From Communism to Capitalism: Private vs. Public Property and Rising Inequality in China and Russia

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Abstract: This paper combines national accounts, survey, wealth and fiscal data (including recently released tax data on high-income taxpayers) in order to provide consistent series on the accumulation and distribution of income and wealth in China and Russia over the 1978-2015 period. We contrast the different speed and magnitude of privatization observed in the two countries and relate these findings to the differences in inequality levels.

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Introduction

Since 1980, many economies around the world saw two strong ongoing trends: rise of private wealth together with rise of income inequality (Piketty and Zucman 2014; Piketty 2014). These trends are especially phenomenal in China and Russia since their transitions away from communism (Piketty, Yang, and Zucman 2017; Novokmet, Piketty, and Zucman 2017). Indeed, the transition away from communism in both China and Russia had profound effects on aggregate wealth and income inequality in both countries. However, there were also considerable differences between the two countries due to the institutional differences, particularly their respective privatization strategies for public assets. In China, the transition ushered in gradual but nevertheless wide-reaching reforms, expanding geographically from special economic zones in coastal cities towards inland provincial regions, and in sectoral waves, while Russia has experienced a "big-bang" model of transition from the previously planned, state-led economy to one that was to be led by free-market principles after the fall of the Soviet Union in 1990– 1991. In this paper, we compare our recent findings of private and public wealth accumulation, as well as rise of income inequality resulting from the different strategies of privatization in the two countries.

Privatization and Rise of Private Wealth

Private Wealth vs. Public Wealth

Figure 1

A general rise in the ratio between net private wealth and national income has been observed in nearly all countries in recent decades (Piketty and Zucman 2014; Piketty 2014; Piketty, Yang, and Zucman 2017; Novokmet, Piketty, and Zucman 2017), which can be attributed to a combination of factors including the combination of growth slowdowns and relatively high saving rates and general rises in asset prices. The case of China and Russia can be viewed as an extreme case of this general evolution. Especially, the liberalization and public asset privatization strategies chosen by the two countries also had crucial impacts on the development of these countries' wealth to national income ratios.

After the transitions away from communism, China and Russia both experienced large rises in their private wealth-income ratios. While to some extent these increases are to be expected (as a large proportion of public wealth is transferred to the private sector), the scale of change experienced is particularly striking in China. At the time of the "opening-up" policy reforms in 1978, private wealth in China amounted to just over 110% of national income, but by 2015, this figure had reached 490%, following almost unrelenting rises. Russia's transition began twelve years later in 1990, but the change since has been no less spectacular. Over this shorter period of time, Russia's private wealth-income ratio more than tripled from around 120% to 370%, which mostly come at the expense of public wealth. In Russia, the voucher privatization strategy chosen aimed to transfer public assets into the private sector as quickly as possible, and subsequently had the effect of reducing the net public wealth to national income ratio enormously, from over 230% of national income in 1990 to around 90% in 2015. In contrast, the gradual process of privatization of public wealth in China led to a slight over-fall in the value of public wealth as a proportion of national income, from just over 250% of national income in 1978 to approximately 230% in 2015, in a context of rapidly rising asset prices. (See Figure 1)

Composition of Private Wealth

Figure 2

In order to better understand the processes at work, it is critical to look separately at the different asset categories. The most noticeable finding is the critical role played by housing in the rise of private wealth (Figure 2). Although the method by which property wealth was privatized was different, private housing assets has been increasing dramatically since the beginning of transition in both countries. In order to transform the welfare housing system into market-oriented housing system, the Chinese central government launched several waves housing reforms since 1978 (Yang&Chen 2014). Especially, in 1991 the property rights of privatized housing were officially recognized by the State Council.[1] Since then Chinese citizens had had been experiencing rapid urban housing privatizing transition and huge reductions in welfare housing allocations, and by 2002, 85% of urban housing was privately-owned (by 2015, the percentage increases to 95%). Additionally, following the housing privatization and housing market liberalization, housing price has been escalating. As the result, private housing (net debt) has increased more than 3 times since 1991 from 60% of national income to 182% of national income in 2015 (Figure 2 Panel A). *In Russia, on the other hand,* private housing increased from less than 50% of national income in 1990 to 250% of national income in 2008-2009 (at the peak of the housing bubble), down to about 170% of national income by 2015 (Figure 2 Panel B). In addition to real estate price movements, the gradual rise of private housing between 1990 and 2015 can be accounted for by the fact that housing privatization happened in a more continuous manner than the voucher privatization

[1] "The resolutions of the state council about actively and appropriately carry out urban housing reform" (SC [1991] No. 30)

method used for companies.

What is particularly striking is the very low level of recorded financial assets owned by Russian households. Household financial assets have always been less than 70-80% of national income throughout the 1990-2015 period, and they have often been less than 50% of national income (e.g. in 2015 household equity assets are 18% of national income and household saving is 38% of national income). In effect, it is as if the privatization of Russian companies did not lead to any significant long-run rise in the value of household financial assets, although, it is the private sector now own the equity shares of Russian firms. While in China household equity and saving assets have been increasing significantly since 1978. Following the reform of SOEs and establishment of stock exchange markets in China, corporate sector saw its private capital increasing significantly from 0 in 1978 to 90% of national income in 2015, which accounts for more than 30% of total corporate equity in China. Meanwhile, due to the high saving rate and tight capital outflow control, together with the increase of the economy, Chinese household saving increases from 17% of national income to 140% national income.

