



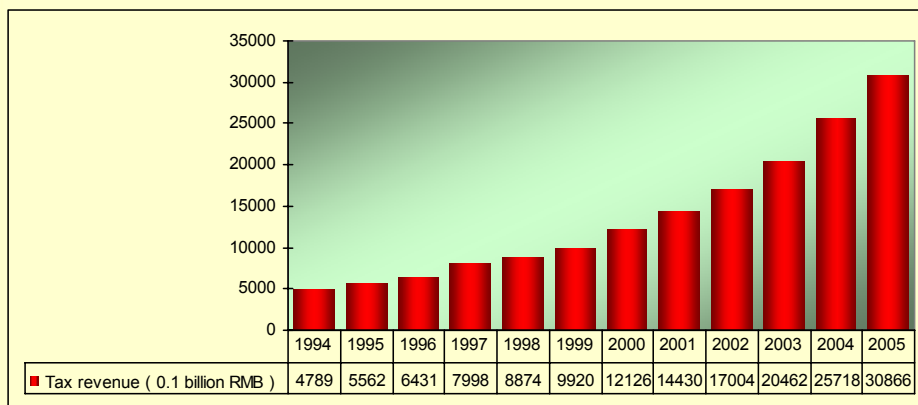
# Chinese Revenue Position: Current Status and Future Trend

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# Rapid and Sustained Growth in Revenue (1994 - 2005)



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## Rapid and Sustained Growth in Revenue I: Facts

- 2005: tax revenue reached RMB3086.6 billion, +20.0%, + RMB514.8 billion, 10% of GDP (+ 1%)
- Two breakthroughs: record high total revenue RMB3000 billion, record high increase RMB500 billion
- The magic of tax revenue
  - 1993: slightly over RMB400 billion
  - 1994 – 1997: average increase of RMB100 billion p.a.
  - 1998: a special year – RMB100 billion increase
  - 1999: embarking on the fast track, exceeding RMB 1000 billion
  - 2001: RMB 1500 billion
  - 2002: RMB 2000 billion
  - 2003: RMB 2500 billion

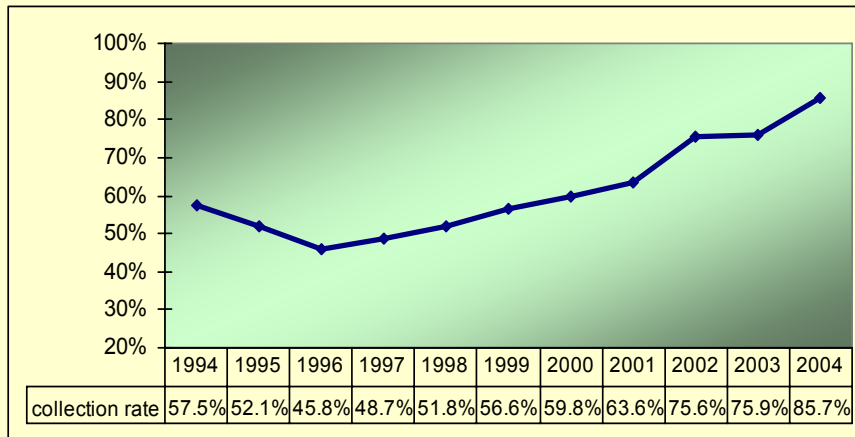
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## Special Stories about Chinese taxation II: Analysis

- **The prevailing “multi-factors” theory:**
  - Economic growth + rising prices + structure of revenue sources + regional imbalances + tighter tax enforcement + balancing import and export
- **A special factor: large room for tax enforcement**
  - Effective rate of collection: 50% (1994) → 70% (2003)
- **Background of current tax system:**
  - Increase revenue + curb overheating → low collection rate
- **Concept in the design of the current tax system**
  - Broad targets/bases and focused effects/collection
- **Features of the current tax system:**
  - Broad tax bases + high tax rates
- **Realities:**
  - Stricter enforcement → raise collection rate → raise tax revenue

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## Changes in Effective Collection Rate of VAT (1994 - 2004) - I



