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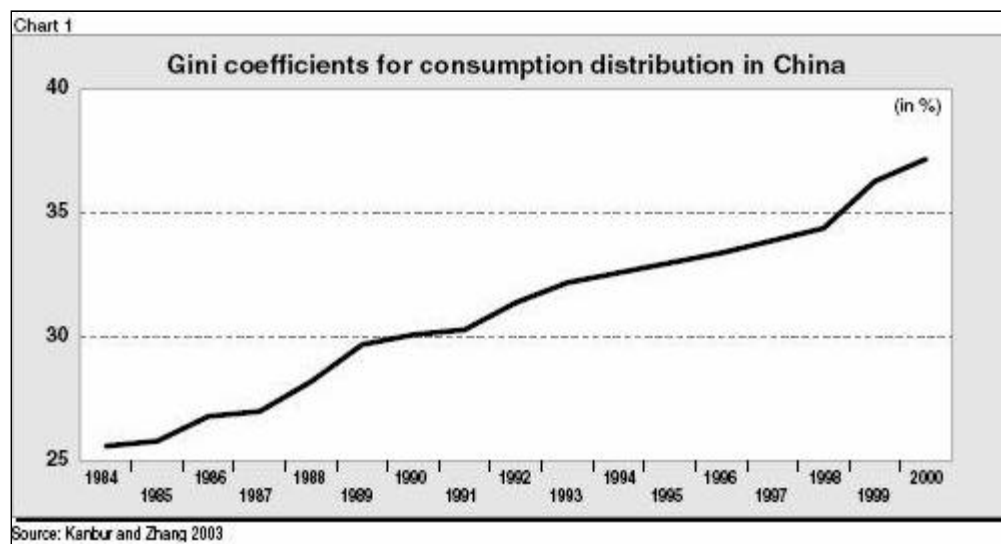
## Rising inequality in China

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*Spectacular economic growth in China has been accompanied by growing inequalities of income and wealth distribution. In this edition of Macroscan, C. P. Chandrasekhar and Jayati Ghosh examine recent patterns of inequality in China.*

THERE is much international interest in China's economy, because of its remarkable growth over the past quarter century. Recently, attention has also focussed on the fact that this growth has been associated with significant increases in inequality in both income and wealth distribution, which were relatively low during the central planning period.

Two new reports also focus specifically on this issue of inequality in China, and provide important new information on recent patterns in this regard. The recently released China Human Development Report 2005 of the UNDP in Beijing (which is prepared mostly by Chinese economists) has as its theme the issue of inequality in economic and human development indicators. And the OECD has just come out with a report on income disparities in China, as part of its series on China in the Global Economy.

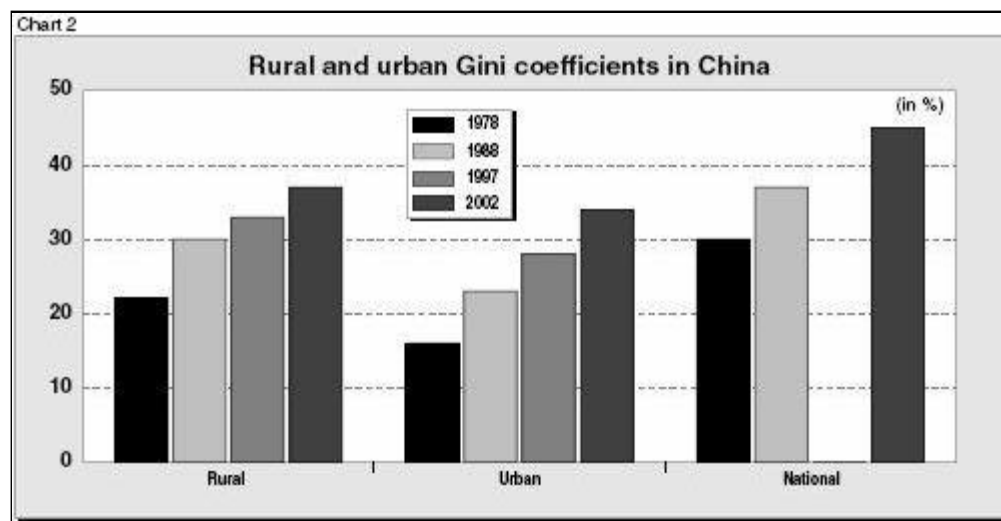


Both of them reinforce the perceptions of observers and analysts that economic inequalities have increased sharply over the economic reform period since the early 1980s, and this has been especially marked since the substantial opening up of the economy since the early 1990s. As Chart 1 indicates, the Gini coefficient measure of inequality based on consumption data suggest some decrease from the mid-1970s to the mid-1980s, and increase

thereafter. Intra-rural and intra-urban inequalities also increased over the 1990s, despite an episode of declining inequality within urban and rural areas around the mid-1990s.

