

The Economics of China

Transformation Part 2



Fall 2020

Is China Socialist?

- More than 40 years ago, China's new leadership (Deng Xiaoping) decided to break with policies of the old leadership (Mao Zedong).
- 40 years later, is China still socialist?
- Long story short, the answer is: **No**.
- More than 20 years ago, Chinese leadership at the time used the term "socialist market economy" to describe China's economic system.
- However, in reality, in the 1990s (during the time of Jiang Zemin and Zhu Rongji) China became more like a "Wild West Capitalism".

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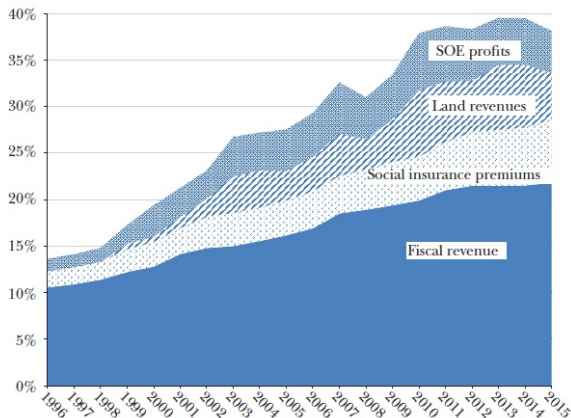
- In particular:
 - "In the 1980s and 1990s, as China's government surrendered much of its direct control over the economy, it gradually lost effective control over a sufficient share of national income to carry out a socialist program".
 - "Government tax revenues relative to GDP had declined dramatically, substantially limiting government capacity".
 - "Social service provision had collapsed in most rural areas; inequality soared and a new wealthy class emerged; and de facto privatization enriched a group of people".

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- "However, in the last 20 years this situation has changed dramatically". Well, not so dramatically.
- Today, China's economic system is a form of "state capitalism".
- That is, "China is a predominantly market economy in which government is unusually large, powerful, and intrusive".
- "Moreover, government ownership remains substantial and concentrated in strategic, large-scale, and capital-intensive sectors of the economy".
- This last point is similar to the Socialist Era. Hence, the confusion.

Is China Socialist?

Figure 1
Public Revenue in China
(% of GDP)



Source: Chinese government sources; for details, see Data Appendix available with this paper at <http://e-jep.org>.

Note: SOE is "state-owned enterprises."

Is China Socialist?

- How does public revenue in China compare with other countries?
 - In terms of fiscal (tax) revenues as a share of GDP, China today is above middle-income average and almost equal to OECD countries (mostly high income) average and above the USA.
 - In the 1990s, it was below low-income average.
 - Nonetheless, unlike high-income countries in which personal income tax is a relatively important source of tax revenue, the share of personal income tax of GDP in China was 1.3 percent recently.
 - The main sources of tax revenue in China are:
 - Taxes on goods and services (like value-added tax: 4.6 percent of GDP).
 - Enterprise income taxes (4 percent of GDP).
 - Transaction taxes (on land transactions and stock transactions, plus business and luxury taxes).

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- How does public revenue in China compare with other countries?
 - "Social insurance contributions in China were 6.8 percent of GDP in 2015".
 - "While lower than the level for OECD countries, this is high for a middle-income country".
 - However, unlike many high income countries which face an aging population problem, the Chinese population is still relatively young.
 - As a result, China's "social security revenues are consistently above social security outlays, so that its social security fund has an annual surplus (1 percent of GDP in 2015) and a relatively large and growing balance".

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- How does public revenue in China compare with other countries?
 - The next two sources of government revenue in China are: land revenues and State-Owned Enterprises (SOE's) profits.
 - "All land in China is publicly owned...Commercial developers pay local governments to lease development rights".
 - SOE's pay profit tax and a "proportion of after-tax profits to their governmental owners".
 - In addition, state-owned banks generate substantial profits.
 - Overall, land revenues and SOE's profits combined were 9.5 percent of GDP in 2015.
- Total public revenue (the sum of the four components discussed) in China was about 38 percent of GDP in 2015.

