

## Is China Socialist?

Barry Naughton

**I**t has been 40 years since Deng Xiaoping broke dramatically with Maoist ideology and the Maoist variant of socialism. Since then, China has been transformed. Spectacular growth, powered by the expansion of markets, has made urban China into a mainly middle-class society and lifted hundreds of millions of rural residents out of poverty. Throughout these enormous changes, China has always officially claimed to be socialist. Since 1992, China has called itself a “socialist market economy.” Does the “socialist” label make sense when applied to China today?

There is no generally accepted definition of “socialism,” and there seems little point in arguing over whether a complex reality coincides with a simple and arbitrarily defined label. Instead, the strategy of this piece is to advance four general characteristics that are plausibly related to a broad range of conceptions of socialism: that is, we will be talking about descriptive characteristics of socialism, rather than “models.” Whether or not the reader accepts that these features are related to a coherent ideal of “socialism,” raising the question of socialism in this way can help to gain a fresh perspective on the current reality of the Chinese economy.

In this spirit, a plausibly socialist system would be judged on the following four criteria: capacity, intention, redistribution, and responsiveness. First, a socialist government controls a sufficient share of the economy’s resources that it has the *capacity* to shape economic outcomes. One traditional definition of socialism includes “public ownership of the means of production,” but “capacity” is here

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broadened to include the ability to control assets and income streams, through taxation and regulatory authority. Second, a socialist government has the *intention* of shaping the economy to get outcomes that are different from what a noninterventionist market would produce. Third, because a socialist government typically justifies itself as benefitting those citizens who are less well off, it is natural to look for evidence of whether such policies are succeeding in the outcomes involving growth, social security, and pro-poor *redistribution*. Fourth, a socialist government should have some mechanism through which the broader population can influence the government's economic and social policy, so that policy shows at least some partial *responsiveness* to the changing preferences of the population.

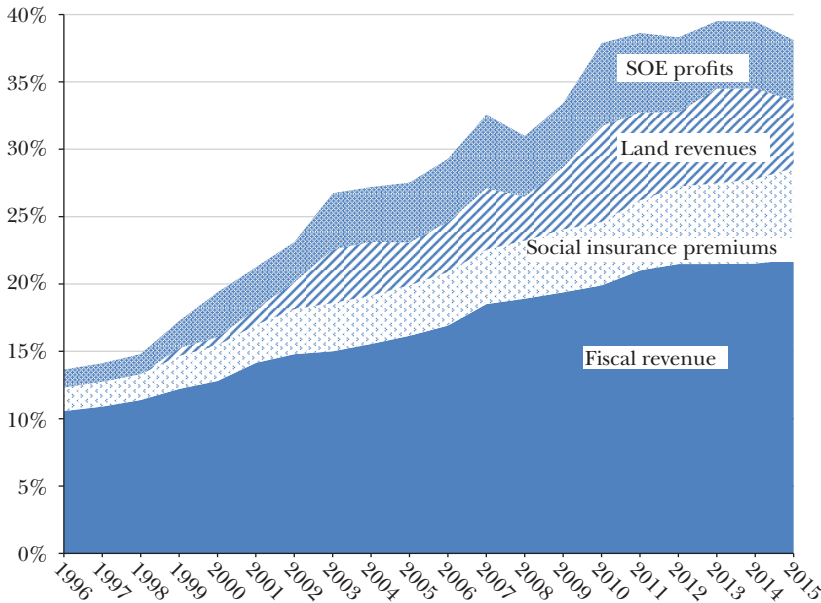
In thinking about China's economy through the prism of these four descriptive characteristics, we must be sensitive to how the definition of socialism in China has evolved and thoroughly changed. Forty years ago, in 1978, China was unquestionably a socialist economy of the familiar and well-studied "command economy" variant, even though it was more decentralized and more loosely planned than its Soviet progenitor. Twenty years ago—that is, by the late 1990s—China had completely discarded this type of socialism and was moving decisively to a market economy. At that time, the question "Is China Socialist?" seemed meaningless to most people. China had shrugged off its old model of socialism, and obviously was never going back. China had officially recognized that no economy that excluded the market could hope to deliver satisfactory outcomes. Moreover, powerful trends at this time were limiting the scope of what China's government could achieve. 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. At the time, it appeared that China's economic success had been achieved at the cost of discarding socialist values. In the mid-1990s, the important question seemed to be: Would China continue to be a kind of "Wild West Capitalism," in which almost anything might be for sale, or would it converge with the developed market economies, with improved regulation and rule of law?

China today is quite different both from the command economy of 40 years ago, and from the "Wild West Capitalism" of 20 years ago. The government in China has much more influence over the economy than in virtually any other middle-income or developed economy. State firms and state banks remain prominent. Government five-year plans command attention, both domestically and internationally. The Communist Party remains in power. What, then, is the relationship between China's government and the economy? And, thus, to what extent is it reasonable to think of China as a form of socialism?

### **Does China's Government Have the Resources to Shape the Economy?**

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

*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.”

of national income to carry out a socialist program. It faced, instead, a crisis of state capacity. However, in the last 20 years this situation has changed dramatically. Today, 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.

### Control over National Income

China’s government controls an unusually large proportion of national income flows, and these income streams have grown dramatically as a share of GDP since the mid-1990s. Figure 1 shows an expanded concept of government revenues that includes four main components: 1) budgetary revenues (not including social security); 2) social insurance premiums; 3) land revenues; and 4) net income from state-owned enterprises. This expanded concept provides an index of government control of resources, which tripled as a share of GDP between 1996 and 2013. This expanded concept is admittedly an *ad hoc* definition, but it gives a much better indication of the overall size of government than any of its components by itself. The

first two components can be placed in both international and temporal context, while the final two can be traced over time in China, but lack clear international comparisons.