In our view, the widely divergent patterns of household financial assets accumulation observed in Russia and China can be accounted for the substantial offshore wealth hold by a small subset of Russian households. According to Novokmet, Piketty, and Zucman (2017), offshore wealth has gradually increased between 1990 and 2015, and represents about 75% of national income by 2015, ie., roughly as much as the recorded financial assets of Russian households.[2] It is hard to pin down an accurate number of China's offshore private wealth, however, it is reasonable acclaim that China's offshore wealth is much less than Russia's due to the tight control of capital flow.

The Decline of Public Property

Figure 3

It is also interesting to compare the evolution of the overall share of public property in Russia and other countries (Figure 3). In developed countries, the share of net public wealth in net national wealth was significantly positive in the post-WW2 decades up until about 1980, around 15-25% of national wealth, reflecting low public debt and significant public assets. Net public wealth declined significantly since the 1980s, due both to the rise of public debt and the privatization of public assets. By 2015 net public wealth has turned negative in Britain, Japan and the U.S., and is barely positive in Germany and France.

Ex-communist countries like Russia, China and the Czech Republic have followed the same general pattern as developed countries in recent decades – namely a declining share of public property – but starting from a much higher level of public wealth. In these three ex-communist countries, the share of net public wealth was as large as 70-80% in 1980, and falls between 20% (Russia) and 30-35% (China and the Czech Republic) in 2015, i.e. a level that is higher but not incomparable to that observed in "capitalist" countries during the "mixed

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[2] Novokmet, Piketty, and Zucman (2017) estimate the magnitude of the offshore wealth in Russia by exploiting the large discrepancies between trade balance surpluses (in the first place, from oil and gas exports) and net foreign assets accumulation. Namely, they cumulate net errors and omissions and capital transfer outflows in the balance of payments.

economy" period (1950-1980). In other words, these countries have ceased to be communist, in the sense that public ownership has ceased to be the dominant form of property, but they still have much more significant public wealth than other capitalist countries.

This is due both to low public debt and significant public assets (including in Russia in the energy sector). There are also strong differences between these countries. In particular, the privatization process was much more gradual in China than in Russia: it started earlier, and is still going on. In China public owned corporate equity increase from about 60% of national income in 1990 to 149% of national income in 2015, which account for about 55% of the total corporate equity in China. In contract the public owned equity stabilized in a very low level since 1990 in Russia, by 2015, public equity assets is only 13% of national income. The gradual privatization pattern observed in the Czech Republic is intermediate between the two, and is in some ways closer to China.

Income Inequality

Next, we present the findings on income inequality dynamics in China and Russia in Figure 4. The new income distribution series for China and Russia are constructed by combining national accounts, survey, wealth, and fiscal data. Income inequality has increased markedly in both China and Russia since the beginning of their respective transition to the market economy. Figure 4 displays the income inequality dynamics in China and Russia since 1978 by looking at the evolutions of the top 10% and the bottom 50% income shares (Panel A) and the evolution of the top 1% income share (Panel B). According to our estimates, inequality was somewhat higher in China than in Russia in 1978 (due in particular to the substantial urban-rural gap), but has now become substantially higher in Russia. In particular, it is striking to see that the rise in income inequality in Russia occurred so rapidly after the fall of the Soviet Union. The top 10% income share in Russia rose from less than 25% in 1990-1991 to more than 45% already in 1996, and has stagnated at levels around 45-50% since then. This enormous rise of the top 10% income share in Russia came together with a massive collapse of the bottom 50% share, which dropped from about 30% of total income in 1990-1991 to less than 10% in 1996, before gradually returning to about 18% by 2015. In China, the rise in income inequality was substantial between 1978 and 2015 – with the top 10% income share rising from 27% to 41% and the bottom 50% income share declining from 27% to 15% – but it occurred in much more gradual manner than observed in Russia.

However, the development of the top 1 percent income share suggests markedly higher top income concentration in Russia than in China (Panel B). In Russia, we observe a sharp and continuous rise of the top 1% income shares, from less than 6% in 1989 to about 16% in 1996, and over 26% in 2008, which then dropped in the aftermath of the 2008-2009 financial crisis and stabilized around 20-22% since 2010. In China, the top 1 percent income share has more than doubled in size since the beginning of the market reforms, rising from 6% to 14% between 1978 and 2015, but is still substantially lower than in Russia. As a result, Russia, who used to be more equal than China, has become one of the most unequal countries in the world.

Figure 4

The evolution of income inequality in China and Russia also reflects the different privatization strategies pursued in the two countries. As noted above, this can be related to the fact that the privatization process was much more gradual in China, where the government is still the largest corporate owner. We also observe much higher increase in top income shares in Russia than in ex-communist countries in Eastern Europe (Novokmet 2017), suggesting overall the importance of post-communist transition policies and institutions for the divergent income and wealth inequality dynamics in former communist countries. In Russia, there was arguably the most dramatic regime shift, manifested in very fast shock therapy and voucher privatization. It is plausible that within a chaotic monetary and political context of the Russian transition (e.g. 'institutional economies of scale'; Guriev and Rachinsky 2008), small groups of individuals were able to buy back large quantities of vouchers at relatively low prices, and also in some cases to obtain highly profitable deals with public authorities (e.g. via the infamous loans-for-shares agreements). Together with capital flight and the rise of offshore wealth, this process arguably led to extreme level of wealth and income concentration in Russia (Figure 5). This finding is consistent with the Forbes billionaire data, showing a much higher level of billionaire wealth in Russia than in China or ex-communist countries in Eastern Europe.

