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The Relationship between Economic Growth and Inequality
in China

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Contents:

Abstract	2
1. Introduction	3
2. Pervious Studies	5
2.1 Background Overview	5
2.2 Historical Course	6
2.3 Who is the Murderer?	8
3. Data	11
3.1 Quantitative Data	11
3.1.1 Staple Indicators	11
3.1.2 Periphery Indicators	14
3.2 Healthcare and Education Gap	18
4. Analysis	21
4.1 Is Inequality a Necessary Price to Pay?	21
4.2 Turning Point	22
4.3 Trickle Down to Where?	25
5. Conclusion	27
References	28

Abstract

This essay will take China as the case, to see whether rapid economic growth can really be trickled down and how inequality is affected. China's growth is unique and unprecedented. However, while all sorts of economic indicators are pointing upwards over decades, inequality is increasing at the same speed. The relationship between economic growth and inequality in China can not be explained by the Kuznets Curve hypothesis and most inequality measurements confirm the result. Strategies after the reforms of 1978 have largely created such a condition. The urban-rural gap is the main component of national inequality. Looking into it historically after the 1978 economic reform, there is never a tendency of reduced inequality. When testing different variables between urban and rural areas, the divergence is enormous and growing. Thus it is hard to see or even predict a Kuznets-like turning point in the relation between economic growth and inequality.

1. Introduction

China has been enjoying a continuous rapid economic growth for several decades as its GDP per capita started steadily increasing by 8.1% on average from 1978 till the late twentieth century. While the rate of GDP per capita in 1980 was 17% lower than the world average, it was almost 60% over in 2000. (Milanovic 2005) The growth acceleration in China, no doubt, is magnificent and unique no matter what the comparison in space or time period in the history. However, by being told China is experiencing about 8 percent average annual growth in real GDP per capita over all these years, it is hard to see how this kind of growth is distributed within the nation.

It would be fascinating to view how and to what extent growth is trickled down since one traditional opinion about the relation between economic growth and inequality is that, there is a fundamental trade-off between productive efficiency growth and social justice or equality. (Aghion et al 1999) This means, to some degree, that inequality will finally be reduced by growth.

The development strategies after the 1978 economic reform point out the major direction of growth in China and have, no doubt, had huge impact on inequality.

What are the influences and consequences of these post-reform development strategies and policies on inequality in China? This is the main question of the essay. The essay will carry out a discussion about the relation between economic growth and inequality in China, in order to foresee whether inequality will finally decrease under the great economic growth. And to judge the trend of the Kuznets Curve in the case of China according to the theory that regional inequality tends to rise as growth occurs in discrete locals but eventually declines because of the improvement of infrastructure, investment in human capital and so on. China, though unique because of its rapid growth and development type, it is an ideal case to examine the relation between economic growth and inequality since it has experienced plenty of both after the economic reform began in 1978. As a matter of fact, while growth rate is accelerating, the Gini coefficient has increased from 0.28 to 0.39.

The focus in this essay will be narrowed down to the rural-urban relation. It is true

that inland-costal disparities is increasing dramatically and becoming a heated issue recently. However, the rural-urban inequality is still the major component of country-level inequality in China. (Kanbur and Zhang 1999) During the decades of growth, increasing urban-rural income differentials have been the driving factor behind the rising overall inequality in China. Over 60% of national inequality is caused by urban-rural income distribution within provinces. Looking into the urban-rural gap is essential to see the consequence of post-reform policies and the Kuznets trend, although the Kuznets Curve as an indicator narrows down to a personal inequality level. However, in order for the Curve to turning down, rural-urban inequality must be decreased. Hence it is meaningful to investigate the consequence of post-reform strategies by studying the urban-rural gap.

The Kuznets Curve hypothesis proposes that there will be a turning point in the relation between economic growth and inequality, as inequality will eventually decline with the growth. This essay will try to throw light on the condition of urban-rural inequality brought on by the post-reform strategies after 1978. If there exists a convergence between urban and rural areas, it indicates China's inequality is decreasing, and vice versa. Pervious studies will be revised to discuss the topic in a historical perspective, and then the latest data will be invoked to test the overall rural-urban inequality tendency. Analysis and conclusion will follow, to sum up the findings and conclude whether China's inequality is decreasing or increasing during its growth under post-reform strategies over all these decades.

2. Pervious Studies

2.1 Background Overview

Since the beginning of economic reform in 1978, China has experienced the largest increase in income inequality of all regions around the world according to available data. While the Gini coefficient was only 0.282 in 1981 measured by the World Bank, it rose to 0.388 in 1995 and rapidly broke through 0.4 in the coming years. (Yang 1994) The policy of openness in trade, one of the main components in economic reform, has indeed brought mounting GDP through exports and imports. Exports and imports as a source of GDP increased from 8% to 35% between 1979 and 1993. However, this remarkable achievement also led to the great shift in growth sectors. The share of primary industry in GDP dropped from 28.4% in 1978 to 21.2% in 1993, and the secondary together with the tertiary sector increased their share of GDP by 10%. (Sun and Dutta 1997) Since the agricultural sector is always a fundamental part of rural China, this no doubt is a bad news to rural development, not to mention its later effect on rural marginalization.

