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Edited by Li Shi, Hiroshi Sato and Terry Sicular

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ONE

Rising Inequality in China

Key Issues and Findings

Li Shi, Hiroshi Sato, and Terry Sicular

I. Introduction

More than three decades have passed since China embarked on economic reform and began to transform its economy from a socialist planned economy to a market economy. During these decades China has experienced rapid growth in gross domestic product (GDP) and personal living standards. Growth, however, has been accompanied by widening income inequality. The rise in inequality has been documented in a wide range of studies by individual researchers, international organizations, and government agencies (Benjamin et al. 2008; Griffin and Zhao 1993; Gustafsson, Li, and Sicular 2008; Ravallion and Chen 2007; Riskin, Zhao, and Li 2001; World Bank 2009; Zhang 2010). The various studies give different estimates of the level of inequality, but the authors all agree that since the 1980s inequality in China has increased markedly.

In the context of China's reforms and ensuing rapid growth, it is not surprising that inequality has increased. Growth is often associated with early stages of economic takeoff, which usually begin in particular sectors and regions. As those leading sectors and regions pull ahead of others, income distribution becomes increasingly uneven. Transition from a socialist planned economy characterized by egalitarian wage and income distribution systems also generates inequality. Markets bring income variation arising from risk and uncertainty, and they differentiate among households and individuals based on productivity, human capital, effort, entrepreneurship, and wealth holdings. In a market system, such sources of inequality can play a positive role in providing incentives for innovation, risk taking, effort, and investment.

Although rising inequality is associated with initial stages of growth and transition, it need not continue indefinitely. As an economy develops

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and matures, growth can spread through various linkages to other sectors and regions (Hirschman 1958). Employment can then expand, leading to rising wages that spill over more broadly, and the benefits of growth can spread. Growth can also make possible improvements in health and education. Government policies potentially play an important role here by strengthening positive linkages among sectors and regions and by investing in health and human capital in ways that promote equality of opportunity. Thus, under the right conditions, ongoing growth can be accompanied by a moderation of or a decline in inequality.

In the context of economic transition, whether or not initial increases in inequality are followed by a moderation or a decline in inequality also depends on country-specific factors. Milanovic and Ersado (2008), using data from twenty-six post-Communist countries in Europe and Central Asia, examine the impact of different components of economic transition on income inequality. They conclude that the relationship between transition and inequality depends on the nature of the transition process. For example, they find that large-scale privatization tends to have a dis-equalizing effect, whereas small-scale privatization tends to raise the income shares of the bottom deciles.

Differences in inequality outcomes among post-Communist countries to some extent may reflect the degree to which politically advantaged groups have benefited disproportionately, and whether their disproportionate benefits are structural and so persistent. Discussion of this issue in economic sociology is referred to as the “market transition debate” between the new institutional and the corporatist views (Keister and Borelli 2012; Nee and Oppen 2010; Walder 2003). According to the new institutionalist view, the development of markets causes the rewards for market-based performance (typically returns to human capital) to increase and the rewards for political capital to decrease. The advantages of political capital persist only in the shrinking state-controlled domain, although institutionalists do acknowledge that state intervention in the market continues in China. Corporatists argue that during the economic transition, state control becomes structurally embedded in the market. Politically advantaged groups reorganize and enhance their vested interests through rent seeking, monopolistic business activities, and the mobilization of social networks (social capital). As the existing literature and some chapters in this volume show, empirical evidence on this question is mixed and depends on the definition of the state domain, how human, political, and social capitals are measured, and what kind of outcome measures are used.

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This book examines inequality in China from 2002 to 2007, a period covering most of the first decade of the twenty-first century, up to but not including the World Financial Crisis. This period is significant in several regards. First, in the latter half of the 1990s, inequality-moderating processes had emerged, and China's income inequalities appeared to be stabilizing (Gustafsson, Li, and Sicular 2008). These trends raise the question of whether or not China had reached a turning point between growth with rising inequality and growth with stable or even declining inequality. Analysis of the trends during the 2002–2007 period provides an answer to this question.

