

# Analysis of the Positive Effects and Limitations of China's Public Finance Policy

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**Abstract:** Public finance policy plays a vital role in achieving national economic development, social equity, and national security. Since the Reform and Opening-up, China has been able to create an economic miracle that has amazed the world, and one important reason for this is its public finance policy. Therefore, this paper aims to conduct in-depth research on the implementation of public finance policy since the Reform and Opening-up, analyzing its specific impact on various aspects of China's economy and society, and thus comprehensively evaluating the effectiveness of public finance policy. At the same time, the paper will also focus on the problems and challenges faced by the implementation of public finance policy, such as inadequate policy design, insufficient implementation force, and inflexible adjustment mechanisms. Through in-depth analysis of these issues, the paper will propose some specific suggestions with the hope of providing assistance for the further adjustment and improvement of China's public finance policy.

**Keywords:** Public finance policy; Economic Growth; Income Distribution; Employment; Stability; Limitations

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## 1. Introduction

Public finance policy plays a crucial role in China's socialist market economy, demonstrating significant effectiveness in promoting economic growth, improving income distribution, and stabilizing employment since the era of reform and opening up. However, as China's economic development enters a new normal and the post-pandemic era, public fiscal policy faces new challenges and requires greater emphasis on structural adjustments and promoting transformation and upgrading. Studying the effects and limitations of public fiscal policy is essential for understanding its role and limitations in the new period, optimizing policy formulation, and recognizing the government's role in the economy, promoting the sustainable and healthy development of society and the economy. Therefore, research on the effects and limitations of public fiscal policy holds important theoretical and practical significance.

## 2. The positive effects of public finance policy

### 2.1 The impact of public finance policy on economic growth

#### 2.1.1 Tax policy

##### Tax Reduction and Burden Reduction

The Chinese government aims to stimulate market vitality and reduce the burden on enterprises by lowering the corporate income tax rate, implementing value-added tax (VAT) reforms, and introducing tax reduction policies specifically targeted at small and micro enterprises and innovative enterprises<sup>[1]</sup>.

##### Optimize the tax system

The Chinese government is establishing a simple and transparent tax system. In recent years, measures have included merging and abolishing complex tax categories such as agricultural tax and pastoral tax, creating a favorable tax environment for enterprises.

A series of adjustments to tax policies, including tax incentives and reforms to the tax collection and administration system, have promoted China's economic growth. Since the implementation of the reform and opening-up policy, China's total tax revenue has continued to increase. According to data from the National Bureau of Statistics, China's tax revenue reached 16.6 trillion yuan in 2020, approximately 28 times the amount in 1978; in 2020, the national corporate income tax revenue reached 4.83 trillion yuan, a year-on-year increase of 4%; in 2020, the national value-added tax (VAT) revenue reached 7.07 trillion yuan, a year-on-year increase of 4.3%, and approximately 16 times

the amount in 1994 (for details, see Figure 3.1); in 2020, the proportion of tax revenue in GDP was 16.3%, an increase of 3.6 percentage points from 1978. These figures indicate that tax incentive policies have shown significant results in stimulating market vitality and driving economic growth.

### *2.1.2 Financial subsidy policies*

#### *Agricultural Subsidies*

The Chinese government has implemented a series of agricultural subsidy measures, such as subsidies for agricultural structural adjustments, direct subsidies to farmers, subsidies for high-quality seeds, subsidies for the purchase of agricultural machinery, and support for agricultural product prices. These measures have played a significant role in promoting the growth of China's agricultural sector: China's total grain output has increased from 609.5 billion jin in 1978 to 1373.1 billion jin in 2022. The grain production reached 633.24 million tons (126.65 billion jin), an increase of 4.9 million tons (1 billion jin) year-on-year, showing a steady growth trend; the per capita disposable income of rural residents in China has increased from 134 yuan in 1978 to 20,133 yuan in 2022, and the income level of farmers has been continuously improving. The above data indicate that since the implementation of the reform and opening-up policy, the changes in agricultural subsidy policies have had a positive impact on agriculture, including increasing farmers' income, promoting agricultural production, adjusting the structure of the agricultural industry, protecting the agricultural ecological environment, and driving the development of rural social undertakings<sup>[2]</sup>.

#### *Corporate Subsidies*

The Chinese government's subsidy policies primarily assist enterprises in research and development, tax reduction, provision of fiscal funds, policy-based loans, government procurement support, talent introduction and training, green development, and optimization of industrial structure. According to data from the National Bureau of Statistics, since the implementation of the reform and opening-up policy, China's gross domestic product (GDP) has seen significant growth. By 2022, China's per capita GDP had reached 85,698 yuan, which represented a real increase of 3% from the previous year. Calculated at the average exchange rate, per capita GDP reached 12,741 US dollars, marking the second consecutive year above 12,000 US dollars. At the same time, the national industrial added value reached 40.2 trillion yuan, while the manufacturing added value reached 33.5 trillion yuan, ranking first in the world; the total retail sales of consumer goods stabilized at around 44 trillion yuan. Authoritative data show that China's enterprise subsidy policies have achieved substantial results in promoting economic growth, industrial upgrading, supporting small and medium-sized enterprises, and driving green transformation.

