

Original Article

Analysis on Ternary Paradox of Fiscal Distribution: Theory and Mitigation Methods

Jia Kang¹, Su Jingchun²

¹. Jia Kang, First President and Chief Economist of China Academy of New Supply-side Economics, Research Fellow in Chinese Academy of Fiscal Sciences, Beijing, the People's Republic of China

². Su Jingchun, Associate Research Fellow in Chinese Academy of Fiscal Science, the Ministry of Finance, P.R.C., Guest Researcher in China New Supply-side Economist 50 Forum

Abstract - This paper proposes the ternary paradox of fiscal distribution. Firstly, it points out the three goals of fiscal distribution: tax cuts, increased public welfare expenditures, and control of government debts and deficits, among which there are only two goals that can be achieved at the same time. This paradox has brought obvious and difficult problems in China's current government regulation and control. There are inevitable responsibilities of the regulatory authorities to face up to the ternary paradox. To mitigate the ternary paradox, it is necessary to pay special attention to the institutional innovation and comprehensive supporting reform in four aspects of spending less money and doing more work, making good use of money and doing practical things, borrowing less and doing more work and expanding the fiscal sources and optimizing the powers.

Keywords - Fiscal Distribution, Ternary paradox, Mitigation method

I. TERNARY PARADOX OF FISCAL DISTRIBUTION

In contrast to the form of Mundell Krugman's impossible triangle and ternary paradox, examining the inherent constraints of fiscal distribution, the ternary paradox of fiscal distribution can be derived under conventionally defined conditions. If the management level of recurrent fiscal expenditure, the administrative costs of the government and the financing multiplier of the government debts are established, among three goals of tax cuts, increased public welfare expenditures and the control of government debts and deficits in fiscal distribution, only two goals can be achieved at the same time. It is impossible to achieve three goals at the same time.

A. RELATIONSHIPS AMONG THE THREE GOALS

Figure 1 visually shows the impossible triangle of fiscal distribution under the aforementioned conditions: in any given period, only three choices can be made among the goals of tax cuts, increased public welfare expenditures and the control of

government debts and deficits that seems to be "reasonable". First, if cutting the taxes and controlling government debts and deficits in fiscal distribution, then it is necessary to reduce (impossible to increase) the public welfare expenditures. Second, if cutting the taxes and increasing the public welfare in fiscal distribution, then it is necessary to improve (impossible to control) the government debts and deficits. Third, if controlling government debts and deficits and increasing public welfare in fiscal distribution, then it is necessary to increase (impossible to reduce) the government non-debt revenues represented by taxes. Thus, we can deprive Figure 2: the ternary paradox of fiscal distribution. The achievement of the goal on each corner of the triangle will necessarily require the matching of the items on two side waistlines but inevitably violates at least one goal on the other two corners of the triangle.

