

China Macro Flash

Distribution Reforms Focus on Low-Income Group

- **Distribution reforms aim to improve welfare of low-income class** – The State Council yesterday circulated income distribution reform guidelines after the NBS published the Gini coefficient for the first time in a decade that highlights severe income disparity in China. The main thrust is line with our expectations, featuring a redistribution of income in favor of households, farmers and the low-income class through taxation, transfers and a broader social safety net.¹ The proposals are heavy on increasing incomes and benefits of those on low incomes and light on dealing with the incomes of the most wealthy, focusing more on new income (flow) and less on accumulated wealth, presumably to reduce resistance to reforms.
- **Increasing the income share of households** – According to the guidelines, the government will adjust spending to provide equal access to basic public services and cut tax burden on the low- and middle-income classes. The SOEs will be required to surrender more profits to the state to fund social spending. In particular, the profit surrender ratio for the centrally controlled SOEs will be increased by 5ppts from the current level by 2015.² Listed companies are expected to pay more dividends to investors. Interest rate reform (widening the floating range) is also proposed to increase the income of depositors. We continue to think the upward floating range for deposit rates may be increased from 10% to 20% later this year when CPI inflation rises above 3%, effectively elevating the deposit rates.
- **Protecting the most vulnerable and boosting farmers' income** – The guidelines set a target to raise minimum wages to more than 40% of urban average wages by 2015, and encourage collective wage negotiations. The government also aims to finish building the universal social safety net (pension and medical insurance), with social housing covering 20% of urban households by 2015. The government will continue to raise procurement prices for agricultural products, increase agricultural subsidies and push for higher compensation for land transfers. In addition, the government aims to convert migrant workers to urban citizens with access to basic public services.
- **Reform measures appears to favor consumption** – The guidelines envisage a few measures addressing the high-income class and assets, including limiting the compensation of SOE senior management, tightening tax enforcement and gradually expanding the pilot program on property tax. The reform measures, if properly implemented, should over time increase the incomes and welfare of those on low incomes, who tend to have a higher propensity to consume.

¹ See China Macro View: Economic Prospects 2013-14: Cyclical Upturn Restrained by Structural Gravity, Nov 27, 2012.

² Currently, the shares of net profits to be surrendered are 5% for military and research SOEs, 10% for SOEs in competitive industries, 15% for resource-related SOEs and 20% for tobacco industries.

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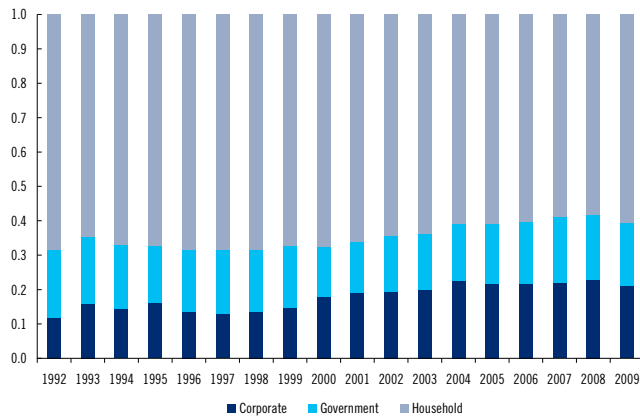
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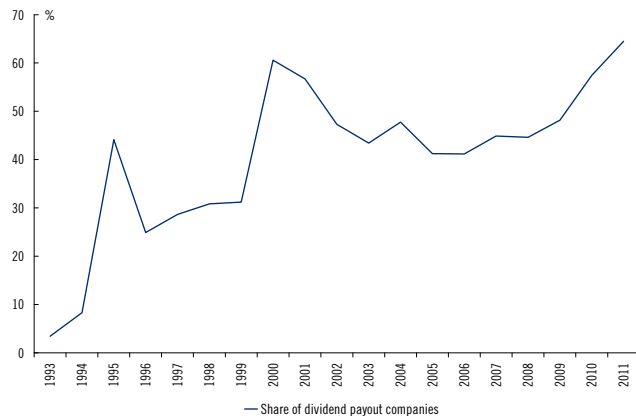
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Figure 1. Household share of income generally declined



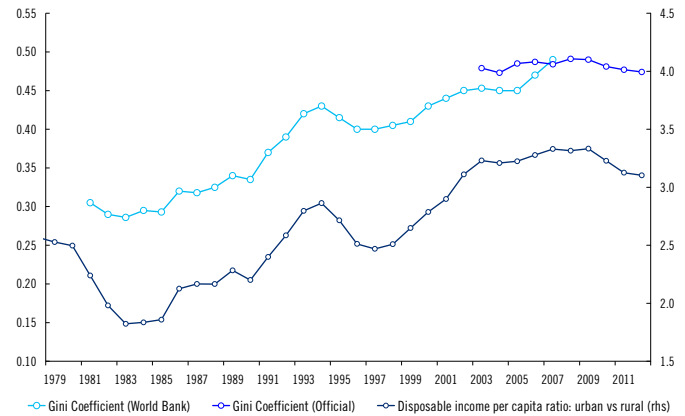
Source: CIEC and Citi Research

Figure 3. The government may press for dividend payout by listed companies and SOEs...



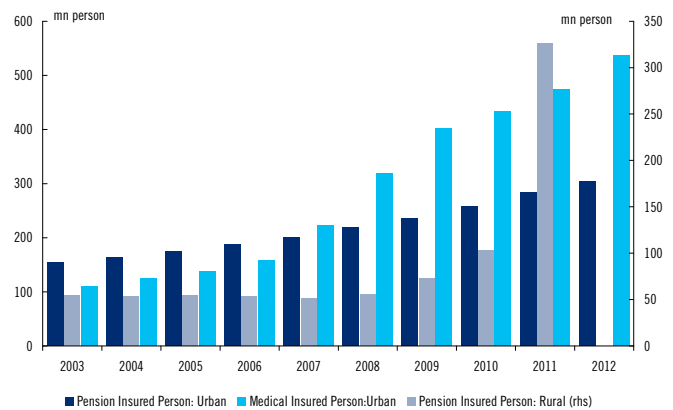
Source: Bloomberg and Citi Research

Figure 2. Severe income disparity



Source: World Bank, NBS, CEIC and Citi Research

Figure 4. ...and further broaden the coverage of social safety net



Source: CEIC and Citi Research

Appendix A-1

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