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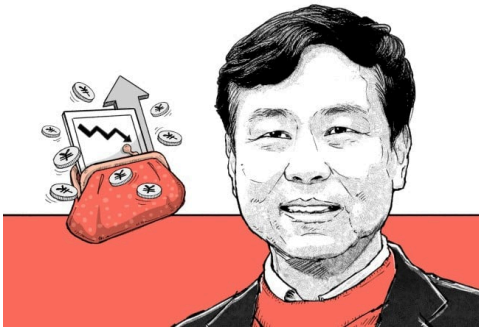
Open Questions | Chinese economist Lu Feng on why the time is ripe for a consumption rebalance

Peking University professor says China's next five-year plan could provide the necessary momentum to shift more public resources to households

Ji Siqu in Beijing

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This interview first appeared in [SCMP Plus](#). For other interviews in the Open Questions series, click [here](#).

There's been a lot of talk about [weak consumption in China](#). What are the underlying reasons for this?

Actually, this issue has been there for a long time. It should be said that since [former Chinese premier] Zhu Rongji's era [1998-2003], both domestic academic circles and international observers have recognised that China's consumption is relatively weak. However, in recent years, this problem has become particularly pronounced.

Indeed, consumption growth has been relatively slow, and there are a series of structural reasons behind this, including weakened public confidence after the Covid-19 pandemic. I think perhaps more importantly, income distribution, our social security system and the hukou [household registration] system all reflect what we might call a dual economy: while some groups have benefited, it must be said that the degree of inclusiveness is insufficient, which has led to the relatively low consumption of other groups.

On the other hand, our country's system has long directed substantial public resources towards production, technology, supply and productivity. This has led to rapid growth in these areas, and the resulting contradiction with our insufficient final demand and especially weak consumption is becoming increasingly obvious.

A basic principle of economics highlights the importance of the balance between supply and demand. When your production capacity becomes exceptionally strong, even if consumption continues to grow, the excess supply will eventually lead to a series of problems.

Data shows that consumption in China's major cities, as represented by Beijing and Shanghai, appears particularly weak. What are the reasons behind this?

Beijing might be a special case because it had several major events this year, such as the [\[September 3\] military parade](#), which implies somewhat restricted daily consumption for certain periods. Additionally, as the capital, Beijing has a long-term goal of reducing its permanent population and transferring it to areas like [Xiongan \[New Area in Hebei province\]](#). These factors may also be playing a role.

But generally speaking, the problem of weaker consumption in large cities is indeed more pronounced, suggesting that the intensity of competition – or “involution” – in these cities may be greater than in ordinary areas. In the past, large cities were more economically active, especially in terms of consumption. The current situation, I think, started after the pandemic.

The simple logic is that due to pandemic control measures, large cities – because of their high population density and greater risk of rapid spread – imposed stricter restrictions. This led to a significant degree of damage to many service industries during the pandemic. This segment of the working population, which should have been relatively active and growing in employment, also took a hit.

Back in 2022, while I was researching labour issues, I spoke with some young people and their parents. One young person, whose parents had migrated to a large city for work, had planned to learn hairdressing or culinary skills and then enter the city’s service sector. However, the pandemic hit, and he graduated but couldn’t find those jobs, so he had to return to factory work instead. Of course, this is just an individual case, but it reflects how young people’s career choices are closely linked to broader economic patterns and conditions.

In other words, the service sector should have been becoming more active and creating more jobs in this economy, but the pandemic, to a certain extent, altered this trend. As a result, the employment situation in the service sector of large cities has become more challenging, leading many to flock to industries like ride-hailing and food delivery – fields that are now also highly competitive.

The fact that consumption in large cities is weaker than in other regions is a significant issue. Generally, modern economic growth relies on agglomeration effects. Large cities, with their economies of scale, should generate more demand and more employment. Yet, what we are observing now does not align with that expectation.



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Some policies in China, while not strictly economic in nature, can still impact consumption. For example, do you think measures like the [recently reinforced austerity rules to maintain party discipline](#) and the [anti-corruption campaign in the financial sector](#) also had a significant effect on dining consumption?

Of course, anti-corruption efforts and political discipline are necessary; they are essential to governance, and tough measures against corruption are largely welcomed by the general public. But objectively, they do have an impact [on consumption], partly because there’s a risk of going too far. For example, sometimes when we attended work meetings with relevant officials, we weren’t even allowed to have lunchboxes. I don’t know if that’s their own interpretation of the rules or an official regulation, but from an ordinary citizen’s perspective, it does feel somewhat excessive.

