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# China Economy: 'Hidden' Income

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# Summary

1. **Interesting new research estimates average incomes in China are a staggering 90% higher than official figures suggest, given large amounts of unreported income (e.g. *hongbao* cash payments at Chinese New Year,). For the richest 10% of households 'real' income levels are 3.2 times higher than official figures imply (as the richest have the largest 'gray' income). Income inequality therefore worse than official figures suggest and a major cause of relatively low consumer spending - as the richest save a much higher proportion of their income.**

## Detail

2. Official statistics are widely believed to understate income levels in China, given assumed high levels of unreported income (e.g. generous cash payments at Chinese new year). Recent research funded by Credit Suisse by professor Wang Xiaolu of the China Reform Foundation suggests the discrepancy between official and 'real' income figures is even larger than most commentators had assumed. Wang's analysis is based on a survey of over 4,000 people across 19 provinces in China (relatively small sample for a country this size) and he argues his methodology provides a more accurate estimate than the official survey conducted by the National Bureau of Statistics. With the usual health warnings over sample-based estimates, here are the main conclusions from Wang's research (carried out in 2009 and early 2010 using 2008 data):

- **China's economy is around 10% larger than official figures suggest** (Wang assumes a certain amount, but not, all of the 'hidden' income comes from activities not recorded in the national GDP accounts).
- 'hidden' income is equivalent to 30% of GDP
- **average incomes in China are a staggering 90% higher than official figures suggest**
- **income inequality is worse than official figures suggest** as 'hidden' income accounts for a larger share of income the richer people are (more opportunities to earn it). 63% of 'hidden' income is in the hands of the top 10% of urban households. Wang

estimates that for the poorest 10% of households their 'real' income is just 13% higher than official figures suggest. But for the top decile their 'real' income is estimated to be 3.2 times higher than official figures, and for the second decile 2 times higher .

## Comment

3. There is obviously a need to cast a critical eye over research such as this, which is based on a relatively small sample. But Wang's results are somewhat in line with anecdotal evidence. And they throw up a number of interesting policy implications, on issues such as 'rebalancing' the economy (in the context of the G20). These include:
  - Wang's figures suggest the **Chinese economy is more imbalanced than official figures do**. Wang estimates savings accounted for 56% of GDP in 2008, compared with the official figure of 51.5% (and he believes household savings account for a larger share of total savings, compared with government and corporate savings, than official figures suggest).
  - Wang's revised income figures suggest **disposable income growth has kept pace with GDP growth over recent years**, rather than lagged it as official figures suggest. This weakens the argument - made most forcibly by McKinsey in a 2009 paper and most frequently by Professor Michael Pettis of Peking University - that slow income growth (and therefore declining household income as a share of GDP) in recent years has been the main reason for proportionately low levels of household consumption in China.
  - the research strengthens the argument, however, that **income inequality is a key cause of proportionately low domestic consumer spending**. Wang estimates those earning less than RMB 7,000 (£654) a year have a negative savings rate (spend more than they earn). The savings ratio is positive for other income categories and rises as income goes up. According to Wang, people with an annual disposable income of over RMB 400,000 (£37,700) a year save 63% of their disposable income on average.

- Credit Suisse argue the authorities would already be aware that income inequality is as bad as Wang estimates and this likely explains why they have been raising minimum wages recently, had a more open attitude to labour strikes and demands for higher wages, and why Chinese media reports suggest boosting wage growth will figure prominently in the

next 5-year plan (2011-2015), with rumours that will include a target to double manufacturing wages.

- although savings are higher than official figures (and therefore consumer spending proportionately lower), Wang's research also suggests the size of the consumer market (in absolute terms) is larger than previously thought. And **producers of high-end/luxury products stand to benefit the most** in the current environment (given the concentration of wealth in the hands of the richest).
- high levels of unreported income represent an **enormous loss of potential tax income** to the government, which could usefully spend the money on building more hospitals, schools, improving the social safety net, income support for rural areas, and other measures that would lead to more balanced, equitable, and sustainable growth.

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