

Income Inequality in China's Emerging Economy and Its Interaction with China's Growth Pattern

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Abstract

Over the last two decades, China has become an emerging country with remarkable economic growth in the world. Along with the highly-speed industrialization, China has encountered the problem of income inequality. The rising of income inequality has noticeable influence on the development of the country from both economic and political dimensions. The interaction between the situation of income inequality in China and the Chinese growth model is the concentration of this paper, with an aim to develop a more sustainable economic growth model in which the income inequality could be reduced.

1. Introduction

The issue of income inequality has attracted increasing attention and has been gradually linked to the issue of growth and development especially after the financial crisis. Interest has been renewed in the issue of “whether and how income and wealth inequality interact with production and growth” (Bertola, Foellmi and Zweimüller, 2006, pxi) Countries in the global north attach increasing importance to the interaction between income distribution and economic growth with the aim to figure out the way for the recovery from the Great Recession since 2009. However, the issue of income inequality and economic development in developing countries also deserves to the academic attention, especially for the developing countries with emerging economic growth, such as China, Brazil, South Africa and India. While most industrialized nations in the global north are suffering from the slow economic growth because of the Great Recession, these countries have experienced remarkable economy development along with rising income inequality, especially China.

Therefore, the research on the interaction between income inequality and economic growth regime in the emerging economy could be a very valuable perspective for the study of combating inequality, and also could provide some inspiration for developed countries to rethink their development pattern.

When it comes to that issue in China – one of the emerging countries, the most important explanation should be connected to the growth pattern after its reform. With no doubt, China is the typical representative for high economic growing countries in the world. Since the opening-up reform started in the late 1970s, China has experienced dramatically rapid economic growth, with real annual gross domestic product (GDP) growth averaging nearly 10% through 2012 (Morrison, 2013). However during the process of reform, China has experienced a significant rise of income inequality which has been documented in numbers of research and study. Most studies discuss the income distribution in China by concentrating on the rural-urban inequality, the costal-inland gap, the unfair governmental policy on inequality as well as inequality and poverty. (see Luo and Zhu, 2008; Benjamin, Brandt, Giles and Wang, 2005) Relatively, there is little research on income inequality in China through the functional income distribution, wage dispersion and personal income distribution at the macroeconomic level.

Therefore, the interaction between the situation of income inequality in China and the Chinese growth model is the concentration of this paper, with an aim to develop a more sustainable economic growth model in which the income inequality is also required to be reduced. Firstly, the current situation of income inequality in China is presented through factors of income distribution in China, including functional income distribution, wage dispersion, household and personal market income distribution as well as household disposable income distribution. Throughout this analysis, one can find out that income inequality in China has been increasing during the period of reform. Then the growth model of China and its interaction with income

inequality is identified. The current growth of China is greatly driven by the investment and export with low power of domestic consumption, which could be seen as the key characteristics of the profit-led regime. Under this profit-led growth regime, little attention is paid on the income distribution. Meanwhile, this growth model is not sustainable for the country. So in the next part, a new wage-led growth regime would be added to the current growth model of China, in which the aggregate demand is more driven by rising wage share. It can be seen as a more sustainable growth regime and could reduce the income inequality at the same time. Under this growth logic, policies in labor market like minimum wages and wage bargaining along with the government policies in income distribution should be developed and improved. Also the strategy of trade union in this regime would be analyzed, especially in the field of collective bargaining and minimum wages policy.

2. Income inequality in China

Comparing to other countries, there is great absence of the data on factors of income distribution in China. For instance, the global wage database of ILO, almost including all the countries in the world, lacks the wage dispersion information of China. Another example the in the research of OECD database, a variety of data on China's income distribution like household disposable income distribution is difficult to find. This probably because the lack of information or different measurement standard of the China's Bureau of Statistics (NBS). However, a rapid increase in disparities of income distribution was observed during these decades. China has changed from a country with a fairly even income distribution into a country with wide income disparities. (Han, 2004)

2.1 Functional income distribution

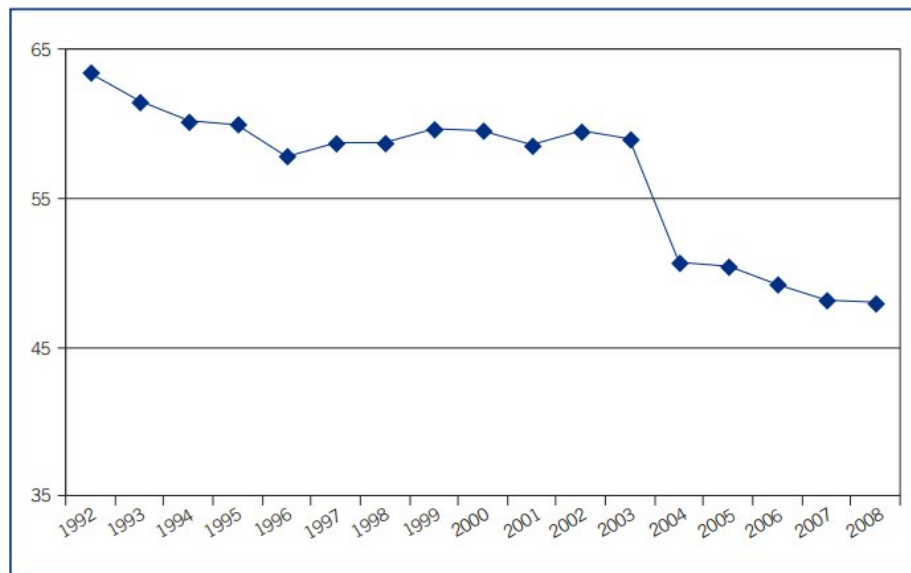
There is consensus that most countries including industrialized countries and developing countries has experienced a decreasing labor's share in the total economy, especially after the implementation of the neoclassical policy. For the declining labor share in industrialized countries, many studies give the explanation on the globalization (Heshmati, 2003; Segal, 2006; Adams, Jr, 2002). As the argument in the neoclassical view, the relocation of labor-intensive industry in developing countries depresses the labor demand in developed countries and results in decline of labor share in these countries. Apart from industrialized countries, China as one of the emerging developing countries in the world also experiences sharply increasing of income inequality.