Though there is an idea that inequality might play a positive role in economic growth, this is not the case of China. Further expansion of growth sectors may disturb the stability. An over-expansion of consumption goods will indeed bring profits to many suppliers, but China's domestic demand is not large enough to digest all these goods. According to the Cass–Koopmans–Ramsey model, the relation between growth and consumption is too weak to be based on rural regions. Markets in rural China are not mature enough to be stimulated by such “good” inequality. The effects of inequality can only skew the share of private investment, hinder the growth as well as the access to capital and technology. (Ravallion 1998) Farm households in rural China can normally not benefit from such “good” inequality and they may even be damaged since their capital stock is weak during the early period of economic development when capital markets are imperfect. It seems obvious that although absolute poverty has decreased through the rapid economic growth which occurred in China over the last decades, inequality has not. The overall inequality and urban-rural marginalization is not only maintained but increasing. At the beginning of economic

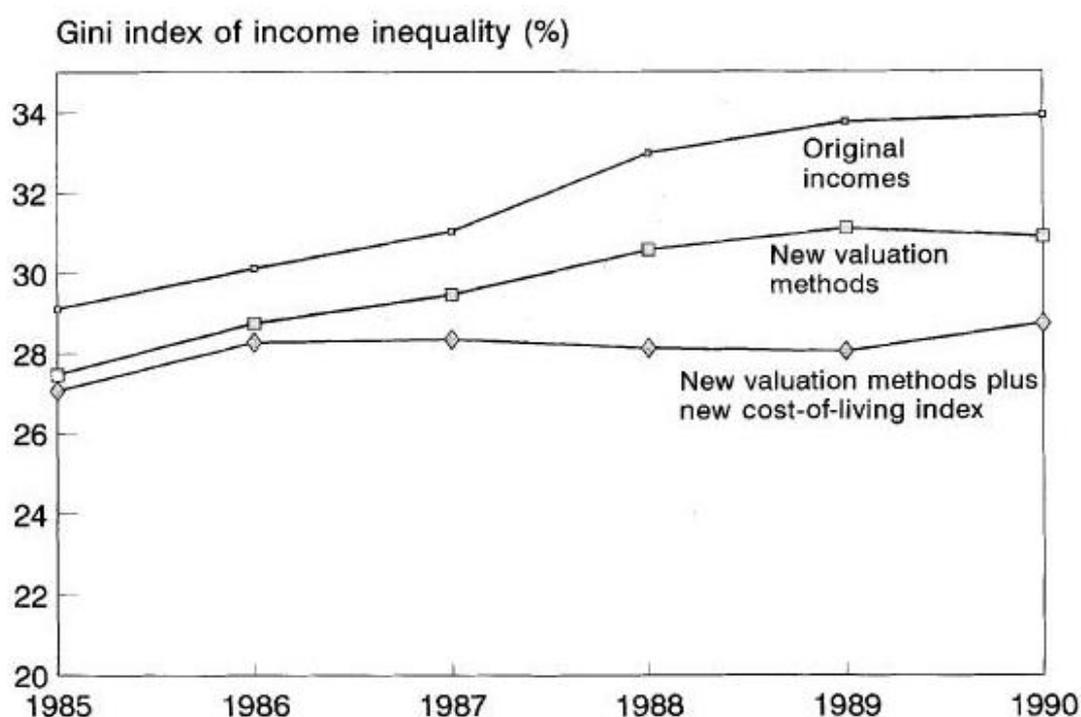
growth not much or at least not enough has trickled down to the population segments living in poverty.

2.2 Historical Course

After entering into a more industrial type of economy growth in 1978, did China show the inverted U-shape relation between income inequality and economic growth as the Kuznets Curve predicts? Or did it illustrate the theory that “a transition from a socialist economic system to a market economy will entail rising inequality”? (Ravallion and Chen 1999)

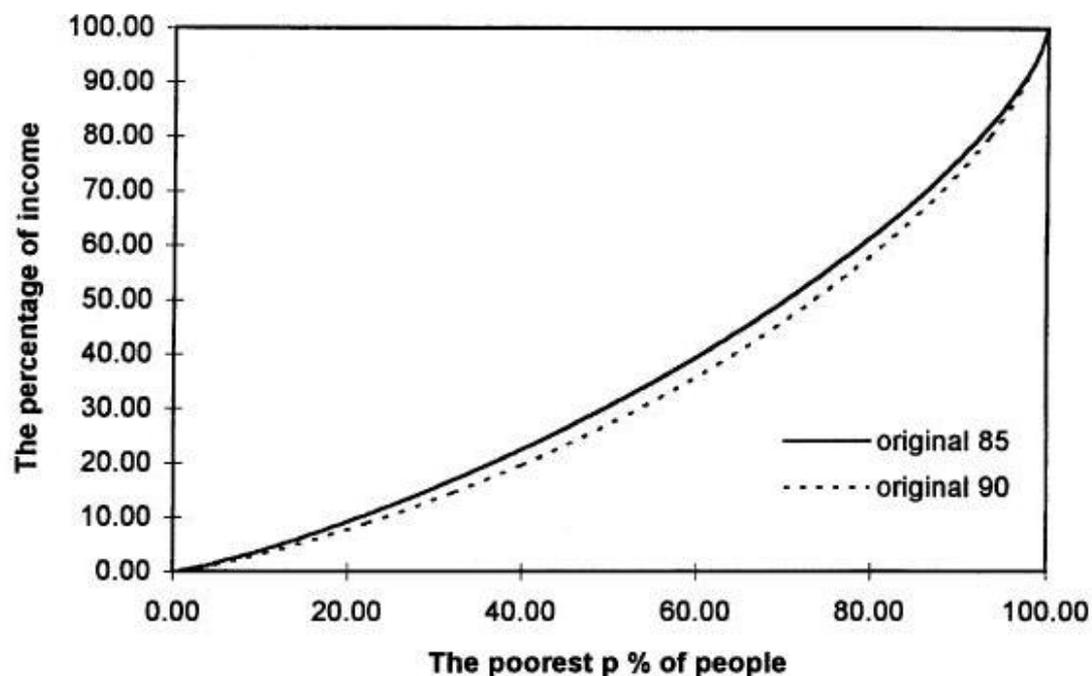
Data from the 1980s to 1990s seems to support the later idea. The two charts below show that except the new valuation plus a new cost-of-living index, all overall trends of Gini are upwards. The Lorenz Curve chart indicates, through the variation of total poorest people in whole Chinese population percentage (which mostly appears in rural area) and original income distribution, that the curve in 1990 is clearly more bending than it in 1985.

