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The target of the public fiscal policy: Giving attention to both the equality and the efficiency

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Brief Biographies:
Lianshi ZHOU was born in June in 1949. She is installed as a professor in Shanghai Administration Institute and assigned as a commissioner in the Chinese policy research seminar. She got the master degree of economics in East China Normal University in 1986. She took up teaching in the economic department of the same school in 1993. Later she spent six years teaching in the financial department. Then in 1999 she went to Shanghai Administration Institute. She mainly researches in the science of economic policy, the monetary financial policy, fiscal policy, regional economic policy, industrial policy and so on. She wrote three books: *The Foundations of the Modern Science of Economic Policy*, *The Theory of Macro Economic Policy*, and *The Theory of Economic Planning*. And main theses: *Coordination of International Public Process of Globalization of the World Economy*, *The target system of the policy focusing on the exchange rate of RMB*, *Risks and Protections of Chinese Fiscal Policy*. Also, she anticipated and accomplished many research projects: *The Harmonization: Plan, Fiscal Policy and Financial Policy* of the research project of fund of the national social science; *Adjustment of Industrial Structure and Recombination of Enterprises* of the research projects of the fund of the social science in national education department; *The Valetta of RMB after Joining WTO* of the research project of fund of the social science in Shanghai.
Introduction

The theme of the paper is that the contradiction of the equality and the efficiency is the eternal difficulty in economics. In order to solve this problem, Arthur Okun proposed that the efficiency is supposed to be accomplished in the fields of production while the equality to be achieved in the fields of redistribution through the social security. As the tool of redistribution, the public fiscal policy should primitively achieve the equality target. However, it proved to be true that during the procedure of conducting the public fiscal policy, we still cannot avoid the contradiction of the equality and the efficiency. This paper proposed that both of them need considering. If the government invests mainly in the fields of production and the specific public products of the exhausting expenditures, the dual targets are likely to be accomplished.

The paper will try to analyze:

1. The equality target of the public fiscal policy
   The resource of Okun’s policy opinion and its contradiction
   The contradiction of the fiscal policy target

2. The dual target of public fiscal policy
   Neo-liberalism’s value of the equality and their evaluation
   Two different kinds of public products

3. The dual utility of the Chinese fiscal policy
   The investment in public products promoting the inhabitants’ income equality in different regions
   The investment to diminish the gap in the income of different industries
   The investment in the infrastructures of the countryside to promote the income equality in the cities and villages
   Control a certain scale of transferring expenditure
   The validity of the equality target and the efficiency target

4. The limitations of public fiscal policy
   The limitations of the boundary conditions
   The limitations of the equality target and the efficiency target
Main body
The contradiction of the equality and the efficiency is regarded as the eternal difficult problem in economy. We have to achieve the equality at the cost of the efficiency while we have to raise the efficiency at the cost of giving up the equality. It is the very task for the economists to research and consider for their harmonization all the time.

The target of the public fiscal policy is believed to accomplish the social equality, yet unavoidably harmful to hurt the efficiency. This paper is trying to discuss that it is possible and necessary for the public fiscal policy to achieve both of the targets: the equality and the efficiency.

1. The equality target of the public fiscal policy
Arthur M Okun, an economist in U.S., was the first person to put forward the question of the way to keep the balance between the equality and the efficiency as a difficult problem. He used to work as the chairman of the consultant committee of President Johnson. As a senior decision maker in the field of the economy in U.S., he met with quite a lot of policy contradictions during his tour. He thought the equality and the efficiency as the most two difficult choices for him, to which he devoted himself throughout his life, yet failing to find any satisfactory way to solve them out. Finally, he put forward his methods: in the field of production, the efficiency is considered to be in the first place in order to increase the social production efficiency and the social wealth. In the field of redistribution, the inequality is supposed to be eliminated by the government policies to achieve the target of income equality: the progressive income tax, the social insurance, the social welfare and etc. All the above is called the equality target of the public fiscal policy. We can see that public fiscal target is rightly keeping the balance between the contradicted equality and efficiency. At the same time, it emphasized particularly on the side to solve the social inequality.

