

EC2374

Economy of Modern China

Semester II, 2009/2010



Sarah Y. Tong



Department of Economics

Topic 3 (cont) Rural Economy & Income Inequality

Achievements and challenges:

- Development and structural changes
- Rural organization & urban-rural divide
 - socialist dualism
 - rural to urban migration & urbanization
 - economic consequences
- Income inequality
- Rural industrialization
 - township & village enterprises (TVEs)

Rural Economy & Income Inequality

Development & structural changes

- general patterns
 - importance of primary sector declines
 - importance of secondary sector (mining, manufacturing, and construction) first rises, through “middle income” stage, then declines
 - importance of tertiary sector (services) rises
 - potential growth rates are at the maximum during the “middle income” stage

Development & economic structure

	%Agr/GDP		%Ind/GDP		%Serv/GDP		GDP growth	
	2000	2004	2000	2004	2000	2004	2000	2006
High Income	1.86	1.71	28.01	25.92	70.14	72.37	3.83	3.03
OECD	1.85	1.71	27.74	25.67	70.41	72.62	3.71	2.95
Non-OECD	2.01	1.71	35.05	32.92	62.99	65.40	6.45	6.04
Middle Income	9.70	9.59	36.31	36.05	53.99	54.36	5.53	6.47
Lower middle income	14.12	13.07	42.54	42.12	43.34	44.81	6.32	8.05
Upper middle income	6.21	6.81	31.40	31.21	62.39	61.98	4.91	5.01
Low income	26.44	21.78	26.32	28.28	47.24	49.94	4.00	7.98

Source: World Development Indicators, The World Bank

Rural Economy & Income Inequality

Development & structural changes

- causes
 - technological change => industrial deepening
 - % of intermediate goods and capital goods ↑
 - demand for business services ↑
 - early industries: food, textiles, chemical products
 - late industries: metals, machinery
 - incomes rise => demand changes
 - % of food in consumption ↓
 - % of manufactured goods & services ↑
 - income elasticity

Rural Economy & Income Inequality

Development & structural changes

- model structural changes

- a dualist framework

low MPL in the traditional agricultural sector

higher MPL in modern (industrial) sector

capital and investment

labors move from agriculture to industry

= > productivity ↑

- rural-urban migration stop when

agricultural income = expected urban income

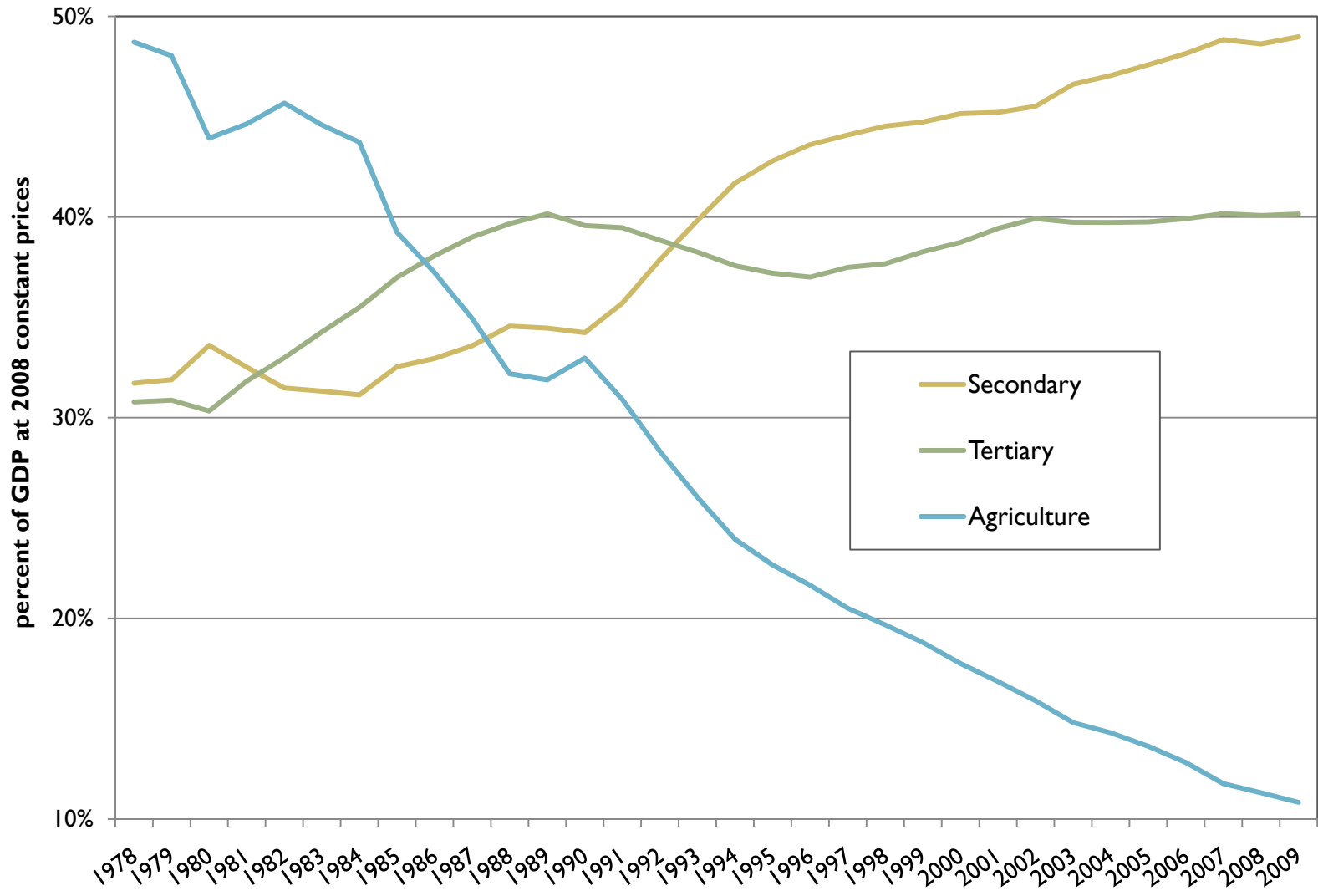
high urban unemployment; informal sector