Second, in the early 2000s China adopted a new development strategy. In the preceding decades, growth in the “productive forces,” that is, GDP and its underlying inputs, was the primary task, as reflected in a government policy agenda that deliberately and successfully promoted rapid GDP growth.¹ By the late 1990s, however, China's rising inequality had become a cause for concern. After Hu Jintao and Wen Jiabao assumed leadership in 2002–2003, these concerns were articulated and incorporated into official policy. The new development strategy, sometimes referred to as the “Hu–Wen New Policies” (*Hu–Wen xinzheng*) or the “Scientific Outlook on Development” (*kexue fazhanguan*), emphasized sustainable and equitable growth. With the new strategy came a set of policy measures designed to reduce disparities and to protect the economically vulnerable, including agricultural support policies, social welfare transfers, targeted tax reductions, minimum wage increases, and increased spending on poverty alleviation. The frequency of keywords such as “scientific outlook on development,” “harmonious society” (*hexie shehui*), “people's welfare” (*minsheng*), “integrated and balanced urban-rural development” (*tongchou chengxiang*), and “agricultural, rural, and peasant problems” (*nongye, nongcun, nongmin wenti, or sannong wenti*) in policy documents and Hu's and Wen's speeches reflect the direction of the new policies.²

Under the umbrella of this new development strategy, China's economy continued to grow rapidly; indeed, the size of the GDP pie roughly doubled in the ensuing decade. But what happened to the distribution of that pie? Did inequality continue to rise or was it moderated? Did the benefits of growth trickle down to the poor? Did the equalizing processes that had begun to

¹ See Jiang Zemin's report to the 14th National Party Congress, October 12, 1992, at <http://cpc.people.com.cn/GB/64162/64168/64567/65446/4526308.html>. Accessed June 3, 2012.

² See, for example, Hu Jintao's report to the 17th National Party Congress, October 15, 2007, at <http://english.people.com.cn/90001/90776/90785/6290120.html>. Accessed June 3, 2012.

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emerge in the late 1990s continue? Was the new “harmonious society” policy agenda able to influence the direction and pattern of inequality?

In this volume we address these questions from an empirical perspective through an analysis of household survey data. The data are from the China Household Income Project (CHIP), which provides a rich source of nationwide, household-level information about incomes and other variables. The CHIP surveys have been ongoing since the late 1980s, with data collected in four waves: 1988, 1995, 2002, and, most recently, 2007. Earlier waves of the CHIP surveys are the subject of three earlier books (Griffin and Zhao 1993; Riskin, Zhao, and Li 2001; Gustafsson, Li, and Sicular 2008) and have provided rich materials for the study of the development-transition-inequality nexus in China. Of particular note, and a motivation for the CHIP, is that these data sets allow fuller measurement of income and analysis at the household level. Analysis of the 2007 CHIP household survey data, with comparisons to 2002, is the main focus of this volume. Some chapters also examine trends going back to 1995 and 1988. Use of this common data source allows for comparability and consistency across chapters, even though the chapters examine different topics and use various approaches.

The first several chapters examine nationwide patterns of inequality. Chapter 2 provides an overview of nationwide trends between 2002 and 2007 in income levels, inequality, and poverty, with special attention to the contributions of the different sources of income, the urban-rural income gap, and inter- versus intraregional income differentials. Chapter 3 analyzes homeownership and its implications for the distribution of housing wealth and income. Here the contributors provide a detailed discussion of estimation of imputed rents from owner-occupied housing, a component of income that is included in CHIP income estimates used elsewhere in this book. Chapter 4 looks at inequality of education and its transmission across generations. Chapter 5 discusses incomes, inequality, and poverty in rural China, and Chapter 6 analyzes the impact of migrants and migration. Chapters 7 through 12 examine aspects of inequality in urban China, including but not limited to the roles of employment and unemployment, gender, ethnicity, the state sector, and the personal income tax.

A key finding that emerges is that inequality increased between 2002 and 2007. Thus, the stabilization of inequality in the late 1990s and early 2000s was temporary. Between 2002 and 2007 the benefits of growth were not shared equally: richer groups benefited more than did poorer groups. Nevertheless, we do not find evidence of many losers from the growth process during this period. Both the poor and the rich saw their incomes grow, and poverty declined markedly.