Generally, fiscal revenues as a share of GDP increase as an economy becomes richer (Besley and Persson 2014). According to the dataset for 1975–2006 assembled by Baunsgaard and Keen (2010), low-income countries on average raise 14.5 percent of GDP in taxes; middle-income countries, 18.7 percent; and high-income countries, 32.5 percent. Thus, China was well *below* the low-income average in 1996 with 11 percent of GDP in fiscal revenues; and subsequently increased to well *above* the middle-income average at 21.8 percent of GDP in 2015. The figures of Baunsgaard and Keen (2010) do not distinguish clearly between ordinary taxes and social security contributions, but OECD data permit us to do so for a set of developed countries (OECD 2014). In 2012, 30 OECD countries collected on average 22.4 percent of GDP in taxes, plus 10 percent of GDP in social security contributions.<sup>1</sup> China's fiscal revenue of 21.8 percent in 2015 excluding social security is thus already equal to the OECD average (and also above the US level of 18.9 percent).

This pattern is surprising not only because of China's overall level of development, but also because China relies very little on personal income tax, the adoption of which is highly correlated with an increasing share of taxation in the economy (Besley and Persson 2014). Personal income tax was only 1.3 percent of GDP in China in 2015, and property taxes are also small. Instead, taxes on goods and services (especially the value-added tax at 4.6 percent of GDP) and enterprise income taxes (4 percent of GDP) are the largest categories, along with a dizzying array of transaction taxes (on land transactions and stock transactions, plus business and luxury taxes).

Social insurance contributions in China were 6.8 percent of GDP in 2015. These are not included in the Chinese figures for budgetary revenue (with some exceptions; budgetary contributions to the social security fund have been deducted from budgetary revenues to avoid double counting). While lower than the level for OECD countries, this is high for a middle-income country. Population aging is a key driver of the size of social security, and while China has a long-term aging problem, China *today* is still young, with an extremely low elderly dependency rate. Its 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. Compared to OECD countries as a group, China's public revenues are relatively unencumbered, in the sense that they are not pre-committed to paying for existing services or social security outlays. Adding ordinary budgetary revenues and social insurance contributions together gives 28.6 percent of GDP, which is clearly higher than China's expected level as a middle-income economy.

The next two categories of government revenues are possibly unique to China. While not easily placed in a comparative context, their control clearly pushes the

<sup>1</sup>A Data Appendix available with this paper at <http://ejep.org> offers additional discussion.

Chinese government further above its expected position, and they represent important dimensions of control of the economy's resources. All land in China is publicly owned: urban land is owned by the state, and housing is "privately owned" only in the sense that households hold long-term leases, typically of 50–70 years. Commercial developers pay local governments to lease development rights: those fees go into a separate account, not included in the formal budget, but under the control of local officials. State-owned enterprises also generate large profits. State-owned enterprises pay profit taxes and a changing—but relatively small—proportion of after-tax profits to their governmental owners (these are included in budgetary revenues). The majority of profits remain in the firm, where it is subject to government influence but not direct government allocation. The financial system in particular is overwhelmingly dominated by the state-owned banks, which generate substantial profits. These profits and, more importantly, the pattern of lending are subject to governmental influence. These funds together reached a peak in 2010, when land revenues accounted for 7.1 percent of GDP and after-tax profits of state-owned financial and nonfinancial enterprises were 6.1 percent of GDP. Since 2010, both have drifted down with the cooling of China's economy, and they totaled 9.5 percent of GDP in 2015.

Summing all four components, the Chinese government had direct or indirect control of 38 percent of GDP in 2015. Overall, the Chinese government is large, well-resourced, and potentially highly intrusive. This is both a distinctive feature of the Chinese economy in comparative context, and a dramatic change from the China of 20 years ago.

### **Assets: 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. Since that time, a gradual process of liberalization, entry, and *de facto* privatization has fundamentally transformed the composition of ownership in goods-producing sectors, which are now predominantly private. Lardy (2014) describes this transformation as the dominant driver of China's economic performance. Crucially, the diversification and privatization of productive assets is a movement in the *opposite* direction from the increased government control of income streams described in the previous section. Since the 1990s, government has gotten bigger even as it has released its control over many productive assets.

Today's pattern of state ownership has been shaped by an evolutionary process of entry and competition, which is particularly clear in the industrial sector. The state share of industry declined as private and foreign-invested firms entered and grew rapidly. "Bottom-up" transformation was then complemented by a major downsizing of the state sector in the late 1990s, in which uncompetitive and loss-making state-owned enterprises were closed down or sold off. As a result, when small-scale firms and family artisans are included, workers in state-controlled firms make up only 12 percent of the total industrial labor force (according to China's 2013 Economic Census). In this sense, state ownership of industry in China is probably less than it

was in France or Italy before the 1980s wave of privatizations, and China's industry and agriculture have both become predominantly private and market-driven.

However, the evolutionary processes at work require several important qualifications to this generalization. First, the Chinese government has never overtly accepted privatization. The official position—written into China's Constitution—is that while multiple ownership systems coexist, state ownership is the “leading force.” Second, barriers to entry—either legally created or driven by economies of scale and capital market inefficiencies—meant that substantial government ownership was retained in capital-intensive sectors: resources, utilities, and several heavy industrial sectors including steel, nonferrous metals, and transportation equipment. Government ownership is tiny (but not zero) in food products, textiles, and garments. Because state ownership is concentrated in capital-intensive sectors, when we look at the large-scale formal sector for which annual data are regularly available (in this case, data for 2014), state ownership of industrial assets (39 percent of the total) is substantial; much more so than the state share of revenues (24 percent), or workers (18 percent).

State ownership is actually somewhat more prevalent in the service sector than in industry. The government controls at least 85 percent of banking sector assets; the entire telecommunications and transport network; and essentially all education and scientific and technological services. In addition, the Communist Party owns and controls virtually all public media. Small-scale and labor-intensive services, such as retail and restaurants, are of course predominantly private, but government ownership and control is evident in the more capital-intensive and the more human-capital-intensive sectors.

