

Research on the Impact of Tax Reduction on Local Fiscal Sustainability

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Abstract

During the period of economic transformation and development, in order to cope with the downward pressure of the economy, we have promoted the implementation of a series of tax and policies, which has brought great challenges to the financial sustainability of local governments. In the short term, tax reduction and have a negative impact on the financial revenue of local governments to a certain extent; However, in the medium and long term, the tax reduction and policy can stimulate market vitality, enhance the ability of enterprises to innovate and develop, cultivate tax sources and improve financial sustainability. Therefore, local governments should take the opportunity of tax reduction and to optimize the local business environment, improve the efficiency of fiscal expenditure, innovate tax collection and management methods, and improve the financial sustainability of local governments.

Keywords

Tax Reduction; Financial Revenue and Expenditure; Financial Sustainability.

1. Introduction and Literature Review

The opening of the 19th CPC National Congress marks that China's economic development has entered a new era, shifting from high-speed development to high-quality development. However, under the action of the common factors of severe and complex external environment abroad and insufficient effective domestic demand, China's economic development is facing serious downward pressure, so the central government issued a series of tax and policies to deal with this situation. According to the report of the National Tax Work Conference held in Beijing on January 8, 2021, during the 13th Five-Year Plan period, more than 7.6 trillion yuan of taxes and fees were added nationwide, and 250 million yuan of taxes and fees were cut in 2020, a new record compared to 2019. However, such large-scale tax and fee cuts have caused local governments to face the dual pressure of shrinking fiscal revenue, rigid fiscal expenditure and inertial growth of public fiscal expenditure. The coexistence of income reduction and rigid growth of expenditure has led to a sharp increase in the gap between the revenue and expenditure of local governments, thus posing great challenges to the sustainability of local government finance [1]. However, the introduction of tax and policy is of great significance to both the government and enterprises. Therefore, in the context of the new era, it is of strong practical significance to study the impact of tax reduction policies on the fiscal sustainability of local governments.

In terms of the research on tax reduction and fiscal sustainability, some scholars have made an in-depth analysis of the overall situation of tax reduction in 2019, conducted a comprehensive and systematic review of the government revenue system, and sorted out four categories of government revenue including tax, fee, rent and price, which is conducive to improving the sustainability of government finance and ensuring the effect of tax reduction[2]. Some scholars from the perspective of economic growth, with the local government debt as proxy variable of

sustainability, the tax cuts to local government finance sustainable exploration on the possible effects and its mechanism, that tax cuts to the local government financial fund pressure, has prompted local governments to expand the scale of borrowing, is not conducive to fiscal sustainability of local governments [3]. Some scholars constructed fiscal sustainability measurement indicators based on entropy method, and confirmed through specific cases that tax cuts significantly negatively affect the fiscal sustainability of local governments, and the degree of fiscal decentralization will have a certain positive impact on this impact.

2. The Necessity of Implementing Tax Reduction Policies

From the perspective of promoting China's economy from high-speed development to high-quality development, the implementation of tax reduction policy is a positive fiscal measure that the state and government must adhere to at this stage[4]. At present, China's economic development is in the throes of reform and transformation. During this period, weak economic growth is inevitable, or even an inevitable process. In this case, the development of enterprises will also face many challenges. In order to improve this situation, accelerate the transformation of manufacturing enterprises and the development of small and micro enterprises, tax reduction policy came into being. At the micro level, the implementation of tax reduction policy effectively reduces the tax burden of enterprises, increases the retained profits of enterprises, and increases the disposable income of individuals, which helps to stimulate the market vitality, enhance the power of economic development, increase the power for the supply-side structural reform, and further promote the innovative development of enterprises. At the same time, as small and micro enterprises are an important part of the market economy, and compared with large enterprises, they are more limited in capital, technology and risk resistance ability, so they need more support from the state and the government to seek development and fulfill their social responsibilities. Thanks to the implementation of tax reduction policies, the pressure on small and micro enterprises can be eased, which plays a very important role in the development of most local economies.

In the case of severe downward pressure on economic development, China proposes to carry out supply-side structural reform, and take measures to improve economic development from the perspective of supply [5]. Supply-side structural reform is one of the important means of China's economic transformation and development, and the active fiscal policy of tax reduction is the main means of cost reduction. Therefore, the implementation of tax reduction policy is an inevitable choice in the process of China's economic transformation and development.