Figure 5

A further insight into divergent transition outcomes could be obtained by looking at the distributional impact of growth in Table 1. The economic transformation has produced much higher growth in China than in Russia. Notwithstanding the fact that in both countries growth has not been equally shared, with higher income groups enjoying higher growth rates, the outstanding growth experience in China entailed that lower income groups also saw a substantial increase in their living standards. On the other hand, the bulk of the post-communist growth in Russia has been captured by the top incomes. Over the 1989-2016 period, the top 1% experienced very high growth rates and captured more than two-third of the total growth in Russia, while the bottom 50%

actually saw a decline in its living standard.

This suggests that Russian capitalism places few constraints on top incomes (partly coming from outright plundering of the country's natural resources and foreign reserves), and shows high tolerance for extreme inequality after the failure of Soviet Communism and its egalitarian ideology. Ideology matters. The enormous ideological shift that occurred in Russia could be seen as an extreme version of the ideological reversal in the US *and many western countries* since the 1980s. On the other hand, it is plausible that the present Chinese development model is subject to stronger ideological constraints that may mitigate the more extreme rise of inequality in the future.

Table 1

Conclusion

The dramatic economic transformation has resulted in the substantial increase in inequality in China and Russia. However, the rise of inequality was much more pronounced and immediate in Russia, and more limited and gradual in China. … Markedly divergent post-communist inequality patterns suggest that the rise in inequality is not inevitable and point to the importance of policies, institutions and ideology in shaping inequality.

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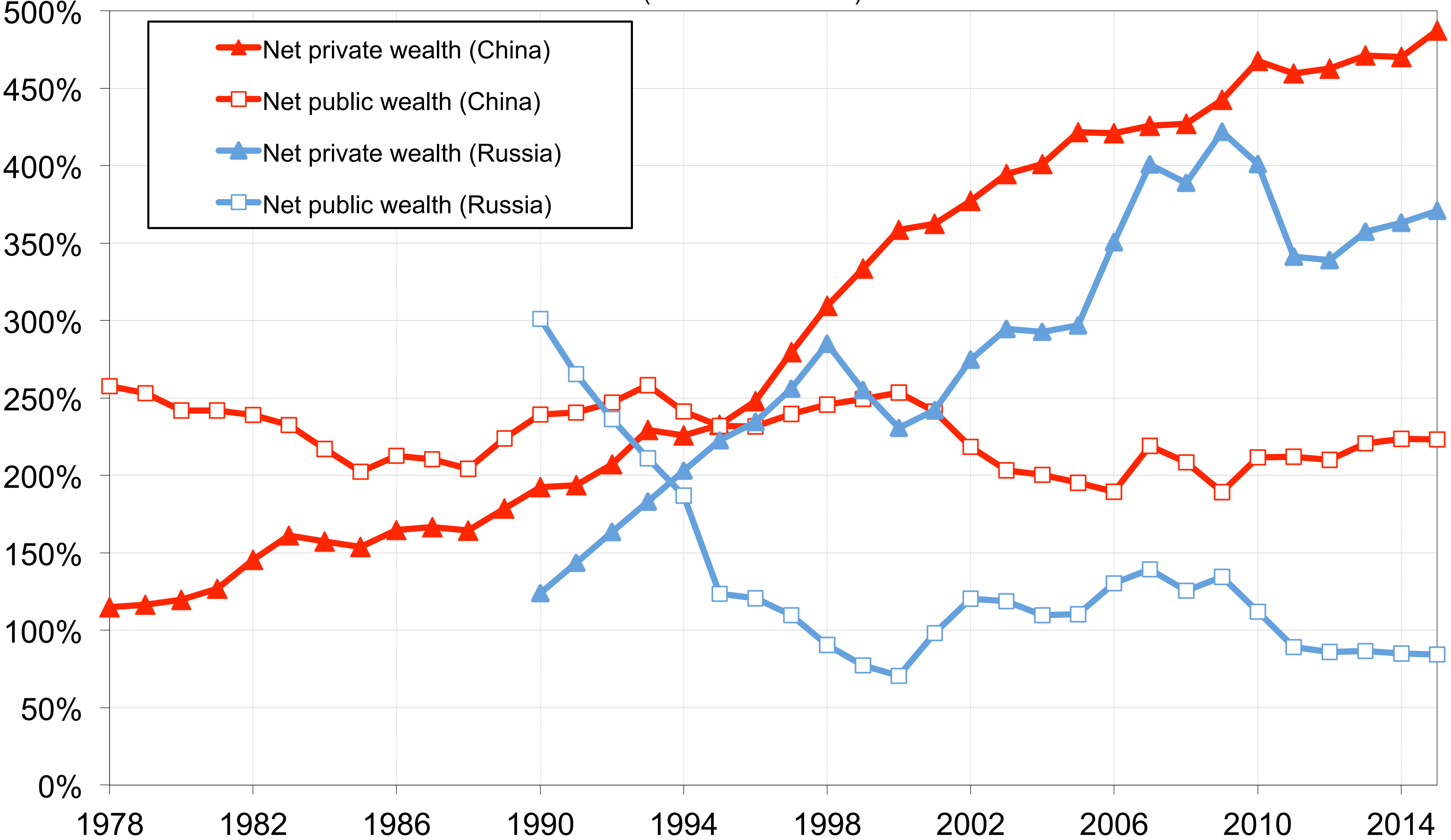
Figure 1: Public vs private property in China andRussia 1978-2015

