

# Public Social Expenditures and Household Consumption in China

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The views expressed in this paper are those of the authors and do not necessarily represent those of the IMF or IMF policy.

# Outline

## I. Background

## II. Contribution of this Paper

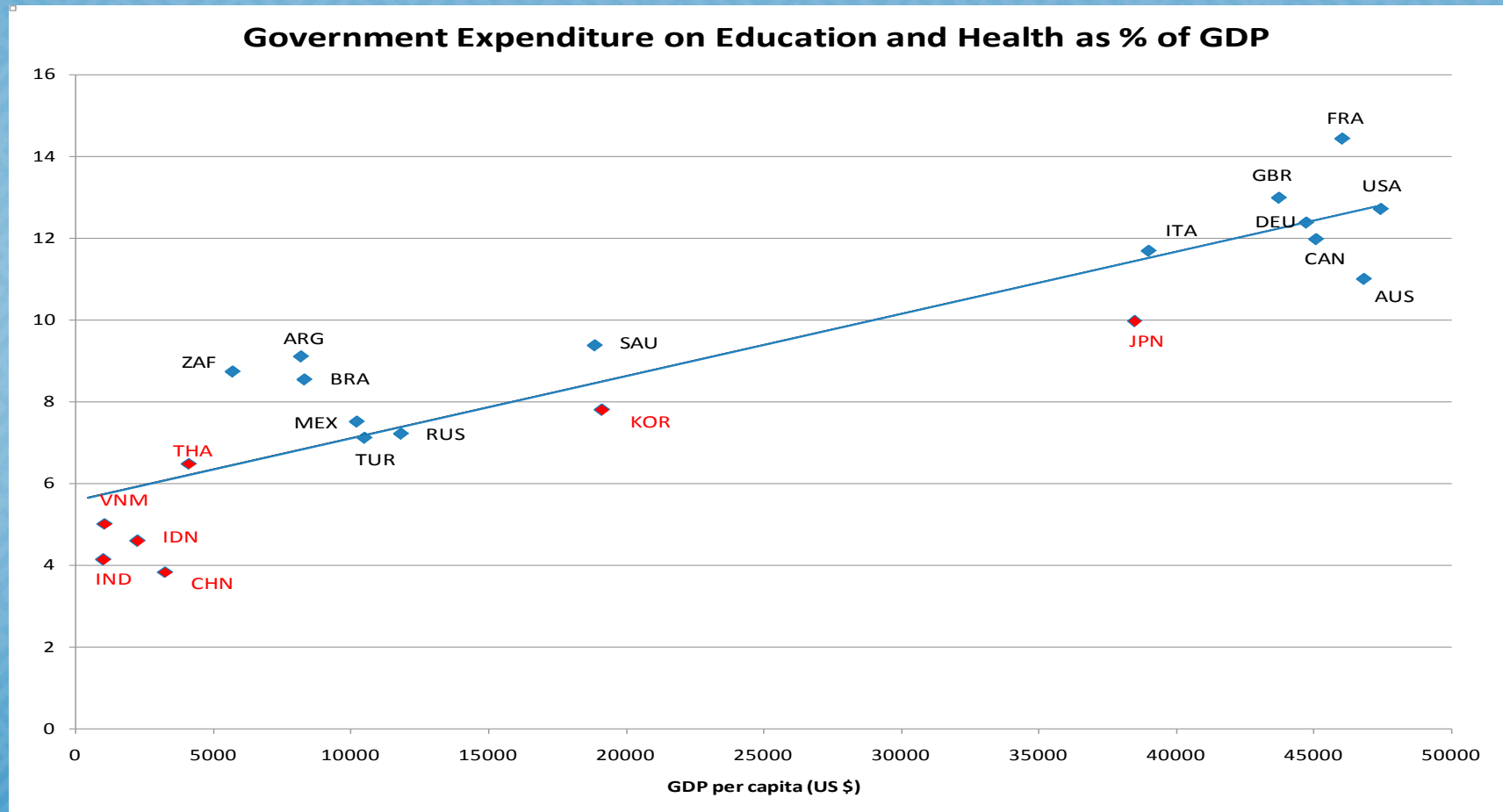
- Cross-country analysis of consumption and social spending
- Generational accounting analysis for China

