Overview

The slowdown and in some years reversal of poverty reduction in China forcefully demonstrates that growth is not sufficient for combating poverty even if that growth is of unprecedented magnitude. Policy initiatives should take into consideration inequality, especially urban-rural disparity. This Policy Brief provides a summary of the research findings from UNU-WIDER’s project on Inequality and Poverty in China. It also offers policy recommendations for tackling the poverty-growth-inequality inter-relationships in the short- and long-run. In particular, it is suggested that the only long-run policy option for the Chinese government is to encourage urbanization.

Poverty Reduction in China: Is High Growth Enough?

Should growth or inequality be prioritized in the design and execution of development policies? An oft cited paper by Dollar and Kraay of the World Bank advocates growth as the primary objective of development. Opponents argue that growth may not be pro-poor, thus growth alone is insufficient for poverty reduction—the ultimate goal of development. They instead emphasize redistribution as an important policy instrument. From a practical point of view, most policies involve trade-offs between efficiency (i.e., growth) and equity, at least in the short-run. With this in mind, development strategists and policymakers face the challenge or dilemma: what should be prioritized in the design and execution of development policies?

To further complicate the matter, many channels exist through which growth may affect distribution in different ways. Meanwhile, growth and poverty outlooks depend on the current level and dynamics of inequality. The emerging literature on the inequality–growth nexus has produced conflicting findings. Clearly, more research is needed in order to better understand the poverty–growth–inequality (PGI) triangle, which states that any poverty change can be expressed as a mathematical function of growth and the variation in inequality.

Post-reform China represents a good opportunity for studying the PGI triangle. While growth in China has been hailed as a miracle and its impact on poverty is well-recognized, the efficiency-emphasizing but equity-ignoring development experience has lead to the fast rise of inequality along every dimension and must have contributed to the emergence of urban poverty and the slowdown, even reversal, of poverty reduction in China.

Needless to say, exploring the PGI triangle in China is important for a number of reasons. First, the alarmingly high level of inequality poses a threat to the sustainability of growth as it undermines China’s social and political stability, to say the least. Second, China’s growth prospects and inequality-related domestic demand have profound implications for other economies, particularly in terms of China’s...
huge trade surplus and ever increasing trade disputes. Finally, China’s PGI profile determines the global inequality and poverty scene and insights from this profile may help international organizations and other national governments in tackling poverty, growth, and inequality.

Despite the importance of PGI linkages in China, only limited literature exists, focusing on poverty or growth or inequality separately. In what follows, we summarize major findings from the UNU-WIDER project on ‘Inequality and Poverty in China’ and provide policy recommendations for addressing the PGI triangle.

**The PGI Triangle in China**

Despite the fact that China began its remarkable growth by dismantling the egalitarian system, it is found that inequality is harmful to growth no matter what time horizon (short-, medium-, or long-run) is considered, and that the growth–inequality relationship is non-linear. Conversely, growth and inequality are positively correlated, implying further rises in income inequality in China unless concerted policy interventions are instituted. Both income growth and favourable distributional changes can explain China’s remarkable achievement in combating poverty in rural areas in the first half of the 1990s. However, in the latter half of the 1990s, both rural and urban China suffered from rapidly rising inequality and stagnant income growth, leading to a slowdown in poverty reduction, and even to a reversal in the poverty trend.

As is well-known, poverty is much more prevalent in inland China. The most important contributors to the poverty difference between inland and coastal China are inequality and domestic capital. Consequently, policy measures to assist poor regions in accumulating physical capital and tackling within-region inequality are urgently needed. Moreover, globalization is found to work alongside and interacts with other poverty determinants. Therefore, the challenge is to keep close tabs on the circumstances at the local level and to ensure that globalization serves the poor.

Surprisingly, fiscal transfers in China are largely regressive. At the provincial level they exert little or regressive effects on inequality. At the household level, residents in the central and western regions received less social benefits of all types than those in the eastern regions. Also, important in-kind benefits—namely health and food in 1988 and education in 2002—were positively related to pre-tax pre-transfer income. The working poor (the near-bottom income groups) have not only fared poorly in earnings but have also been left behind with respect to social benefits.

Since growth has been positive throughout the post-reform era, the PGI triangle in China essentially hinges on the issue of inequality. It can be said that future reduction in poverty largely rests on the inequality trend. Although inequality has been rising along all dimensions in China, regional inequality is the pivotal component. Thus, it is crucial to identify fundamental determinants of regional

---

**About the Author**

**Guanghua Wan** is a Senior Research Fellow and project director at UNU-WIDER. An honorary professor of some leading universities in China, and a prolific researcher with over 50 analytical papers in top-class journals, he is a pioneer in developing the regression-based techniques for inequality and poverty decomposition.

