

China: Spectacular Growth and Inequality

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Abstract: Economic growth in China has proceeded at a dramatic pace over the past thirty plus years. In this period, China adopted a number of economic policies and reforms that made significant and continuous economic progress possible. Much of the population benefited from the reforms but a large part of the population remains below or near the poverty line. There are vast differences in the geographical distribution of income. In this paper we will consider (1) the factors most responsible for China's enormous economic expansion; (2) income inequality; and (3) current government policies and reforms to promote a more equitable distribution of income.

Key words: growth; inequality; convergence; reform; rebalancing and reform

JBE codes: D31, D63, E50, E51, F63, O10

1. Three Policy Phases

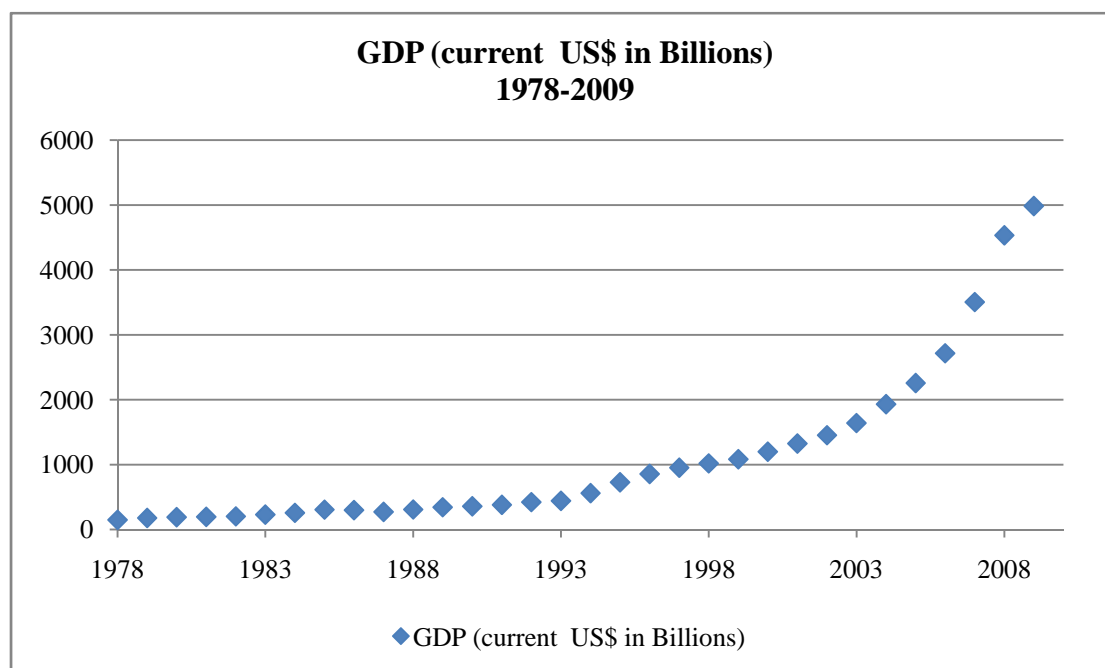


Figure 1 Exponential Growth of China's GDP from 1978 to Present

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The Peoples Republic of China (PRC) was established in 1949. Soviet style central planning was the policy until 1965 that includes the disastrous policy experiment of the Great Leap Forward. The Cultural Revolution (1966-1977) virtually destroyed central planning and forced regions to adopt autarkic policies since there was a complete breakdown of interregional cooperation. From 1978 to the present, free market mechanisms were adopted although heavy industry and agriculture remains to a greater degree in the control of the state (Communist Party). China's growth has been astounding since the switch to market principles. Figure 1 depicts the exponential growth of China's GDP from 1978 to present. Table 1 presents annual growth rates. The results of this transition provide compelling evidence of the efficiency of market incentives. Other factors that have contributed to China's ascendancy to a world economic power include privatizing much of its industry, joining the World Trade Organization (WTO), formation of the Chinese Stock Exchange, passage of the Company Law (1993) and a multitude of corporate governance principles to protect shareholders and provide a framework of shifting from state to private ownership of capital. Currently, China is the largest destination for foreign investment (Reuvid, 2008).