Rural Economy & Income Inequality

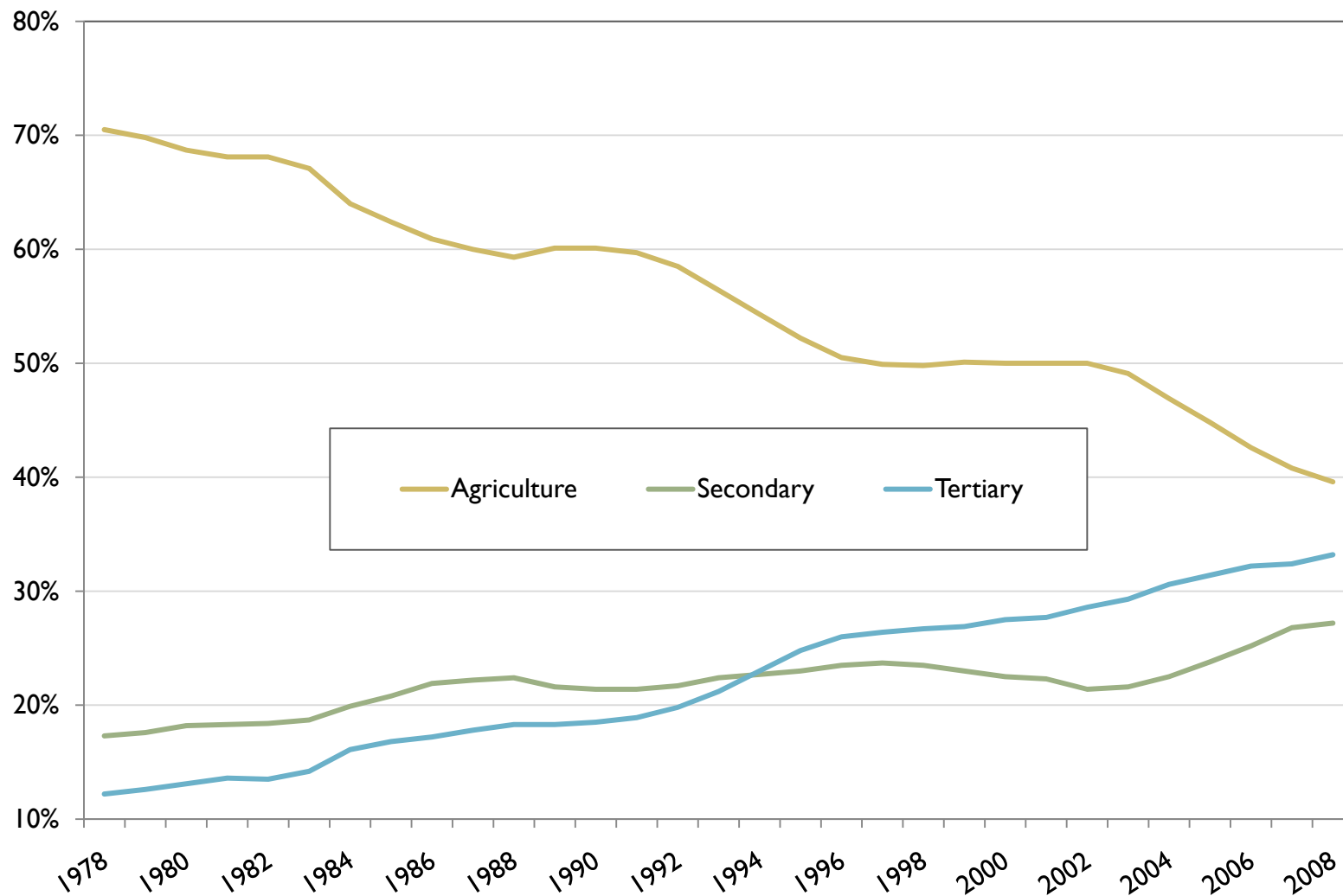
Development & structural changes

- Importance of rural China
 - Economic consideration
 - output: % in GDP (production and consumption)
 - employment
 - Political/social consideration
 - food security
 - social stability
 - social safety net

Composition of GDP



Structural change in employment



Rural Economy & Income Inequality

Urban-rural divide: an overview

- characteristic for developing countries
- unique features
 - the main source of China's income inequality
 - rooted in China's urban-biased economic/socialist policies
- early reforms substantially reduced the disparity
- the gap remain large & is widening in recent years

Rural Economy & Income Inequality

Urban-rural divide: China's *socialist* dualism

rural	urban
agricultural collectives	work units (<i>Danwei</i>)
local socialism – self-reliance for social insurance, etc.	high level of social protection and social services
low income	low income
massive surplus labor bottled up in agriculture	

Rural Economy & Income Inequality

Rural organization (pre-1978):

- Rural collectives:
 - households, villages, & communes
 - the “grain first” policy
- Household responsibility system
 - productivity and income
 - decline in public services

Rural Economy & Income Inequality

Urban-rural divide: China's *socialist* dualism

- big push industrialization
 - government's need to control resources
 - maintain low cost for urban residents
 - low agricultural price / high SOE (industrial) profit
 - restriction on labor mobility
- the *Hukou* system
 - GLP and migration restriction
 - strict restriction on R2U migration => social division