In designing development policies, a dilemma or challenge is: should growth or inequality be prioritized as the primary goal?
inequality as far as PGI in China is concerned.

Broadly speaking, China’s regional inequality consists of two dimensions: the east–central–west divide and the urban–rural divide. The latter contributes a very large (over 70 per cent of the total) and increasing proportion to overall regional inequality. The fluctuations and increase in overall regional inequality, particularly since the early 1990s, is almost entirely attributable to the urban–rural gap. The east–central–west divide however only contributes some 30 per cent to total regional inequality and its contribution has been more or less stable since 1991, with the exception of 1996–98.

Regarding fundamental factors, globalization as represented by trade and foreign direct investment (FDI) variables is found to be among the most influential factors causing fast rises in regional inequality in China. The relative contributions of education, location, urbanization, and the dependency ratio to regional inequality have been declining although their absolute contributions have not. More interestingly, domestic capital is the largest and increasingly most important contributor to regional inequality. Uneven distributions of domestic capital, FDI, and trade account for almost 50 per cent of total regional inequality.

Not only is the stock of domestic capital important, capital is also less productive in less developed regions. While financial deepening helps promote economic growth in coastal China, this is not the case for inland regions where most financial indicators are insignificant in explaining growth. Further, the increase in regional inequality from the mid-1960s to the mid-1970s is mainly due to the contribution of total factor productivity (TFP) overwhelming that of physical capital. The opposite is true for the 1980s. The increase in the 1990s is mainly driven by the skewed distribution of investment in favour of the richer coastal provinces reinforced by the increasing contribution of TFP.

Policy Recommendations

It is clear that growth alone is insufficient for achieving the ultimate development goal. If unprecedented growth in modern China is not enough to combat poverty, it is simply unrealistic to expect achievement of the Millennium Development Goals in any other country without emphasizing distribution issues.

To tackle the PGI triangle in China, it is essential to target the urban–rural gap rather than the coastal–inland disparity as a first priority. China could only cut its regional inequality by some 30 per cent if the east–central–west disparities were eliminated. On the other hand, a drop of over 50 per cent could be achieved by eliminating the urban–rural gap. Clearly, a rewarding move is for China to target the rural areas in the poor west and centre of the country.

It is worth mentioning that to tackle the two major dimensions of inequality in China, the urban–rural and coastal–inland divides, the Chinese government launched an ongoing campaign of ‘western development’ in 1999, and the recent campaign of ‘building a new socialist countryside’. Neither of these, however, is likely to work. The bare fact that the specific targets of each campaign have not been met is a telling point.

Miracle growth in China has not been sufficient for poverty reduction since the 1990s, due to inequality increase along all dimensions.
The ultimate long-run solution to the poverty–growth–inequality triangle in China lies in moving 550 million rural residents into cities.
even without jobs, these new migrants can still survive without direct financial support from the government and they would certainly have a better quality of life in the cities than if they had stayed behind. Most importantly, as long as they are treated equally as urban residents in public education, their children and thus the migrant families would have a much brighter future.

Is it realistic for 100 million extra labourers to find jobs in the cities? The answer is yes; not least because the service sector in China lags behind the state of the overall economy. Settling the 400 million migrants permanently in urban China will stimulate the service sector, which is by its nature labour-intensive. How many jobs would be created remains unknown, if and when the service sector matches the development status of China. Critical issues that must be carefully addressed in this context include the economies of scale in urban development and agglomeration effects.

To minimize the social problems potentially associated with massive migration, a step by step procedure is necessary whereby migrants with long-term jobs or secure housing in urban areas should be given priority. Those with better education should also enjoy concessions. In fact, application for migration can be assessed using a scoring system, with demographic and other characteristics of all family members being taken into consideration. To ease fiscal pressure, new migrants may be provided with limited (phasing out) access to financial assistance in housing, education, health care, and other welfare provisions. Community colleges should also be set up in the cities to provide training and education to temporary and long-term migrants and their family members.

---

1 http://politics.people.com.cn/GB/14562/6928395.html
Endorsements

Inequality and Growth in Modern China, Oxford University Press

The chapters contained in this volume offer a comprehensive view of modern China’s experience with the triangle of growth, inequality, and poverty. They collectively provide valuable insights for other developing countries in the pursuit of inclusive growth strategies.