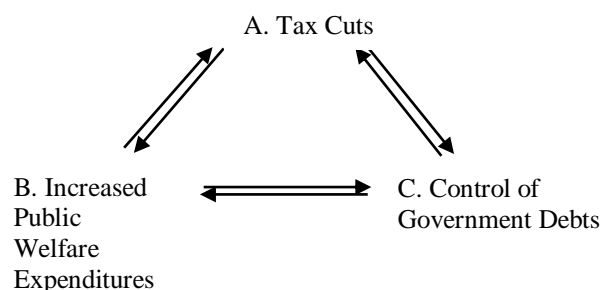


Fig. 1 Diagram of Impossible Triangle in Fiscal Distribution

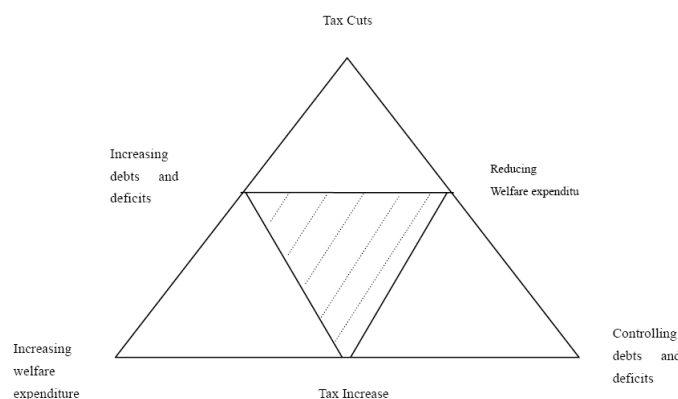


Fig. 2 Diagram of Ternary Paradox of Fiscal Distribution



Actually, the quantitative relationship here is very clear. Therefore, it is very easy to break the “paper layer of the window” between relevant public concerns and the inherent paradox. Specifically, A. tax cuts can reduce the burden on enterprises and the residents. Thus, it will be popular. B. Increased public welfare expenditures will increase the benefits of social members, and thereby it will be popular. But both of them will increase the gap between government revenues and expenditures, leading to C. deficits, thus increasing the total amount of government debts raised to make up for the deficits, which involves “safety issues”. In fact, the public does not lack common sense on this issue. When referring to government debts, it tends to cause widespread public concerns and dissatisfaction. Therefore, the common sense is that “You can’t make bricks without straws” and “You cannot have your cake, and eat it”. From the perspective of fiscal distribution, tax is income, welfare is an expenditure, and the two must be matched in the same direction, increased or reduced at the same time. If you want to improve the welfare and cut the tax, you must find another income source - debts, which will be increased to support the original matching relationship. Among the aforementioned A, B, and C, the achievement of A and B is at the expense of C, however, which may encounter the objective constraints of public risks. It is impossible to have the three of them at the same time. The constraints embodied here are objective laws and will definitely extend and connect to the ultimate constraints under the concept of sustainability in economic and social life.

From the above analysis, we can conclude a basic understanding. However, the improvement of public welfare is the starting point and destination of economic and social development. However, under specific conditions, for an economy at a certain stage, the case is not that the higher the public welfare (represented by the scale of public welfare expenditures), the better the conditions. When the public welfare is higher than a certain point, its supporting role for economic development will be rapidly reduced, even resulting in unsustainable economic growth. The positive effects of welfare improvement on economic development, which is brought by welfare expenditures, and its transformation can be concisely expressed in rectangular coordinates, as shown in Figure 3.

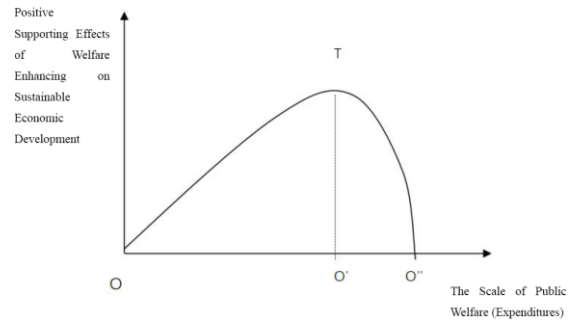


Fig. 3 Transformation Curve of Welfare Enhancing Effect

In the figure, the horizontal axis represents the level of public welfare (represented by the level of public welfare expenditures), and the vertical axis represents the positive or supporting effect of welfare-enhancing on sustainable economic development (can also be quantified in a certain numerical unit). At the origin O, assume that there is no welfare; of course, there will be no positive effects. Once there is certain public welfare on the right side, its positive supporting effect on economic growth will rise quickly with the increase of public welfare (in real life, it is often called economic vitality promoted by the enthusiasm of the people, who are motivated or mobilized, etc. by the material interests) until to the highest point (optimal value) on curve T, which corresponds to O' on the horizontal axis. However, if we continue to improve the welfare, the decline in positive effects (in real life, the rapid decline in economic growth and vitality) will quickly reduce the positive effects at O' point, which may fall into the negative range (compared with the case of Latin American mid-income trap). The distance between O' and O'' is quite short. In other words, once the level of public welfare exceeds the optimal value, its positive support for the sustainable development of a country's economy will soon be transformed into a negative effect after a rapid decline. Therefore, the regulatory authorities should carefully and prudently control it within a range close to or even reaching peaks but not exceeding the critical point.

This transformation curve of welfare-enhancing effect is similar to the positive effect curve of government debts¹ proposed by Jiakang in the 1990s. The inherent logic of the two is completely consistent, and in a sense, it can be taken as different expressions of the same evolution process.

¹ Jia Kang, *The Cognition on Moderate Scale of China's Government Debts*, Public Finance Research, Vol.10, 1996; Jia Kang, Zhao Quanhou, *The Moderate Scale of Government Debts and The Actual Scale of China's Government Debts*, Economic Research Journal, Vol.10, 2000.

B. CASE ANALYSIS: EUROPEAN DEBT CRISIS AND THE PARTICULARITY OF THE UNITED STATES

The most important event in the world economy in recent years was the “once-in-a-hundred-year” global financial crisis triggered by the US subprime mortgage crisis. After hitting the US economy, it triggered a serious European debt crisis.

According to the inherent logic of the ternary paradox of fiscal distribution, the basic element to alleviate the European debt crisis is to reduce taxes to stimulate the economy to reduce deficits and control the scale of debts to reduce default risks. The achievement of these two goals of fiscal distribution is at the expense of public welfare, which inevitably contradicts the direct interests and short-term benefits of the people. Thus, it is a tough problem. It tends to “politicize the economic issues” and has triggered many rounds of strikes and social turbulence in Greece and other places. After the outbreak of the European debt crisis, in addition to the strong economy of the eurozone, such as France and Germany, the ruling party of the frustrated countries such as Greece and Italy, etc., logically proposed to reduce the deficit and control the scale of debt. However, under the rigid framework of the “welfare state”, it is difficult to reach an effective trade-off between minimizing tax cuts and maximizing welfare expenditures, which clearly embodies the inherent logic of the ternary paradox of fiscal distribution. This case can be summarized as follows. In the eurozone, the goals of tax cuts, deficits reduction and the control of debts of fiscal distribution are at the expense of public welfare. Currently, in the eurozone, if it needs to cut taxes to stimulate the economy, cut deficits and control debts to maintain fiscal sustainability, then it is impractical to comply with public opinion to maintain the original comfortable and leisurely work and relatively high public welfare. Sometimes, impractical things need to be diminished or disguised by politicians to soothe public opinion and fight for votes. But in theoretical analysis, for the ternary paradox of fiscal distribution that we have outlined, impractical is impractical.

