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Spreading the wealth: Common Prosperity may start to address inequality in China

NAB Group Economics

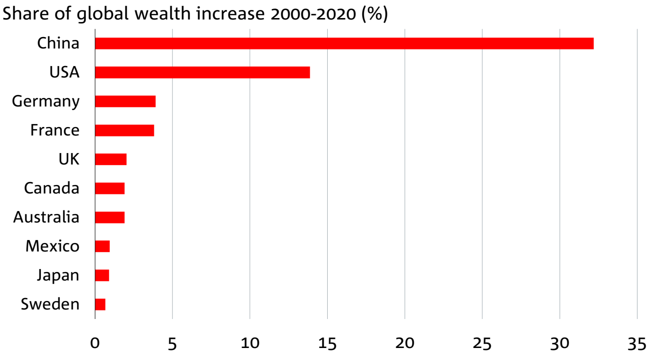
China's rapid industrialisation over the past two decades has generated an enormous amount of wealth in the country, however that wealth has been distributed in a highly uneven fashion – with a relatively small proportion of the population overwhelmingly benefiting from this growth. This inequality appears to be receiving greater focus from Chinese authorities, as the policy agenda moves away from poverty eradication towards Common Prosperity, however policy implementation may take a long time.

INDUSTRIALISATION HAS GENERATED WEALTH FOR SOME

At an aggregate level, China's net wealth has increased enormously since the turn of the century, as the country's rapid industrialisation transformed it from a relatively small producer into the world's largest exporter. According to a recent study by the McKinsey Global Institute, China's per capita net worth rose from around US$5.5k in 2000 to US$86k in 2020 – with the China accounting for around one-third of the total increase in global wealth over this period. This would imply that China's total net worth now exceeds that of the United States (although other estimates, such as Credit Suisse's Global Wealth Report suggest that China remained second to the US in total wealth in 2020).

CHANGE IN GLOBAL WEALTH

China accounted for an outsized share of the global increase in the past two decades



Source: McKinsey, NAB Economics

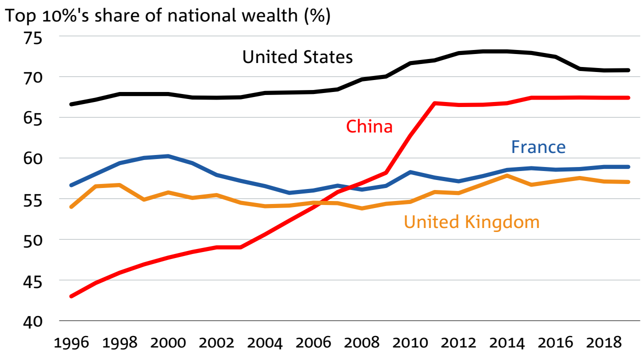
That said, China's wealth is far from evenly distributed, in part related to the long run model of the country's economic development. As China began to open up following the rise of Deng Xiaoping in the late 1970s, it did so in a highly directed and uneven fashion – with various regions and industries favoured. This was built on the belief that creating a small pool of wealthy people would speed up the country's economic growth. In addition, financial repression was implemented – a policy that limited the return on savings, ensuring a low cost source of funds for industrial development, but limiting widespread growth in household wealth.

Combined with reforms in the 1990s that largely dismantled social security provided by state-owned enterprises, these policies resulted in a small proportion of the population reaping the bulk of the rewards of China's economic growth. According to the World Inequality Database, the top 10% of China's households controlled around 43% of the country's wealth in 1996. This share steadily increased over the following years, rising to 67.4% in 2015 (the most recent data available).

According to the Forbes World's Billionaires List for 2021, mainland China is home to 43 of the world's 200 wealthiest people – compared with 58 for the United States and 11 each in Germany and Hong Kong. In comparison, there were four Chinese billionaires in the top 200 in 2010 and none in 2000.

WEALTH INEQUALITY BY COUNTRY

China's top 10% holds a large share of wealth



Source: World Inequality Database, NAB Economics

This inequality presents multiple problems for Chinese authorities. Vast income and wealth inequality are typically constraints on domestic consumption – which is a key component of the "dual circulation" growth model that China is attempting to shift towards. In addition, China's government always maintains a focus on social cohesion, which is also negatively impacted by inequality.