The resource of Okun’s policy opinion and its contradiction
Okun’s proposal originated from Keynesianism and Welfarism. Keynesians think that in order to eliminate the inequality brought from the economic crisis, the government mainly increases its expenditure and hold up public projects to stimulate the effective demand and deal with the large amounts of unemployment. Next step is to decrease the polarization of wealth distribution by the progressive income tax, the property inheritance tax and etc. Particularly, welfarists strongly support to reduce the differences of the social members by such policies as expanding the social welfare and the social security by redistributing the national income. In some high welfare countries, the expenditure of the social welfare occupies over 30% or 40% of their GDP.

The contradiction of the fiscal policy target
However, after the public fiscal policy is carried out, new side effect appears when time went on. As the welfare treatment is too high to restrict the employers’ enthusiasm for work, “Lazy-boned economy” gradually raises its head. Because “If each family of four can be promised to get 5000 dollars” as their subsidy, then “those who cannot be paid 5000 dollars though working will give up their job”, and “those who put themselves on the edge of exhaustion only to 6000 dollars will prefer to do nothing and get free 5000 dollars at the same time”. The government has to raise the taxation, which greatly prevent enterprises and employers from enthusiastic working because of the excessively high expenditure of the social welfare. In some high welfare states, the economy grew slowly because of the heavy fiscal burden. For example, in the 1980s, Swedish social security expenditure occupied 17%of the GDP, which rose to 60% in the 1990s, largely

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exceeding the GDP growth. The economy increased slowly while the labor productivity decreased.

It proved by the fact that the public fiscal policy appeared to eliminate the inequality. On the other hand, the overdoing welfare policy still harmed the efficiency, at the cost of giving up the efficiency. The contradiction of the equality and the efficiency was still in function.

2. The dual target of public fiscal policy
Focusing on the appearance of the welfare countries and the corresponding disadvantages, neo-liberalism heavily attacks the opinions of welfarism.

Neo-liberalism’s value of the equality and their evaluation
In neo-liberalism’s point of view, it took for granted that we should strive for “equality” as a social target. However, if the government carried out such measurements as “income equalization” or “equal wealth distribution”, they would only damage the market orders and reduce the effect by the market on stimulating the efficiency, so that the inequality enlarged its way. They addressed “equal opportunities” as their value of equality. They thought that it was important to supply equal opportunities for the competitors in the aspects of employment, promotion, income accumulation and so on, in order that the lower-paid employers of capacity can automatically caught up with the higher-paid ones, through which the equality target was accomplished.

I cannot totally agree with the neo-liberalists’ opinions, though it is correct for them to combat the exaggeratedly emphasized effect on achieving the equality target by the redistribution of the national income and locate the importance of the equality target policy in the fields of production. They are regarded as the most valuable parts of the neo-liberalism’s theory. Despite of the inequality of the assets’ ownership, the main cause of the income inequality comes from the fields of production, e.g. the large amount of the unemployment causing the income distance between the employed and the unemployed; the unbalance of the industrial structure making the incomes of professionals different, for instance, in 1998, the income gap between the employers in well-off industry and the poor industry was 4.3:1, and the highly-paid professions mainly collected in the fields of finance, portfolio, insurance, realty, electric power, post and telegram, traveling; the unbalanced regional productivity resulting in the different inhabitants’ income in the advanced areas and the poor districts. These above factors are highly and closely related to the efficiency target and the equality target. When the laborers’ skills are no longer in discrepancy, the differences of payment will be diminished to equal; when the employment rate is largely raised, the unemployed will find jobs in large amounts, then the social members will get equal incomes; and the income of professionals will approach to the average after reaching the equilibrium; finally when the reasonable regional industrial distribution is achieved, the discrepancy in the inhabitants’ incomes in different regions will also be decreased.

Therefore, the elimination of the above causes cannot only promote the efficiency increase but also the income equality. The public fiscal policy is supposed to put the focus in the fields of production in order to harmonize the contradiction of the two targets: the efficiency and the equality.