Different from the ternary paradox of fiscal distribution, the United States is in control of the world currency hegemony independently, which provides it with the opportunity to choose other logical paths at a certain stage, that is, let the bodies holding the dollar assets in global to pay for the crisis and relax the constraints on its own fiscal distribution. Since the outbreak of the global financial crisis triggered by the US subprime mortgage crisis, the United States has chosen a combination of goals, that is, reducing taxes and maintaining original public welfare to maintain social stability. The path is to reduce taxes and relax the control over debt and

deficit. However, it does not lower the basic public welfare standards of the public but adopts QE (quality engineer) policy to forcibly and economically decentralize the risks (inflation pressure and financial debt risks), etc., to the major economies of the world by means of its supremacy status in the hard currency of global economy and let the world pay for it. Thus, two rounds of promulgated QEs and the third round of QE under planning was carried out without fear. From the perspective of the ternary paradox of fiscal distribution, the substantive secrets are as follows. Supported by the “world monetary hegemony”, the authority of US fiscal distribution is capable of producing huge income except for taxes and debts by means of QE policy without interrupting the sustainability of its financial operation, which is the currency issuance income. Therefore, the ternary paradox of fiscal distribution in the United States is looser than any other economy. This cannot be imitated by other economies in the world. This is the particularity of the United States.

However, the looseness of the United States does not negate the ternary paradox and the ultimate constraint it reveals. This looseness is not unlimited. Its objective boundary lies in the objective, critical line in which the status of the “international security assets” can be maintained when the US dollar implied by the concept and form of the US fiscal suspension are depreciated.

C. DEFINED CONDITIONS AND CONTINGENT LOGIC

The previous analysis on the impossible triangle and ternary paradox of fiscal distribution is based on defined conditions, including the established level of fiscal recurrent expenditure management, fixed government administrative costs and specified financial multiplier of government debts. These defined conditions are “slow variables” that are difficult to be changed greatly in the short term but can be changed gradually. Their changes will have an impact on the goals of the ternary paradox of fiscal distribution. The specific analysis is as follows.

1) DEFINED CONDITIONS AND CONTINGENT LOGIC

The recurrent fiscal expenditure mainly includes personnel expenditure, public expenditure and social security expenditure. The logical relationship between the level of fiscal recurrent expenditure management and the goals of an impossible triangle is as follows. First, the higher the level of fiscal recurrent expenditure management, the higher the utilization efficiency of personnel expenditure, public spending and social security expenditures of fiscal expenditures, the less the capital loss, and the stronger the ability to “do more things with less

money”. Obviously, it is beneficial to reduce taxes and control debts and deficits. Second, the higher the level of fiscal recurrent expenditure management, the higher the performance of social security expenditures. Obviously, it helps to improve public welfare. In short, the level of fiscal recurrent expenditure management is positively related to the goals of the impossible triangle in fiscal allocation: the higher the management level, the more favourable it is to reduce taxes, improve public welfare and control debts and deficits, and vice versa (refer to Table 1).

Table 1. The Relationship Between the Fiscal Recurrent Expenditure Management Level and Three Elements of Impossible Triangle

Performance of Recurrent Fiscal Expenditure	Tax Cuts	Increased Public Welfare	Control of Debts and Deficits
↑	+	+	+
↓	-	-	-

2) GOVERNMENT ADMINISTRATIVE COSTS

The administrative costs of the government mainly include the relevant expenses of the state administrative organs, administrative institutions, the public security organs, procuratorial organs, the court and various foreign institutions. Such expenses are not similar to economic construction expenditures that can directly promote economic development, nor similar to social expenditures that can directly improve the public social welfare. It is generated by the government in the process of performing its functions. In nature, it can be regarded as a kind of running costs or “sunk costs” that cannot be avoided by any operating system, which is closely related to institutional arrangements and the construction of management mechanisms. The logical relationship between changes in the government administrative costs and the objectives of an impossible triangle is as follows. First, the higher the government administrative costs, the greater the “self-consumed” costs incurred by the government in performing its functions. These expenses are all from the fiscal revenue. Obviously, it is not conducive to reducing taxes and controlling debts and deficits. Second, the higher the government administrative costs, the greater the crowding-out effect on fiscal and social expenditures under the same financial level. Obviously, it is not conducive to improving public welfare. In short, the level of government administrative costs is negatively related to the objectives of an impossible triangle in fiscal distribution: the higher the administrative costs, the more unfavourable it is to reduce taxes, improve public welfare control debts and deficits, and vice versa (refer to Table 2).

