

Katarzyna Twarowska

Maria Curie-Skłodowska University in Lublin

e-mail: k.twarowska@umcs.pl

ORCID: 0000-0002-2508-0153

**DETERMINANTS OF THE DETERIORATION
IN CHINA'S PUBLIC FINANCES IN 2005-2018**

**CZYNNIKI WPLYWAJĄCE NA POGODZENIE
STANU FINANSÓW PUBLICZNYCH W CHINACH
W LATACH 2005-2018**

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JEL Classification: F34, H62, H63, H70

Summary: The aim of the paper is to assess the condition of China's public finances, identify the main factors that contribute to the increase in public debt, and to provide some suggestions that could be considered to improve the quality of public finances and reduce systemic risk. To achieve the objective of research the descriptive comparative method was used. The analysis was carried out for the period 2005-2018, however, due to the special conditions for the development of the Chinese economy, the background from previous years is also presented, as well as forecasts up to 2024. The analysis allowed to formulate conclusions, the most significant of which are that the main causes of China's debt problem and the rising systemic risks are the effect of the global financial crisis and the change of the economic growth strategy to a strategy based on internal demand, which results in fiscal expansion. A particularly troubling development is the pace of growth in public debt, in particular the increase in local government debt and the increase in the share of short-term financing in external debt.

Keywords: central and local government debt, domestic and external debt, budget deficit, systemic risk, crisis.

Streszczenie: Cele analizy stanowią ocena kondycji finansów publicznych Chin, identyfikacja głównych czynników, które przyczyniają się do wzrostu zadłużenia publicznego, a także wskazanie propozycji mogących służyć poprawie kondycji finansów publicznych i obniżeniu ryzyka systemowego. W badaniu wykorzystano metodę porównawczą opisową. Okres analizy obejmuje lata 2005-2018, jednak ze względu na szczególne uwarunkowania rozwoju chińskiej gospodarki uwzględniono lata wcześniejsze i prognozy do 2024 r. Przeprowadzone badanie pozwoliło sformułować wnioski. Najważniejsze mówią o tym, że głównymi przyczynami problemów związanych z zadłużeniem Chin są rosnące ryzyko systemowe, wpływ globalnego kryzysu finansowego i zmiana strategii wzrostu gospodarczego na strategię

opartą na popycie wewnętrznym, co wiąże się z większą ekspansją fiskalną. Niepokojącym zjawiskiem jest tempo wzrostu zadłużenia publicznego, a w szczególności wzrost zadłużenia na poziomie lokalnym, a w zadłużeniu zewnętrznym wzrost udziału finansowania krótko-terminowego.

Słowa kluczowe: zadłużenie sektora rządowego i samorządowego, zadłużenie krajowe i zagraniczne, deficyt budżetowy, ryzyko systemowe, kryzys.

1. Introduction

China, over the last four decades since the introduction of crucial systemic and economic reforms initiated at the plenary session of the Central Committee of the Communist Party of China in December 1978, has made an unprecedented leap forward in civilisation. From a poor and economically backward country, it has become one of the fastest-growing economies and a world economic centre with great development potential. However, it turns out that, despite its outstanding economic performance, the economy is also affected by various problems. One of them is the deteriorating condition of public finances, in particular the rapid expansion of China's local government debt. This leads to an increase in systemic risks for financial stability.

The aim of the research is to assess the condition of China's public finances and identify the factors contributing to the growth of China's public debt. The paper also makes recommendations for addressing the challenges to maintain financial stability and economic growth. The problem of public finance debt in China is rarely discussed in Polish economic literature, which encouraged the author to prepare this paper.

Hypotheses:

1. An important factor influencing the increase in systemic risk in China is the growth of public debt, in particular the growth of local government debt, the growth of external debt and the increase in short-term financing.
2. The global financial crisis in 2008-2009 stimulated the expansion of fiscal policy in China, which resulted in an increase in public debt.
3. The implementation of infrastructure investments is delegated to local level, which results in an increase in expenditure of local government, without adequate compensation on the revenue side, leading to an increase in debt at local level.

2. Theoretical background

The role of the public finance sector and the effectiveness of fiscal policy instruments in economic development have been a key issue in the discussions of the world's leading economists for decades. At two opposite poles are the views of two schools of economics: Keynesianism and monetarism.

The effectiveness of the self-adjusting market mechanism during the crisis of the 1930s was criticised by J.M. Keynes. In *The General Theory of Employment, Interest and Money* [Keynes 2011], published in 1936, he formulated the foundations of a new theory. One of the most important ideas of Keynesianism was the need for state intervention to stimulate effective demand, but also to stabilize the economy. It has been proven that in a period of economic depression, interest rate cuts and tax cuts do not have a sufficient impact on the growth of corporate investment expenditure and household consumption expenditure. An increase in government expenditure was an effective solution to boost effective demand and the budget deficit itself was considered a positive phenomenon.

