

CHALLENGES OF ENLARGING THE MIDDLE INCOME
GROUP, RELATIVE TO CURRENT GLOBAL ECONOMIC
DEVELOPMENT CHANGES, AND FREE TRADE

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1. HISTORY

1949 – 1979: No Middle Income Group. Or Middle Class. Only three classes:

- Peasants
- Workers
- Intellectuals

From 1979: “... getting rich is glorious”, a statement attributed to Deng Xiaoping. The middle class emerges.

Housing reform of 1990, Andrew Nathan (2016):

“... the Chinese middle class grew out of the housing reforms of the 1990s, reforms that heavily favored the employees of government offices and state enterprises, which owned most of China’s housing during the Mao period and rented apartments to their employees.”

2002 – Plenum of the 16th National Congress of CCP in 2002 – ratified The Three Represents, Jiang Zemin explains:

“Our Party must always represent the requirements for developing China's advanced productive forces, the orientation of China's advanced culture and the fundamental interests of the overwhelming majority of the Chinese people.”

Broadening the CCP's base of power by including entrepreneurs, intellectuals and technocrats (Cheng Li 2010).

Also at the 16th National Congress of CCP in 2002 – the Chinese leadership calls for “enlarging the size of the middle income group” – the topic of today.

March 2017: Private entrepreneurs account for about 20 percent of the nearly 3.000 delegates to National People's Congress.

2. OBSERVATIONS ON THE MIDDLE INCOME GROUP

Middle class, no well established definition exists. Defining characteristics:

- Income
- Education
- Occupation

A huge middle class, for the first time in China's history, now sits between the ruling elite and the masses.

Annual income of 75,000-280,000 yuan (The Economist and McKinsey):

2000: around 5 million households

2016: around 225 million households

2020: around 275 million households

An old and well established middle class does not exist in China.

Middle class growing alongside an astonishing increase in economic disparities.

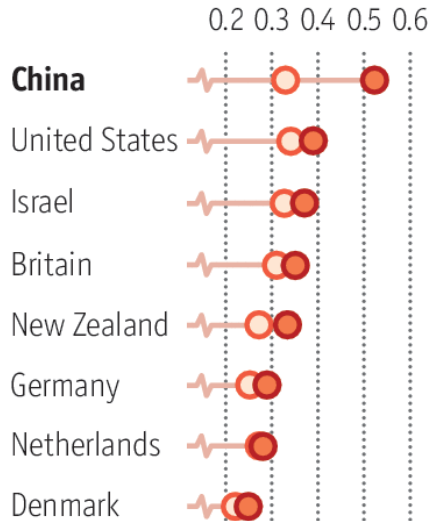
Some further observations, quite summarily:

- ✓ Middle class does not align with anti-poverty policies
- ✓ Conservative on social and economic reforms (in no hurry to dismantle hukou system)
- ✓ Fear of instability and saves a high share of income
- ✓ Fear “chaos” and in favor current political order
- ✓ Feel unfairly targeted by the anti-corruption campaign
- ✓ Middle class is a very heterogeneous group

From Mao to now

Gini coefficients
0=perfect equality
1=perfect inequality

○ 1985 ● 2012



Sources: GCIP; OECD

Economist.com

Middle class well connected to CCP, Alice Ekman (2014):

“... current and former civil servants appear to constitute the core of the middle class population in China the well-off part of the Chinese population is often connected in one way or another to the governing Communist Party.”

BUT: Education more important than Party membership in determining income.

Progressive disconnection between the CCP and the young generation of the middle class (Ekman 2015)

China's population is ageing; the middle class is getting younger. The Economist, 9th July 2016:

“The middle class is increasingly dominated by those born after 1989... They are no longer so cowed by history or so grateful to the party for the improvements in living standards ...” And also feels “...being squeezed, both from the bottom and the top.”