Table 2. The Relationship Between the Level of Government Administrative Costs and Three Elements of Impossible Triangle

Level of Government Administrative Costs	Tax Cuts	Increased Public Welfare	Control of Debts and Deficits
↑	-	-	-
↓	+	+	+

3) FINANCING MULTIPLIER OF GOVERNMENT DEBTS

The Keynesian multiplier theory refers to a macroeconomic effect, that is, the degree of a chain reaction of changes in the economic aggregate caused by the increase or decrease of a certain variable. Referring to the definition of the multiplier effect, we believe that the “government debt financing multiplier” can be defined as the degree of the chain reaction of the change in the total amount of government financing caused by changes in government debts. The logical relationship between the government debt financing multiplier and the goals of the impossible triangle is as follows. First, the larger the government debt financing multiplier, the more the total funds are raised through government debts. In order words, a smaller amount of government debts can be financed to obtain more available financial resources. Thus, there is less pressure on the government to raise direct debts, or there are more disposable expenditures brought by the government’s debts. Obviously, it is beneficial to reduce taxes and control debts and deficits. Second, the larger the government debt financing multiplier, the more disposable funds available from financing under specified government debts, the more disposable funds available for non-financing affairs, and the larger the social, fiscal expenditures. Thus, it is beneficial to improve public welfare. In short, the government debt financing multiplier is directly proportional to the goals of an impossible triangle in fiscal distribution: the larger the financing multiplier, the more favourable it is to reduce taxes, improve public welfare and control debts and deficit (refer to Table 3).

Table 3: The Relationship Between Government Debt Financing Multiplier and Three Elements of Impossible Triangle

Government Debt Financing Multiplier	Tax Cuts	Increased Public Welfare	Control of Debts and Deficits
↑	+	+	+
↓	-	-	-

4) DERIVATION AND ANALYSIS ON THE FORMULA OF TERNARY PARADOX OF FISCAL DISTRIBUTION

Based on the analysis of the ternary paradox of fiscal distribution, defined conditions and contingency logic, we can know that the principle can be expressed by the following formula:

$$D = \theta + \alpha_1 T + \alpha_2 W + \alpha_3 S \quad \textcircled{1}$$

Among them, D (Distribution) is the goal of fiscal distribution; T (Tax) is tax; W (Welfare) is the level of public welfare; S (Stability) is the stability of the financial situation, which is reflected by the level of the debt and deficit; θ is the aggregate of other factors other than tax, public welfare and the stability of financial situation and is regarded as a constant in this formula. $\alpha_1, \alpha_2, \alpha_3$ Are coefficients and $\alpha_1 \cdot \alpha_2 \cdot \alpha_3 < 0$.

The formula $\textcircled{1}$ can be used as a general formula for the ternary paradox of fiscal distribution. The meaning of the formula is expressed as follows. If taking tax (T), public welfare (W) and debts and deficits (S) as measurable dimensions, according to the principle of ternary paradox, the goals of fiscal distribution — tax cuts, increased public welfare, and the control of debts and deficits cannot be achieved at the same time. Only two of them can be achieved simultaneously. Among the coefficients of α_1, α_2 and α_3 , two of them are of the same sign, and the product of the three is less than zero. For the convenience of mathematical logic analysis and formula derivation, the author assumes the coefficient of W as a negative value, and $t = -\alpha_2$, then formula $\textcircled{1}$ can be expressed as follows:

$$D = \theta + \alpha_1 T - tW + \alpha_3 S \quad \textcircled{2}$$

Among them α_1, t, α_3 are coefficients and $\alpha_1 > 0, t > 0, \alpha_3 > 0$.

Formula $\textcircled{2}$ is transformed from formula $\textcircled{1}$ and illustrates the relationship between the three more clearly. According to the above logical sequence of analysis on the combination of the goals, first, if tax cuts and the control of debts and deficits are chosen as the goal of fiscal distribution, then T and S in formula $\textcircled{2}$ must be reduced at the same time. If D is kept unchanged, $-tW$ it must be increased, and W

must be reduced. That is, this goal combination is at the expense of public welfare. Second, if controlling the debts and deficits and increasing public welfare are chosen as the goal of fiscal distribution, then in formula $\textcircled{2}$, S must be reduced, and W must be increased. Analysing the data item, if $\alpha_3 S$ and $-tW$ are reduced and D is kept unchanged, then $\alpha_1 T$ T must be increased. That is, this goal combination is achieved by increasing taxes. Third, if increasing public welfare and reducing taxes are chosen as the goal of fiscal distribution, then in formula $\textcircled{2}$, T must be reduced, and W must be increased. Analysing the data item, if $\alpha_3 S$ and $-tW$ are reduced and D is kept unchanged, then $\alpha_3 S$ S must be increased. That is, this goal combination is achieved by raising debts and deficits.

