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## Mainland China's 2008 budget focuses on improving livelihood

- Mainland China's budget deficit fell to RMB200 billion in 2007, equivalent to 0.8% of GDP, the lowest among major countries. The budget deficit is projected to fall further to RMB180 billion this year. Although economic growth is expected to slow as well, the deficit is expected to fall to 0.6% of GDP.
- In 2007, government spending on education and health care grew well above those in other areas. But while spending on education is now comparable to those of many developing countries, spending on health care is still well below comparable world levels.
- In 2008, spending priority is not only given to education and health care, but also to such key areas as social security and environmental protection. Looking ahead, spending on all these areas will continue to grow strongly as mainland China strives to improve its people's livelihood.
- With constant pressure on spending growth, keeping the budget deficit at manageable level will be a challenge for the government, even more so when considering that actual spending growth in the past constantly overshoot the government's budgetary growth.

Strong fiscal revenue and economic growth helped reduce mainland China's budget deficit to only 0.8% of GDP in 2007. During the year, the Central government's budget revenue grew 34.7% to RMB2,859 billion, while expenditure rose 30.3% to RMB3,059 billion. Faster revenue than expenditure growth resulted in a smaller budget deficit of RMB200 billion for 2007 than 2006<sup>(1)</sup>.

For 2008, growing economic uncertainty coupled with the government's traditionally conservative budgetary approach prompts the Central government to plan for a growth of only 13.8% for fiscal revenue. Equally, expenditure is planned to rise by only 12.2%, resulting in yet another small budget deficit of RMB180 billion for 2008 (Exhibit 1). Although economic growth is expected to slow in the months ahead, the budget deficit will likely to fall to 0.6% of GDP this year.

<sup>1</sup> Under mainland China's Budget Law, only the Central government is permitted to incur a budget deficit and issue public bonds. Local governments must have a balanced budget.



# ECONOMIC FOCUS

Treasury Division



## Exhibit 1: Central government budget, 2007-2008

(RMB billion)	2007		2008	
	Budget	Actual (a)	Budget (b)	(b)/(a) %
Budget revenue	2,442.1	2,859.0	3,253.2	13.8
- Central government revenue	2,359.0	2,773.9	3,162.2	14.0
- Local government contribution	83.1	85.1	91.0	7.0
Budget expenditure	2,687.1	3,058.9	3,433.2	12.2
- Central government expenses	1,106.2	1,144.5	1,320.5	15.4
- Transfers to local governments	1,580.9	1,811.2	2,162.7	19.4
- Stability adjustment fund	0.0	103.2	-50.0	-148.45
Budget balance	-245.0	-200.0	-180.0	
as % of GDP		0.8%	0.6%	

Source: Government Budget Statement, 2007-2008

## Spending on social related areas increased markedly

In 2007, Central government spending on health care and education soared by 297% and 76% respectively over 2006. Less dramatic but equally significant was the growth of spending on agriculture and rural development, and science and technology-related areas (Exhibit 2).

## Exhibit 2: Central government spending on key areas

	2007 Actual			2008 budget		
	RMB billion	Growth %	Share of total %	RMB billion	Growth %	Share of total %
Agriculture & rural development	431.5	23.0	14.1	562.5	30.3	16.4
Defence	348.3	16.9	11.4	409.9	17.7	11.9
Industry, commerce, finance	242.9	NA	7.9	337.3	38.9	9.8
Social security	222.4	13.7	7.3	276.2	24.2	8.0
Education	107.6	76.0	3.5	156.2	45.1	4.5
Science & technology, R&D	90.0	16.3	2.9	113.4	26.0	3.3
Environmental protection	78.2	NA	2.6	102.8	31.4	3.0
Health care	66.4	296.8	2.2	83.2	25.2	2.4
Debt servicing	99.3	NA	3.2	123.6	24.5	3.6
Other	1,372.3	NA	44.9	1,268.1	-7.6	36.9
Total	3,058.9	30.3	100.0	3,433.2	12.2	100.0

Source: Government Budget Statement, 2007-2008

In 2008, Central government spending on the above areas will continue to grow well above the pace of the total. Spending on education, agriculture and rural development, and environmental protection grows particularly strongly.

