

15. Recent changes in income inequality in China

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During the past three decades China's economic growth has been among the fastest in the world. At the same time the country experienced one of the fastest increases in income and wealth inequality in the world. Since 2008, however, the Gini coefficient measuring income inequality seems to have stabilized and may even have started to decline. This contribution looks at recent data and underlines the policy measures that may explain this new trend.

Since the end of the 1970s China has undergone dramatic changes in its economic structures, institutions and social policies, and in the composition of its employment. During the past three decades China's economic growth has been among the fastest in the world. Yet China also experienced one of the fastest increases in income and wealth inequality in the world over the same period. While the rate of annual GDP growth was close to an average of 10 per cent between 1985 and 2014, the Gini coefficient of income distribution increased from 0.38 to 0.47¹ during the same period.

Despite this change, official statistics also show a more recent declining trend in income inequality in China over the past five to six years. The Gini coefficient of national income inequality reached its highest level in 2008 (0.491), and has been declining ever since. It seems that 2007–08 was a turning point for income inequality trends.

However, questions have been raised recently about whether income inequality really has decreased. This contribution attempts to provide explanations for the latest changes in income inequality in China by providing new evidence from the 2013 China Household Income Project (CHIP) survey.² Increasing income inequality and disequalizing forces are briefly discussed, and some explanations are provided for the decrease in national income inequality over the past few years.

Economic transition and disequalizing forces

Income inequality has increased considerably since the beginning of the Chinese economic transition that started in the early 1980s. China had previously been an egalitarian society with a planned economy and low income inequality,³ particularly in urban areas where the government strictly controlled the wage system and wage distribution. The National Bureau of Statistics China (NBS) estimated the urban Gini coefficient at 0.16 in the early 1980s.

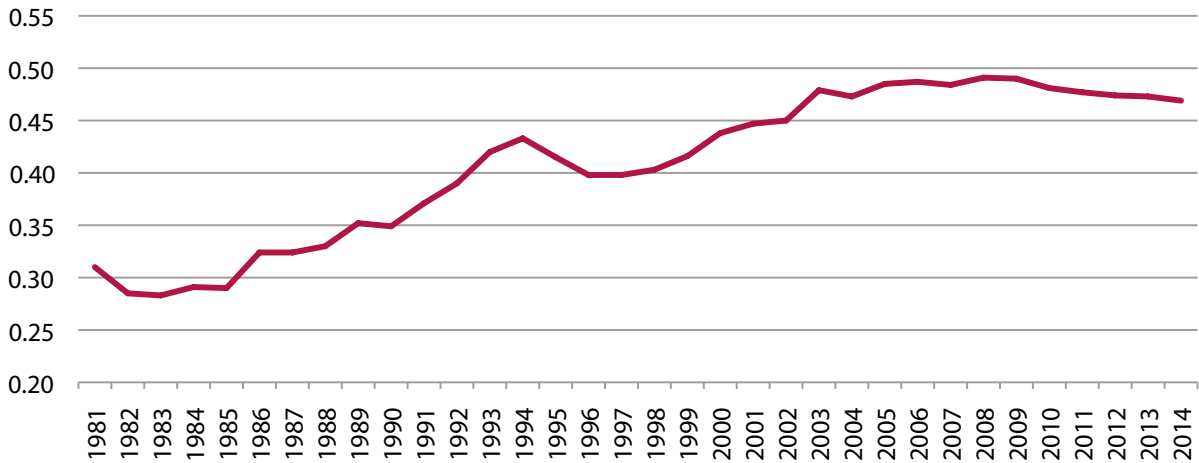
Income distribution gradually became less equal from the mid-1980s. Income inequality increased in the country as a whole, both between and within urban and rural areas.⁴ According to official statistics, the Gini coefficient of income inequality reached 0.35 in urban areas and 0.38 in rural areas in 2008, while the national figure climbed to 0.491 (see *Figure 15.1*), the highest level in the history of the Chinese communist regime.

