

Webinar #4, 11th September 2024: Social rebalancing

"Despite Chinese governments social policy efforts over the past 10 years, the redistributive effect is simply not large enough yet"

This text is transcribed from a webinar hosted by CMG and edited for clarity and brevity.

Markus / CMG: Good afternoon in Asia and in China, good morning in European time zone. My name is Markus Herrmann. I'm the Managing Director of China Macro Group, CMG. Very warm welcome to our webinar today.

It's our fourth webinar in the third edition of the webinar series, "Staying in Dialogue with China", a European China Initiative, structured along six structural transitions in China's evolving political economy, today on social rebalancing with Professor Li Shi from Zhejiang University whom I'll introduce shortly.

To quickly advertise our newest CMG primer, titled "Xi's third Third Plenum pivots to implementation, doubling down on China's industrial ambition". You see the QR code here and it's also accessible on our website under "Insights". It offers three deep dives, one on how the three capital forms foreign, state and private are treated moving forward, one on the innovation value chain and a last one on China's emerging new industrial policy framework centered on the "new quality productive forces", as the Third Plenum is organizing a lot of different previous policy measures into frameworks.

Next, I would like to remind those who have previously joined webinars in 2024 or those who are joining for the first time that our webinar concept uses six structural transitions as the underlying structure. Briefly, we see the six structural transitions as the most important changes in China's political economy. So cumulatively, these structural transitions can explain a lot of the policy phenomena that foreign business needs to understand to make long-term decisions regarding the Chinese market.

The first structural transition is about economic transition from an agrarian to an innovation and service-based economy plus industrial upgrading. The second is market-oriented reforms, so the use of the market as an instrument, gradually and in a targeted way, plus market governance. Third, economic globalization, addresses both inbound and outbound flows of services and goods.

With the 14th Five-Year Plan, three more structural transitions have been added. The domestic demand system, so the focus on China's own market as a demand system, social rebalancing, the topic that we will be discussing today. And then finally, as a sixth structural transition, security, which was the topic of the report that we've written together with the European Union Chamber of Commerce in China, EUCCC, most recently. We are happy to debate this framework. My first question to Professor Li will be about the framework itself and how he sees the social rebalancing as one of the structural transitions in China's political economy.

Quick overview of the six webinars that we're going through. We're now top right, social rebalancing, today with Professor Li. We're thankful to all the cooperation partners, to our anchor partner, Caixin Global, and we're very happy to host this webinar series.

Finally, it's my pleasure to introduce Professor Li Shi, professor at the School of Public Affairs at Zhejiang University and Dean of the Institute for Common Prosperity and Development at Zhejiang University. Moreover, Professor Li, is a research fellow at the German Institute of Labor Economics, a member of the Academic Committee of the China Development Research Foundation and a member of the NDRC Expert Committee for the 14th Five-Year Plan. Prior to this, Professor Li held positions in expert advisory committees of various state organs, including the Ministry of Human Resources and Social Security, the State Council's leading group on poverty alleviation, and the Ministry of Agriculture and Rural Affairs. His research focuses on China's income and wealth distribution, labor and employment, plus social security.

In terms of logistics, we have 45 minutes. I will weave in your questions when they suit, so please use the Q&A box. You also heard that we are recording the session, but we will not distribute the recording, but share a transcript of this webinar after a few days.

So now having introduced you, Professor Li, thank you so much for joining from sunny Hangzhou today, as I can see on your face. The first question I'll give to you directly is the question of how you think about structural transitions in China's political economy and the idea that social rebalancing is one of them.

Li Shi: Okay, thank you, Markus, for inviting me to join this dialogue. It's really my pleasure indeed. My general comment on the framework is that it is very important for China to complete these six transitions in the future. You know China used to be a planned economy. So, from 1978, China started to transition from a planned to a market economy. Even China has been carrying out these transitions for more than four decades, they are still not completed. There is still a long way to go for China.

Because these transitions touch economic, political and social aspects, which are complex in China. I think these transitions are important for China's future: if China cannot continue to transition from a planned economy to a completed market economy, and cannot make a transition in the political system, China cannot be a modern society.

Markus / CMG: Professor Li, to link to your area of research and also the focus of your institute, how do you see the overall state of China's income and wealth distribution today? What are the main issues and solutions?

Li Shi: Okay, when we talk about income inequality in China, we should look at the long-term change over the last four decades. At the beginning of economic reforms in the late 1970s, income inequality was quite low. According to different research, the Gini coefficient of income distribution in China was about 0.3, which is quite low compared to other countries, even European countries. But in this process of economic reforms and economic growth, income equality inevitably increased over time.