However, the increase in public debt since the 1960s as a result of excessive budgetary expenditure has become a reason to curb long-term economic growth. Moreover, the economic crisis of the 1970s and high inflation revealed the weaknesses of interventionism, but also became a catalyst for the development of a new theory – monetarism. M. Friedman is considered its author [Friedman 1968, pp. 1-17]. According to monetarists, fiscal policy was not significant, and its role was limited to redistributive and allocation functions, while it did not affect the long-term growth of aggregate demand. Monetarists point out that not only the budget deficit has a negative impact on the economy, but also a high tax rate. High taxes are as harmful as a budget deficit, even under conditions of a balanced budget [Wojtyna 1993, p. 179].

As experience shows, in times of economic crises, Keynesian economics becomes more important and the priorities of national economic policies change. In order to stimulate the economy, strict compliance with the permissible level of budget deficit is abandoned by launching anti-crisis packages, the implementation of which results in an increase in budget expenditure and a decrease in budget revenues, which has a negative impact on the public finances [Ferrarini, Raghbendra, Ramayandi 2012, p. 1].

3. Empirical analysis

3.1. Development of the Chinese economy in 2005-2018

China is one of the fastest growing economies. Figure 1 shows the dynamics of China's real GDP growth since the beginning of the reforms and the programme to open up the economy to the world. China has been experiencing high economic growth rates throughout the entire period. GDP growth was slightly weaker in the period 1989-1990, when it amounted to 4.2% and 3.9%, then it increased to double-digit values, and again fell slightly below 10% in 1996-2002. The next period of slightly weaker growth was during the global financial crisis of 2008-2009, but in such conditions GDP growth amounting to 9.6% and 9.2% should be assessed as very high.

In 2005-2018, the average GDP growth rate in China was 9.1%, which was significantly above the average for emerging and developing Asian countries (7.9%), emerging markets and developing economies (5.7%), and the average for the world (3.8%). The average growth rate of GDP in advanced economies in that period was 1.7%. Less favourable are the forecasts for GDP growth in China for the next few years. According to the estimates, the GDP growth rate will fall from 6.3% in 2019 to 5.5% in 2024, and from 2019 it will be lower than the average for emerging and developing Asian countries.

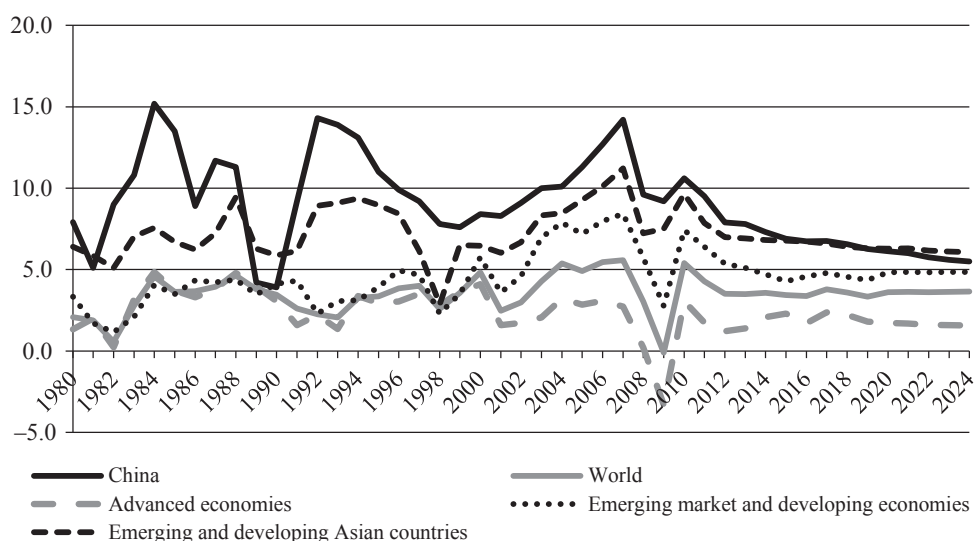


Fig. 1. GDP growth in 1980-2018 and forecast (in %, constant prices)

Source: own compilation based on [International Monetary Fund 2019].

Such high economic growth was possible, among other factors, thanks to the implementation of the export-led economic growth strategy [Liu, Margaritis, Zhang 2019]. China, due to low labour costs and maintaining the undervalued renminbi exchange rate, achieved high price competitiveness in exports. Moreover, an active export-supporting policy was pursued, which resulted in a high export growth rate (Figure 2 and Table 1), as well as in an improvement of the position in world trade (Table 2). During the analysed period, China maintained very strong export growth, above the average for emerging markets and developing economies, as well as the global average. Exports fell only in the crisis year of 2009 and in 2015. Prolonged economic stagnation in advanced economies and an increase in protectionism in world trade after the global financial crisis also contributed to the decrease in the rate of growth of Chinese exports.