Of all the economic transition processes, the development of the private sector and the privatization of state-owned enterprises (SOEs) were the most important. At the beginning of the economic transition, almost all urban employees worked for either SOEs or urban collective enterprises (UCEs, a type of urban public enterprise). In 1988 more than 90 per cent of all urban workers were employed in SOEs or UCEs (see *Figure 15.2*). However, the percentage of SOE and UCE employees decreased dramatically in the following years, falling to less than 25 per cent in 2007. Wage and income inequality also increased significantly in public sector enterprises such as SOEs and in the government institutions (Gustafsson and Sicular, 2008).

Along with decreasing public-sector employment, employment in private enterprises, foreign enterprises and joint-venture firms increased very rapidly, as did self-employment. Consequently, private-sector

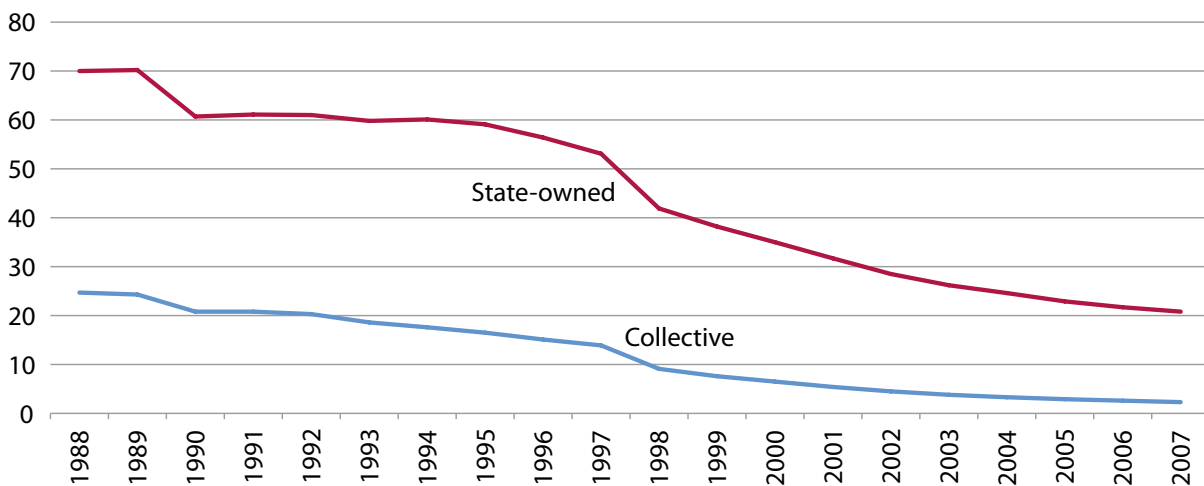
employment exceeded public-sector employment at the end of the century, which contributed to increased inequality of wages and incomes.⁵

Figure 15.1 Gini coefficient of income inequality in China, 1981–2014



Sources: The Gini coefficients for 1981–2001 are by Ravallion and Chen (2007), who calculated them using the income data from the NBS urban and rural household surveys. The Gini coefficients for 2003–14 are from NBS (2015). The 2002 Gini coefficient is from Gustafsson and Sicular (2008).

Figure 15.2 Number of workers in state-owned and urban collective enterprises as a percentage of all workers in urban China



Sources: Based on data from the *China Statistical Yearbook 2008* (NBS).

Urban–rural disparity

The income gap between urban households and rural households increased significantly from the mid-1980s, and particularly between 1997 and 2008. As shown in *Figure 15.3*, the ratio of urban household income per capita to rural household income increased from 2.5 in 1997 to 3.0 in 2009, so that income per capita is three times higher in urban areas than in rural areas. This urban–rural income gap has played an increasingly important role in income inequality in China as a whole. An analysis based on the decomposition of Theil indices⁶ indicates that the urban–rural income gap contributed 37 per cent, 41 per cent and 46 per cent to national income inequality in 1988, 1995 and 2002 respectively (Sicular et al., 2007).

Income inequality also increased in rural China. With the collapse of the rural collective economy, the privatization of land, the emergence of family farms and the growth of township-village enterprises (TVEs), it increased particularly in the 1990s. TVEs first emerged in the coastal regions, where they grew more quickly than elsewhere (Khan and Riskin, 1998), leading to an imbalance in regional growth that became one of the major contributors to increasing income inequality. As a result, non-agricultural incomes and wage incomes from employment in TVEs were concentrated in rural households in the coastal region rather than in the central and western regions.