After 30 years of economic transition, by 2008, the Gini coefficient reached almost 0.5, its highest level in the past 40 years. After 2008 until 2016, the Gini coefficient declined slightly from 0.49 to 0.46, it decreased by less than 3 points. But after 2016, income equality became stable, somewhere between 0.46 to 0.47, fluctuating from one year to another. So, income inequality stopped further declining.

Prior to this stabilization, there were two key dis-equalizing factors at play.

First, in the last 20 years household incomes increased very fast. China conducted housing reforms, some public housing became privatized and private property, with housing prices rising enormously which allowed some people to enjoy a very fast household income growth, or property income, coming from wealth increase. So large wealth inequality led to the larger income inequality among households.

Second, another contributor to rising income inequality is the income or wage gap between highly educated and less educated people because China has new industries which really demand a more skilled workforce. So, they pay high wages to these skilled workers with very good education background.

In turn, there are also equalizing factors, especially redistribution policies. Because in the last 20 years, the government paid more attention to reducing income inequality, particularly the income gap between urban and rural areas. So, the government issued policies trying to reduce the income gap between urban and rural areas, trying to stimulate faster growth of the household income in rural areas, e.g. via more subsidies, better welfare for people in rural areas, and more income transfers to these peoples. So, if you look at income growth of rural households over the past 20 years, it surpassed that of the urban households, while the rural income gap became smaller, fundamentally driving the income inequality decrease in China.

But now we're still facing three key problems. The first problem is that the income gap between rural and urban households is still large compared to other countries. This accounts for a larger part of the overall inequality in China. So, we continue trying to reduce the income gap between the urban and rural areas.

The second problem is that despite Chinese governments social policy efforts over the past 10 years, I think the redistributive effect is simply not large enough yet. China should put even more emphasis on redistribution policies, for instance there should be more transfers to lower income groups and rural people.

The third problem is that China still has a large divergence in the access to public services between rural and urban areas and amongst different regions, like coastal and inland China. I think this is really a big challenge.

Markus / CMG: Professor Li, when do you expect the party and the central government will start introducing new taxes such as property tax?

Li Shi: I think five years ago, there was a lot of discussion in China about whether the government should introduce property tax because household wealth increased rapidly, resulting in a rising wealth inequality.

But in recent years, China's economy was not as good as before and economic growth slowed. So, I think the government is worried about introducing the property tax, and its negative impact on economic growth, it could make the real estate sector go to the worst situation. When the Chinese economy is recovered, the Chinese government should consider introducing the property tax. The government has the intent to introduce it, but the timing now, which is important, is simply not so good.

Markus / CMG: Professor Li, earlier you listed three main issues of what would you say are the key factors that inhibit central government from tackling them more forcefully? Is it again the economic situation?

Li Shi: You are right. The current economic situation is not as good as expected. Stimulating economic growth is becoming a priority of the government. For instance, three years ago, the central government put forward the concept of "Common Prosperity" and asked Zhejiang province to do some experiments in this direction, which

implies two development goals. On the one hand, China should have faster economic and thus also faster household income growth. On the other hand, this means China should achieve a goal of significant smaller inequalities in all dimensions. Given the difficult economic situation, Zhejiang now focuses on three big issues. First, reduce the inequality between urban and rural areas, second, reduce regional disparities and third, reduce income inequalities, which is less ambitious.

Markus / CMG: Professor Li, your institute has been founded in June 2021, just three months after the 14th Five-Year-Plan was formally adopted by the NPC in 2021. Could you give the reasons why Zhejiang was selected as a pilot zone, and what are the main findings from policy measures that have been experimented with?

Li Shi: Zhejiang was chosen by the central government not as pilot region but as a demonstration zone. The demonstration zone means Zhejiang moves first towards "Common Prosperity" as a long-term development goal, before this initiative is spread to the whole country. As a matter of fact, the central government set up the agenda to realize "Common Prosperity" in the next 30 years.

So why did the central government choose Zhejiang?

I think there are several reasons. First, Zhejiang province was not so advanced in the 1970s, as there was less investment in Zhejiang than that in other regions as it is close to Taiwan, but then it developed really very fast and became one of the most advanced regions in China.

Second, Zhejiang has a more market-oriented approach, very different from e.g. its neighbor province Jiangsu. As a matter of fact, Zhejiang has a very high share of the private sector.

