

Chapter 1

# China's social record after 30 years of rapid development?

China appears to have crossed a new threshold in its development process. Is this merely in reaction to recent events or is it the sign of a deeper trend in this post-Covid period, a period that has shed light on the flagrant imbalances in China's development? While a more inclusive view of growth does not, in and of itself, seem to be a general trend, it is worth separating the announced praiseworthy goals from the politically charged sub-context. Should we remain confident and expect pragmatism to return to the fore, or should we read the latest events through a more political prism and step back for another look at the Chinese Eldorado? After providing some insight into the impact of China's forced development on its social situation, we assess the political stakes for President Xi. In this new context, after taking forceful action in sectors identified as at risk, the authorities are laying down a longer-term investment policy in an economy that, whatever happens, is still the world's second-largest.

*By Laetitia Baldeschi, Head of Strategy*

**The Chinese economy's rapid development had a goal – to lift the country out of poverty. This goal has now been achieved, according to the Chinese authorities. However, it has also carried with it disastrous repercussions on China's inequalities. The Covid crisis has shed light this particularly unbalanced social situation. After reviewing the social situation, we will mention a few paths being considered by the authorities to reduce these inequalities. We will attempt to understand the authorities' new credo of "common prosperity".**

## **China can take pride in having drastically reduced its poverty rate**

Based on the World Bank's metric for assessing China's poverty rate, i.e., \$1.90 per day (using 2011 purchasing power parity), the poverty rate fell from 66.3% in 1990 to 0.5% in 2016! By way of comparison, in India it fell from 50.7% in 1987 to 22.5% in 2011. Based on a slightly broader metric, i.e., \$5.50 per day, 18% of the Chinese population could still be considered poor, of which one third lived in urban areas. According to the National Bureau of Statistics (NBS), which has revised this metric three times, only 0.6% of the population was poor in 2019, based on the latest estimate (\$2.30 per day in 2011 PPP), vs. 17.2% in 2010. Poverty in China is traditionally considered to be a rural phenomenon. That's why all the government's efforts to combat it and track it have

focused on rural areas. With growing urbanisation, the percentage of persons who are below \$5.50 per day (2011 PPP) and live in urban areas has risen from 20% in the early 1980s to 35% in 2018. According to these latest estimates, 92 million city dwellers would have been considered poor in 2018.

## **Poverty has been reduced at the cost of increased income inequalities over the past 30 years**

The Gini index, one commonly used measure of inequalities, rose from 30 in the mid-1980s to 49 in 2018, a level seen in some more inegalitarian countries of Latin America or Africa.

One indicator used in assessing the social situation is per capital disposable income. Two phases emerge rather clearly from trends in this indicator. Until the great financial crisis, the increase in per capital income was almost constant. Since then, the trend has reversed itself, with income still rising but less rapidly.

*See Annexes – Chart 1*

Obviously, the Covid shock has disrupted the long-term trend. An analysis of the components of this per capita income figure bring out several points. The first is the lack of safety net when production ground to a halt. Unemployment benefits were not there to replace the shortfall of wages. This was a major shock for workers'

income and has continued to drag down the rebound in consumption since the first quarter of 2020.

*See Annexes – Chart 2*

Only a small percentage of the working population is covered by a social welfare system, and most of that is paid for by employers. More than one quarter of the working population holds a so-called “flexible” job, meaning without social protection or job security. This obviously includes the 278 million migrant workers who were the initial victims of the Covid disruptions in the first quarter of 2020. Keep in mind also that the Chinese labour market must absorb more than 9 million graduates each year, in addition to the flow of migrants from rural areas.

**Poverty has undeniably been reduced over the past 30 years but has also exacerbated inequalities in income distribution within China.** Based on NBS data, the per capital income trend by income quintiles shows that the richest are getting richer faster than the middle classes. The same goes for geographical distribution. Chinese persons living on the eastern coast, which is more highly developed than the west, have seen their incomes rise more sharply. The income gap between the richest and the poorest is quite wide in urban areas, by a factor of 1 to 5 but even more so in rural areas, by a factor of 1 to 8, which is far less intuitive, and is one reason for the authorities' new political rhetoric.

