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"Common Prosperity" and China's State Capitalist Welfare State: Implications for U.S. Policy

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Abstract

China and the United States will increasingly compete over socioeconomic models, with major implications for the development of world order in the 21st century. An underappreciated aspect of this competition revolves around the ways that economic models ensure suitable levels of equality as well as growth. The Communist Party of China (CPC) has indicated its intentions to develop its own approach to the public financing of a welfare state. Specifically, the CPC has advocated a common prosperity agenda based on redistribution to address deep-rooted challenges of inequality, financed by a stronger state sector that contributes more to transfers and redistribution, creating a "state capitalist welfare state." If successful, this model could help put China on a path towards sustainable economic growth. The CPC believes that this version of "socialism with Chinese characteristics" will resonate abroad and improve China's soft power. If successful, this policy direction has major implications for the Chinese economy as well as the attractiveness of the China model. This chapter discusses China's vision, current implementation, and related implications for U.S. policy.

Implications and Key Takeaways

- Do not make policy based on assumptions of China's economic failure. Demography is not destiny, and U.S. policy should not be based on an assumption of future U.S. dominance.

- Pressuring market reform in China via bilateral trade and investment policy will become increasingly ineffective. Multilateral trade inducements have proved more effective in the past. If the United States seeks to shape Chinese economic reform and engage fairly with China in the global trading system, it should engage with partners on WTO reform and negotiate entry into CPTPP.

- The State Department should take China's soft power challenge seriously and seek to better understand public opinion abroad. Do not assume U.S. soft power superiority.

- The United States should continue to use the DFC and USAID to compete with BRI, but propaganda to undermine China's investments is ineffective. Instead, the United State should promote its own shared prosperity language abroad. The United States has a more equitable economic model than China does today, and rather than opposing China, working together with China, especially through international organizations, allows the United States to highlight confidence in its economic model advantages.

- U.S. policymakers should not assume continued domestic support for policies perceived as furthering decoupling or economic containment of China. These policies are economically costly and difficult to reverse when public opinion shifts.

- The United States should fund further public education on China, including language and area studies. Congress should provide additional funding to the Department of Education's Title VI and Fulbright-Hays programs, and the Biden administration should revive the Fulbright-China program.

Introduction

Since the Fifth Plenum of the 19th Central Committee of the Communist Party of China (CPC) in October 2020, the CPC and General Secretary Xi Jinping have increasingly emphasized "common prosperity" (共同富裕). In 2021, "common prosperity" became a core political slogan, with Xi using the term in his speeches at least 65 times.[1] According to Xi, common prosperity seeks to address inequality: "We must not allow the gap between the rich and the poor to grow wider, the poor getting poorer and the rich getting richer, and an insurmountable gap between the rich and the poor must not appear."[2] To do so, the common prosperity agenda calls for using taxes and fiscal transfers to support low income populations, expanding the middle class through salary increases, tax deductions for small and medium size enterprises (SMEs), reforming the household registration system, training new skilled workers, improving social protection and education, and cracking down on "illegal" high incomes.[3]

Yet concrete policies to achieve common prosperity goals remain vague, allowing for wide variance in external interpretation of the CPC's actual ambitions. Economically, China in recent years has experienced a strengthening of the state sector, expansive industrial policies, and a freezing or reversal of many market reforms. Politically, the CPC has centralized power, taken over government functions, and become increasingly repressive. Understandably, then, many observers interpret "common prosperity" as another mechanism for CPC control over the economy, particularly the private sector, pointing to the recent regulatory anti-trust crackdown on large technology companies and the promotion of "tertiary distribution" (第三次分配), a euphemism for semi-coerced private sector charitable donations.[4] This interpretation sees the redistributive aspects of common prosperity as mere rhetoric, perhaps justifiably given China's persistently high levels of multi-dimensional and multi-scalar inequality.

The interpretation of common prosperity through the lenses of party control and private sector suppression has been prominent in Washington, DC, policy-making circles. Over the past year, in nearly two dozen formal interviews and informal discussions with Biden and Trump administration officials at the State Department, National Security Council, Department of Defense, and Department of Commerce, not a single official took seriously

the possibility that "common prosperity" would effectively achieve China's stated economic redistributive goals. Policy planning documents, including but not limited to the Biden administration's Interim National Security Strategy[5] and the Trump State Department's "The Elements of the China Challenge,"[6] similarly do not take seriously Xi's redistributive socialist rhetoric. Instead, these officials and these planning documents see common prosperity through the same prisms of Xi's centralization of party power and ideological straitjacketing.

These interpretations may well be correct—indeed, CPC rhetoric frequently serves political and propaganda purposes—but this paper argues that it is important to take the CPC's own language seriously and consider the consequences if the common prosperity agenda achieves its stated goals. Common prosperity is the CPC solution to the "principal contradiction" in modern China between "unbalanced and inadequate development and the people's ever-growing needs for a better life."[7] It is a long-term economic project that seeks to address persistent and deep-rooted economic challenges with inequality and domestic imbalances in order to enable China to become a high-income economy. It is also a project that requires significant increases in public expenditure, and the CPC has made clear over the past several years, prior to the recent "common prosperity" propaganda push, that it intends to fund increased social expenditure, social insurance, and income redistribution, not through a modern taxation system, but through state-owned enterprise (SOE) share transfers and dividends. The use of state asset ownership in a predominantly market economy to develop a non-tax-based redistributive welfare system—what this paper calls a "state capitalist welfare state" (SCWS)—has important implications for China's future economic development. It necessitates a larger and more profitable state sector, helping to explain the trajectory of SOE reforms, but also makes China's future growth trajectory more sustainable.

