

The Monopolistic Political System & Income Disparity in China

By Long Ke



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Thirty-four years ago, China decided to reform its economic system and open its market to foreign companies. About 20 years ago, the Chinese government decided to build a market-oriented economic system to replace the socialist central planning economic system. Under the Mao Zedong administration (1949-1976), the Chinese economy almost went bankrupt. After Mao died in 1976, Deng Xiaoping returned from exile to become a real political leader. He faced the difficulty of a very poor Chinese society with a shortage of food and general consumer goods. At the end of the 1970s, millions of Chinese refugees escaped from Guangdong to Hong Kong to realize their dreams. At the time, Hong Kong was a British colony, which suggests that socialist China does not hold out any hope for ordinary Chinese people to realize their dreams.

When Deng announced an open-door policy to his people, he was supported widely in China because he offered the people a beautiful dream. The philosophy of the Mao socialist economy was one of “fairness”; but in that instance, fairness meant everyone was equally poor. Deng promised his people that those who worked hard would become rich, and those who did not would not. The reform that Deng effected was to give the people an incentive to work hard, but this was not a revolution. Many studies on China characterized the Deng reform as a “gradualist reform” compared with the shock therapy reforms in East European countries.

When we look back at Deng’s reform, we find that the early 1990s was a very important turning point. As a result of the tragic Tiananmen Square Massacre in 1989, Deng’s reform reverted to a central planning system for some years. At that time, China in fact faced the risk of going back to Mao’s era. In the spring of 1992, Deng visited Shenzhen, the frontier city of the open-door policy in Guangdong Province, near Hong Kong. He asked the province to speed up the reform and open-door policy. This was the start of market-oriented economic system building. Since then the Jiang Zemin administration has effected fiscal and financial system reform, and it privatized most of the small and middle-sized state-owned enterprises in 1998. In 2001, China successfully entered the World Trade Organization (WTO), an important milestone in its economic reform and open-door policy.

China’s gradualist economic reform helped realize the goal of improving economic development. In 2010, China’s nominal gross domestic product in US dollars had grown to become the second biggest in the world, overtaking Japan. Some predict that China will overtake the United States as the largest economy in the world in the next 10 years. We can therefore say that the Chinese economic reform was very successful in terms of macro-economic development, but the problem of how to share income fairly remains.

The Meaning & Goals of Economic Development

In some ways, the economic reform and open-door policy gave the Chinese people a Chinese dream. Early in Mao’s administration, the people dreamed they could have a better life, but eventually they realized that they could not realize their dreams. When Deng promised to enact economic reform and an open-door policy, the people were once again able to dream. They dreamed of being richer, and Deng promised that the people could realize that dream if they worked hard. This means that Deng’s philosophy was not a socialist ideology; under the socialist system everyone must be allocated income equally whether they work hard or not.

At the beginning of the Deng administration, the people really

believed that their dreams would be realized by Deng’s reform. At that time, most Chinese people turned to support Deng’s reform and worked very hard not only for the country, but also for themselves. Everyone believed that tomorrow would be a more beautiful day.

In fact, not only Deng, but other political leaders too believed that only economic growth could help China become a happy society. Over the past 30 years, policy-makers have promised to realize high-speed economic growth and their policy-making has been focused on such growth, aiming for a rate of 7-8%. No one knows the real reason why the policy-makers targeted a 7-8% growth rate. According to the World Bank, for the past decade the potential economic growth rate has been around 9%. Conversely, the Chinese economic growth rate has reached 9.9% on average over the past

three decades. A 7-8% economic growth target is not meaningful as a policy target when the economy is growing at 9-10% annually.