Rural Economy & Income Inequality

Urban-rural divide: China's *socialist* dualism

- urban *Danwei* (work unit) system
 - lifetime job
 - access to low price goods (food, edible oil, meat)
 - healthcare and childcare/school for children
 - low cost housing
- rural collectives
 - autonomous, subject to government guidelines
 - outside government system
 - no entitlement to government services
 - limited resources to subsidize goods & services

Rural Economy & Income Inequality

Urban-rural divide: China's *socialist* dualism

- is it fading away?
 - urban *Danwei* (work unit) system
 - relative importance diminished
 - “iron rice bowl” broken
 - services provided by market + government
 - rural collectives
 - self-reliance organizations
 - services provided by market + government
 - urban biased reforms
 - housing, healthcare, education, etc.

Rural Economy & Income Inequality

Urban-rural divide: China's *socialist* dualism

- is it fading away?
 - vanishing urban-rural divide
 - migration restrictions relaxed since 1980s
 - grain rationing is slowly phased out
 - Hukou* not needed to live in cities
 - *visible/invisible barriers remain*
 - Hukou* system remains
 - lower barriers for the educated & the rural rich
 - disadvantage in child education/healthcare
 - weak protection & vulnerable to labor abuse

Rural Economy & Income Inequality

Urban-rural divide: China's *socialist* dualism

- Seasonal & semi-permanent r2u migration
 - huge in numbers & is increasing
 - is it leveling off?
 - Characteristics
 - short-distance vs. long-distance migration
 - short-term vs. long-term migration
 - regional concentration
 - age & gender
 - pull & push factors

