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Efficacy of Fiscal Policy in Stimulating Economic Growth During Recession in China

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Abstract

Fiscal policy involves decisions related to government expenditures on public goods and services, as well as the collection of revenue through taxes and other sources. The government can use fiscal policies to adjust its spending and taxation levels to stimulate or restrain economic activity, influence consumer and business behavior, and achieve desired macroeconomic outcomes. A recession is characterized by a contraction in output, income, employment, and trade, usually accompanied by a general decline in business activity and a decline in consumer spending. During recessions, when economic activity declines, policymakers often turn to fiscal policy as a tool to boost aggregate demand, create jobs, and promote recovery. The study noted that China has experienced various economic downturns and has implemented fiscal policies to address them. Like during the global financial crisis in 2008-2009, China implemented a massive fiscal stimulus package to counter the economic downturn. Structural reforms, such as improving market competition, reducing administrative burdens, and enhancing the business environment, can amplify the impact of fiscal policy measures. Combining fiscal policy with structural reforms had a more significant effect on stimulating economic growth in China. In conclusion, timely and targeted fiscal interventions can have a positive impact on economic growth during recessions. Large-scale infrastructure projects, when implemented efficiently, have the potential to boost employment, drive domestic demand, and contribute to long-term economic development. The study recommended that policymakers should carefully identify and target sectors with high multiplier effects, such as infrastructure, innovation, and technology, to maximize the impact on economic growth. To maintain long-term fiscal sustainability, China should carefully manage public debt levels and ensure responsible fiscal practices. Continuous evaluation and monitoring of fiscal policy measures are essential to assess their effectiveness and make necessary adjustments.

Keywords: *Fiscal Policy, Economic Growth, Recession, China*

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1.0 Introduction

China, as the world's second-largest economy, has experienced periods of recession throughout its economic history (Chen, 2019). China's transition from a centrally planned economy to a market-oriented one began in the late 1970s with economic reforms. In the early stages of these reforms, China faced economic challenges, including periods of recession. The shift from a planned to a market economy brought about structural changes and disruptions, leading to economic downturns in the 1980s and early 1990s. China felt the impact of the Asian financial crisis that began in 1997. Although the crisis primarily affected Southeast Asian economies, China experienced a slowdown in economic growth (Williams & Haynes, 2022). Exports, investment, and industrial production were affected, leading to a temporary economic downturn. The global financial crisis (2008-2009) had a significant impact on China's economy. As a result of the crisis, China's export-oriented economy faced declining demand from major trading partners. Industrial production and investment were affected, resulting in a slowdown in economic growth. However, due to proactive fiscal and monetary policies, China was able to mitigate the impact and rebound quickly compared to other economies. Dhar (2020) noted that the outbreak of the COVID-19 pandemic had a severe impact on China's economy. As the epicenter of the virus, China experienced widespread lockdowns, disruptions in supply chains, reduced consumer spending, and decreased global demand. The containment measures to control the spread of the virus led to a sharp contraction in economic activity, with GDP declining in the first quarter of 2020. However, China implemented aggressive measures to control the virus and stimulate the economy, leading to a rapid recovery in subsequent quarters.

Fiscal policy refers to the government's use of spending and taxation measures to influence the overall state of the economy (Ullah, Ozturk & Sohail, 2021). It involves decisions related to government expenditures on public goods and services, as well as the collection of revenue through taxes and other sources. The primary objective of fiscal policy is to stabilize the economy by managing aggregate demand, promoting economic growth, and addressing issues such as unemployment, inflation, and income inequality. Through fiscal policy, the government can adjust its spending and taxation levels to stimulate or restrain economic activity, influence consumer and business behavior, and achieve desired macroeconomic outcomes. A recession is a significant and widespread decline in economic activity within a country or region (Banks, Karjalainen & Propper, 2020). It is characterized by a contraction in output, income, employment, and trade, usually accompanied by a general decline in business activity and a decline in consumer spending. Recessions are a normal part of the economic cycle, but their impact can be severe and have far-reaching consequences.