Figure 1: *Inequality Measures for alternative income measures*



Source: *Ravallion and Chen 1999*

Figure 2: *Lorenz Curve for 1985 and 1990 using original income*



Source: *Ravallion and Chen 1999*

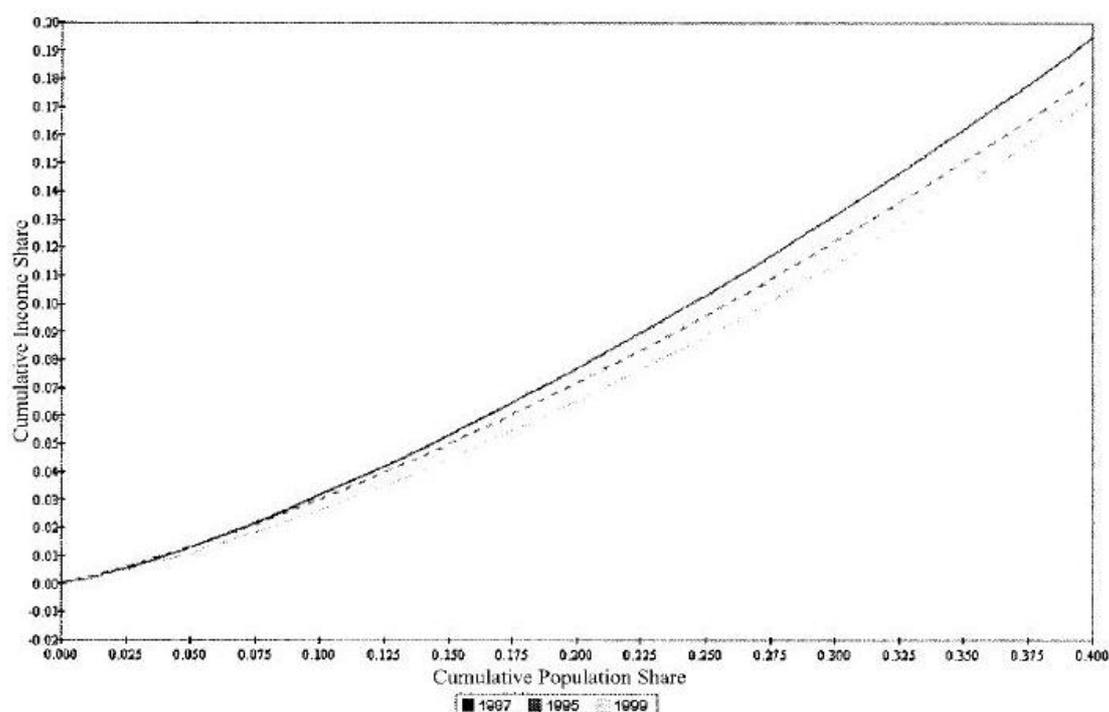
The data is collected by the Rural Household Survey, which to some extent is the most scientific and realistic information available. Combining various income definitions, all indexes of rural income inequality demonstrates a rising tendency over time. Although a 5 year snapshot is far from enough to reveal the relationship between inequality and economic growth over time, it shows that inequality has increased after the economic acceleration.

Looking further back in time, there is a rural-urban convergence from 1978 to 1985, which evolves into a divergence there after. Growth has mainly benefited certain regions, such as big cities and urban area in costal China. It directly causes the divergence after 1985, together with powerless inter-provincial fiscal transfers, it became even harder to achieve convergence between and within provinces. (Raiser 1998) As openness, global integration and trade developed, inequality steadily

increased in both rural and urban sectors after 1990s.

The level of absolute living standard for the poor has even declined between 1995 and 1999, when it approached the same rate as in 1987. Moreover, the national Gini coefficient for rural China increased from 0.24 in 1980 to 0.35 in 1999. (Benjamin et al 2005) Lorenz Curves for 1987, 1995 and 1999, focusing on the poorest 40% in rural areas, show that the inequality has increased over time.

Figure 3: *Income share by poorest 40% population in rural area in 1987,1995 and 1999*



Source: *Benjamin et al 2005*

Rural inequality is not increasing as a consequence of the Kuznets-Curve-type of structural processes, but as a by-product of collapsing agricultural prices during the economic transition. Within-rural and within-urban inequality show an ascendant contribution to overall national inequality, and the urban-rural inequality does not drop during that period.

2.3 Who is the Murderer?

Even if there is a gradually widening gap between the urban and rural sectors, both of them are still enjoying rapid within-sector growth. Rural industry development still is a strong primary source of income for the rural sector, which accounts for nearly 80% of the total population in China. The total output value from 1978 to 1993 measured in 1978 prices at 20.73% per year on average. (Sun and Dutta 1997) It is pretty remarkable. Then why did this growth not trickle down to reduce inequality and narrow the gap between rural and urban areas?

There are some defects inherited from earlier policies that hinder the reduction of inequality reducing. Agriculture shows a rapidly declining share of total rural income. While agricultural income accounted for 53% of total income in 1987, it dropped till only 6.3% in 1999. (Benjamin et al 2005) This is not because of a rise of rural non-farm income but purely because of falling income within the agricultural sector. After that, rural-to-urban migration labour becomes an essential source of earnings. However, the migration movement did not prove and joint of urban-rural divergence. First, this is because of a policy of residence from 1958, according to which any change in residence will need an official permission (which is extremely strict before 1980s). And second, though the residence policy is a little bit loosened after 1980s, the rural population still dominates. (Jian et al 1996) In 2002, when the urban population share reaches 39%, more than 80% of rural-to-urban migrant labourers still send remittances back home. While these huge amounts of migrants contribute to urban economic development, they enjoy different welfare rights compared to other urban citizens because of the rule of citizenship, such as limited access to human capital investment and health care system. This “soft” inequality makes them the most marginalized group.

However, the real cause of the widening gap between urban and rural sectors is the post-reform policy failure. Although there exist policies such as tax cuts in rural areas and price controls to provide a better environment for rural development, they are just effective against inequality in a short-term. Applying a heavy industry strategy widens

the gap between rural and urban areas, and also creates inequality. Using it as long-term economic strategy is fatal to urban-rural convergence. Especially after the 1990s, when western-based development policy is adopted, the divergence is accelerating. (Liu and Liu 2008) Many channels of convergence, such as labor migration, capital flows and technological diffusion, were simply cut off under central planning. Both central and local governments applied an economic development strategy which became the major “murderer” for promoting divergence and growing inequality.