Meanwhile, inequality between urban and rural areas rose steadily over the 1990s. The ratio of urban-rural per capita income (urban disposable income to rural net income) increased from 1.86 in 1985 to 3.11 in 1990. While there was a short period of declining differences between 1995 and 1997, the post-1997 period saw a dramatic and continuous increase in this ratio between 1997 and 2002, from 2.47 to 3.11.

It is likely however that these are still underestimates of the actual rural-urban income gaps. As the China Human Development Report (CHDR) 2005 points out, "if public housing subsidies, private housing imputed rent, pension, free medical care, and educational subsidies were included, the actual per capita income of urban residents in 2002 would increase by 3,600 to 3,900 yuan, bringing the urban-rural income ratio to about four-fold instead of the 3.2-fold acknowledged by official figures." (page 27) This would make rural-urban inequality in China among the highest in the world.



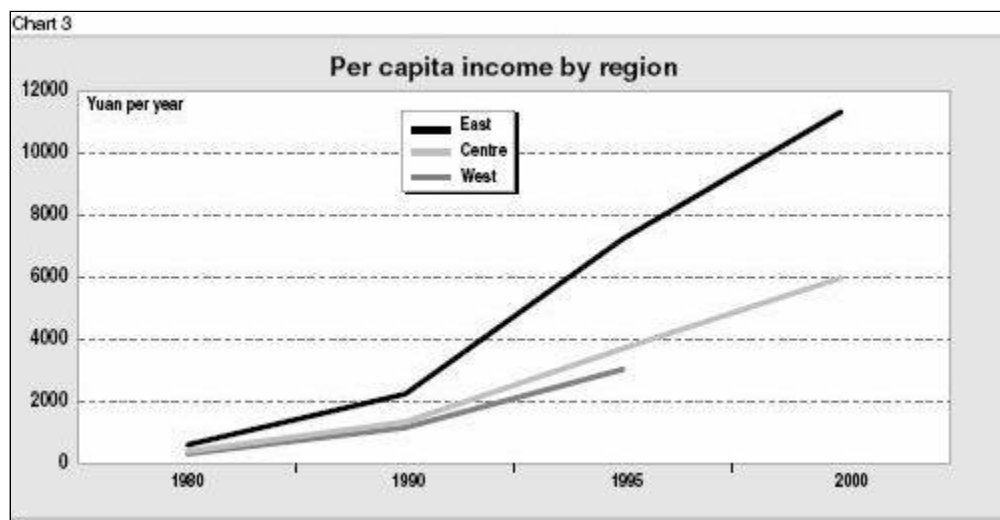
The CHDR also points to widening inequality within rural and urban areas as well, based on data from a household survey conducted in 2002 (Chart 2). These increases in inequality are ascribed to the economic growth process, which has meant that rural non-farm income opportunities are concentrated in a few areas, while some urban areas have grown more rapidly than others.

China's regional inequality had declined between 1979 and 1990, but reversed to a rising trend over the 1990s. In particular, the difference between inland and coastal China increased, especially in the late 1990s.

According to the China HDR 2005, the ratio of per capita incomes of eastern to central regions increased from 1.42 in 1997 to 1.52 in 2003. Most of the regional inequality in China is to be found between three large regions and within provinces (that is, between districts within provinces). Coastal-inland inequality has been always much lower compared to rural-urban inequality, even though it has been rising more sharply in recent years.

The three largest cities of Beijing, Tianjin and Shanghai account for a large part of the variation in regional incomes. These large metros, which enjoy a high level of

industrialisation and with over 71 per cent of their population living within 100 km off the coast or navigable waters, were able to reap the full benefits of public infrastructure expansion and export promotion, and therefore attracted substantial FDI inflows.

