

Causes of China's Low Consumption from the Perspective of Local Governmental Competition

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ABSTRACT

Taking into account the three-sector general equilibrium perspective of the government, business, and household sectors and taking government public goods investment as intermediary; this article builds mathematical models of local governmental competition and three-sector consumption. It also theoretically analyzes the impacting path of local governmental competition, causing increased investment in public goods, thereby reducing consumption. At the same time, based on the model of China's provincial panel data from 1993 to 2015, the empirical analysis shows that a 1% increase in the level of competition among local governments will result in a corresponding decrease of 0.757% in total consumption, 0.348% in governmental competition, 0.340% in business consumption and 0.366% in household consumption. Local governmental competition leads to the government's tendency to invest in public goods and reduces the regional consumption, which especially damages the consumption capacity of the household sector.

KEYWORDS

Local Governmental Competition, Low Consumption, Simultaneous Equation Model, Three Sector Model

INTRODUCTION

The real average GDP growth rate of 9.7% in China during the past 40 years has attracted much attention. It is known as “miraculous growth” and “the China mystery” in the eyes of scholars and government officials. As the economy continues to grow rapidly, consumption as one of the “Troika” has remained at a low level during this period. The average consumption rate is only 58.3%. Especially since 2000, the consumption rate in China has been declining year by year, with there being an average rate of only 53.3%. In general, when a country enters the era of urbanization, the slightly lower consumption rate has some reasonableness. However, compared with the average consumption level of 60%-78% in the world, China's consumption rate is obviously low. Many scholars have emphasized the importance of local governmental competition to China's economic growth by studying economic growth theory (Zhang, 2005, 2007; Zhou, 2003, 2005; Zhang 2008, 2009; Zhou, 2005, 2007, 2008; etc.). As such, is consumption – being the main engine of economic growth – also affected by local governmental competition? Is local competition the “behind-the-scenes promoter” of China's low consumption?

For a long time, the central government has regarded economic growth as being the core standard for the performance of local officials. Over time, it has established its preference for investment over consumption and its preference for the supply of investment-oriented public goods over the supply of

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consumer-oriented public goods. In order to gain promotion during their term and to win competition among regions, the regional governments were comparatively more inclined to choose investment-oriented public goods, thereby resulting in a certain degree of imbalance between investment and consumption. With diminishing marginal returns and overcapacity to investment, consumption has gradually become the main driving force for sustained economic growth – but the excessively low consumption rate has become the “shortfall” in China’s economy. Therefore, based on the political and economic characteristics of local governmental competition, this paper constructs a mathematical economy model of local governmental competition and consumption. It does so from the perspective of three-sector general equilibrium; taking public sector investment as an intermediary to explain the mechanism of how local governmental competition is affecting consumption. At the same time, using panel data of 30 provinces in China during 1993-2015, a simultaneous equation model is constructed to quantitatively study the impact of local governmental competition on consumption. Through analyzing the causes of low consumption in China in the economic restructuring period, the authors hope consumption rate could be enhanced.

LITERATURE REVIEW

As for the reason why the consumption rate in China is so low, scholars have conducted various research studies and have obtained valuable findings.

Summarizing the existing literature, the authors find that scholars have mostly studied the causes of low consumption from the following three aspects of the issue: Firstly, the macroeconomic variables that affect consumption – variables including the price index (Chen, 2009; Zhang, 2009; Liu, 2014; Liao, 2014, etc.), income disparity (Meyer & Sullivan, 2013; Lise, 2014; Zhang, 2016), interest rate, and financial development (Wang & Jiang, 2006; Wu, 2015; etc.); Secondly, the micro-economic variables related to income (Chakrabarty et al., 2006; Zhu, 2012; Chen, 2012; Zheng et al., 2015; Mao et al., 2016) and family situation (Tan et al., 2014; Li & Chen, 2014; Song, 2016); Thirdly, various consumer-related policies, mainly social security policies, fiscal and taxation policies, credit policy, and so on (Jia, 2012; Guo et al., 2013; John, 2014; Long et al., 2016).

Of course, there are many other scholars who have taken other routes to find alternative ways of thinking. For example: Scholars such as Aziz (2007), Ye (2008), and Attari (2010) argued that consumption was not actively at a low level but was “squeezed out” by high investment or high savings. Ludvigson (1999), Wang and Wang (2013) argued that China’s real consumption was not as low as it has been reputed but merely underestimated.

Although there are various bodies of literature on the causes of China’s low consumption, it is only the rare study that explains low consumption from the perspective of local governmental competition. The literature concerning local governmental competition and consumption mainly studies them from the standpoint of analyzing the following two aspects of the issue:

One aspect is how local governmental competition affects the national savings rate or the investment rate. For example, Yao (2011) studied how local governmental competition can expand investment based on household data of various provinces in China, which in turn had an impact on household consumption. Tang and Zhen (2011) analyzed why Chinese investment was higher than that of other countries basing their work on the power structure and local governmental competition. It was pointed out that misconceptions regarding ‘GDP maximization’ lead to the government preferring capital investments over labor and people’s livelihoods so as to form a high savings rate (which would have an impact on the global economy, China’s economic structure, and consumption). Zhang (2011) pointed out that the local government is a public-service-oriented government whose duty is to promote public service construction. However, the “only-GDP” performance evaluation has made the government biased towards investing in investment-type public goods – to the detriment of household issues such as education, employment, healthcare, and housing. This has indirectly impacted on ‘household’ spending power; Liu (2013), using the generation overlapping model as the basis for the analysis, discussed the impact of local governmental competition on savings. Liu

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