The urban-rural dual development has indeed played a key role in economic development for many low level growth countries at the very beginning. However, a heavily favoured urban growth strategy for a considerable long time is no doubt a blow on equality. After consistently higher inflationary taxes imposed on rural earnings served as a trigger for divergence, the gap is exacerbating itself. Institutional-led inequality matters more than ever in the case of urban-rural inequality in China.

3. Data

A long time period is necessary and essential to investigate the relation between economic growth and inequality in order to test a Kuznets Curve surmise. Although China had experienced economic acceleration before 1978, it is reasonable to choose 1978 as the starting point. 1978 is the year of new economic reforms and from then on growth speeds up. Three decades may, of course, still not be enough to investigate the whole relationship between economic growth and inequality in China. Yet, it is possible to examine the historical trend and predict future alignment, to see whether there is or will be a turning point of inequality decreasing while growth continues.

The investigation into whether China's inequality is decreasing through rapid economic growth will focus on urban-rural marginalization, that is to say, whether economic growth has trickled down to reduce the inequality gap between urban-rural sectors. The tendency of convergence or divergence between urban and rural areas can somehow present a Kuznets-like trend since, as mentioned above, urban-rural differentials is the driving factor behind the overall inequality in the case of China. Both quantitative data and qualitative information will be used to examine the urban-rural convergence or divergence.

3.1 Quantitative Data

Quantitative data has the advantage of being able to enumerate and predict relationships for large populations. (Holland and Compbell 2005: 4) Quantitative data can be used to identify casual impact and permits aggregation to compare findings across populations. In the case of the relation between inequality and growth in China, probing the topic by applying quantitative data can provide a general statement.

3.1.1 Staple Indicators

To take a look at some staple indicators regarding rural and urban areas, the income ratio is the first thing to look at. According to most research based on mean per capita income in urban China, it is estimated that the income ratio between urban-rural areas

is more than three-fold, and is the highest in the world. (Sicular et al 2007) The ratio dropped from 2.9 to 2.2 between 1978 till 1985, the lowest in the history ever. However, it increased to 2.9 in 1990 and to 3.3 in 2008. It is measured by National Bureau of Statics of China through household survey, using the UN standard system of national accounts definitions. However, the data might show some discrepancies since the household survey in China has one huge limitation of not taking rural-to-urban migration into account. Migrants usually living in urban areas often have rural citizenship, since they do not have settled living addresses and often move without any registration. This number is growing as time goes by. It is tricky to investigate and has always been the grey area in researches of all kinds.

Using raw income data is certainly inadequate. Spatial differences in cost of living is also a key factor to take into consideration, especially in a geographically huge nation like China. Unlike the World Bank data that refer to aggregate income only, National Bureau of Statics data can be decomposed into different variables. Sources of inequality in income distribution can be discerned by the NBS database.

Table 1: *Mean Household Disposable Per Capita Incomes: National, Urban, Rural and the Urban–Rural Gap (units: yuan, ratios)*

MEAN HOUSEHOLD DISPOSABLE PER CAPITA INCOMES: NATIONAL, URBAN, RURAL AND THE URBAN–RURAL GAP (UNITS: YUAN,						
	1995			2002		
	NBS, Unadjusted	Unadjusted	PPP	NBS, Unadjusted	Unadjusted	PPP
National	2,396	2,921	2,584	4,770	5,826	5,139
Urban	4,429	5,635	4,259	8,038	10,004	7,798
Rural	1,564	1,810	1,899	2,673	3,145	3,434
Ratio urban to rural	2.83	3.11	2.24	3.01	3.18	2.27
Urban minus rural	2,865	3,825	2,360	5,366	6,858	4,364

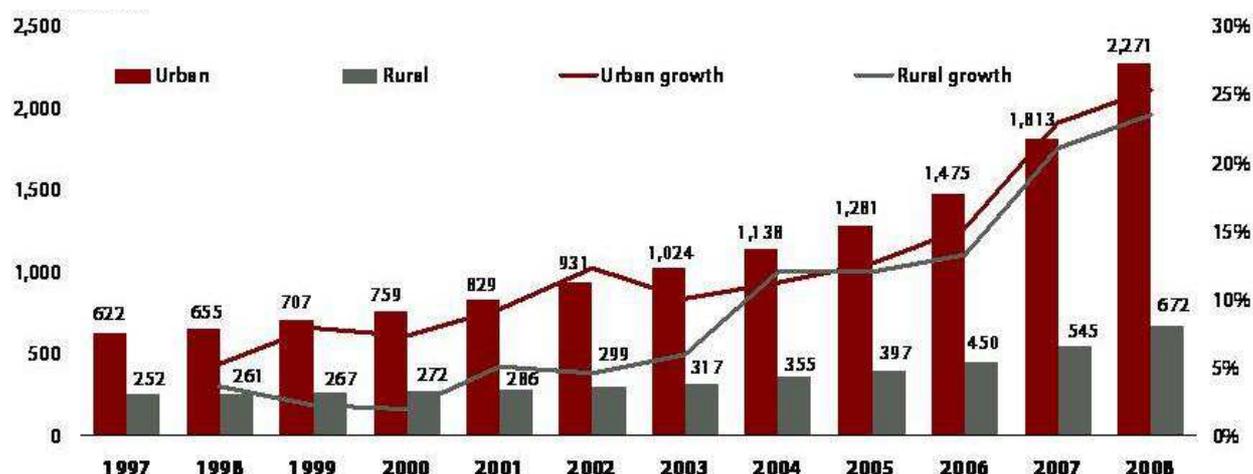
Source: *Sicular et al 2007*

By applying Brandt-Holz spatial cost of living estimates (Brandt-Holz spatial cost of living is measured by nationwide cost of living for a joint basket of consumer goods, weighted by current population shares) in 1995 and 2002, the income gap between

urban and rural area as the PPP number reveals, is still remarkably high. (Sicular et al 2007) Later investigations show that although the growth rate between urban and rural areas is almost the same, the income gap and tells another story.

