

Income Disparity in China: Status Quo and Prospects

Yimeng Liu, June 16 2010

According to the World Bank, China's success in combatting poverty since the reforms that began in 1978 is undeniable. By 2001, China had met the foremost of the Millennium Development Goals — to reduce the 1990 incidence of poverty by half — and it had done so 14 years ahead of the 2015 target date set for the developing world as a whole. Ravallion and Chen (2007) calculated with a new set of poverty lines¹ and found that, between 1981 and 2001, the proportion of population living in poverty in China fell from 53 percent to just 8 percent. According to Chinese official statements, the rural population in absolute poverty in China declined to 14.79 million at the end of 2007, from 250 million in 1978, with the percentage of the total rural population in absolute poverty falling from 30.7% to just 1.6%. However, with the growth of Chinese economy, income disparity across a range of perspectives in China is becoming more and more evident.

First, from the perspective of aggregate income distribution in China, the data shows that China's Gini Coefficient, a main gauge of income disparity, jumped from 0.32 in 1987 to 0.47 in 2009 (exceeding the acknowledged 'security line' of 0.4 since 2000). From 1997-2007, the income of the highest-income group (RMB 9,304) was 1.64 times of that of the lowest-income group (RMB 5,667) in urban areas; whereas the income of the highest-income group (RMB 3,972) is 2.41 times that of the lowest-income group (RMB 1,648) in rural areas. The World Bank report shows that the 1% top income households in China are possessed of more than 40% of the aggregate national wealth, while in the US, 5% of the total population owns 60% of the national wealth, which means the concentration of wealth in China is far more than the US.

China's rural-urban wealth gap was the widest last year since its economic transformation three decades ago, with the per capita income in 2009 being RMB 17,175 (USD 2,500) in urban areas, against only RMB 5,153 (USD 755) in rural areas. The urban-rural income gap has expanded from the late 1980s: the real urban-rural income ratio increased from 1.53:1 (1985) to 2.64:1 (2008). Both the total income of the farmers and their wage income were growing slowly or at a declining rate. In the first half of 2009, the growth of per capita cash income of rural households was at its lowest level for the past 5 years. The sharp fall in the income growth of rural households has resulted in a widening income disparity between urban and rural households. And the income disparity *within* rural areas is also larger than that of the urban areas. In 2008, per capita

¹ Region-specific food bundles are used, with separate food bundles for urban and rural areas, valued at median unit values by province. The food bundles are based on the actual consumption of those between the poorest 15th percentile and the 25th percentile nationally. These bundles are then scaled to reach 2100 calories per person per day, with 75% of the calories from foodgrains. Means of these regional lines are simply used to measure poverty nationally. With a little rounding off, poverty lines of RMB850 per year for rural areas and RMB1200 for urban areas, both in 2002 prices, are chosen. (According to my roughly calculation by household CPI deflator, they are comparable to RMB1041 and RMB1469 respectively, and can be converted to USD150 and USD211 accordingly, in 2008 prices and exchange rate, and around USD0.41 and USD0.58 per day.)

disposable income of urban households in Shanghai was less than 2.5 times that of Gansu, the province with the lowest per capita income. Per capita cash income of rural households in Shanghai, however, was more than 4 times of Gansu.

Furthermore, the income gap between regions is widening alongside economic growth. The overall Gini Coefficient among regions rose from 0.12 to 0.21 in the period 1978-2007. In 2007, per capita GDP of Western China was only 41.47% that of Eastern China, compared to more than 50% during the 1980s. For example, per capita GDP of an eastern coastal province, Zhejiang, was RMB 37,411 in 2007, compared to RMB 6,915 in a western province, Guizhou: only 18.48% of the former.