Table 1 China Data (1960-2009)

Year	Life expectancy at birth, total (years)	GDP (current US\$)	Population, Total	GDP Growth (Annual %)	GNI per capita, PPP (Current international \$)
1960	47	61,377,930,682	667,070,000
1961	48	50,100,934,916	660,330,000	-27	..
1962	49	46,464,003,927	665,770,000	-6	..
1963	51	50,280,424,169	682,335,000	10	..
1964	53	58,613,239,133	698,355,000	16	..
1965	55	69,709,152,023	715,185,000	16	..
1966	57	75,879,433,528	735,400,000	11	..
1967	58	72,057,026,116	754,550,000	-6	..
1968	60	69,993,499,400	774,510,000	-4	..
1969	61	78,718,820,946	796,025,000	17	..
1970	62	91,506,213,646	818,315,000	19	..
1971	63	98,562,021,764	841,105,000	7	..
1972	63	112,159,815,864	862,030,000	4	..
1973	64	136,769,881,126	881,940,000	8	..
1974	64	142,254,740,054	900,350,000	2	..
1975	64	161,162,497,664	916,395,000	9	..
1976	65	151,627,679,387	930,685,000	-2	..
1977	65	172,349,008,333	943,455,000	8	..
1978	65	148,178,859,491	956,165,000	12	..
1979	66	176,634,786,271	969,005,000	8	..
1980	66	189,399,992,474	981,235,000	8	250
1981	66	194,111,112,580	993,885,000	5	280
1982	66	203,183,214,982	1,008,630,000	9	320
1983	67	228,455,947,880	1,023,310,000	11	360
1984	67	257,432,147,241	1,036,825,000	15	430
1985	67	306,666,660,698	1,051,040,000	14	490

(to be continued)

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Year	Life expectancy at birth, total (years)	GDP (current US\$)	Population, Total	GDP Growth (Annual %)	GNI per capita, PPP (Current international \$)
1986	67	297,831,879,942	1,066,790,000	9	540
1987	67	270,372,194,997	1,084,035,000	12	610
1988	68	309,522,625,242	1,101,630,000	11	690
1989	68	343,973,680,226	1,118,650,000	4	740
1990	68	356,936,901,184	1,135,185,000	4	780
1991	68	379,468,656,246	1,150,780,000	9	870
1992	69	422,660,918,111	1,164,970,000	14	1,010
1993	69	440,500,898,965	1,178,440,000	14	1,160
1994	69	559,224,707,281	1,191,835,000	13	1,320
1995	70	728,007,199,936	1,204,855,000	11	1,460
1996	70	856,084,729,312	1,217,550,000	10	1,620
1997	70	952,652,693,079	1,230,075,000	9	1,790
1998	71	1,019,458,585,326	1,241,935,000	8	1,920
1999	71	1,083,277,930,360	1,252,735,000	8	2,080
2000	71	1,198,480,321,713	1,262,645,000	8	2,290
2001	72	1,324,804,848,409	1,271,850,000	8	2,520
2002	72	1,453,827,687,613	1,280,400,000	9	2,790
2003	72	1,640,966,533,768	1,288,400,000	10	3,130
2004	72	1,931,643,872,028	1,296,075,000	10	3,590
2005	73	2,257,068,235,352	1,303,720,000	11	4,130
2006	73	2,716,869,089,037	1,311,020,000	13	4,790
2007	73	3,505,529,765,516	1,317,885,000	14	5,600
2008	73	4,532,791,593,897	1,324,655,000	10	6,240
2009	..	4,984,731,371,688	1,331,460,000	9	6,770

2. Income Inequality

Upon coming to power, Hu and Wen dramatically increased support for the poor classes. In 2001, the central government adopted the Minimum Subsistence Guarantee (MSG), which replaced the Basic Subsistence Guarantee (BSG). The program covers poorly paid workers, laid-off workers, unemployed pension and retirement pension labor. Recipients of MSG aid increased from 4.6 million in 2001 to 22.4 million in 2004. Payments to recipients soared from 1.2 billion per year in 1998 to 10.2 billion in 2004 plus an additional 9 billion Yuan from local government sources.