Third, I think the political governance in Zhejiang is very efficient and effective compared to other provinces. So, it's less bureaucratic and officials are closer to the people.

However, so far, it is hard to evaluate anything as time has been short, it will take 5 or 10 more years. That future evaluation would show the positive experiences which can be copied by other provinces.

Markus / CMG: Just to briefly supplement the fact that Zhejiang province, with 65 million population, is at scale of France, with 67 million. So, this demonstration zone is a large European country. My follow-up question is what is being concretely experimented? Have any new policies been introduced on Zhejiang level?

Li Shi: I think Zhejiang is in a very difficult situation, based on my experience in Zhejiang, when talking to local officials or joining conferences here in Zhejiang.

Why? Because the central government really hopes Zhejiang does well, and has very high expectations.

But, to make notable progress, Zhejiang needs to introduce new policies. But the governance generally is centralized, for the economy and the society. So, Zhejiang tried to get autonomy in making such policies, because when you want to reduce income inequality, you should change the tax system. But in China taxation policy is made by central government. For the local governments, if they want to change the structure of financing and public expenditures, they first need to get approval from the central government.

Zhejiang wants to reduce the income gap between urban and rural areas, which is actually the smallest compared with other provinces, for instance with more transfers to rural households. Further, it wants to reduce regional disparities, because there are still some mountainous areas in Zhejiang, which are less developed compared to Zhejiang's coastal regions, via regional transfers and assistance to these mountainous areas, plus increase the expenditures on public services in mountainous areas. Finally, they want to reduce income inequality, which is really a puzzle, even me who has been studying income inequality for more than 30 years, I really don't know how large it is in Zhejiang province. Why? Because there is no data.

Markus / CMG: Two more specific questions on the Zhejiang demonstration zone. First, does Zhejiang have specific KPIs for the long term? Second, to what extent do you think lessons from Zhejiang can be translated to much less developed regions like Gansu province or Xinjiang?

Li Shi: Let me answer the first one first. No, we do not have such indicators indeed.

For your second question, I think some good experience of Zhejiang can be copied by other provinces like Gansu, even if Gansu is a much less developed area. But I think some experiences Gansu should consider learning from Zhejiang are: first, try to develop a private sector first. So, for instance, try to complete the market reforms as soon as possible, try to reduce interference by government into economic activities. Second, it should provide universal, more equal and effective public services to all people. Third is to have good governance.

Markus / CMG: *The Third Plenum put forward an entirely new reform measure on strengthening local government's sovereign financing capacity and to expand tax income sources (增加地方自主财力, 拓展地方税源). Will this provide the policy basis for Zhejiang to take action?*

Li Shi: The central government now encourages local governments to find some revenues from different sources. It's not so easy to implement, because you see, nowadays, the tax rate for enterprises or households is already high, letting them shoulder a big burden. So, this depends on the local governments. If they want to really have some policy to stimulate economic growth, I think they should reduce tax, not increase it. So that is really the dilemma. And, thus, I think in this economic situation, most local governments cannot or will not introduce new taxes.

Markus / CMG: Do you agree that the "Third Plenum" puts more focus on the "supply" and industrial side as opposed to the "demand" or social policy side?

Li Shi: My personal opinion is that China has problems with the supply-side, but it will take a long time to build up a more efficient supply-side system. But the now emerging problem is the "demand side", also consumption is low and people have low confidence, even some enterprises have low confidence.

The government believes that increasing investment will create more demand for labor providing income and then stimulate consumption. But I think this is really a long way to reach this objective. So, I would suggest to give out cash money to some lower income groups, because we still have very large share of lower income group people in China. So, their income is just around the poverty line. If the government can give some cash transfer to these people, this would have an immediate effect on consumption.

Markus / CMG: Prof. LI, in your research, when you look outside of China, are there also lessons that you are trying to take from other countries related to social rebalancing that you use in your policy advice that can be relevant to the specific conditions of China?

LI Shi: Yes, I have been to Europe, UK and Sweden many times. I have a professor colleague in Gothenburg University, from whom I learned something about the welfare system in Sweden, and I also gave some suggestions to the Chinese government.

Essentially, we should build up a more generous welfare system in China because if you have the market economy, that means the market economy automatically will lead to an increase in inequality, plus government should do redistribution by providing some welfare program for the low-income people.

Markus / CMG: Professor Li, I would like to close with a personal question. Your Institute of Common Prosperity and Development has been set up in 2021. What are you most proud about in leading this Institute and what keeps you awake at night? What are the challenges you face?