Economic growth is a vital aspect of a country's overall development and well-being. It refers to the sustained increase in the production of goods and services over time, resulting in higher standards of living, improved quality of life, and increased opportunities for individuals and businesses (Ahmad, Jiang, Murshed, Shehzad, Akram, Cui & Khan, 2021). Economic growth is measured by changes in the Gross Domestic Product (GDP), which represents the total value of all goods and services produced within a country's borders. Investment in physical capital, such as infrastructure, machinery, and technology, is crucial for driving economic growth. Increased investment leads to higher productivity, efficiency gains, and innovation, which fuel economic expansion. The knowledge, skills, and education of a country's workforce, known as human

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capital, play a significant role in fostering economic growth. Investing in education, healthcare, and training programs enhances the skills and productivity of the workforce, leading to higher output and innovation. Technological progress is a major driver of economic growth. Innovations, such as new products, processes, or organizational methods, increase productivity, lower costs, and create new opportunities for businesses (Khan, Hou, Irfan, Zakari & Le, 2021). Investments in research and development and the adoption of new technologies fuel economic growth.

Entrepreneurs play a critical role in economic growth by identifying and seizing opportunities, creating new businesses, and driving innovation (Rytkönen & Oghazi, 2022). Entrepreneurship leads to job creation, increased competition, and the introduction of new products and services, which boost economic activity. International trade promotes economic growth by expanding markets, increasing efficiency through specialization, and encouraging the flow of ideas and technologies across borders. Countries that engage in trade often experience higher growth rates due to access to larger markets and the benefits of comparative advantage. Strong institutions, including the rule of law, property rights protection, and a stable regulatory environment, are essential for economic growth. They provide a foundation for business investment, entrepreneurship, and innovation by ensuring stability, predictability, and fairness. Adequate infrastructure, such as transportation, communication networks, and energy systems, is crucial for economic growth. Infrastructure investments facilitate trade, reduce transaction costs, and enhance productivity, attracting businesses and supporting economic expansion. Maintaining macroeconomic stability is essential for sustained economic growth (Feng, Li & Wu, 2021). Stable prices, low inflation, sound fiscal policies, and effective monetary management create an environment conducive to investment, consumer confidence, and long-term planning. Access to financial services, including banking, credit, and investment capital, is essential for economic growth. A well-functioning financial system facilitates savings mobilization, efficient allocation of resources, and investment in productive activities.

The effectiveness of fiscal policy in stimulating economic growth during recessions is a topic of significant interest in economics (Chugunov, Pasichnyi, Koroviy, Kaneva & Nikitishin, 2021). During recessions, when economic activity declines, policymakers often turn to fiscal policy as a tool to boost aggregate demand, create jobs, and promote recovery. Fiscal policy operates through the multiplier effect, which refers to the magnification of an initial change in government spending or taxation. During recessions, an increase in government spending can have a multiplied impact on economic activity as it stimulates demand, leading to higher production, income, and employment (Petrović, Arsić & Nojković, and speed of implementation. Quick and well-2021). The effectiveness of fiscal policy in stimulating growth during recessions depends on the timing timed fiscal stimulus can provide a timely boost to the economy, minimizing the depth and duration of the recession. Increasing government spending during recessions can directly stimulate aggregate demand, particularly when targeted towards infrastructure projects, public investments, or job-creating sectors. Increased government spending can generate multiplier effects and lead to a broader expansion of economic activity.

Lowering taxes during recessions can increase disposable income for households and businesses, encouraging consumption and investment (Leclaire, 2022). Tax cuts can also incentivize businesses to expand and hire, potentially boosting economic growth. One potential limitation of fiscal policy effectiveness is the possibility of crowding out. When the government increases its borrowing to finance fiscal stimulus, it may compete with private borrowers for funds, leading to

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higher interest rates that could discourage private investment. The effectiveness of fiscal policy in stimulating growth during recessions can also be influenced by considerations of fiscal sustainability. A high level of public debt or budget deficits may limit the government's ability to implement expansionary fiscal policies, as it could risk exacerbating long-term fiscal imbalances (Stupak, 2019). The effectiveness of fiscal policy also depends on the composition of government spending. If spending is directed towards productive investments, such as education, research and development, or infrastructure, it can have positive long-term effects on economic growth. Fiscal policies can have distributional effects, impacting different groups within society. For instance, targeted transfer payments or social programs can provide support to those most affected by recessions and contribute to overall economic stability.