This figure below shows the tendency of annual income of urban households and rural households from 1997 to 2008, in US dollars. It is clear that both urban and rural areas have experienced income increase. However, the urban sector has experienced a more rapid increase. Although after 2004 there exists a converging point in within sector growth, it only means that the gap becomes stable, not narrowing.

Figure 4: *annual income of urban and rural households, 1997 to 2008, in US dollars*



Source: *National Statistics Database 2012*

The urban-rural gap in more developed areas, such as costal regions, is larger than in inland regions. Between-group inequality in costal China is two to three times higher than in other areas, however within-group inequality is almost the same as in other regions. (Sicular et al 2007) Taking sample from seven provinces by RECE data source, it appears that the regional rural income difference is declining over time. (Benjamin et al 2005) The same result can be got from looking into mean rural income between provinces. Urban income fluctuation seems to be the key factor behind the overall urban-rural income gap, especially in west China.

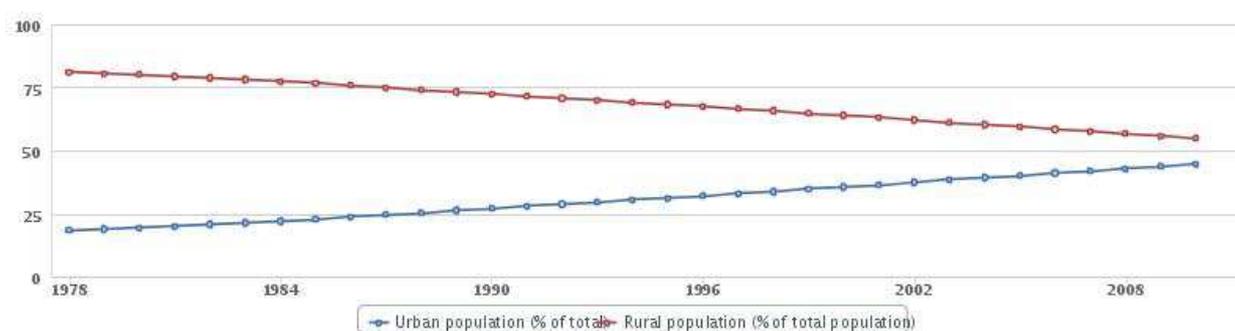
3.1.2 Periphery Indicators

Income distribution alone can not comprehensively describe the inequality. Inequality itself is a proxy for heterogeneity of household resources that are captured at a congregation level. (Benjamin et al 2004) There are other essential indicators that should be taken into consideration while talking about the relation between growth and inequality.

The main cause of inequality in China is the adoption of a heavy-industrial-oriented development strategy at very beginning, which favors capital intensive heavy industry in costal urban areas. It leads to a further deterioration of urban-rural inequality and undermines the employment rate. The uneven income distribution also has become an important incentive for rural-to-urban migrations to seek better paid jobs.

The most direct mechanism for rural residents to increase their income is of course to move to urban areas. (Lin and Chen 2011) As the graph from the World Bank Database 2011 shows, the population share in urban and rural areas is almost the same as both are approaching 50% of the total.

Figure 5: *population share in urban and rural areas, 1978 to 2008*



Source: *World Bank Database 2012/6/3*

However, looking into details of this tendency, about 22% of growth in urban population after 1990s is not because of real migration but due to the reclassification of rural areas. The real situation of these 22% has not been changed. The definition of

rural and urban was blurry before 1980s. The central government relaxed the criteria for population size and the proportion of non-agricultural residents to define a town in 1984, and as the number of township increased, many households were classified as urban. (Yang and Zhou 1999) Right now, urban and rural is largely defined by citizenship (hukou system), and the earlier reclassification is not a big problem in this study, because it only causes a shift in rural-urban ratios but does not affect changes in the ratios over time. Furthermore, only about half of percentage of total urban population growth is due to migration, and there is a large amount of unregistered population in grey areas that is hard to take into account. The World Bank might not be reliable on this data because unregistered rural-to-urban migration might be counted into urban category, and the number of this grey area population is increasing over time and is quite huge.

While the population rate in rural areas was about three times larger than in urban areas in the 1980s till 1990s, the ratio of employed persons was about the same. As the two populations tend to be equally large, the employment persons numbers are also reasonable with the change.

Table 2: *Total Employment persons in urban and rural areas, 1978 to 2010*

Year	(10 000 persons)		
	Total	Urban Areas	Rural Areas
		Subtotal	Subtotal
1978	40152	9514	30638
1980	42361	10525	31836
1985	49873	12808	37065
1990	64749	17041	47708
1991	65491	17465	48026
1992	66152	17861	48291
1993	66808	18262	48546
1994	67455	18653	48802
1995	68065	19040	49025
1996	68950	19922	49028
1997	69820	20781	49039
1998	70637	21616	49021
1999	71394	22412	48982
2000	72085	23151	48934
2001	72797	24123	48674
2002	73280	25159	48121
2003	73736	26230	47506
2004	74264	27293	46971
2005	74647	28389	46258
2006	74978	29630	45348
2007	75321	30953	44368
2008	75564	32103	43461
2009	75828	33322	42506
2010	76105	34687	41418

Source: *China Yearbook 2011*

One thing to be noticed is that the quality of this employment in urban and rural areas is very different. Employees in the rural sector usually have less access to social welfare and public goods. Urban employees tend to have a more complete social welfare system with decent wage levels. The citizenship system is still a disturbing obstacle for urban and rural people enjoying the same rights.