## III. Policy Implications

# Background

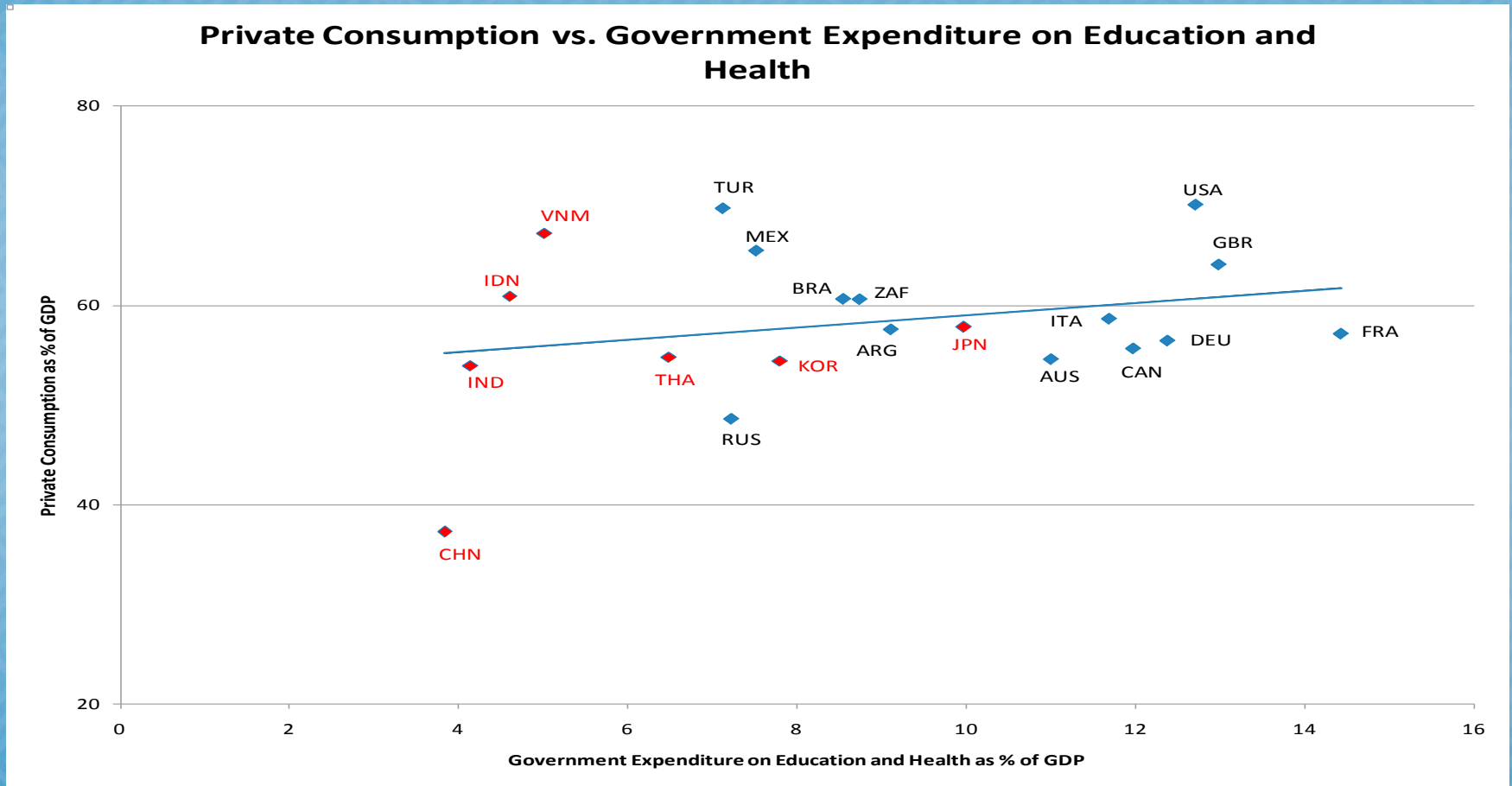
- Low level of public expenditures on education, health and education seen as key factor behind low household consumption ratio and high savings rate in China
  - Households must save to cover high out of pocket expenditures (decline in SOEs)
  - High precautionary savings to cover risk of incurring high expenditures (especially health)

# Social expenditures low in region as a whole, especially China (2008 data)



Sources: CEIC Asia Database, WHD, and UNESCO.

# .....and appear to be part of reason for low consumption



Sources: CEIC Asia Database, WHD and UNESCO.

# Cross-country analysis: Evidence from OECD countries

- Impact of 1 percentage point of GDP increase in social expenditures high in China given low expenditure levels

