

Urban-Rural Income Disparity in the Chinese Economic Transition

Lingyi Sun
Economics and Mathematics
Faculty Supervisor: Dr. Sohrab Behdad
8607 Slayter Union
D01398884

I. Introduction:

1. Transition and Development

The year 2008 marked the 30th anniversary of China's economic reform. This significant reform gradually replaced China's central planning system with a market economy. It features a number of fundamental changes in the organization of the Chinese economy.

Privatization of property and non-state ownership

As a key step towards transition to a market economy, China has privatized most of its previously state-owned enterprises, especially during the past 20 years. Only key economic activities such as banking, electric power, and telecommunication remain largely state-owned. As a result, there has been a surge in business investments and increased productivity. The private sector has flourished and has now entered many economic areas as diverse as light and heavy industries, financial services, educational and cultural activities, media, infrastructure and urban planning (Huang, 2003).

Financial market liberalization

Financial liberalization characterizes Chinese banking reform and the start up of share trading. Beginning in 1979, the Chinese government began substituting state budget allocation with bank loans (Li and Liu, 2001). The Shanghai and Shenzhen Stock Exchanges started in 1990 and 1991, respectively. These two stock markets and the revitalization of banking sectors unleashed the flow of domestic and foreign capital. The inflow of capital has played an important role in the rapid growth of the Chinese economy in the past three decades.

Encouragement of Foreign Direct Investment (FDI)

In 1980, the Chinese government established Special Economic Zones (SEZs) in Shenzhen, Zhuhai and Xia'men along its eastern coasts to attract foreign investments. The special zones enjoy tax incentives for FDI, obtain greater independence in international trade and have most of their enterprises organized as Sino-foreign partnerships. These favorable policies attracted waves of FDI inflows. From 1980 to 1995, the annual growth rate of FDI in China averaged about 40%. According to the United Nations Conference on Trade and Development (UNCTAD 2003), China became the largest recipient of FDI in the world in 2002.

2. Inequality and Social Problems

Due to these fundamental changes in economic conditions and other great changes such as China's accession to the WTO (World Trade Organization), China has been increasingly integrated into the world economy and has experienced unprecedented economic growth. Statistics have shown that China became the second largest economy in the world in 2007, and successfully dropped its poverty rate from 53% in 1981 to 6% in 2001 (Ravallion, 2006).

However, the rapid development of China's economy has been accompanied by emerging economic and social problems. Statistically, China is now among the countries with the greatest income inequality. Imbalances of regional development, large-scale migrations from rural to urban areas, and income inequality have been significantly aggravated during the past three decades. Recent unrest in border regions, although seeming to originate from ethnic conflicts, can trace their roots to regional economic imbalance and increased income disparity. Many economists have pointed out that if China continues to pursue a high rate of GDP growth without curbing its income inequality problems, the country is likely to follow in the footsteps of many Latin American countries, leading to social and political turmoil and harming its economic development in the long term (Li, 2003).

Studies in Chinese income inequality have indicated that regional income disparity is tightly related to urban-rural income inequality (Tsui, 1993; Hussain, et al., 1994; Kanbur and Zhang, 1999). According to the NBS (National Bureau of Statistics of China) in 2006, average disposable income per urban inhabitant was 11,759RMB, while that of a rural inhabitant was 3,587RMB--the urban-rural income gap increased more than 85% during the past 20 years. Early researchers attribute this phenomenon to relatively low productivity in rural areas (Cai, 1998) while Li (2003) suggests several other reasons: government control of the price of produce, high tax burdens on farmers, urban-biased economic policies and discrimination in social security.

II. Justification and Goals:

As a native of China, I am very concerned with the aggravated urban-rural income disparity in China. The stark difference in urban vs. rural development has long made me wonder how it took place.

Although there are numerous studies in the field of urban-rural income disparity in China, the different impact of each of these factors (such as government incentive policies, urbanization and globalization) in affecting urban-rural disparity is unclear. Therefore, I feel it is necessary to study the impact of possible causes aggravating urban-rural income disparity in the context of the Chinese economic transition. In this project, I will focus mainly on the impact of major government incentive policies and urbanization on urban-rural income disparity. The result of this study will lead to a report of the current situation of urban-rural income disparity in China and an evaluation on various government policies to remedy the urban-rural disparity.

III. Methodology:

In this project, I would like to employ both empirical and analytical methodologies to study the increasing gap in urban-rural income. In previous studies, the means of measurement of urban and rural income differ greatly. Because of the difference between components of rural and urban income, it is important to classify these components in two categories.

For components of rural income, I would analyze these data:

1. Income of labor, pension and other forms of labor compensation
2. Net income from farming, such as the income from the sale of crops
3. Net income from subsidy activities and non-farm enterprises
4. Income from property, such as bonds and securities

For components of urban income, I would like to look into these data:

1. Income of labor
2. Income of retired members
3. Housing subsidies
4. Income from property
5. Other income

After calculating urban-rural income distribution, I will compare these data with incentive and growth-related data such as regional FDI, GDP per Capita, CPI and the trend of Gini Coefficient (a graphic trend of income inequality) from the year 1980-2007. I will summarize the trend of development of these data to help analyze government policies relevant to China's urban-rural income disparity.

