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REDUCING INEQUALITY IN THE PEOPLE'S REPUBLIC OF CHINA THROUGH TAX AND FISCAL REFORMS (2021)

Dominik Pesche



A Book Review by

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The book “Reducing Inequality in The People’s Republic of China Through Tax and Fiscal Reforms” by Dominik Pesche discusses the reasons of high-income inequality in People’s Republic of China even after redistribution policies. At the provincial level, the book examines income and wealth inequality and per capita Gross Regional Product (GRP). It also examines policy choices for various taxes and fiscal transfers to address inequalities.

The book identifies that there are no gift or inheritance taxes, and personal income tax (PIT) focuses solely on wage income, ignoring capital income as the root cause of widening gap. The lack of a nationwide recurrent property tax and growing housing values exacerbate the problem. Inequality in the People's Republic of China (PRC) is still relatively high, and without state action, it would likely continue to rise in the future.

A lack of redistribution is one of the reasons of heightening inequality. At the individual level, redistribution through PIT and public transfers is restricted and at the regional level, fiscal arrangements have left many local governments with growing fiscal deficits and rising debt. The PRC has one of the greatest levels of fiscal-expenditure decentralisation in the world. It shows itself in significant geographical disparities in the delivery of public services and social security benefits.

This book identifies 3 major problems faced by PRC when measuring inequalities:

1. The first is data accessibility and quality. The time series of the Gini coefficient from the National Bureau of Statistics (NBS) for income inequality begins only in the early 2000s, and detailed income distribution data for the full decade is not available from the NBS. Some academics suggest that official data understate the income share of top earners, resulting in greater income inequality in reality.
2. The second problem is the time lags in the available data. This appears to have an impact on PRC findings since the time series are shorter, making it difficult to discern long-term patterns.
3. The unavailability of credible, up-to-date statistics on wealth distribution is the third obstacle. It is frequently difficult to estimate wealth distribution. Another stumbling block in the PRC is the lack of relevant tax data. There are no inheritance or gift taxes in the country, and there is no recurrent property tax. Individual capital gains are also often not taxed. As a result, no relevant tax data exists to support wealth distribution results.

When formulating policy suggestions, it's crucial to consider not only the amount of inequality, but also the trend in inequality. While there is enough evidence that income inequality after redistribution is substantial and necessitates further redistribution, the trend is also crucial in determining the need for and scope of policy actions.

In this context, demographics and wage polarisation are two potential future sources of inequality that need to be considered. Furthermore, the COVID-19 shock, which is likely to have a greater impact on poorer households, has the potential to exacerbate inequality.

The recommendations in this book for changing both taxation and intergovernmental fiscal relations give a road map for improvements and underline the interdependence of suggested reforms, which should aid policy consistency. The author examines tax and fiscal policy options for addressing income, wealth, and interprovincial disparities. On the tax aspect, the author suggested 3 recommendations:

1. additional PIT revisions,
2. implementing a nationwide recurrent property tax, and
3. enacting inheritance and gift taxes.

PIT reforms include steps to broaden the tax base as well as improve long-term efficiency and compliance with the tax. Limiting special deductions while including individual business income, pensions, annuities, and capital gains in comprehensive income are among the recommendations to strengthen the tax base. According to the findings of the author, PIT progressivity would also improve if more types of income were included in comprehensive income. Tax withholding and reporting must be improved.

A legislative foundation that assigns taxation power and duty to local governments is required for a state-wide deployment of a recurrent property tax. A nationally standardised tax base and a reasonable tax rate (with few exemptions) must be established. Local governments must develop the ability to value properties using the property registry.

This book suggests that inheritance and gift taxes should be established at progressive rates beyond particular tax-free amounts for close relatives, as income is now taxed but wealth is not. The property tax registry could be used to determine the tax base for these taxes.

Given the significant and growing gap between local government fiscal expenditure and revenue, central-local government, the book emphasizes that fiscal relations reforms should focus on revisiting and, where appropriate, reassigning fiscal expenditure responsibilities, improving the fiscal transfer system, and strengthening local government fiscal revenue. Recommendations include the following:

1. In accordance with international best practices, responsibility for public pensions and unemployment insurance should be elevated to the level of central government. More broadly, responsibilities for fiscal expenditures should be clearly defined and the scope of joint duties should be restricted.
2. To reduce the central government's financial burden, higher transfers from the central government to poorer local governments are required, with a significant emphasis on increasing transfers to poorer provinces. While shared-function transfers for fundamental public services should be increased, local budget management and evaluation of these services should be improved. Sub-provincial transfers should also be established.
3. A recurrent local property tax as own-source revenue at the local level, a broader PIT base, and the introduction of gift and inheritance taxes are all needed to boost local government fiscal revenue. It is also worth considering levying a local surcharge on PIT or revisiting the tax-sharing mechanism to fine-tune local government revenue.

This book by Dominik Pesche, holds academic importance. It can help many students and researchers who are interested in studying the underlying causes of existing inequalities in growing economies like People's Republic of China. Also, this book can aid policy makers in China to formulate future policies that are both effective and efficient in order to reduce the growing inequality gap. This book can also help policy makers to identify the shortcomings of the prior policies that aimed to reduce inequality; however, ironically, they further widened this gap instead.

The credibility of this book cannot be doubted as the author has supported and backed every argument by statistical data. He has mentioned the sources of every mathematical statistic he has used and cited all the sources very carefully; hence, dubious claims have been avoided in this book.