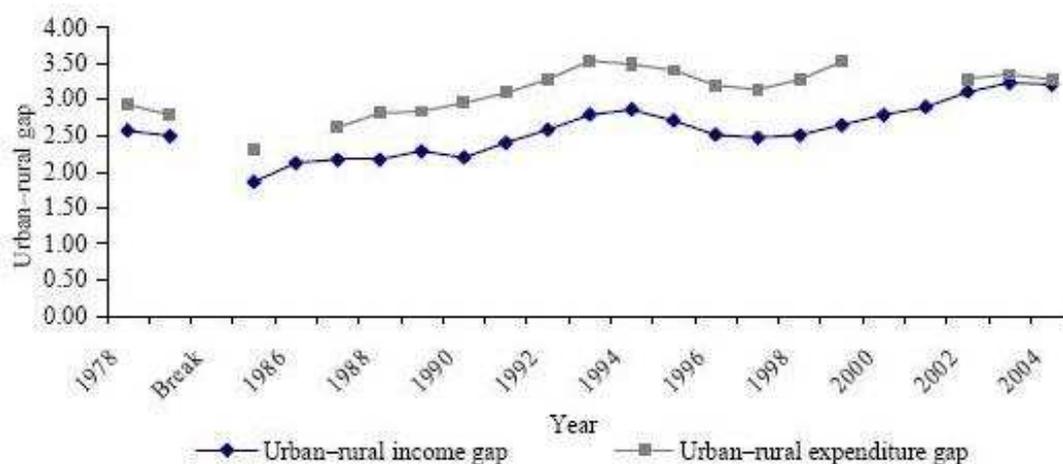
Another major cause of persisting urban-rural gap and overall inequality is China's

skewed taxation structure. It is way too regressive for rural areas, especially for the poorest. An agricultural tax has put heavy burdens on the rural sector. Rural household income is much lower than the urban, and heavy taxation has made things worse. (Wang and Piesse 2010) It creates and maintains the income gap between the urban and rural sectors. It would be quite impossible to eliminate or narrow the uneven distribution with such a skewed tax system.

The Agricultural Tax Regulations set the national average rate of 15.5% of the total value in a yard in a normal year and ad valorem from 5% to 25%. (Wang and Piesse 2010) It is a quite a burden considering that people themselves have to pay for, social welfare, education and health care. As matter of fact, agricultural tax is only a tiny share of Chinese government revenue, yet the agricultural tax is a major expense for rural farmers.

Comparing urban-rural income gap is a bit subjective since inflation, commodity prices and cost of living may differ between those areas and from province to province. Glancing at the expenditure ratio by household level might be more precise.

Figure 6: *Urban-rural income gap ratio and expenditure gap ratio, 1978 to 2005*



Source: *National Bureau Statistics 2005, from 29 provinces*

The data is collected by NBS till 2005 and consists of a large national sample from 29 provinces. It is clear that expenditure as inequality measurement shows a bigger gap

between urban and rural areas compared to income. Besides, drawing a line from 1978 till 2005, the overall tendency is slightly upwards.

Looking into indicators such as migration, employment, taxation and expenditure in rural and urban areas, there appears a remarkable divergence. What is more, the gap is stabilizing over the years.

The quantitative data used above is mostly from the National Bureau of Statics, which, unlike international databases, offers figures at a more disaggregated level. However, it also has its disadvantages such an incomplete accounting of subsidies by work unit and large populations missing in household surveys. These disadvantages could be pivotal in further analysis. Still, it might be the best database available for an investigation into urban-rural inequality.

3.2 Healthcare and Education Gap

Explaining how economic growth has affected inequality simply by numbers might be dry and pale. In the case of inequality in China, some variables can not be quantified, such as inequality in human capital. Education and health care, two very basic but essential social welfare sections, could be quantified by school enrollment rate and medical investment figure. However, it is just no enough to look at how far they have been made available to the grassroots.

Take health care in China as first case. The differences in medical treatment in urban and rural are enormous. Public health care is one of the most valid indicators to evaluate a population's well-being and social stratification. (Dorsten and Li 2010) It has been regarded the very basic rights for citizens. The health care system and structure in China is slightly different between provinces. However, without any exception, people in urban areas enjoy more advanced and complete medical care than those in rural areas. If we use average life expectancy as measurement, the average for rural residents is 5 years less than for urban residents. This number varies geographically. In costal areas the age gap is 3.39, in central areas 4.6 and in the

western sector 7.9. It is a tremendous gap between urban and rural residents.

The ratio of health care expenditure between urban-rural areas can also reveal the disparity. With an average national ratio of 3.5, let us consider two extreme regions, Shanghai's ratio is about 1.4 and Tibet's about 7.6. This means that while residents in rural Shanghai spent nearly 70% as much as urban residents, the rate is just 13% in Tibet. People in rural areas tend to be self-healing at home rather than go to hospitals. The reason is that rural residents have way much less medical allowance than urbaners, and even they go to clinics or hospitals for treatment, they usually reduce the amount of prescription medicines since most of their employers do not accept reimbursement. People in urban areas, especially those living in big cities with consummate medical insurance, have very different opportunities. Besides the public health care system, they can also enjoy private medical insurance bought by their enterprises. The probability of death by chronic diseases in rural areas is double that in urban areas.

Public health care expenditure is indeed increasing over the time. However, with the skewed medical system and citizenship policy, it is hard to keep the pace of urban and rural areas at the same level. The gap is even larger than before 1978, when China was having communism as development strategy.

Choosing education as the other case, it might be the only household characteristic that contributes substantially to the urban-rural gap directly. (Sicular 2007) There is a surging financial support by the government to allocate funds into compulsory education both in urban and rural regions. The number of compulsory education enrollment years in urban areas is 12, from primary school till high school, and rural areas about 9, from primary school till junior. Taking a random sample from urban and rural areas same enrollment rate from the exactly same education period, the final achievement rates are distinctively different. While over 85% of students in rural areas have accomplished their studies, the rate in urban areas is only approaching a quarter. (Fu and Ren 2010) The density of schools in urban area is higher than in rural regions. It may make students in rural areas two hours to get to school, some even

more.

