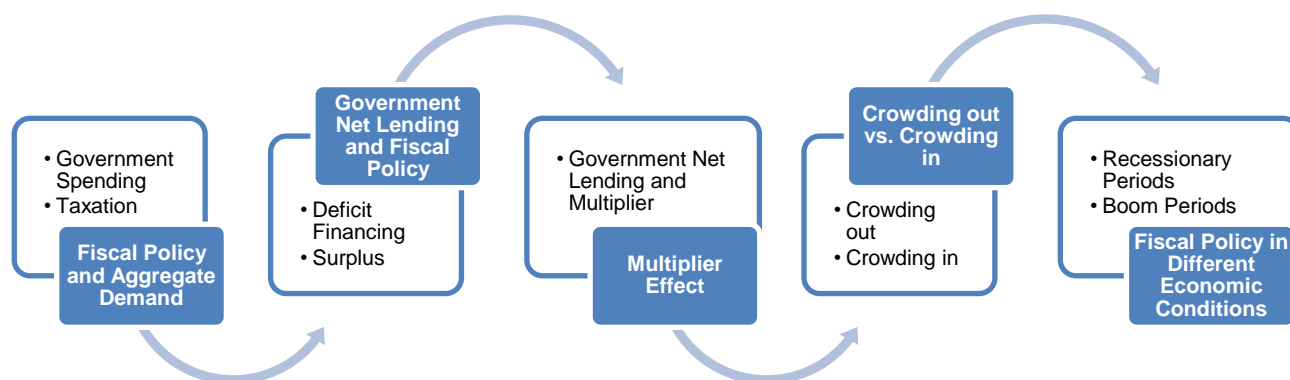


Fig. 1. Fiscal policy and the relationship between Real GDP growth and government net lending
Source: developed by the author

Fiscal Policy and Aggregate Demand. Fiscal policy, involving the government's choices regarding expenditure and taxation, has a direct impact on aggregate demand (AD) within an economy. The growth of real GDP is primarily propelled by fluctuations in aggregate demand, making fiscal policy a crucial instrument for governments aiming to either enhance or reduce aggregate demand. *Government expenditure* plays a crucial role in enhancing aggregate demand by elevating the demand for goods and services. This escalation subsequently results in an increase in output (GDP) and employment levels, thereby promoting economic growth. When the government allocates more funds to areas such as infrastructure, education, and healthcare, it invigorates business operations and boosts consumption and investment through multiplier effects. Reductions in *taxes* can enhance household consumption and stimulate business investment, as both individuals and companies possess increased disposable income for spending or investing. In contrast, increases in taxes diminish disposable income and suppress demand, which can hinder GDP growth.

Government Net Lending and Fiscal Policy. Government net lending denotes the disparity between government income, primarily derived from taxation, and government spending. It shows the net fiscal condition of the government and serves as a crucial measure of the fiscal policy approach—indicating whether the government is experiencing a deficit (when net lending is negative), a surplus (when net lending is positive), or maintaining a balanced budget. *Deficit Financing:* has place when a government experiences a budget deficit, where expenditures surpass revenues, it often resorts to borrowing to cover the shortfall. This borrowing acts as a direct infusion into the economy, particularly when the government invests the borrowed capital in productive ventures, such as infrastructure development. Although this approach may lead to an increase in public debt, it has the potential to stimulate economic growth by enhancing aggregate demand in the short to medium term. A *fiscal surplus* arises when the government's tax revenues exceed its expenditures. This situation may lead to a decrease in overall economic demand, as reduced government spending can hinder growth, especially during times of economic stagnation. Nevertheless, fiscal surpluses can play a significant role in lowering national debt levels, which may ultimately alleviate the debt burden on the economy in the long term [5].