*See Annexes – Charts 3 and 4*

### What is being done to mitigate income inequalities?

One path the government is taking is to continue easing the household registration system (called “*hukou*”<sup>1</sup>) in large cities. This would provide migrant families greater access to public education and healthcare services and would be tantamount to a major transfer of wealth to them. This is all the more necessary as the government's new target, in its 14<sup>th</sup> five-year plan – to raise the urbanisation rate to 65% – implies that more than 60 million persons will move to cities in the next five years. Other paths, including taxation, are being explored. Reforms making the tax structure more progressive could help slow the rise in income inequalities while raising resources to boost social spending. Indeed, China depends closely on the VAT and other consumption taxes,

which account for half of the tax receipts of its public administrations vs. one third on average in OECD countries. Meanwhile, progressive taxes on individual income account for 5% of the state's receipts, vs. 15% on average in OECD countries. Wealth and property taxes, considered progressive, are still underused in China and could play a key role in reducing imbalances, in particular in local government budgets.

### A new political doctrine: “common prosperity”

This constant widening in inequalities is a major concern for the authorities, and its new “common prosperity” credo is key to analysing the latest events. “Common prosperity” explicitly includes the idea that growth must benefit everyone. In other words, China's economy policies have until now aimed to strengthen growth at any cost. Now they must ensure that growth benefits everyone.

*See Annexes – Chart 5*

This realisation was triggered by China's demographic trends. Its low birth rate, with 1.3 children per woman in 2020, is no longer high enough to prevent a premature ageing of the Chinese population. China's potential growth will inevitably trend more slowly. To boost it, the usual production factors must be strengthened.

### Strengthen the labour factor and labour productivity

The first step is to implement policies in support of birth rates, in order to boost the size of the workforce. But this will take time to produce its effects, and the situation may already be somewhat compromised, given the population shrinkage in recent years. To boost the birth rate, the causes of the slowdown till now must be assessed. Three reasons have been cited in the comments that accompanied the release of the latest census findings: the burden of the elderly, the cost of educating children, and housing costs, especially in the large cities<sup>2</sup>.

*See Annexes – Chart 6*

With this in mind, it is interesting to observe now political actions in recent weeks has been consistent in these two issues of the cost of primary and secondary education and housing costs. It's true that the authorities have long

<sup>1</sup> The *hukou* system was introduced in China in 1958. This is a legal document that carries each citizen's personal information, including name, birthdate, parents' names and marital situation. The system categorises Chinese citizens as either a holder of a peasant *hukou* (in rural areas) or a non-peasant one (in urban areas). As it is registered in the name of the head of family, the *hukou* is transferable. Each type of *hukou* carries various, specific rights applicable to that type. The rural *hukou* allows its holder to work in farming areas, while the urban *hukou* provides access to government jobs, subsidised real-estate property, education and healthcare, with benefits varying from one city type to another.

<sup>2</sup> See “Ageing of the population: China is also being affected”, Laetitia Baldeschi and Nicolas Picard, 29 June 2021:

<https://www.cpr-am.fr/retail/Local-content/Actualites-Presses-Recompenses/Decoding-Ageing-of-the-population-China-is-also-being-affected>

taken action against high housing costs, having sounded the alert to bubbles for several years now.

The second area in which the authorities can take action is in labour productivity. This will require universal education. Here, again, is a justification cited for the measures taken over the past few months, and for mentioning primacy of this objective, particularly in the new five-year plan.

### Ensure better allocation of capital

China's national savings rate is particularly high, especially compared with many emerging market economies. Some of this is precautionary savings to mitigate the lack of social welfare, in both family and pension benefits. Taking action in social welfare will help release some of these savings. It is not the quantity of capital available that is a concern for the Chinese economy, but, rather, how such capital is allocated. And, clearly, allocation is far from being optimal. Recent events involving the property bubble is one illustration. The lack, or low variety of, savings vehicles is a source of weakness for the Chinese economy. Capital must be steered into the Chinese productive system. This was one of the reasons why President Xi announced the creation of a new stock market for innovative small and mid-sized companies.

