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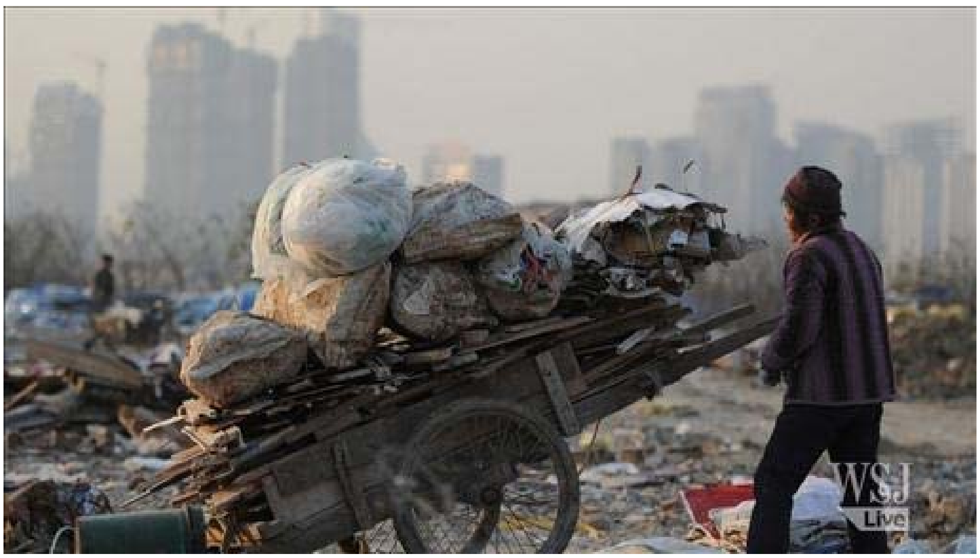
China Tries to Shut Rising Income Gap

Beijing Faces Resistance From State-Owned Firms Against Boosting Wages at the Expense of Profits

By BOB DAVIS



As China's economy grows, the gap between the rich and poor continues to be a challenge for the new government. Dragonomic Research Analyst Thomas Gatley tells Deborah Kan why closing China's income gap will pose new challenges.

BEIJING—Eight years ago, China's state planners were given an ambitious task: come up with a plan to narrow the vast gap between China's rich and poor.

The project was at the heart of a promise made as President Hu Jintao and Premier Wen Jiabao came to power, to build a "harmonious society."

Their vision was to raise the income of workers and farmers faster, even if it meant a transfer of wealth from state-owned enterprises—to boost wages at the expense of profits.

Now, the plan is finally set to be released this month after a push by Mr. Wen, in the 11th hour of his tenure. But after at least a half-dozen drafts, some of the most significant proposals have been watered down, or

European Pressphoto Agency

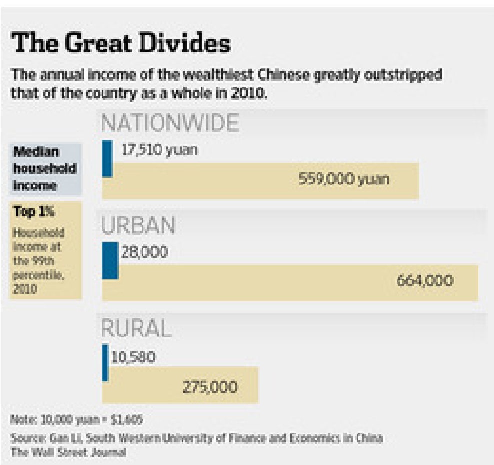
A recent aviation show in Beijing sought customers for private jets and helicopters among China's rising rich. The inequality threatens to stall growth and ignite social unrest.

dropped completely, after opposition from state-owned firms, researchers involved in the project say.

The result is a general set of principles rather than a practical road map with specifics on how to redistribute wealth, they say.

"The policy's target is to reduce enterprise income and give more money to labor," said Qi Jingmei, a research fellow for the State Information Center, a government think tank. "But monopoly companies and state-owned banks don't want to give more profit to the country and let the government redistribute it."

The problems of the plan underscore the difficulties China's new Communist Party chief, Xi Jinping, and incoming premier, Li Keqiang, will face as the task of dealing with an issue that threatens to stall growth and ignite social unrest falls to them.



Whether they decide to take concrete measures to ease China's income gap—which has begun to rival Latin American and African nations—presents an early test of their willingness to embark on difficult economic changes. Despite a number of recent statements on the need for reform, Messrs. Xi and Li have been short on specifics.