Multiplier Effect. A fundamental mechanism by which fiscal policy influences Real GDP growth is the multiplier effect. An increase in government expenditure generally results in heightened income and consumption levels among households and businesses. This initiates a cycle in which the initial government spending catalyzes additional rounds of economic activity, leading to a total GDP increase that surpasses the initial expenditure. The magnitude of the multiplier is contingent upon several factors, such as the economic conditions, the configuration of the tax system, and the degree of confidence among households and businesses. An increase in a *government's net lending via deficit spending* enhances the *multiplier effect*. This approach is especially beneficial during economic downturns or times of diminished private

sector demand, as government expenditure can bridge the gap and promote economic recovery. The greater the amount the government borrows and invests, the more it can elevate GDP in the short term.

'Crowding out' vs. 'Crowding in'. An important aspect of the interplay between government net lending and economic growth is the discussion surrounding 'crowding out' versus 'crowding in.' *Crowding out*: when government borrowing results in increased interest rates, it may displace private investment. Elevated borrowing costs can diminish the inclination of businesses and consumers to seek loans for investment and consumption, consequently undermining the efficacy of fiscal policy in promoting growth. In such scenarios, government borrowing may adversely impact Real GDP growth, especially in economies characterized by advanced financial markets. *Crowding in*: government spending can have a positive impact when allocated to productive investments, such as infrastructure or research and development. This strategic allocation may enhance the overall business climate, alleviate uncertainties faced by the private sector, and ultimately stimulate private sector investment. In this context, the phenomenon known as 'crowding in' occurs, whereby government net lending fosters private sector expansion rather than constraining it, thereby contributing to an increase in Real GDP growth [6].

The impact of fiscal policy and the relationship between government net lending and Real GDP growth can differ significantly based on the prevailing economic environment. *Recessionary periods*: in times of economic decline or recession, there is typically a reduction in private sector demand, rendering monetary policy insufficient for stimulating economic growth. During such periods, the implementation of an expansionary fiscal policy characterized by increased government expenditure and/or tax reductions, which result in higher net lending becomes crucial for enhancing Real GDP growth and stabilizing the economy. The government can effectively inject demand into the economy, thereby mitigating the decline in private consumption and investment. *Boom periods*: during phases of economic growth, the implementation of excessive fiscal stimulus, particularly when it results in significant deficits, can lead to overheating, inflationary pressures, and potentially unmanageable public debt. In these circumstances, it may be essential to adopt a more prudent fiscal policy, which could include achieving fiscal surpluses and decreasing net lending, in order to prevent the emergence of inflationary pressures that might adversely affect GDP growth.

In the first three quarters of 2024, year-on-year growth has decelerated to 4.8 %. The decline in property investment persists, attributed to ongoing weaknesses in the real estate sector, although the rate of decline has moderated. Infrastructure investment continues to expand at a consistent yet moderate pace, while manufacturing investment remains strong, bolstered by significant export demand. Industrial production has shown resilience, particularly in high-tech industries. China's economic performance in 2024 demonstrated a return to consistent growth, achieving a 5 percent increase in GDP, which aligns with the government's objectives, according to the official data released by the National Bureau of Statistics [7]. For 2025, the IMF expects a GDP growth rate of around 4.6 percent (see fig. 2).