### Invest in innovation and technical progress

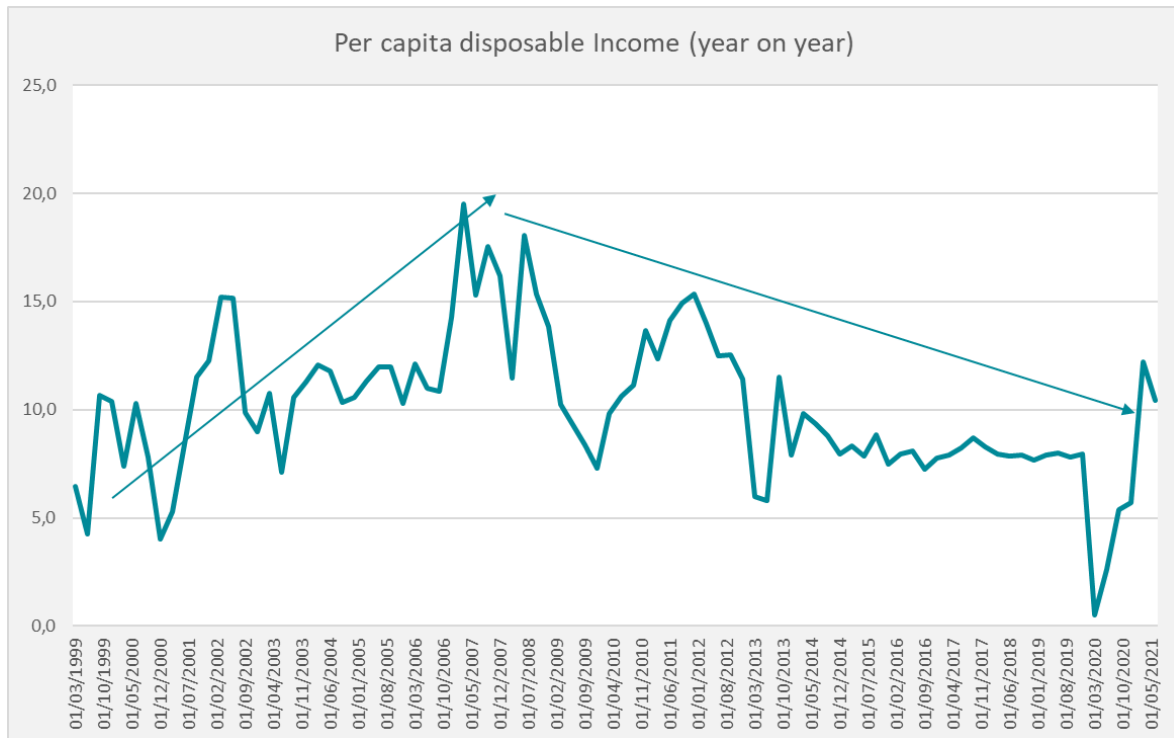
In addition to the usual production factors of labour and capital, it is in overall productivity that the authorities can take action. The goal here is to promote innovation, in order to strengthen technical progress. This is one of the cornerstones of the 14<sup>th</sup> five-year plan (2021-2025) and China's industrial priority. This includes developing new infrastructures in the Internet (5G), semiconductors – particularly to strengthen China's autonomy – green energies, electric vehicles to address climate commitments, just to name a few.

Seek through this prism, some consistency emerges in Chinese authorities' recent action. The focus on strengthening collective well-being while preparing to deal with an older population is at the heart of the recent announcements. Those announcements may have looked brutal and sudden, but this is due more to how China is governed. We will address this, more political, aspect in a future article of our "Strategy Reports" series. In any case, turning away from this huge country is out of the question. New investment opportunities are going to open up, but probably in areas that will have been identified by the authorities as priorities.