According to the Figure 2.1 from ILO global wage report, the unadjusted labor income share in China from 1992 to 2008 shows a declined tendency in general. The unadjusted labor income share reduced rapidly in the first five years from nearly 65 to approximately 57 percentages. After frequent fluctuation during the year 1996 to 2003, it abruptly dropped to roughly 50 percent in 2004 without changing the total trend of decrease. The sharp decrease of labor income share is explained by the changes in accounting methods since 2004. The income of self-employed individuals in non-agricultural sector has been counted as capital income, which was counted entirely as labor income before 2004. At the same time the surplus of state or collective farms began to be counted as labor income. During the period from 2004 to 2008, the unadjusted labor income share in China was still in the downward direction decreasing to nearly 48percent in the year of 2008.

Figure 2.2 reveals the total labor income share throughout the reforming period in

China. No matter the labor income share of GDP or the labor income share of all factor income, they are both in the general tendency of decline with a light increase from 1978 to approximately 1984, gradual decline with fluctuation to about 1999 and then with a remarkable decreasing from 1999 to 2007.

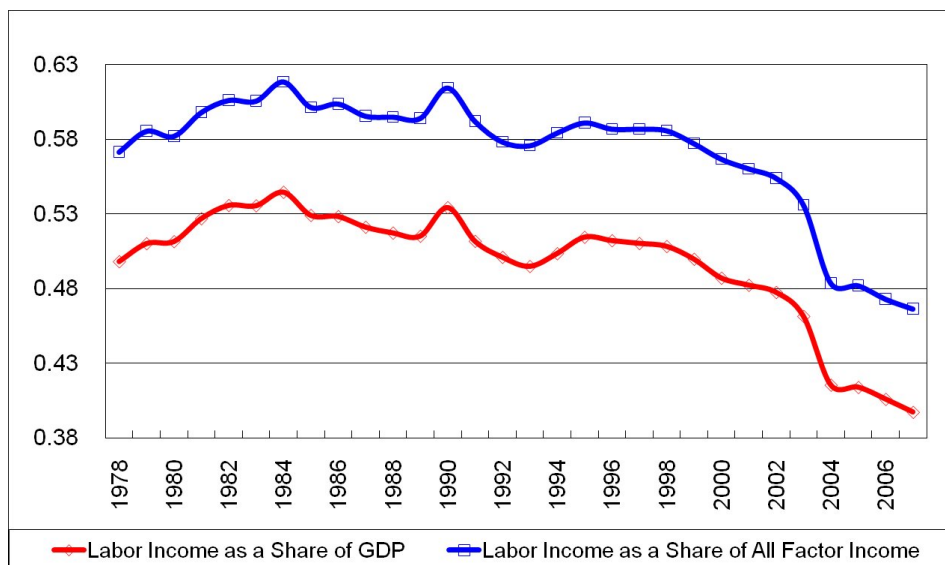
Figure 2.1 Unadjusted labor income share in China, 1992-2008



Note: The unadjusted wage share is calculated as total labour compensation of employees divided by value added. The sudden change between 2003 and 2004 likely reflects an adjustment to the data; nonetheless, it does not change the direction of the trend.
Source: ILO calculations based on data from the *China Statistical Yearbooks*, <http://www.stats.gov.cn/english/statisticaldata/yearlydata/> [accessed 17 Sep. 2012].

Source: ILO Global Wage Report 2012/13

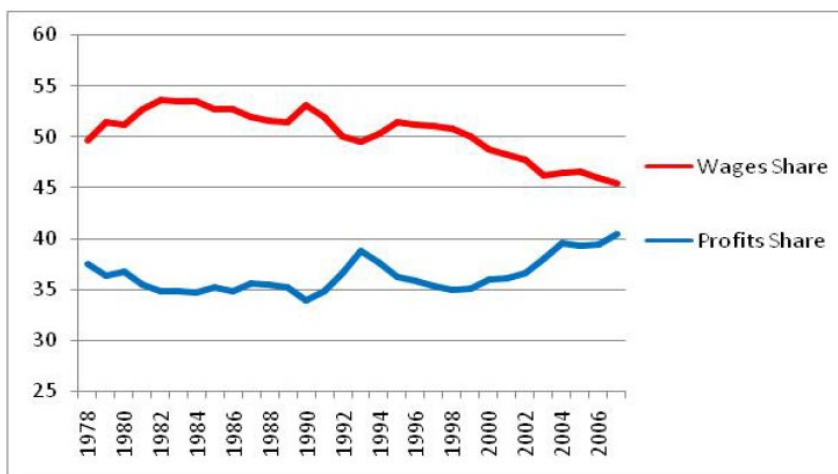
Figure 2.2: China's labor income share from 1978 to 2007