Rural Economy & Income Inequality

Urban-rural divide: China's *socialist* dualism

- Urbanization as the solution
 - what (kind of) urbanization?
 - administrative division
 - enlarge existing cities vs. developing new small cities
 - urbanization often accompanies industrialization
 - China's urbanization lags behind
 - job creation
 - provision of social service
 - farm land & food security

Rural Economy & Income Inequality

Income gap:

- Main components
 - regional gap:
between coastal and inland regions
 - rural-urban gap
the key component
 - within rural and within urban income inequality

Rural Economy & Income Inequality

Income gap:

- Rising gap & its consequences
 - earlier reforms: pro-agriculture/rural
reduced rural-urban gap
 - income gap rose since late 1980s
continued restrictions on mobility
reforms are more pro-industry/urban
WTO membership that intensified import competition
 - economic/development consequences
insufficient domestic demand
inconsistent with long term development objectives

Rural Economy & Income Inequality

Income gap:

- Earlier reforms reduced the gap
 - main policies
 - increase of agricultural procurement prices
 - give the collectives autonomy for self-management
 - household responsibility system: contract land
 - outcome
 - output growth: grain production, cotton, oilseed, & meat
 - higher labor productivity
 - free up labor to move into non-agricultural activities

Rural Economy & Income Inequality

Income gap:

- Recent efforts to reduce gap
 - new policies to protect & boost rural income
 - abolish agricultural tax
 - subsidy to grain growers
 - increase agricultural productivity
 - government provision of public services
 - infrastructure
 - subsidized medical plan
 - free/compulsory primary education
 - other measures
 - investment: eg. *go west* campaign
 - minimum living allowance

Rural Economy & Income Inequality

Rural industrialization:

- TVEs as a unique development phenomenon
 - related to China's economic tradition:
rural non-agricultural activities in pre-industrialization
 - originated from rural collectives
 - prospered between mid-1980s and mid-1990s
 - as an organizational form largely disappeared since late 1990s
restructured, transformed, or disappeared

Rural Economy & Income Inequality

Rural industrialization:

- Origins of TVEs
 - rural non-agricultural activities in China's traditional economy
 - 1950s, collectivization led to de-industrialization
 - 1970s state-sponsored rural industrialization
 - “commune and brigade enterprises”
 - “serve agriculture”: producer goods

Rural Economy & Income Inequality

Rural industrialization:

- Expansion of TVEs during mid-1980s to mid-1990s
 - the most dynamic part of the economy
grew by 30% a year between 1978 & 1996
 - crucial to absorb rural surplus labor
employment: 28 mil in 1978 => 135 mil in 1996
 - important in transforming the economy
raised rural income => reduced urban-rural gap
created competition for SOEs
contributed to trade expansion (labor intensive industries)

Rural Economy & Income Inequality

Rural industrialization:

- Factors behind TVE's rapid expansion
 - comparative advantage
 - cheap surplus rural labor
 - less access to cheap subsidized credit
 - entry barriers lowered
 - still highly profitable
 - niche markets (buttons, ribbons, building materials)
 - TVEs as collectives are readily acceptable

Rural Economy & Income Inequality

Rural industrialization:

- Factors behind TVE's rapid expansion
 - favorable institutional framework
 - support from local governments: owners/stakeholders
 - employment creation & government revenue
 - lower taxes
 - local bank capital
 - local credit institutions
 - proximity to key market
 - urban coastal cities
 - markets in Southeast Asia

Rural Economy & Income Inequality

Rural industrialization:

- TVE's restructuring post mid-1990s
 - background
 - govt's efforts to improve markets and regulatory institutions
 - market integration & more intensive competition
 - macroeconomic policy (banking)
 - recognition of private ownership mid-90s
 - restructuring & privatization
 - drop in TVE's employment share (of collectives): 50% in '95, 10% in '04

Rural Economy & Income Inequality

Rural industrialization:

- Recent development & its limitations
 - need to adapt to a more open/competitive environment
 - weaker ties to local governments
 - more inter-regional
 - the emergence of ‘industrial clusters’
 - large number of small firms
 - intense competition
 - fine division of labor among different production stage
 - strong export orientation
 - constrained by their rural-ness
 - lacks in physical, institutional and social infrastructure

Rural Economy & Income Inequality

Concluding remarks:

- Rural urban gap the main source of inequality
 - Acceleration urbanization
Policy relaxation
 - Equalizing public services between rural and urban China
Integrated rural-urban development
 - Reducing rural-urban as well as regional gaps
Restructure central-local fiscal relations