The tuition fees also differ from rural to urban areas, from province to province. Although the cost of education in urban areas is much higher than in rural areas, especially for those parents who put their kids in private schools, the tuition fees is still a burden for some less developed rural regions. In addition, the quality of education in urban and rural areas is quite different. The situation is worse for rural-to-urban migration kids. While paying a high tuition fee, they can not get the same education quality as city kids have. The establishment of special schools for those grey-area kids actually makes the situation worse. It is gradually becoming a kind of discrimination.

Though the overall level of health care and education is moving up, the gap between urban and rural areas remains. It has even widened a bit because of the unreasonable inherited policy, such as citizenship policy.

4. Analysis

Looking into income distribution, urban-rural migration, employment rate, taxation, education and health care, all these indicators show a huge gap between urban and rural areas. Besides, the urban-rural inequality is widening during the rapid economic growth after 1978. It seems that the profits from growth profits have not trickled down to decrease the inequality in China under decades of urban-favored development policies.

4.1 Is Inequality a Necessary Price to Pay?

Is inequality a necessary price to pay for achieving economic growth? Certainly not. In the case of China, the creation and widening of urban-rural inequality is determined by its uneven development structure. After the economic reform of 1978, the structural change has been dramatic. Rural enterprises became the emerging source in total GDP. From almost zero before 1978, this share rose to more than 50% in 1997 (before the Pacific Asia economic crisis). However, this rural growth has not been fully used into reducing inequality and narrowing the urban-rural gap. The concentration ratio turns into the highest for income from individual and enterprises, the income distribution for individual workers is far more equal than profits gained by enterprises. (Khan et al 1993) However, this has been neglected because the individual income share is insignificant in total income, but no one has paid attention to its considerable huge affection in inequality. The skewed structure keeps lingering on and nothing is really contributed or invested into reducing inequality in a direct way, and the inequality becomes the by-product of economic growth in China.

The investment funds which should be used for narrowing the inequality gap are largely controlled by government for other activities. National financial resources are commanded by the state through five major state banks. Continued flows of investment are pouring into low-return state-owned enterprises, and capital allocation becomes inefficient. Other factors are also essential. Migration is one of the most efficient ways to narrow urban-rural gap, but it is discouraged by citizenship policy.

Labour mobility is low, although there is a huge surplus of labour in the agricultural sector, the conditions make it hard to transfer labour into urban areas for improving the economic efficiency. This directly enlarges the urban-rural gap in income distribution and access to social welfare.

Of course, it is hard to predict that China will enjoy the same growth speed without such high inequality. It might experience a deceleration compared to the one China had after 1978, its emphasis will be put on reducing inequality. But one thing is for sure: inequality is not the necessary price to pay to get the growth, and the reason why China is having amazing inequality while enjoying growth is because of its own development failure.

Actually, on the other way around, the high inequality is gradually reducing the growth speed. The defects of economic reform after 1978 are growing, structural fissures are increasing. GDP growth starts to slow down and becomes unstable. In the first season of 2010, it reached 12%, but in the first season of this year (2012) it is only 8.1%. The uneven growth is showing its fatal face. Allocating more capital to agriculture and rural development will certainly create a more sustainable economic efficiency. (Fan et al 2003) Inequality, ironically, makes China's economic growth to pay a price for it.

4.2 Turning Point

Before we try to find the Kuznets Curve-like turning point between growth and inequality, we have to see whether the Kuznets hypothesis could be applied on the case of China.

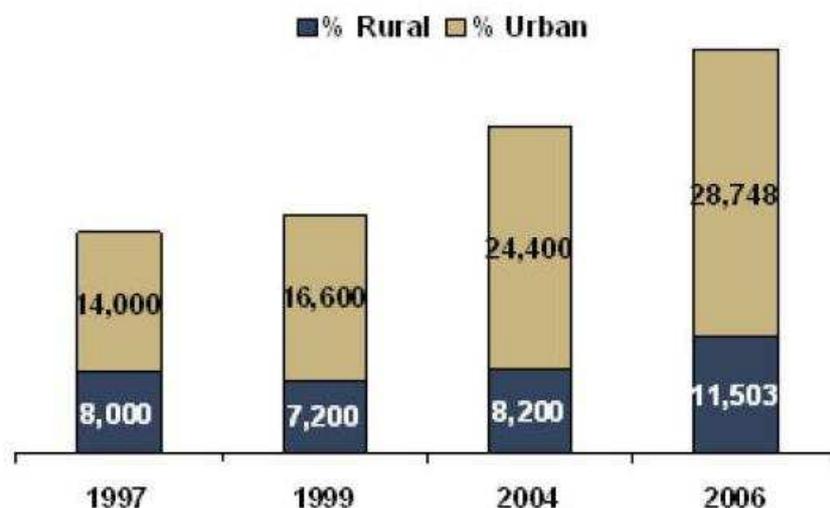
Growth after the economic reform began in 1978 shows an upward tendency. Inequality presents the same trend. When observing growth in GDP per capita and inequality as shown by the Gini coefficient, there appears to be no curve with a turning point. The relationship between economic growth and inequality in China seems very unitary, inequality increased along with growth. Of course it is argued by many Kuznets Curve-believers that the period from 1978 till now is not long enough

to hold the whole relation, and a turning point will eventually occur. The inequality that China is experiencing right now, can be explained by Kuznets Curve hypothesis and the urban-rural gap is just postponing the turning point. (Ye 2009)

However, this view may be over optimistic. Take a look at the current population composition: the bottom 20% of all Chinese receive 10% of rural income and no urban income, while the top 20% percent receive 21% of rural income and 75% percent of urban income. (Khan et al 1993) It means that the poorest 20% of the population is entirely in rural areas and the richest 20% mostly in urban areas. This information was gathered in the 1990s and the situation right now is even worse. This raises the question that who is really getting most benefit from the decades of growth. It is actually the most essential question to answer since uneven growth will only exaggerate inequality. The turning point of decreasing inequality and continued growth can never be achieved with such a skewed tendency.