3. Analysis of Anhui Government's Financial Revenue and Expenditure Situation under the Background of Tax Reduction

With the introduction and implementation of a series of large-scale tax reduction and positive fiscal policies, Anhui's fiscal revenue and expenditure have also changed to varying degrees, the contradiction between fiscal revenue and expenditure has further intensified, and the financial pressure of local governments has further increased. In order to cope with the shortfall in local government revenue and expenditure, we need to adjust inventories and increase revenue and reduce expenditure to enhance fiscal sustainability.

3.1. Changes in the Growth Rate of Government Revenue

Since most of the burden of tax reduction is borne by local governments, the most direct impact of the implementation of tax reduction policy is the reduction of local governments' financial revenue, which leads to the decline of local governments' disposable financial resources. In 2020, the general public budget revenue of Anhui provincial local governments was 321.601 billion yuan, up 1.0% year on year, 3.4 percentage points lower than the growth rate of the

previous year. This is partly due to the impact of COVID-19, but the impact of tax cuts should not be ignored. In 2019, the growth rate of its general public budget revenue was 4 percentage points lower than that of the previous year. In terms of the main factors of the decline in the growth of fiscal revenue, it is mainly caused by the decline in the growth of tax revenue. In 2020, Anhui province achieved tax revenue of 219.952 billion yuan, an increase of -0.46%, 1.79 percentage points lower than the previous year; Non-tax revenue reached 101.648 billion yuan, up 4.47%, 7.63 percentage points lower than the previous year. In 2019, excluding the impact of COVID-19, the growth rate of tax revenue fell by 9.33 percentage points, while the growth rate of non-tax revenue increased by 9.00 percentage points. Growth rates of general public budget revenue, tax revenue and non-tax revenue are shown in Figure 1.

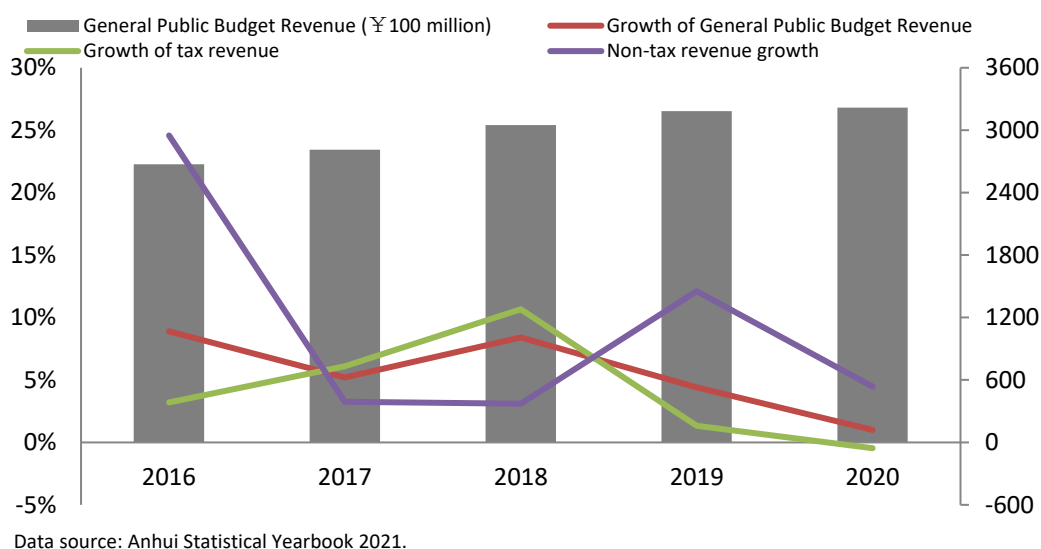


Figure 1. Growth Trend of General Public Budget of Anhui Province (2016-2020)

3.2. Changes in the Growth Rate of Government Expenditure

Fiscal expenditure, especially related to people's livelihood, is not only rigid, but also has the characteristics of inertia growth. Although the growth rate of fiscal revenue of local governments has slowed down or even declined since the implementation of the large-scale tax reduction policy, there is not much room for the reduction of fiscal expenditure, and it will even increase. In 2020, Anhui province's general public budget expenditure was 747.359 billion yuan, up 1.1% year on year and 11.4 percentage points lower than the previous year, which was largely affected by the COVID-19 epidemic. In order to exclude the impact of COVID-19, the growth rate of general public budget expenditure in Anhui province was 12.5% in 2019, up 6.6 percentage points from the previous year. The above situation shows that the fiscal expenditure of local government has the characteristics of rigidity and inertia growth. Among government expenditures, spending related to the people's livelihood is usually relatively large, accounting for about 80 percent. As the public's demand for medical care, education, environmental protection and employment continues to increase, the intensity of fiscal expenditure on relevant expenditures also keeps increasing. Coupled with the debt repayment and interest payments and other factors, the demand for rigid fiscal expenditure keeps increasing. At the same time, when the overall economy is facing serious downward pressure, private investment will also be in a depressed state. In order to drive economic growth, government infrastructure investment needs counter-cyclical investment, so government infrastructure investment will have a faster growth rate, which further increases the burden of government financial expenditure.

