



Implications for macroeconomic policies

- Key challenges that need to be addressed

- Specific implications for macro policies and reforms



Two longer term challenges

- Improve utilisation of labour and other resources
- Achieve better balance in regional growth and development

Achieving better resource utilisation

- A longer term goal that will take many years
- Higher real growth will be needed
- But current structural problems limit what can be achieved in the near-term

Achieving better balance in regional development

- Essential to China's overall development
- Internal integration of the economy will provide a powerful stimulus to productivity and growth
- Continued fragmentation could threaten China's dynamism- - including that of coastal provinces



Three more immediate challenges

- Establish sustainable public finances that can support development
- Improve the effectiveness of macroeconomic policy instruments for demand management
- Lay the foundation for more flexible exchange rate and capital control regimes



Keys to sustainable public finances

- Continue to increase tax revenues relative to GDP
- Reduce government provided pension benefit rates to sustainable levels over time
- Contain future NPL (most critical)



Other important fiscal reforms

- Reform central-local government fiscal relations
- Improve efficiency of the tax system
- Achieve greater efficiency in budgeting and expenditure policies

Improving the flexibility of macroeconomic instruments

- Macro instruments will confront a changing balance of pressures on aggregate demand
- There needs to be less reliance on fiscal policy
- Monetary policy needs to become more effective
- Measures that would help improve monetary policy:
 - interest rate liberalisation
 - further development of money (and capital) markets
 - reforms to restore the financial health and improve capabilities of financial institutions

Laying the foundation for more flexible exchange rate and capital account regimes

- In the long-term, a flexible exchange rate and capital account convertibility are likely to be best for China
- A fixed exchange rate and capital controls are still necessary now
- But there will need to be greater flexibility to deal with changes over the next several years

Considerations bearing on the ‘sequencing’ of the liberalisations

- The exchange rate parity may need to be changed at some future point
- A flexible exchange rate requires more liberalised capital accounts to be beneficial
- Capital controls are likely to become more difficult to enforce
- Liberalised capital flows help domestic financial system development. Delaying liberalisation imposes costs

Common features of market based regulatory frameworks

- Government is 'arms-length' formulator and enforcer of rules to support effective market functioning
- Government does not seek to influence resource allocation directly
- Key supporting principles: comprehensiveness; co-ordination; long range strategic planning; evaluation of trade-offs; consultation; transparency



Strengthening the Government's Capacity to Support Development

- Macroeconomic Policies
- Regulatory Policy Framework