Furthermore, policies around some urban consumption – such as high-end leisure and entertainment – keep changing. One moment it’s regulated this way, the next moment that way. This also affects consumption, and in the end, this regulation can result in a chilling effect, stripping away everyday vibrancy and leaving cities feeling lifeless.

For example, outdoor barbecuing is said to harm the environment. But how much impact does barbecuing actually have? Are there any quantitative studies? I’ve never quite understood how grilling on such small stoves could cause significant pollution. Environmental protection is important, of course, but are many of these policies based on scientific and reasonable grounds? Entire industries can vanish overnight – consumption stops, incomes disappear and many jobs are lost. Regulations need to take economic costs into account.

Another example is the tutoring sector, which was essentially shut down a few years ago, even though the objective demand for it still exists. The rationales for the policies are there, the question is how can these issues be handled better? Regulation should be conducted within a scientific, legal and transparent framework, which would help improve our governance. At the same time, I believe it would at least marginally help stabilise our consumption.

Of course, the central government has already stated that every policy should be evaluated for its impact on macroeconomic growth before implementation. Whether this is consistently put into practice is hard to say, but it's certainly a necessary step.

Beijing is aware of the urgency to boost consumption and has taken some action, including issuing additional special government bonds since last year to support programmes like consumer goods trade-in subsidies. How effective have these policies been?

Policymakers have indeed recognised – or are increasingly emphasising – the issue of insufficient consumption, which is why they have rolled out a series of measures. For example, the stimulus policies introduced in September 2024, while perhaps not as large in scale as the 4 trillion yuan package in 2008, still represent the most substantial stimulus in over a decade. This shows that top leadership is aware of the shortcomings in demand and weak consumption.

Last year, 300 billion yuan (US\$42.1 billion) was allocated for consumer goods trade-ins and corporate equipment upgrades. This year, the funding has effectively doubled, with an additional 300 billion yuan in ultra-long-term special bonds dedicated to each of these two areas. I do think the scale of support is quite significant.

In addition, some longer-term policies are being implemented, such as subsidies for childbearing and support services for disabled or elderly people. In my observation, the past two years have seen the most concentrated roll-out of specialised policies aimed at revitalising consumption – consumption has not always been emphasised this much in the past.

The real question, however, lies in the effectiveness of these policies. Take consumer goods trade-ins, for example. In the short term, they do boost spending on certain categories – such as home appliances and other durable goods. It was estimated that the extra consumption generated by the policy this year contributed to perhaps over 1 percentage point for the overall consumption growth rate.

But the policy has not fully addressed the root of the problem. From January to September, retail sales of goods amounted to 32.49 trillion yuan, up by 4.6 per cent year on year. But in the single month of September, retail sales of goods increased only by 3.3 per cent, and if we exclude the portion driven by trade-in programmes, the remaining year-on-year growth rate was just 1.5 per cent that month.

Moreover, the trade-in programme has front-loaded demand in these categories, meaning that consumption in related areas may weaken in the period ahead.

This represents a typical short-term liquidity response: if consumption is temporarily sluggish due to certain short-term factors, such stimulus can help bridge the gap until it returns to a normal state. However, the current situation appears different. It suggests that behind weak consumption lie deeper structural issues. Unless these causes are addressed, stimulus policies may have some effect, but they cannot resolve the fundamental problem.



China's industrial structure has reached a more advanced stage, our exports have reached a high surplus level, and yet the return on investment continues to decline

You mentioned some structural factors affecting consumption growth, such as the household registration system and social security issues, and said there is some degree of consensus in academic circles on the need for reform. So why has progress in these areas been relatively slow, and why have the outcomes been less than satisfactory?

I've been reflecting on this question in recent years, and it seems existing research rarely addresses it systematically from this perspective. I believe it may be related to the distinctive way that resources are allocated within China's public sector. Here, we need to define the public sector: it is broader than just the government, and includes state-owned enterprises (SOEs) and public institutions providing various services.

These three components together control a pool of resources that is significantly larger than fiscal resources alone. Based on data from 2023, the resources managed by the public sector are estimated to account for over 45 per cent of gross domestic product. Therefore, how these resources are allocated has a crucial impact not only on economic growth but also on structural balance within the economy.