— Xianbin Yao, Director General, Regional and Sustainable Development Department, Asian Development Bank

Inequality in income and wealth, what causes it and how it affects the rest of economy, has become one of the key topics both in the economics literature and the popular press. This is because the last quarter century has witnessed a veritable exposition of inequality in almost all parts of the world. And perhaps nowhere has this exposition been as large as in China. Its impact there was ‘softened’ by remarkable economic growth. Yet as regional and class fissures, reminiscent of a long-gone era, reappear, the relationship between inequality and growth is rapidly becoming one of the top political issues in China. This book addresses different facets of China’s inequality—growth relationship, and will be a useful reading for China specialists as well as for those interested in inequality and growth as such since China is the largest laboratory where they can observe it.

— Branko Milanovic, Lead Economist, World Bank Research Department

Over the past three decades, China has made huge strides in its battle against poverty as it has transformed into one of the most dynamic economies in the world. It will be harder for China to maintain its past rate of progress against poverty without addressing the problem of rising inequality. The book Inequality and Growth in Modern China provides a useful overall assessment about inequality in China, focus on inequality in view of the growing concerns with rising inequality, the cause and impacts of rising inequality, and its relation to overall growth and poverty reduction. It will not only help policy makers understand the inequality in China—but also be a useful pedagogical tool for Chinese and other researchers.

— Shaohua Chen, Senior Statistician, Development Research Group, World Bank

This volume of high quality research resulting from UNU-WIDER provides an essential reference for scholars and students worldwide in their research and studies on growth and income inequality in modern China. The editor, Dr Guanghua Wan, is one of the world’s most productive and authoritative experts on the Chinese economy.

— Shujie Yao, Professor of Economics and Chinese Sustainable Development, and Head of the School of Contemporary Chinese Studies, University of Nottingham and Special Chair Professor of Economics, Xian Jiaotong University

The papers collected in this book come from leading scholars studying China’s inequality issues. It is a timely book. Rising inequality in China is well known; less well known are the linkages between various aspects of China’s economic growth strategy and inequality. This book offers fresh perspectives as well as solid evidence for a better understanding of these linkages. It is a valuable reference for scholars concerned with the relationship between economic growth and inequality as well as for students on China.

— Yang Yao, Deputy Director, China Center for Economic Research, Peking University

Over the past three decades, China has made huge strides in its battle against poverty as it has transformed into one of the most dynamic economies in the world. It will be harder for China to maintain its past rate of progress against poverty without addressing the problem of rising inequality. The book Inequality and Growth in Modern China provides a useful overall assessment about inequality in China, focus on inequality in view of the growing concerns with rising inequality, the cause and impacts of rising inequality, and its relation to overall growth and poverty reduction. It will not only help policy makers understand the inequality in China—but also be a useful pedagogical tool for Chinese and other researchers.

— Shaohua Chen, Senior Statistician, Development Research Group, World Bank
Understanding Inequality and Poverty in China: Methods and Applications, Palgrave Macmillan

The miraculous economic growth in China has, since the mid-1980s, been accompanied by rapidly rising inequality. This is slowing down poverty reduction and is tearing at China’s social fabric. Understanding the causes and implications of this rising inequality is thus critical. This volume provides the most up to date and thorough empirical analyses of these crucial issues by leading China scholars. It should be required reading for China scholars as well as policy-makers trying to address this worrying rise in inequality.

— Stephan Klasen, Professor of Economics, University of Göttingen; Director, Courant Center ‘Poverty, Equity, and Growth in Developing and Transition Countries’; Editor, The Review of Income and Wealth

The book gathers a fascinating collection of articles on various aspects of income inequality and poverty in China. This is applied economics at its best, with essential policy implications for the fastest growing economy in the world for the past quarter of a century.

— Jacques Silber, Bar-Ilan University; Founder and former Editor-in-Chief of the Journal of Economic Inequality

Author’s recent UNU-WIDER publications on Inequality and Poverty in China


‘Poverty, Pro-Poor Growth, and Mobility: A Decomposition Framework with Application to China’: pp. 250–70 (with Zhang Yin).


Author’s other recent publications


The World Institute for Development Economics Research (WIDER) was established by the United Nations University (UNU) as its first research and training centre and started work in Helsinki, Finland in 1985. The Institute undertakes applied research and policy analysis on structural changes affecting the developing and transitional economies, provides a forum for the advocacy of policies leading to robust, equitable, and environmentally sustainable growth, and promotes capacity strengthening and training in the field of economic and social policy making. Work is carried out by staff researchers and visiting scholars in Helsinki and through networks of collaborating scholars and institutions around the world.

INSIDE:
Policy Brief

“Poverty Reduction in China: Is High Growth Enough?”

A summary of project findings, including specific policy recommendations for tackling the poverty–growth–inequality inter-relationship.