In the contrast, the too excessive systems of the social welfare and the social insurance are in fact another kind of averagism in another form. The methods to solve the distribution problem that fetching the higher to patch the lower can neither deal with the wealth discrimination of the social members nor relieve the government from the heavier expenditure burden. Then the taxpayers lose their passion in working. As a result, the economy faces its difficulty in the way of development.
Of course, the main weakness of the neo-liberalism the theory is that: excluding the income equilibrium, the neo-liberals regarded the equal opportunities as the social target, which disabled income as the controllable target for the government. It was long-termed and suffering to only provide equal opportunities while completely depending on the rule of competition in market, automatically decreasing the discrepancies in laborer’s skills, adjusting the production structure and close the income gaps between industries. And it cannot solve out the urgent political problems in the society brought from the income inequality.

**Two different kinds of public products**

After the analysis of the different opinions on the value of equality, we can see that it is far from enough for the public fiscal policy to look the equality as the sole target. In order to harmonize the relationship between the efficiency target and the equality target, the public fiscal target is supposed to be dual: probably avoiding the efficiency lost at the same time when achieving the equality target to stimulate the efficiency increase. The category of the public products is the foundation of the dual targets.

There are two kinds of public products produced by the social finance: one is the transferring expenditure, which includes the social welfare expenditure by the government such as annuities, subsidies, unemployment alms and so on. The more this public products exist, the higher payment the social members enjoy, and the more intensive the social equalization becomes. However, as the huge amounts of the social welfare expenditure, the government has to increase the social security tax, so that the taxpayers (including enterprises) reduce their passion for working and production efficiency by the heavy tax burden. The efficiency was attacked. I call this kind of public products as lower-efficient public products. The input of this kind of products is necessary without doubts. They are important to stabilize the whole country, especially when coping with the urgent events. However, in the whole quantity of the public products, they should be limited in a certain proportion instead of large quantities.

The other kind is the exhaustive public expenditure, which is that the government achieves its economic goal by means of buying regular commodity, capital products, labor and services to occupy and use the social resources. Usually they are those infrastructures provided by the government to develop the economy: roadways, transportation systems, environment and sanitation systems, investments in health and education, etc. Such kind of public products have dual investment targets. They both achieve the equality target and stimulate the economy, called the higher-efficient public products, which are closely related to the equality target and the efficiency target.

The exhaustive expenditures can further be subdivided into two kinds. One kind is only related to accomplish the efficiency or to the general public welfare, such as nationwide railways, nationwide epidemic protection stations, zoological water conservancy projects and so on. When these public products stimulate the economy, they expand the opportunities of employment and provide equal public welfare services. So they are called ordinary higher-efficient public products. The other one can directly diminish the income gap between the well-off and the poor to achieve the equality target as well as stimulate the economy. For example, the national stratagem economic department put money in the governmental investments, the public infrastructures in poor regions, employment training in high-rated unemployment areas. These public products have the powerful impelling force in the aspects of improving the industrial structure and the regional industrial distribution, increasing the laborers’ skills and promoting the efficiency of economic growth. At the same time, they can rapidly diminish the income discrepancy in different industries among regions and in the unemployed and the employed, in order to reach the equality target. Therefore, they are called as the specific higher-efficient public products.
Therefore, as a tool of the public fiscal policy, the governmental expenditure necessarily focuses on the fields of production, and regards the specific higher-efficient public products as the pivot of the investment. In order to provide resources, transportation and telecommunications for the local region and the economic department, the government applies the fiscal investment to strengthen the weaker links of the economic structure, such as the infrastructure constructions in the rural areas and poor regions. The policy can in long-terms promote the economic efficiency and basically increase the inhabitants’ incomes in order to achieve their income equality in urban and rural districts, in the advanced and poor areas. In the whole quantity of the governmental expenditure, the social welfare expenditure is still necessary yet to be controlled in a reasonable range.

3 The dual utility of the Chinese fiscal policy
When China faced the situation lack of investment and consumption, a new fiscal policy issuing the government bond for 660 billion RMB and arranging 6620 investment projects for governmental investment --the so-called “Chinese Roosevelt’s new policy”— made its appearance in 1998. As the Chinese public fiscal policy mainly invests in the projects of specific higher-efficient public products, the dual policy utility of the equality and the efficiency can be initiated.

The investment in public products promoting the inhabitants’ income equality in different regions
In this public fiscal policy, Chinese government put most of the public projects in the western poor regions, which largely improved the traffic infrastructures and regional distributions of the productivity the west. Along with the economic development, we shall also increase the income of the western inhabitants to diminish the income gap between regions.