In simple terms, while resource allocation touches upon many areas, the majority is still channelled through various forms of investment, primarily focused on boosting technological progress and industrial development, which is the supply-side capacity.

Of course, there is a growing emphasis on livelihoods and consumption, but the proportion of investment directed towards these areas remains relatively insufficient compared with supply-side and productivity investments. As massive resources from both the public sector and private investment are channelled towards the supply side, coupled with the improved efficiency of supply investment, the pace and speed of supply expansion have greatly increased. Conversely, consumption is fundamentally unable to keep up with the growth in supply. This leads to supply exceeding demand, resulting in overcapacity and low profits.

In the past, we primarily addressed this issue through three policy instruments. First is promoting investments to achieve the objectives of upgrading industrial structure and boosting short-term demand.

Moreover, since Zhu Rongji's administration, over more than two decades, we have almost continuously engaged in intermittent or sustained efforts to cut overcapacity – though the terminology has varied. Sometimes it was called “addressing overcapacity”, other times “capacity reduction” and now it's referred to as “[anti-involution](#)”.

Third, expansion of exports utilising external demand. In essence, these measures serve multiple purposes, including alleviating the pressure of supply exceeding demand caused by weak final consumption.

So, there have been various ways to manage the problem, but in recent years, the situation has changed. These old pathways have become increasingly difficult to pursue. China's industrial structure has reached a more advanced stage, our exports have reached a high surplus level, and yet the return on investment continues to decline. This is mainly because weak demand prevents goods from fetching good prices, leading to shrinking profits.

The return on investment is actually the most important indicator guiding rational investment across society. When returns on investment are poor, people are naturally reluctant to invest more – it's simple logic. So, who invests under such conditions? The government does, because the government does not always prioritise profitability. It may invest in projects that are temporarily unprofitable to maintain macroeconomic stability, often in infrastructure.

Such investments can sometimes be reasonably ahead of demand. However, if consumption remains persistently weak and there are not enough users of this infrastructure, the returns on such investments will also weaken over time, making this approach difficult to sustain in the long run.

Chinese policymakers have acknowledged this in the proposals for the next five-year plan, calling for the expansion of effective investment, maintaining a reasonable growth rate of investment and improving its efficiency.

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Which groups in China have greater consumption potential, and how can this potential be fully unleashed?

From the perspectives of income distribution, [urban-rural disparities](#) and structural differences in social security, it is likely that the consumption needs of those at the bottom are not fully met. In other words, their marginal propensity to consume is probably higher.

Although overall consumption remains sluggish, there are still some bright spots among urban groups with higher pensions or incomes – for example, the surge in travel during national holidays. However, there is a population of several hundred million in rural areas who essentially would not even consider something like travel as recreation and entertainment. Therefore, the economy needs to be rebalanced and rationalised.

We need to both boost the confidence of the middle and high-income groups, making them willing to spend, and allocate resources to low-income groups to give them the capability to consume.

There is actually no formal concept of retirement in rural China – the elderly keep working until they can no longer do so, because the pensions they receive are extremely low. This is an issue of social equity and inclusiveness that must be addressed. It is also a crucial factor in supporting consumption.

By the measure of the permanent resident population, there are still about 500 million people in rural areas, while the population registered to rural households is over 700 million. So, if the consumption of this segment can be increased, the effect on overall consumption would be significant.

Insufficient consumption is, in essence, also an income issue. Income can be divided into transitory and permanent income, and raising people's permanent income is particularly important for boosting consumption. In modern societies, this is why having a social security system is necessary. The government needs to establish institutional arrangements to ensure a basic level of income for certain groups, and this is related to the increased uncertainties in a market economy. Moreover, as life expectancy increases, the period requiring pension support also lengthens.

My point is that a significant proportion of income increases may need to be secured through government redistribution. For instance, 30 or 40 years ago, we could not overemphasise this, as the market economy was still in its early stages. Back then, it was more important for people to explore opportunities and seek income within the market economy – which was objectively correct and successful. Thanks to the unleashed potential of the market economy, China's per capita income has greatly increased.

However, in the current situation, while the vitality of the market economy remains, some people still lack the ability or willingness to consume. I think this is largely a policy issue. For example, in terms of social security, if farmers were provided with a slightly higher and more stable pension standard, their permanent income would effectively increase. Suppose they currently receive about 200 yuan (US\$28) per month – if that were raised to 1,000 yuan, their consumption behaviour would certainly change.