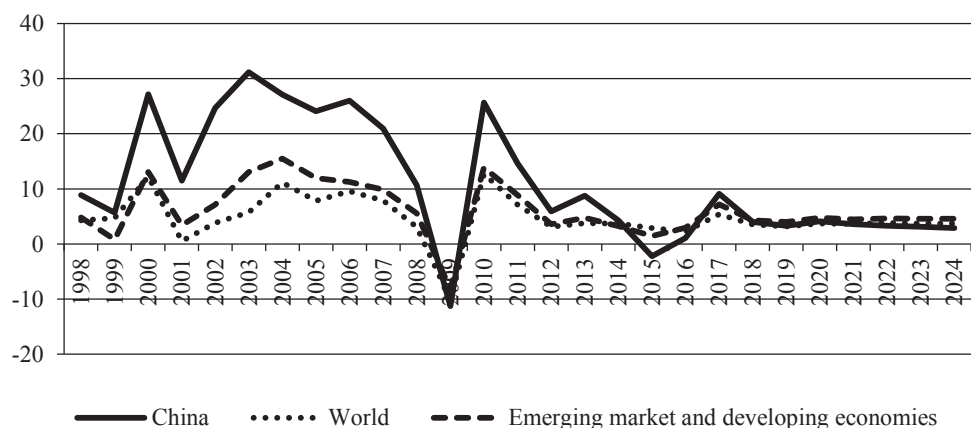


Fig. 2. Growth of volume of exports of goods and services (in %)

Source: own compilation based on [International Monetary Fund 2019].

Table 1. Growth of volume of exports of goods and services (in %)*

Countries	1998-2004	2005-2007	2009	2010-2018	2019-2024	2005-2018
China	19.4	20.4	-11.3	7.9	3.4	10.1
Japan	5.3	6.9	-23.4	5.5	2.6	3.8
United States	2.9	7.7	-8.4	4.2	3.2	4.3
World	6.1	7.1	-10.1	4.9	3.6	4.5
Advanced economies	5.3	6.0	-11.0	4.6	3.1	3.9
Emerging market and developing economies	8.3	9.7	-8.2	5.6	4.5	5.7
Emerging and developing Asian countries	12.0	14.7	-9.5	7.3	5.2	8.2

* Averages calculated by the author.

Source: [International Monetary Fund 2019].

Table 2. Shares in merchandise exports and imports (in %)

Year	1979	1990	2000	2005	2009	2011	2013	2015	2017	2018
Merchandise exports (in %)										
China	0.8	1.8	3.9	7.3	9.6	10.4	11.7	13.7	12.8	12.8
United States of America	11.2	11.3	12.1	8.6	8.4	8.1	8.3	9.1	8.7	8.6
Germany	–	12.0	8.5	9.2	8.9	8.0	7.6	8.0	8.2	8.0
Japan	6.1	8.2	7.4	5.7	4.6	4.5	3.8	3.8	3.9	3.8
Merchandise imports (in %)										
United States of America	13.1	14.3	18.9	16.1	12.6	12.3	12.3	13.9	13.4	13.2
China	0.9	1.5	3.4	6.1	7.9	9.5	10.3	10.0	10.3	10.8
Germany	–	9.9	7.5	7.2	7.3	6.8	6.2	6.3	6.5	6.5
Japan	6.5	6.5	5.7	4.8	4.3	4.6	4.4	3.9	3.7	3.8

Source: [UNCTAD 2019].

Since the beginning of the reforms in the late 1970s, China has significantly improved its position as a global exporter and importer. In 1979 their share in merchandise exports amounted to 0.8%, in 2000, i.e. before joining the World Trade Organisation 3.9%, in 2005 already 7.3%, and since 2009 China has become the world's largest exporter, overtaking the US, Germany and Japan (Table 2). China, at the same time, has a slightly lower share in world imports.

3.2. Assessment of the condition of public finances in China in 2005-2018

China's public debt to GDP at the beginning of the 21st century was relatively low, amounting to 26.1% of GDP in 2005 (Table 3), and was lower than the average in advanced economies and emerging markets and developing economies. Particularly

Table 3. General government gross debt (% of GDP)

Year	China	Japan	United States	Advanced economies	Emerging market and developing economies	Emerging and developing Asian countries
2001	24.4	146.8	53.1	69.6	48.4	43.9
2002	25.7	156.8	55.5	70.7	52.1	44.6
2003	26.6	162.7	58.6	72.8	50.2	45.0
2004	26.2	171.7	66.1	76.5	47.2	43.9
2005	26.1	176.8	65.5	76.0	42.1	42.1
2006	25.4	176.4	64.2	73.3	37.5	39.3
2007	29.0	175.4	64.7	71.0	35.8	40.2
2008	27.0	183.4	73.7	77.8	34.0	37.1
2009	34.3	201.0	86.7	91.0	39.0	41.8
2010	33.7	207.9	95.4	97.4	37.9	40.4
2011	33.6	222.1	99.7	101.5	37.2	39.8
2012	34.3	229.0	103.2	105.6	37.2	39.8
2013	37.0	232.5	104.8	104.2	38.5	41.5
2014	39.9	236.1	104.4	103.6	40.4	43.5
2015	41.1	231.6	104.7	103.1	43.9	44.8
2016	44.2	236.3	106.9	105.6	46.8	47.0
2017	46.8	235.0	106.2	103.6	48.5	49.2
2018	50.5	237.1	105.8	102.6	50.6	51.7
2019	55.4	237.5	106.7	103.0	53.0	55.0
2020	59.5	237.0	107.5	102.7	54.5	57.7
2021	63.2	237.4	108.4	102.6	55.9	60.1
2022	66.7	237.8	109.4	102.5	57.3	62.3
2023	69.7	238.0	110.0	102.2	58.5	64.2
2024	72.4	238.3	110.3	101.9	59.7	66.0