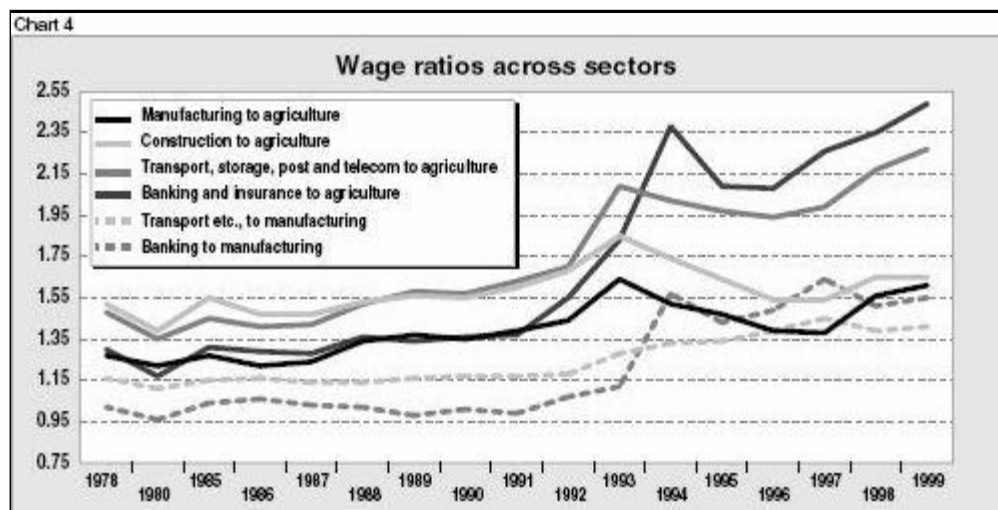


The central region, the agricultural heartland, reaped benefits from deregulation in the early phase of the reform period and had a growth rate of 7.7 per cent, higher than the national average, between 1979 and 1984. However, the subsequent period saw growth rates fall as agricultural expansion reached its limit. With the lack of access to the mainland, compounded by difficult terrain and lack of mineral resources, western China has lagged behind average growth rates in the post-planning period, especially in the 1990s. The movements in per capita income across regions (Chart 3) indicate these trends.

Employment in China has increased steadily over the last two decades, much of it fuelled by the industrial and services sectors, and has registered an average annual growth rate of 2.55 per cent between 1980 and 2002. However, growth has been much slower in the period after 1990 at 1.09 per cent per annum, compared to 4.33 per cent in the earlier decade.

The share of agricultural employment in the aggregate has declined steadily from 68.7 per cent in 1980 to 50 per cent in 2000-2002. However, rural employment is still dominated by agriculture, which accounts for two-thirds of rural workers, and therefore, slow rates of expansion of agricultural employment have reinforced the widening of rural-urban inequality. Total rural employment has been almost stagnant between 1995 and 2002. Employment has grown at a low 0.22 per cent per annum over 1990-2002, much lower than the 4.13 per cent of the previous decade of structural reform in agriculture.

Part of the stagnation in rural employment reflects an economy in the process of industrialisation and development. The urban areas have absorbed part of the workforce from the rural areas reflected in large-scale migration, and this has compensated, at least partially, for stagnating rural employment. However, migration has also been partially the reason behind increasing urban unemployment post-1985. Unemployment (in terms of absolute numbers of people) has risen steadily since 1985, reaching a high of 7.7 million in 2002. This rise has been particularly sharp since 1990, recording an annual growth rate of 6 per cent, compared to - 3.4 per cent between 1980 and 1990.



The disparity between rural and urban areas has been significantly accounted for by the growing gap between wages in agriculture which is dominant in rural areas and wages in industry and services which predominate in urban areas. The ratio of industrial wages to agricultural wages, which has always been high since 1980, has generally experienced a rising trend (Chart 4). This rising pattern is even sharper in the ratio between most of the service sector wages and agricultural wages, with declines only between 1993 and 1996. The remarkable rise in service sector wages and to a certain extent in industrial wages has, therefore, not benefited the rural population much.

Wage rates have also varied widely within the dominant sectors and between various sub-sectors within urban China, adding to urban inequality. Wages in new sectors such as telecommunications, banking and insurance, and real estate have increased significantly in recent years. Meanwhile, the government's recent attempts to stimulate domestic consumption have raised average wage levels in state-owned organisations dealing with healthcare, sports, education, culture, and scientific research and in government whereas wage levels in more traditional manufacturing industries with more older state-owned enterprises have stagnated throughout the decade because of the cut in government subsidies.

While external liberalisation may have facilitated more rapid growth, it has also been a major factor behind increasing inequalities. Part of this is due to the basic nature of FDI flows, which choose safe destinations that are already somewhat developed. That is why foreign investment in the coastal regions exceeded that in the interior regions by far — in 2000, foreign investments in the eastern region were more than 85 per cent of total FDI.