In the fields of railway, roadway and airport constructions, 24 new airports were completed into use by the end of 2000, which are located in the west as Yinchuan, Lanzhou, Wulumuqi, Baotou, Chongqing, Xining. Two events (Tibet-Qinghai Province railway was set to start working and the southern Xingjiang railway was put into use) had the decisive meaning to develop the west. Especially, the increasing appropriations of the railroad constructions in the poor mid-western towns help them get rid of poverty. The mid-western colleges were also appropriated more subsidies in the educational facilities.

After these policies carried out, the western economy obliviously turned out to light. In figure 1, we can see that in 2001, despite that the industrial growth was slightly less than that of the east, the investment growth increased 6% more than that of east, also did the growth of the social retail quantum. In 2002, the investment growth of the west still kept its leading role as 20.2%, when that of the east was 16.2%, and the middle was 20%.
The comparasion of the guidelines in the east, the middle and the west in 2001

<table>
<thead>
<tr>
<th></th>
<th>east</th>
<th>middle</th>
<th>west</th>
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<tbody>
<tr>
<td>Investment growth</td>
<td>13.3</td>
<td>12.8</td>
<td>9.6</td>
</tr>
<tr>
<td>Industrial growth</td>
<td>16.3</td>
<td>11.8</td>
<td>3.5</td>
</tr>
<tr>
<td>Social retail quantum</td>
<td>19.3</td>
<td>5.1</td>
<td>3.4</td>
</tr>
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The conduct of the public projects powerfully impelled the economic development in the west. In the aspects of the income and the consumption expenditure, the discrepancy decreased between the western regions and the others. In 1995, the yearly income per-capita in 12 provinces of the west versed the national average as 1:0.88. In 1999, the data rose to 1:0.91 when the yearly consumption per-capita was also raised from 1:0.90 to 1:0.94.

<table>
<thead>
<tr>
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<th>1995</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
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<tbody>
<tr>
<td>Yearly income per-capita</td>
<td>0.88</td>
<td>0.91</td>
<td>0.87</td>
<td>0.88</td>
</tr>
<tr>
<td>Yearly consumption per-capita</td>
<td>0.90</td>
<td>0.94</td>
<td>0.91</td>
<td>0.91</td>
</tr>
</tbody>
</table>

The comparison: the income and consumption expenditure in 12 provinces of the west with that in the country (the whole country=1)


The investment to diminish the gap in the income of different industries

This public fiscal policy promotes the industrial upgrading by large amounts of money: discounting the interest rate on the equipment renovation projects in 880 highly new technology and stratagem departments, emphasizing on high technology industrialization projects such as the great evolution in new materials exclusive projects, network exclusive projects. High definition TV system for testing made its success, either did the receipt machine. The exports of the high technique products by rare earth material were raised from 38% to over 70%. The next step was to strongly support the exports of the foreign trade through several adjustments on the tax: the export drawback reached at 62.2 billion RMB when the integrated drawback rate reached at 15%, so that the export trade was effectively promoted. The measurements above expanded the employment and diminish the income gap between different professions as well as promoting the reasonable industrial structure.

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1 Kang Jia: The retrospect and evaluation of the Chinese fiscal policy published in The Collection of discussions on Finance 1st section in 2003
The investment in the infrastructures of the countryside to promote the income equality in the cities and villages

In recent years, the inhabitants’ income discrepancy in the urban regions and the rural areas is increasing. This fiscal policy focused on the investment in the infrastructure construction of the countryside to improve the farmers’ production, life and electric power conditions in order to get the dual utility of the equality and the efficiency.

For a long time, the electric networks in the rural areas are poor and old enough but highly priced, which was three times, five times or even ten times as expensive as what was paid in the cities. The TV signal was too weak to receive that no TV program could be seen in many regions. 49.7% of the rural areas had no running water, which strictly limited the consumption for color TV sets, refrigerators and washing machines.