Source: [International Monetary Fund 2019].

high debt was recorded in Japan (in 2005 176.8% of GDP, and during the crisis it increased to 201.0% in 2009 and 237.1% in 2018). China's public debt remained at a relatively low level, not exceeding 30% of GDP, until 2009, i.e. until the global financial crisis, when it started to grow quite significantly as a result of a loosening of the fiscal policy. Although the global financial crisis affected most countries in the world, the degree to which it has influenced the economy and public finances of individual countries varied. Both the developing and developed countries of the Asia-Pacific region suffered less than the countries of other regions of the world [Palczewska 2014]. The lesser susceptibility of the economies of the Asia-Pacific region to the negative impact of the financial crisis resulted, among others, from the economic reforms carried out in these countries after the crisis of 1997-1998 [Asian Development Bank 2010, p. 8].

Table 4. General government net lending/borrowing (% of GDP)

Year	China	Japan	United States	Advanced economies	Emerging market and developing economies	Emerging and developing Asian countries
2001	-2.6	-6.5	-0.1	-1.5	-3.0	-4.3
2002	-2.9	-7.9	-3.3	-3.3	-3.4	-4.5
2003	-2.4	-8.0	-4.3	-3.9	-2.7	-4.0
2004	-1.5	-5.9	-3.9	-3.2	-1.1	-2.9
2005	-1.4	-5.0	-2.8	-2.4	0.6	-2.4
2006	-1.1	-3.5	-1.7	-1.3	1.2	-1.9
2007	0.1	-3.2	-2.5	-1.1	0.7	-1.1
2008	0.0	-4.5	-6.3	-3.4	0.8	-1.6
2009	-1.7	-10.2	-12.7	-8.6	-3.7	-3.3
2010	-0.4	-9.5	-10.6	-7.5	-2.2	-2.2
2011	-0.1	-9.4	-9.3	-6.1	-0.9	-1.6
2012	-0.3	-8.6	-7.6	-5.3	-1.0	-1.6
2013	-0.8	-7.9	-4.1	-3.5	-1.7	-1.9
2014	-0.9	-5.6	-3.7	-2.9	-2.5	-2.0
2015	-2.8	-3.8	-3.2	-2.4	-4.4	-3.3
2016	-3.7	-3.7	-3.9	-2.5	-4.8	-4.0
2017	-3.9	-3.2	-3.8	-2.1	-4.2	-4.1
2018	-4.8	-3.2	-4.3	-2.1	-3.9	-4.7
2019	-6.1	-2.8	-4.6	-2.4	-4.7	-5.6
2020	-5.5	-2.1	-4.4	-2.2	-4.3	-5.1
2021	-5.4	-1.9	-4.4	-2.2	-4.3	-5.1
2022	-5.4	-1.8	-4.4	-2.2	-4.3	-5.1
2023	-5.3	-1.9	-4.0	-2.1	-4.2	-5.0
2024	-5.3	-2.1	-3.7	-2.0	-4.2	-4.9

Source: [International Monetary Fund 2019].

Moreover, the region, thanks to its expansionary fiscal policy, first coped with the effects of the global crisis and in 2009 the countries of emerging and developing Asian countries recorded an average GDP growth rate of 7.5%, while the average global GDP growth rate was -0.1% , in advanced economies -3.3% , and in emerging markets and developing economies the average growth rate was 2.8% [UNCTAD 2019]. However, in 2009 the ratio of public debt to GDP in emerging and developing Asian countries increased by 4.7% compared to the previous year. It was only a temporary increase in this ratio, as the public debt has decreased since 2010.