Common prosperity and SCWS also have important implications for the global attractiveness of the "China model" and thus U.S.-China competition. Since Xi's 19th Party Congress speech there has been more explicit CPC attention to developing and exporting a "China solution" (中国方案). As the theorist Jiang Shigong notes, having adopted Western lessons, Xi's CPC is now seeking to define an alternative socialism with "Chinese characteristics"

whose export can serve as a global public good.[8] A key part of this global influence agenda is promoting CPC efforts to "build a socialism that is superior to capitalism" (建设对资本主义具有优越性的社会主义).[9] Successful SCWS development would make China more attractive, not only to developing economies, but also to middle- and even high-income economies struggling with similar questions related to the efficiency-equality tradeoff.

Implementing the common prosperity agenda remains difficult and uncertain, and as discussed in the conclusion, common prosperity may prove to be no more than a tactical propaganda campaign. Yet more progress has been made at addressing poverty and inequality through the use of state assets than has been broadly appreciated. By interpreting "common prosperity" only from the perspective of party dominance, U.S. policymakers risk underestimating the possibility that the emerging SCWS system could bolster China's economic resilience while also setting China up as a true soft power competitor. Taking these developments seriously would necessitate a different balance of global hard and soft power investments by the United States.

Common Prosperity's Economic Rationale

Multi-dimensional inequality increasingly undermines China's economic prospects, and common prosperity can be interpreted as a response to this challenge. After four decades of nearly double-digit economic growth, China has become an upper middle income country with the world's second largest economy. Yet structural and demographic changes have led to decreasing returns to capital and slower economic growth while exacerbating inequality and pressuring fragmented and underfunded social security and welfare systems. China's high levels of inequality have increasingly become a barrier to future growth. On the one hand, inequality and persistent poverty undermine human capital development and thus prevent the work force productivity gains that become increasingly essential as China's population ages and the workforce shrinks. Additionally, inequality undermines domestic consumption and rebalancing, forcing China to continue to rely on debt-financed investment with decreasing returns. In this sense, inequality-related challenges may undermine party legitimacy even if they do not cause social unrest as often perceived.[10] In publicly explaining the common prosperity agenda, Xi

himself has argued that the Soviet Union's collapse was due to its lack of attention to the people.[11]

In terms of human capital development, health and education shortcomings for rural and migrant youth—driven by broader regional and urban-rural income inequality—threaten to undermine the productivity of China's future workforce. Nearly 90 percent of the rural labor force lacks a high school education; rural children suffer disproportionately from anemia (25 percent of rural youth) and intestinal worms (40 percent of rural youth); and half of all rural infants are cognitively delayed and thus unlikely to reach an adult IQ of 90.[12] Based on global comparisons of educational attainment, Hongbin Li and coauthors estimate that China's rural/migrant education gap will push China's annual GDP growth down to a maximum of 3 percent, and likely much lower.[13] Improving rural and migrant health and education outcomes to address this deep challenge to future growth requires considerable additional public financing and fiscal transfer mechanisms. The poverty alleviation push under Xi should be seen in this context, as should the more recent focus on rural revitalization. Although in the 1980s and 1990s, China relied on a "trickle-down regional economic development strategy," since 2013 China's "precision poverty alleviation" (精準扶貧) strategy targeting poor households rather than poor villages has increasingly relied on targeted interventions financed by fiscal transfers.[14]

Common prosperity also seeks to address China's imbalanced economy to enable domestic demand to become a sustainable source of growth. China's consumption share of GDP remains only 54 percent in 2020, and the CPC has raised "rebalancing" concerns since at least Wen Jiabao's "Four 'Uns'" speech in 2007.[15] Although the economy has still grown rapidly over the past 15 years, productivity has shrunk and become a drag on growth over this period; growth itself has only been sustained by high levels of debt-fueled investment which the CPC acknowledges are unsustainable. But inequality with minimal redistribution undermines efforts to rebalance the economy towards consumption. Population aging adds to this difficulty, as the current pension system cannot support high levels of retiree consumption, a challenge that will become more problematic as China's old-age to working-age population ratio rises from 18.5 percent in 2020 to 58.3 percent in 2060, exceeding OECD levels.[16]

China's high levels of inequality and aging are extreme, but today's high income countries all faced similar pressures to address these two trends through greater public expenditure and redistribution, even if the degree to which they did so differed. No resource-scarce country with such high levels of inequality has ever made the transition to high income.[17] Economic growth alone cannot solve current entrenched inequality in China; instead, the state will have to play a greater role through growing expenditure. On average, as a share of GDP, OECD countries spend 2.6 times more on health, 1.4 times more on education, 1.9 times more on social protection, and 1.4 times more on general public services; a combined 15 percent of GDP more on these four categories.[18] Yet despite assertions of a "socialist" market economy, China's overall public financial system remains regressive on net.

The CPC recognizes the challenges this poses for China's high income transition and the need for a greater state role. Overall, the past two decades have seen a remarkable increase in social expenditure. Despite attention to state-financed R&D and growing defense spending, these budgetary categories have stayed constant or declined as a share of total expenditure.[19] Rather, a growing share of expenditure has been taken by social expenditure. According to IMF data, functional government spending on education, health, housing and community amenities, and social protection rose from 5 percent of GDP in 2005 to 17 percent in 2018.[20] Poverty alleviation funds from the central budget skyrocketed, doubling between 2012 and 2018 and reached 146 billion RMB (20.6 billion USD) in 2020. On the surface, on the back of this growing expenditure and assistance, China in the Xi Jinping era has successfully addressed many challenges related to demographics and distribution. The Gini coefficient has peaked, extreme poverty by the CPC's own definition has been eradicated, rural-urban gaps have shrunk, and wage-based inequality has declined.[21]

But the common prosperity agenda recognizes that considerably more social expenditure is necessary to achieve China's economic goals. Despite peaking, inequality remains persistently high across multiple dimensions. And despite assertions that China eliminated poverty in 2020, the CPC continues to focus on China's poor; Premier Li Keqiang famously noted that 600 million Chinese continue to live on less than 1000 RMB per month. The common prosperity agenda, focused on increased taxes and fiscal transfers to support

low income populations and improving social protection and education, requires significantly greater fiscal expenditure.