At the end of 2000, there were about 1000 towns and villages invested by the government in the rural electric network construction. The electricity tariff largely reduced to encourage the farmers to use electricity, especially the electricity tariff for farmers’ daily life averagely decreased 0.1RMB-0.3RMB per thousand watts. In 1999, the electricity quantum used in rural areas increased 9.47%, obviously higher than the social level 6.54%. One month after the electric network was constructed, in a village farmers bought more than 30 air-conditions. The construction of the electric network turned out to have great influence on stimulating the rural consumption and the popularization of the electrical machines used in the countryside.

The money from the national bond was in part put in the infrastructure constructions in towns and villages. At the end of 2000, there were 556 infrastructure constructions being finished and put into use. They could strengthen the urban capacity of running water by 18.86 million tons, gas supply per day by 7.08 million cube meters, the networks and tunnels of drainage and coal gas by 1585 kilometers and deposition of slop by 8.24 million per day. These constructions largely improved the style of farmers’ life and consumption by leading the rural kitchen revolution, toilet revolution and housing revolution. Farmers began to use modern styled toilet and kitchen, the washing machines and refrigerators, which strengthened the their capacity of consumption and indirectly stimulated the economic development.

At the same time, the government reduced the farmers’ taxation by several measurements to increase their income in direct ways. Above all, the farmers’ net income growth fell down to the lowest 1.9% in 2000, but went up to 4.8% in 2002 again.

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</tr>
</thead>
<tbody>
<tr>
<td>The net income growth</td>
<td>22.1</td>
<td>8.5</td>
<td>3.4</td>
<td>2.2</td>
<td>1.9</td>
<td>4.2</td>
<td>4.8</td>
</tr>
</tbody>
</table>


Control a certain scale of transferring expenditure

This fiscal policy still put quite amounts of investment into such transferring expenditure as social alms and social indemnification to diminish the income discrepancy of the social members as well as actualizing the exhaustive expenditures. 54 billion RMB was applied to increase the income of the poorest and lowest social members, i.e. the insurance for those unemployed, the living wage for inhabitants, so as to increase the income of the officials, the staff in state-owned schools and the retirees. 84 million people were benefited in this way in the whole country. We can see that the transferring expenditure still occupies the important statue of the governmental expenditure, whose proportion is controlled within a range of 10%. Therefore, at this time, the fiscal policy possibly tries its best to avoid attacking the efficiency.

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The validity of the equality target and the efficiency target

Firstly, in the aspects of the efficiency, the government directly stimulates the economic growth to retort the tendency of continuously decreasing industrial growth for five years.

Table 3: The contribution to GDP from Chinese fiscal policy (from 1998 to 2001)

<table>
<thead>
<tr>
<th>Year</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rate</td>
<td>1.5%</td>
<td>2%</td>
<td>1.7%</td>
<td>1.8%</td>
</tr>
</tbody>
</table>

Reference: Kang Jia from Finance Graduate School of The Finance Department: *The brief retrospect and utility evaluation for Chinese fiscal policy*

Secondly, in the aspects of the equality target, the Gini coefficient decreased.

When China got rid of the planned-economy by highly centralization and absolute income equality, the main aim of China is to consider the efficiency first and also give attention to the equality. Then the social members’ income tended to be divided. In recent years, the World Bank continuously reported that the Chinese income gap had been expanding, which drew all the attention of the academia. (See table 4) The Gini coefficient once reached 0.418 in 1995, up the level of 0.328 of the highly income countries in the 1990s. After the fiscal policy was brought into effect, yet different from the various kinds of statistic results, the unified Gini coefficient was decreasing which decreased to 0.403 in 1998.

Table 4: The change of Chinese Gini coefficient

<table>
<thead>
<tr>
<th>Year</th>
<th>0.33</th>
<th>0.288</th>
<th>0.376</th>
<th>0.418</th>
<th>0.403</th>
</tr>
</thead>
</table>

Reference: The development report of World Bank for each year.