Alice Ekman (2015) adds:

“...the middle class is increasingly concerned with a set of specific domestic issues, related to the *degradation of the environment* and *property-law disputes*, among others issues directly affecting their interests and living standards.” (my underlining)

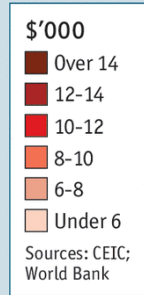
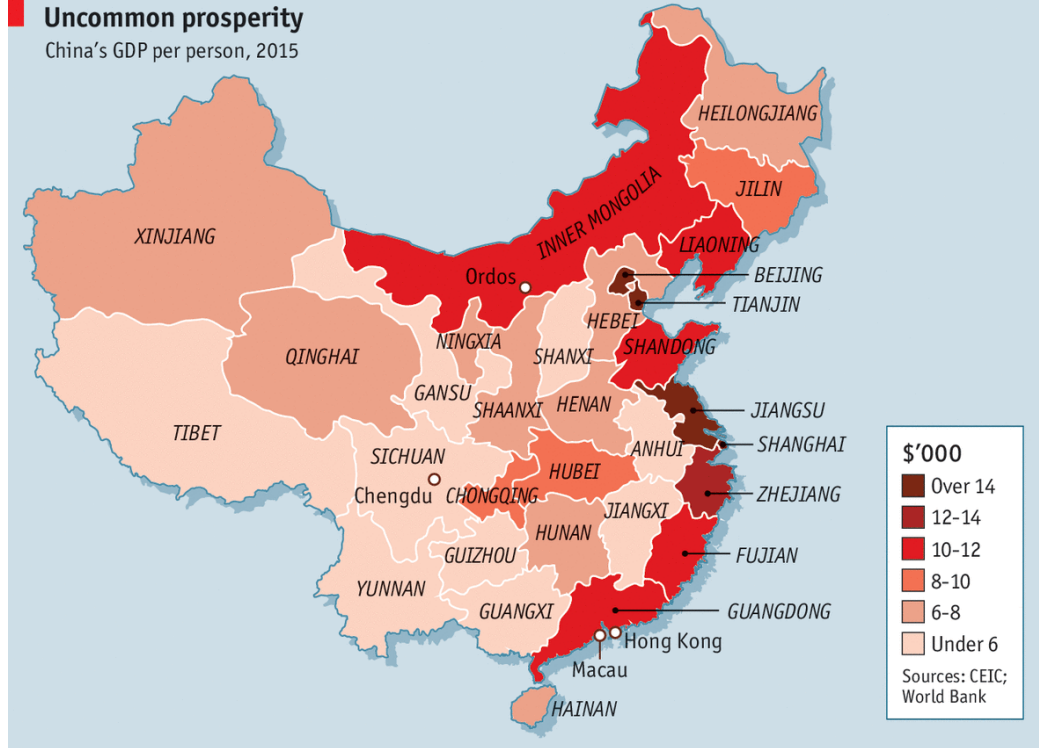
Nathan (2016) makes the following point:

“Politically, the middle class is caught between a ruling party above, ... and mass of workers and peasants below, ... possessing interests that the middle class sees as adverse to their own.”

Huge differences in income across the Chinese provinces, which means that the middle income groups are geographically fairly concentrated.

Uncommon prosperity

China's GDP per person, 2015



Economist.com

3. WHY ENLARGING THE MIDDLE INCOME GROUP?

- ✓ To reach the goal of *Xiaokang society*
- ✓ To maintain political stability, a less uneven distribution of income is called for
- ✓ To have a sustainable economic model in which private consumption takes over as the engine of growth (from the demand side), from real investments and exports

In 1979, Deng Xiaoping used the term *Xiaokang society* as the goal of Chinese modernization – a “moderately prosperous society”.

Xi Jinping in Manila in November 2016, at APEC meeting:

China is on the road to building a "moderately prosperous society" by 2020. "We will work hard to shift the growth model from ... factory-driven to innovation-driven, and from depending mainly on investments and exports to relying on coordinated increase in consumption, investment and export."

<http://www.straitstimes.com/asia/east-asia/apec-xi-jinping-sees-moderately-prosperous-society-for-china-by-2020-economy-still>

However you look at it, a central element is enlarging the middle income group. Also, fits in with Hu Jintao's focus on developing a "harmonious society".

In economic terms, the marginal propensity to spend is much higher for poor people than for rich people.

- You want consumption-based growth?
- Redistribute income from the rich to the poor.

Remember Henry Ford's five dollar a day in 1914?

Why, when the going wage rate was less than half?

Who should buy my automobiles if workers are not paid well?

Avoid the middle income trap as a country,
by expanding the middle income group.

4. THE MIDDLE INCOME GROUP, GLOBAL ECONOMIC DEVELOPMENT, AND TRADE

December 2001 and China joins WTO.

Benefits enormously from international trade.