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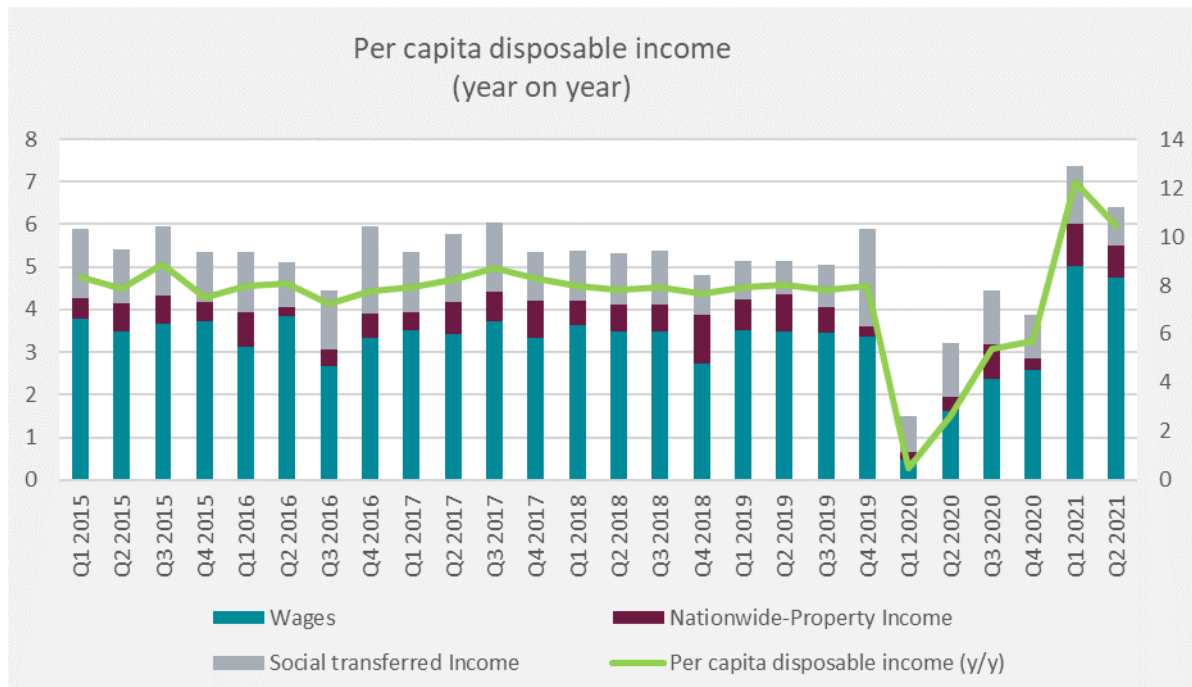
Annexes