Source: Simarro. (2011) Functional Distribution of Income and Economic Growth in the Chinese Economy, 1978-2007

Contrary to the profit share in the economy, the drift of wages share in China keeps in the downward direction since the beginning of the economic reform. (Figure 2.3) The rate of decline started to speed up from the year 1995. This is one result of the regime of profit-led growth in China

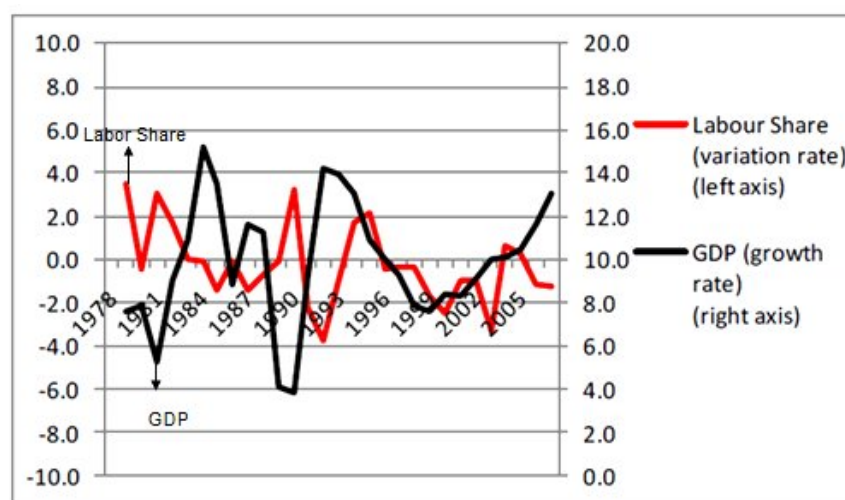
Figure 2.3 China's primary distribution of income 1978-2006



Sources: Simarro. (2012). Primary Distribution, Top Incomes and Inequality in China, 1978-2007

Besides, when we put the decreasing labor income share and the rising GDP in China together (See Figure 2.4), the labor share and the GDP growth rate in China seems inversely correlated in general especially during the time between 1978 and roughly 1996. Although the absolute values of wages roughly tripled over the last decade, GDP increased at a faster rate than the total wage bill, which could be one reason on the going down of labor income share. (ILO Global wage Report 2012/2013) This also indicates the GDP growth in China is driven mostly by profit in stead of the wage-led.

Figure 2.4 Labor's share and growth evolutions in China, 1978-2007



(percentage of GDP)

Source: Simarro Ricardo Molero. (2011). Functional Distribution of Income and Economic Growth in the Chinese Economy, 1978-2007

Figure 2.5 Direction of effects of a 1% decrease in labor income share on private consumption of domestic goods and services, investment and net exports in 16 economies

	Private consumption	Investment	Net exports
Euro area-12	\ (-0.439)	/ (0.299)	/ (0.057)
Argentina	\ (-0.153)	→ (0.015)	/ (0.192)
Australia	\ (-0.256)	/ (0.174)	/ (0.272)
Canada	\ (-0.326)	/ (0.182)	/ (0.266)
China	\ (-0.412)	→ (0.000)	/ (1.986)
France	\ (-0.305)	/ (0.088)	/ (0.198)
Germany	\ (-0.501)	/ (0.376)	/ (0.096)
India	\ (-0.291)	→ (0.000)	/ (0.310)
Italy	\ (-0.356)	/ (0.130)	/ (0.126)
Japan	\ (-0.353)	/ (0.284)	/ (0.055)
Mexico	\ (-0.438)	/ (0.153)	/ (0.381)
Republic of Korea	\ (-0.422)	→ (0.000)	/ (0.359)
South Africa	\ (-0.145)	/ (0.129)	/ (0.506)
Turkey	\ (-0.491)	→ (0.000)	/ (0.283)
United Kingdom	\ (-0.303)	/ (0.120)	/ (0.037)
United States	\ (-0.426)	→ (0.000)	/ (0.037)

Source: Global Wage Report 2012/2013 – International Labor Organization

The changes of labor share have different effects on the various elements of macro economy such as private consumption, investment and net exports. According to the statistics from ILO (Figure 2.5), 1% decrease in labor income share could lead to 41.2 percent decline in private consumption. China has experienced sharply decreasing of labor income share as discussed above; it is not difficult to estimate the decrease of private consumption on domestic goods and services. On the other hand, 1% decrease in labor income share could bring about 1.986 percentage rising in the net exports which has been strongly emphasized by the export-led growth strategy. The decrease of labor income share implies lower unit labor cost meaning the increase of competition advantage comparing other exporting countries. That could explain why the GDP still grows rapidly with the decline of labor income share at the same time. (World Bank, 2012)