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The rise in inequality from 2002 to 2007 raises questions about contributing factors. To what extent did the increase in inequality during this period reflect a widening income gap among regions, or between urban and rural areas? What patterns of inequality arose within urban areas and within rural areas? How did the rapid expansion of migration during this period affect levels of inequality and poverty? What particular institutions or aspects of transition shaped trends in inequality? Were new policies such as the minimum living standard guarantee (*dibao*) program and tax adjustments effective redistributive mechanisms? These and other questions are investigated in the various chapters of this book.

In this introductory chapter we provide general background to set the stage for the chapters that follow; in addition, we draw out key findings and highlight some cross-cutting issues. We begin in Section II with an overview of the key redistributive policies adopted during the Hu-Wen period, to provide a policy context for understanding the inequality outcomes. In Section III we discuss the measurement and definition of income, and in Section IV we describe the main features of the CHIP data sets. Section V contains a discussion of the central findings that emerge from the collection of chapters. This is followed by a concluding section, Section VI, in which we reflect on the findings and identify areas for future research.

II. The Policy Context

In the early 2000s China adopted a wide range of policy measures that had implications for equity and income distribution. Here we discuss a selection of the policy measures associated with the Hu-Wen New Policies aimed at distributional concerns. Of course, other policies also had distributional consequences, for example, China's trade liberalization following accession to the World Trade Organization (WTO) at the end of 2001 and regional development programs such as the western development strategy (*xibu dakai fa zhanlüe*). Some of these and other measures are taken up in later chapters.

A. Social Welfare and Social Security Programs

In the prereform era, basic politico-economic units (urban work units and rural collectives) assumed the functions of social security. This institutional framework resulted in the absence of an independent social security system and a large urban-rural disparity in well-being that persisted after the reform. It was not until the 2000s that establishment of a coherent

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nationwide social welfare and security system was an important aspect of the party and government agenda, encompassing pensions, medical insurance, unemployment insurance, and minimum living standard guarantee programs.

Reform of the urban public pension system began in the early 1990s. Originally, it had been a dual-track system with different pension programs for enterprise employees and employees of public sectors (government, party, and other nonbusiness institutions). A substantial reform that established the basis of the current pension program for enterprise employees was implemented between 1995 and 1997 (Feng, He, and Sato 2011; He and Sato 2013). This reform introduced the Basic Pension Insurance Program for Enterprise Employees (*qiye zhigong jiben yanglao baoxian zhidu*), which changed the financing scheme from pay-as-you-go to a hybrid of pay-as-you-go and newly introduced compulsory individual accounts. The program applied to employees in all urban enterprises, including state-owned, privately owned, and foreign-owned enterprises. An important redistributive consequence of this 1997 pension reform was an increase in intergenerational inequality in pension benefits.³

Since 2005 the government has repeatedly raised the level of pension benefits for retired enterprise employees. These increases have been prompted by the disparities in postretirement well-being between employees of enterprises and employees in the public sector. The latter are part of a pay-as-you-go system, in which benefits have been increased more rapidly with the rapid growth of government revenue. Consequently, public-sector employees continue to enjoy high pension benefits upon retirement, a legacy of the prereform era.

In contrast to the urban areas, in rural areas responsibility for old-age security during much of the reform era has rested with the individuals and the family, except for the small proportion of elderly people entitled to *wubao* (five-guarantee program) or other social assistance programs.⁴ During the 2000s, the government experimented with some rural pension

³ A study based on the CHIP survey suggests that decreased expectations of pension benefits from the new pension program had the effect of raising the urban household savings rate, especially among the younger generation (Feng et al. 2011). Even though in late 2005 the method of calculating pension benefits was adjusted to make it more actuarial, the basic scheme of the 1997 reform remained unchanged.

⁴ The *wubao* program, which dates from the 1950s, provides social assistance for food, clothing, medical care, housing, and burial (and education for children). The elderly, handicapped, and minors who cannot work and have no family members/relatives to take care of them are entitled to *wubao*. The funds for *wubao* assistance came from the village collective (and township) until the rural tax and fee reform at the beginning of the 2000s,

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programs, but it was not until the late 2000s that a nationwide rural pension program formally appeared on the central government's agenda. In 2009 the State Council began a pilot program – the New Rural Social Pension Insurance (*xinxing nongcun shehui yanglao baoxian*) – which originally covered 10 percent of the counties, but has since been expanded.