4. The limitations of public fiscal policy

The limitations of the boundary conditions

In order to achieve both of the targets—the efficiency and the equality, it is impossible for the public fiscal policy to be conducted without any conditions. On the contrary, it is restrained by the boundary limitation. The boundary condition of the policy tool is one of the foundations in the science of economic policy established by J. Tinbergen, who won the noble prize in economics. The boundary condition means the ultimate value of the policy tool determined by the factors in politics, economy, psychology, and so on. When the economic policy overpasses the ultimate value, it will cause the lost in politics and economy. For example, the excessively high tax will result in tax evasions; and too low wage rate will cause social chaos. Therefore, in order to achieve both of the targets—the equality and the efficiency, we should pay attention to the restraint of the boundary conditions. As long as we break the boundary conditions, we will be involved in the
conflicts with the above two targets. So, we are supposed to adjust the policy in time to keep the politics and the economy out of danger.

The Chinese fiscal policy collects money for the public projects through issuing national bond in large scales. However, huge amounts of the national bond are far beyond the boundary condition. In 2002, the guideline to show the national bond dependency (The amount of the national bond issued/ the central government’s financial expenditure) was 15% further beyond the boundary condition, which was raised to 42%\(^5\) in 2002. Occupying 3.03% weight of the whole GDP, the deficit was also 3% further beyond the boundary condition to form the high risk of Chinese financial credit.

The limitations of the equality target and the efficiency target
After the Chinese fiscal policy’s conduction, the nongovernmental investment growth decreased when the state-owned investment growth obviously increased. In 1999, the state-owned investment rose up 5.1% when the collective economy leveled up 3.8%, and the private economy with its rising up as 3.5%; In 2000, the investment’s amplitude approached to 12% in the state-owned enterprises and the companies when that of the nongovernmental investment was only about 6%. Large amounts of nongovernmental investment were in their disadvantages. The whole society depended on the state-owned economy, which would be in the obstacle of the economic development.

Next, the Chinese fiscal policy mainly stimulates the investment of the in-between consumption, yet slowly affecting on the ultimate consumption. It failed to change the inhabitants’ anticipation of the consumption for the future. The price of the retail commodity was continuously decreasing: In 2002 the price was reduced by 0.8% when the commodity in the situation of supply exceeding consumption was more than 70%. The ascending unemployment rate showed that the ultimate reason to expand the income discrepancy of the social members was still waiting for elimination. (See table 5)

<table>
<thead>
<tr>
<th>Table 5</th>
<th>Chinese main guidelines from 1996 to 2002</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail price index</td>
<td>6.1</td>
<td>0.8</td>
</tr>
<tr>
<td>The unemployment rate registered in towns</td>
<td>3.0</td>
<td>3.1</td>
</tr>
<tr>
<td>The commodity’s supply and consumption structure</td>
<td>10.8</td>
<td>23.91</td>
</tr>
<tr>
<td>Supply &gt; Consumption</td>
<td>2.17</td>
<td>4.35</td>
</tr>
<tr>
<td>Supply = Consumption</td>
<td>87.00</td>
<td>71.74</td>
</tr>
</tbody>
</table>

The data of 2002 was concluded according to the information in www.stats.gov.cn

This fiscal policy effects slowly in the aspects of achieving the equality target. As the government mainly invests in the fields of production, and the infrastructures in the poor regions and rural areas, instead of directly increasing the inhabitants’ profession incomes in those districts. So, the policy’s influence on increasing the income of the social members and diminishing the income discrimination seems to be in effect after a long period of time of developing. In short terms, such influence is not obvious enough. For example, firstly, the registered employment rate of the urban residents was continuously ascending, indicating the existence of the income discrepancy; secondly, the discrepancy in the inhabitants’ income of different regions was also expanding in several years after 1998. (See Table 1) The income yearly income and expenditure per-capita of the 12 provinces in the west were falling back in 2000 after the rising up in 1999.

\(^5\) The above data of the dependency on the national bond was calculated according to the result that the issuing of the national bond was divided by the central government’s expenditure. If we calculate it according to the central level itself, the data reached over 70%.
Therefore, in the aspects of achieving the equality target and the efficiency target, there still exist limitations and transitions. After a period of time of carrying out the policy, we need to fade it out and substitute for a new policy.

**Conclusion**
The eternal contradiction—the equality and the efficiency—is nothing but extricable. If the public fiscal policy emphasizes its focus in the fields of production, besides, invests in the public products highly and closely related to the equality target and the efficiency, not only the efficiency can be stimulated to increase but also the equality can be promoted. In this way, the dual policy targets can be accomplished.