In the years immediately preceding the crisis, China managed to achieve a budget surplus (Table 4), but in 2009 there was a deficit of 1.7% of GDP. Compared to other economies, it was not high (see Table 4). The increase in China's deficit was caused by lower GDP growth and the introduction of the stimulus package [Palczewska 2014]. In November 2008 China announced its huge fiscal stimulus package amounting to 4 trillion renminbi (13% of GDP), which was about US\$ 590 billion [Li 2017, p. 9]. The huge two-year fiscal package was aimed at stimulating domestic demand in a context of falling external demand, which was the main driver of the Chinese economy before the crisis. Domestic demand was stimulated by government investment programmes since 2009, such as the low-cost housing programme. The anti-crisis aid package was aimed at infrastructure development, reconstruction

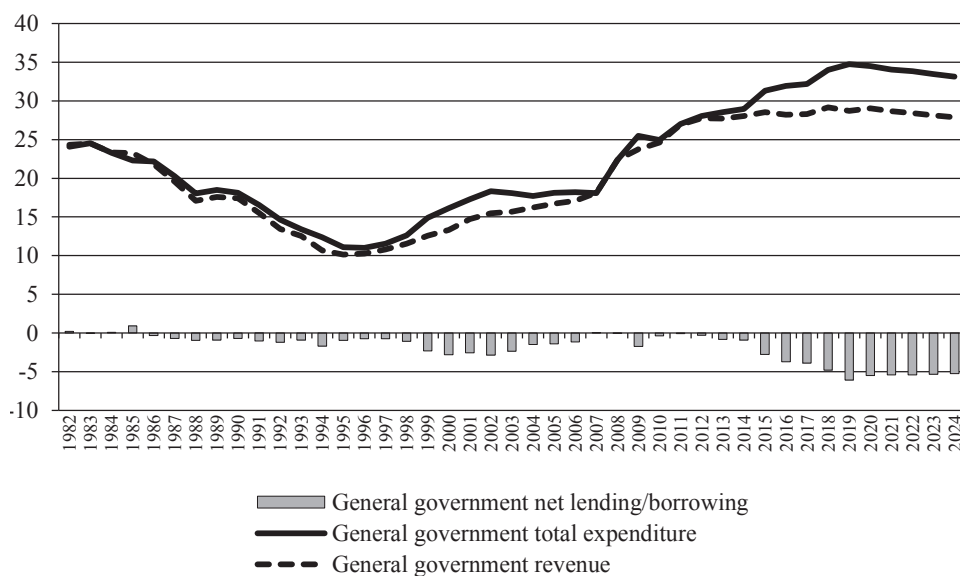


Fig. 3. General government revenue, expenditure and budget balance in China in 1982-2018 and forecast (% of GDP)

Source: own compilation based on [International Monetary Fund 2019].

of earthquake areas in 2008, social welfare, rural development, technology development, sustainable development and education. In addition, a value added tax reform was carried out [Palczewska 2014, pp. 31-32]. The financing of the stimulus package was divided between the central and local budgets: 1.18 trillion renminbi (US\$ 175 billion) came from the state budget and 2.82 trillion renminbi (US\$ 415 billion) from local government budgets [Chen, Ye, Huang 2018, pp. 152-173].

In connection with the implementation of the stimulus package, a number of facilitations were introduced for local governments in terms of obtaining financing, such as limited permission to issue local bonds and the possibility of obtaining funds from other sources through local government financing platforms (LGFPs) [Lu, Sun 2013, p. 3]. In addition, the People's Bank of China was obliged to relax its lending policy for LGFPs, which meant that restrictions on the amount of loans granted to them were removed. As a result these platforms took out mass loans for infrastructure development. This led to the rapid indebtedness of local governments. In 2009 the budget deficit of local government rose to 8.16% of GDP, while the central government budget had a surplus of 5.93% of GDP (see Table 5 and Figure 6).

As shown in the Figures 4 and 5, there is a certain dissonance between the revenues and expenditures structure in terms of the share of local and central governments. Local governments, which are responsible for infrastructure development in China by implementing programmes for the construction of roads, motorways, bridges and housing estates, have very high expenditures (Figure 5),

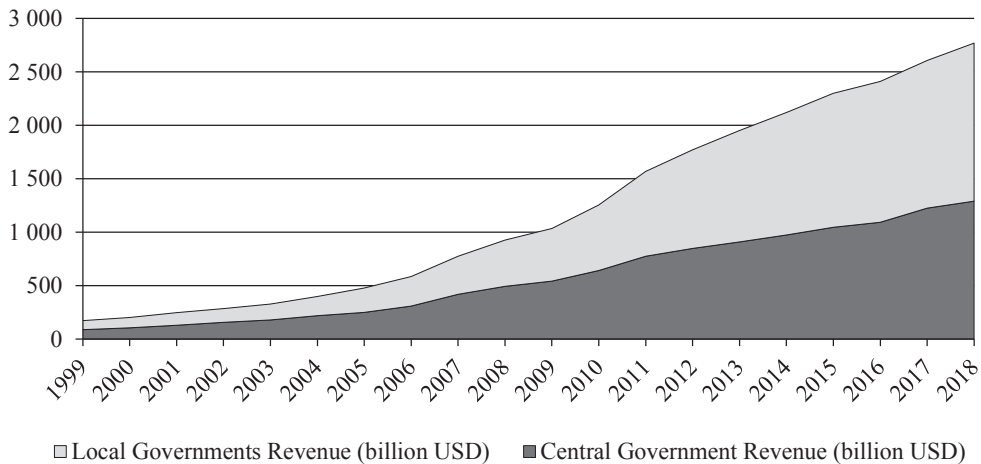


Fig. 4. National Government Revenue (billion USD)*

* To convert the data into US dollars, the average USDCNY exchange rate for 2018, amounting to 6.6187, was used. Based on the Bank for International Settlements data.