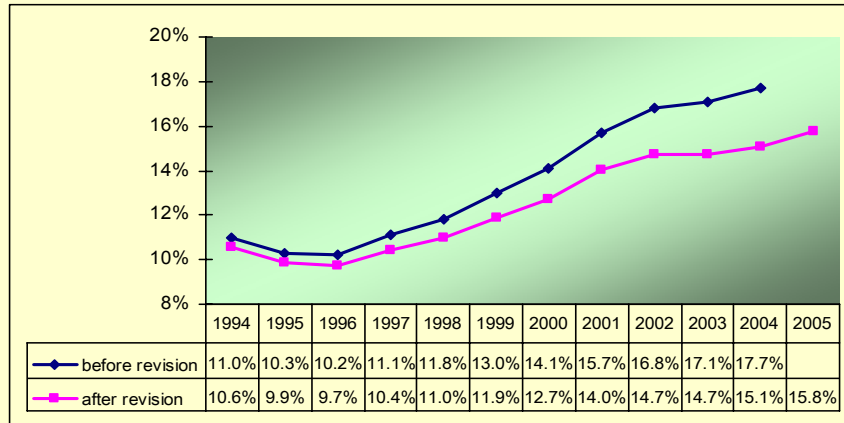
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## Basic Conclusion 1: The Puzzle of Chinese Tax Burden

- Is tax burden heavy or light? Opinions vary
- Taxpayers perspectives: heavy, very heavy → nominal burden
- Government's perspectives: light, not heavy → effective burden
- Forbes Magazine: 2<sup>nd</sup> in Tax Misery Index (?)
- What is the truth?
- The controversy in the 90's: fees greater than tax → light tax burden but heavy fee levies → the reform of fee and tax levies
- The present point at issue: narrowing the gap between effective and nominal tax burden

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## Basic Conclusion 1: The Macro Perspective of the Trend of Effective Tax Burden



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## Basic Conclusion 2: Whether Normal or Not

- Two different criteria or frames of reference
- Current tax system in practice: no change in tax system → tax according to laws → normal
- Economic and social environments: fundamental changes → no change in tax system → abnormal
- Tax system: should be closely aligned with the advancement of the economic system
- Focus: compatibility between current tax system and economic, social environments?

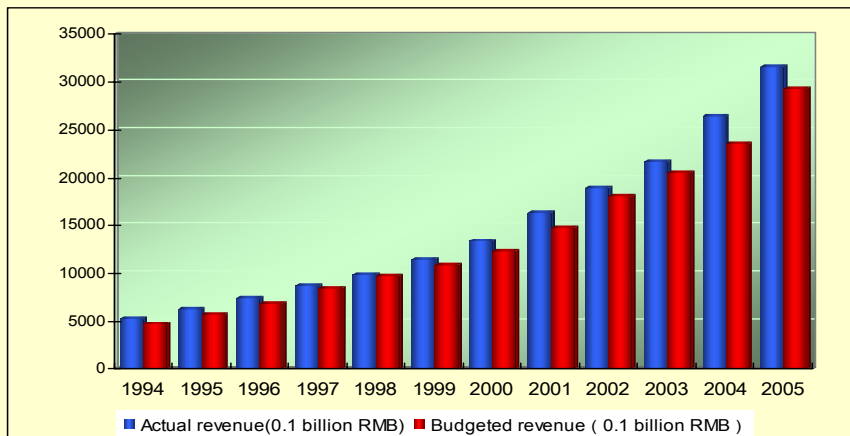
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### Basic Conclusion 3: “Revenue Increment” & “Revenue Variance”

- Compared with actual of previous year – “revenue increment”
- Compared with budget or plan – “revenue variance”
- Revenue increment ≠ revenue variance, considerable gap
- 2005: national revenue RMB3,162.80 billion, “increment” RMB523.15 billion, “variance” RMB237.30 billion, variance accounted for 7.1% of total revenue, 45.4% of revenue increment
- Insights / Background: Change in GDP+ 2~3% → higher revenue (favorable variance) → higher expenditure (unfavorable variance)
- This has become a norm: significance, implications?

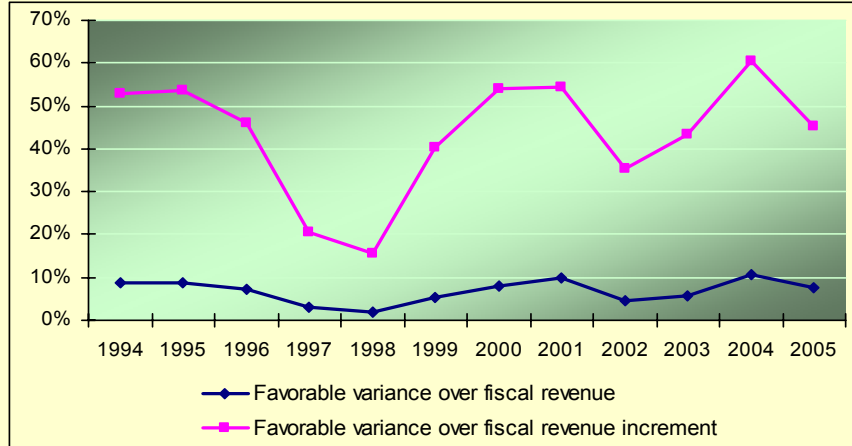
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### Basic Conclusion 3: “Favorable Revenue Variance” Lasting for Many Years