(% national income)



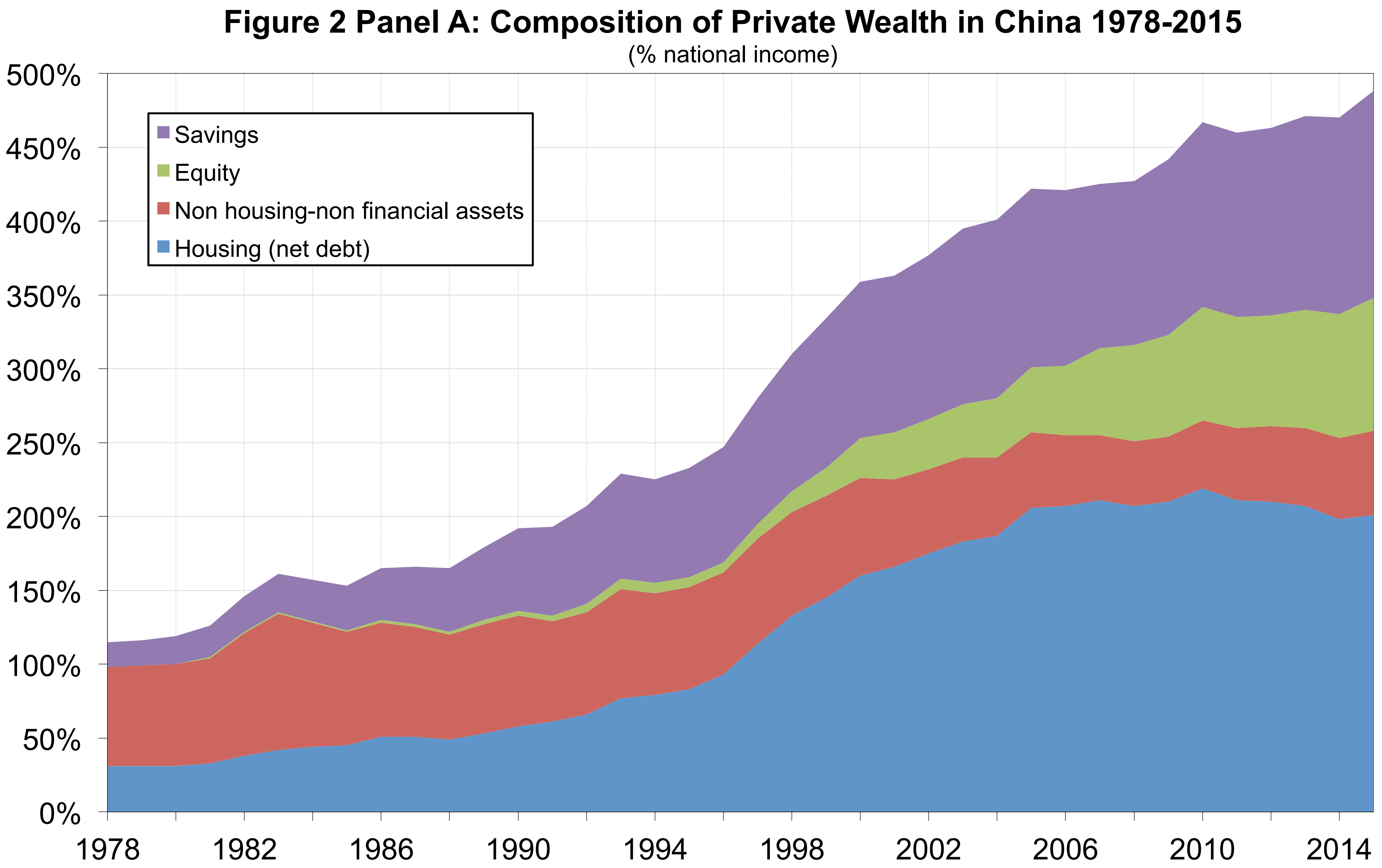


Figure 2 Panel A: Composition of Private Wealth in China 1978-2015
(% national income)
Savings
Equity
Non housing-non financial assets
Housing (net debt)
500%
450%
400%
350%
300%
250%
200%
150%
100%
50%
0%
1978
1982
1986
1990
1994
1998
2002
2006
2010
2014

Figure 2 Panel B: Composition of Private Wealth in Russia 1990-2015

(% national income)