Is China Socialist?

- Does China's Government Own the Means of Production?
 - "In 1978, virtually all of China's productive assets were owned by the state or by rural agricultural collectives" as a result of previous policies that aimed at building a socialist economic system.
 - Today, the economic system is market-based, and ownership is mixed.
 - On one hand, "government ownership and control is evident in the more capital-intensive and the more human capital- intensive sectors".
 - For example, the government controls "the entire telecommunications and transport network; and essentially all education and scientific and technological services".
 - In addition, "government has maintained control over all land and almost all financial institutions".
 - One of the main goals of keeping government control over these sectors is to maintain the government's ability to "steer" today's market-based economy.

Is China Socialist?

- Does China's Government Own the Means of Production?
 - "For example, within a few months of the global financial crisis in 2008–2009, China mobilized an investment effort equal to over 10 percent of GDP".
 - "Crucial aspects of this investment surge included the ability to mobilize local governments to initiate infrastructure projects; state-owned banks to loan without restraint to those projects; and state-owned enterprises to undertake the business and construction work".
 - On another hand, private ownership is prevalent in "[s]mall-scale and labor-intensive services, such as retail and restaurants".
 - In addition, "the vast majority of Chinese workers are self-employed or work for firms" that are privately-owned.

Is China Socialist?

- Does China's Government Own the Means of Production?

Takeaway:

- Today, the Chinese government maintains control over sectors that it considers "strategic" or important, while private ownership is prevalent in other sectors.
- Unlike the Socialist Era, today's government ownership is part of "multiple ownership systems" in a **market-based economy**.
- This makes government ownership today different from the nationalization and land reform policies in the 1950s which transferred ownership of the means of production to the government and agricultural collectives as part of building a socialist economic system.

Is China Socialist?

- Does the Chinese Government Self-Consciously Steer the Economy?
 - Government intervention exists, in different shapes and for different reasons, in almost all countries with capitalist economic systems.
 - However, government intervention in the case of China has some distinctive features.
 - 1. Pro-Growth Incentive System for Bureaucrats
 - 2. Planning
 - 3. Interactions Between the Two Types of Steerage: between complementarity and tension.

Is China Socialist?

- Pro-Growth Incentive System for Bureaucrats:
 - "China's system of incentives for local bureaucrats to encourage growth is extremely unusual, and seems to exist only in China".
 - "Chinese policymakers have seen value in linking the career incentives of local officials with the economic performance of that locality".
 - "Beginning in the 1980s, formal 'target responsibility systems' established targets—or success indicators—for bureaucrats at all levels and gave them explicit weight in an evaluation function".
 - "These targets were predominantly economic, with GDP growth and increase in fiscal revenues the most important".

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- Planning: National five-year plans in addition to local plans.
- Three elements of recent plans in China:
 - 1. A vision statement.
 - 2. A handful of binding targets.
 - 3. A panoply of associated sectoral and local plans.
- 1 & 2 are not unique to China, and are present in market-based economies.
- "for example, the state of California, where binding targets are established through legislation and regulation".
- However, 3 seems to be absent in today's market-based economies, which makes it a distinctive feature of China's economy.
- The main goal of planning in China has been to promote growth and development. Recently, sustainability goals started to show up as well.