Since the late 1990's, China shifted its regional development focus from the coast to the western and northeast regions. A large amount of funds have been invested in infrastructure, energy, environmental and extraction projects.

About 60% of the population lives in the countryside. In 2004, the central government increased its funds for education, culture and the health services to the countryside. Rural residents are now allowed to work in the city and the state has helped peasant workers receive unpaid wages (Chen, 2009).

Nevertheless, efforts to deal with income inequality have a long way to go. In 2004, rural per capita income was only 31% of the rural income. 21.5 million rural populations earn only about \$90 per year. An additional 35.5

million rural population earn \$125 million per year (Chen, 2009).

China has made a conscientious start toward correcting peasant poverty. But much more needs to be done including providing peasants with basic service and the means to achieve upward mobility. The central government needs to provide effective education, health and housing services, empower local governments to deliver the aforementioned services and restrain the abuses by local cadres.

The ratio of urban to rural income was 3 1/3: 1 in 2007 (Chen, p. 121). The population of rural residents is about 720 million. An additional 230 million rural residents work in urban areas (Chen, p. 134). Beginnings with the 16th NCCPC (2004) agricultural taxes were abolished and farmers were to receive subsidies for their production.

Beginning in 1998, major attention was given to infrastructure development especially in electric, biogas, water and rural roads. Rural highways cover about 95% of townships and 87% of administrative villages. By 2007, China's cumulative investment in rural electric utilities exceeded RMB 270 million (Chen, p. 127).

Social development in rural areas was enhanced by government investment in education, medical services and culture development (television and radio are broadcasted to all villages). Also, a social security system that provides a basic living allowance of 50 RMB per month was approved in 2006 (Xie, 2008).

The government has maintained many aspects of the planned economy so that it can influence market forces. For example, it maintains an extensive network of grain reserves. From 2006-2008, state owned enterprises (SOE) were the dominant purchasers of grains. In this period, global prices were falling so that this action supported domestic prices. The size of grain reserves is kept secret so it is not possible to assess demand and supply conditions. Inhibiting the free flow of information is anathema to the efficient functioning of competitive markets. The government's immense purchase of grain is inconsistent with its privatization and development of free markets in the agricultural sector of the economy.

The low productivity and income of the rural population is a legacy of the planned economy, which prohibited the free flow of labor and capital across regions. Currently, agriculture contributes only 11% of GDP while employing over 40% of the labor force. The government uses subsidies and pricing policies that marginally increase farm income in the short run. But, the long run effect is to keep farmers entrenched in low-income grain production.

In the last several years, China's supported grain prices have been above global prices. Consequently, grain exports have fallen. Intent on supporting China's production of grains (wheat, corn, rice, cotton and soybeans), the government purchased large quantities for its reserves. China was tempted to raise grain tariffs but this would have been a violation of its WTO commitment to keep tariffs below 3% (Gale, Wohman and Twan). China needs to introduce greater freedoms and flexibility in its grain policies to improve its international competitiveness.

3. The Economies of Convergence

The Solow-Swan growth model demonstrates that regional (and country) differences in per capita income are largely the result of differences in the capital-labor ratio (K/L). Higher K/L ratios produce higher growth rates in per capita income over regions and the opposite is true for lower ratios. Given factor mobility, labor will migrate to capital rich regions and capital will move to labor rich regions. Factor mobility across sectors will speed the rate of convergence. Studies have shown that this convergence pattern has occurred among the states of the US and the countries comprising the Common Market (Sachs and Warner).

The path of convergence also depends on a host of other factors: technology, skilled labor, foreign direct investment (FDI), resource endowment, government restrictions and so forth. Generally, convergence is faster and more effective in regional sectors that are linked by open trade and factor mobility (Jian, Sachs and Warner). Many of the forces of convergence are repressed in socialist economies. In China, restrictions imposed on the movement of labor and favoritism shown to state owned enterprise (SOE) reduces the self-correcting forces of free markets. Constraints against unregistered migration from rural to urban areas are not currently as restricted as they were before 1980. Still unregistered migrants may lack access for their children to schools and medical services.