As discussed above, the positive and negative correlations between the defined conditions and the goals of the impossible triangle in fiscal distribution are shown in Table 4.

Table 4: Positive and Negative Correlation Between Defined Conditions and Three Elements of Impossible Triangle

	Tax Cuts	Increased Public Welfare	Control of Debts and Deficits
A	+	+	+
C	-	-	-
M	+	+	+

Among them, A (Administration) is the fiscal recurrent expenditure management level; C (Cost) is the level of government administrative costs; M (Multiplier) is the government debt financing multiplier.

Again, taking formula $\textcircled{2}$ as an example, the aforementioned defined conditions directly affect three coefficients in the formula. If the effect is expressed in a formula, the following equations can be obtained:

$$\begin{cases} \alpha_1 = a_1 A - a_2 C + a_3 M & * \\ t = -c_1 A + c_2 C - c_3 M & ** \\ \alpha_3 = m_1 A - m_2 C + m_3 M & *** \end{cases}$$

Among them a, c, m are coefficients and $a > 0, c > 0, m > 0$.

By combining formula ③ with equations ③, the following formula ④ is obtained, and the influence of defined conditions on each goal is more clearly and intuitively reflected in the following:

$$\left\{ \begin{array}{l} D = \theta + \alpha_1 T - tW + \alpha_3 S \quad \textcircled{2} \\ \alpha_1 = a_1 A - a_2 C + a_3 M \quad * \quad \textcircled{4} \\ t = -c_1 A + c_2 C - c_3 M \quad ** \quad \textcircled{3} \end{array} \right.$$

$$\alpha_3 = m_1 A - m_2 C + m_3 M \quad ***$$

II. THE CHARACTERISTICS AND MITIGATION METHODS OF TERNARY PARADOX OF FISCAL DISTRIBUTION AT MID-INCOME STAGE

The ternary paradox of fiscal distribution presents different characteristics at different stages of economic development and resident income. Combing its inherent logic with the characteristics of constraints is helpful for reasonably adjusting the mitigation methods. After more than 30 years' development in the new period of reform and opening-up, China has entered the mid-income stage currently, specifically the transition period from the lower middle income to upper middle income. Seen from the growth trend of per capita GNI (GDP), China will step into the transition period from the mid-income stage to the high-income stage quickly. However, the discussion on the mid-income trap has attracted wide attention. In view of the fact that Latin America has fallen into the mid-income trap due to the implementation of welfare catch-up based on populism, China should pay close attention to the correct grasp of the development strategy in the mid-income stage. From the perspective of this paper, it is necessary to analyse the characteristics of the ternary paradox of fiscal distribution at a mid-income stage in China and to take correct regulation and mitigation methods based on its inherent logic.

A. THE WELFARE CATCH-UP AND MID-INCOME TRAP BASED ON POPULISM AT MID-INCOME STAGE

The welfare of the residents is the starting point and destination of development but should be gradually improved with the continuous upgrading of

the economy in the economic catch-up period. However, the “welfare catch-up based on populism” in the representative countries of Latin America has been aborted due to various factors in the last century and has dragged the national economy into the mid-income trap.

The main performance of Latin American welfare catch-up is the blind expansion of populist labour protection and social spending. First, with the rapid economic growth, the income gap between urban and rural areas in Latin America has gradually widened, and the continuous influx of migrant workers from rural areas to cities has led to an oversupply of urban labour markets and a steady decline in wages, which further intensified the problem of the income gap. Under the dual role of the high unemployment rate and the “example effect” of the welfare system in developed countries, the countries simply copied American-style “election” democracy, the populist sentiment became more and more prominent, and many parties promoted the establishment of high employment protection and high welfare in Latin America, which has become a heavy burden for macroeconomic development.

Second, Latin American countries were enthusiastic with a populist. After the 1970s, fiscal expenditures were mainly used to expand social expenditures. The ratio of social expenditure in GDP in various Latin American countries increased from 1990 to 2000. In certain countries, social expenditure accounted for as high as 60% to 70% of public expenditures. Even in the case of severe financial shortages, the deficit was still blindly expanded to satisfy social expenditures, thus completely dragging down the macroeconomy.

The logic of the populist-based welfare catch-up that leads to economic catch-up failure and mid-income trap can be incorporated into “populist macroeconomics” (Dornbusch & Edwards, 1989). The logical path is rough as follows: the macroeconomic policy is successful in the first battle — the economic growth encounters bottlenecks — the economic development is hindered — the populist government goes bankrupt.