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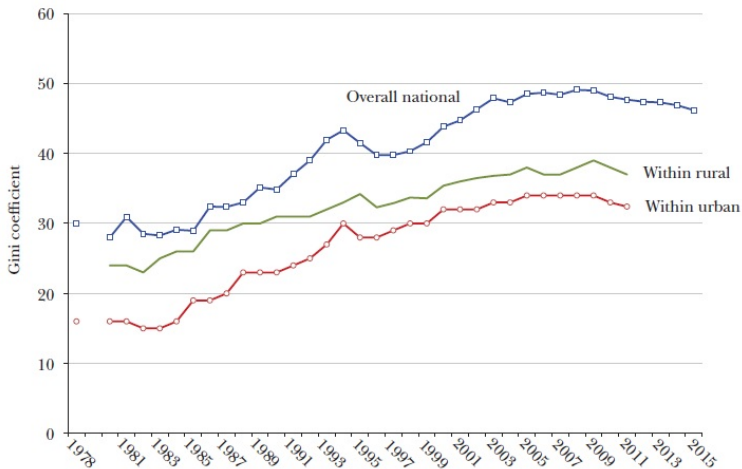
- Inequality:

- Recall that one of the elements of the development strategy of the Socialist Era was that growth had to go hand in hand with distribution.
- By the end of the Socialist Era, China was "one of the most equal large-population societies in the world".
- In contrast, inequality started rising in China shortly after abandoning Socialism and transforming to market-oriented policies.
- As a result, "China has become a relatively unequal society".
- At a national level, inequality remained on an upward trend until it peaked in 2009, after which it started to fall.
- In addition, the urban-rural income gap grew during this period.
- "Average urban incomes were less than twice rural incomes in 1983, at the minimum, and increased to 3.3 times rural incomes in 2009".

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Figure 2

Evolution of China's Gini Coefficient



Source: Author's calculations based on official household survey data.

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- Poverty:
 - When it comes to the reduction of extreme poverty, performance was much better.
 - The number of people in rural areas living below the poverty line dropped from 260 million in 1989-1992 (when the total population size was 1.1-1.2 billion) to 56 million in 2015 (when the total population size was approximately 1.4 billion).
 - "According to World Bank data, the reduction in the absolute number of those living in poverty in China between 1981 and 2010 accounted for 95 percent of the total reduction worldwide of those in poverty".
 - "China has had an active policy of targeting poor counties since 1986".

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- Redistribution:
 - Since abandoning Socialism and transforming to a market-oriented system, the government largely resigned from redistributive policies, at least until recently.
 - "The social safety net in the countryside, tied to the agricultural collectives, had collapsed".
 - "transfer payments of all kinds are low".
 - "In the mid-1990s, China was doing almost nothing to redistribute income".
 - "The only social insurance system that remained intact was the one protecting urban workers in state firms, and that system was threatened by the dramatic downsizing of the state sector".
 - In the past one/two decades, some efforts were made "toward re-establishing at least a rudimentary welfare system that covers its entire population".
 - However, progress in this direction has been slow.

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- Public Goods: A couple of examples.
 - Infrastructure: China has done well in this field, over the past 20 years.
 - "China is now knit together with a complete grid of highspeed limited-access highways, and is well on the way to completion of a similar grid of high-speed rail".
 - "This rail system is not only far and away the largest high-speed rail network in the world, but it also seems poised to ultimately create a high-speed transportation network that goes beyond China's borders".
 - Environmental Quality: was not on the agenda until recently.
 - Recently, "serious measures began to reduce the emission of air and water pollutants and create conditions for an improved environment".
 - China seems to be following "a standard 'environmental Kuznets curve'—the observed pattern in which environmental damage increases in the early stages of economic development but then is reduced in later stages (Dasgupta, Laplante, Wang, and Wheeler 2002)".

Is China Socialist?

- Conclusion:

- Since 1978, and in particular through the 1990s until early 2000s, "political leaders like Jiang Zemin and Zhu Rongji were leading China away from socialism" toward an extreme version of capitalism focused solely on GDP growth.
- Today, China is still a market-based system, albeit with growing government involvement compared to 20 years ago.
- In addition, in recent years, the need for redistributive (and environmental protection) policies has come to China's new leadership attention, and initial steps have been taken in that direction.
- If we apply the definition of Socialism from last week (or even more flexible definitions), **China today is not a socialist country.**