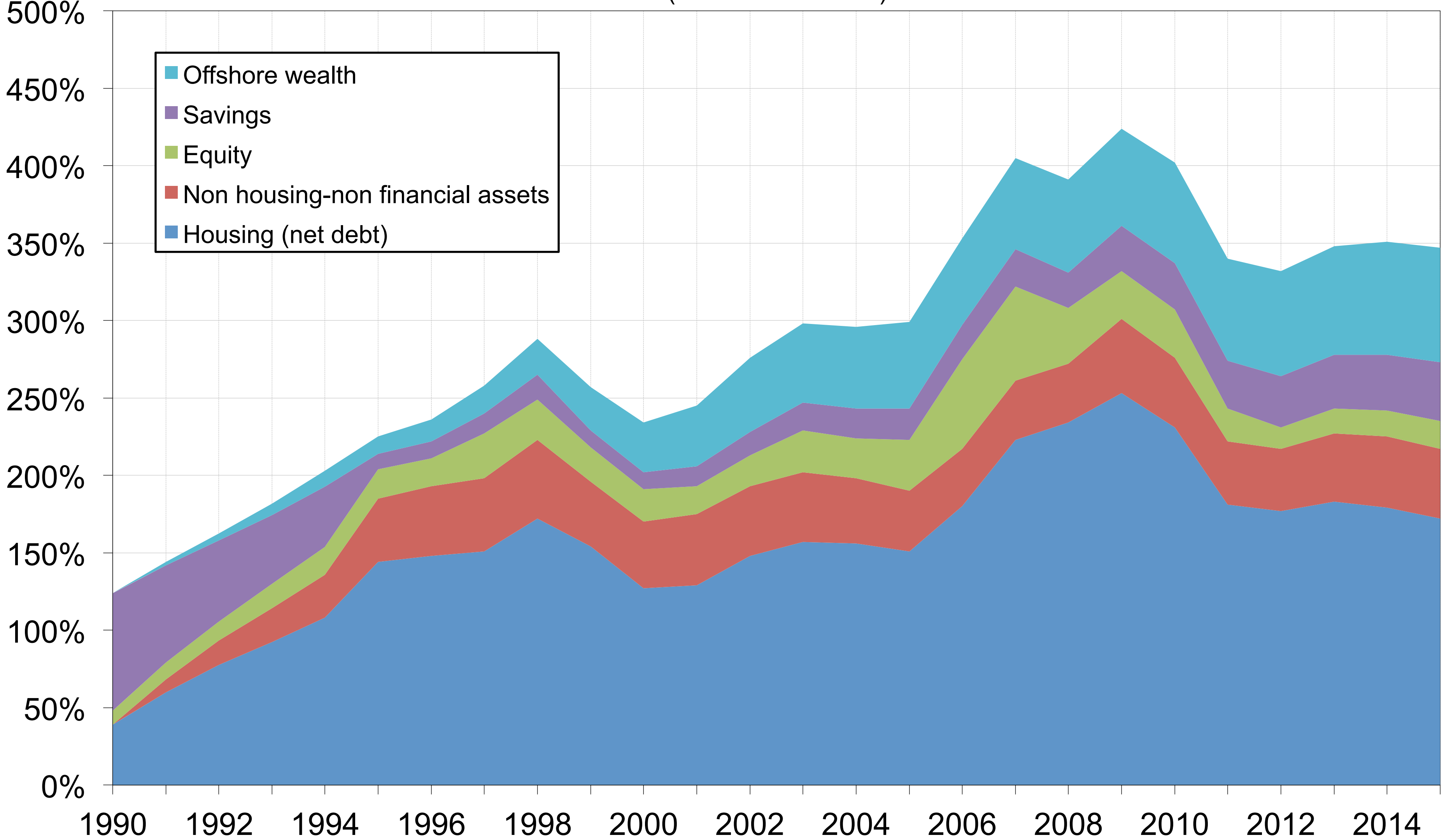
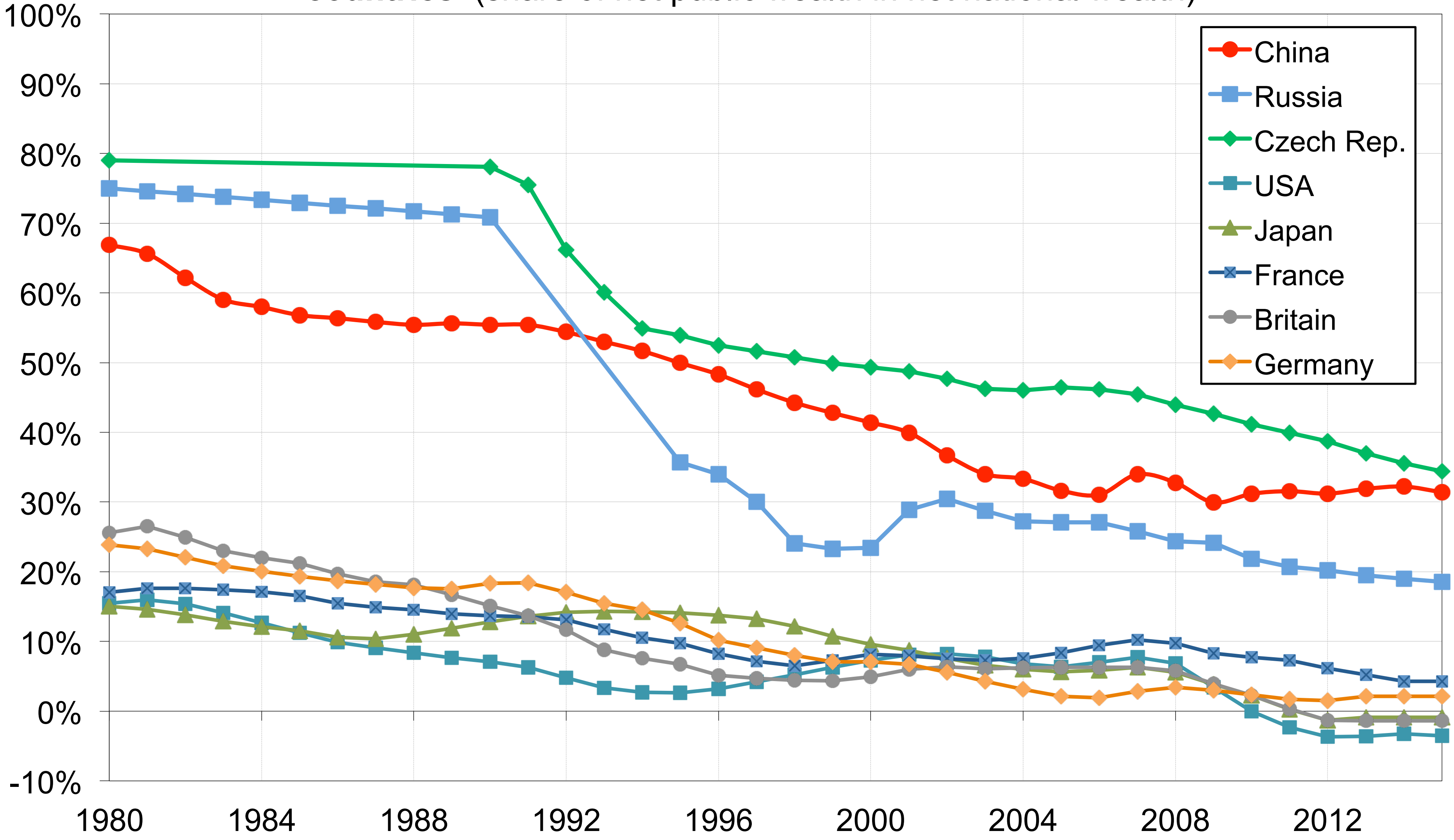
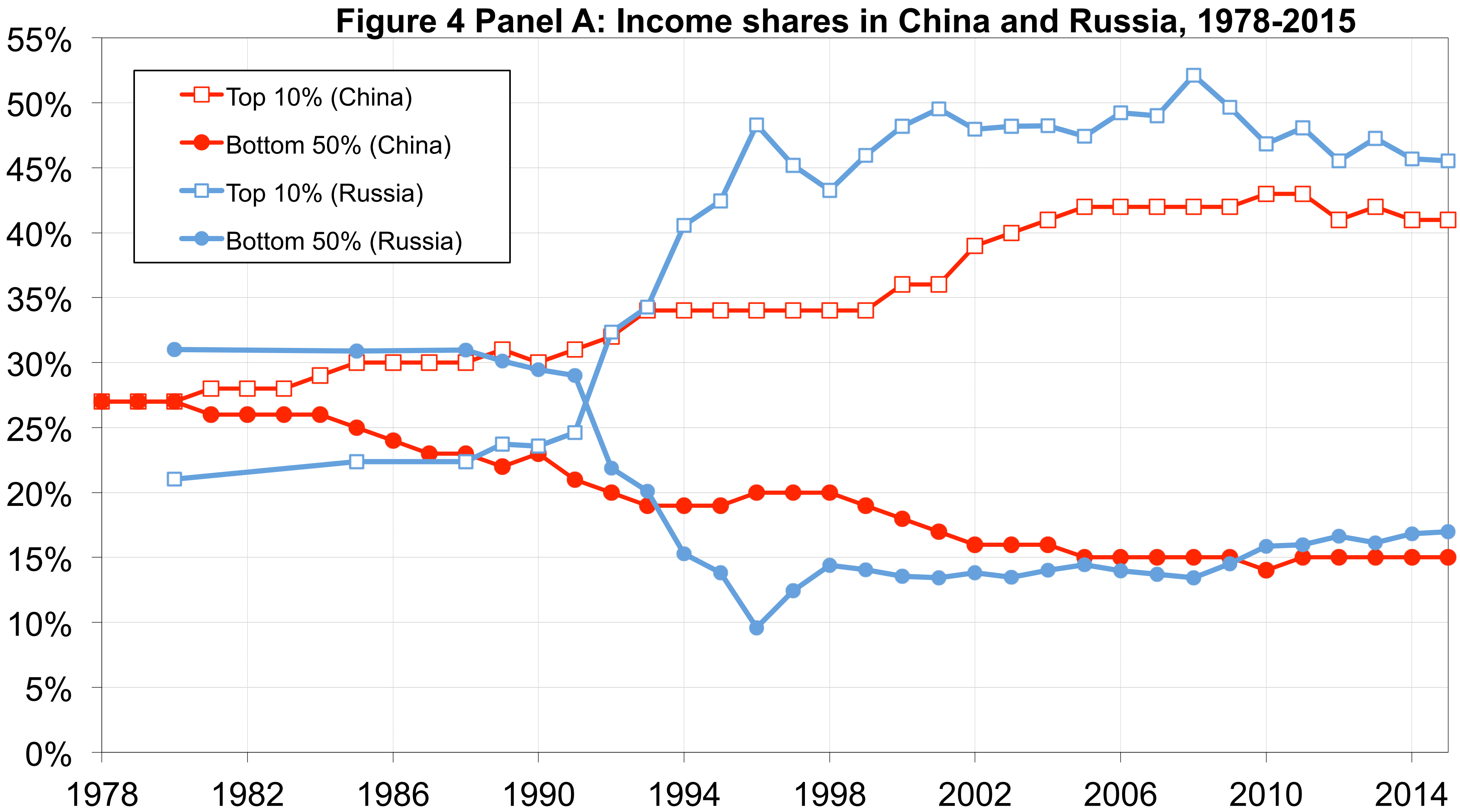


