ADJUSTING PRIORITIES

From production-oriented to welfare-oriented government

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The Chinese government is a “production-oriented government” because it spends more money and effort on economic affairs than on services and transfers that aim to improve citizens’ welfare. This label can be justified on several grounds.

First and foremost, economic growth is the central task of the Chinese government. The current administration puts more effort into rebuilding China’s social security and health care systems than the previous administration, but the essence of government policy still prioritizes economic growth over immediate welfare improvement. Second, out of total government spending, more than 20 per cent is spent on economic affairs, particularly infrastructure. The figure in other countries is most often less than 10 per cent.

Third, the Chinese government saves a lot. It is commonly held that China’s national savings are extraordinarily high because Chinese people love to save a lot. In addition, however, the government’s saving rate has been higher than the household saving rate in most recent years. While households save 37 per cent of their disposable income, the government saves about 40 per cent of its disposable income.

Fourth, the central government controls close to 60 per cent of total government budgetary revenue. Out of that, about 70 per cent is transferred back to the provinces. More than 60 per cent of the transfer is either project-based or proportional to tax growth in individual provinces; less than 40 per cent is formula-based. Last but not the least, governments at all levels give subsidies to producers by suppressing the prices of land, energy, labour, capital, and environmental costs. According to economist Ying Huang (CCER), the total amount of subsidies reaches 10 per cent of GDP.

Despite its positive role in promoting China’s economic growth, the production-oriented government distorts the Chinese economy. The most serious distortion is in economic imbalances. By encouraging production and paying less attention on welfare improvement, the government suppresses domestic consumption.

Take the example of government infrastructure investment. In any other developing country, increasing infrastructural investment is a virtue. In China, however, government infrastructural investment seems to have passed the productive limit and begun to have a negative impact on the country. In a recent study of Chinese provinces in the period 1978-2008, Binkai Chen and I find that when infrastructure investment increases by one percentage point in a provincial government’s budget, household consumption drops by 0.31 percentage point as a share of GDP in that province.

Why is the Chinese government a production government? One cause is the legacy of the planned economy. In the period of economic planning, only agriculture, factories, transportation, and the like were regarded as productive forces, the growth of agricultural and industrial outputs were the only aims identified for society. Consistent with this emphasis, the improvement of people’s welfare was kept to a minimum.

Another cause is the lack of political participation by ordinary citizens. Government officials have strong incentives to pursue economic growth because it suits their own interests, either in the form of direct financial gains or their promotion. But economic growth is not the only concern of ordinary citizens. They also care about health, security for the elderly, housing, education, the environment, equality, and so on, none of which is necessarily linked with higher rates of economic growth. Allowing ordinary citizens’ voices to be taken seriously in the political process would thus change the nature of the production government.

China’s income distribution has worsened and will continue to worsen if no action is taken. The production-oriented government should take much of the blame because it subsidies producers and does minimal redistribution.

International experience shows that societies that have successfully escaped the ‘middle-income trap’ are those that have kept their social structure flat and opened up the political process for democratisation, permitted free movement of labour, and enhanced the welfare system. Japan, South Korea, and Taiwan all fall in this group. Their transition began when their per capita purchasing power parity (PPP) income reached $8,000. In the next ten years, China’s per capita PPP income will likely increase from the current $6,200 to $13,000. Using the East Asian experience as a reference, the next ten years will be a critical period for China to take serious political reform.

The Chinese government has been aware of the danger of the middle-income trap and has written in its 12th Five-Year Plan that structural adjustment and welfare improvement are its most important goals in the period 2011-2015. Still, the measures proposed to achieve these two goals are inadequate. At the policy level, they are summarised as ‘transforming the mode of production’, which is often understood by local governments to mean moving up the global value chain.

The goals set by the 12th Five-Year Plan are admirable, but to realise them, it is imperative to transform the production government into a welfare-oriented government. China’s private sector is strong enough to sustain the country’s healthy economic growth. The government should shift its attention from production to welfare enhancement. The Chinese people suffered tremendously in the planning era and have continued to save a lot in the last three decades. It is time for them to enjoy the fruits of economic growth.