Source: own compilation based on [National Bureau of Statistics 2019; Bank for International Settlements 2019].

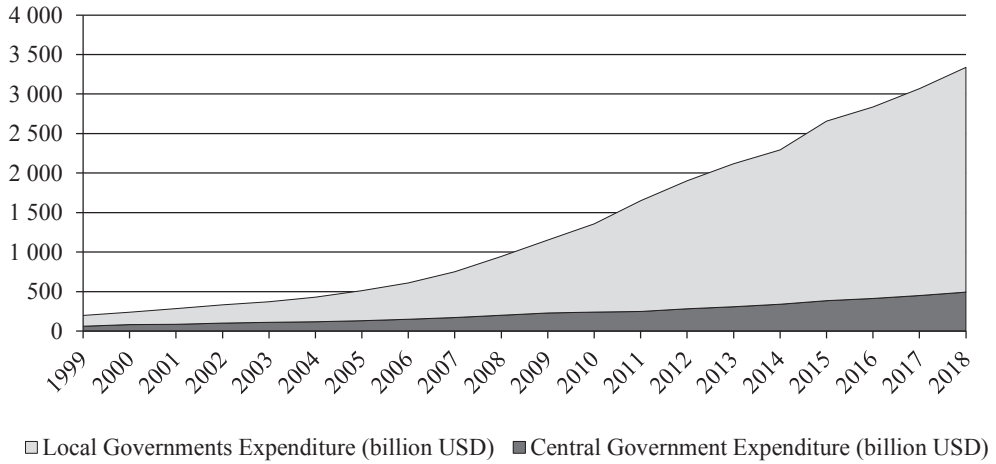


Fig. 5. National Government Expenditure (billion USD)*

* To convert the data into US dollars, the average USDCNY exchange rate for 2018, amounting to 6.6187, was used. Based on the Bank for International Settlements data.

Source: own compilation based on [National Bureau of Statistics 2019; Bank for International Settlements 2019].

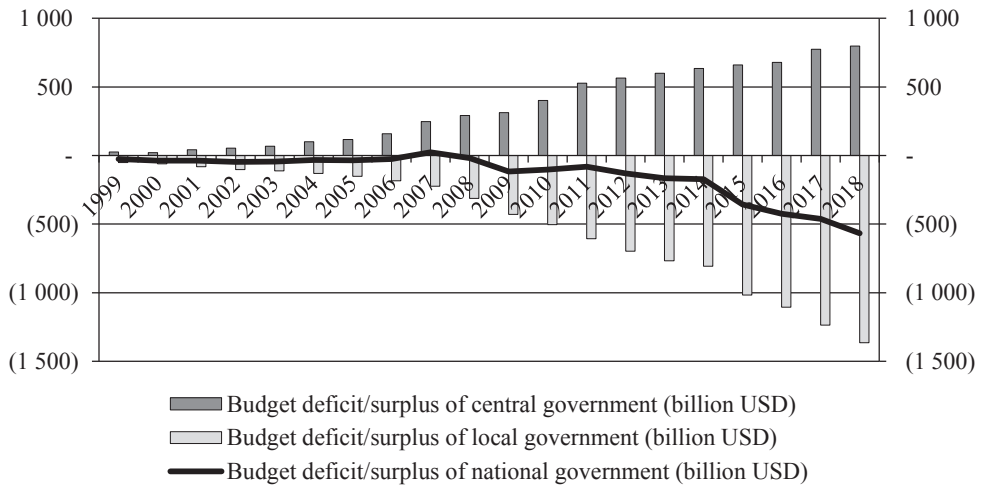


Fig. 6. Budget deficit/surplus of national, central and local government (billion USD)*

* To convert the data into US dollars, the average USDCNY exchange rate for 2018, amounting to 6.6187, was used. Based on the Bank for International Settlements data.

Source: own compilation based on [National Bureau of Statistics 2019, Bank for International Settlements 2019].

which, however, are not reflected in revenue (Figure 4), and this results in a high budget deficit (Figure 6) and growing local government debts.

In 2010 China's central government acknowledged that local government debt was growing too fast and tightened the conditions for granting loans to financial platforms. The possibility of taking out loans was limited to financing the construction of high-speed railway lines and the construction of cheap housing. In addition, banks were obliged to increase their reserve funds [Fan, Lv 2012, p. 216]. Despite the measures taken, the increase in the deficit of the local government was not stopped effectively (see Figure 6). In 2010 it was slightly lower than in the previous year and amounted to 8.07% of GDP, but in the following years it increased again, reaching over 10% of GDP in 2018 (Table 5).