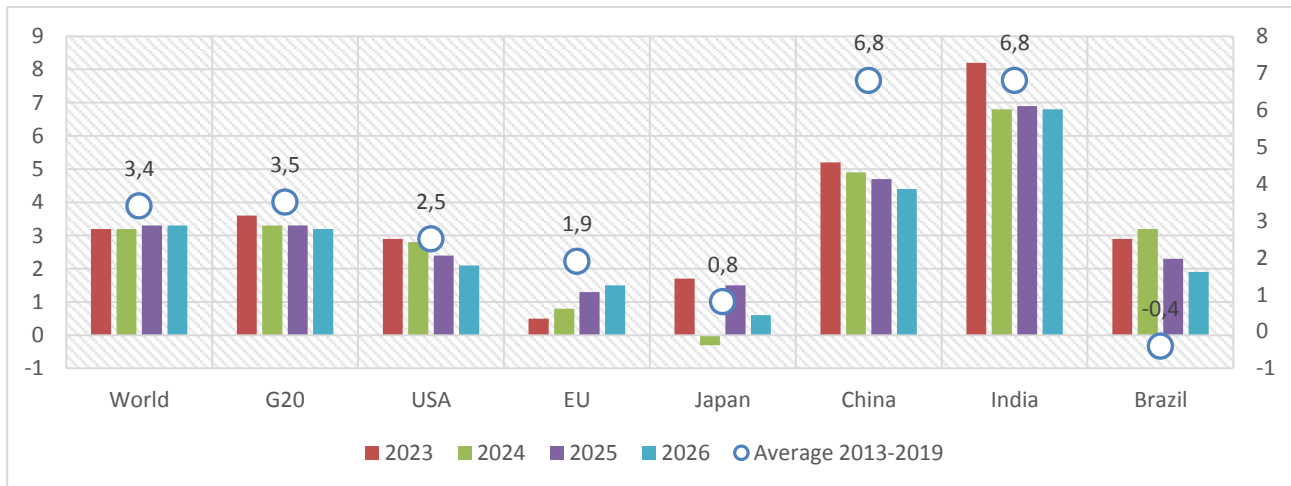


Fig. 2. Real GDP growth

Source: [8]

This result was significantly supported by stimulus initiatives that facilitated a stronger-than-anticipated recovery in the fourth quarter. Despite facing challenges such as a declining population and weak consumer demand, there were encouraging signs in critical sectors, including industrial production and the growth of the digital economy. Furthermore, China is starting to reduce its reliance on the property sector, with the digital economy increasingly contributing to overall economic growth.

However, consumption growth remains tepid, largely due to sustained high levels of precautionary savings. In 2024, the Consumer Price Index (CPI) inflation recorded a year-on-year increase of 0.3 %, accompanied by decreases in prices for certain services, including transportation and telecommunications.

Decreasing input prices have significantly contributed to the decline in producer prices in upstream sectors. Enhancements in productivity, improvements in quality, and ongoing innovation are instrumental in maintaining low prices, particularly in the context of a relatively sluggish recovery in consumption. Although the urban youth unemployment rate has decreased, it remains elevated at 17.1 %. The resurgence in external demand has invigorated Chinese exports, particularly in high-tech sectors, with lower input costs ensuring the competitiveness of these exports. While there has been a slight increase in goods imports, a diminished dependence on imported inputs and the low import content associated with consumption hinder a more robust recovery. Additionally, a tepid rebound in tourism-related imports has constrained overall import growth and enhanced the current account surplus [8].

In China, the management of Central Government (CG) debt is conducted with a high degree of conservatism, maintaining a relatively low level in comparison to other major economies and most developing nations. Conversely, Local Governments are inherently in a state of deficit, necessitating the use of various strategies and loopholes to balance their budgets. As of the end of 2023, official statistics indicate that China's total public debt stands at 71 trillion RMB, representing 69 % of GDP. This shows comprises CG debt amounting to 30 trillion RMB (24 % of GDP) and LG debt totalling 41 trillion RMB (32 % of GDP) (see fig. 3). The CG debt includes sovereign bonds issued by the Ministry of Finance of the PRC, while the LG debt consists of bonds issued directly by provincial or municipal authorities. The remaining 13 % is attributed to various Government funds. Nevertheless, significant contingent (or off-balance sheet) liabilities at the local level arise from debts incurred by entities known as Local Government Financing Vehicles (LGFVs). These vehicles have been established by local governments to circumvent the restrictions placed on their ability to issue debt directly. The International Monetary Fund (IMF) estimates that the total liabilities associated with LGFVs have reached 60 trillion RMB, or 48 % of GDP in 2023, a substantial increase from 13 % in 2014 [9].