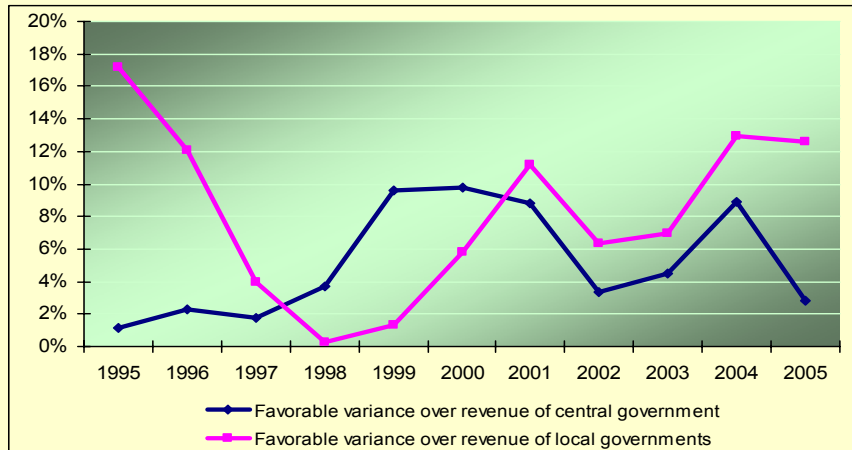
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### Basic Conclusion 3: High "Revenue Variance" 1



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### Basic Conclusion 3: High "Revenue Variance" 2



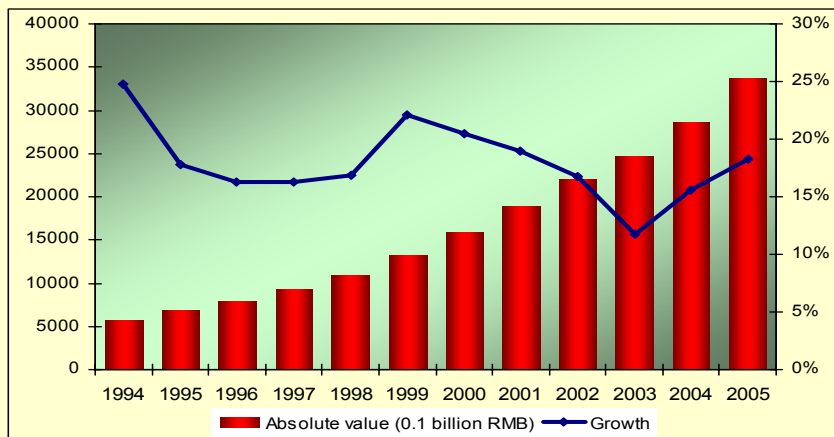
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### Basic Conclusion 4: Supporting Expansion of Government Expenditures

- Government expenditure: RMB 579.26 billion (1994) → RMB 3,370.81 billion (2005), average growth 18.53%
- Government expenditure growth > GDP growth → GDP distribution in favor of government
- Government expenditure as a fraction of GDP, 1978: 31.2%, 1960: 39.3%
- 2005: 18.49% based on government revenue and expenditure, + repayment of national debts on maturity + expenditure on social securities + ex-budget expenditures + other significant expenditures = expenditure as fraction of GDP, 30~ 35%
- Rapid increase in expenditure, supported by rapid increase in revenue → goals?

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### Basic conclusion 4: Supporting Expansion of Government Expenditures



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## Basic Conclusion 5: Message Reiterated

- Situation continues during The 11<sup>th</sup> 5-Year Plan ?
  - quality and technical skill of tax personnel at administration ↑
  - strength of tax enforcement ↑
  - nominal tax burden →← effective tax burden
- 1st half of 2006, nationwide tax revenue total RMB 1932.2 billion, + 22.3%, + RMB352.2 billion
- If the trend is allowed to drift, will it come to an end? If so, what will it be?
- Problem lies in current tax system: tax system should keep pace with changes
- The message: move quickly on initiating a new round of comprehensive tax reform

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Thank you!



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