Table 5. Revenue, expenditure, budget deficit/surplus of national, central and local government (% of GDP)

Years \ Indicators	National government revenue (% GDP)	National government expenditure (% GDP)	Budget deficit/surplus of national government (% GDP)	Central government revenue (% GDP)	Central government expenditure (% GDP)	Budget deficit/surplus of central government (% GDP)	Local Governments Revenue (% GDP)	Local Governments Expenditure (% GDP)	Budget deficit/surplus of local government (% GDP)
2005	16.9	18.11	-1.22	8.83	4.69	4.15	8.06	13.43	-5.37
2006	17.66	18.42	-0.76	9.32	4.55	4.77	8.34	13.87	-5.53
2007	19	18.43	0.57	10.27	4.24	6.04	8.73	14.19	-5.47
2008	19.21	19.61	-0.4	10.24	4.18	6.06	8.97	15.43	-6.45
2009	19.66	21.89	-2.23	10.31	4.38	5.93	9.35	17.52	-8.16
2010	20.16	21.81	-1.64	10.31	3.88	6.43	9.85	17.93	-8.07
2011	21.29	22.39	-1.1	10.52	3.38	7.13	10.77	19.01	-8.24
2012	21.77	23.39	-1.62	10.43	3.48	6.95	11.34	19.9	-8.56
2013	21.79	23.65	-1.86	10.15	3.45	6.7	11.64	20.19	-8.56
2014	21.89	23.67	-1.78	10.06	3.52	6.54	11.83	20.15	-8.32
2015	22.2	25.64	-3.44	10.1	3.72	6.37	12.1	21.92	-9.82
2016	21.57	25.37	-3.8	9.78	3.7	6.08	11.79	21.67	-9.88
2017	21.03	24.74	-3.72	9.88	3.64	6.25	11.14	21.11	-9.96
2018	20.37	24.54	-4.17	9.49	3.63	5.86	10.87	20.9	-10.03

Source: [National Bureau of Statistics 2019].

Although the increase in local government debt since 2009 may seem very large, it should be noted that the total general government debt did not grow so fast. Moreover, such a dynamic increase in the general government debt in 2009 by 27.2% [International Monetary Fund 2019 and Figure 7] was a temporary phenomenon and in 2010 the debt already decreased. The debt started to grow again from 2013

with the second wave of the crisis (Figure 7). This trend was not only in China, but also in emerging markets and developing economies, and in advanced economies (Table 3). The forecasts for the following years are also unfavourable.

Furthermore, China's general government's gross debt is much lower than in most of the world's leading economies, as well as lower than average in advanced economies and emerging markets, and in developing economies. Despite an upward trend, the level of debt in the crisis of 2009 increased to 34.3% of GDP, which was not high, but a continuing upward trend resulted in the debt exceeding 50% of GDP in 2018. What is worse, forecasts indicate a further increase in China's public debt (to 72.4% of GDP in 2014), which is worrying and threatens the stability of the public finance sector. Moreover, forecasts indicate that from 2019 China's public debt will be slightly higher than the average in emerging markets, and in developing economies (Table 3). A higher projected growth rate of China's debt in comparison to other developing economies, including Asian countries, indicates that the increase in debt results from internal factors and can be associated with the implementation of a growth strategy based on internal demand, i.e. budget expenditure aimed at creating internal demand (consumption and investment).

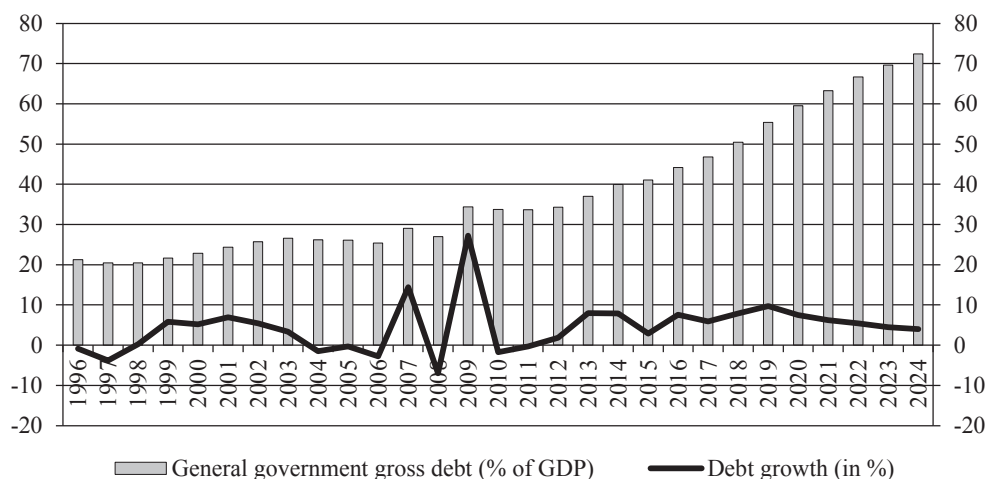


Fig. 7. General government gross debt in China (% of GDP) and its changes (in %) in 1996-2018 and forecast

Source: own compilation based on [International Monetary Fund 2019].