Public resource mobilisation has shown an increasing in-equalising tendency and a bias towards richer, coastal areas. Before economic reform, there was a centralised budget and an equitable distribution of resources, which were generated from the profits of and taxes on the state-owned enterprises (SOEs), since the rich provinces were required to turn over large surpluses to the government while the poorer provinces received large subsidies. However, as profitability of the SOEs declined in the reform era, the system was marked by chaos with local governments imposing other revenue raising measures.

There was a proliferation of ad hoc, extra-budgetary projects monitored through the banking system, which continues even today. The share of central revenues and, consequently, the

ability of the central government to spend on physical and social infrastructure, declined considerably.

Industrial growth in the reform era has been very high, but even then, patterns of development have encouraged the forces of inequality. There has been acute capital-deepening in new enterprises, which have replaced traditional ones, so employment elasticity in manufacturing has been very low. Service sector employment growth has been inadequate to meet the needs of the labour force, and also typically service sector employment has required a higher level of skill which much of China's population, especially in rural interior areas, has not possessed. Further, reduced subsidies and greater external competition faced by SOEs have reduced their profitability and employment generation potential.

Since 1984, when benefits of the agrarian reform were exhausted, agricultural growth has decelerated and lagged behind industrial and service sector growth rates. Unlike the industrial sector, this sector has not received much state patronage in terms of investment, nor has it seen proliferation of small enterprises on the scale of the industrial and service sectors.

New agricultural policies that are now trying to regularise property rights in land in accordance with the structures of a market economy are likely to have a severe adverse impact on the rural population, since China's egalitarian distribution of land has had a strong equalising effect on the distribution of farm income. Recently there have been sharp increases in wealth inequality, driven by land ownership in particular. (China HDR 2005)

Restrictions on labour movements have been one important factor behind rural-urban inequalities in China. The origin of this lies in the Hukou, or household registration system, which was started during the central planning era. Individuals were tied to their birthplace and given a household-based residence status at birth. Only approved urban registered residents were allowed to live and work in urban areas, and in consequence rural residents were forced to stay and work within rural areas. More important, only the urban-Hukou holders were entitled to receive the guaranteed social service benefits such as education, housing and healthcare in the urban areas.

From 1980s onwards, some rural migrants have been granted temporary residence permits that allow them to remain in cities and enable them to access some social services, though at excessively high fees especially when compared to urban residents. The larger part of the migrant population, however, did not qualify for temporary residence permits, and had to remain in the informal sector without access to the public utilities and other benefits available to urban residents.

It is estimated that about half of the total flow of migrants would have been denied any kind of legal status in the form of temporary permits or urban Hukous. In addition, rural migrant workers in cities often face discrimination as a result of local regulations, being charged various "administration fees". (China HDR 2005) They also face harsher and more unhealthy and dangerous working conditions. All this has added to inequalities in access to income and public services among the migrant community and led to severe poverty among migrants.

A case can be made that increasing inequality during this phase of economic transition in

China is inevitable. Thus, recently a government official argued : "Looking at income inequality as a whole, it may be the case that rational, and thus inevitable, disparities are more significant than irrational disparities. The widening of income disparities occurred, on the one hand, during a process when overall incomes increased steadily and, on the other, where economic efficiency has also been continuously improved. In this regard, the process has helped overall economic growth and social development." (Han Wenxiu, 2005, page 11).

However, it is also accepted that widening income disparities can impose more and more negative effects in economic and social development. The government of China seems to have recognised the growing problems of inequality and poverty. Recent "White Papers" on employment, poverty and women acknowledge the need to correct regional imbalances as well as rural-urban and gender disparities. There has been a specific attempt to develop infrastructure and natural minerals of the interior regions to generate incomes.

The recent strategies of developing the west and revitalising the northeast have involved funding new infrastructure projects and increasing fiscal transfers to these areas.

Other recent efforts include expanding the security net and providing pensions and unemployment insurance which was started in the 1980s, allowing some relaxation in migration norms, the launch of poverty relief programmes (including the aid-the-poor fund) on a much wider scale than before, extension and some decentralisation of the banking sector to make credit accessible to interior and rural areas.

Addressing the problems of poverty and inequality in China will require wide-ranging and multi-pronged policies. Fortunately, the Government still retains enough control over crucial economic levers to ensure a redirection of growth patterns in more progressive ways.

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