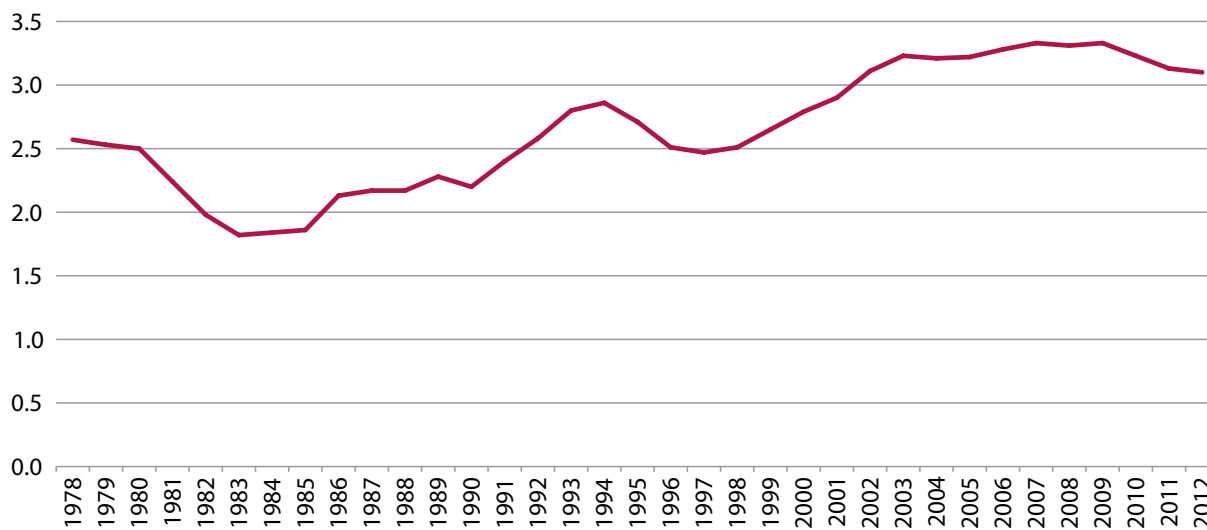
Declining income inequality in recent years

Figure 15.1 presents changes in national income inequality, showing that the income inequality increased until 2008, and began to decrease afterwards. Between 2008 and 2014, the Gini coefficient declined by a total of 2.3 percentage points, a small but significant change.

It is often argued that the official estimates of income inequality are biased towards a lower figure, because extremely rich households are less likely to figure in the NBS household survey. In spite of this, it is possible that national income inequality has shown a declining trend over the past few years. The data from the last two waves of CHIP surveys – 2007 and 2013 – also indicate that national income inequality decreased by 3 percentage points in this period (Li et al., 2015). A decomposition analysis of the data implies that the decreasing income inequality in the country as a whole is due to the narrowing income gap between urban and rural households. Nonetheless, income inequality within urban and rural areas has risen since 2007. The urban Gini coefficient increased from 0.34 in 2007 to 0.36 in 2013, while the rural one increased from 0.36 to 0.37 (Li et al., 2015).

Why has the urban–rural income gap narrowed during the last few years? There are several answers to this question.

Figure 15.3 Income gap between urban and rural areas in China



Sources: *China Statistical Yearbook* (NBS) for relevant years.

Figure 15.4 Number of rural–urban migrant workers in China (in millions)

Source: *Monitoring Report of Rural Migrant Workers* for various years (NBS).

The increasing number of rural–urban migrant workers has led to faster wage income growth for this group, increasing their remittances to rural areas. There were close to 170 million rural–urban migrant workers by the end of 2013 (see *Figure 15.4*), compared with fewer than 80 million in 2001. And after almost twenty years of rural–urban migration, the wages of unskilled workers – including migrant workers – have started to increase⁷ more rapidly than the wages of skilled urban workers. The real wages of rural–urban migrant workers increased by 16 per cent in 2010 and 15 per cent in 2011 (Li et al., 2015).

