

China's New Finance Minister Faces a Juggling Act

Bloomberg News

November 7, 2016 — 11:01 AM EST

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- Reallocation of revenue underway as local governments curbed
 - Loss of reformer Lou a 'big deal,' says China watcher Naughton
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China's new finance minister Xiao Jie inherits from his reformist predecessor a plan to rein in local authorities' profligate ways without derailing growth in the world's No. 2 economy.

Xiao, 59, previously a senior aide to Premier Li Keqiang, will replace 65-year-old Lou Jiwei, who held the job for a little more than three years, according to an official Xinhua News Agency report Monday. There was no news on what post, if any, Lou will go on to take. The change probably won't have much impact on fiscal policy, according to Citigroup Inc.

Lou restructured local-government finances to reduce the cost of a record amount of debt run up by provinces after the global financial crisis. But his plans to clamp down on spending ran into opposition as they collided with

the weakest growth in a quarter of a century. Xiao now takes up the baton at a time monetary policy has switched to neutral, leaving the economy more reliant on fiscal support.

"Xiao comes in at a critical moment for China's fiscal reform," said Jin Dongsheng, a former researcher at an institute under the State Administration of Taxation. "Some may worry if he is able to carry forward the reforms left behind by his predecessor. I think he is."

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Remaining undone from Lou's agenda is a plan approved in August by the State Council to reform the allocation of fiscal revenues between the central and local governments.

The document, in line with ideas put forward in Lou's 2013 book "Rethinking of Intergovernmental Fiscal Relations in China," says the central government should take over from local governments the responsibility for funding things such as medical care and pensions. That would reduce the financial burden on local governments and help solve at root the forces that drove provincial authorities to rely on land sales as a source of funding.

"The biggest challenge remains to broaden the local governments' narrow revenue base," said Raymond Yeung, chief greater China economist at Australia & New Zealand Banking Group Ltd. in Hong Kong. "Reliance on land sales has been a major culprit behind many issues such as the property frenzy. So far, no finance minister seems to have tackled this issue well."

In a 2005 speech, Xiao suggested fiscal reform could be used as a tool to achieve better equality among regions, adding that business, personal and value-added taxes should be priority areas for reform. China rolled out a plan for value-added and consumer tax reform this year.

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At the same time as he grapples with domestic challenges, he'll have to forge a relationship with what's likely soon to be a new U.S. Treasury secretary in a global environment where protectionist sentiment is on the rise.

The news of Xiao's appointment from the Standing Committee of the National People's Congress, the nation's top legislature, came in a one-line statement. The announcement follows a plenum of top Communist Party officials last month, where President Xi Jinping was declared as the "core" leader of China, a designation that underscored his strengthening authority.

The replacement of the reformist Lou is a worrying portent of a loss of momentum in fiscal and other economic reforms, said Eswar Prasad, a former chief of the International Monetary Fund's China division and now a professor at Cornell University in Ithaca, New York.

"Lou managed to push through some important fiscal reforms, including reining in local government borrowing, but leaves behind a large and important unfinished reform agenda," said Prasad. "Xiao Jie does have substantial experience in fiscal policy, but it remains to be seen whether he has the acumen and clout necessary to push forward those reforms."

Lou's retirement was widely expected and will have little impact on fiscal policy, according to Liu Li-gang, chief China economist at Citigroup in Hong Kong. "Fiscal policy is often decided by the State Council, while the MOF is often viewed as a policy executioner," he wrote in a note. Xiao "will be even less likely to change this practice."

The NPC standing committee also approved two other appointments Monday. Chen Wenqing was named as the new state security minister and Huang Shuxian as the civil affairs minister. There was no immediate sign of a change in status for central bank Governor Zhou Xiaochuan, who has been in office since December 2002 in a tenure that's coincided with multiple finance ministers.

Finance Veteran

Xiao holds a doctoral degree in economics. The Finance Ministry veteran spent more than two decades there since 1982, rising from an employee of its long-term planning division to become a vice minister in 2001. He then had stints as deputy governor of Hunan province, chief of the nation's tax authority, and as a top secretary at the State Council, China's broad equivalent of a cabinet.

Lou, a protege of reformist former premier Zhu Rongji, in the 1990s helped

craft the fiscal framework that underpin two decades of 10 percent average growth. As a vice minister from 1998 to 2007, he played a role in economic restructuring that led to China joining the World Trade Organization in 2001. He later served as the chairman of China Investment Corp., a sovereign wealth fund set up in 2007, where he oversaw purchases including a stake in Morgan Stanley.

Lou became finance minister in 2013 and oversaw efforts to rein in lending and give local governments an officially-sanctioned channel for raising money after provinces and cities took on trillions of yuan of debt through opaque financing vehicles after the global financial crisis.

A restructuring of China's fiscal system is "seriously overdue" and the loss of Lou is a "big deal," said Barry Naughton, a professor of Chinese economy at the University of California at San Diego.

— *With assistance by Yinan Zhao, and Kevin Hamlin*

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