2.2 Wage dispersion

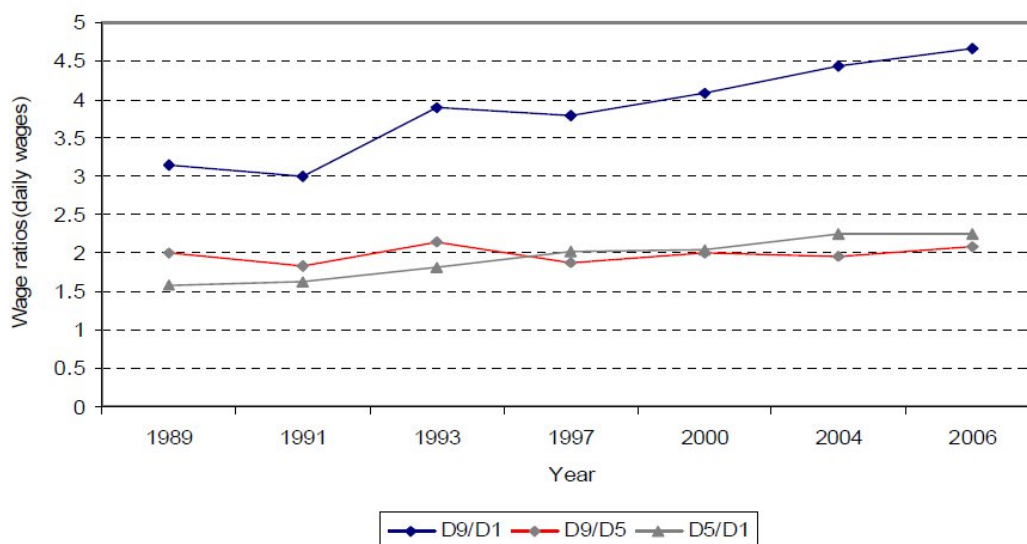
There is no sufficient data on the wage dispersion in China. From the national statistic database of China to the world wage database and the ILO global wage database, there is lack of information about the wage dispersion in China. One reason would be the difficulty of measurement because of the huge existence of unregistered employment. Another reason could be only wages of urban workers are calculated in the official data collection, so it is hard to give a clear identification on the overview of wage dispersion in China. Fortunately there is still some estimation from the former research.

The wage dispersion within country is commonly measured by D9/D1 ratio which presents the wage gap between the D9 denoting the upper limit of the 9th decile in the wage distribution (or the lower limit of the top decile), and D1 (the upper limit of the bottom decile). (ILO, Global Wage Report, 2008/09). Thus D9/D1 refers to the wage of the 10% best-paid workers to those of the 10% least-paid workers, calculated as the ratio of the upper bound value of the 9th decile to the upper bound value of the 1st decile. D9/D5 refers to the ratio of wages of the 10% best-paid workers to those at the median of the earnings distribution. In the same sense, D5/D9 is the ratio of the wages of the workers at the median of the earnings distribution to those of the 10% last-paid worker. (OECD, 2011)

In Figure 2.6, the wage dispersion between the three comparing groups all experiences a rising tendency in general, which indicates the widening wage gap in the 17 years. Firstly, the wage disparity between top 10 percentage wage earners and the bottom 10 percent wage earners stays in the higher level with highest rate of rising throughout the period comparing to the other two groups of data. With a little fluctuation in the previous years, it started to grow up rapidly in 1997 and peaked to over 4.5 in 2006, from which an increasing trending in the following years can be predicted. This means, the daily wages of the top 10 percent wage earners is over 4.5 times of the daily wages of the bottom earners. Secondly, the gap between D9 and D5

went up and down around the ratios of 2 from the year of 1989 to 2006 with the highest ratio of about 2.2 in 1993 and the lowest at approximately 1.7 in 1991. It is observable that the wage dispersion between the top group and the medium group did not change too much in general. Besides, the gap between D5 and D1 widened gradually from a little more than 1.5 in 1989 to about 2.3 in 2006. It can be identified that with the increasing of wage income during these years, the wage dispersion is enlarged from 1989 to 2006 in which the gap between the top and the bottom widens the most with stable difference between the top and the medium group. In other words, accompany with the rapid economic growth, the wage inequality in China trends to deteriorate within the wage-earning labor.

Figure 2.6: Trends in decile ratios in China, 1989-2006

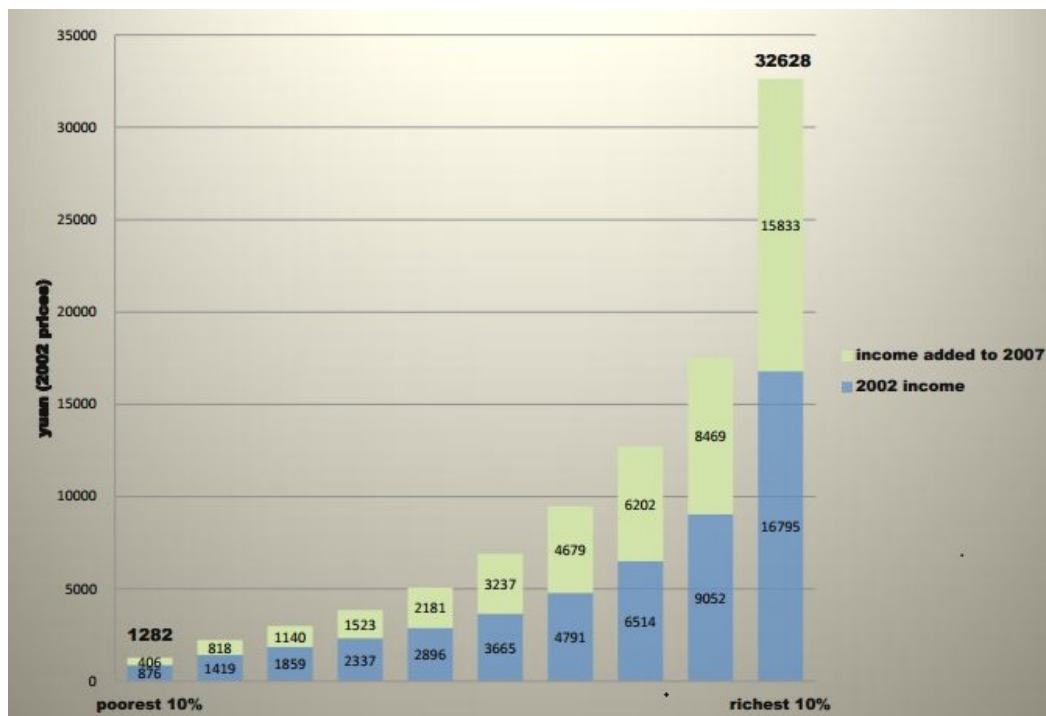


Source: Hu Yongjian. (2010). Analyzing the Widening Wage Inequality in China: Temporary or Persistent Phenomena

