

Chinese Political and Economic Governance System and the Imbalance between Consumption and Investment

Julan Du

The Chinese University of Hong Kong
Hong Kong Institute for Monetary Research

and

Hongsheng Fang
Zhejiang University

and

Xiangrong Jin
Zhejiang University

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Summary

In this paper, we seek to understand the unbalanced consumption-investment structure in the Chinese economy in the context of the country's political and economic governance system. We argue that one fundamental cause of the imbalance between consumption and investment in China is its political and economic governance system, an institutional structure that is credited for China's rapid economic development over the past three decades. The overtaking strategy and the real estate development strategy generated by this governance system has contributed significantly to China's neck breaking economic growth, but at the same time these growth strategies have led to a distorted income distribution and internal macroeconomic imbalances.

Using the overtaking strategy and the real estate development strategy to characterize the behavior of local governments under the regionally decentralized authoritarian system, we document a strong relationship between the two strategies and the imbalanced consumption-investment structure. The impact of the governance system and its strategies remains significant even after considering the effects of economic structure and demographics. Moreover, we verify that the primary and secondary income distribution serves as an important channel through which the governance system and its development strategies translate into an imbalanced consumption-investment structure. Our findings imply that the Chinese government will be able to accomplish China's transition from an investment-led growth model to a consumption-based growth model only if it modifies its political and economic governance system and thus removes the distortions in its development strategies.