As part of the marketization process, government relaxed its control over most productive assets. Today, the vast majority of Chinese workers are self-employed or work for firms. However, government has maintained substantial control of a number of upstream sectors and large intermediate good and machinery producers. Some sectors, notably oil and gas, are structured to generate monopoly rents. Moreover, government has maintained control over all land and almost all financial institutions, as described above. In an increasingly marketized environment, it is increasingly easy to “monetize” that control, generating the large revenue streams described in the previous section. Thus, while the Chinese government owns a relatively small share of overall productive assets, the assets that it owns often give it a monopoly position (land, natural resources, transport, and communication), or are strategically positioned upstream in the production system (intermediates and production equipment).

There have been several serious efforts to draw up a national balance sheet for China in recent years. Based on the extensive results of Li, Zhang, and Chang (2015; see also Ma, Zhang, and Li 2012), we can derive a highly simplified government balance sheet. Table 1 shows that government assets in China are about three times GDP, and net assets (after accounting for debt) are almost one-and-a-half times GDP. The four primary government asset holdings are land, assets in nonprofit “public service units,” state-owned enterprises,

*Table 1*  
**Simplified Sovereign Wealth Balance, China 2013**

	<i>Trillion RMB</i>	<i>Percent of GDP</i>		<i>Trillion RMB</i>	<i>Percent of GDP</i>
<b>Government assets</b>	<b>194.6</b>	<b>306%</b>	<b>Liabilities</b>	<b>104.8</b>	<b>165%</b>
of which:			of which:		
Land	62	97%	Central government debt	11.8	19%
Public service units	11.8	19%	Local government debt	8.6	14%
Nonfinancial SOEs	96.4	151%	Policy bank bonds	8.9	14%
Financial SOEs	20.3	32%	Local government funding vehicle debt	15.5	24%
			Debt or nonfinancial SOEs	51.6	81%
All other assets	4.1	6%	All other liabilities	8.4	13%
<b>Memo: GDP</b>	<b>63.65</b>		<b>Government net equity</b>	<b>89.8</b>	<b>141%</b>

*Source:* Li, Zhang, and Chang (2015, pp. 29).

*Note:* “SOEs” means state-owned enterprises.

and state-run banks and other financial enterprises. Public service units are government-owned nonprofit entities: they provide services for payment, and dominate the health care, environmental services, education, and cultural services sectors.

The value of government assets in China, relative to GDP, is much higher than in other countries. The US government has nonfinancial assets worth about 34 percent of GDP (12 percent of which is land; while 22 percent is made up of structures, equipment, and intellectual property assets) (Larson 2015; Board of Governors 2016). Government debt in China is substantial, although not as large as in developed countries. The right-hand column of the table shows government debt in four main categories summing to 71 percent of GDP; in addition, state-owned enterprises have debt equal to 81 percent of GDP. These numbers are not small, but they are much less than gross assets. Moreover, outstanding debt is owed mainly to the banks, which are themselves predominantly government owned. Thus, China’s government maintains significant net wealth and control of a broad swath of society’s assets.

The Chinese government clearly does not own the “means of production,” and in fact by relaxing its restrictions on ownership, the Chinese government has been able to reap the benefits of competition and create a much more efficient and productive economy. However, the government still has a strong ownership position in the economy overall. Moreover, in a market economy, it is relatively easy for the state to transform its ownership of urban land, resources, and other assets into robust income streams. This has produced a qualitative change over the past 20 years. Twenty years ago, in the late 1990s, the Chinese government faced a crisis of state capacity, with budgetary resources below the low-income average. Since then, with the rationalization of the tax system and the ability to monetize its ownership

of land and other assets, the government has steadily increased the share of income under its control. Today, the Chinese government is wealthy and clearly has the capacity to intervene strongly in the economy.

### **Does the Chinese Government Self-Consciously Steer the Economy?**

The Chinese government consistently emphasizes how it steers the economy because it sees a strong economic performance as a core part of its political legitimacy. Beyond the tools of funding direct government programs and ownership, the Chinese system has two distinctive mechanisms through which it attempts to foster development: 1) a set of bureaucratic incentives that reward officials for growth (of GDP and revenue); and 2) planning that is centered on the national-level Five-Year Plans but includes a broad array of sectoral, regional, and project plans that propose a certain trajectory for growth.

#### **The 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. It is a blunt but powerful instrument, encouraging growth and indirectly promoting investment and high-profile development projects. Ever since the success of township and village enterprises in the early 1980s, 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 (Whiting 2001; Chan and Gao 2008). Good performance in meeting these targets brings cash awards and an increased chance of promotion. An extensive political economy literature has developed on the operation and impact of these incentives (among others, see Li and Zhou 2005; Shi, Adolph, and Liu 2012; Lü and Landry 2014). It needs to be stressed how unusual it is for such high-powered incentives to be introduced into government bureaucracies. Normally, high-powered incentives are avoided for publicly accountable officials, because incentivizing for one or two main targets draws effort away from other objectives (Acemoglu, Kremer, and Mian 2008; Naughton 2008). Such an incentive system can only make sense when a single objective—such as economic development—is seen as an overwhelming priority. This has been true of the Chinese leadership in the last few decades, and may reflect a broader social consensus.

The power of these formal incentives is enhanced by two other characteristics of the Chinese system. First, China's bureaucratic system is a vast pyramid, with norms that establish term limits and rotation of power at the top. All bureaucrats want to move up, but the number of slots for promotion is limited. Thus, incentives for performance become even stronger as officials approach ages associated with



“up or out” career intersections. Second, development incentives are quite compatible with the ordinary deal-making incentives of local officials. Land development and support for businesses can be ways to enrich cronies and relatives, and may also contribute to growth and investment (if the deal-making is handled with restraint). When attitudes toward corruption are relatively permissive, as has usually been the case, the personal and systemic incentives in favor of deal-making reinforce each other and drive local government behavior.