Another feature of China's public debt is its structure in terms of financing sources (domestic and external). Most of the debt is internal debt. China's external debt, unlike that of most developed countries, is very low and accounts for less than 10% of GDP [Palczewska 2014, p. 34]. The analysis of the data presented in Table 6

Table 6. Structure of debts of central government (in million yuan and %)

Indicators	2005	2010	2015	2018
Balance of debts of central government (100 million yuan)	32 614.2	67 548.1	106 599.6	149 607.4
Balance of debts of central government (100 million USD)*	4 927.6	10 205.6	16 105.8	22 603.7
Domestic Debts (100 million yuan)	31 848.6	66 988.0	105 467.5	148 208.6
Domestic Debts (100 million USD)*	4 811.9	10 121.0	15 934.8	22 392.4
External Debts (100 million yuan)	765.5	560.1	1 132.1	1 398.8
External Debts (100 million USD)*	115.7	84.6	171.0	211.3
Share of domestic debts (%)	97.7	99.2	98.9	99.1
Shares of external debts (%)	2.3	0.8	1.1	0.9

* To convert the data into US dollars, the average USDCNY exchange rate for 2018, amounting to 6.6187, was used. Based on the Bank for International Settlements data.

Source: own calculations based on [National Bureau of Statistics 2019; Bank for International Settlements 2019].

shows that shares of external debts in central government debt are decreasing. In 2005 it amounted to 2.3% of total debt and in 2018 to 0.9% of total debt.

However, a negative trend is the change in the structure of the external debt in terms of maturity. The share of long-term and medium-term debt is significantly reduced and the share of short-term debt is increasing. In 2007, the share of short-term debt in external debt amounted to 58.9% and increased to 72% in 2011 [Palczewska 2014, p. 35]. This increases the refinancing risk, although the high level of China's foreign exchange reserves [Twarowska 2019, p. 439] neutralises the country's insolvency risk.

4. Conclusions

Over the past two decades, China has become one of the largest economies in the world, with an unusually high rate of development. However, this global economic leader is experiencing various problems, including the problem of growing public debt. From the beginning of the 21st century until the outbreak of the global financial crisis, China had a low general government gross debt, which did not exceed 30% of GDP, but the weakening of economic growth associated with the 2009 crisis and the launch of fiscal stimulus programmes led to an increase in debt. These trends seemed initially temporary, but it turned out that despite the recovery of the economies from recession, China's public debt is still continuing its upward trend.

Even though China can tolerate a higher debt level than many other emerging and developing economies owing to the sheer size and other special features of the Chinese economy, systemic risks for financial stability have been rising since the

global financial crisis [Li 2017]. China's attempts to limit the increase in public debt are proving ineffective and the International Monetary Fund forecasts indicate that China's public debt will continue to grow in the coming years and could reach 72.4% of GDP in 2024, posing a high risk for the stability of the economy.

The main causes of China's debt problem and rising systemic risks are:

- impact of the global financial crisis, which caused the launch of an anti-crisis stimulus package causing an increase in public expenditure and a decrease in budget revenues,
- structural problems,
- an increase in the share of short-term debt in the structure of external debt, which increases the risk of refinancing,
- a change of the economic growth strategy from the strategy based on external demand to the strategy based on internal demand, which is connected with a more expansive fiscal policy, the objective of which is to increase the disposable income of the population in order to create additional consumption and investment demand,
- the trade war with the US is also a threat to China. The growing trade conflict with the United States has heightened concerns on the progress of China's economic rebalancing and restructuring from an export-led growth strategy to one propelled by domestic consumption [Liu, Margaritis, Zhang 2019]. This strategy encourages greater fiscal expansion and public spending in order to stimulate consumption.

The main problems with rising systemic risks in China result from particularly high local government debt and corporate debt, which can turn into non-performing loan. It seems, however, that even in such a situation the Chinese central government would still have the tools and resources to deal with the problem including gradually restructuring its underlying assets to help the economy avoid a serious liquidity/credit crunch [Li 2017, p. 29]. As experience during the financial crisis shows, the socialization of debt has been repeatedly used. To a large extent, Chinese public debt is financed by banks and some large banks are state owned, so the government has the ability to influence these banks in order to gain access to debt financing.

Although many factors, such as high foreign exchange reserves and sources of debt financing limit the risk of a sovereign debt crisis in China, it is a fact that public debt is reaching dangerously high levels, so now is the time for China to address its rising systemic risks and curb the growing public debt. Among the corrective actions, the following can be considered:

- undertake structural reforms and taxation reform for local government, to increase revenues to the budget of local governments. However, these reforms should not hamper economic activity,
- maintain the high level of economic growth and high exports,
- increase the share of long-term debt financing,
- reduce the risk of sudden capital outflow, if there is no other solution, by maintaining capital control.

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