Spending on agriculture and rural development now constitutes the biggest part of Central government spending, accounting for 16.4% of the total in 2008. This is followed by spending on defence, industry, commerce & finance, and social security. Spending on education accounts for another 4.5%. Together, these five areas account for about half of total Central government spending in 2008.





## Local governments' financial burden is equally heavy

Central government spending, however, accounts for only 56.5% of the national budget. Except for defence spending which is almost the sole responsibility of the Central government, spending on most of the other key areas is shared between the Central and local governments. In some areas, it is the local governments that bear the majority of the financial burden.

Figures in 2006 showed that, while the Central government accounted for 46% of total government spending on social security, it accounted for only about 10% each of the spending on health care and education (Exhibit 3). The majority of the expenses on the latter fall on local governments. The problem is, local governments, especially those in poorer locations, are often too financially constrained to be able to spend more on those areas. Many local governments are forced to borrow from the market to finance their spending needs, resulting in substantial hidden debt <sup>(2)</sup>.

### Exhibit 3: Central and local government spending on key areas

	National spending RMB bn	Central government		Local governments	
		RMB billion	Share of total %	RMB billion	Share of total %
Education	475.3	53.6	11.3	421.7	88.7
Health care	131.2	13.8	10.5	117.4	89.5
R&D	126.0	77.4	61.4	48.6	38.6
Social security	433.8	201.0	46.3	232.8	53.7

Source: Government Budget Statement, 2006-2007

Nevertheless, mainland China still managed to lift spending significantly on such key areas as education and health care. Spending by Central and local governments on education, for example, doubled to 3.8% of GDP in 2007 from 1.9% in 2001. Much of the increase was made in 2007. Educational expenses now constitute almost 1/5 of total government spending (Central plus local governments), compared with just 11.8% in 2006. Between 2001 and 2007, total government spending on health care also doubled to 1% of GDP, while that on social security rose to 2.1% of GDP from 1.8%.

At 3.8% of GDP in 2007, the Mainland's total government spending on education was also close to the government's target of reaching 4% of GDP by 2009, and near the upper bound of the 1 to 4% range of other developing countries (Exhibit 4). However, at only 1% of GDP in 2007, Mainland China's total government spending on health care was at the lower bound of the 1-3.4% range of other developing countries (Exhibit 4).

<sup>2</sup> Under law, local governments must balance their budget, and are not allowed to borrow from the market to finance their budgetary needs. In 2005, Premier Wen Jiabao pointed out that hidden debt incurred by local governments was the biggest risk factor jeopardizing the country's economic safety and social stability (Finance & Trade Economics (财贸经济), 02/2008, p.81).





**Exhibit 4: Government spending on education and health care in selected countries, 2004**

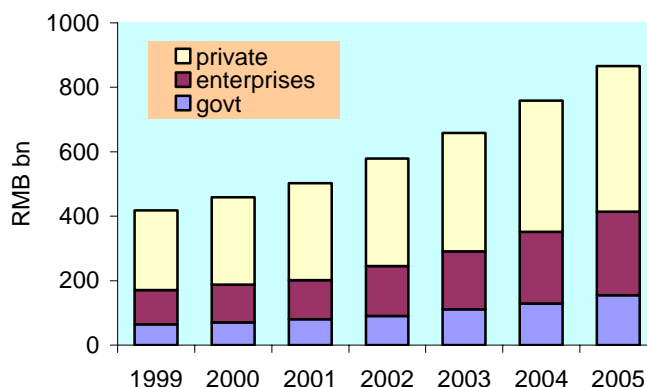
(% of GDP)	Education	Health care
China *	3.8	1.0
Japan	3.7	6.4
South Korea	4.6	2.8
Brazil	4.1	3.4
India	3.3	1.2
Indonesia	0.9	1.1
Thailand	4.2	2.0

\* 2007 figures

Source: "Public Finance in China", World Bank, 2008

In Mainland China, rising health care cost is a major source of financial stress for households, especially poor rural households. Although government spending on health care has increased over the years in both absolute and relative terms, it still accounted for just 18% of the country's total health care expenses in 2005 (Exhibit 5). Enterprises, the majority of which are former state and collective enterprises turned commercial businesses, accounted for another 30%. In other words, private individuals had to bear over half of their health care expenses<sup>(3)</sup>.