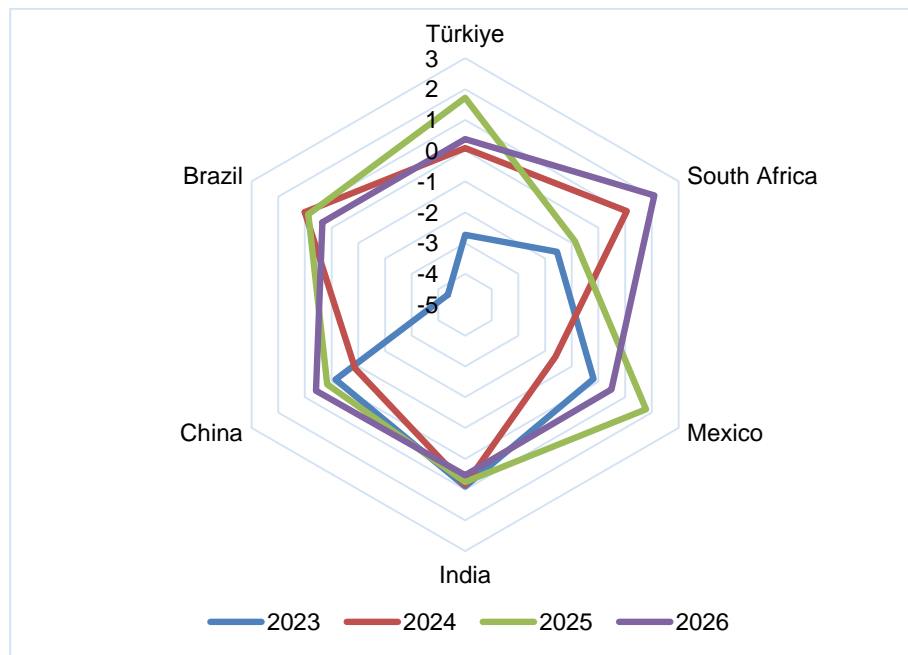


Fig. 3. Government net lending, % of GDP

Source: [8]

Monetary policy underwent substantial easing in 2024 to facilitate economic recovery and maintain sufficient liquidity. There have been several reductions in interest rates and the reserve ratio required to be held at the central bank, including a 20-basis point decrease in the primary policy rate, as well as a 25-basis point reduction in both the 1-year and 5-year loan prime rates (LPR) (see fig. 4). Additionally, the benchmark mortgage rate has been lowered, and a new mechanism for adjusting mortgage rates has been introduced, enabling reduced premiums, especially in cities experiencing declining property prices. Mortgage agreements featuring flexible rates can now be modified more often than once a year. The relaxation of prudential regulations, including less stringent down payment criteria for secondary residences and the option to sell a mortgaged apartment, has begun to stimulate transactions, particularly in major metropolitan areas, first-tier cities, and resort destinations. Additionally, the easing of requirements concerning the relending quota for state-owned enterprises acquiring unsold but completed properties will further bolster housing demand.