Social security provides the starkest example. China's existing pension system does little to address old-age poverty and actually exacerbates inequality. At a simplified level, two components comprise the public pension system: employment-based pension systems for urban formal workers and a social pension system for rural and informal urban residents. The urban employment-based pension system, covering less than 30 percent of the current working-age population, is relatively generous but increasingly underfunded; the social pension system has expanded rapidly over the past decade, but remains extremely limited in terms of benefits. This dual approach leads to considerable inequality given that social pension annual benefits are only ~2 percent of GDP per capita, *25 times* lower than public unit pensions at 50 percent of GDP per capita. And employment-based pensions themselves are highly regressive, with bottom quartile recipients receiving only 2 percent of those in the top quartile.[22]

The multi-pronged pension system that China has developed and implemented is laudable in terms of its rapid expansion of coverage, but the generosity of benefits remains extremely low for rural and informal urban residents, and the current system is already financially unsustainable. Even without increasing benefits, population aging will drive the system to insolvency. If China hopes to increase social pension generosity, this insolvency will come much sooner. Even with no increase in generosity, population aging will result in spending increase from under 4 percent of GDP to over 10 percent of GDP from 2015-2050.[23] And contributions will only reach 2.8 percent of GDP, leaving a gap of 7.3 percent of GDP.[24] A widely discussed 2019 report released by the Chinese Academy of Social Sciences and the Ministry of Human Resources and Social Security's National Council for Social Security Fund forecast that the pension balance would become negative by 2028, and reserves would dry up by 2035, with payment shortfalls accumulating to 11 trillion RMB by 2050.[25] Today, pension benefits already exceed revenues in many provinces. And these shortfalls refer only to the formal urban system. All of these estimates assume that social pension expenditure remains miniscule. Nearly 40 percent of the working age population contributes to the social pension contributory system, with small

government contributions, but the low generosity leads to low overall expenditure (0.3 percent of GDP in 2014). Raising social pension benefits to just 10 percent that of urban workers (from 2 percent today) would result in an additional 3 percentage point of GDP gap in 2050; equalization of benefits would yield a 41 percentage point gap.

The common prosperity agenda explicitly seeks to address the shortcomings of China's existing social security system. In Xi's words, China "still needs to attach great importance to and make practical improvements on the weak links of the system, as the principal contradiction in Chinese society has evolved…Social security is the most imminent and realistic issue the people care about."[26] In February 2021, Xi announced a far-reaching—if vague—reform plan to broaden the range and strengthen the benefits of the system, arguing that doing so was imperative for state security (是治国安邦的大问题).[27] Although the reform plan was vague, it made clear that system generosity and reach both had to expand, necessitating considerably more public financing.

Pensions are just one piece of the common prosperity agenda, albeit one of the most expensive and consequential. Health, education, housing, and targeted poverty funds are all included in common prosperity rhetoric, and all require significant increases in state expenditure that the state has increasingly committed itself—rhetorically at least—to financing. China hopes to avoid the fate of other communist countries that experienced economic stagnation and service quality deterioration following periods of increasing the generosity of social guarantees.[28] But if the CPC truly envisions tackling inequality and redistribution by reaching OECD-level fiscal expenditure norms, this will require over 15 percent of GDP in *additional* annual fiscal expenditure.[29]

Financing Common Prosperity: The Emerging State Capitalist Welfare State

How will China finance this ambitious common prosperity agenda? It has become increasingly clear that one way the CPC intends to achieve this goal is by funding social expenditure and income redistribution not through a modern taxation system, but through SOE profits via share transfers and

dividends. The use of state asset ownership in a predominantly market economy to develop a non-tax-based redistributive welfare system—a "state capitalist welfare state" (SCWS)—has important implications.

Until relatively recently, China appeared to follow the playbook of other successful high income economies by expanding broad-based taxation to enable higher levels of social expenditure. As Zhu Rongji pushed through massive SOE restructuring in the late 1990s, a basic welfare system emerged. SOE restructuring paved the way for WTO entrance and a private-sector-led economy. By the mid-2000s, private sector entry and creative destruction drove economic growth. A modern taxation system based on a value-added tax (VAT), corporate income tax, and, to a lesser extent, progressive personal income tax, financed rapidly expanding social, health, and education expenditure. With regard to social security, international organizations promoted common global frameworks for social security development through technical assistance, policy dialogues, and recommendations, many of which China adopted.[30]

But SCWS as envisioned by the CPC marks an end to that convergence and a return to an earlier model of SOE-based public finance. Yet this is not the *danwei*-based iron rice bowl, but rather a more sophisticated and potentially sustainable SOE-based public finance 2.0. China's tax-based revenue has already shrunk significantly in relative terms—from over 93 percent of revenue in 2001 to less than 83 percent in 2019—while social expenditure continues to rise.[31] The CPC could have instead chosen to have a more progressive income tax-based fiscal system to be more in line with advanced economy trends, but China seems unlikely to move towards OECD levels of personal income taxation.[32]

Instead, China has made clear its intentions to finance redistribution through state asset transfers rather than broad-based taxation. The basic idea is to boost SOE assets and profits and transfer these profits to state coffers. The system itself is in part designed on James Meade's idea of "social dividends."[33] The system also has clear echoes in the Singaporean model. Non-tax revenue dependence for social welfare provision will depend on enhanced SOE strength and profitability, and SCWS thus has two key and inseparable components: SOE revitalization and SOE profit transfers.