LI Shi: Thank you for your question. Yes, this institute was set up at Zhejiang University and I was asked to lead it as a Director. I really feel very proud of being involved in some research projects which the institute has conducted. Some projects come from the central and some from provincial government. Also, we have a lot of connections with local governments and local people in the Zhejiang province.

I'm very happy to work with my colleagues and also with some local officials because when you go somewhere you can learn a lot from what they are doing in some cities, counties or villages. So, I think that is very important for a research institute. When you do theoretical research, you also need empirical studies, for instance learning the basic situation of the localities. So, today I know Zhejiang much better than five years ago.

When you ask me what challenge we face, I think the biggest challenge I mentioned before is data collection, for instance via household or enterprise surveys. But the data is always a problem in China, and we know that the government does not like to provide data to the public, so it is also more difficult to go somewhere to collect data nowadays than before. I think that's a big challenge.

Another challenge is that we think some research should be done together with some international experts. We would like to have more international cooperation. You know the situation is different and it has become so difficult nowadays to invite international scholars to come to China. Anyway, my attitude is always to remain optimistic.

Markus / CMG: Thank you, Professor Li, ending on your optimistic attitude, but also taking us through some of your challenges. I hope you can, in the interest of this very important demonstration zone, work effectively into the future. I would like to thank you again on behalf of everyone who is participating in this webinar for your precious time and good luck for your work. And we look forward to stay in touch and get an update. I also hope you will be in Europe more regularly for these international communications that you mentioned. So thank you very much for your time.

LI Shi: Thank you very much. It's really my pleasure.

For reference: CMG's political economy framework: six structural transitions

Political economy: China's pursuit of 'high quality development' taking place amid six structural transitions			
Key structural transitions	Key policy goals	Key issues	Key policies
Economic transition and industrial upgrading	<ul style="list-style-type: none"> Transition to innovation-based economy Climb industrial value chain Digitalization and decarbonization 	<ul style="list-style-type: none"> Service sector contribution to GDP low Manufacturing struggling at mid-end products, low industrial value-added 	<ul style="list-style-type: none"> <i>Made-in-China 2025</i> <i>Opinions on High-quality Development of Service Industry 2019</i> <i>14th FYP 2021 Ch. 8, 10.</i>
Market-oriented reforms and market governance	<ul style="list-style-type: none"> Institutional transition, factor liberalization, SOE reform and "SSSR" Socialist market governance incl. anti-monopoly, / 'social credit' 	<ul style="list-style-type: none"> Low TFP Lower efficiency of state capital Monopolies and overcapacity "Disorderly expansion of capital" 	<ul style="list-style-type: none"> <i>Building Market-Oriented System for Allocation of Factors 2020</i> <i>14th FYP 2021 Ch. 19-22.</i>
Economic globalization	<ul style="list-style-type: none"> Integration into global flow of goods, services, capital, talent and ideas Continued opening-up 	<ul style="list-style-type: none"> Comparatively weak trade of service Comparatively low outbound FDI stock Geopolitics and decoupling policies 	<ul style="list-style-type: none"> <i>14th FYP 2021 Ch. 40</i> <i>Opinion on Increasing Efforts to Attract Foreign Investment 2023</i>
"Domestic demand system"	<ul style="list-style-type: none"> Consumption-boosting policies Rebalancing of public investments Business environment policy 	<ul style="list-style-type: none"> Low consumption share to GDP Demographic shift to aging population Imperfect social security system 	<ul style="list-style-type: none"> <i>14th FYP 2021 Ch. 12-14.</i> <i>Strategic Plan for Fully Expanding Domestic Demand 2022</i>
Social rebalancing	<ul style="list-style-type: none"> Equality and poverty reduction Social fairness and protection Balanced regional development 	<ul style="list-style-type: none"> Inequality: top 1% holds 30% of wealth Vulnerability of social groups (e.g. youth) 	<ul style="list-style-type: none"> <i>14th FYP 2021 Ch. 23-32.</i>
Economic security	<ul style="list-style-type: none"> "Coordinate development and security" 	<ul style="list-style-type: none"> Import dependencies and perceived supply chain risks China's weaker geoeconomic power 	<ul style="list-style-type: none"> <i>14th FYP 2021 Ch. 41-42, 52-53</i>

Longer-term transitions

Trade-off / rebalancing processes



China moved from linear economic development model of reform and opening up under Deng to dealing with strategic trade-offs