Transfer payments are one component of household income. In rural areas, many elderly people who still work can only earn enough for basic subsistence – not enough to change their consumption structure. Without support from their children and relying solely on themselves, they can barely make ends meet. If the state has the capacity and conditions, it should provide them with more.

Some may ask: if the state gives money to rural residents, might they just save it instead of spending it? That is quite possible, especially if it is a one-time payment or transitory income growth. Economic common sense predicts that one-time income growth will mostly be saved. However, if the income growth is expected to be long-term and permanent, overall consumption will rise, and this would also boost the level of common prosperity, especially since we are, after all, a socialist nation.

There has been considerable controversy recently regarding China's social security system, including inequalities between urban and rural residents and its sustainability amid an ageing population. Some young people worry that they will not benefit from the social insurance they are currently paying, and [the Supreme People's Court's judicial interpretation](#) stating that any agreement not to pay social insurance is invalid has caused anxiety among many small and medium-sized enterprise owners and employees. How do you view these controversies?

The total expenditure on social security in China is not the primary issue. While China's proportion of social security spending to GDP is relatively low compared with developed countries, this is still understandable given China's different stage of development compared with developed nations. Among the Group of 20 member states that are emerging economies, China is not at the bottom – it is in the middle or even slightly above average.

The main problem lies in the structure – the unbalanced allocation of resources. Due to the unique evolution of our system, it has some very distinct structural characteristics. Simply put, the social security benefits one receives after retirement are significantly determined by one's occupation, location and social stratum.

In practice, the system is divided into three major groups. The first group consists of public sector employees, including government and public institution staff, who account for about 7 per cent of the elderly population and receive an average of 70,000 to 80,000 yuan per year per person.

The second group is urban enterprise employees, making up less than 40 per cent of the elderly population, with an average of 40,000 to 50,000 yuan per year per person.

The third group includes rural elderly and those urban residents without formal employment, representing about 55 per cent of the elderly population, and they have the basic pension. Most in this group receive only around 2,000 yuan per year – roughly 200 yuan per month. During this year's "two sessions" [legislative meetings], it was announced that the

basic pension standard for this category of urban and rural elderly residents would increase by 20 yuan per month – a 10 per cent raise. Which is a high percentage, but the base amount is very low.

The reasons behind this situation are profound. During the planned economy era, social security was primarily provided through work units, with no nationwide system in place. Since all work units – whether enterprises or administrative institutions – belonged to the state, the government provided fiscal subsidies, forming a work unit-based social security system.

After the reform and opening-up, this system had to change. First, in the enterprise sector, reformed enterprises were required to contribute to social security for their employees, but the burden on these enterprises became very heavy. If an enterprise ceased to exist, who would take care of its retirees? This meant that new contributors had to support not only their own future benefits, but also the existing retirees.

As a result, social security contribution rates in China are very high. For instance, pension contributions have long been around 20 per cent of wages, with individuals bearing 8 per cent. Adding medical, unemployment and maternity insurance, the total social security burden is over 40 per cent for employers. An enterprise hiring an employee has to pay almost another half of the employee's salary towards social insurance, which is a rather heavy burden.

You mentioned the recent judicial interpretation mandating compulsory social security contributions. In the past, because contribution rates were so high, many businesses couldn't afford them, and some employees were unwilling to contribute, especially younger workers who were uncertain about their future.

An unwritten practice emerged: if both employers and employees agreed not to contribute, authorities would not intervene, as long as no disputes arose. This meant employees would forgo future social security benefits, and many accepted this, preferring not to think about the long-term implications.

However, with the accelerating ageing of the population, pressure on social security funds is increasing. The growth of contributions is lagging behind the growth of demand, prompting efforts to enforce mandatory payments. The court's move is understandable in this context.

Yet, those who previously did not contribute are often low-wage workers, such as migrant workers, who are employed by businesses under significant competitive pressure. Forcing them to contribute now can lead to resistance, as they feel their current wages are already insufficient. They might think that, even setting aside their own future concerns, contributing does not help their parents in rural areas, who receive minimal pensions.

In the end, this judicial interpretation may be shelved. With the economy already under strain, imposing such requirements on many small businesses could well become the final straw that breaks them.