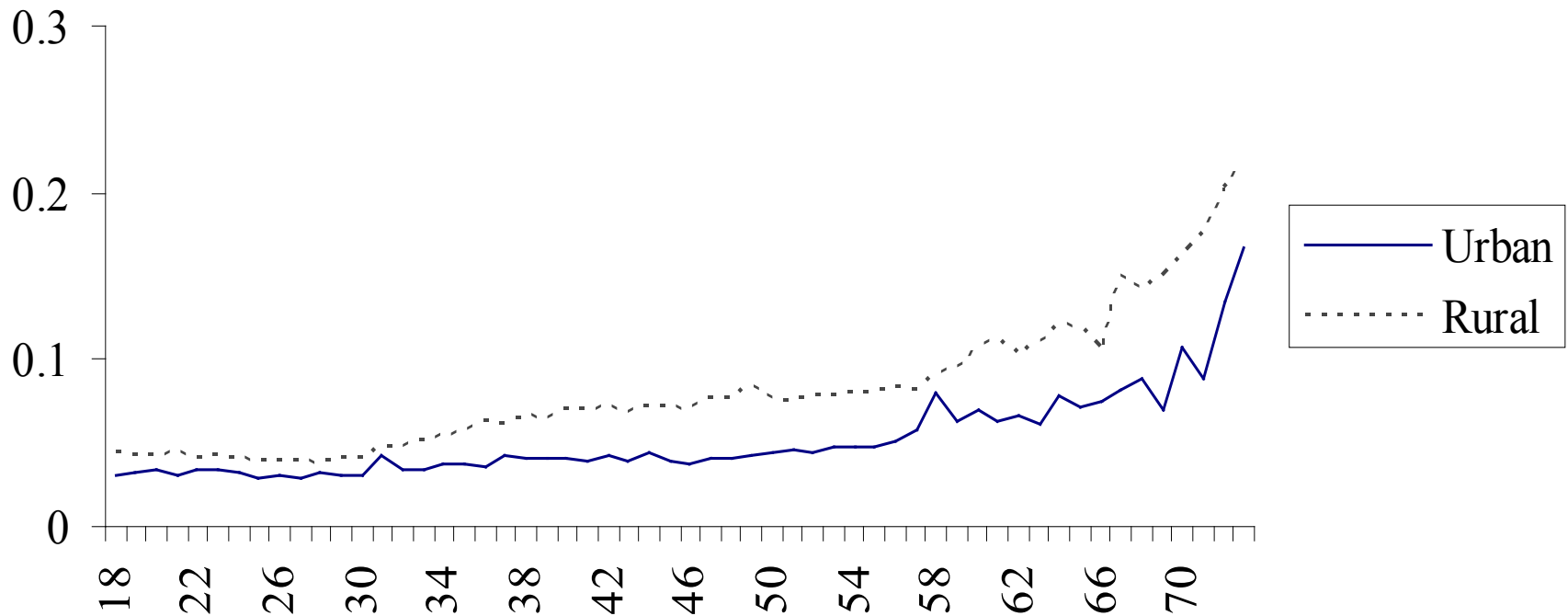
	Total Social Spending Columns (1)-(2) and (4)	Health Columns (3), (A)	Education Column (B)	Social Security Columns (3), (C)
Marginal reduction in household saving in <b>OECD</b>	0.14 ~ 0.24	0.70 ~ 0.78	0.79	0.22 ~ 0.29
Measured at OECD average	at 28.1 percent of GDP for total social spending	at 6.3 percent of GDP for health spending	at 5.8 percent of GDP for education spending	at 16.1 percent of GDP for social protection
Marginal reduction in household saving in <b>China</b>	0.56 ~ 1.03	2.09 ~2.12	1.26	0.68 ~ 0.72
Measured at current levels in China	at 6 percent of GDP for total social spending	at 0.9 percent of GDP for health spending	at 2.9 percent of GDP for education spending	at 2.2 percent of GDP for social security spending

# Generational accounting approach for China

- Government expenditures increase consumption through three channels
  - Increase in household resources (income effect)
  - Targeting of expenditures to those with high propensities to consume (income effect)
  - Decrease in propensity to consume due to decrease in precautionary savings (insurance effect)
- Targeting and insurance effect increase savings rate

# Example of profile of propensities to consume from lifetime resources

## Urban and Rural by Age





# Assess consumption impact of three expenditures

- Pension Transfer
  - Income transfer to everyone over 55 years of age
- Education Transfer
  - Income transfer proportional to expenditures on education
- Health Transfer
  - Income transfer proportional to expenditures on health

# Income effect of social expenditures (percent of GDP)

<i>Expenditure Reform</i>	<i>Pension</i>	<i>Health</i>	<i>Education</i>
<i>Simulation</i>			
Total	1.42	0.77	0.51
Urban	0.92	0.46	0.24
Rural	0.50	0.32	0.27
<i>Budget Shares</i>			
Urban	0.75	0.69	0.58
Rural	0.25	0.31	0.42

# Total (income plus insurance) effects for China (percent of GDP)

<i>Expenditure Reform</i>	<i>Pension</i>	<i>Health</i>	<i>Education</i>
<i>Total</i>	1.6	1.3	0.8
<i>Income Effect</i>	1.4	0.8	0.5
<i>Insurance Effect</i>	0.2	0.5	0.3

# Impact of financing from taxes

- Above estimate of consumption impact assumes financed from running down public savings
  - Range of 0.8-1.6 percent of GDP is equivalent to 1.6-3.2 percentage point decline in household savings rate from current 25 percent level
- Financing increase from income tax increase would reduce consumption ratio by 0.6 percentage points
  - Range of consumption impact would fall to 0.2-1.0 equivalent to 0.4-2.0 percentage point decline in household savings rate

# Policy implications of results

- Government expenditures can make a significant contribution to increasing consumption ratio in China
- Substantial differences in effectiveness of different social spending in boosting consumption
- Targeting expenditures to rural areas would also substantially increase consumption impact