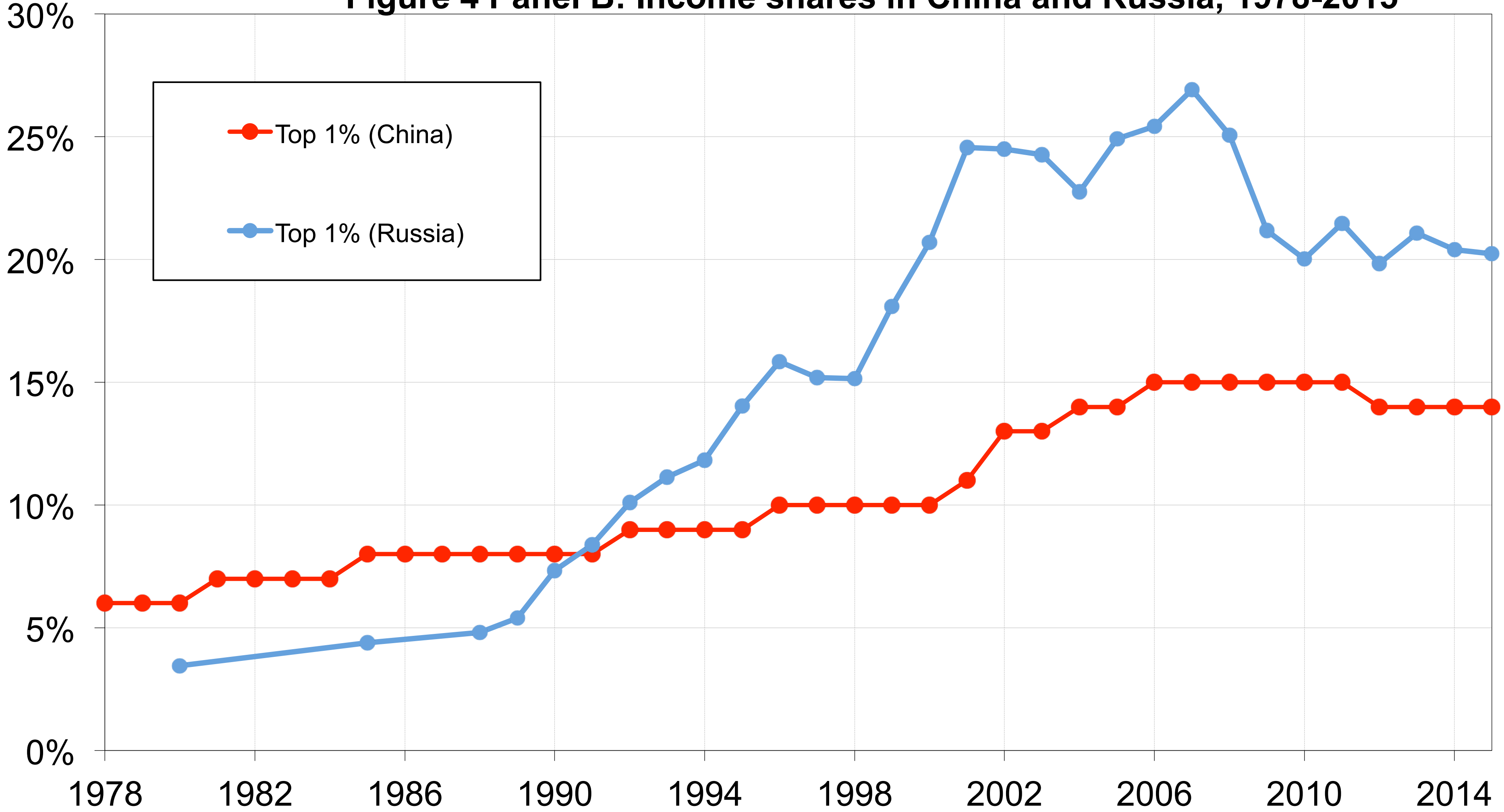
Figure 3: The decline of public property: China vs Russia vs other countries (share of net public wealth in net national wealth)