Any meaningful reform must be driven by top-level design. It's up to Beijing to adjust the overall system to truly align with the goal of stimulating consumption

We now have a clearer picture of the problems facing the social security system, but how can these issues be resolved through reform?

The key is where the money will come from. Asking businesses to contribute more is difficult for them. Asking those at the lower end of the income spectrum to pay more is also challenging, as they already face high expenses on things such as rent and supporting both children and elderly parents.

Therefore, I believe the solution likely lies with the government and the allocation of public resources. As I mentioned earlier, most resources have historically been directed towards investment and the supply side. It seems to me that this model may have reached a point where it needs to be modified and improved.

For instance, in 2023, public sector resources were estimated to account for 45 per cent of GDP. Suppose roughly 25 per cent was allocated to the supply side and 20 per cent to consumption and social welfare. Could we reverse this ratio – direct 25 per cent towards consumption and 20 per cent towards the supply side?

This doesn't mean we abandon "[new quality productive forces](#)", we still need them. But not every region needs to pursue initiatives like the [low-altitude economy](#). In the end, only a few places will achieve real breakthroughs. If everyone rushes into the same sectors, it will only lead to overcapacity and intensified "involution" again.

However, this transition won't be easy. Local governments have become accustomed to the existing model: when they have funds, they focus on developing new quality productive forces, implementing industrial policies and pushing for industrial upgrades.

Do they consider residents' welfare? Yes, to some extent. But the unwritten rules of the game dictate that you only shine and receive a higher evaluation as an official if you do well on the supply side.

Is it possible that one reason is because focusing on "new quality productive forces" tends to generate more government revenue, whereas boosting consumption contributes relatively less to local fiscal income, thus giving local officials weaker incentives to promote consumption?

You are absolutely right. Essentially, to ensure China could catch up with and surpass other economies in technology and supply capability, most resources were directed towards the supply side and productivity enhancement. Over decades, this approach shaped a whole set of governance mechanisms, including the performance evaluation system for officials and the tax structure.

For example, the tax system relies heavily on value-added tax, which is collected mainly where production takes place. So, if the government wants to increase revenue, it depends largely on the production side and supply competitiveness.

Therefore, shifting more public sector resources towards consumption would require systematic reform and adjustment across these systems. In fact, many of these reforms have been proposed before. For instance, reforming the evaluation system for officials has been discussed for decades. While there has been some progress, no fundamental change has occurred.

Recently, I visited a southern city. Throughout the week, no one talked about how to boost consumption – officials were all discussing how to channel resources into high-end sectors. Breakthroughs in these areas are more visible and more likely to lead to promotions.

That's why any meaningful reform must be driven by top-level design. It's up to Beijing to adjust the overall system to truly align with the goal of stimulating consumption.



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The [proposals for the 15th five-year plan](#) place greater emphasis on consumption compared with previous plans, explicitly listing the increase of the household consumption rate as a development target. Do you believe the reforms we discussed earlier can be achieved during the period the next plan will cover?

The changes I mentioned are, to some extent, already under way; reforms to the household registration system, improvements in public services and the latest childcare subsidies. Reforms are progressing, but they are not sufficient yet and need to be deepened. Therefore, the 15th five-year plan period should be a window of opportunity, though it is still uncertain how far these efforts will ultimately go.

Looking at the history of five-year plans, the 15th will likely be among those with the highest policy priority for consumption and people's livelihoods. Compared with previous communiques, the latest one placed noticeably stronger emphasis on policies to stimulate domestic demand and boost consumption.

Moreover, while the plan sets "effective" conditions for expanding investment, it demands an active, "vigorous revitalisation" of consumption. This indicates that, based on recent realities, the top leadership is paying greater attention to the constraint imposed by the consumption shortfall, requiring a "virtuous interaction between supply and demand" driven by the dual engines of consumption and investment.

Furthermore, consumption-related policy measures have been elevated to the level of strengthening domestic circulation and building a powerful domestic market.

In President Xi Jinping's explanation of the draft proposal, he also mentioned this: "For the present and a period in the future, we must persist in strengthening domestic circulation and accelerate the formation of a powerful domestic economic circulation system, using the stability of domestic circulation to hedge against the uncertainties of international circulation."

Looking back at economic growth during the 14th five-year plan, it clearly exhibited a dual pattern of "strong supply versus weak demand". Therefore, the 15th five-year plan period presents a new challenge for China's economic development: consumption must be boosted while simultaneously promoting structural adjustment. It is now a highly urgent matter to make up for the consumption shortfall by optimising the past resource allocation model.