Revitalization and evolution of state capital

SCWS requires profitable state-owned enterprises. It is common to hear that SOE reforms have reversed under Xi as the state has advanced while the private sector retreats (国进民退). Although partially true, this is an overly simplistic interpretation. Rather, SOE reform has taken three broad directions under Xi: 1) continued removal of purely state-controlled enterprises from competitive industries along with efforts to strengthen the private sector in these industries; 2) maintaining—and expanding—state ownership of strategic and public-focused industries; and 3) increasing state investments in the private sector as a tool of industrial policy and to bolster state profits, which consequently obfuscates the private/state distinction.

The CPC has sought to exert heightened oversight and control over the private sector in recent years, and, as discussed above, common prosperity is often interpreted in these terms. Yet despite greater oversight and central control, the private sector continues to expand faster than the state sector and continues to drive China's investment, employment, growth, and exports.[34] The number of SOEs in competitive sectors has continued to shrink, albeit at a reduced pace. Premier Li Keqiang has personally led a campaign to reduce red tape for private sector firms, and central regulators and the PBOC have attempted to channel preferential tax and lending policies towards the private sector to spur growth. Perhaps ironically, part of the turn to state-asset-dependent financing modalities for common prosperity have arisen because of efforts to cut private sector corporate income and labor taxes, which has necessitated finding new revenue sources.

Yet two countervailing trends show that in other ways, the state sector has indeed advanced. First, many sectors have been deemed strategic or public, with SOEs expected to dominate these sectors and act as implementers of government policy. With little consistency over time, policy uncertainty has risen over what constitutes a strategic or public sector. The most recent example may be commercial housing. With Xi's repeated assertion that "houses are for living in, not for speculation," along with the Evergrande debacle and broader property sector corrections, SOE developers have become key players by taking over debt-laden but still viable commercial projects. State developers will likely face pressure to build low-income affordable housing.[35] SOEs will play a stabilizing role in real estate markets, guaranteeing state profits while also

ensuring that people have access to housing.[36] This is a clear example of the state advancing at the expense of the private sector, with common prosperity goals and stability in mind.

The final SOE evolution under Xi relates to state investments. State capital has expanded far beyond majority purely state-owned firms: the "investor state" has risen.[37] When "mixed ownership" reforms were touted in 2013, they were seen as a way to reinvigorate SOEs with private sector stakes and dynamism. But actual implementation has more frequently meant state investments in private firms. At times, this serves as a form of industrial policy, as with the Ministry of Industry and Information Technology (MIIT) investments in nearly 5000 emerging "little giants" since 2019.[38] But another key aspect is increasing returns for state capital investment bodies, which have proliferated. This trend accelerated during the pandemic-related economic downturn, with floundering private sector firms seeking state bailouts/investments.

In sum then, SOE evolution seeks to combine private sector dynamism with state control and state profitability. This is a tall order, and, as discussed below, even if implemented "successfully" would still lead to considerable efficiency losses as compared to a market reform scenario. But the strategy has succeeded in giving the state new levers of policy control as well providing a new source of revenue: in 2021, SOE profits were higher than private sector profits for the first time since 2008.

SOE asset transfers: the case of social security funds

Reform-era China has a relatively long—if until recently underwhelming—history of efforts to transfer state assets to support the public budget, social security funds in particular. Efforts began in earnest in 2001 with measures to transfer 10 percent of SOE initial public offering proceeds to the National Social Security Fund.[39] In 2007, central SOEs, which had been exempt from paying dividends previously, began paying 10 percent dividends in profitable industries, though strategic sector SOEs remained exempt. In 2011, top dividend rates increased to 15 percent, a rate well below that facing most global SOEs.

Under Xi, asset and profit transfer efforts have become more ambitious, particularly with regard to social security financing, an area with great financing needs. The Office of the National Working Commission on Aging estimates that elderly care will consume 26 percent of GDP by 2050, up from 7

percent in 2015.[40] Any increase in social pension generosity—as envisioned by common prosperity—will drive these figures considerably higher. But urban employment pensions cannot simply be funded from greater contributions, as contribution rates (at 28 percent of wages on average) are already well above advanced (20 percent) and emerging market economy (15 percent) averages. The system already has high minimum thresholds, and there is already considerable evasion by small companies and those with high turnover.[41] And gradually raising retirement ages, as mooted in 2021, will simply be offset by rising life expectancies, especially at the envisioned pace of change.

Consequently, in addition to expanding individual contributions, China plans to reform its pension system by increasing share transfers from SOEs to allow local and central governments access to SOE dividends to shore up social security funds. The most recent and ambitious step is transferring state-owned assets directly to social security funds. The policy began in Shandong in 2015 with 18 companies picked to transfer 30 percent of their total capital to the newly created provincial social security council (山东省社会保障基金理事会). Later more companies were added, but the transfer share was reduced to 10 percent.

Following Shandong, in November 2017 the State Council issued the "Implementation Plan for the Transfer of Some State-owned Assets to Firm up Social Security Funds" (划转部分国有资本充实社保基金实施方案). The Ministry of Finance in 2019 followed up with more specifics on transferring SOE shares to social security funds, pressuring reforms that had lagged after the initial 2017 announcement. The transfer of financial and non-financial SOE shares proceeded rapidly after mid-2019. In 2019 alone, over 1 trillion RMB of SOE shares were transferred to the fund.[42] By January 2021, the Ministry of Finance announced completion of the program, with 10 percent of all 93 of the largest state owned companies transferred to the national pension fund, worth 1.7 trillion RMB.