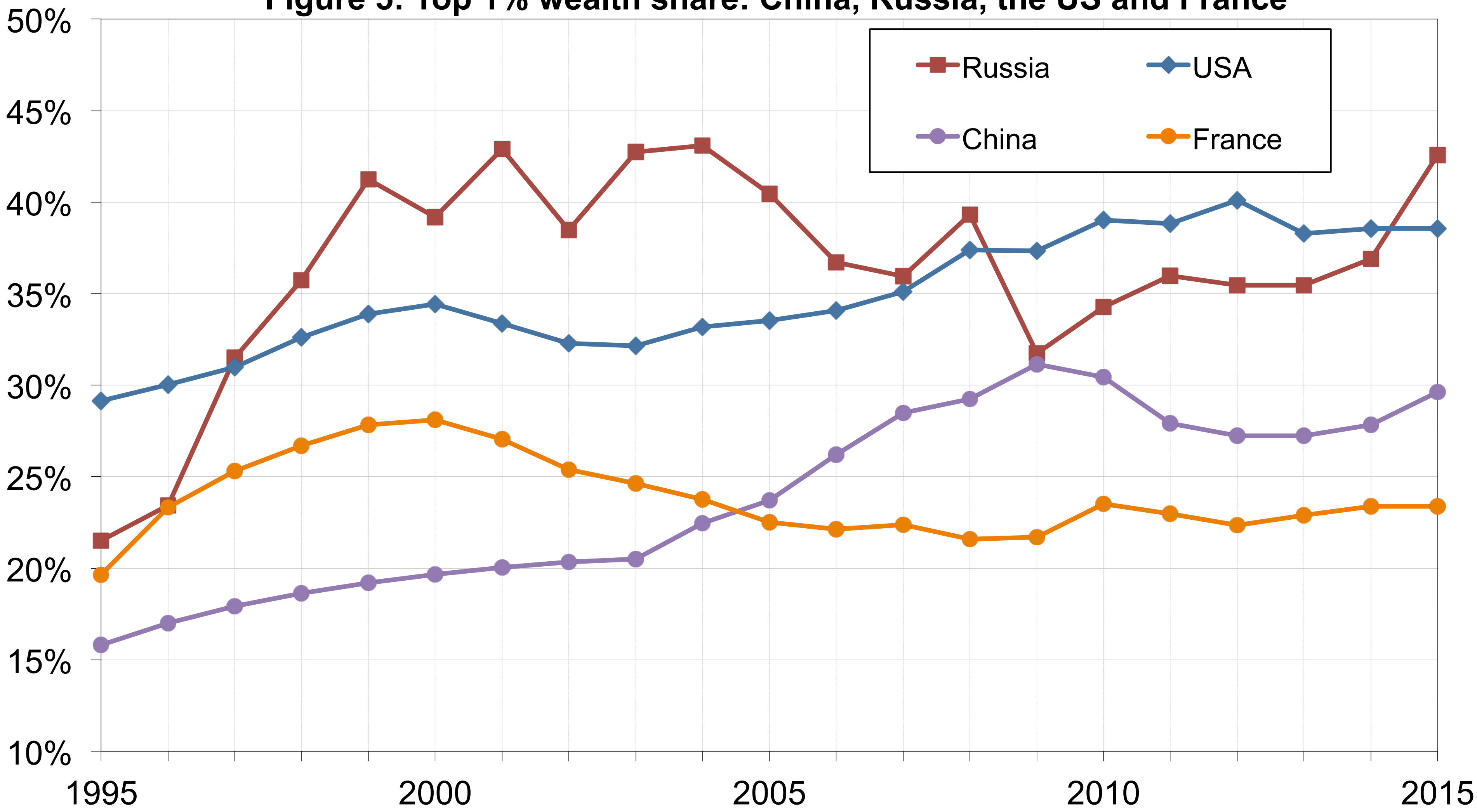
Distribution of pretax national income (before taxes and transfers, except pensions and unempl. insurance) among adults.
Corrected estimates combine survey, fiscal, wealth and national accounts data. Raw estimates rely only on self-reported survey data.
Equal-split-adults series (income of married couples divided by two).