These targets are one way in which China has created a growth and investment machine. Knight (2014) argues that China is a “developmental state” because he finds this priority for developmental objectives built into the system at all levels, with officials given resources and instruments to carry out these goals. As one example, China since 2009 has been investing 48 percent of its GDP, a figure unmatched in large economies (ever), and some portion of China’s extraordinary savings and investment effort is clearly attributable to the energy officials put into raising funds for local development projects. These incentives create a pro-growth environment that systematically encourages investment and growth and is diffused throughout the entire bureaucratic apparatus. They also affect and distort the allocation of resources; for example, urban land is one of the most important resources that a local government official controls. The official’s discretion in the use of land almost always comes down in favor of industrial or commercial development. Su and Tao (2015, pp. 13–14) show that Chinese municipal governments allocate about three times as much land to industry proportionately as other countries, and the price of land for industrial uses is one-sixth that of land for residential use. Such policies clearly have distortionary consequences, not least of which is restricting the supply and pushing up the price of residential land.

Under extraordinary circumstances, government officials can coordinate control of many different kinds of assets. 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. Policymakers issued consistent commands down through separate government and Party hierarchies, and the result was a remarkably large and prompt stimulus effect (Naughton 2009). Of course, such cases are very rare.

### **Planning**

Forty years ago, China was a command economy, with central plans that purported to steer the economy but that actually didn’t work. This type of planning was largely abandoned over the next 20 years. By the late 1990s, China essentially had no long-range plans or industrial policies. Zhu Rongji, the premier at the time, was extremely suspicious of grandiose and ineffective government programs. However, since the turn of the 21st century, long-range plans and industrial policies have made a strong comeback (Chen and Naughton 2016). China today operates with

scores of national plans, and literally hundreds of local government plans. At the center of this activity are the successive five-year plans, including the just completed 13th Five-Year Plan (2016–2020). These plans combine three elements:

1. *A vision statement.* Each of the recent five-year plans has had a theme and a set of overall motifs. These vision statements are consensus documents that communicate some of the hopes and objectives of policymakers, but they do not necessarily involve operational targets. They perform a coordination function, and allow local actors to get on the same page with central policymakers. In this sense, they resemble the “Indicative Planning” that the French pioneered in the 1950s. This function of the plan has changed relatively little over the last four five-year plans.

2. *A handful of binding targets.* Each of the last three plans has included a few environmental targets that, unlike other targets in the plan, are “compulsory.” Beginning with a 20 percent energy conservation target in the 11th Five-Year Plan (2006–2010), these have expanded to include several targets for emissions reduction, carbon emission, and water and energy conservation. The 13th Five-Year Plan (2016–2020) also includes a binding target of bringing all 55 million of China’s people below the poverty line out of poverty by 2020. The government then organizes a special data collection and enforcement program for these “compulsory” targets.

3. *A panoply of associated sectoral and local plans.* The national five-year plan is simply the beginning of a broader nationwide planning process. As soon as the overall plan is completed, local governments and ministries write their own plans that incorporate national objectives. Over the past 20 years, these follow-on plans have proliferated enormously. In the early 2000s, the State Council approved between zero and two industrial policies per year, whereas during 2016 at least 50 sectoral plans associated with the 13th Five-Year Plan have been given official status. There are plans for specific high-technology sectors (like semiconductors or electric vehicles) as well as portmanteau plans for technology development and “strategic emerging industries,” as well as some more loosely integrated concept plans such as “Internet Plus,” and one on industrial upgrading (“Made in China 2025”). The number and density of these associated plans is a recent and distinctive feature of China’s system.

The different elements of China’s planning process need to be considered separately, especially in a comparative context. The combination of a vision statement and a few concrete targets is a fairly standard, common-sense approach to planning. The Chinese plan incorporates and summarizes many existing programs, so it may not be particularly consistent, or announce much new (Kennedy and Johnson 2016). The addition of a vision statement gives it coherence and a more attractive message. The introduction of “binding” targets sends an additional strong measure to decentralized actors that they must take environmental objectives seriously (Heilmann and Melton 2013). But described in this way, China’s planning process is not terribly different from how it is done in, for example, the state of California, where binding targets are established through legislation and regulation. In China, the target is enforced through administrative action, but decentralized actors are left free to choose specific steps.

The proliferation of associated sectoral and local plans, on the other hand, pushes decentralized actors to specific interventions that have no parallel in other market-oriented economies. The plans in China have teeth: while they rarely specify output targets, they specify desired outcomes very precisely and are intended to guide the allocation of resources. They influence local governments, state financing institutions, and other bodies. They convey government priorities and encourage local actors to align their investments with national targets, reducing risk for investments. The increase in government resources documented in the previous sector has been accompanied by a notable increase in targeted interventions. Financing guided into targeted sectors can be very large: for example, a high-priority sector like integrated circuits can expect access to over a hundred billion dollars in investment funding over the 13th Five-Year Plan.

These policies target multiple sectors, employ multiple instruments, and incentivize multiple actors. An additional layer of regional and land-use plans is layered onto the sectoral plans. This complexity means it is quite difficult to determine the net incidence of planning, much less its effectiveness. Resources pour into the highest priority sectors, which brings in more investors and creates unpredictable competition down the road. With so many plans and industrial policies, it is in some ways difficult to say whether China has any plan or a coherent industrial policy. As one example, the powerful sectoral incentives created may not align very well with the overall “vision” of planners. The current 13th Five-Year Plan envisions a transition to service-led development, but the sector-specific interventions channel scarce resources into high-tech industry, potentially diverting finances and high-skilled labor away from services.