Yet this 1.7 trillion RMB transfer only covers central firms, and is not enough to fill expected pension gaps, which are themselves concentrated at the sub-national level given China's highly decentralized fiscal system. The State Council made clear that provincial and sub-provincial SOEs should also transfer shares. Implementation varies: although SOE share transfer were intended to be completed by 2021 in all provinces, over half of China's provinces

have yet to set up a social security council and transfer shares.[43] But assuming these efforts continue, these transfers could make a considerable dent in expected pension shortfalls. There are several unknowns regarding dividend payout ratios (currently at 15 percent, much less than the 50-60 percent level of US industrial firms)[44]; the share of assets transferred to social security funds (currently 10 percent but originally envisioned at 30 percent); and future SOE profits (currently 5 percent of GDP and rising). Reasonable estimates could yield between 0.3 percent and 1.5 percent of GDP in additional revenue for social security funds each year.

More broadly, increasing SOE profits and dividend payout ratios could yield an additional 2-3 percent of GDP in revenue for general government budgets across administrative levels, held in related State Capital Management Budgets (国有资本经营预算). These funds would not be earmarked for any specific purpose, but could help finance other aspects of the common prosperity agenda.

Implications for U.S. Policy

Implementing the common prosperity and SCWS agenda is far from certain.[45] Challenges with firm capture, central-local relations, and elite politics could all conspire to make the common prosperity reality far less than the vision. Indeed, the reason that common prosperity in 2021 focused on antitrust regulation and tertiary distribution may be that these were low-hanging fruits politically. But assuming that China successfully implements this agenda, what are the implications? Below, I focus on three implications for U.S. policy:

1. *Economic competition*. Common prosperity and SCWS imply a less dynamic but potentially more sustainable growth trajectory, but also militate against further market reforms. By boosting domestic demand and enabling dual circulation and self-reliance, common prosperity and SCWS make China more robust to external economic pressure.

2. *Global soft power*. Common prosperity and SCWS imply a potentially workable version of market socialism that the CPC believes would

resonate globally, boosting China's soft power. Given growing global discontent with inequality and capitalism, the CPC may not be mistaken, despite soft power shortcomings stemming from China's authoritarianism.

3. *Domestic support for China policy.* The Beltway consensus spurring more combative or "decoupling"-type policies towards China, particularly in the economic realm, is facilitated by growing anti-China sentiment among the American public. Common prosperity and SCWS could change American perceptions of China and reduce support for current policy directions.

Implications for U.S.-China Economic Competition

Current DC perceptions of China's economic prospects appear to fluctuate between two extremes. One increasingly common view sees China's current demographic and debt challenges as insurmountable. From this vantage point, concerns about competition with China are either overblown, or China is a "peaking power" that is likely to become increasingly externally aggressive before its relative power declines.[46] In contrast, other U.S. policies correspond with a view of China as an emerging techno-industrial superpower whose state interventions will enable cutting-edge innovation and supply chain dominance. From this latter perspective, the United States should seek to contain China or decouple from China before it is too late.

Yet successfully implemented SCWS is likely to chart a middle path for the Chinese economy. SCWS would help China overcome its demographic and debt challenges, boosting domestic demand through redistribution and improving human capital through increased education and health expenditures. This will help China escape the middle income trap. It will also reduce external dependence and make China more self-sufficient. China's economy would continue to grow, and per capita income would continue to converge.

But SCWS would also coincide with slowing growth in China. Beyond short-term pandemic effects, China's current economic slowdown can be arithmetically explained by two factors: declining (total factor) productivity growth, and the reversal of China's demographic dividend. The key determinant of

productivity decline has been capital misallocation that prevents the exit of underperforming firms and the entry of productive firms.[47] SCWS will not solve this problem, and could exacerbate it. The extent of efficiency costs will depend on broader SOE reforms. Moving towards a state investment system modeled on Singapore's Temasek would enable more efficiency than keeping SOEs dominant in production itself. The bigger question is China's far more numerous local SOEs, many of which operate un-competitively within competitive, non-strategic sectors; allowing these firms to close would boost overall productivity and allow new entrants. SCWS would not depend on profits from these loss-making firms and thus would not necessarily impact local government willingness to shut them, yet as state capital bails out large state- and private-sector local firms, closing these firms may become even more difficult.

In terms of overall growth, then, China, with a shrinking population and continued support for "zombie" firms would experience slowing yet positive growth. Although China has a market-based economy and is adapting its state sector to fit—China is not becoming a command economy again—prospects for further market reform and privatization are distant. China will double down on industrial policy and state guidance. Because of the boost to domestic demand and continued state control over key "strategic" sectors, as well as continued industrial policy to shore up key technology sectors, China will be more self-reliant and less susceptible to external pressure in the form of either carrots or sticks. If SCWS succeeds, then, China would have slower growth that is more balanced both internally and externally.

These growth trends have implications for U.S. policy. First, in contrast to many existing discussions, U.S. policymakers should not design policies based on assumptions of China's economic failure. Demography is not destiny, and U.S. policy should not be based on an assumption of future dominance. Similarly, however, U.S. policymakers should not assume that China will rapidly become the world's largest economy. Second, pressuring market reform in China will become increasingly ineffective. Recent bilateral sticks, most notably the trade war initiated in 2018, have proven ineffective, but multilateral trade inducements have provided effective carrots for China's reform in the past. If the US seeks to shape Chinese economic reform and engage fairly with China in the global trading system, the windows for WTO reform and joining CPTPP to incentivize change in China are closing.