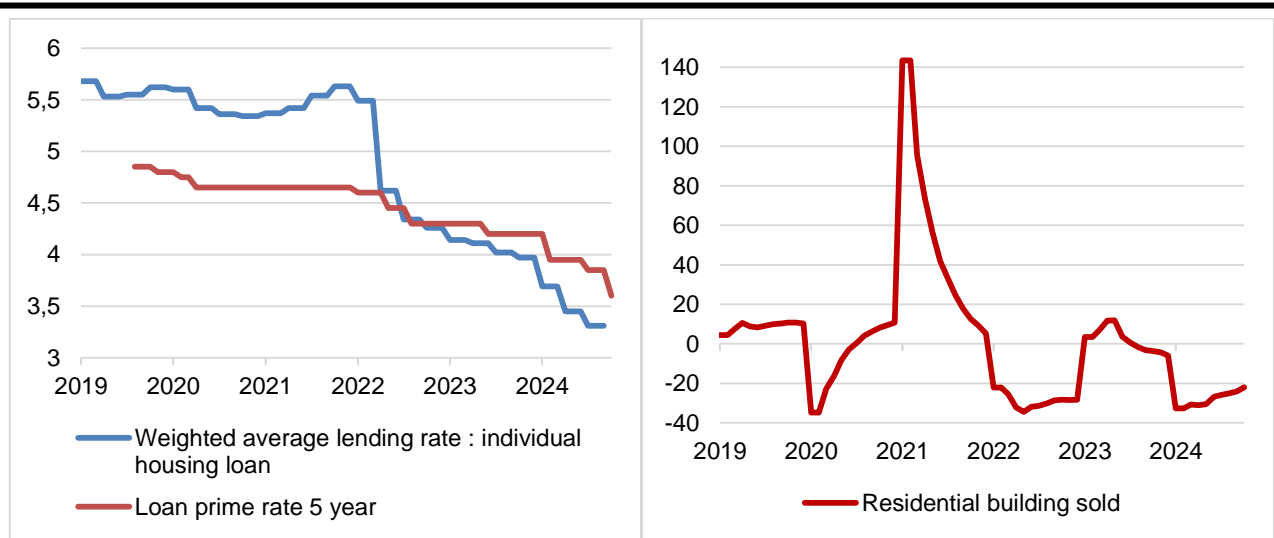


Fig. 4. Dynamics of mortgage rates and housing sales in China, Y-o-y % changes

Source: [8]

In 2024, fiscal policy has adopted a more expansionary stance, as the central government initiated the issuance of ultra-long maturity bonds, exceeding ten years in duration, amounting to 0.8 % of GDP to finance key projects. Additionally, certain unused special local government bonds from 2023 are being utilized to support initiatives in 2024, contributing approximately 0.4 % of GDP. The quota for special local government bonds was increased, with plans to issue bonds equivalent to 1.5 % of GDP in both 2025 and 2026, similar to the issuance in 2024. To alleviate the debt servicing obligations of local governments, a provision has been made to allow the conversion of implicit debts, up to 3 % of GDP, into explicit local government debt by 2028, effectively addressing a significant portion of the implicit debt recognized to date. Increased oversight of local special bond financing is essential for enhancing efficiency. Although resolution plans have mitigated the financial strain on heavily indebted local governments, the fundamental mismatch between revenue allocations and expenditure responsibilities at the sub-national level remains unaddressed. Consequently, local governments continue to experience financial challenges due to declining real estate values. The Third Plenary Session proposes the centralization of certain critical spending responsibilities, which is a positive development as it will ensure a baseline of public services across the nation. Furthermore, project financing will undergo stricter monitoring, with funds being disbursed solely for approved initiatives. The 'cash-for-clunkers' program, designed to modernize machinery, equipment, and appliances, will bolster both consumption and investment. Overall, the policy environment is expected to remain supportive during the years 2025-26 [8].

China's recent fiscal announcements aimed at tackling medium-term structural challenges to economic growth stemming from the financial difficulties faced by local governments. However, these measures are not expected to deliver an immediate uplift or mitigate deflationary pressures. The fiscal initiatives enhance the borrowing capacity of local and regional governments (LRGs), allowing them to incorporate concealed local-government financing vehicle (LGFV) debt into their balance sheets. While this will not decrease the total leverage of LRGs, it is anticipated to reduce overall interest expenses, thereby potentially providing LRGs with increased fiscal flexibility in the medium term. China had the capacity to increase public expenditure in the fourth quarter of 2024, even in the absence of new explicit fiscal stimulus. The potential downside risks to the 4.8 % growth forecast for 2024 appeared to be minimal. Following a period of neutral fiscal policy characterized by sluggish spending, China's fiscal approach shifted to an expansionary stance in the third quarter of 2024. Analysts anticipate a budget deficit of 7.2 % of GDP for 2025 [10].

In 2024, the Ministry of Finance declared the issuance of CNY6 trillion in additional special-purpose bonds (SPBs) designated for local government debt swaps over the forthcoming three years, along with CNY4 trillion allocated for a five-year period. These funds will be sourced from the incremental annual SPB quotas of local governments. China has the capacity to expand its deficit, raise the SPB quota, and issue a greater volume of ultra-long central government bonds. This fiscal stimulus is both incremental and reactive to potential downside risks, such as the increasing possibility of heightened trade tensions with the United States, thereby establishing a support level for growth, which is projected to moderate to 4.5 % by 2025. The fiscal deficit is expected to remain high in the medium term. This situation will contribute to an upward trajectory in government debt and may exert additional pressure on China's sovereign rating, contingent upon the extent to which fiscal and monetary policy measures stimulate underlying demand and alleviate deflationary pressures [10].