It is true that the government always wants to achieve rapid economic development. First of all, successful economic development could prove that what the government is doing now is correct. The government has a need to show the people how wise it is. Secondly, economic growth can contribute to job creation; the official unemployment rate announced by the government is consistently about 4.2-4.3%, but the real unemployment rate is of course not 4.3% — it is closer to 9.6%. The unemployment rate as announced by the government is in fact the registered unemployment rate in urban areas. It is therefore important to lower the unemployment rate; maintaining rapid economic development is an efficient policy. Thirdly, the government wants to stabilize society by maintaining economic development. Recently, there have been many anti-government movements and the people are angry at being treated unfairly and unjustly. This problem has arisen because of the monopolistic political system, and without political system reform it will be difficult for the Chinese government to stabilize China's society.

China's Lost Decade

In China today, everyone agrees that it is necessary to deepen the various reforms in order to build capacity. However, from a short term point of view, any kind of reform would not be a plus sum game, but would likely be a minus sum game. As a result, there would no doubt be some groups which would oppose such reforms. Chinese political leaders, including Chairman Hu Jintao and Premier Wen Jiabao, have emphasized the necessity of political reform again and again. Furthermore, no one in the government can refuse an eventual democratic political system reform. But the problem is how to build a democratic political system gradually. The government and the communist party usually differentiate between the democratic political systems in Western countries and in China in order to maintain a monopolistic political system. The chairman of the national congress, Wu Bangguo, has emphasized every year during the period of congress that China would not build a Western-style democratic system, but no one knows what the real differences are between the two kinds of democratic system that he mentioned.

In the past three decades, China has had one big chance to reform the political system, and that was in 1989. Many people demanded that the party reform the political system and build a real market-oriented system from the grassroots level. Such consensus enjoined

the government to build a democratic system. Unfortunately Deng refused to accept the recommendations of university students, and the result of the movement was the Tiananmen massacre. Furthermore, the former chief secretary Zhao Ziyang failed to improve the reform. Instead of building a democratic political system, Deng proposed speeding up economic development and liberalizing economic controls. Since then, China has ramped up the speed of its economic growth and the government has liberalized the control of investment by private companies.

The growth rate of the Chinese economy from 1991 to 2011 reached an average of 10.2%, which has been called the "Chinese miracle". The Chinese economy has been the second biggest in the world since 2010, but it now faces two problems: the first is how to sustain economic growth in the future and the second is how to share the GDP fairly. Under the socialist system, equal income allocation could be called the "Chinese dream", but currently Chinese society is not equal at all. Over the past three decades, the government has made efforts to encourage economic growth, but efforts to improve income allocation equality are sorely lacking.

Under the Hu administration, it was expected that the income distribution system would be reformed and political system reform would begin. But looking back on the kind of reform that has taken place in the past 10 years, we find that nothing has been done at all. In the opinion of the author, China has lost 10 years under the Hu administration. As a result of postponing reform, Chinese society has also lost stability, and therefore if China wants to sustain its economic growth, it first needs to stabilize its society.

Economic Development Never Means Equality

To liberalize economic controls in an effort to become a superpower, for the past three decades the Chinese government has given incentives to the people to work hard in order to drive economic development. Under a central planning system, no one has the freedom to decide what to do about economic activities, even the leaders in government. Since 1979, when the economic reform started, the people were given more freedom to decide on economic activities.

However, under a free market economy the income distribution is generally not equal, in which case the government improves equality through the taxation system. Let us look back at the institutional reforms that have been implemented over the past three decades. The government reformed the agricultural system and the state-owned enterprises (SOE) system to encourage the production of

agriculture and manufacturing industries. Agriculture production doubled in the 1980s, but industrial production started to grow dramatically at the end of the 1990s. In 1998 former premier Zhu Rongji advanced the privatization of SOEs.

In 1994 Zhu also reformed the financial and fiscal systems. At that time, the Chinese government made it clear that the focus of the reform was to build a real market-oriented system instead of a central planning system. This was a big step for the Chinese economic reform toward a market economy. Although there were still some different ideas — mostly socialist ideology against a market economy — at the top levels of the Jiang administration, the movement to build a market economy had gained the consensus of the nation. Most Chinese people looked forward to gaining more freedom to participate in economic activities as they liked. For example, more Chinese people wanted to establish their own companies; they wanted to do business for themselves. Until the end of the 1990s, the business environment in China had been very free. Anyone could establish his own business, although private businesses were still excluded from infrastructure industries.