Implications for China's Global Leadership and Soft Power

In the context of growing global discontent with inequality and capitalism, SCWS—and the CPC's explicit intentions to export this emerging brand of market socialism—also has implications for U.S.-China soft power and ideological competition. The development of a uniquely Chinese sustainable welfare state will help shape the global attractiveness of a "China Model." Yet today, this aspect of global competition gets short shrift. Dominant perspectives in U.S. policymaking communities on the ideological nature of U.S.-China ideological competition focus on political system competition. According to one view, China does not pose an ideological challenge given that China's authoritarian/totalitarian state capitalism has few adherents.[48] An alternative view takes the authoritarian challenge seriously, particularly given the end of the "third wave of democratization" that has coincided with China's rise.[49] Edel and Shullman argue that the CCP is exporting authoritarianism "not through seminars on Marxist ideology...but through a broad range of antidemocratic activities."[50]

A contrasting view of the ideological competition from an economic perspective acknowledges that China has now begun to challenge U.S. dominance as a potential socioeconomic system competitor, but sees this competition through the lens of state control and technological capability, not through the lens of soft power attractiveness. The threat focuses on industrial policy and state ownership in a market economy, as well as China's efforts to export this model through global financing as part of the Belt and Road Initiative. But there is a tendency to overstate the potential influence of the "China model" when analyzed through these prisms of techno-industrial policy and development finance. Although techno-industrial policy will help shape U.S.-China competition, China's approach is neither successful enough nor original enough to pose a broader threat to the liberal economic order.

By focusing on the competitive challenge posed by China's hard power and not acknowledging the deeper goals—and potential socioeconomic effectiveness—of Xi's redistributive push, U.S. policymakers may underestimate the soft power challenge posed by China's rise. This economic ideology challenge should be seen through the lens of rising global discontent with capitalism as well as through China's explicit promotion efforts. In terms of China's promotion efforts, SCWS is a key element of the "China Solution" that the CPC has

promoted since the 19th Party Congress, and whose export the CPC believes can serve as a global public good.[51] The idea of funding redistribution through SOE shares has precursors in the West and in Singapore, and China's efforts are based on Western social science ideas, but the CPC believes its ideas will resonate abroad.

China's redistributive turn would likely find a receptive audience, coming at a time when global perceptions of capitalism have never been so negative. One Edelman survey in 28 countries finds that 56 percent of respondents think capitalism as it exists today does more harm than good in the world, and only 18 percent say the "system is working for me."[52] The world is increasingly favorable towards socialist ideas; most country publics see redistributive socialism as beneficial, even when they negatively associate socialism with aspects of social and political totalitarianism.[53]

Comparing large-scale rigorous time-series polling data in Latin America (AmericasBarometer), Africa (Afrobarometer), and Asia (Asian Barometer) yields several interesting and cross-regionally-consistent findings related to the potential attractiveness of "Chinese socialism."[54] As has widely been reported, publics in most countries hold increasingly "unfavorable" opinions of China, and much of this low opinion arises due to perceptions of China's authoritarianism. However, publics in Asia, Africa, and Latin America already generally perceive Chinese influence as equal or more positive than U.S. influence. And today, although China is still not the top external "model" for development, it comes second after the United States and has been closing the gap. For instance, in the latest Afrobarometer (2019/2020), the China model (23 percent) is second after the United States (32 percent).[55] In other words, China is already more attractive than often perceived, despite China remaining a relatively non-prosperous and unequal country.

There are also indications in the Barometers surveys that SCWS could make the China model more attractive. The cross-regional polling data reveals both increasing redistributive preferences as well as growing correlations between these redistributive preferences and support for the China model. Controlling for individual country effects, all three regions exhibit a consistent trend towards more support for redistribution, unsurprisingly given the global shift towards pro-socialist attitudes and discontent with inequality. Moreover, respondents with greater redistributive preferences are already

more likely to see the China model as desirable, despite China's high levels of economic and social inequality. In all three regions, there is a growing association between left ideological preferences and support for the "China model," which also correlates with trust in China. A decade ago, in Asia at least, concern with inequality predicted *less* support for the China model, but this has reversed across regions, either as a result of discontent with "Western" capitalism and its effects on inequality, or as a result of perceptions of greater Chinese success confronting inequality.

In sum, Xi's aspirations of re-establishing China as a global socialist model may seem improbable given China's high levels of inequality, but left-leaning populations in the developing world already perceive China favorably. If China successfully implements SCWS and common prosperity, China would become even more attractive, not only to developing economies, but also to middle-income economies struggling with similar questions related to the efficiency-equality tradeoff. This is much more of a competitive soft power threat than authoritarianism itself, which detracts greatly from China's attractiveness.

In terms of policy recommendations, U.S. policymakers should take China's soft power challenge seriously and seek to better understand public opinion abroad. One reason for the perceived lack of soft power resonance regarding China may come from U.S. policymakers' greater familiarity with elite positions; socioeconomic elites in the developing world, as shown in the Barometers surveys, tend to have much more negative opinions of China and more favorable views of the US than general populaces.[56]

Additionally, U.S. policymakers and diplomats should improve U.S. messaging abroad and promote America's own shared prosperity language. Currently, the State Department competes with China abroad through propaganda efforts that aim to portray BRI and Chinese investment negatively. This propaganda is ineffective. The United States has an equitable development model and provides considerably more global aid than China, and U.S. policymakers at the State Department and USAID, as well as through representation at international organizations, should focus on these American advantages. Rather than opposing China, working together with China, both bilateral and through international organizations, allows the US to highlight confidence in these advantages. This does not preclude highlighting China's

human rights violations and CPC authoritarianism. Indeed, the United States has a major advantage arising from "moral asymmetry."[57] But that advantage is squandered through inconsistency and conflating China's positively-perceived economic engagement abroad with CPC authoritarianism.

Implications for public support for U.S. policy towards China

Among the American public, attitudes towards China have hit unprecedented lows.[58] These negative attitudes give policymakers space to impose more confrontational policies on China, especially in the economic sphere; indeed, conventional wisdom has it that being "soft" on China would be politically disastrous for either party. Yet SCWS may affect American opinion on China in unexpected ways, limiting policy choice.