In the first phase, the government supported by the populist social foundation implemented welfare catch-up in the economic catch-up. The economic output and real wages were universally improved at the beginning. Due to the introduction of labour legislation, the maintenance of suitable employment rates and satisfying the will of the people to improve social security, the economy showed a thriving scene. However, since the first stage was a pure consumption stage without accumulation, its further development encountered the bottleneck. The second

stage made the invisible problem of the first stage explicit. On the one hand, the increase in the scale of fiscal expenditure based on the expansion of the fiscal deficits caused huge demand for domestic goods, which was seriously opposed to the insufficient supply. More goods needed to be imported with foreign exchanges. At the same time, the already very hard-working finances must maintain “high welfare”. Simply mechanical copying of the European and American welfare system and catching up with Europe and the United States made the financial situation even worse. On the other hand, due to the large number of foreign exchanges used for imports, the foreign exchanges were seriously in shortage, resulting in more goods being needed. However, there were no more foreign exchanges to support the imports to meet the demand. At the third stage, the typical contradiction between supply and demand made the government unable to control the price of goods and could only implement price adjustment, local currency depreciation, foreign exchange control, and industrial protection. At this stage, the wages of the people increased rapidly, but inflation increased faster, leading to a decline in actual purchasing power. After the development of the first three stages, the government supported by the former populist social foundation inevitably fell into bankruptcy under the intensification of various contradictions. The new government presided over the overall situation, had to implement the stability plan under the orthodox macro policy or made use of the assistance of international agencies such as the IMF to maintain the economic development of the country. At this time, the real wages of the domestic people had fallen sharply, which was lower than the level before the populist government took office and would be at such a low level for a long period of time. Economic growth stagnated or even regressed and fell into the so-called mid-income trap. The serious consequences of the implementation of welfare catch-ups based on populism made Latin American economies fall into the mid-income trap. It can be seen that although the welfare catch-up is the destination, without strong economic catch-up as sustainable means of support, the welfare goal will not be realized ultimately.

B. THE CHARACTERISTIC AND MITIGATION METHODS OF TERNARY PARADOX OF FISCAL DISTRIBUTION AT MID-INCOME STAGE

The experience of “Latin Americanization” shows that the economy at the mid-income stage should focus on avoiding the welfare catch-up based on the populism and the consequences caused by it due to the intensification of social contradictions. According to the ternary paradox of fiscal distribution proposed in this paper, it is clear that Latin America chooses the goal combination of reducing taxes and increasing public welfare in the process of fiscal

distribution at the mid-income stage. According to the logic revealed by the ternary paradox, the achievement of this goal combination needs to increase debts and deficits. From the practice of Latin American welfare catch-up based on populism, which made its economy fall into the mid-income trap, this region was indeed striving to cut taxes and improve public welfare by increasing debts and fiscal deficits, which ultimately dragged the national economy down into a trap. For China, which is also at the mid-income development stage, it is worthwhile to think deeply about how to realize sustainability and alleviate the ternary paradox of fiscal distribution. In general, the characteristics of the ternary paradox of fiscal distribution at the mid-income stage are prominently reflected in the following two aspects.

1) THE RESTRICTIVE RELATIONSHIP REFLECTED IN THE TERNARY PARADOX USUALLY STRONGLY CONTRADICTED WITH PUBLIC OPINION

The theoretical analysis and empirical investigation of development economics show that when a country enters the mid-income stage, it usually comes with the people’s higher expectations on income and welfare. This expectation is easily ahead of the actual income growth rate and the ability of the government to improve public services and public welfare. Thus, the people may be dissatisfied and act as “Behave like a gentleman while the dishes are being served; swear like a bully when the dinner is over”. There will be various “prominent contradictions”. The populist tendency with the inherent logic of “the people being always right” is easy to occur and even become popular at this stage. When horizontally compared with the economic development and welfare system of western developed countries, this populist sentiment tends to heat up quickly and strives for welfare. The populist sentiment has prevailed and gradually warmed up in China in recent years. According to the logical path of the ternary paradox of fiscal distribution, the tendency is obviously the choice that Latin America has made: strongly striving for reducing taxes and increasing public welfare. However, such a demand needs to be achieved by increasing debts and fiscal deficits, which are by no means borderless. The catalysis of populism tends to cause welfare catch-up to surpass the economic catch-up and excessive expansion of the debts. When emphasizing the restrictive relationship contained in the ternary paradox and responding rationally, a person may be strongly resisted by the public and under the pressure of “being attacked by the masses”. The disparity of western power is easy to promote the raising of welfare catch-up, make the scale of debts and deficits out of control, and ultimately drag the national economy into the trap. The welfare will decrease dramatically as well as the possibility of economic

catch-up and the development of the entire country. Therefore, the mid-income stage is the best period for the economy catch-up. We should firmly and rationally implement the economic catch-up strategy, meanwhile, steadily provide the suitable welfare catch-up, and avoid the rising and developing of populism, which focuses on immediate interests instead of long-term interests and becomes a hidden danger of sustainable economic development. Therefore, it is believed that at the mid-income stage, under the ternary paradox of fiscal distribution, it is scientific to choose the goal combination of reducing taxes and controlling debts and deficits, the achievement of which is at the expense of controlling the public welfare. Thus, it is not welcomed by the public. In order to avoid the welfare catch-up based on the populism at the mid-income stage and eventually realize the economic catch-up strategy that spans the mid-income trap, the policymakers should guide the public to think rationally in a visionary, determined and strategic way, and coordinate the short-term interests, long-term interests and fundamental interests to realize the balance and connection of the interests.