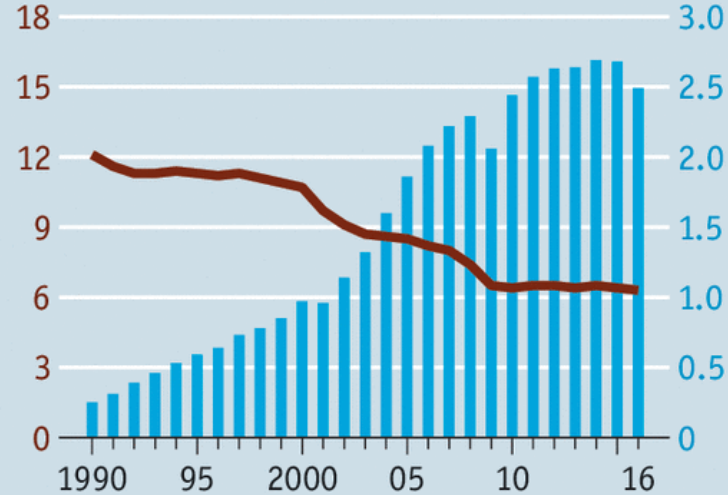
The middle income group in China grows.

Cheap but not cheerful

United States

*Manufacturing employment
As % of working-age population**

*Goods imports
from China
As % of GDP*



Sources: Census Bureau; BEA; BLS * 15- to 64-year-olds

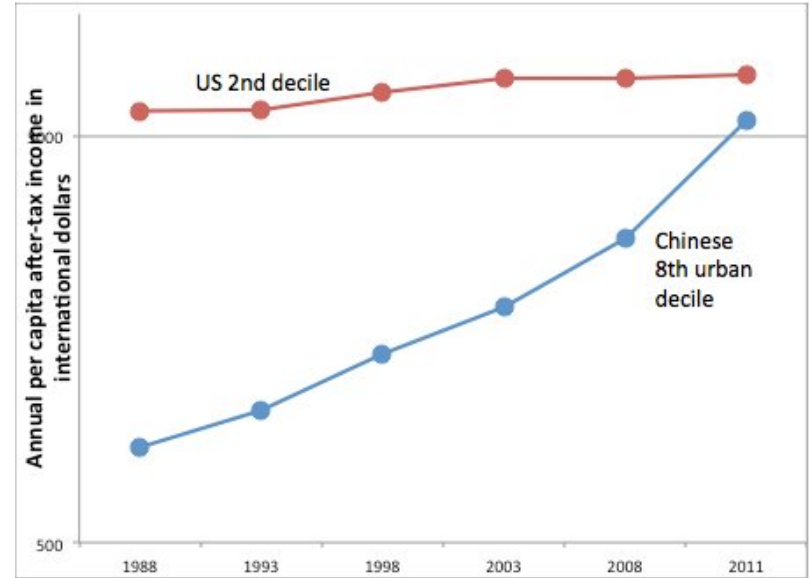
Economist.com

<http://www.economist.com/news/finance-and-economics/21718513-china-shock-has-not-been-debunked-it-worth-understanding>

Factor price equalization theorem at work.

Relatively low-paid American workers
lose to relatively well paid Chinese
workers.

Note: Vertical axis in logs.



http://www.huffingtonpost.com/branko-milanovic/winners-of-globalization-_b_4603454.html

David Autor, David Dorn, and Gordon Hanson argue that import growth from China cost the United States about 2.4 million jobs over a dozen years.

On top of it, capital takes a larger share of the pie.

Used to be 2/3 to labor and 1/3 to capital in many countries.

Recent data, 60 percent to labor and 40 percent to capital.

Hollowing out of the middle class in America?

Edmund Phelps (Columbia University) links populist voters' anger to their *loss of dignity* in the larger political economy.

Trump elected president.

Consequences for middle class in China: Protectionism on the rise in America.
China deemed a currency manipulator? Ten years too late.

International trade considered a zero-sum game by Trump.
Tariff on Chinese exports to the US? Possible.
But a trade war would be a two-way street.

American firms have US\$250bn invested in factories and business operations in China. Protectionism, and those investments a liability for America?

TPP aimed at building Asia-Pacific trading bloc with very open rules on trade and investment, and high standards of intellectual property protection.

Trans-Pacific Partnership (TPP) gone January 23, 2017.