Consistent with the global polling data cited above, inequality in America has triggered growing discontent and rising support for redistribution across ideological and party lines. Both liberals and conservatives now agree that inequality of income and opportunity have reached levels that undermine the American economy.[59] And American support for socialism has grown, largely driven by liberal youth, but also among conservatives,[60] likely because "socialism" now tends to activate ideas of government-led redistribution rather than government ownership of the means of production.[61]

But is there any reason to think that this evolving sentiment would affect attitudes towards China and preferences regarding U.S. policy towards China? To assess how the American public perceives China's economic system and whether "socialist/redistributive" developments in China would affect perceptions of China as a threat, I commissioned a nationally-representative survey of 1,016 Americans by Ipsos KnowledgePanel. Additionally, to compare preferences between the public and the policymaking community, I ran an identical survey for alumni of the Johns Hopkins School of Advanced International Studies (SAIS). SAIS alumni predominantly work in government or private/non-profit/think tank communities connected to international affairs, with over 40 percent of 560 respondents having worked (or currently working) for the U.S. government.[62]

Analyzing and comparing these two surveys highlights stark differences between the foreign policy community and the American public, and highlights ways in which SCWS development in China might make Americans less will-

ing to support policies based on perceptions of China's economic threat.[63] First, in terms of how they perceive the Chinese economy, the American public is significantly more likely to think of China as a command economy than the foreign policy community; and significantly more likely to think China's growth has been based on unfair trade, rather than market reforms or globalization.[64] In terms of the perceived threat emanating from China's economic rise, although the two samples have no differences in overall favorability towards China, the foreign policy community is much more likely to see the economic threat in military terms, while the public is more likely to see the threat in terms of competitiveness and American job loss. Relatedly, the public is much more likely to see the primary goal of economic interactions with China as American job creation, whereas the foreign policy community would like to pursue political and military goals using economic levers. Although the foreign policy community strongly believes that political reform (democratization) in China would lessen the threat from China, the public does not, instead expressing concern only with the overall size of the Chinese economy.

Summarizing these findings, the public sees China as having a command economy; thinks this leads to unfair trade; and sees the threat from China as one to economic competitiveness of the United States, but does not worry about the security risks surrounding economic integration. The foreign policy community is more knowledgeable about China's actual economic model but sees economic interactions through security lenses. The public is less likely to be concerned about ideology and much more likely to be concerned about Chinese economic effects on American jobs.

Moving beyond baseline differences, the surveys sought to explore how perceptions of economic redistribution in China affected the public's policy preferences. Controlling for baseline favorability towards China, perceptions of trade effects, ideology, party, age, race, and gender in order to provide a better indication of the pure effect of redistribution perceptions and perspectives, respondents who (incorrectly) think that China has a more generous safety net than the United States have lower threat perceptions. Relatedly, respondents who think China has a command economy are more supportive of containment policies, while those who think that China's efforts to share prosperity helped grow its economy are *less* likely to support containing China. In other words, across ideological and demographic lines, perceiving China as having

a more equal economy and less of a command economy leads to lower threat perceptions and lower support for confrontational economic policy.

To further explore the potential effects of changes to China's economic model, I added experimental cues to each survey. In each survey, one-quarter of respondents received a cue emphasizing bipartisan consensus on China's unfair trade practices ("unfair trade"); one-quarter received a cue emphasizing bipartisan critiques of China's human rights practices, including the genocide in Xinjiang ("Xinjiang genocide"); one-quarter received a cue highlighting China's goals and progress in fighting poverty and inequality ("common prosperity"); and one-quarter received no cue ("control"). Following these prompts, respondents were asked about threat perceptions regarding China and policy preferences.

The results are striking. For the public, receiving the "common prosperity" cue makes respondents considerably (nearly half a standard deviation) less likely to see China as a threat. The "Xinjiang genocide" cue makes respondents significantly more likely to see China as a threat, though the magnitude of the effect is smaller. The unfair trade cue has no effect, possibly because this information is already internalized by respondents. Looking at frame effects on specific policy preferences, the "common prosperity" frame causes respondents to be less supportive of decoupling and containment. Unexpectedly, party and ideological leanings do not shape the impact of these frames; instead, Republicans and Democrats both have lower threat perceptions after hearing about China's redistributive goals and poverty alleviation (though their baseline threat perceptions differ significantly). These findings indicate that perceptions of China's redistributive socialism trigger lower levels of support for policies that are perceived to punish China economically, and they imply that increased knowledge of China's redistributive goals and common prosperity agenda would decrease support for many current policies seen as limiting bilateral economic interaction.

In terms of policy recommendations, it is important that U.S. policymakers not assume continued support for policies that are perceived as attempting to contain China economically or decouple from China. Today's conditions lead to support for these policies, but conditions are likely to change, while these policies themselves can have more lasting consequences and become difficult to reverse.

Additionally, greater public education about China is essential; the United States should fund language training and study of China. The American public is generally not very knowledgeable about China, as seen by the high share who perceive China as continuing to have a command economy and the fact that only 47 percent of respondents can identify Xi Jinping as China's leader from a list of names. On the one hand, therefore, China's propaganda efforts to highlight its common prosperity successes in the United States may be ineffective. Yet as China becomes more important globally, it is likely to have more success touting its model abroad, including in the United States. Even during the Mao years, CPC propaganda had a major effect on U.S. domestic politics, where Mao found support among alienated minority groups, feminists, and idealistic youth.[65] And the survey results show that framing has a large influence on public policy preferences. Baseline knowledge of China, and even being able to identify Xi Jinping as China's leader, mitigates the impact of the experimental cues. The more Americans know about actual conditions in China, rather than propagandized stories from the CPC or fear-mongering distortions by U.S. politicians seeking political gain, the more rational public policy preferences will become.