3.3. Comparative Analysis of Fiscal Revenues and Expenditures

Under the effect of various factors of reducing revenue and increasing expenditure, the contradiction between revenue and expenditure of government is becoming more and more prominent. In 2020, the general public budget revenue of Anhui province is 321.601 billion yuan, the general public budget expenditure is 747.359 billion yuan, and the general public budget revenue and expenditure gap is as high as 425.758 billion yuan. Under the current fiscal and taxation system of central-local fiscal decentralization in China, the gap of the local government's general public budget is mainly made up by the transfer payment from the central government to the local government. In 2020, transfer payments from the central government to Anhui province amounted to 363.769 billion yuan. After excluding the transfer payments from the central government, the gap between local governments' general public budget revenue and expenditure reached more than 60 billion yuan. In terms of fiscal revenue and expenditure growth of local governments in 2020, general public budget revenue increased by 1.0% and general public budget expenditure increased by 1.1%, which seems to be not a big gap in growth rates. However, this is due to the impact of COVID-19 on the one hand, and the revenue base is far lower than the expenditure base on the other hand. In 2019, expenditure in the general public budget grew by 12.5%, 8.1 percentage points higher than the 4.4% increase in revenue in the general public budget. This is a very significant growth gap. General public budget revenue and expenditure and its growth rate are shown in Figure 2.

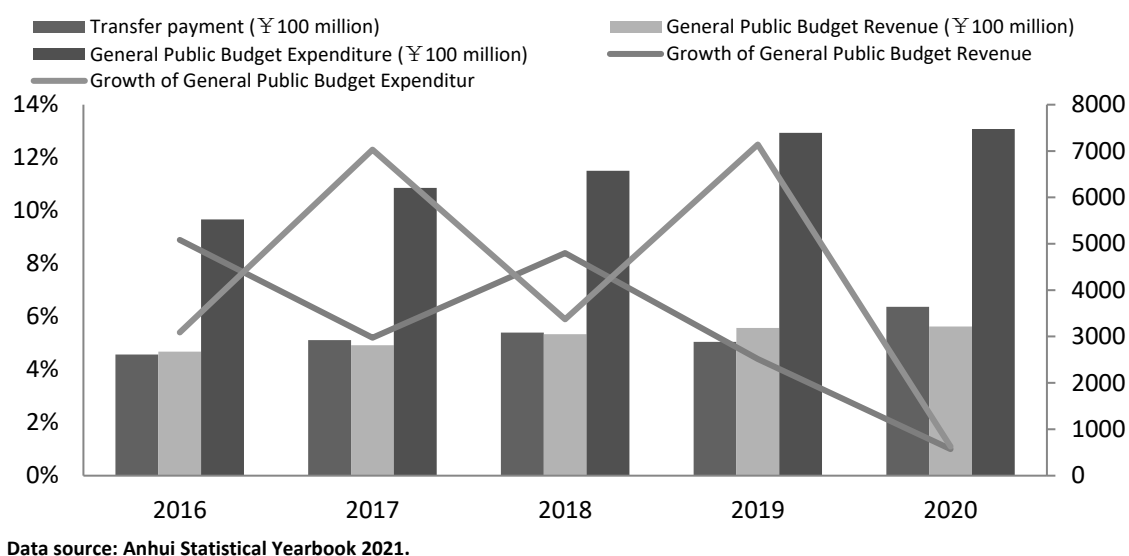


Figure 2. Comparison of general Public Budget Revenue and expenditure Trend of Anhui Province (2016-2020)

As the contradiction between local government's financial income and expenditure continues to intensify, the pressure on the sustainability of local government's finance is also increasing. In this case, not only the overall balance ability of local government's financial funds is facing a great test, but also the local economic development will be affected to a certain extent. But in terms of economic and social development stage, and these effects are short term, from the point of long-term economic development, the implementation of the tax cuts at the micro level to get a main body and burden for the enterprise, increase the profit of enterprise main body, activate market main body, raise the ability of the enterprise innovation and market competition ability; At the macro level, it can also optimize the local business environment and promote the efficient operation of economy, thus promoting the development of local economy, realizing the goal of releasing water to nourish fish, consolidating the tax base and expanding

tax sources, thus improving the fiscal revenue of local governments and enhancing the fiscal sustainability of local governments.