According to David, Nguyen-Duong and Selim (2022), fiscal policy can influence confidence and expectations in the economy. Expansionary fiscal measures, when well-communicated and perceived as credible, can enhance consumer and business confidence, encouraging spending and investment. The effectiveness of fiscal policy in stimulating growth during recessions can also be influenced by global interdependencies. In an interconnected world, the impact of fiscal stimulus may be influenced by international trade, capital flows, and the overall global economic environment. There can be time lags associated with the implementation of fiscal policy measures and their impact on the economy. Delays in enacting fiscal stimulus or the time required for the effects to materialize can reduce the effectiveness of fiscal policy during recessions. The effectiveness of fiscal policy can be influenced by political considerations, such as the ability to build consensus for fiscal measures, political will, and institutional capacity for effective implementation (Palley, 2020). The interaction between fiscal and monetary policy can affect the effectiveness of fiscal measures during recessions. Coordination between fiscal and monetary authorities is essential to ensure that both policies work in harmony to stimulate economic growth.

1.1 Statement of the Problem

The effectiveness of fiscal policy in stimulating economic growth during a recession in China is an important and complex issue that warrants further examination. During periods of economic downturn, such as recessions, fiscal policy measures play a crucial role in stimulating economic activity and restoring growth. Given China's unique economic structure and the influence of state-led investment, it is essential to understand how fiscal policy interventions interact with other factors and policies. The extent to which fiscal stimulus measures can effectively counteract the negative impacts of a recession and promote sustainable growth needs to be examined. The efficacy of different types of fiscal policy tools in China should be investigated. This includes evaluating the impact of government spending, taxation, and investment policies on key economic indicators such as GDP growth, employment rates, and consumption patterns. Understanding the relative effectiveness of different fiscal measures can help policymakers make informed decisions on the allocation of resources during a recession.

The issue of fiscal sustainability arises when implementing expansionary fiscal policies. China's high debt levels and the potential risks associated with excessive government spending need to be considered. Assessing the long-term implications of fiscal stimulus measures on public finances and debt sustainability is crucial for maintaining macroeconomic stability. Furthermore, the impact of fiscal policy on different sectors of the economy should be analyzed. Examining how fiscal measures influence industries such as manufacturing, services, infrastructure development, and social welfare can provide insights into the targeted approach needed to achieve balanced and inclusive growth. Identifying the potential spillover effects of China's fiscal policy on the global economy is also of significance. Given China's significant role as a global economic player, understanding how its fiscal policy measures during a recession affect international trade, investment, and financial markets can have implications for both China and its trading partners.

2.0 Literature Review

Tanchev and Mose (2023) conducted research on fiscal policy and stimulating economic growth during a recession. The research methodology involved analyzing historical data and employing econometric techniques to assess the impact of fiscal policy measures on economic growth. Through their analysis, they found that expansionary fiscal policies, such as increased government spending and tax cuts, can effectively stimulate economic growth during a recession. They observed that targeted investments in infrastructure, education, and healthcare have a particularly positive effect on long-term growth. Additionally, they concluded that the effectiveness of fiscal policy measures is contingent upon the appropriate timing and magnitude of implementation, as well as the country's specific economic conditions. Based on their findings, the researchers recommend that policymakers carefully design and implement fiscal policies during recessions, ensuring a balance between short-term stimulus and long-term sustainable growth objectives. They emphasize the importance of maintaining fiscal discipline, enhancing public expenditure efficiency, and fostering structural reforms alongside fiscal measures to support economic recovery and long-term growth.

Slepov, Burlachkov, Danko, Kosov, Volkov, Ivolgina and Sekerin (2019) conducted extensive research on fiscal policy and stimulating economic growth during a recession. The research methodology likely involves a combination of empirical analysis, theoretical modeling, and policy evaluation. Based on the previous work, the findings suggest that during recessions, an expansionary fiscal policy that focuses on direct job creation can be an effective means of stimulating economic growth and reducing unemployment. The study argues that the government can use its fiscal power to directly hire workers for socially useful projects, thereby boosting aggregate demand, addressing unemployment, and supporting long-term economic development. It was concluded that to emphasize the importance of prioritizing employment and targeted fiscal interventions to promote inclusive and sustainable economic growth. The study recommended that implementing a Job Guarantee program, investing in infrastructure and public services, and adopting a more expansive approach to fiscal policy that prioritizes job creation and reduces income inequality.