2.3 Household and personal market income distribution

“Households can have wage income and at the same time income coming from profits. Functional income distribution and wage dispersion is reflected in market-determined personal income distribution.”(Herr and Kazandziska, 2011, p111) It is a common approach that using the household market income distribution and personal market income distribution across the country to observe the personal income distribution. However, before looking upon the term household income distribution in China as whole varying by time, one thing needs to be emphasized that there is a great inequality inside the household income distribution between the rich and the poor. (See Figure 2.7) In 2007, the per capita household income of the top 10 percent rich is over 30 times of that for the poorest 10 percent. This is also underlined by Simarro (2012), it is important to notice that the share of the top 1% incomes would have grown at a rate of over 120% (Piketty and Qian, 2009). That rate would be even higher if we bear in mind the results of the latest research which find a large amount of hidden household income which would multiple the ratio of the income of the richest 10% of household relative to the poorest 10% until reaching a value of 65 times (Wang and Woo, 2010).

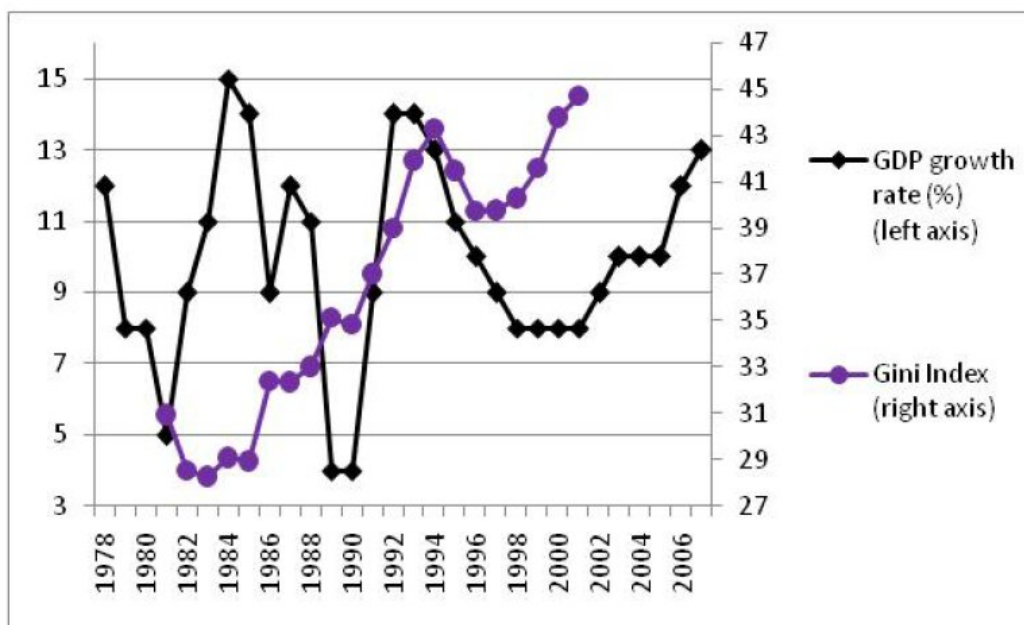
Figure 2.7: Per capita household income by decile, 2002 and 2007



Source: Sicular Terry. (2011). Inequality in China: Recent Trends (presentation), http://iis-db.stanford.edu/evnts/6930/China_inequality_Sicular.pdf (accessed 2014/2/28)

Gini coefficient is widespread used for measure the inequality of a distribution. Defined as a ratio with values between 0 and 1, 0 corresponds the perfect income equality while 1 corresponds to perfect income inequality. The Gini index is the Gini coefficient expressed as a percentage and is equal to the Gini coefficient multiplied by 100. According to the United Nations, 0.4 is the warning level of Gini index. However based on the National Bureau of Statistics, the Gini coefficient reached 0.474 in 2012 since hitting a peak of 0.491 in 2008, dropping to 0.49 in 2009, 0.481 in 2010 and 0.477 in 2011. Recalculating the hidden household income in China, Wang and Woo (2010) propose that the Gini coefficient of the household income is probably much higher than what has been given by the NBS.