4. Analysis of the Impact of Tax Cuts on Fiscal Sustainability

Implementing the proactive fiscal policy of tax reduction is a systematic and overall project, which has far-reaching influence. Its scope of influence is not limited to the government, enterprises and other subjects, and even individuals will be affected to a considerable extent. This paper focuses on the impact of the implementation of tax reduction policy on the fiscal sustainability of local governments, and intends to explore this impact from the short and medium term perspectives. At the same time, since the sustainability of local government finance and the sustainability of local government debt are two sides of the same body, this paper will also discuss the impact of tax cuts on the sustainability of local government finance from the perspective of government debt.

4.1. The Impact of Tax Cuts on Fiscal Sustainability in the Short Term

The core of the tax reduction policy is the reduction of value-added tax rate, supplemented by the increase of special deductions for personal income tax, which will directly affect the fiscal revenue of local governments. In the short term, under the same conditions, local government fiscal revenue will decrease and the growth rate will slow down. The Tax theory of Keynesian school defines tax as the transfer of social resources from taxpayers to the government. Therefore, the implementation of tax reduction policy is actually to reduce the resources transferred from the market to the government in the form of policies and regulations. Because taxes are mandatory, fixity and free sex, the implementation of the tax cuts is actually the government initiative to give up part of fiscal revenue to reduce the tax burden on taxpayers, but this behavior directly leads to a decrease in government revenue in the short term, increase the government's fiscal gap, thus weakening the government fiscal sustainability.

4.2. The Impact of Tax Cuts on Fiscal Sustainability in the Medium and Long Term

In the medium and long term, the effect of tax reduction policy on economic development is mainly reflected in its incentive effect and agglomeration effect, which indirectly affects the fiscal sustainability of local governments.

An important function of taxation is to regulate the economy. The implementation of tax reduction policy reduces the tax burden of taxpayers and increases the disposable funds of micro subjects. As for enterprises, due to the reduction of tax payment, the profit margin of enterprises and even industries can be improved, production enthusiasm can be fully mobilized, market vitality can be released, thus increasing the income of enterprise owners. According to Keynesian consumer behavior theory, with the increase of income, economic agents will increase consumption on the one hand and investment on the other hand. The incentive effect of tax reduction is precisely from the demand side to boost national economic growth by promoting consumption and investment, thus expanding tax fundamentals, improving government fiscal revenue, alleviating government fiscal gap and strengthening government fiscal sustainability.

At the same time, the agglomeration effect of tax reduction policy strengthens the positive promotion effect. Agglomeration effect refers to the effect of encouraging industrial technology upgrading and attracting industrial clusters to promote economic growth through tax reduction policies. The implementation of tax reduction policy has an effect on various factors of production through the linkage of multiple taxes. On the one hand, the reduction of corporate income tax encourages enterprises to develop and expand and upgrade technology; on the other hand, the reduction of VAT rate reduces enterprise costs, which promotes the flow of

factors of production and increases enterprises' returns to scale. Therefore, the implementation of tax reduction policy improves China's investment rate of return in multiple dimensions, which is conducive to attracting investment and forming industrial clusters, thus promoting economic growth, improving government fiscal revenue and strengthening government fiscal sustainability.

4.3. The Impact of Tax Cuts on Local Government Debt

On the whole, the scale of local government debt in Anhui province has been at a medium level. In 2021, the balance of local government debt in the province was 1,157.6 billion yuan, lower than the local government debt limit of the year of 1254.8 billion yuan, an increase of 20.58% over the previous year, and double-digit growth for four consecutive years. Local government bonds issued 281.5 billion yuan, including 180.9 billion yuan in new bonds and 100.6 billion yuan in refinancing bonds. In terms of debt balance and debt limit, there is still a certain room for the rise of local government debt in the province, and the overall debt risk is controllable. However, we need to be vigilant that the pressure of debt repayment will increase in the future. Over the past three years, Anhui's refinancing bond issuance has risen sharply. The balance and limit of local government debt are shown in Figure 3.