Charlton (2019) conducted on research regarding fiscal policy and stimulating economic growth during a recession. The research methodology involved a combination of theoretical analysis, empirical data, and policy evaluations. The findings suggests that expansionary fiscal policy, such as increased government spending and tax cuts, can be effective in stimulating economic growth during a recession. The researchers argues that the multiplier effects of government spending and targeted investments in infrastructure and human capital can have positive impacts on overall economic output. The conclusion stress the importance of timely and well-targeted fiscal interventions to mitigate the effects of a recession and promote sustainable long-term growth. The recommendations included carefully calibrated fiscal stimulus measures, ensuring sufficient support to areas with high economic multipliers, and considering a combination of monetary and fiscal policies to achieve the desired economic outcomes.

Hok (2020) performed study to investigate the influence of fiscal policy on Cambodia's economic growth. Furthermore, this study determines if Cambodia's fiscal policy is contractionary or expansionary in order to stimulate the economy throughout the last two decades. Due of the restricted observation period of 26 years, from 1994 to 2019, this study adopts Bayesian inference based on Bayesian Model Averaging (BMA) and Markov Chain Monte Carlo (MCMC), which uses Gibb Sampling to approximate posterior mean. The empirical outcomes of these two methodologies are similar. The empirical findings indicated that Def, Debt, Faids, Er, and Ex, which represent the government deficit, public debt, foreign assistance, nominal exchange rate (KHR/USD), and export, respectively, had a positive link with Cambodian production growth. The rise in the deficit, public debt, and foreign aid indicates that the government is using fiscal policy to fine-tune the economy. Furthermore, this analysis demonstrates that Cambodia's fiscal policy is consolidated and stabilized. It is possible to conclude that a rise in the deficit, public debt, and foreign debt might stimulate the economy during a recession when fiscal policy is performed as expansionary policy. During a post-recession, the Royal Government of Cambodia (RGC) will implement a contractionary fiscal policy to calm the economy, particularly if it is overheated.

Hong (2022) performed study to assess the efficacy of fiscal policy in the Central and East European EU economies using local forecasts and a Panel Structural Vector Auto-Regressive model. During economic downturns, it was noted that increasing public investment has a large beneficial influence on output, employment, wages, and consumption. Public investment financed by deficits does not raise the debt-to-GDP ratio and is largely self-financed. A rise in public consumption, on the other hand, has minimal effect on economic activity and raises the debt-to-GDP ratio. The observed short-term impacts are consistent with a neo-Keynesian pattern in which more public investment increases demand for labor in the private sector, resulting in greater real wages and consumption. In the medium run, more public investment boosts private investment, resulting in a supply side benefit. The study concluded that, now that monetary policy has run its course, public investment may be an essential policy tool for combating recessions and increasing long-term growth.

Munir and Riaz (2020) conducted study to explore the impacts of fiscal policy shocks on a collection of macroeconomic indicators in Pakistan are examined in this study. The study use the SVAR paradigm and employs quarterly data from 1980:Q1 to 2020:Q4. Fiscal policy shocks are discovered by taking decision delays in policy formulation into account as well as the elasticity of fiscal variables. According to the findings, an increase in government developmental spending raises real GDP more than an increase in current expenditure, whereas current expenditure raises prices and developmental expenditure lowers prices. Prices are positively associated to subsidies and defense spending, but adversely related to social service spending. Tax income raises real GDP more than non-tax revenue, and tax revenue and non-tax revenue are both positively and adversely connected to prices and interest rates. A rise in direct tax has a positive impact on prices and interest rates but a negative impact on real GDP, whereas indirect tax has a positive impact on real GDP but a negative impact on interest rates. Prices are tied to excise duty, sales tax, and international trade tax. The findings confirm the Keynesian concept that fiscal policy is a positive instrument for stabilizing and stimulating the economy at the expense of inflation. To guide the economy to prosperity, the government should redirect spending into productive ways while enforcing rigorous responsibility for income creation and collection.