Chart 1

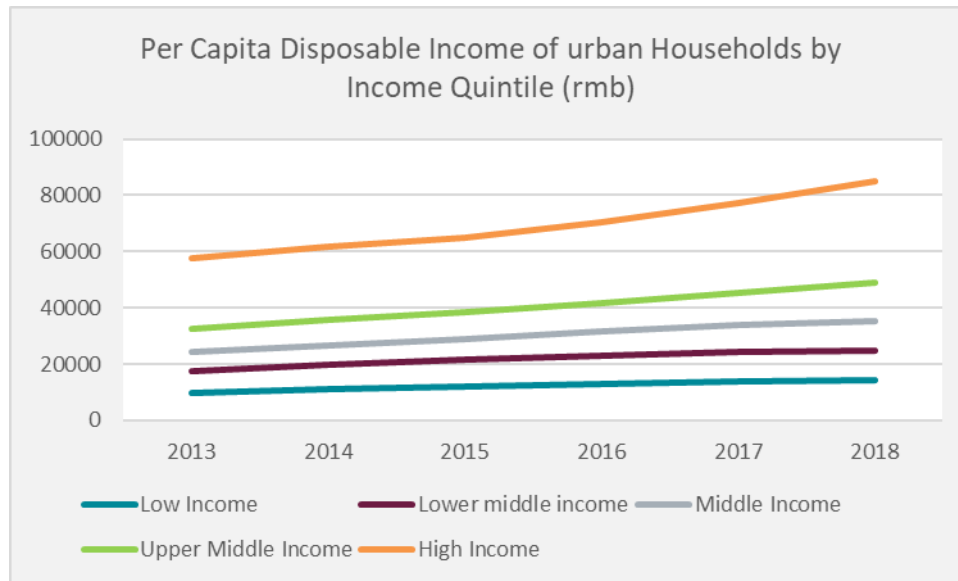


Sources: Refinitiv, CPR AM

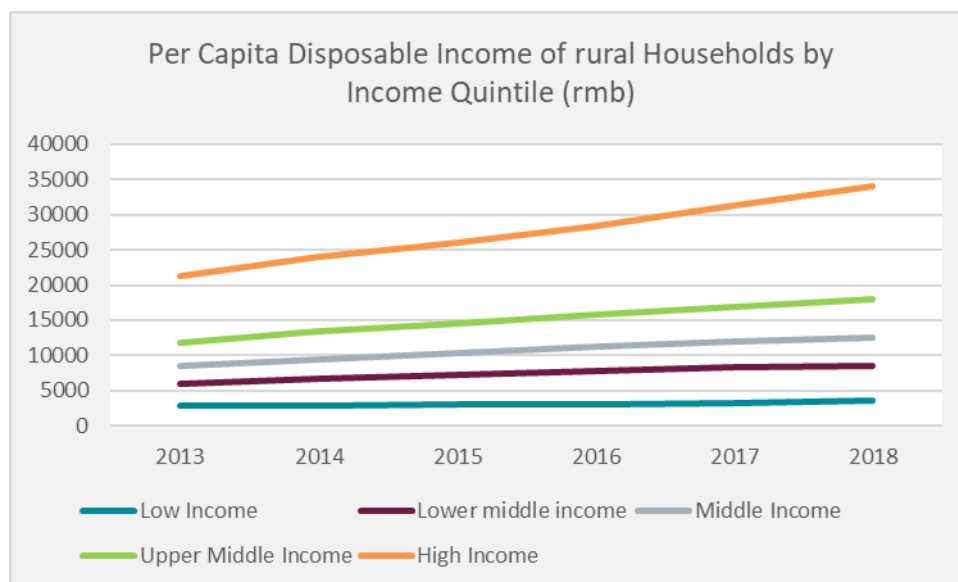
Chart 2



Sources: Refinitiv, CPR AM

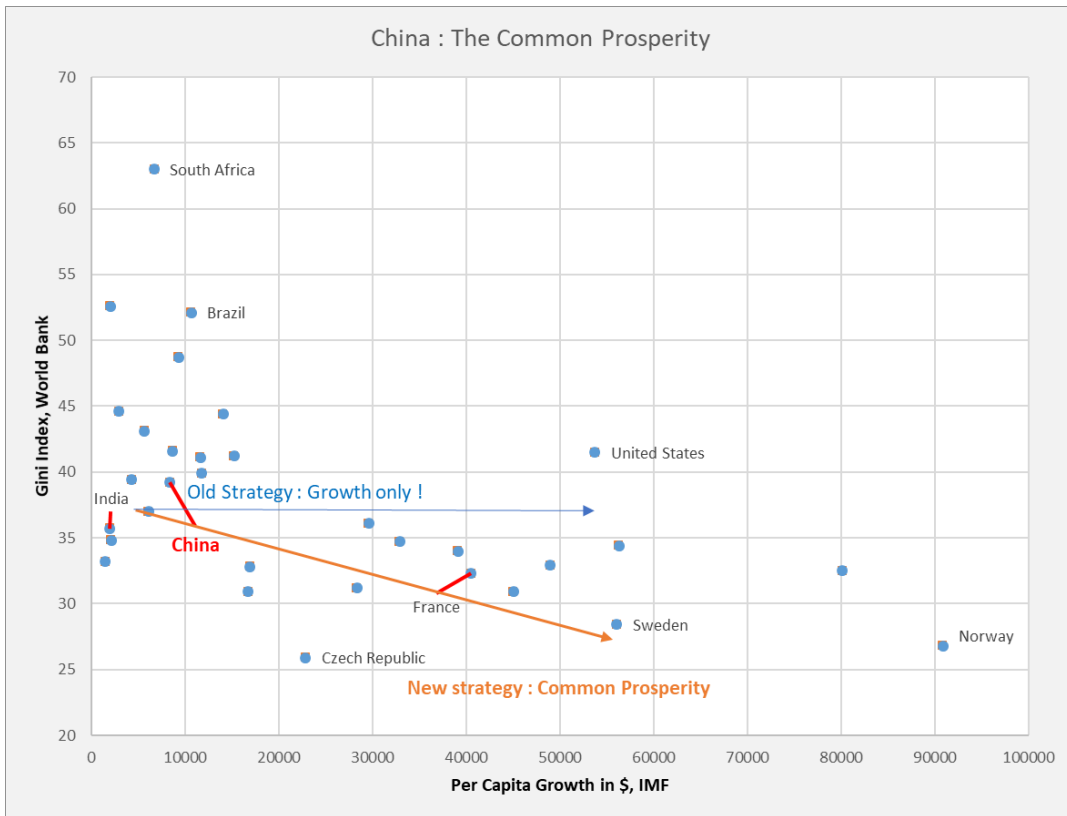
**Chart 3**

Sources: National Bureau of Statistics of China, CPR AM

**Chart 4**

Sources: National Bureau of Statistics of China, CPR AM

Chart 5



Sources: Refinitiv, World Bank, CPR AM

Chart 6



Sources: Numbeo.com, CPR AM

**Information :**

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