## **2.2 The regulatory role of public finance policy on income distribution.**

### *2.2.1 Tax policy*

Since the Reform and Opening Up, the Chinese government has gradually improved the tax system, implementing a progressive tax rate system that taxes higher incomes at higher rates and reduces the tax burden on lower-income individuals. In 1994, China reformed the value-added tax (VAT), changing it from a production-based VAT to a consumption-based VAT. In 2011, personal income tax was adjusted to raise the threshold, aiming to reduce the tax burden on middle- and low-income individuals and enhance tax fairness.<sup>[3]</sup> The nine-level progressive excess tax rate was adjusted to seven levels, and the top rate was also reduced. In the personal income tax reform of 2018, China began to implement a tax system that combines comprehensive and classified taxation, levying taxes on both comprehensive tax items and classified tax items. According to data from the National Development and Reform Commission, from 2011 to 2020, the per capita disposable income of rural residents in China increased steadily at a nominal annual growth rate of 10.6%, which is 1.8 percentage points higher than that of urban residents. At the same time, the income gap between residents in different regions continued to narrow. For example, the income ratio between Shanghai and Tibet decreased from 4.62 in 2011 to 3.55 in 2020 (using the income ratio between Shanghai and Gansu as an example), reaching the lowest point since the new century. The overall income gap between residents has narrowed, and the national per capita disposable income Gini coefficient has decreased from a peak of 0.491 in 2008 to 0.468 in 2020, a total reduction of 0.023.

The above data indicate that the continuous adjustment of China's tax policy plays a vital role in promoting resource optimization, improving income levels, narrowing income gaps, and enhancing the fairness of income distribution.

### *2.2.2 Government assistance policies.*

The government helps poor areas and populations through policies such as poverty alleviation and development, relocation, education, health, and social poverty reduction. It provides funding, projects, and skill training to support local industries and increase income, and offers relocation opportunities and improved living conditions for people in difficult areas. The government also provides free health services, such as health check-ups, major disease treatment, and family doctors, to improve the health of the poor and help them escape poverty. From 2012 to the end of 2019, the number of rural poor people in China decreased from 98.99 million to 5.51 million, a total reduction of 93.48 million; the poverty incidence also fell from 10.2% to 0.6%, a total decrease of 9.6%. According to current standards, rural poor households have been fully lifted out of poverty, and absolute poverty and regional overall poverty have been completely resolved. About 100 million rural poor people have successfully escaped poverty through the establishment of household registration card, reducing the poverty rate to less than a single digit, with an average annual number of people lifted out of poverty exceeding 10 million. These data indicate that the Chinese government's assistance policies for poor areas and populations have significantly improved the income of the poor, reduced income gaps, and promoted shared wealth.

## **2.3 The impact of public finance policy on employment.**

### *2.3.1 Financial penditure policy*

Since the implementation of the Reform and Opening Up policy, the Chinese government has increased employment opportunities by improving fiscal expenditures, increasing investment in infrastructure, education, science and technology, and social security. Infrastructure and public project investments absorb labor, promote industrial upgrading, develop high-tech industries and the service sector, and provide sustained economic growth momentum and high-quality employment. The government also encourages entrepreneurship and the development of small and medium-sized enterprises through fiscal support and tax incentives, enhancing market vitality and employment quality. Data show that China's employment market has been stable in the long term, with the number of employed people increasing from 180 million in 1949 to 750 million in 2020. Employment structures have been optimized, shifting from mainly agricultural employment to 47.7% in the tertiary industry and 61.6% in urban employment. In summary, since the Reform and Opening Up, the Chinese government's adjustment of fiscal expenditure structure has had a positive impact on employment.

### *2.3.2 Education and training policies*

In the early stages of the Reform and Opening Up, China advocated for comprehensive quality education, placing importance on adhering to the Party's educational guidelines, and focusing on improving the overall quality of the national population as the core goal. Since 1985, the "Decision of the Central Committee of the Communist Party of China on Educational System Reform" for the first time clearly positioned the goal of educational reform as improving the national quality and cultivating more outstanding talents. After the 1990s, China gradually established and continuously promoted vocational qualification certificates and the labor reserve system. According to the data from the Seventh National Population Census, in 2020, the average years of education for people aged 15 and above in China increased to 9.91 years, while the average years of education for the working-age population aged 16 to 59 increased to 10.75 years, and the illiteracy rate dropped from 4.08% to 2.67%. This has significantly improved the quality of Chinese workers, with the average years of education rising to 10.8 years, and the total number of skilled personnel reaching approximately 200 million. In summary, since the Reform and Opening Up, China's education and training policies have greatly promoted the prosperity and development of the employment market.