Figure 2.8: China's economy growth and inequality, 1978-2007

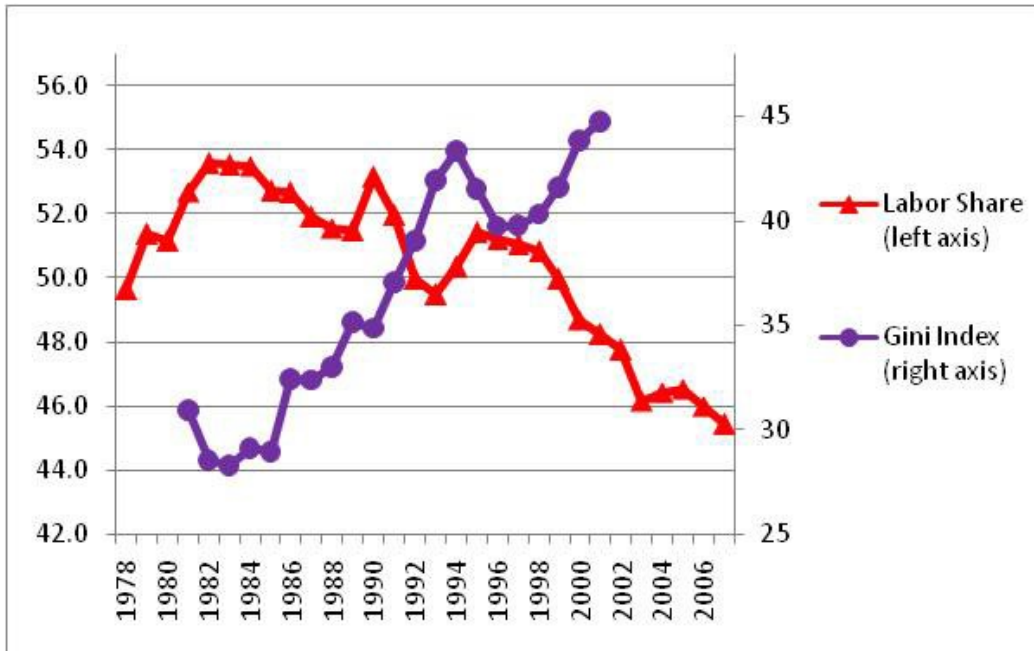


Sources: Simarro. (2012). Primary Distribution, Top Incomes and Inequality in China, 1978-2007

As can be seen from Figure 2.8, along with the economic growth since the opening reform, the Gini index experiences a general trend of increasing, which means the rising of personal income distribution in the macro economy. When combining with the declining of labor share in the functional income distribution, the rising of personal income distribution also indicates the increasing level of income inequality in the emerging economy of China. (Figure 2.9)

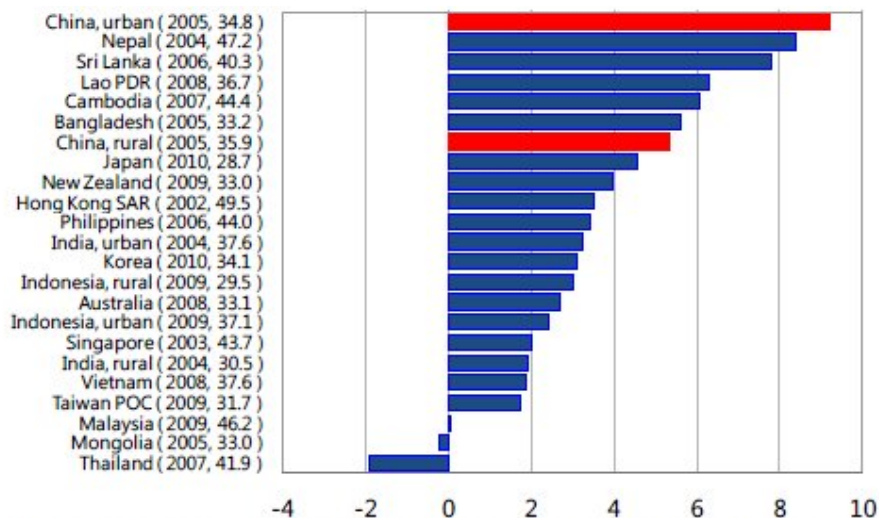
When comparing with other countries in Asia, the statistic is divided by urban and rural since the incredible urban-rural gap. (see Figure 2.10) In the last to decades, the urban Gini index in China increased with the highest speed comparing to other countries. Change of Gini index in rural China is also higher than the medium level in the figure, which even higher than Japan. There is no doubt that the income inequality has been emerging along with high economic growth in China.

Figure 2.9: China's primary and personal distributions of Income (1978-2007)



Sources: Simarro. (2012). Primary Distribution, Top Incomes and Inequality in China, 1978-2007

Figure 2.10 Asia: Change in Gini index in last two decades (in Gini Points)



Sources: CEIC Data Company Ltd.; World Bank, PovcalNet database; WIDER income inequality database; Milanovic (2010); national authorities and IMF staff calculations.

¹ In parentheses, the latest available year and corresponding Gini coefficients.

2.4 Household disposable income distribution

According to the definition of OECD, the household disposable income is the sum of household final consumption expenditure and savings (minus the change in net equity of households in pension funds). It also corresponds to the sum of wages and salaries, mixed income, net property income, net current transfers and social benefits other than social transfers in kind, less taxes on income and wealth and social security contributions paid by employees, the self-employed and the unemployed. The final distribution of household income (disposable incomes) is the result of a complex set of relationships, including family formation and dissolution, longevity and fertility, as well as the more obvious trends in earnings, transfers, taxes and the returns on capita. (Förster, 2004)

From the figure 2.11, one can be conscious of the remarkable increasing of disposable per household incomes China in values, from 1,045.3 US\$ in 1990 to 4,809.8 US\$ in the year of 2010, rising 230.2 times in the specifying 20 years. The Gini coefficient of real disposable income is in the tendency of increasing (see Figure 2.12), increasing

from about 20 in 1984 towards over 40 in 2007, indicating the growing of inequality of disposable income. Besides, the downward trend of the household disposable income share in GDP illustrates that the growth of economy is not efficiently shared by the population. This also results in the weak consumption demand in the macro economy in which the domestic demand should play an important role in stimulating the economic growth.