Most of the current industrial policies are relatively new, and we rarely have good information about costs or a good measure of the benefits. What features of the Chinese economy today might *not* be in evidence if there had been no “planning”? So far, nobody has suggested a convincing example. Anecdotal evidence suggests very little correspondence between specific initiatives envisaged in successive plans and any of the subsequent outcomes. On the one hand, cases of apparently successful development—such as China’s solar panel industry—have been achieved at the cost of excessive, duplicative, and failed investment. On the other hand, some successes that one would assume are due to planning turn out not to be. For example, the world’s largest high-speed rail network is in China, but that network didn’t appear in the five-year plans until 2016, by which time 19,000 kilometers had already been built.

We might conclude that there is little evidence so far that planning in itself is effective in shaping development; or that it is a cost-effective instrument. However, planning is part of a complex system of national institutions that overall have generally fostered development and growth.

### **Interactions Between the Two Types of Steerage**

What is the relationship between the highly incentivized bureaucratic environment and the official plans, and how will the relationship change as China’s economy

evolves? There are some indications that during China's high-speed growth era (approximately 1980–2010), the two were complements. The bureaucratic incentive system was a blunt instrument that fostered investment across the board, so the plans did not have to take on this function and indeed sometimes could lean against the wind. The five-year plans generally target “soft” GDP growth rates well below the economy's potential. For example, the 11th Five-Year Plan (2006–2010) called for more sustainable, balanced, environmentally friendly economic growth, and greater attention to rural development. It projected annual GDP growth at 7.5 percent, which was below China's potential growth rate. The “message,” therefore, was that local governments should take the environment and long-term sustainability into consideration, and not merely push for the highest attainable GDP growth rate.

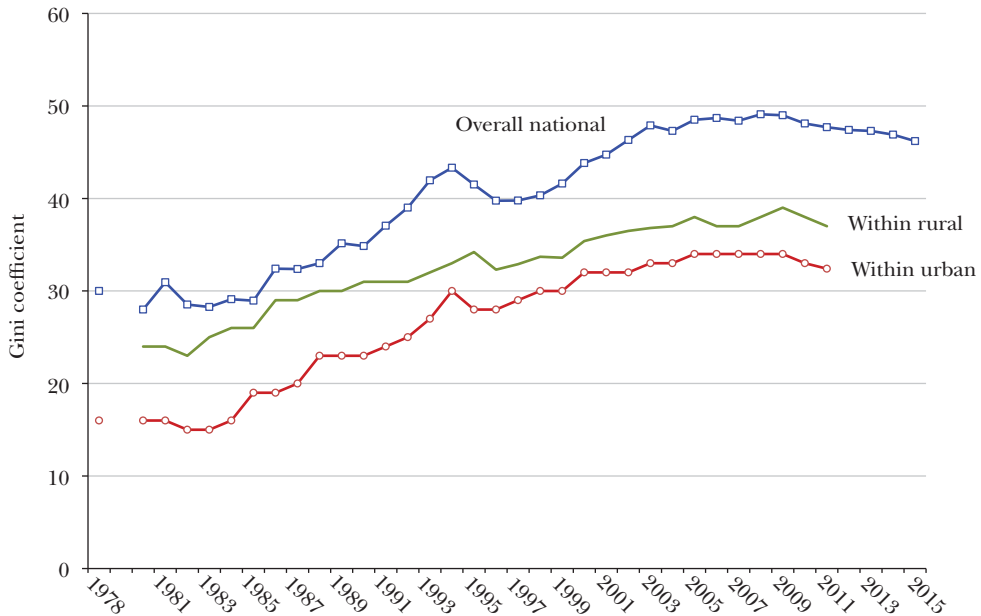
Was that message received? Apparently not, since China's GDP growth rate actually accelerated to over 10 percent in the three years beginning in 2005 and peaked at 14.2 percent in 2007. Moreover, in many respects, China's growth became less balanced and more high-investment driven over the plan period. Nevertheless, the plan may have played some positive role in moderating the worst aspects of an investment-driven growth model. In fact, the tension between bureaucratic incentives—which have consistently rewarded growth since the mid-1980s—and the more specific objectives of the planning process like environmental goals has been a long-term feature of the Chinese system that worked out reasonably well during the high growth era.

Since about 2010, China's “miracle growth” era has come to an end, due to rapid changes in labor force conditions, incomes, and external markets. In the wake of this change, the complementarity between bureaucratic incentives and the plan appears to be declining. The Xi Jinping administration has since 2012 reduced the focus put on economic growth in official success indicators, squeezing in new indicators such as managing local government debt, reducing poverty, and improving the environment (*New Capital Post* 2014; Wei 2016). At the same time, the most recent 13th Five-Year Plan (2016–2020) GDP target of “more than 6.5%” growth is close to, or perhaps even above, growth potential. The 13th Five-Year Plan seems to have become an instrument to maintain high-speed growth, even as the bureaucratic incentive system becomes less single-minded. It is a paradox of contemporary China that administrative interventions are increasing in size and multiplying in form just as growth potential is slowing and the benefits to a less-interventionist stance would seem to be increasingly evident.

## **Does China Intervene to Help the Less Well Off?**

China's economy has grown faster for longer than any other economy in history. Growth of per capita GDP at the rate of 7–8 percent per year for almost 40 years has meant 2014 GDP per capita is 20 times what it was in 1978. There is no serious doubt that the benefits of this extraordinary growth have been broad-based. According to the widely used Human Development Index, which includes data on income, health, and education, China has improved from the “low human development”

Figure 2  
Evolution of China's Gini Coefficient



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

level of .42 in 1980 to the “high human development” level of .73 in 2014. This extraordinary improvement in overall living standards must be the starting point for any discussion of well-being and redistribution in China.