China – and The Regional Comprehensive Economic Partnership – takes over.

Belt-and-Road initiative; Asian economic integration driven by Chinese-financed (AIIB) and -engineered infrastructure, rather than by US-sponsored trade agreements.

China Inc. will probably continue to be one of the biggest winners from the populist turn in American politics.(*)

(*)Here I have drawn upon “For China, Trump Is A Paper Tiger” by Arthur Kroeber, *China Economic Quarterly*, March 2017.

Fung Business Intelligence, 23 March 2017

Asia is quickly catching up with trade liberalization moves of its own. China has recently taken a leadership role in the region by stating its commitment to free trade and promoting its "Belt and Road Initiative" as an open platform for intra- and inter-regional economic cooperation. This initiative has the potential to present an alternative path to globalization, complementing the WTO system while still keeping momentum going for trade liberalization across a massive geographical span. China's growing influence is thus set to inject a new dynamic – and dynamism – into international trade.

BREXIT and populist turn in Europe too.

Elections in France in April and May.

In Germany in September.

What will happen to EU? Consequences for middle income group in China?

Chinese Midea buying the German company Kuka, leading in robot technology. In spite of German politicians misgivings about the deal.

China happy – in line with, “Industry 4.0” and “Made in China 2025”.

“Industry 4.0” concept of fully automated production facilities that require minimal human involvement.

“Made in China 2025”, innovations in key industrial sectors, to improve the image of Chinese brands.

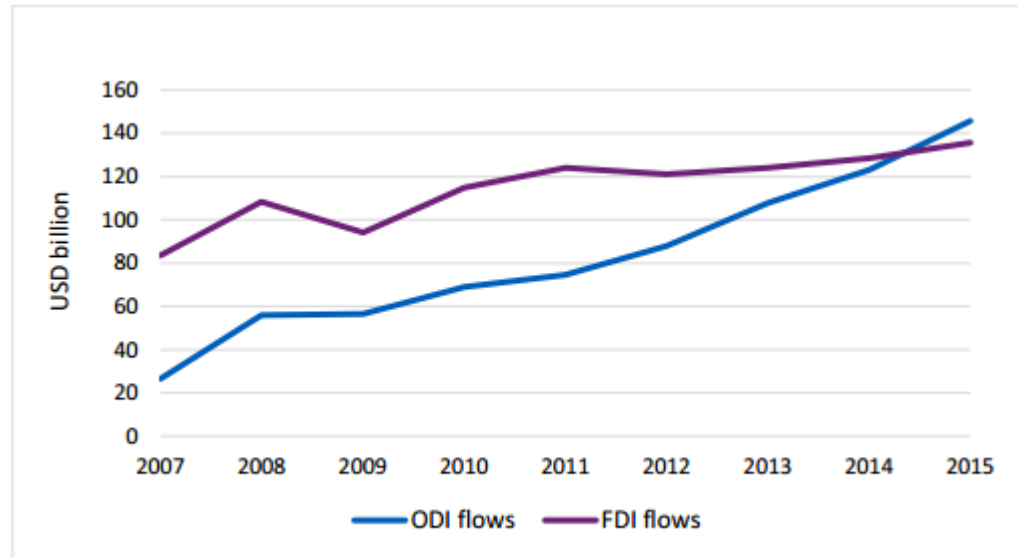
EU may be less forthcoming on direct foreign investments in the future.

A key source of irritation in Berlin on the Kuka deal, is that such a deal would be impossible in China, which in many industries restricts foreign companies to joint ventures.

See: <https://www.ft.com/content/e0897e24-598e-11e6-8d05-4eaa66292c32>

January-July 2016, Chinese firms snapped up 459 companies in 63 countries for a transaction volume of \$54.3bn, up 52 per cent from the previous year and already surpassing the total for 2015.

China ODI vs FDI growth – 2007-2015 (USD billion)



Source: Ministry of Commerce; CEIC, KPMG analysis

5. ARISTOTLE HAS THE FINAL WORD

Aristotle – the Greek philosopher who lived 2,400 years ago – saw the benefit of a large middle class, relative to the rich and the poor:

“The best political community is formed by citizens of the middle class, and that those states are likely to be well-administered in which the middle class is large, and stronger if possible than both the other classes . . . ; for the addition of the middle class turns the scale, and prevents either of the extremes from being dominant.”

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