Several chapters in this volume examine the distributional implications of these pension policies. Chapter 7 illustrates the role of pension income in inequality and poverty among urban residents, and Chapter 9 compares earnings, including pension income, among ownership sectors.

In the prereform era, urban residents were covered by either the Government Employee Health Insurance (*gongfei yiliao*) Scheme or the Labor Health Insurance (*laobao yiliao*) Scheme. Reform of urban medical coverage only began in the late 1990s. At the end of 1998, the State Council launched a new medical insurance scheme called the Basic Medical Insurance Program for Urban Employees (*chengzhen zhigong jiben yiliao baoxian zhidu*) (State Council 1999). In principle, this program covered all urban workers, including employees of enterprises and the public sector, private business owners, and self-employed people. In practice, coverage gradually spread during the first half of the 2000s. In 2007, to reach out to nonemployed urban residents such as students, the State Council introduced a complementary medical insurance program called the Basic Medical Insurance for Urban Residents Program (*chengzhen jumin jiben yiliao baoxian zhidu*). Although urban medical insurance covers a broader portion of the urban population than the public pension program, it should be noted that there exists a dual track for civil servants (*gongwuyuan*) versus other urban residents, and a great divide exists between urban residents with local household registration (*hukou*) and rural migrants.⁵

The most important progress in the medical insurance system in the 2000s was the launch of the New Rural Cooperative Medical Insurance Program

after which it was funded by fiscal transfers (see the revised regulations, in State Council [2006]).

⁵ In response, in 2009 the State Council issued an instruction to accelerate equalization of medical care. Regarding public servants, the State Council is to commence reform of the Government Employee Health Insurance Program from 2013. As for the divide between local urban residents and rural migrants, the 2009 instruction emphasized the need to improve interregional transfers of health insurance programs and to absorb rural migrants into medical care programs: the Basic Medical Insurance Program for Urban Employees for migrants with labor contracts, and the Basic Medical Insurance Program for Urban Residents or the New Rural Cooperative Medical System for other rural migrants. See “Implication of the Gradual Reform of Public Medical Care,” Social Security Inquiry Network, at <http://www.chashebao.com/yiliaobaoxian/8263.html>. Accessed February 6, 2012.

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(*xinxing nongcun hezuo yiliao baoxian*) in 2003 (Central Committee of the Communist Party and State Council 2002). Although a cooperative medical care system had operated at the commune level prior to the early 1980s, it had deteriorated after decollectivization. The New Rural Cooperative Medical Insurance Program was meant to fill the vacuum of medical coverage in rural areas. This program differs fundamentally from the commune-based medical care of the prereform era. First, it is an individual-based voluntary insurance program. Second, the program is financed by subsidies from central and local governments as well as by contributions from participants. Third, it is operated at the county level and hence has a larger risk pool than the earlier commune-based scheme. Fourth, it focuses on in-patient care, whereas the prereform scheme focused on basic public health services, including preventive interventions (Wagstaff et al. 2009). Individual enrollments reached 86.2 percent in 2007 and 96.0 percent in 2010 (NBS, *China Statistical Yearbook* 2011, Table 21–21). Although the level of rural compensation is still very limited compared with urban compensation, the government's goal of establishing a basic medical insurance system in the rural areas has been achieved.

The development of an unemployment insurance program can be divided into two stages: from the latter half of the 1980s to the late 1990s and then the period thereafter. In 1986 and 1993, the State Council issued administrative regulations for unemployment insurance for employees who were “waiting for employment” (*daiye*). To cope with the rising number of laid-off (*xiagang*) urban workers who, due to the restructuring of state-owned enterprises in the late 1990s, kept their ties with the work unit, at the beginning of 1999 the State Council promulgated the Regulations for Unemployment Insurance.⁶ As a result of these regulations, employees began to make contributions for unemployment insurance, and therefore it can be said that an unemployment insurance program in China was launched at the end of the 1990s, even though the program still was not universal.⁷ In 2006, a pilot program to extend the usage of the unemployment insurance fund to cover social security for unemployed workers and to promote reemployment (e.g., a subsidy for social security fees and an interest subsidy for loans for business promotion) was undertaken in seven provinces/municipalities in the eastern coastal region (Lai et al. 2011). Chapter 7 in this volume provides

⁶ For the process of SOE restructuring in the late 1990s and its distributive impact, see Li and Sato (2006) based on a 1999 urban household survey that focuses on retrenched/unemployed workers.

