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Income inequalities in China: Stylized facts vs. reality[☆]



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Summary There have been many papers recently (both theoretical and empirical) analyzing the problem of income inequality in China. Most of them usually state that the income inequality in China is growing in two dimensions – among the regions and between the urban and rural areas. Moreover, an opinion that reducing the inequality must be connected with sacrificing some part of economic growth prevails. These results seem to be widely accepted also by the media and politicians.

In this paper we provide evidence that the income inequality remains stable in last years and that its relationship with economic growth is very ambiguous. Using the comparison with some other countries, we document that the inequality in both dimensions mentioned above does not change significantly faster than in other countries.

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Introduction

Since the late 1970s, People's Republic of China experienced the period of dramatic economic development. Growth of GDP, followed with increased disposable income and living standards was accompanied with significant changes

in inequality of both income and wealth. These changes appear especially in two dimensions – among the regions and between rural and urban areas. There is a widely accepted opinion that the extent of income disparities is positively correlated with economic growth. Thus, China faces a choice. Either it has to face all the negative consequences of income inequality, or it has to sacrifice some part of its growth to reduce the inequality.

The goal of this paper is to document the recent trends in Chinese income inequality. As there are many studies in the literature focusing on older data or longer time series (see for example [Chen and Lu \(2009\)](#), [Sicular et al. \(2007\)](#) and

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studies mentioned in following text), we focus mainly on the recent data (2000–2014 series). The structure of the paper is as follows. First, we focus on the development of income inequalities in China from the late 1970s, its probable causes and consequences. Then, we briefly examine the relationship between economic growth and inequality. The survey of empirical literature on this topic is also provided, then possible alternative outcomes for China are discussed. Following part of this paper is dedicated to international comparison (mainly with the United States) of main inequality indicators. In the end, we provide the conclusions and discuss possible recommendation of further policies to reduce the inequality.

China's disparities – a historical overview

Discussing the evolution of income inequalities in China, its post war history can be divided into several phases. The land reforms after the revolution (1949–56) were followed by so called "Great Leap Forward". However, this period of economic growth was broken by the Great Famine (1959–61). After the post-famine recovery in first half of 1960s, the period of several reforms appeared – the cultural revolution and transition to reforms (1966–78), the rural reforms (1979–84) and the post-rural reform connected with the governance reform and opening up to trade (after 1985). Although this paper focuses mainly on the period 2000 and after, it is beneficial to briefly comment the previous phases of Chinese economic development.

First peak of inequality – the Great Famine

During the initial period of land reform, Chinese government set the fastening of industrialization process as one of its main goals. Redistribution of resources from agriculture to heavy industry was followed with restrictions of labour-mobility and decreasing of agricultural prices. In 1958, government introduced the Hukou¹ system of households' registration. Strategy of promoting the urban population and putting most of the resources to heavy industry helped the economy to face the "Great Leap Forward", but was broken by the Great Famine in 1959–1961. This period was characterized by a huge increase of inequality in China, as the Gini coefficient increased from 0.235 in 1955 to 0.326 in 1960. Most of the economists agree that the main cause of this increase was the dramatic increase of disparities in income distribution between urban and rural areas. [Fan et al. \(2011\)](#) calculated the difference between the rural and urban component of Gini coefficient in 1955 as 0.066, while this value more than doubled in 1960. Similar values were obtained by [Kanbur and Zhang \(2005\)](#).

¹ Hukou is a term widely used in the public, although "Huji" system is more precise and correct term. It confined the individuals to a municipality of their birth to ensure that there was enough work force to produce sufficient grain for the urban population.

Changes after cultural reform and results of openness strategy

In the second half of 70s, government shifted its support to agriculture and other labour-intensive sectors. The rural reform, increasing the farmers' rights, led to a dramatic increase of agriculture production. Growing incomes of agriculture workers decreased the inequality substantially – the total Gini coefficient, as well as its urban–rural and inland–coastal components reached their minimum in the half of the 80s as a result of the mentioned policies.

Since 1985, the income inequality started to rise continuously. Government strategy, promoting the openness to the rest of the world, led to the massive development of the areas oriented to the export – especially Beijing and the coastal areas. Boom of coastal areas was also strengthened by the division of central government of investment, as this investment to coastal areas exceeded the sum of investment to central and western areas together between 1999 and 2005 ([Fan et al., 2011](#)).

Inequality measured by the Gini coefficient was rising on till the year 2008. Since that, the Gini coefficient values are slightly declining as a result of new government policies. Central government realized the inequality (both in rural–urban and inland–coastal dimension) as a serious problem and introduced new policies and reforms to decrease it.

As mentioned above, Chinese inequality is mainly determined by the regional and urban–rural disparities. Chinese central government applied both universal and selective measures for their reduction. Implementation of the system of minimum wage, fighting against corruption and higher pressure on administrative efficiency can be named as the examples of universal measures. Selectively, the "SanNong" strategy made the issues of agriculture, rural development and farmers the top concerns and priorities recently. Since January 1, 2006, China government has abolished the agricultural tax regulations, it also relaxes the restriction of the Hukou from this year. Also the share of transfers from the central government to rural increased. From the regional aspects' point of view, major infrastructure construction projects were launched to support the development of the Midwest and the regions were given the policies to increase the openness. All these policies contributed to the reduction of income disparities.

Growth and income inequality – is there a relationship?

One of the most widely accepted stylized facts (both by researchers and politicians) is that Chinese inequality is (at least in the short run) closely related to the economic growth. Assuming that, Chinese government faces a dilemma of either accepting quite high level of inequality, or sacrificing some part of economic growth to reduce it. This opinion is based on Kuznets "reverse U hypothesis", stating that growing per-capita income leads first to an increased inequality (mainly due to the investment and human capital of high income groups) and then starts to decline when

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