In contrast, China's efforts to improve distribution and increase the supply of public goods have met with only limited success. During the same period that incomes grew explosively, China's income inequality substantially worsened. From being one of the most equal large-population societies in the world in the early 1980s, China has become a relatively unequal society. It follows that improvement of living standards for those at the bottom of the distribution would have been even more rapid if distribution had not deteriorated. Figure 2 shows China's income Gini coefficient according to official household survey data. The Gini peaked at .49 in 2008–2009, and since then has drifted down slightly. The national Gini is much higher than both the within-urban and within-rural Gini because of the large gap between urban and rural incomes in China. Average urban incomes were less than twice rural incomes in 1983, at the minimum, and increased to 3.3 times rural incomes in 2009. The *hukou* household registration system divides all Chinese households into two categories, those with and without an urban household residence permit. Lack of an urban household residence permit continues to limit

access to income-earning opportunities and consigns rural residents to a second-class package of social benefits. As China's explosive growth increased incomes in the cities, rural incomes grew as well, but at a substantially slower rate though 2008–2009. In addition, entrepreneurship and diversification of income sources within urban and rural areas also increased overall inequality (Li and Sicular 2014; Zhou and Song 2016). The moderate decline in inequality since 2009 is almost certainly due to structural changes in China's labor markets. Since the mid-2000s, wages for unskilled and migrant workers have increased relatively rapidly, and more rapidly than those of skilled urban workers. Reflecting these changes, the urban/rural household income ratio has narrowed to less than 3.

### **Poverty Alleviation**

China's record in poverty alleviation since the start of the reform period has been excellent. 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 (using the traditional \$1 per day—now \$1.90 per day at 2011 purchasing power parities). Some of the World Bank's data are based on backward reconstruction that may not correctly capture changes in China's prices and rural distribution system in the early 1980s. However, the most conservative calculation, which would start with the years 1989–1992 when there were on average 260 million rural people below the poverty line, still finds a reduction of more than half to 114 million a decade later in 2001. By 2015, this total had again dropped by more than half, down to 56 million as of 2015 (Wei 2016), notwithstanding a Chinese domestic poverty line that is now slightly above the World Bank's standard \$1.90 benchmark set in 2011. There is no question that China's overall record in poverty alleviation has been outstanding.

How much of this poverty reduction is due to government policy? China has had an active policy of targeting poor counties since 1986. About one-quarter of China's counties are designated "poor," which provides them with fiscal transfers for local economic development and infrastructure, food for work, and subsidized loans. The strategy is very much one of fostering local economic growth, especially nonagricultural production. As a method of poverty alleviation, the program has been criticized: geographic targeting misses poor people outside designated regions and benefits wealthier people within targeted regions; there is evidence that a portion of budgetary transfers inflate administrative expenses rather than helping poor people; and agricultural growth may be more fundamental to the success of these areas than industrial investments (Montalvo and Ravallion 2010). Clearly, agricultural and rural growth are the main drivers of poverty reduction in China, not government antipoverty programs. However, China's antipoverty approach is utterly consistent with the pro-growth bureaucratic incentive system. The antipoverty program at a minimum ensures that bureaucrats at the local level have some resources to feed into their competitive growth effort (Ang 2016). There is some evidence that counties near the poverty cutoff grew faster if they were designated "poor" but the effect is small (Meng 2013).

### **Redistribution in China**

China is certainly not a welfare state. China has virtually nothing in common with countries like Cuba or Brazil—otherwise so different—which have made substantial efforts to transfer money directly to the poor and to invest in social services. In China, transfer payments of all kinds are low and are also restricted in important ways. However, even in this respect, there are important differences with the situation 20 years ago. In the mid-1990s, China was doing almost nothing to redistribute income. The social safety net in the countryside, tied to the agricultural collectives, had collapsed. 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.

Since the 1990s, the Chinese government has sought to restore the urban social compact and spread a social safety net across the entire population. The existing urban system for those with permanent residence permits has been updated and adapted to a market-based economy, and it was not too difficult to update this existing, rather generous system. Systems for rural residents and rural-to-urban migrants, by contrast, had to be recreated from scratch. Over the past decade, the Chinese government has created new low-cost and low-benefit programs that cover the rural and migrant populations—for example, for medical insurance and pensions. The current extraordinarily complex system is—theoretically, at least—the beginning of a protracted transition toward an integrated national social security system. Today, there are four different medical insurance and pension systems, which between them cover virtually all Chinese citizens. However, the actual flow of resources through these combined systems is still modest. The government's direct contribution to social welfare benefits is still strikingly small. In 2014, budgetary outlays for education by China's government were 3.6 percent of GDP; for health, 1.6 percent of GDP; and for public housing, 0.8 percent of GDP. These are all strikingly low by comparative international standards.

In a similar spirit, China has universalized its system of direct income transfers. After rapid expansion, today about 20 million urban dwellers and 50 million rural residents receive direct minimum income payments. Actual direct relief payments to these 70 million recipients are set by local governments and vary substantially across regions. However, average payments are very low. Even a wealthy province like Zhejiang gives average payments of about US \$50 per month, and in most places, the payments are far lower.

What are the proximate causes of China's relatively low redistributive effort? In practical terms, China has not established an institutional framework that makes broader redistribution feasible. As described earlier, personal income tax is still only 1.3 percent of GDP; moreover, income tax is levied only on wage income and some types of interest income, so almost all entrepreneurial and investment incomes escape coverage. As a result, the scope for redistribution through progressive taxation is small. According to the large household survey carried out by Li et al. (2014), the net redistributive impact of taxation on income distribution was essentially zero.