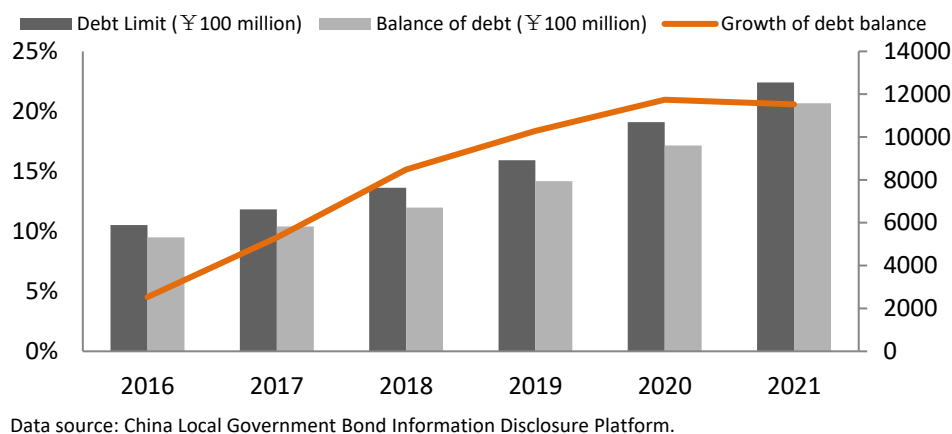


Figure 3. Local government debt of Anhui Province (2016-2021)

5. Conclusion

The implementation of tax reduction policy is an extremely important positive fiscal policy in response to the transformation of China's economic development. Its importance is not only reflected in the level of the state and the government, but also reflected in the reduction of the burden on enterprises, individuals and other micro subjects, increase the development power of enterprises, and stimulate the market vitality. Similarly, the sustainable and high-quality operation of local government finance is not only the basis and important pillar of a country's social governance, but also an important guarantee to maintain the steady development of regional economy and social stability. However, through the analysis of relevant data, it is found that in the process of implementing tax reduction, the fiscal sustainability of local governments is facing great challenges. In the process of implementing tax reduction policies, it is necessary for local governments to expand tax sources, improve fiscal expenditure efficiency, innovate collection and management methods and strengthen collection and management efforts to increase fiscal revenue, so as to improve the fiscal sustainability of local governments.

5.1. Improve the Efficiency of Government Spending and Maintain Reasonable Growth of Local Economies

The implementation of tax reduction policy in the long run is to release water to nourish fish and lay a solid foundation for economic development, but one cannot make bricks without straw. In the process of implementing and promoting tax reduction policy, the local government has become an inevitable choice to increase income and reduce expenditure. In terms of open source, local governments need to understand the trend of local economic growth and develop emerging industries with local advantages according to local conditions, so as to optimize the industrial structure, increase tax sources and improve the financial sustainability of local governments. In terms of reducing expenditure, local governments should actively reduce general expenditures and expenditures on official overseas visits, official vehicles, and official vehicles, and arrange the structure and sequence of fiscal expenditure in a scientific and reasonable way according to local fiscal revenue and expenditure, so as to improve the efficiency of fiscal expenditure.

5.2. Innovating Methods of Collection and Administration and Strengthening the Intensity of Collection and Administration

Local government tax revenue is not only related to the local economic development, but also has a close relationship with the way of tax collection and management to a certain extent. In the current era of the rapid development of the Internet and big data, the tax collection and management method are still relatively traditional, which makes some omission of tax sources in the process of tax collection and management, resulting in unpaid collection and even tax evasion from time to time. Therefore, in order to improve fiscal sustainability of local government, should constantly strengthen tax collection and administration, the emerging technology aided tax collection and administration work, such as large data can not only improve tax collection and administration efficiency, also can take advantage of the large data be stipulated, make up for the deficiencies of the traditional collection and management mode, improving the tax collection and administration system, thus improve the fiscal sustainability of local governments.

5.3. Improve the Business Environment, Attract Investment and Increase Financial Resources

Regional business environment is one of the important indicators for enterprises to consider when choosing a site. Therefore, local governments should take tax reduction policies as an opportunity, combine local advantages, and strive to create a good business environment, so as to take advantage in attracting investment, so as to expand local financial resources and improve the fiscal sustainability of local governments. This is mainly because with the economic development, manufacturing and other real economies in coastal areas begin to shift to inland areas. Investment attraction can stimulate the vitality of local market and drive the development of local economy, thus expanding the tax source of local governments, increasing their fiscal revenue and enhancing their fiscal sustainability.

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