**Exhibit 5: Mainland China's total health care expenditure**



Source: China Statistical Yearbook 2007

## Maintaining a sound fiscal position could be a challenge

Mainland China's fiscal position started to improve in both absolute and relative terms since 2002. The government's budget deficit fell steadily from RMB314.9 billion in 2002 to RMB200.0 billion in 2007. As a share of GDP, it fell from 2.6% to 0.8% in the same period (Exhibit 6). At 21.1% of GDP in 2007, mainland China's public debt outstanding is also the

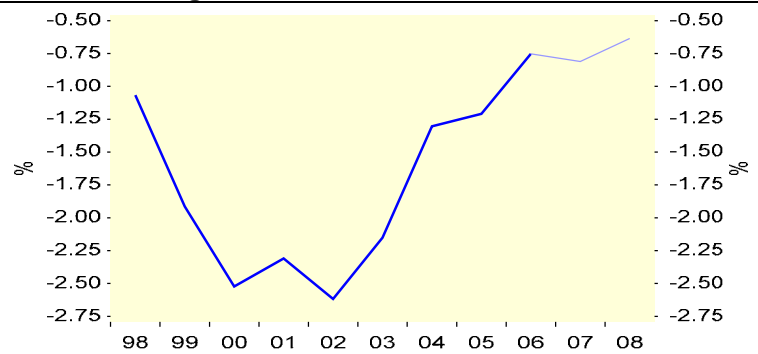
<sup>3</sup> To address the health care problem, mainland China introduced a medical-insurance scheme in the rural areas in 2003 with contribution from both rural residents (RMB10 a year) and local governments (RMB40 a year). Some 780 million rural residents were covered by the scheme by end-2007. A similar scheme was introduced in urban areas in 2007 for non-workers including students. The scheme aims at covering every urban resident by 2010.





lowest among major countries. However, mounting social pressures for more government spending on such key areas as education and health care mean that there is no room for complacency.

**Exhibit 6: Budget balance as % of GDP**

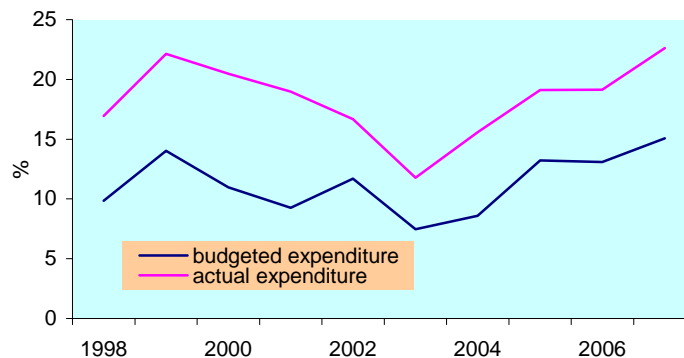


Source: Reuters EcoWin; Hang Seng Bank

In his latest Government Work Report, Premier Wen Jiabao assigned top spending priority to social welfare programmes. Compulsory free primary and mid-secondary school education will be extended to the urban areas this autumn from the rural areas. Spending on low-cost housing, health care and environmental protection will also be raised significantly in the years ahead.

It is such marked increase in spending that makes the containing of the budget deficit a challenge. The task would be even more difficult when considering that governments at both the central and local levels are not quite capable of controlling expenditure growth. As Exhibit 7 shows, the actual growth of national expenditure constantly overshoot the government's planned expenditure growth by a wide margin. For mainland China, having reached its present fiscal position is a remarkable achievement, maintaining or improving it further would need more than luck.

**Exhibit 7: Planned and actual growth of national budgetary expenditure**



Source: Budget Statement, various issues



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