The problem of weak household consumption is underpinned by deeper contradictions in the economic structure. Therefore, besides directly implementing some stimulus policies, truly solving this problem will likely depend on deeper, systemic reforms.

So we must gradually adjust the past practice of allocating massive public resources to the production and supply sides. We also need to achieve new breakthroughs in the equalisation and accessibility of public services. For example, allowing migrant workers – the "new citizens" – to enjoy more equal public services in housing, education, healthcare, social security and pensions.

Additionally, we should accelerate the long-planned hukou reform to eliminate the inhibitory effect of the urban-rural dual structure on consumption.

Finally, the central government should increase the proportion of spending on public services. This inevitably requires further promoting tax structure reform to optimise incentive mechanisms and help local governments find more stable and sustainable sources of tax revenue.

In fact, many things in the past were intended for reform, but the constraints were felt to be too numerous and the balance too difficult to strike, preventing the changes. My feeling is that the situation may now be changing: what was previously considered impossible to reform may now be possible, necessary and likely. That is why I say the 15th five-year plan is a crucial opportunity.

We have been discussing issues like the hukou, social security and income distribution for many years. You cannot say the top leadership did not want to change them; it was simply constrained, because money was needed to support technological progress and the expansion of supply capability.

Now, China still needs to do that, but the substantial progress on the supply side and the persistent imbalance of "strong supply versus weak demand" – underpinned by the relative shortfall in household consumption – may have tipped the balance and broadened the policy adjustment scope in Beijing.

It is like a family moving from the countryside to the city to start a business: you first have to solve the fundamental problem of gaining a foothold before you address the problem of improving your quality of life. But now, if you do not solve the problem of a better quality of life, it may paradoxically undermine your original goal.



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Can boosting consumption truly drive China's economy in the way that exports and real estate did in the past? What roles will these main engines – exports, real estate and infrastructure investment – play in China's economy going forward?

First, a return to the past 10 per cent growth rate is not possible any more – the potential growth level has indeed declined. Second, this doesn't mean exports or investment will disappear; rather, the goal is to achieve a more harmonious and balanced structure.

If exports decrease somewhat and rising consumption increases demand for imports, the trade surplus would shrink, which could at least ease some external pressure. This won't fundamentally resolve conflicts such as those in US-China relations, but it could help alleviate tensions, not only with the US, but with other countries as well.

The real estate sector is unlikely to return to the rapid expansion seen during the nearly two decades from 1998 to 2020. However, once the current adjustment is over, the sector may still enter a normalised phase. The priority is to stop the decline, achieve stability and then transition into steady growth, as China still has substantial demand for housing upgrades.

That said, the previous overexpansion in this sector was severe, and the current adjustment has been particularly sharp and painful. To be honest, it's hard to predict exactly when the sector will fully emerge from this phase.

If real estate stabilises, it would also benefit consumption. Without the real estate downturn, the severity of issues caused by weak consumption might be less pronounced than it is now.

Still, even after the real estate adjustment concludes, without systematic reform in how public resources are allocated, the problem of relatively insufficient consumption cannot be fundamentally resolved.

What minimum GDP growth rate do you believe China should maintain over the next five years?

I believe that rebalancing the economy towards consumption would actually support investment. Currently, investment returns are poor, which is suppressing investment activity. If consumption strengthens, many investments would become profitable, and investment would subsequently pick up.

So, I think if deep reforms are implemented – such as adjusting the allocation of public resources, overhauling the household registration and social security systems, and making significant adjustments to income distribution, as I mentioned earlier – it would be entirely possible to achieve a growth rate of 5 to 6 per cent over the next five years. Without such reforms, the GDP growth rate will continue to decline.

After 2010, following the 4 trillion yuan stimulus package, the average growth rate fell by around 2 percentage points during each subsequent five-year plan period. This persistent downward trend is unsustainable. If growth drops by 1 to 2 percentage points every five years, and our current growth is only around 4 to 5 per cent, then within just three to five years, the rate could fall to a very low level – say, 2 to 3 per cent – which would clearly be unacceptable.

Therefore, we still need to pursue a series of substantial reforms and structural adjustments to drive economic rebalancing and stabilise growth at a reasonable level – at least comparable to that of the 14th five-year plan period.

Additional reporting by Xinyi Wu