## **2.4 The role of public financial policy in economic stability**

### *2.4.1 Implementing proactive financial policy*

China has adopted expansionary fiscal policies, such as increasing fiscal spending and reducing taxes and fees, to stimulate corporate investment and resident consumption., thereby promoting economic growth. In the face of external challenges such as the international financial crisis and trade friction, the government has quickly implemented proactive fiscal measures to stabilize the domestic economy, for example: during the 2008 global financial crisis, the Chinese government implemented a 4-trillion-yuan investment stimulus plan to increase fiscal spending, effectively halting the economic downturn; in the face of the COVID-19 pandemic, the Chinese government took measures such as

tax reduction and fee reduction, and increased fiscal spending to stimulate the economy, effectively alleviating the downward pressure on the economy. In recent years, the Chinese government has effectively raised the living standards of the people through measures such as increasing subsidies to social security funds, raising the minimum wage, and promoting balanced development of education. Since the Reform and Opening Up, the government's proactive fiscal policy has played a key role in economic stability.

#### *2.4.2 Responding to external shocks*

Facing the challenges of global economic integration, China's public fiscal policy has taken various measures to respond to external economic shocks, such as the international financial crisis and trade friction. This includes reducing tariff barriers, implementing tax incentives to attract foreign investment and promote industrial development, as well as strengthening social security spending to improve the living standards of the people. At the same time, through prudent monetary policy and cooperation with international financial institutions, China strives to maintain exchange rate stability and financial market tranquility to reduce the impact of external economic risks on the domestic economy of China.

### **3. Limitations of public financial policy.**

#### **3.1 Spatial and temporal limitations of financial policy implementation**

##### *Spatial limitations*

**Uneven regional development:** After the reform and opening-up, due to differences in geography, infrastructure, and industrial structure, the eastern coastal regions have experienced rapid economic development and greater fiscal resources, while the central and western regions have developed slowly with fewer fiscal resources, leading to significant imbalances in the implementation of fiscal policy across different regions. **Urban-rural gap:** Since the reform and opening-up, the gap between urban and rural areas in China has continued to widen, with the urban economy being more developed than the rural economy. This gap limits the effective implementation of fiscal policy between urban and rural areas. Although the government has increased investment in rural areas in recent years, the urban-rural gap remains significant, affecting the overall effectiveness of fiscal policy<sup>[4]</sup>.

##### *Temporal limitations:*

**Time lag in policy adjustment:** Since the reform and opening-up, China's fiscal policy has achieved some effectiveness in stabilizing the economic cycle and structural adjustments. However, policy adjustments often have delays because it takes time to identify issues, develop, and implement policies, which may weaken the timely effects of the policies.

#### **3.2 Issues of fairness and efficiency in public financial policy.**

In the early stages of reform and opening-up, China's public fiscal policy focused on promoting economic growth and efficiency, placing emphasis on efficiency while also considering equity. During this period, the economy developed rapidly, but issues of unequal income distribution emerged.

Since the reform and opening-up, the government's investment in areas such as education, healthcare, and social security has continued to increase, contributing to the improvement of social equity. However, at the same time, public fiscal expenditure in areas such as infrastructure and scientific and technological innovation still needs to be strengthened.

In terms of tax policy, the Chinese government has shifted from focusing on "efficiency" to "equal emphasis on fairness and efficiency." For example, through reforms to the personal income tax system and adjustments to corporate income tax policies, the goal is to achieve fairness and efficiency in the tax system. However, the role of tax policy in adjusting income distribution still needs to be further leveraged to reduce income disparities.

#### **3.3 Debt risk**

**Government Debt Levels:** Since the reform and opening-up, the scale of China's government debt has been continuously increasing, including national bonds, local bonds, and special bonds. With the expansion of financing channels and the increase in investment projects, the total debt has risen. Although the level of debt has not exceeded the international warning line, its growth trend still needs to be monitored.

**Debt Structure:** In the structure of China's government debt, national bonds and local government debt account for a significant proportion. Among them, local government debt, which is related to infrastructure construction, social security, and other fields, is of great importance to economic development and improvement of people's lives. However, some local governments have a heavy debt burden, and the risk of default still exists.

**Debt Risk Transmission:** Government debt risk may spread to the financial market, triggering systemic financial risk. Especially during economic downturns, when the risk of government debt default increases, it may lead to financial market turmoil and affect economic stability.

## 4. Conclusion

Public finance policy has played a significant role in China's economic growth, income distribution, and employment, but there are also challenges such as debt risk, issues of fairness and efficiency, policy lag, and short-sightedness. In the context of globalization, these challenges require innovative solutions through both theory and practice. Specific measures include: adjusting the structure of fiscal expenditure to support industrial restructuring and the improvement of people's lives; perfecting the tax policy system to reduce the tax burden and improve tax collection and management efficiency<sup>[5]</sup>; strengthening the execution of policies to increase policy transparency and regulation; drawing on international experience to strengthen academic cooperation; and paying attention to the international economic situation to do a good job in risk prevention. These measures aim to ensure that public finance policy plays a greater role in China's economic development.

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