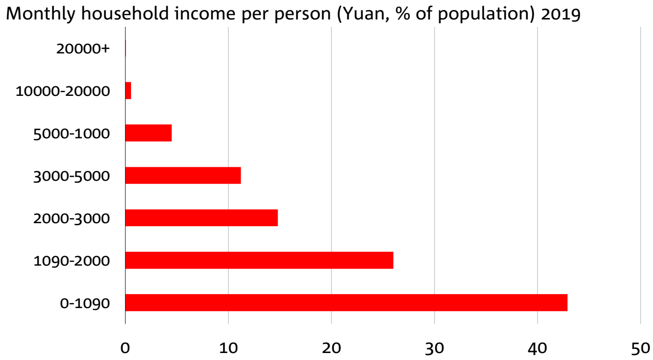
COMMON PROSPERITY IS A NEW FOCUS FOR CHINESE AUTHORITIES

A key platform of President Xi's policy agenda since 2015 has been the poverty alleviation drive, which set out to lift over 100 million rural residents out of extreme poverty (using an income equivalent of less than US$2.30 a day as its basis). Chinese authorities declared that they achieved this goal in 2020 – having relocated millions of people into new villages, developed new roads and other infrastructure and implemented cash transfers. Some critics have noted that there was insufficient investment in education in rural regions – which would have provided greater long term support.

Since mid-2021, President Xi's speeches have increasingly focussed on the theme of Common Prosperity – a long standing concept within China's Communist Party, dating back to Mao Zedong – signalling a new focus of his government. Following the Central Financial and Economic Affairs Commission meeting in August, the commission highlighted that it was necessary to "reasonably regulate excessively high incomes" as part of this program.

INCOME DISTRIBUTION IN CHINA

Large share of low income earners



Source: Caixin, NAB Economics

At this stage the specific policies that may be implemented to achieve Common Prosperity are unclear, however it was interesting to note statements from unidentified senior party officials in August stressed that Common Prosperity does not mean "killing the rich to help the poor", particularly given recent regulatory moves against the technology industry – which had created a number of high net worth individuals in recent years. Reports in the People's Daily state that the policy is intended to expand the proportion of middle-income groups, increase the incomes of low-income groups as well as cracking down illegal incomes.

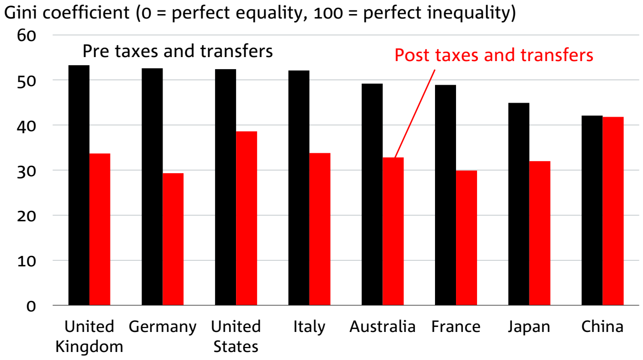
POTENTIAL POLICY MEASURES

According to reports, there are a broad range of policy measures that Chinese authorities are considering to implement Common Prosperity – however the likelihood of these policies being implemented, as well as the size or impact, is unclear – particularly given the history of earlier attempted interventions. For example, policy makers have proposed nationwide property taxes since around 2003, but have faced sufficient opposition from various groups to have them delayed.

Changes to personal taxation (including income, capital gains, property and inheritance taxes) and improvements to income transfers could reduce income and wealth inequality. China's social safety net is minimal and public service provision differs widely between cities and rural areas. A comparison of pre and post-tax Gini coefficients across a broad range of countries highlights the minimal impact of taxation and transfers on income inequality for China at present.

GINI COEFFICIENTS BY COUNTRY

China makes minimal use of transfers compared with other countries



Source: The Standardized World Income Inequality Database, NAB Economics

Li Shi, an economics professor at Zhejiang University, argues that China could achieve a significant improvement in overall inequality by increasing the share of direct taxes (currently one-third of China's fiscal revenue), such as income tax – as these taxes tend to narrow income inequality – without increasing the overall tax burden.

A property tax could have a substantial impact on wealth distribution – depending on its scope – given the Moody's estimates at least 70% of China's household assets are tied to real estate.

In addition, corporate taxation may see some changes. A range of technology companies currently receive preferential corporate tax rates – at 10% - compared with the standard 25% rate applied to other companies. Given the recent regulatory crackdown on the broad technology sector, it would not be surprising to see these taxes brought into line.

A non-tax based approach to wealth redistribution is what Chinese authorities refer to as "the third distribution" – which involves charitable donations by corporations and high-net worth individuals. Technology firm Tencent has already made a commitment of 100 billion yuan to Common Prosperity in recent months. The risk of greater regulatory pressure may provide encouragement for such donations.

CONCLUSIONS

Until specifics around policies are clarified, it is impossible to know how effective the Common Prosperity agenda will be at reducing inequality. Pilot property tax programs were introduced in Shanghai and Chongqing in 2011, however they were limited in scope and appear to have had minimal impact.

In addition, any measures are unlikely to be introduced in the near term. Zhejiang – China's third richest province – was selected for a Common Prosperity pilot program in June, with the targets it is aiming to achieve set for 2025. This would suggest that widespread reductions in inequality due to Common Prosperity policies are several years away, at the earliest.

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