

When only economic growth cannot reduce income inequalities: the case of China

Topic: Income Distribution in Input-Output: Applications of Miyazawa's Model

Author: M^ánica SERRANO

Income inequality is a challenge problem that strongly affects the economy and society. The impact is strong, significant, and wide (Dabla-Norris et al., 2015). Based on a long-time span analysis for OECD economies, Cingano (2014) shows that income inequality has a negatively and significant impact on economic growth and retards the human capital accumulation of those countries in the bottom group also affecting education (Comfort et al., 2001) and health levels (Chetty et al., 2016).

Being the largest developing economy, China faces inequality problems more mixed and deeper than developed countries. The Chinese inequality magnitude has been dramatically increasing since the marketization reform in 1978. According to Piketty et al. (2019) the top 10 percent income share increased up to 41%, while the bottom 50 percent decreased a 15% from 1978 to 2015. The analysis shows China's inequality level approaches that of US, even though its level was close to that of Nordic countries at the very beginning of the period. This trend implies that China's income inequality has been increasing with its economy grows for the last decades, reaching a GINI coefficient ranged between 0.53 and 0.55 in the period 2005-2012 (Yu & Xiang, 2014). Results by Yu & Xiang (2014) rank China's income inequality among the highest in the world, being significantly driven by structural factors such as regional disparities and the rural-urban gap. Evidence from Young (2013) shows that the urban-rural gap accounts for about 40% of country inequalities generally, and people migrating from rural hometowns to urban regions are likely to earn more wages. This conclusion is in line with Yang (1999), which decomposes inequalities in two Chinese provinces and finds the urban-rural income differences occupies a large share of total inequalities. The literature suggests the necessity to get deeper insights into China's urban-rural income gap, also considering regional differences.

Theoretically, individual income is affected by three components: remuneration of primary factors (labour and capital), through the effect of relative prices in consumption, and government interventions. The first one, the remuneration of primary factors, is key in China's distribution system today. After the abolishment of planned economy system labour supply, capital investment, intellectual properties, etc. are all legally permitted to get involved in production activities, although there still are some restrictions due to Chinese political system. The second factor, changes in relative prices, has a statistically significant impact on income inequality (Slottje, 1987). Third factor, goals of government interventions are achieved via taxation and subsidize or even other redistributive policies. By adjusting the tax rate and relocate tax revenues to those in need, the government can proactively intervene the distribution process.

As discussed, urban-rural income inequality in China has been long-existing, impose negative impact especially on the welfare of those living in rural areas with low income and impairs the long-run growth. Specially, this gap problem is closely related with regional disparities for levels of development of over the provinces in China that differ largely.

In this context, this paper aims at analysing to what extent China's economic structure might downsize the existing urban-rural income gap in Chinese provinces. The paper seeks the interdependence between income, consumption, and production, to see if marginal increase of labour compensation stimulated by new production needed to satisfy additional consumption is large enough to eliminate the divergency trend. The geographical distribution of production (income generation) and consumption processes makes interrelationship occurs in different regions, linking

the increase of one product consumption by one household-type in one region with the labour compensation (income generation through production) of another household-type that works in a different sector in another region.

This paper develops an income distribution model based in Miyazawa (1976) in a multiregional and multisectoral setting. The analysis combines income, consumption, and economic data for two-type of households (urban, rural), 31 Chinese provinces, and 42 economic sectors for China 2012. Results based on the country-level data suggest that extra consumption stimulated is not large enough to let the urban-rural income gap go down, while results based on the regional-level data lead to more detailed conclusion after taking regional disparities into consideration. Nonetheless, the current economic structure of China would amplify the urban-rural income gap if there is not any specific intervention from the government to redistribute income. It is advised to use a mix of tools including government interventions to help alleviate the urban-rural income gap in China today.