Although Chinese economic growth slowed after the international financial crisis in 2008, this slowing-down did not have a negative impact on employment in urban areas. The number of urban employees increased by 24 per cent during the 2007–13 period, even though the economic growth rate fell by 2–3 percentage points. To deal with the shock of the international financial crisis, the Chinese government instigated a stimulation package in 2009, including large investments in infrastructure which generated increasing demand for unskilled and migrant workers.

Since 2003, the Chinese government has issued new policies to increase the income of rural households and of low-income groups. These policies have played a very important role in reducing the income gap

between urban and rural households (Li and Sicular, 2014). Since 2006 they have included an exemption from agricultural taxes and fees for rural households. These taxes and fees had been a huge burden for rural Chinese households, particularly in the 1990s when they accounted for around 10 per cent of rural households' average income. Moreover, rural taxes and fees were regressive rather than progressive, with lower-income groups taxed at higher rates than higher-income households. This exemption from agricultural taxes and fees has had a positive impact on reducing income inequality in rural areas and between urban and rural areas, and taxes have become more progressive since the reforms.

Since 2002, policies have also included agricultural subsidies for farming households. This policy was initiated partly to offset the potential shock effect of China joining the World Trade Organization (WTO) on rural household incomes. Nevertheless, the subsidies led to a narrowing of the income gap between urban and rural households. In addition, the Dibao Program, a cash transfer programme guaranteeing a minimum income for poor and low-income households, which started in the mid-1990s, was expanded very rapidly from 1999 onwards to cover rural as well as urban areas. By the end of 2013, nearly 54 million rural people were receiving Dibao funds.⁸

Finally, the rural social protection network has gradually expanded during the past ten years to cover all people living in rural areas. The New Rural Cooperative Medical Scheme, a type of health insurance initiated in the late 1990s, has seen its coverage grow rapidly since 2005. By the end of 2013, more than 800 million rural people were participating in the programme, with a participation rate close to 99 per cent in rural areas. This programme has had important indirect effects on rural incomes. Further, the New Rural Pension Scheme was established around 2010 and has expanded rapidly. In most counties, all rural people aged 60 and above receive 65 yuan per month, equivalent only to one-third of the rural poverty line in 2010.

To conclude, China experienced rapid economic growth and a swift increase in income inequality in the first three decades of its economic transition. However, income inequality has narrowed since 2008 due to a reduction in the income gap between urban and rural households. This reduction was mainly due to rural migrant workers' wages increasingly more quickly than those of skilled urban workers, and to the social policies implemented in rural areas. These trends have to be placed in the context of China's new social and economic policies. In recent years, China has changed its social policy with the aim of reducing disparities in income distribution. The government's economic policy has also changed, from a focus on economic growth and efficiency to equal sharing of the outcomes of growth and a harmonious society; from stimulating investment and export growth to encouraging an increase in consumption.

Notes

1. In this article, China refers to mainland China. If Hong Kong, Macau and Taiwan, China were to be included, income inequality would be much greater.
2. The CHIP survey was conducted in five waves, in 1988, 1995, 2002, 2007 and 2013. The 2013 CHIP survey was conducted in the spring of 2014, collecting information on household income and consumption expenditures in the previous year.
3. The Gini coefficient of income inequality was estimated around 0.3 in the early 1980s (Ravallion and Chen, 2007).
4. It should be noted that urban–rural division in China is administrative rather than demographic. Some rural areas in the coastal region are in fact peri-urban areas.
5. Wage inequality is higher in the private sector than in the public sector, as wage distribution in the public sector continues to be largely controlled by the government.

6. The Theil index is a weighted average of the inequality within subgroups, as well as of the inequality between these subgroups. For example, income inequality in China is measured as the average inequality in urban and rural areas, plus the inequality between urban and rural areas.

7. As an economy develops, labourers in the subsistence sector move into the modern sector and a point is reached at which excess labour is fully absorbed into the modern sector, and further capital accumulation and economic growth begin to increase wages. This is called the Lewis turning point.

8. See China National Bureau of Statistics, <http://data.stats.gov.cn/easyquery.htm?cn=C01>

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