On a deeper level, the hesitation of Chinese policymakers to push for a greater degree of redistribution is driven by two structural factors. First, the deep institutional divide between rural and urban residents continues. Even though hundreds of millions of farmers have already left the countryside and settled in the cities, China has not found a way to extend the benefits of urban citizenship to migrants or rural residents. In theory, all employees, including rural migrant workers, should be covered by the social insurance system, to which both employers and employees should contribute. The proportion of migrant workers covered by social insurance increased until 2013, but only to 15.7 percent for pension plans and 17.6 percent for medical insurance, and the coverage ratio seems to have stagnated since (NBS 2014). Simply extending urban benefits to the rural and migrant population would be prohibitively expensive and administratively difficult, so China has instead settled for a provisional system that extends a much cheaper and less-comprehensive set of benefits to rural dwellers. As a result, the new systems replicate the old urban-rural divide. Urban dwellers with permits have inherited the benefits of the old command economy system. Social services for rural residents have improved significantly, but they remain far below those enjoyed by urban residents.

Second, although China's population today is young, it stands on the brink of an extraordinarily rapid aging process. The current urban system already faces funding challenges in some localities because retirement ages are low and benefits generous (pensions have been raised annually for the past 15 years). However, this generosity extends to only a relatively small proportion of the total population. Contribution rates of current workers are high, which raises labor costs overall, because policymakers worry that setting contributions lower will create funding shortfalls as population aging accelerates. Population aging is not just an urban phenomenon: rural out-migrants are disproportionately young, and the population they leave behind obviously has a higher share of elders. Policymakers struggle to find a solution that covers the rural left-behind aged and also integrates younger workers as contributors into a national system. These factors lead policymakers to take an extremely cautious attitude toward expansion of retirement and other social welfare provisions.

China has taken real and meaningful steps toward re-establishing at least a rudimentary welfare system that covers its entire population. The change from 20 years ago has been dramatic in terms of the creation of an institutional framework to cover the entire population. After a decade of effort, the level of benefits provided is still quite low and the safety net has some large holes. Moreover, the system has failed to tackle the fundamental inequalities of the old society, so that it redistributes income primarily among the comparatively well-off urban population. Overall, the limited scope of the effort is striking, especially when set against China's massive physical asset investment effort.

### **Public Goods**

For the past 20 years, as government resources have grown, China has engaged in a massive physical infrastructure effort that has transformed China's built environment and dramatically expanded the stock of physical infrastructure. Any of a



number of quantitative indicators could be selected, but perhaps the most striking single fact is simply that China is now knit together with a complete grid of high-speed 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 and creates a new reality of integrated transport across the Eurasian land mass. These regional infrastructure programs have benefits in promoting overall growth, but they are certainly far less cost-effective as means of redistributing income to the less well-off than direct social programs that Chinese policymakers have decided they cannot afford.

An alternative method of helping those who are less well-off is to provide public goods, like environmental protection, rather than direct income transfers. In sharp contrast to its aggressive and activist record in physical infrastructure, China's record with respect to the environment is fair to poor. Although strong consciousness of environmental issues spread in China since about 2000, it took a decade before serious measures began to reduce the emission of air and water pollutants and create conditions for an improved environment. While China has steadily stepped up its investment into environmental protection, it has done no more than follow 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). So far, China has experienced substantial environmental deterioration that shows clear signs of flattening out, but only limited indications of significant improvement.

### **How Responsive Is China's Government to Popular Demands?**

Socialist systems, such as those in the former Soviet Union, have a long tradition of being nondemocratic but claiming to speak for the interests of the masses or the working class. China certainly fits comfortably into this tradition. China is an autocratic government, with all political processes controlled by the Communist Party. One peculiar characteristic of China's Communist Party is how frankly elitist it is. In 2002, the Party redefined its claim to legitimacy and focused it on educated elites and knowledge workers, rather than its traditional working class constituency. In the "Three Represents," proposed by Jiang Zemin and formally adopted by a Party Congress in that year, the Communist Party declared that it represented "advanced productive forces, the orientation of China's advanced culture and the fundamental interests of the overwhelming majority of the Chinese people." In this formulation, although the Party is charged with representing the interests of the "overwhelming majority," the Party itself is made up of "advanced" elites. The Party recruits heavily from elite schools and emphasizes that recruitment of Party members is highly selective. Among today's Party members there are three times as many managers and technicians as there are ordinary workers, and nearly all government employees (and teachers) are Party members.

The Chinese system has become partially institutionalized in a way that sets it apart from other Communist systems. The Communist Party has developed a system of term limits, leadership rotation, regular promotion, and credentialing for its officials. There are channels for the 83 million Party members to express their views. These mechanisms give far more weight to the views of urban dwellers than to rural residents. In policy formulation, the Party and government go to great lengths to solicit opinions broadly and gradually form and enforce a policy consensus (Chen 2011; Wang and Fan 2013). Moreover, the Party focuses single-mindedly on public opinion, primarily to shape it through media control, but also secondarily to understand policy preferences and to absorb and blunt criticism. In China, as in other East Asian societies after World War II, there has almost certainly been a profound social and political consensus in favor of growth. A major achievement of the Chinese system has been its ability to fulfill the deep popular desire for development.

Despite the quasi-institutionalization of the Chinese system, it remains wholly without external accountability. The enormous increase in the flow of revenues through the government since the late 1990s, the return to profitability of state-owned enterprises, and the enormous growth in the value of government assets clearly creates a dynamic that is different from the system in the 1990s. With power so concentrated, with little transparency and few checks or balances, it is inevitable that insider control will be pervasive and corruption a major problem. Indeed, in that sense, the major alternative label for China is “state capitalism” (Naughton and Tsai 2015). The term “state capitalism” was invented by Lenin to describe a state that pursues its own interests in the marketplace. Bremmer (2009, p. 41) calls state capitalism “a system in which the state functions as the leading economic actor and uses markets primarily for political gain.” While this captures some of the Chinese reality, Bremmer (along with Lenin) assumes the state is a unitary actor, and for that reason underemphasizes the capture of rents and resources by individuals working under the state umbrella. Is the Chinese system responsive to a unified vision of development (albeit developed by autocrats), or is it responsive to a diverse collection of interest groups? For example, the land revenues and profits of state-owned enterprises described in an earlier section are not under the complete control of the state, but rather are partially controlled by the interest groups that grow up around them.

