Rising Inequality in China

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How much has inequality risen in China?
Why is this a concern for China’s development?
What should be done about inequality?
Data on inequality in China

NBS urban and rural household surveys: High quality surveys by international standards, but some concerns nonetheless.

– **Unit nonresponse**: selective compliance, esp., by “rich”:
  • this is thought to an increasing problem, esp. urban areas.
  • Probably underestimating inequality but overestimating poverty.

– **Item nonresponse** and **under-reporting**. Not much known.

– **Urban subsidies** (declining over time): urban-rural disparity may be larger than we think, but not be increasing as much.

– **Floating population**: incomplete coverage in urban surveys.

– Rising data problem over time

– Leading to underestimation of urban poverty and inequality.
Trend increase in income inequality but more so in some periods

Gini index of income inequality

National without adjustment for cost-of-living difference
National, with adjustment

Signs that inequality might be stabilizing at around Gini=47%
(42% with COL adjustment)

But is it sustainable?
Incidence of growth

Growth incidence curve for China 1993-2004

Growth rate of percentile p (% per year)

The poorest p% of population ranked by per capita income
Rising inequality between urban and rural areas since mid 1990s

Ratio of urban mean income to rural mean income

Without any adjustment for cost-of-living differences

With adjustment for urban-rural cost-of-living differential and urban/rural
Rising inequality within urban and rural areas, but rising faster in urban

- Signs of inequality convergence.
- The stabilization is mainly due to rural areas.
- Better prices for farmers + remittances + public transfers

But is this sustainable? There were also signs that inequality was stabilizing in mid-1990s, but not sustained.
Very few developing countries have seen the same rise in inequality as China.
Nonetheless, China has made huge overall progress against absolute poverty.
Though uneven progress against poverty
Trend rates of change in rural headcount index
(upper line; by province; %/year; 1983-2001)
Provinces with higher growth rates in rural mean income saw faster poverty reduction.

Elasticity = -2.4 (t = -4.3) (dropping Beijing, Shanghai, Tianjin)
Both the rate of growth and the “pattern of growth” matter to poverty and inequality

- Economic growth was a key proximate cause of poverty reduction.

However:
- Growth in the primary sector (primarily agriculture) did more to reduce poverty than either the secondary or tertiary sectors.
- The composition of growth also mattered to the evolution of aggregate inequality.
- Agricultural growth was also inequality decreasing.
An aggregate growth-equity trade off?

- Tradeoffs can be expected in all areas of policy making.
- However, it is not clear that China faced an aggregate growth equity trade off within the post-reform period.
  - The periods of more rapid growth after 1980 did not bring more rapid increases in inequality.
  - Nor did the provinces with higher growth rates tend to see steeper rises in inequality

=> Poverty might have fallen even faster without the increase in inequality!
Why is high inequality a concern for China’s future development?
People are averse to inequality

• Universally, most people prefer to live in a society with low inequality than one with high inequality at a given level of mean income.

• However, mean income also depends on the extent of inequality.
A rise in inequality was probably inevitable in post-reform China

- Pre-reform controls on economic activity had kept inequality too low, esp., wage repression.

- Also, differing initial conditions meant that some places were better advantaged, and these were not the poorest.
However, high inequality may well constrain China’s future growth

- Credit market failures in China (as elsewhere): stemming from information asymmetries, notably that lenders are imperfectly informed about borrowers.
  - With diminishing marginal products of capital, the mean future wealth will depend on the distribution of current wealth.
  - When higher current inequality => more credit-constrained people it implies lower future mean wealth at a given value of current mean wealth, i.e., lower economic growth.

- Inequality and associated conflicts also restrict efficiency-enhancing cooperation amongst people, such that public goods needed for growth are underprovided or efficiency-enhancing policy reforms are blocked.
Evidence for China

• Provinces started out the reform process in early 1980s with diverse levels of inequality. The more rapid subsequent growth rates were in the provinces with less inequality.

• At county level using farm-household panel data: Households living in counties with higher initial wealth inequality saw lower subsequent growth rates.