In the 1990s, the private sector developed greatly in commercial business, property business and information technology. Many managers who had worked for SOEs resigned and turned to setting up their own businesses. In Chinese this is called “Xia Hai”, which means “going down to the sea”. Through this development over the past two decades, small and medium-sized businesses grew and created the infrastructure and technological platform for Chinese industries. The manufacturing industries are obviously supported by the SMEs’ development.

But one must point out that economic development does not necessarily mean equal income distribution and allocation. It is true that the government made greater efforts to improve economic development than to create equality of income distribution. This may be the legacy left by the Hu administration. If China wants to sustain its economic development, it must equalize income distribution as soon as possible.

How to Equalize Income Distribution

According to Wu Jinglian, a senior fellow in the Development Research Center of the State Council in China, “China is still not a real market economy.” The Chinese economy is still controlled by the government. As a result, the state-owned sectors are greatly advantaged in terms of income, resource distribution, and market competition. Furthermore, it is said that the top 3% of Chinese people take almost 70% of the wealth. This means that most Chinese people are not benefiting from the reform, though

they may be slightly better off now than 30 years ago. Income disparity has been the biggest hurdle to sustainable economic development for today’s China. The problem is how to equalize income in order to sustain economic development.

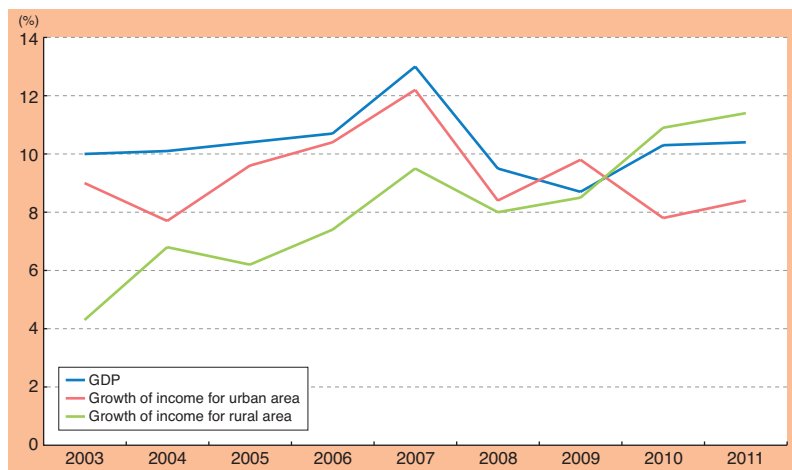
Before discussing how to equalize income distribution, let us first clarify how income disparity came to be so serious over the past three decades. First of all, in China, union activity is limited strictly by the government, and unions are not allowed to organize strikes to request improvements of worker’s salaries. The *Chart* below shows the growth rate for income was lower than the growth rate of GDP from 2003 to 2008. Secondly, the taxation system focuses only on salary-based income, but not other income, for example asset income. For people who only have salary-based income, income tax is too strict; but it is too low for the rich classes, who have a lot of asset income.

In China, the macro-income share of households against national income was only 40% in 2010, compared to 60% in Japan. This is the main reason why it is difficult for the low-income classes to gain more benefit from economic development. If China wants to benefit its lower classes more, it first needs to allow its unions to play the same role as in industrialized market economy countries. Secondly, China needs to reform the taxation system to improve the transition of income from rich classes to poor classes.

Of course, such reform is easily realized. There are some groups who are greatly benefited by the current system and who are strongly against a taxation system reform. But China cannot expect to build a stable society without such an economic system reform; and furthermore, China cannot carry out such a reform of its economic system without a simultaneous political reform. China needs to reform its political system and put more effort into building a democratic system.