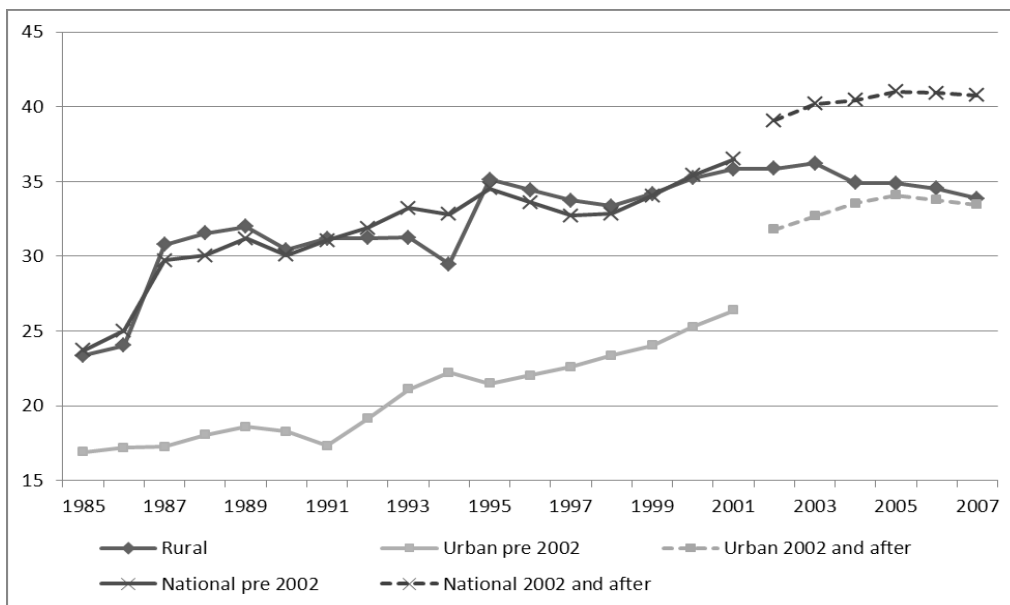
Figure 2.11 Disposable Incomes per Household (Constant) 1990/1996/2003-2010

US\$ per household, at constant 1995 prices % change

	1990	1995	2003	2004	2005	2006	2007	2008	2009	2010	% growth 1995-2010
Algeria	6,463.9	6,067.6	6,144.8	6,314.2	6,440.0	6,359.9	6,526.6	6,793.9	6,997.7	7,371.9	21.5
Argentina	25,678.9	18,931.7	16,548.2	18,515.9	19,356.3	20,429.3	22,851.1	26,008.8	27,123.5	29,061.4	53.5
Australia	40,478.6	39,468.8	43,270.8	44,139.6	44,791.8	46,060.6	47,825.6	48,081.3	48,926.4	50,047.8	26.8
Austria	42,720.8	44,263.9	43,395.4	44,009.1	44,734.3	45,913.0	46,526.7	46,672.8	46,436.0	46,916.0	6.0
Azerbaijan		1,366.9	2,546.7	2,626.2	3,012.7	3,070.4	3,281.6	3,746.6	3,995.2	4,152.3	203.8
Belarus	5,071.9	2,145.6	4,549.1	4,944.2	5,798.5	6,509.4	7,511.0	8,298.6	8,241.8	8,950.2	317.1
Belgium	40,180.3	43,832.9	43,943.6	43,571.9	43,402.1	44,670.1	45,548.8	45,400.6	45,737.5	45,948.7	4.8
Bolivia	3,513.8	3,610.2	3,539.7	3,507.7	3,453.3	3,594.1	3,598.0	3,505.3	3,479.2	3,431.0	-5.0
Brazil	9,364.7	11,928.5	12,914.9	13,102.6	13,144.4	13,720.6	14,473.0	15,281.1	15,571.3	16,373.3	37.3
Bulgaria	8,343.8	3,078.8	2,387.8	2,701.5	2,649.9	2,726.6	2,900.9	2,909.7	2,774.8	2,769.3	-10.1
Canada	34,367.3	33,070.8	37,104.4	37,467.5	38,211.5	38,974.5	40,211.5	40,526.4	39,966.9	40,764.8	23.3
Chile	9,986.7	13,930.3	14,252.4	14,998.6	15,945.7	16,589.4	17,314.8	17,673.1	17,988.3	18,909.2	35.7
China	1,045.3	1,456.6	2,214.8	2,649.8	3,045.1	3,372.9	3,726.6	4,035.6	4,417.6	4,809.8	230.2
Colombia	11,838.4	11,510.8	8,759.6	8,960.3	8,962.2	9,151.6	9,396.8	9,365.4	9,198.4	9,357.9	-18.7
Croatia		8,239.8	11,621.6	12,573.1	13,236.1	13,751.2	14,704.1	14,833.4	13,544.4	13,404.1	62.7
Czech Republic	7,586.7	7,826.4	8,305.2	8,403.3	8,636.4	9,021.5	9,521.0	9,633.4	9,432.7	9,504.2	21.4
Denmark	37,141.7	37,603.1	38,220.0	39,949.4	41,076.7	42,322.4	43,049.2	42,309.2	39,986.7	40,498.3	7.7
Ecuador	20,363.6	5,991.6	615.8	646.8	679.4	702.3	720.7	725.1	709.2	714.3	-88.1