• Also, dynamics of household consumption growth is consistent with nonlinearity such that higher inequality impedes growth at given initial mean.
So inequality is now an issue for China: It will make it harder to achieve Xiaokang

- High inequality may well inhibit future prospects for both growth and poverty reduction, so fewer people will enter China’s “middle class.”

- Aggregate growth is increasingly coming from sources that bring limited gains to the poorest.

- Poverty is also becoming much more responsive to rising inequality.

- Perceptions of what “poverty” means are also changing, which can hardly be surprising in an economy that can quadruple its mean income in 20 years.

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<th>Elasticity of H to Gini</th>
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<td>1981</td>
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However, some aspects of inequality matter more than others

• There are “good’ and “bad” inequalities from point of view of attaining Xiaokang.

• Biggest concern is inequality of opportunity: those inequalities that impede growth and poverty reduction
  – lack of access to education, health care, infrastructure, markets and finance.
What should China be doing about rising inequality?
Key guiding principle:

Don’t reduce inequality in ways that reduce living standards of the poor!

• Identify and focus policy attention on the bad inequalities.
• Then the problem of rising inequality can be addressed without a cost to growth and poverty reduction.
• Indeed, it may be possible to attain even higher growth by redressing inequalities of opportunity.
On the role of agricultural growth and poor-area programs

• Agricultural growth has been a powerful lever for reducing poverty and inequality, and this remains true.

• With fairly equal access to land and relatively few distortions to incentives, achieving higher agricultural growth in China will require
  – sound investments in research and development,
  – and in rural infrastructure.

• Mixed evidence on poor-area development programs.
  – Some evidence that national program helped reduce poverty.
  – However, rigorous research on China’s South West Poverty Reduction Program suggests that it brought only small overall long-term gains to poor, though could have done better.
Some forms of public spending and taxation matter more than others

• Taxation:
  – Higher procurement prices/lower taxes on farmers reduced poverty and inequality esp., mid 1990s and mid 2000s. => Figure
  – This was a powerful lever in the short-term, e.g., 1% point fall in income Gini after eliminating ag. taxes in 2004

• Public spending:
  – Since 2005, both local and central transfers and subsidies have helped stall rising inequality (agricultural production, rural infrastructure, education, health care, pensions, Di Bao).
  – In 2008, public transfers accounted for 7% of rural net income and 10% for the poor.

• Targeted transfer schemes such as Di Bao:
  – Di Bao is well targeted; coverage is the bigger concern
  – Horizontal inequality in Di Bao benefits between cities
  – Expansion to rural areas since 2007 has probably helped.
Policy matters! China’s GIC in mid 1990s

Growth incidence curve for China, 1993-1996

Annual growth in income per person (%)
The future challenge: Stabilizing inequality in a more sustainable way

• Government has made progress in most of these areas, and this has stabilized inequality.
• But history teaches us that inequality has been stabilized before, but this was not sustained.
• Sustained pro-poor policy effort in the above efforts is key.
• But more fundamental pro-poor reforms will probably be needed =>
Reforms favoring the poor and middle class

- **Registration system:** A non-discriminatory system will benefit both urban and rural poor.
- **Markets for land:** Creating a market in agricultural land-use rights will help reduce poverty (Vietnam’s experience)

- **Access to finance:** Making credit markets work better for the poor will make inequality less harmful
- **Access to finance has improved but more to do:**
  - Credit access for small and medium size enterprises
  - Access to deposit accounts for households, esp., rural areas
  - Improved legal and information infrastructure
  - More competitive financial sector
  - Developing small and medium size banks.
Reforms cont.,

- **Human development**: Access to education and health care for poor people (more remote rural areas but also rural migrants in urban areas) is a continuing challenge.
  - Reducing inequity in public spending on health and education
  - Universal health insurance, with higher payouts.
  - Extending schooling subsidies to rural high-schools.
  - Financing reforms, to help poor areas.
Further reading


- World Bank, *Finance for All?* World Bank, Washington DC