⁷ For example, in 2007 less than 65 percent of the urban unemployed received unemployment benefits (NBS, *China Statistical Yearbook* 2008).

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further policy background regarding unemployment and a discussion of unemployment rates in the urban areas.

After several years of regional policy experiments, the minimum living standard guarantee (*zuidi shenghuo baozhang*, or *dibao*) system was established in the late 1990s in urban areas and in the mid-2000s in rural areas. The system provides income subsidies to reduce the disparity between the actual income of the poor and the minimum living standard guarantee line (*zuidi shenghuo baozhangxian*), which is set at the local level with reference to local costs of living and fiscal capacity.

The first pilot urban minimum living standard guarantee program was launched in Shanghai in 1993. By the end of 1996, pilot programs had spread across 101 cities. In 1997, the State Council ruled that minimum living standard guarantee programs be established by 1999 in all urban areas including county seats (State Council 1997). Based on the experiences of the regional pilot programs during the 1990s, in 1999 the State Council promulgated the national Regulations for Urban Minimum Living Standard Guarantees. The proportion of the urban population covered increased steeply in the beginning of the 2000s and stabilized in the latter half of the 2000s (see Table 1.1). It is noteworthy that from the mid-2000s, the central government began to take a comprehensive approach that was intended to combine the minimum living standard guarantee with other social policies, such as medical care, for the urban poor (Lei and Wang 2009).

The minimum living standard guarantee in rural areas also appeared on the policy agenda in the mid-1990s. However, it was not until 2007, almost a decade after that for the urban areas, that the State Council announced the nationwide establishment of the minimum living standard guarantee program for the rural population. In 1996, the Ministry of Civil Affairs issued an instruction to promote social security in rural areas. By 2003, 2,037 counties in fifteen provinces (approximately 70 percent of China's 2,861 counties) had introduced such a program. By mid-2007, all of the thirty-one provincial-level administrative units had implemented the program (Lei and Wang 2009). As shown in Table 1.1, the number of rural people receiving a minimum living standard guarantee increased markedly after 2005.

For a description of trends in the incidence of poverty estimated from the CHIP surveys and analyses of the effect of the minimum living standard guarantee system on poverty and inequality, see Chapter 2 (for China as a whole), Chapter 5 (for the rural areas), and Chapter 7 (for the urban areas). These chapters suggest that the minimum living standard guarantee programs in urban and rural China have had only a moderate effect on

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Excerpt

[More information](#)

10

*Li Shi, Hiroshi Sato, and Terry Sicular*Table 1.1. *Key indicators of redistributive public policies*

	1995	2000	2002	2005	2007	2010
<i>Public pension programs</i>						
Number of urban enterprise-sector workers participating in the Basic Pension Insurance Program for Enterprise Employees (million persons)	87.4	104.5	111.3	131.2	151.8	194.0
Participation rate in the Basic Pension Insurance Program for Enterprise Employees (%) ¹	50.0	49.7	48.6	51.2	54.9	64.2
Number of rural residents participating in the New Rural Social Pension Program (million persons) ²	–	–	–	–	(51.7)	102.8
<i>Medical insurance</i>						
Number of urban workers participating in the Basic Medical Insurance Program for Urban Employees (million persons)	7.0	28.6	69.3	100.2	134.2	177.9
Participation rate in the Basic Medical Insurance Program for Urban Employees (%) ³	4.0	13.6	30.3	39.1	48.6	58.9
Number of urban residents participating in the Basic Medical Insurance Program for Urban Residents (million persons)	–	–	–	–	223.1	432.6
Participation rate in the Basic Medical Insurance Program for Urban Residents (%) ⁴	–	–	–	–	36.8	64.6
Number of rural residents participating in the New Rural Cooperative Medical Insurance Program (million persons)	–	–	–	179.0	726.0	836.0
Number of counties that have launched the New Rural Cooperative Medical Insurance Program	–	–	–	678	2451	2678
Proportion of counties that have launched the New Rural Cooperative Medical Insurance Program (%)				23.7	85.7	93.8