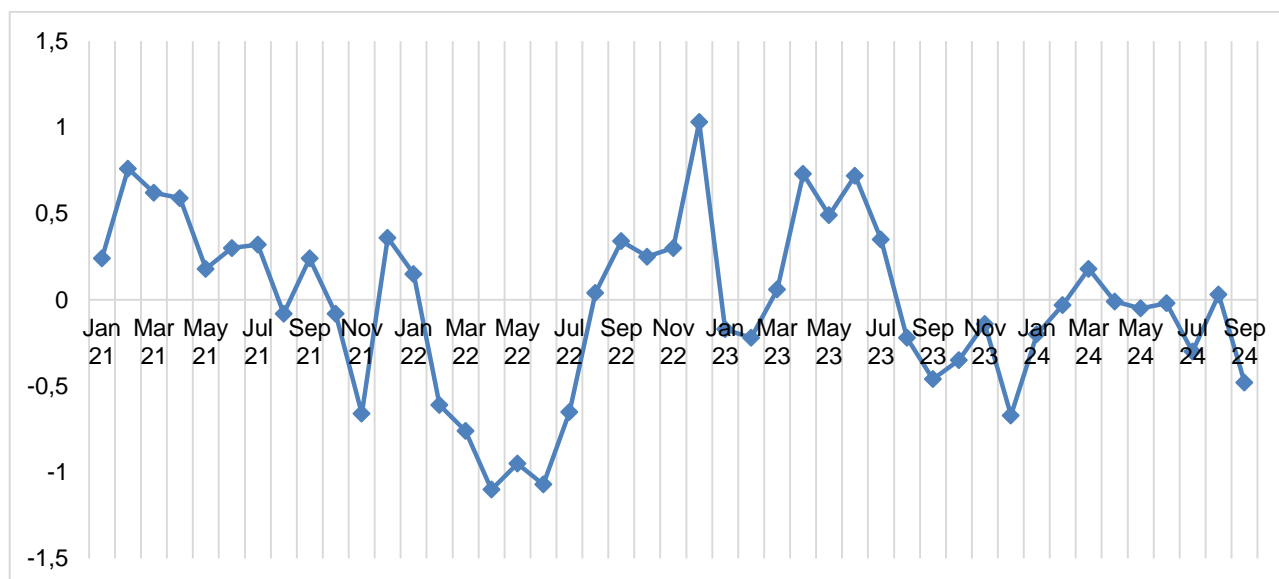


Fig. 5. Month-on-month change in 12-month rolling sum fiscal deficit

Source: [10]

The most recent announcements signify an additional clarification of contingent liabilities stemming from concealed Local Government Financing Vehicle (LGFV) debt onto Local Government (LRG) balance sheets. This development is expected to lead to an increase in overall government debt over the forthcoming five years. Furthermore, the authorities intend to strengthen common equity for the six state-owned banks, which may also result in an escalation of debt. Recent announcements regarding debt swaps are expected to alleviate the medium-term refinancing challenges faced by Local Government Financing Vehicles (LGFVs) and enhance their financing conditions, while also reinstating debt on the balance sheets of Local Regional Governments (LRGs). Although significant deleveraging could lead to an enhancement of LGFVs' Standalone Credit Profiles, it is important to note that this improvement may not necessarily result in upgrades to their credit ratings, which are typically influenced by external support factors. The insufficient cash flow generated by projects, which hinders operators' ability to manage related debt, will continue to pose a significant risk for the Local Government Financing Vehicle (LGFV) sector. The interest obligations for Local Regional Governments (LRGs) concerning the additional CNY2 trillion in Special Purpose Bonds (SPBs) annually represent approximately 1 % of the projected capital revenue for 2024. This situation will further constrain the expenditure flexibility of LRGs' capital accounts, despite the debt swap leading to a reduction in overall interest expenses for the public sector.