"The Western notion that you come in and do everything in the first 100 days—that's not the way China operates," said the World Bank's China chief, Klaus Rohland.

Tackling inequality requires confronting the elites that benefit from the status quo and reining in the corruption that allows officials to pad their pockets. Wang Xiaolu, deputy director of China's National Economic Research Foundation, and Wing Thye Woo, a University of California at Davis economist, say that when counting what they call "hidden" income—unreported income that may include the results of graft—the income of the richest 10% of Chinese households was 65 times that of the poorest 10%, instead of the 23 times that the Chinese government estimates.

The income gap also undermines efforts to revamp China's economy so that it depends more on consumer spending and less on exports and investment. Putting more money in the pockets of lower-income Chinese helps lift consumer spending, while wealthier Chinese are more likely to sock away additional income.

"If you reduce income inequality you can improve domestic consumption," Mr. Wang said.

Some of the most formidable opponents of change are China's hugely profitable state-owned companies, which dominate the energy, transportation, banking and telecommunications industries, say those involved with the redistribution project.

One idea reported in the state press, to limit the salaries of chief executives of the state-owned companies, went nowhere, said a researcher involved in the project, though the final report may include principles for setting such salaries.

At times, the debate appears to have touched on conflicting objectives. One idea was to make transportation cheaper for ordinary Chinese by limiting fuel-price increases. A researcher said the plan was shot down by state-owned oil companies whose profits could be crimped.

Heard on the Street

China Rebound Is No Sure Bet

That might not have been the only opposition: Keeping prices higher limits the number of cars and buses on roads, a goal of many pollution-choked Chinese cities. The National Development and Reform Commission—which runs the income-distribution plan, didn't comment on the project.

One of the hardest-fought issues involves whether to boost the taxes and dividends companies pay to the state. Many Chinese economists have argued that money could be used to boost pensions and health-care payments, particularly to impoverished rural areas. In 2011, China's state-owned firms—many of which benefit from monopoly or near-monopoly positions—earned $264.3 billion, according to China's National Bureau of Statistics. That sum equals nearly 30% of China's central-government spending.

State-owned firms now pay dividends of between 5% and 15% of their earnings to the state, but that money is generally returned to them for investment and other purposes, said Citigroup economist Ding Shuang. Even the top rate is less than half of what state-owned firms pay, on average, in 16 wealthy nations, according to the World Bank.

The state-owned firms' deep pocketbooks make them attractive targets for those looking to revamp the Chinese economy, but have also made the companies powerful foes of change. "State enterprises have become a conduit for the economic and political elite to enrich themselves," said Eswar Prasad, a China expert at Cornell University. He notes that state-owned firms used to be agents of equality by providing housing and health care for their workers, but have given up that role as budgets have shrunk.

Mr. Hu, in his farewell address as party chairman, strongly endorsed China's state-owned sector. "We must unswervingly consolidate and develop" state-owned firms, he told the Party Congress last month before Mr. Xi was named to succeed him.

But there have been recent hints that Beijing may try to tap state-owned firms' riches. This spring, China agreed in negotiations with the U.S. to boost the firms' dividends. Then, in Mr. Hu's farewell address, he set a goal of doubling both GDP and per capita income by 2020.

One way to pull that off would be to reduce the percentage of national income that goes to state-owned firms and direct it to the household sector.

Several researchers said the income-distribution plan may set further goals for the share of income that should go to worker paychecks. Other principles may include exhortations to reduce the income tax paid by poorer Chinese, and to even out differences between health care and other government services provided to poorer rural areas and wealthier urban ones. Another may be to introduce nationally a system of property taxation.

The plan, though, is expected to leave specific measures to ministries responsible for different government functions, such as the Ministry of Finance which sets tax policy. That is bound to set off new lobbying battles.

Mr. Ding, the Citibank economist said, "People want to see detailed proposals and measures. If it's only principles, the plan would be a disappointment."

Reform is difficult because "there are conflicts between different interests," said Li Shi, an income-inequality expert at Beijing Normal University. In the past year or two, he said, government policies have helped slow the rate at which the income gap is expanding by boosting the prices paid to farmers, increasing spending in the poorer regions of western China, and increasing pensions and health-care payments. He figure that China's new leaders would press for further changes because if they don't, "it will be hard to maintain the society and maintain the economy."

But fundamental changes—if they occur—may not come until the new leaders' second five-year term, said Credit Suisse analyst Dong Tao, "because it takes time for the new leaders to build political will and strength."

—Olivia Geng and Tom Orlik contributed to this article.

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