Figure 7:

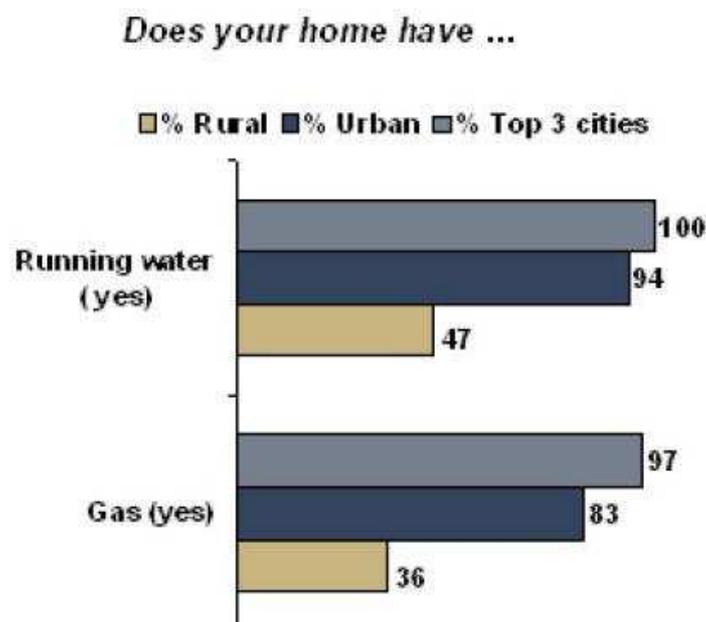
Average Annual Household Income Before Taxes in RMB



Source: Wu 2007

The ratio between rural and urban average annual household income before taxation, as figure 7 shows, has only enlarged and the divergence between rural and urban areas is quite clear.

Figure 8:



Source: *Wu 2007*

Taking a face-to-face interview by random sample in rural and urban areas in 2006, the answers concerning several basic living conditions reveal a harsh difference. Life necessities such as running water and gas in rural areas are only half as frequent as in the urban sector. With uneven income distribution and unbalanced investment, it is hard to imagine a coming turning point under such conditions.

It is true that the Chinese government has already taken some actions to reduce the inequality and integrate urban and rural development. Taxation has been eased in rural areas, new policies try to support public funds in rural areas and increase investments in human capital. The Chinese Central Committee is confident that the widening gap between rural and urban areas will eventually be halted, and that there will finally be a balanced development.

All these policies are new and put into use in the latest five years, it is hard to draw any conclusion whether they are working or not. The latest data from 2011 still indicates a divergence between rural and urban, the inequality is still growing slightly. There are some facts that can not be denied that, first, the imbalanced urban-rural

development has been going on for quite a long time in China along with rapid growth. The growth type, however, is one of the reasons for the divergence. Second, without a break with some old policies and obstacles, even with the new strategies, it will be difficult to reduce the gap. The conflicts and discrepancies between old and new strategies are just not given enough attention.

So far, we can not see any turning point of inequality and economic growth in China. It is even hard to predict one under current conditions. What China is experiencing right now is more like a bottleneck, both growth speed and inequality increases are slowing down, and the divide between urban and rural areas is stable but huge. China's inequality, has not been reduced by its rapid growth, it is always "keeping up" with growth.

4.3 Trickle Down to Where?

Only first part of Deng's development strategy of "allowing some regions to get rich first and in turn helping other regions to gradually become rich" seems comes true. He did not foresee that urban-rural inequality would be so huge and ever-growing because of urban-based policy. The major part of profits from growth has trickled down to urban sectors, especially metropolitan. East cost areas gain more than the central and western part, while the urban sector receives most credits and the rural only little.

It is clear that the benefit of growth is bestially upon the urban sector. The rich are almost to one hundred percent concentrate in developed urban areas while the poor reside largely in rural areas. Urban-based policy has intentionally created advantageous endowments in the cities. (Li 2011) The situation is determined by the very beginning of economic reform in 1978 the gains from such an imbalanced development can only trickle down to the urban sector.

Besides, the more developed urban sector or city tends to convergent with its neighbouring rural areas. Over 80% of rural-to-urban migration takes place with provinces. It is hard for western rural residents to migrate to more advanced areas,

like central cities or some large costal metropolitans. In other words, though the migration movement seems large over decades, the effect is small. People from western China, compared to costal immigrants, are still left behind even though they have moved to a better place. It is small and middle-sized urban towns that are playing the connecting role between urban and rural areas, these towns might be the strongest linkage to rural hinterlands. Rural residents usually turn to non-agricultural employment during the slack season and middle-sized and small urban towns within provinces become their best choice. It creates another source of earnings. However, there are not enough positions for such rural residents, because first, middle-sized and small towns do not have economic activities and manufactures as big cities, and second, the rural population is way too plentiful for existing job vacancies.

5. Conclusion

By investigating different variables over China's post-reform period from 1978, it seems that inequality has increased hand in hand with economic growth.

Previous historical evidence demonstrates that the evolution of the relation between urban and rural areas in China is largely determined by economic reform strategy and uneven investment. The urban-based economic policy has hurt the rural area, and applying it for such a long period has made urban-rural inequality increase. Later data indicates that the gap is still slightly expanding. An economic indicator such as income distribution is not the only index that shows this, employment, taxation and welfare like health care and education confirms the picture.

China's case does not seem to confirm to the Kuznets Curve hypothesis, which predicts a turning point effect which inequality is going down. The economy is approaching a bottleneck because of the uneven development brought on by a long time of inequality. The growth speed has slowed down, not because it is becoming stable, but, on the contrary, because it is riddled with dangerous inequality. The consequence and influence of post-reform policies and strategies clearly block the any attempts to reduce inequality in China. To a large extent, the uneven development strategies and imbalanced government-lead investment are at the roots of the problem. China's inequality obviously has not been declining under the rapid growth over decades. Development policies and economy strategies are mostly favouring urban areas, and the gap is enlarged rather than bridged.

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