According to the income classification by PPP per capita GDP used by the World Bank, the income gaps among different regions and provinces in China are so large that it's described as 'One China, Four Worlds'² by some scholars: the '1st world' is comparable to the developed economies in the world with high income, including regions such as Beijing and Shanghai, etc., which make up 2.2% of China's total population; '2nd world' refers to some coastal provinces consisting of Tianjin, Zhejiang, Guangdong, Fujian, Jiangsu, Liaoning, with more than one fifth of the national population, reaching the income level of those countries with a upper middle income; '3rd world' includes Shandong, the Northeast and part of the North China regions, with more than one fourth of the population and the income level of a lower middle income country; '4th world' are those with incomes even less than the average income of the least developed countries in the world, covering the impoverished regions of central and western China, some ethnic minority areas, some rural areas and remote areas: about half of the total population.

Income disparity among sectors is huge too: in 2007, the average income of the highest-income sector, the defence industry, is 14.49 times that of the lowest-income sector, agriculture. Since 2000, the real wages of the public sector has been higher than the non-public sectors, with the gradually enlarged discrepancy of 12.07%, 21.78 %, and 34.71 % respectively in 2000, 2004 and 2006.

Also, from the perspective of the national income primary distribution, the proportion that goes to wages and salaries, the major source of China's most mid- and low-income families, has continued to shrink. It peaked at 56.5 percent in 1983 and dropped to 39.74 percent in 2007, which was accompanied by a substantial increase in proportions of capital gains as well as government revenue. From the perspective of final national income distribution to the three entities of households, enterprises and the government, we also find that the households income proportion declined more than 10% since 1996, with the proportions of enterprises and the government increasing accordingly.

Justin Lin Yifu, the chief economist and senior vice president of the World Bank, said that increasing income disparity could contribute to other imbalances such as savings and investment imbalances and external imbalances. If income disparity could be reduced, he said, China could possibly continue its economic growth in the coming decades.

Since it's mainly the unfair income distribution system that is at fault for widening income gaps, it may be hard to reverse enlarged income gaps within a short period. In addition, the

² Hu, Angang. The Polarization Trend of Regional Income Disparity in China. *Globalview*, 2010. www.globalview.cn

implementation of the government-led large-scale economic stimulus policy to tackle the latest global financial crisis will inevitably reinforce the investment-led economy, which may make the income distribution situation deteriorate further. The stimulus funds were mainly supplied by the central government, local government, and bank loans. Although major construction projects have stimulated economic growth significantly, the benefits for most workers are still inadequate, which may result in further deterioration of income distribution.³ In addition, the lack of independent and powerful labor unions to promote the capital-labor negotiation system for determining employee wages, the most effective way of increasing workers' salaries, will also hinder the process of income gap correction.

There still seem to be some signs in China's economic and social dynamic, however, that may promote mitigation of income disparity.

In the first quarter of 2010, seven provinces and municipalities such as Jiangsu, Zhejiang and Shanghai, increased their minimum-wage standards from 10 percent to 17 percent while another 20 provinces planned to adjust their minimum-wage levels this year, according to the Ministry of Human Resources and Social Security. Although the impact of minimum-wage policy on overall household income is ambiguous (for it may have crowding-out effects on the employment market, driving unemployment upward), it may have positive effects in terms of narrowing income gaps, on the condition that the present wage levels, especially in the manufacture-dominated coastal regions, are lower than the market clear level (this can be well illustrated by the 'Serious Shortage of Migrant Workers' that has occurred frequently in the past two years in the Pearl Delta Zone and the Yanzi Delta Zone).

Recently, the increasing occurrence of labour protest, either in the form of strikes, or, tragically, factory suicides, resulting in actual wage increases (e.g. the 24% of pay rise at the Honda factory and 65% at the Foxconn plant), may become a trigger to push government authorities as well as employers towards finding more effective measures to mitigate against income inequality. These events may indicate that wage hikes across China's manufacturing and service sectors will be an irreversible trend and the upward pressure on wages will be much faster and steeper than many have expected because China's social structure is undergoing dramatic changes: as Terry Gou, the boss of Foxconn has said.

I have argued that while absolute living standards in China have generally increased, income inequalities considered from a range of perspectives have widened to reach very high levels. Perhaps the recent waves of protests and rising wages will help narrow the inequalities in the future and I do hope so.

³ Can Chinese Style Economic Recovery last? <http://www.infzm.com/content/32207>