The Chinese economy is anticipated to experience a gradual slowdown, driven by declining potential growth attributed to adverse demographic trends and a deceleration in productivity improvements. The ongoing adjustments within the real estate sector are expected to continue impacting residential investment and related consumption areas, such as furniture sales. Conversely, infrastructure investment is likely to increase, supported by a rise in local special bond issuances. There are urgent requirements associated with the green transition, urban village redevelopment, and various environmental and social objectives. Consumption growth is projected to remain stable, with little likelihood of an increase as long as the absence of social security reforms sustains high levels of precautionary savings. Technological advancements and competition within domestic markets are expected to maintain the competitiveness of exports, even as unit labor costs rise more rapidly than in other nations. Tourism imports, which constitute the largest segment of imports, may not return to levels seen prior to the COVID-19 pandemic [8].

The current account surplus is expected to expand further, while inflation is predicted to revert to more typical, albeit still low, levels. Additional credit events could potentially disrupt the orderly adjustment process within the real estate sector. While an excessive easing of demand-side restrictions in the property market might lead to enhanced growth, it could also exacerbate existing imbalances and necessitate a more abrupt adjustment in the future. Failing to address the funding gap at sub-national government levels may result in a further accumulation of implicit debt, leading to more expensive resolutions down the line. Delaying necessary social security reforms could sustain high levels of uncertainty and reinforce a tendency towards increased precautionary savings. A rise in global trade restrictions would likely hinder export growth and industrial activity. However, a fiscal expansion combined with more rigorous measures to enhance spending efficiency could amplify the effects of such spending, thereby fostering higher growth. Additionally, a reduction in the mortgage interest burden on households may lead to a modest increase in consumption [8].

Supportive monetary, fiscal, and financial policies are essential for sustaining demand in the short term. Permitting borrowers to repay their mortgages early without incurring penalties and allowing them to

transfer their loans to different banks would reduce mortgage expenses and enhance competition within the banking sector. In the long run, it is crucial to establish a more robust social safety net to shift the economy's focus towards consumption and decrease the propensity to save. Unemployment insurance should be made available to everyone, and pensions must ensure at least a basic standard of living for all qualified individuals. Additionally, the range of treatments and medications covered by health insurance should be expanded to prevent health-related expenses from driving individuals into poverty. Addressing labor shortages in certain fields can be achieved by better aligning the skills taught in educational institutions with those demanded by the job market. There is a notable deficiency in both technical and soft skills, particularly in areas such as computer programming and sales and marketing. Career guidance should be initiated at an early age, providing ample information regarding the prospects of securing quality employment and the starting and average salary ranges. Given the significant rise in the number of tertiary graduates, it is essential to implement a more practical curriculum and increase internship opportunities to cultivate the necessary skills. Furthermore, the negative perception of vocational education must be addressed by enhancing the quality of teachers and curricula, minimizing the emphasis on early tracking and streaming, and promoting vocational careers among young individuals.

Conclusions from the conducted research. In conclusion, fiscal policy significantly affects Real GDP growth by modifying government expenditure, taxation, and net lending, thereby altering aggregate demand and shaping economic conditions. The influence of China's fiscal policy on real GDP growth and net government lending pertains to the consequences of government expenditure, taxation, and borrowing strategies on the nation's economic performance and fiscal health. Fiscal policy serves as a vital instrument employed by the Chinese government to shape economic activity, stabilize growth, and tackle structural issues. Grasping this influence is essential for evaluating the efficacy of fiscal initiatives in promoting sustainable economic growth while upholding fiscal responsibility. The influence of fiscal policy on Real GDP is contingent upon the nature of the policy (whether expansionary or contractionary), the timing of its implementation, the extent of government involvement, and the prevailing economic context. Additionally, government net lending is pivotal in this dynamic; while deficits can enhance demand in the short run, surpluses may contribute to stabilizing long-term growth by managing debt levels.