Figure 4 Panel B: Income shares in China and Russia, 1978-2015



Distribution of pretax national income (before taxes and transfers, except pensions and unempl. insurance) among adults.
Corrected estimates combine survey, fiscal, wealth and national accounts data. Raw estimates rely only on self-reported survey data.
Equal-split-adults series (income of married couples divided by two).

Figure 5: Top 1% wealth share: China, Russia, the US and France



Distribution of personal wealth among adults. Estimates obtained by combining Forbes billionaire data for Russia, generalized Pareto interpolation techniques and normalized WID.world wealth distributions.

Table 1: Average annual growth rate 1978-2015

Income group (distribution of per adult pre-tax national income)	China (1978-2015)	Russia (1980-2015)	USA (1978-2015)
Full Population	6.2%	1.1%	1.3%
Bottom 50%	4.5%	-0.5%	0.0%
Middle 40%	6.0%	0.5%	0.9%
Top 10%	7.4%	3.3%	2.1%
incl. Top 1%	8.4%	6.2%	3.0%
incl. Top 0.1%	9.1%	9.9%	4.0%
incl. Top 0.01%	9.8%	13.4%	4.7%
incl. Top 0.001%	10.4%	17.0%	5.7%

Souces: China: Piketty, Yang and Zucman (2017). Russia: Novokmet, Piketty and Zucman (2017) . USA: Piketty-Saez-Zucman (2016). Distribution of pre-tax national income among equal-split adults. The unit is the adult individual (20-year-old and over; income of married couples is splitted into two). Fractiles are defined relative to the total number of adult individuals in the population. Corrected estimates (combining survey, fiscal, wealth and national accounts data).