4. Regional Income Inequality

There is a huge difference in the economic well being of urban versus rural and coastal versus inland residents. Substantial income growth occurred in eastern, southern and northeastern China. Very little development occurred beyond Chongqing into central China or further west. Since 2000, eight provinces accounting for 40% of the population have generated 75% of the growth in GDP. In 2006, Shanghai had a per capita income of \$15,000 while Guizhou's per capita income was a mere \$1,247 on a purchasing power parity basis (Reuvid, p. 55).

China is divided into 30 provinces. These provinces can be aggregated into three regions: North Coastal, South Coastal, and Interior. The North Coastal Provinces (Including Shanghai, Tianjin, and Liaoning) have the highest income levels. The South Coastal regions (e.g., Guangdong, Fujian and Zhejiang) are next. The Interior provinces (e.g., Shaanxi, Shanxi and Ningxia) have considerably less income (Jian et al.)

5. Reform to Help Rural Residents

In 2002, the 16th NCCPC (National Congress of Communist Party of China) established policies to raise the income of farmers and improve the efficiency of agriculture. Over the next several years the CPCCC (Communist Party China Central Committee) introduced initiatives to:

- (1) give priority and provide greater assistance to less developed areas;
- (2) expand employment opportunities and enhance public services such as, education and medical care;
- (3) reform onerous rural farm taxes; the overall burden on farmers was reduced from 8.4% to 6% (Chen, p. 125);
- (4) provide a substantial agricultural subsidy program for farmers which was introduced in 2004; by 2008, farmers received RMB 1 to billion (Xie, 2008);
- (5) make significant increases in rural basin infrastructure, e.g., electric, utilities, highways, and water and biogas utilities.

In 2006, the rural residence population was 949 million. About 230 million of rural laborers were working in urban areas (Chen, p. 134). China's farms are much too small to operate efficiently. Combining farms, farming cooperatives will release millions of laborers. How to employ the released labor is a long term and monumental problem that must be solved by the government.

6. Summary

Consider the following equation and its major component parts:

$$Y = C + I + G + \text{Exports} - \text{Imports} \quad (1)$$

Where Y = Gross Domestic Products (GDP or Income)

C = Consumption

I = Investment (Domestic and Foreign)

G = Government Expenditures

China's growth was largely fueled by government expenditure in heavy investment, infrastructure, resource development and residential and commercial real estate. In the 1980's consumer spending exceeded 50 percent of GDP. However, by 2009, consumer expenditure dropped to 30% of GDP as government spending for infrastructure and the export industries overwhelmed residential consumption.

In the most recent five-year plan, nonfarm workers are scheduled to receive wage increases of up to 15 percent annually for the next five years. This is projected to increase consumer spending to 45 percent of GDP. This would represent an increase in consumer spending of \$540 billion. In terms of Eq. (1), consumption (C) will play a greater role in the growth of GDP and this will produce a more balanced and sustainable growth path.

7. Conclusion: Rebalancing the Pattern of Growth

The current 11th Five Year Plan recognizes the following imbalances in past growth strategies: (1) heavy reliance on investment and efforts at the expense of domestic demand; (2) emphasis on heavy industry over services; (3) increases in income disparity between urban and rural areas and between inland and coastal provinces; and (4) large differences in access to social, medical and educational services.

The global crisis of 2008-2009 affected China's economy via exports, foreign domestic investment (FDI) links and the real estate market; China adopted a huge stimulus plan to counter the depression effect of the international crisis. As a result, China's economy grew 8.7% in 2009 (World Bank China, Research Working Paper No. 9). The stimulus was composed of infrastructure spending, tax cuts, consumer subsidies, and transfer payments. Also, substantial loans to local governments were made for infrastructure projects. The share of total new lending going to residents; e.g., mortgages, increased from 14% in 2008 to 26% in 2009. Policy makers stress that future growth should be driven more by consumption and that the benefits of prosperity should be more evenly shared.

There needs to be a reallocation of resources to sectors that have been shortchanged or ignored. Financial sector reform is needed to improve access to funds by private enterprises, particularly service firms and small-size firms. In addition to financial reforms, adjustments are needed in prices and taxes to eliminate the subsidization of industrial (capital) inputs. Also, the dividend policy of state-owned-enterprise (SOEs) must be revised to achieve a more efficient allocation of investment funds. Finally, restrictions of private firms to enter the service sector should be revised.

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