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Чжу Ліхун

ВПЛИВ ФІСКАЛЬНОЇ ПОЛІТИКИ КИТАЮ НА ЗРОСТАННЯ РЕАЛЬНОГО ВВП ТА ЧИСТЕ ДЕРЖАВНЕ КРЕДИТУВАННЯ

Мета. Теоретичне та аналітичне дослідження впливу фінансової політики Китаю на зростання реального ВВП і чисте державне кредитування та розробка рекомендацій щодо майбутньої корекції фінансової політики в контексті появи нових викликів.

Методологія дослідження. У цьому дослідженні використано: метод системного аналізу – для збору, аналізу та порівняння наукової літератури щодо впливу фінансової політики Китаю на зростання реального ВВП і чисте державне кредитування; метод абстракцій – для системного розуміння викликів і можливостей у процесі формування фінансової політики Китаю, для розробки ефективних пропозицій щодо формування фінансової політики та її впливу на економічні результати в країнах, що розвиваються; метод візуалізації – для представлення результатів дослідження.

Результати дослідження. Досліджено вплив державних витрат та оподаткування на зростання реального ВВП Китаю. Виявлено зв'язок між коригуванням фінансової політики та чистим державним кредитуванням. Досліджено зв'язок між змінами фінансової політики та чистим державним кредитуванням. Досліджено мультиплікаційний ефект впливу фінансової політики на зростання реального ВВП та фактори зміни його величини.

Наукова новизна результатів дослідження. Теоретично обґрунтовано сутність фінансової політики в Китаї, її впливу на зростання реального ВВП і чисте державне кредитування, встановлено заходи для стимулювання економічного відновлення, підтримку ліквідності і вирішення структурних проблем та удосконалено рекомендації щодо майбутньої корекції фінансової політики в контексті появи нових викликів.

Практична значущість результатів дослідження. Результати проведеного дослідження щодо впливу фінансової політики Китаю на зростання реального ВВП і чисте державне кредитування мають практичне значення для країн, що розвиваються, в умовах корекції фінансової політики в контексті появи нових викликів.

Ключові слова: державний борг, зростання ВВП, іпотечна ставка, механізм фінансування місцевого самоврядування, фінансовий дефіцит, фінансова політика, чисте державне кредитування.

Zhu Lihong

THE IMPACT OF CHINA'S FISCAL POLICY ON REAL GDP GROWTH AND NET GOVERNMENT LENDING

Purpose. The aim of article is theoretical and analytical research of the impact of China's fiscal policy on real GDP growth and net government lending and developing recommendations regarding the future correction of fiscal policy in the context of new challenges.

Methodology of research. The following methods were used during the research: the system analysis method to collect, analyse and compare the scientific literature on the impact of China's fiscal policy on real GDP growth and net government lending; the abstraction method – to systematically understand the challenges and opportunities in the process of shaping China's fiscal policy, to develop effective proposals for shaping fiscal policy and its impact on economic results in developing countries; the visualization method – to present the research results.

Findings. The impact of government spending and taxation on China's real GDP growth is investigated. The relationship between fiscal policy adjustments and net government lending is identified. The relationship between fiscal policy changes and net government lending is investigated. The multiplier effect of the impact of fiscal policy on real GDP growth and the factors of its change are investigated.

Originality. The essence of fiscal policy in China, its impact on real GDP growth and net government lending are theoretically substantiated, measures are established to stimulate economic recovery, support liquidity and solving structural problems, and recommendations for future fiscal policy correction in the context of new challenges are improved.

Practical value. The results of the conducted study on the impact of China's fiscal policy on real GDP growth and net government lending have practical value for developing countries in the conditions of fiscal policy adjustments in the context of new challenges.

Key words: public debt, GDP growth, mortgage rate, local government financing mechanism, fiscal deficit, fiscal policy, net government lending.