2) THE RISING PRESSURE OF POLITICIZATION OF THE ECONOMY AND THE NARROWED FLEXIBLE SPACE OF BUFFERING SOCIAL CONTRADICTIONS

In view of the fact that the restrictive relationship reflected by the ternary paradox usually contradicts the public opinion more strongly at the mid-income stage. Thus, under the ternary paradox of fiscal distribution, it is a fundamental and primary choice to choose and adhere to the scientific development path that coordinates the overall planning, considers carefully, complies and also guides the public. It is undeniable that populist sentiments will have a significant impact on the policy choice of the government. In a sense, government policies often deal with relevant complex issues. After entering the mid-income stage, a series of sensitive economic issues such as prices, taxation, public utility supply, etc., are easy to be closely related with the contradictions between income distribution and government management, which reduce the critical point of “politicization of economic problems”, and intensify the pressure of “maintaining social stability”. Thus, the available flexible “buffering” space used to compromise and mediate the pressure and dissatisfaction is narrowed.

According to the ternary paradox of fiscal distribution, the goal combination of reducing taxes, controlling debts and deficits and improving public welfare cannot be achieved simultaneously. “Buffered flexible space” is essentially the safe operating space corresponding to the total immediate interests that are achieved through the relatively

unintuitive way of expanding the scale of public debts gradually, meanwhile complying with the social mentality to minimize taxes and increase public welfare in a concentrated and convenient way. According to the logic of the impossible triangle of fiscal distribution, the level of increased public welfare is inversely proportional to the level of reduced taxes and the level of debt and deficit control. The decision-making level must pay special attention to the scale of public debts that are increased to alleviate social conflicts. A series of partial operations to prevent “economic politicization” will be attributed to the relaxation of the control over public debts, and the deficits and debts will continue to accumulate in successive years. Once the boundary of the narrowed buffering flexible space is broken, the hidden problems may be explicit and result in prominent contradictions and crises, and even cause a change in the overall development situation and the interruption of the “golden development” process.

III. POSSIBLE METHODS TO MITIGATE TERNARY PARADOX OF FISCAL DISTRIBUTION

As mentioned above, the ternary paradox of fiscal distribution is the general understanding under defined conditions, which are the established fiscal expenditure management level, the established level of government administrative costs and the given government debt multiplier effect. There is positive or negative relevance between the defined conditions. The higher the level of fiscal expenditure management, the lower the administrative costs, the greater the financing multiplier, and the more beneficial it is to reduce taxes, increase public welfare, and control debts and deficits. In view of this, from the perspective of the transformation of government functions, institutional innovation and deepening reforms, the possible methods to mitigate the ternary paradox of fiscal distribution are the following four aspects.

A. EFFECTIVELY IMPROVE THE MANAGEMENT OF FISCAL EXPENDITURES

Improving the management level of fiscal expenditure requires a comprehensive reform in institutional innovation, management innovation, and technological innovation. In order to truly realize “spending less money and doing more work”, we must start from three aspects and strengthen the reform interaction between them. First, for the institutional arrangement, pay special attention to the deepening of the reform of the financial system and the construction of the fund performance supervision and evaluation system based on it. Second, expenditure management should continue to implement scientific and refined management and

establish a sound monitoring system for the whole process of fiscal expenditure. For relevant financial expenditure performance evaluations, consider the introduction of comprehensive and detailed balanced scorecards (tables) and other methods. Third, for the relevant technical aspects, consider continuing to comprehensively promote and implement the systematic project with the most advanced information processing technology and upgrade the government financial management system on the basis of "Government Fiscal Management Information System (GFMIS)", "Golden Tax" and other government "Golden" projects. On the basis of implementing the "Twelve Golden" projects proposed in 2002, we will continue to improve the advancement, safety and comprehensiveness of e-government, improve the convenience and accuracy of information acquisition, information processing and information transmission, and electronically and systematically integrate and implement the performance management methods, so as to comprehensively improve the management level of fiscal expenditures, spend less money and do more work, and alleviate the constraints of ternary paradox

B. EFFECTIVELY REDUCE THE GOVERNMENT ADMINISTRATIVE COSTS

The key to effectively reducing government administrative costs is to promote comprehensive reform of the economy, administration and politics. The key contents are as follows. First, the implementation of the reform of the administrative system streamlines the institutions and personnel on the basis of rationalization of government functions and powers (expenditure responsibility) at all levels. Improve the quality of human resources, and reduce the costs of government departments and personnel while improving the efficiency of government work. Second, continue to implement the budget information disclosure system to strengthen supervision. The disclosure of budget and final accounts is an essential requirement of public finance and an important part of government information disclosure. To announce to the public the budget information of the "public spending on government cars, overseas trips and official receptions" of the central and local governments demonstrates the government's determination to fulfil its commitments and accept public supervision, promotes the further disclosure of various administrative costs by governments at all levels, and lays the foundation for saving and reducing government operation costs under public supervision. Third, further promote the reform of the management system related to government administrative costs, for example, promote the reform of the official cars, strictly examine and reduce the number of groups and personnel going abroad due to business, strictly control the standard of official business trips and

official reception funds, and strictly forbid gifts, and so on. Fourth, vigorously improve the system of financial fund supervision, evaluation and accountability so that the "taxpayer's money" can be used effectively to maximize the benefits and the saved financial funds can be invested in the most needed aspects of the people's livelihood.