A number of the policy shortcomings described in the previous section are consistent with an interest group interpretation of the policy process: the failure to redistribute income from urban to rural households; preference for expensive physical capital investments over modest social expenditures; difficulties in shifting from an investment-driven to a consumption-driven economy; sluggishness in addressing issues of environmental deterioration; and others. One possibility is that the very revival in the fortunes of the government described earlier led the Chinese system to evolve a network of entrenched interest groups. Redistributive policies cannot be carried through without fundamental reforms of the fiscal, financial, and decision-making systems, which interest groups have so far been able to stall and deflect. In this view, the system ends up reflecting the interests of insiders: for example, of managers of state-owned enterprises. In a broader sense, the interests are those of a

larger group of Communist Party officials, politicians and technocrats, and even the urban population—at least those with urban residence permits—as a whole.

The response of President Xi Jinping to this state of affairs has been to attempt to make China “more socialist.” Xi has of course pursued a high-profile anticorruption campaign since he came to power in 2012. The anticorruption campaign revealed that many state enterprises, particularly in the petroleum sector, had been largely captured by individual interests. This could be an argument for improved transparency, competition, and public oversight (and even privatization). Instead, Xi Jinping has shown himself inclined to a revival of socialist ideals and increased loyalty to the Communist Party. He has increased Party discipline and increased the rhetorical commitment to the “China dream” and “socialist core values” (which on the surface closely resemble universal human values, except that the Chinese Communist Party interprets all the practical details). All these actions can be interpreted as an acknowledgement that internal interest groups—rather than the public interest—have been driving specific economic outcomes. What is particularly striking is that the response has been to tack in an increasingly political direction, essentially gambling that socialism still has strong ideological appeal for ordinary Chinese.

## Conclusion

Today, the question “Is China Socialist?” can reasonably be asked and left open. Sixty years ago, everyone knew that Mao was leading a socialist China; twenty years ago, everyone thought that political leaders like Jiang Zemin and Zhu Rongji were leading China away from socialism. China today clearly fulfills our first two criteria: the government has the capacity and intention to shape economic outcomes. On the third and fourth of our criteria—redistribution and responsiveness—China scores less highly than on the first two.

The objective of China’s state intervention has clearly shifted from growth at any price to a more complex set of goals that includes redistribution and social and economic security. China under its current President (and General Secretary of the Communist Party) Xi Jinping is moving toward a more explicit embrace of socialism and a stronger commitment to socialist goals, as exemplified by the ambitious five-year-plan target of eliminating absolute poverty by 2020. Thus, it seems broadly fair to view China as moving towards a version of “socialism,” albeit a very particular flavor of socialism that is authoritarian and top-down, but with a market economy based primarily on private ownership.

It is also possible to take a more skeptical view of China’s trajectory. China’s system of incentivized hierarchy—the authoritarian growth machine—was effective in mobilizing resources and maximizing growth during a “miracle growth” phase, when demographic, structural, and international factors all came together to raise growth rates. It also gave the Chinese government unprecedented control of resources and incentives, which it used predominantly to drive an enormous physical investment effort. The positive achievements are remarkable: the world’s

best record of growth, tremendous success in alleviating poverty, and a national physical infrastructure built at unprecedented speed that is quickly approaching developed country standards. However, this “growth miracle” phase is now ending. Fundamental demographic changes, completion of many infrastructure programs, and a much-reduced distance to the global technological frontier are combining to lower China’s potential growth rate in a dramatic manner. China has less *need* for growth-before-all-else, but this also means that the incentivization of the hierarchy, so fundamental to the past growth model, is no longer central to China’s most important goals. The Chinese government has only belatedly begun to introduce a new set of instruments to achieve other objectives, and so far there is little evidence that China has developed a new way to steer the economy in a “socialist” direction while retaining some of the benefits of the developmental state.

It is in this context that we must view China’s striking policy shortcomings: its weak institutional effort to redistribute income reflected in the emergence of a highly unequal society; the consistent underfunding of social expenditures; and a problem of environmental deterioration that is evident in air, water, soil, and contribution to global warming. China’s policymakers have taken notice and increased their rhetorical commitment to addressing such issues, but the hoped-for amelioration of these conditions has barely begun.

In my opinion, China cannot be considered a socialist country until it makes much greater progress fulfilling its own declared policy objectives of universal social security, modest income redistribution, and amelioration of environmental problems. In turn, reaching these objectives will almost certainly require much more robust programs of economic reform. When the predominant objective of policy was economic growth, it was not particularly important to whom policy was responsive, since all groups shared an interest in growth. Today, as the government tries to redistribute and provide more public goods, policy must reflect the interests and more diverse preferences of a broader population. So far, China has not found a way to do this. China’s relatively weak performance in achieving broadly redistributive policies, social fairness, and improved public goods provision appears to reflect the limits of responsiveness and the power of entrenched economic and political interests. Given socialism’s authoritarian history, some would argue that responsiveness is not a necessary condition of socialism. However, if the lack of responsiveness prevents the system from devising and implementing efficient redistributive and public goods solutions, then a country cannot achieve the core objectives of a socialist system.

The Chinese leadership today, headed by Xi Jinping, has launched a broad campaign against corruption that implicitly acknowledges these problems. At the same time, Xi seems to favor an effort to make the system more socialist, by stressing collective goals and top-down direction. Thus, even those who judge that the Chinese system today is not socialist might consider that the socialist ideal is still influential, and the system may continue to evolve in the direction of stronger “socialist” and redistributive institutions. As that happens, the mix of attributes will change, and a “Chinese model” of socialism may begin to emerge.

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