Conclusions

China and the United States will increasingly compete over socioeconomic models, with major implications for the development of world order in the 21st century. An underappreciated aspect of this competition revolves around the ways that economic models ensure suitable levels of public goods provision, insurance, and equality to enable continued growth. Since the global financial crisis, Americans—and others around the world—have increasingly questioned whether a liberal capitalist economic model meets these needs. In China, the CPC has made a conscious decision to develop its own approach to the public financing of a welfare state. Specifically, the CPC has advocated a common prosperity agenda based on redistribution to address deep-rooted challenges of inequality, poverty, and aging. This agenda will be in part financed by a stronger state sector that contributes more to transfers and redistribution. If successful, this model could help put China on a path towards sustainable economic growth. The CPC believes that this version of

"socialism with Chinese characteristics" will resonate abroad and improve China's soft power. China's success in this vision, still far from assured, would make its economic model a true global competitor. Understanding China's vision—and its implementation to date—is thus a pressing research challenge, as is gaining a better understanding of U.S. policymakers' perceptions and potential responses.

At one level, the United States should welcome China's development of a more equitable economic model. But China's illiberal system poses a deep challenge to global liberalism and human rights. Ideally, the United States could demonstrate its own liberal meritocratic capitalism solution to problems of inequality, but conclusions that "we need to get our own house in order" are generally unhelpful, even if true.

The analysis presented here points in three general directions for U.S. policy focused on bilateral economic competition and the role of U.S. pressure; policy towards developing countries; and the framing of the "China challenge" domestically. Although specific policies are summarized above, let me repeat the broad implications in these three areas:

1. **The role of economic pressure, carrots, and sticks to achieve market reforms and fair trade practices in China.** The United States should not make policy based on assumptions of China's economic failure and U.S. future dominance. Some argue that the United States should not pressure market reforms in China because wasteful subsidies and state intervention actually help limit Chinese economic growth and power.[66] This is shortsighted. Instead, there is an urgency to pressure market reforms now as opposed to waiting until it is too late. SCWS would make China more self-reliant while also establishing a state-dominated system at odds with American comparative advantage and free market preferences. Efforts to make China bear the costs of state intervention could lead to more viable approaches to state investment, competitive neutrality, and a more stable global trading system. Pressuring market reform in China bilaterally will become increasingly ineffective, but multilateral trade inducements may still work. The United States should therefore engage with partners on WTO reform and negotiate entry into CPTPP.

2. **U.S.-China soft power competition in the developing world.** U.S. soft power competition with China, particularly in developing countries, has increasingly revolved around the economic impact of BRI investments and foreign aid. U.S. policymakers should take China's soft power challenge seriously and seek to better understand public opinion abroad. And at the UN, and even the World Bank, the United States has ceded ground to China in terms of developmental and shared prosperity language. By all means, the United States should use the DFC and USAID to compete with BRI, but propaganda to undermine China's investments is ineffective. Competition over aid and investment makes the United States look weak and makes aid look transactional. Instead, the United States should promote our own shared prosperity language abroad. The United States has a more equitable economic model than China does today, and rather than opposing China, working together with China, both bilateral and through international organizations, allows the United States to highlight confidence in its economic model advantages.

3. **Framing China policy domestically.** The Cold War pitted communism versus liberal capitalism, with "communism" equivalent to command economy socialism combined with totalitarian governance. But in today's emerging cold war, markets have already won. American perceptions of command economy totalitarianism are very negative, but when confronted with redistributive socialism in China aimed at addressing poverty and inequality, they become much less supportive of many current policies towards China. U.S. policymakers should therefore not assume continued support for policies that are perceived as furthering "decoupling" or "containment." Policymakers should also devote greater effort to public education on China given that framing has a large influence on public policy preferences.

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57 Hal Brands and Zack Cooper, "U.S.-Chinese Rivalry Is a Battle Over Values," *Foreign Affairs*, March 16, 2021. Accessed March 15, 2022. https://www.foreignaffairs.com/articles/united-states/2021-03-16/us-china-rivalry-battle-over-values.

58 Mohamed Younis, "China, Russia Images in U.S. Hit Historic Lows," Gallup, March 1, 2021. Accessed March 15, 2022. https://news.gallup.com/poll/331082/china-russia-images-hit-historic-lows.aspx.

59 In 2021, Axios|Momentive polling found that over two-thirds of Americans wanted the federal government to "pursue policies that try to reduce the gap between the wealthy and the less well-off in America," with the share rising over 5 percentage points among Republicans and 7 percentage points among Democrats. Laura Wronski, "Axios|Momentive Poll: Capitalism and Socialism," Survey Monkey. Accessed March 15, 2022. https://www.surveymonkey.com/curiosity/axios-capitalism-update/.

60 Wronski, "Axios|Momentive Poll"

61 Frank Newport, "The Meaning of 'Socialism' to Americans Today," Gallup, October 4, 2018. Accessed March 15, 2022. https://news.gallup.com/opinion/polling-matters/243362/meaning-socialism-americans-today.aspx.

62 Although far from a perfect proxy, survey views are highly consistent with small-n findings in formal and informal interviews, providing a degree of justification for policymaker representativeness.

63 Findings from both surveys are summarized in broad terms here. Additional survey information, including methodology and questionnaires, as well as detailed results, is available at https://davidjbulman.com/data/.

64 In order to look at differences driven by the foreign policy community, the analysis controls for other personal characteristics that are over-represented in the SAIS alumni panel and that affect perspectives on China: education level, party affiliation, age, ideology, and race.

65 Julia Lovell. *Maoism: A Global History* (New York: Knopf, 2019).

66 McFaul, "Cold War Lessons and Fallacies for U.S.-China Relations Today."