Demi, Xhaferri, Uku, Shahini and Lushi (2021) conducted research to determine if the impact of fiscal policy on economic development in Albania varies during the business cycle. A Markov Switching Vector Autoregressive (MSVAR) framework was used to answer this topic. It was discovered that evidence of asymmetric fiscal policy impacts via regimes defined by the stage of the business cycle (recession and boom). In both regimes, the data reveal small positive government expenditure and revenue multipliers in the short run. Most notably, fiscal policy shocks have a greater impact during economic recessions than during expansions, confirming the theory of asymmetric effects. During recessions, however, the impact of government expenditure is greater than the impact of public revenue. Furthermore, fiscal policymakers engage with anti-Keynesian (pro-cyclical) views. The findings suggest that employing the "right instrument" at the "right time" has certain advantages.

According to Hjazeen, Seraj and Ozdeser (2021), Jordan's tax income and economic growth have been on an increasing trend in absolute terms. A lot of studies found conflicting conclusions about the impact of taxes on economic development. Several of these studies discovered a negative association, while others discovered a favorable relationship between taxes and economic growth. As a result, this study attempts to evaluate the short and long run consequences of taxes on economic growth in Jordan, a growing country. Annual data from 1980 to 2018 were utilized to build an Auto-Regressive Distribution Lag (ARDL) method. The boundaries test results indicate that the variables of economic growth, taxes, capital, and trade are cointegrated. The calculated model's empirical results demonstrate a negative short and long term link between taxes and economic growth in Jordan. The cointegration estimation findings also show that the short run deviations from long run equilibrium are corrected by 60% towards long run equilibrium each year. The study contends that fiscal policy is critical for promoting long-term economic growth. As a result, fiscal policymakers should consider suitable tax rates in order to generate adequate income to support government utility costs that encourage economic growth.

3.0 Findings

China has experienced various economic downturns and has implemented fiscal policies to address them. During the global financial crisis in 2008-2009, China implemented a massive fiscal stimulus package to counter the economic downturn. Research indicates that the fiscal stimulus had a positive impact on economic growth. China's fiscal policy often focuses on large-scale infrastructure investment as a means to stimulate growth during recessions. Research noted that infrastructure spending can have positive effects on economic growth. However, it also emphasized the importance of investment efficiency and avoiding excessive debt in infrastructure projects. Research has highlighted the uneven effectiveness of fiscal policy across different regions in China. Due to the country's vast size and regional disparities, fiscal policies may have varying impacts on economic growth. A study by Gaspar, Amaglobeli, Garcia-Escribano, Prady and Soto (2019) found that fiscal policy had a more significant effect on stimulating economic growth in less developed regions compared to more developed regions.

The effectiveness of fiscal policy in stimulating economic growth in China is influenced by investment efficiency. Research suggests that the efficiency of investment projects, particularly those funded by fiscal stimulus, can impact their effectiveness. Improving the efficiency of investment projects was crucial for achieving sustainable and inclusive economic growth. The coordination between monetary and fiscal policies is essential for the effectiveness of fiscal measures. Research highlights the importance of coordinating monetary and fiscal policies to avoid policy conflicts and enhance the overall impact on economic growth. There is need for coordination between the central bank and fiscal authorities to ensure the effectiveness of fiscal policies in stimulating growth. Research noted that the effectiveness of fiscal policy in China's recessions can be enhanced through complementary structural reforms. Structural reforms, such as improving market competition, reducing administrative burdens, and enhancing the business environment, can amplify the impact of fiscal policy measures. Combining fiscal policy with structural reforms had a more significant effect on stimulating economic growth in China. Research has also examined the implications of fiscal policy on public debt and fiscal sustainability in China. While fiscal stimulus measures can boost short-term growth, concerns arise regarding the sustainability of high levels of public debt. There is need for prudent fiscal management and debt control to maintain long-term fiscal sustainability and prevent adverse consequences on economic growth.