CHART

The growth rates of GDP & income in urban & rural areas



Source: China’s national statistics bureau

How to Sustain Economic Development

Theoretically, economic development is driven by private consumption, fixed-asset investments, and exports. First, Chinese exports have been the main engine driving economic development over the past three decades. Cheap labor costs strengthened the competitiveness of export manufacturing industries, especially the labor-concentrated industries. But now labor costs are rising. Meanwhile, the Chinese renminbi has been revalued against the US dollar since 1995. Such revaluation is lowering the competitiveness of export manufacturing industries. Moving forward, China will need to increase its efforts to improve and upgrade its industrial structure.

Secondly, fixed-asset investments are still a strong engine driving economic development. But the main investor is not the private sector, but the government and state-owned enterprises. As a result, the efficiency of these investments is limited to a very low level, and the problem is how to shift investments from the public sector to the private sector. Furthermore, China needs to speed up the privatization of the SOEs. Again, China cannot expect to sustain economic development by relying on the investment of the public sector alone.

Thirdly, the most important issue is how to strengthen private consumption. Some say that private consumption is limited only by the weakness of social safety nets, such as the public healthcare system. If the weakness of social safety nets is the main factor limiting private consumption, then China has little hope of boosting it. In fact, the factor which is influencing household consumption behavior in the short term is not the weakness of social safety nets, but the expectation of increased income. Another factor influencing household consumption behavior is income distribution. It is clear that private consumption will be limited under a big income disparity. These are the issues facing China today.

The solution for China to sustain economic development is now clear. China cannot sustain economic development with its export manufacturing industries alone. Fixed-asset investment continues to be a strong engine for improving economic development. To strengthen household consumption, China needs to make greater efforts to raise the floor of the low income class, and also to reallocate and equalize income distribution.

China needs to speed up political system reform as soon as possible. The monopolistic political system has been the main reason for the background of corruption in China, and it has also made the income disparity bigger and bigger. The Hu administration has a responsibility to reform the political system.

Conclusion

As an emerging economy, China needs to do more to reform its economic and political system in order to build up its capacity. Over the past three decades, the Chinese government partially

relinquished its control of the economy. This liberalization and the above-mentioned incentives encouraged economic development. The Chinese government wants to show the Chinese people that the socialist party is the only party which can make the people happy. In its first three decades, the Chinese government failed to develop the economy. As a realist, Deng held to his philosophy that only economic development could make people happy. It is true that 35 years ago China faced shortages of almost all consumer goods, especially food.

Since then, economic development has been the goal of government policy. Deng believed that he was widely supported by the people. But in fact, the Chinese people supported the economic development policy while opposing the corruption and big income disparity. The Tiananmen incident was a symbol of the fact that Deng was not fully supported by the people.

In today's China there are many arguments about the reasons for corruption and the big income disparity. Neo-liberal scholars criticized government intervention in economic activity as the main reason for income disparity. But scholars belonging to the New Left emphasized that the government needed to strengthen its control over the economy; they seem to believe that corruption is simply due to the lack of control by the government. Indeed, corruption was not as serious under the Mao administration from 1949 to 1976. Some Chinese people believe that China needs to rebuild the same political system as that in Mao's era. The conclusion here is that this is absolutely and definitely not the case. China cannot go back to the Mao era. It is true that corruption was not as serious and income disparity was not as big under Mao, but China was far poorer. It is hard to believe that the Chinese people of today would be happy to go back to the era of Mao.

The issue raised here is how to create a systemic framework which allows the people freedom in their economic activities and guarantees the monitoring of the government by the people. If China wants to build a real market-oriented economic system, it needs to build a real democratic system to guarantee human rights. This is the only correct direction for Chinese reform.

Finally, China is facing difficulties in sustaining its exports to the euro-zone and America. Meanwhile, domestic demand has weakened. The economy is still driven by public investment; private consumption is too weak at only 34% against GDP (2011). The key point here is how to strengthen private consumption. To realize this goal, China needs to decrease income disparity as soon as possible. It is unlikely that a revolution can help China and the Chinese people. China needs to reform its political and economic systems. It is time. China cannot postpone these reforms any longer. **JS**

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