C. IMPROVING THE GOVERNMENT DEBT FINANCING MULTIPLIER

As mentioned above, the government debt financing multiplier refers to the degree of the chain reaction of the change in the total amount of government financing caused by changes in government borrowing funds. The larger the financing multiplier, the more favourable it is to reduce taxes, increase public welfare and control debts and deficits. Improving the financing multiplier of government treasury bonds or local bonds will inevitably require a series of management and institutional innovations, especially comprehensive supporting reforms related to the policy financing system and mechanism. One of the key implementation points is to establish a risk-sharing mechanism (rather than a "bottom-free" fiscal guarantee mechanism) between the fiscal department, financial institutions, enterprises, commercial banks, credit guarantee institutions, and so on. In the market economy, make use of the policy funds, market-oriented operations and specialization management to "multiply" the funds with credit, that is, drive social funds and private capital to follow up and improve the efficiency of capital use like "twice the result with half the effort". It is feasible and necessary to explore the potential in this aspect in the environment of the market economy. It is beneficial to alleviate the constraints of the ternary paradox, "spending less money and doing more work". Improve the multiplier effect to drive and mobilize more social funds to form a relatively large synergy.

D. SUBSTANTIAL TRANSFORMATION OF THE TYPE OF GOVERNMENT FUNCTIONS

With the development of the market economy in China, the rationalization of government functions is imperative. The implementation of state political power governance will mainly be reflected in the management of public social affairs, and the administrative-regulated government should be transformed into a public service-oriented government. As a distribution system of "controlling money with administration and conducting administration with money", the finance must serve this historical transformation and realize its own corresponding transformation, that is, improve public finances. Substantially transforming government functions requires various reforms in government systems, institutions and social management. For

example, in terms of government systems, it is necessary to gradually clear and rationally define the functions of the government at all levels, from the central government to the local governments. Make a detailed record of the powers, establish and implement a complete, transparent, scientific and reasonable modern government revenue and expenditure classification system in the budget, and provide basic management conditions for fulfilling government functions. In terms of government social management, it continues to establish and improve basic education, basic social and health security, basic housing security system, etc., covering the whole people, and emphasizes the transformation of the government into service type government. Encourages and guides the establishment of various non-government entities and intermediary organizations that are open to the market and oriented by public welfare, and improves various institutions and systems for public-private cooperation. The PPP (Public-Private Partnership) model for the supply of public works and public goods should be a model that is particularly worthy of attention and development during the transformation of government functions. PPP model includes many types of public-private contracts, for example, design and construction (DB), operations and maintenance (O&M), designing, building, financing and operation (DBFO), construction, owning and operation (BOO), building, operation and transfer (BOT), purchase, building and operation (BBO), building, leasing, operation and transfer (BLOT), etc., and will be more widely applied and optimized with the improvement of China's market economic system and economic and social development, thus promoting the non-government entities and non-government financial resources to inject new vitality for the transformation and optimization of government functions, opening up new financial resources and resource potential space for the improvement of public welfare and effectively alleviating the pressure of government debts and deficits.

IV. CONCLUSION

The ternary paradox of fiscal distribution reveals that due to the constraint of the impossible triangle, we can only pick two of the three goals simultaneously, which are tax cuts, the control of debts and deficits, and the increased public welfare. These kinds of constraints exist in common, is accompanied by the occurrence of prominent contradictions and cannot be ignored in the process of economic and social devilmment in China at the mid-income stage. In the long run, we should follow the "three-step" strategic goal of the modernization of the Chinese nation that benefits the Chinese people and all mankind in a relatively stable and socially costly way and process. In terms of the decision-making, we must pay special attention to avoiding the

tendency of welfare catch-up based on populism when entering the mid-income stage, which increases the public welfare at the expense of tax cuts and increased debts and deficits, so as to avoid the mid-income trap of economic and social development. Currently, under the guidance of a comprehensive, coordinated and sustainable scientific development concept, China should carefully, prudently and reasonably weigh and grasp the combination of fiscal policy objectives. Deal with a series of difficulties in fiscal distribution to serve sustainable development along the rational, logical path and face up to the ternary paradox of fiscal distribution. Actively improve the level of fiscal expenditure management, effectively reduce government administrative costs, and improve government debt financing multiplier. Substantively transform the government functions and optimize the social management. Thus, mitigate the constraints of the ternary paradox with the vitality and potential of reform and innovation, and move towards a modernized country in a firm and orderly manner.