4.0 Conclusion

In conclusion, the effectiveness of fiscal policy in stimulating economic growth during recessions in China has been demonstrated through various periods of economic downturn. The implementation of fiscal measures, such as stimulus packages, infrastructure investment, and targeted policies, has played a crucial role in mitigating the impact of recessions and supporting economic recovery. Timely and targeted fiscal interventions can have a positive impact on economic growth during recessions. China's ability to respond swiftly with fiscal stimulus packages during the global financial crisis and the COVID-19 pandemic highlights the effectiveness of proactive fiscal policy in stabilizing the economy and supporting growth. Infrastructure investment has shown to be an effective tool for stimulating economic growth during recessions in China. Large-scale infrastructure projects, when implemented efficiently, have the potential to boost employment, drive domestic demand, and contribute to long-term economic development. Regional considerations are important in designing fiscal policies. Recognizing the regional disparities in China, targeted fiscal measures that address the specific needs of different regions can help reduce inequality, promote balanced growth, and foster inclusive development across the country.

Coordination between monetary and fiscal policies is essential for the effectiveness of fiscal measures. Close cooperation and alignment of objectives between the central bank and fiscal authorities can enhance the overall impact of fiscal policy and ensure a harmonized approach towards stimulating economic growth. The combination of fiscal policy with structural reforms can amplify the effectiveness of fiscal measures. Complementary reforms, such as promoting market competition, reducing administrative burdens, and improving the business environment, can enhance the growth potential of fiscal interventions and contribute to sustained economic expansion. Prudent fiscal management, including controlling public debt levels and maintaining fiscal sustainability, is crucial for long-term economic stability and growth. Effective management of public debt can safeguard macroeconomic stability and prevent potential risks to future growth.

5.0 Recommendations

It is crucial for fiscal policy measures to be implemented promptly and in response to the specific needs of the economy during a recession. Timely intervention can help minimize the depth and duration of the downturn. Moreover, policymakers should carefully identify and target sectors with high multiplier effects, such as infrastructure, innovation, and technology, to maximize the impact on economic growth. To optimize the effectiveness of fiscal policy, China should prioritize investment efficiency in infrastructure projects and other government spending initiatives. This can be achieved by improving project evaluation and selection processes, promoting transparency, enhancing oversight mechanisms, and addressing issues related to corruption and wasteful expenditures. Efficient investments will ensure that fiscal resources are channeled into projects that yield the highest economic returns and long-term growth benefits. Given the regional disparities in China, it is essential to design fiscal policies that address the specific needs of different regions. Policymakers should consider the varying economic conditions and development levels across provinces and ensure that fiscal measures are tailored accordingly. Targeting regions with lower development levels can help reduce regional inequalities, promote inclusive growth, and contribute to overall economic stability. Close coordination between monetary and fiscal authorities is critical to ensuring the effectiveness of fiscal policy measures. Regular communication and cooperation between the central bank and fiscal authorities can help align policy objectives, avoid conflicts, and create a synergistic policy framework. Such coordination will enable a comprehensive and unified approach towards stimulating economic growth and managing macroeconomic stability.

Combining fiscal policy measures with structural reforms can significantly enhance their effectiveness. China should prioritize structural reforms aimed at promoting market competition, reducing administrative burdens, improving the business environment, and enhancing labor market flexibility. These reforms can create a more conducive environment for private investment, innovation, and productivity growth, which, when complemented with fiscal measures, can result in sustained and inclusive economic expansion. To maintain long-term fiscal sustainability, China should carefully manage public debt levels and ensure responsible fiscal practices. Prudent fiscal management includes monitoring and controlling debt accumulation, implementing fiscal rules and targets, enhancing revenue collection mechanisms, and prioritizing expenditures based on their impact on economic growth and social welfare. By maintaining fiscal discipline, China can avoid the risk of excessive debt accumulation and create a stable fiscal environment for sustainable economic growth. Continuous evaluation and monitoring of fiscal policy measures are essential to assess their effectiveness and make necessary adjustments. China should establish robust evaluation frameworks to measure the impact of fiscal policies on economic growth, job creation, and other relevant indicators. This evaluation process will provide valuable insights for policymakers and enable evidence-based decision-making in future recessionary periods.

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