IV. Description of Project and Schedule:

I plan to conduct this project in four steps. During the ten weeks, I will meet with Professor Behdad **twice a week** and also communicate by email between meetings.

Weeks 1~3: First, I would like to review the literature regarding income inequality during the past three decades. I will look into different measures of inequality and evaluate previous studies on inequality in China.

I plan to gain a well-rounded view on different perspectives and approaches of studying income inequality during this period.

Weeks 4~6: Second, I would like to look for available data of income (mostly from National Bureau of Statistics of China), figures of FDI, GDP per capita, CPI, consumption, and population in urban and rural area. I will calculate the Gini Coefficient and income distribution of the last three decades to find the trend of urban-rural income disparity in China and summarize relationships between examined data.

Weeks 7~8: Third, I would like to examine various measures indicating the extent of urban-rural inequality in China. Because quantitative data are not the only reflections of difference in urban-rural inequality, I will utilize qualitative measures such as structures of consumption and living expectancy to examine the extent and the impact of aggravating income gap on urban and rural living standards.

Weeks 9~10: Fourth, I plan to analyze the effectiveness of major government economic policies during the past three decades and reach workable policy implications. I will also write a report on the situation of urban-rural income inequality in the context of the Chinese economic reform based on my analysis.

Bibliography

References:

- Broadman, H.G., & Sun, X. (1997). The distribution of foreign direct investment in China. *World Economy*, 20, 339-61.
- Cai, J. (1998). Urban-rural productivity and income disparity. *Economic Research*, 1, 11-19.
- Huang, Mengfu. (2003). Report on the development of the private sector. Retrieved from <http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN016647.pdf>
2003
- Hussain, A., Lanjouw, P., & Stern, N. (1994). Income inequalities in China: Evidence from household survey data. *World Development*, 22, 12, 1947-57.
- Kanbur, R., & Zhang, X. (1999). The evolution of rural-urban and inland-coastal inequality in China from 1983 to 1995. *Journal of Comparative Economics*, 27, 686-1.
- Li, K., & Liu, T. (2001). Financial liberalization and growth in China's reform. *World Economy*, 24, 5, pp. 673-87.
- Li, Shi. (2003). Prospects and reviews of Chinese income distribution. *The Economics*, 2, number 2. 379-3.
- Ravallion, Martin. (2006). Fighting poverty: Findings and lessons from China's success. Retrieved from <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:20634060~pagePK:64165401~piPK:64165026~theSitePK:469382,00.html>
- Tsui, K. (1993). Decomposition of China's regional inequality. *Journal of Comparative Economics*, 17, 3, 600-27.
- Wu X., & Perloff, J.M. (2005). China's income distribution, 1985-2001. *The Review of Economics and Statistics*, 87 (4), 763-75.

List of Summer Research Bibliography Resources:

- Betti, G., & Achilli, J. (2008). *Advances in income inequality and concentration measures*. New York: Routledge.
- Chen, Z., & Zhou, Y. (2005). *Income distribution during system reform and economic development in China: Status of income inequality of Chinese residents*. Boston: Nova Science Publishing.
- Chen, M., & Zheng, Y. (2008). China's regional disparity and its policy responses. *China and World Economy*, 16, 4, pp. 16-32.

- Demurger, S., Fournier, M., & Li, S. (2006). *Urban inequality in China revisited*. Elsevier.
- Eberstadt, N. (2004). *Health and the income inequality hypothesis: a doctrine in search of data*. Washington, D.C.: AEI Press.
- Gustaffson, B. (2008). *Inequality and Public Policy in China*. Cambridge, U.K.: Cambridge University Press.
- Haque, M.O. (2005). *Income elasticity and economic development: Methods and applications*. Springer.
- Hertel, T., & Zhai, F. (2003). *Labor market distortions, rural-urban inequality and the opening of China's economy*. Elsevier.
- Heshmati, A. (2007). *Global trends in income inequality*. New York: Nova Science Publishers.
- Janeba, E. (2000). *Trade, income inequality, and government policies: redistribution of income or education subsidies?* Cambridge, MA: National Bureau of Economic Research.
- Silber, J. (1999). *Handbook of income inequality measurement*. Boston: Kluwer Academic.
- Milanovic, B. (1998). *Income, inequality, and poverty during the transition from planned to market economy*. Washington, D.C.: World Bank.
- Ravallion, M. (1998). *When economic reform is faster than statistical reform: Measuring and explaining income inequality in rural China*. Washington, D.C.: World Bank.
- Wang, F. (2007). *Boundaries and categories: Rising inequality in Post-socialist urban China*. Stanford University Press.
- Yao, S. (2005). *Economic growth, income distribution and poverty reduction in contemporary China*. New York: Routledge.