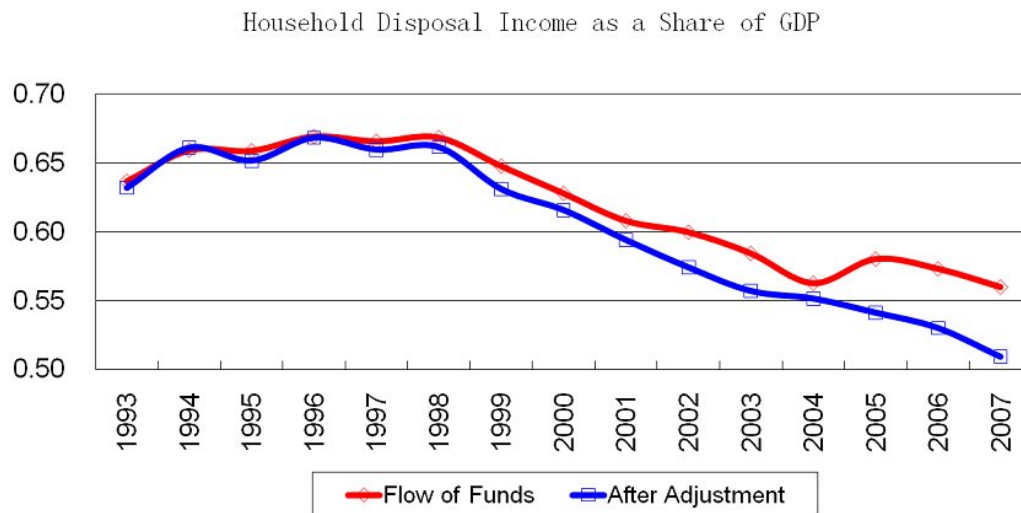
Source: World Consumer Income and Expenditure Pattern 2012

Figure 2.12: Gini coefficient real yearly disposable income, China, 1985-2007



Source: Treeck and Sturm (2012). Income Inequality as a Cause of the Great Recession? A Survey of Current Debates

Figure 2.13: Household disposable income as a share of GDP, 1993-2007



Source: Simarro. (2011) Functional Distribution of Income and Economic Growth in the Chinese Economy, 1978-2007

3. Income Inequality and Growth in China

3.1 The growth model of China

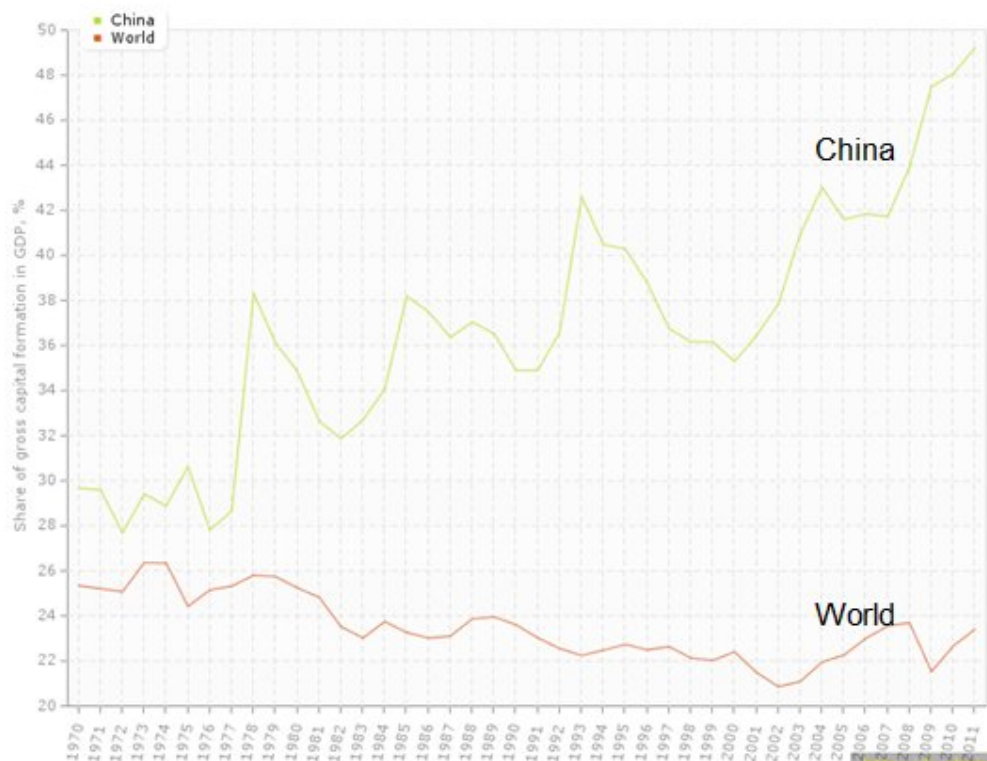
In order to figure out why the emerging economy of China accompanies with rising income inequality, the answer could be found from the country's growth pattern. There are a great many literatures identifying the growth method of China especially since 1990s. Some authors like Naughton lay stress on the function of structural change in China's transition and growth. "China is at a stage of economic development where very rapid structural change provides an impetus for high-speed growth." (Naughton, 2007, p140) By analyzing China's structural change of labor, GDP and its connection with globalization, Naughton illustrates China is following the common pattern of development – the structural change, and the process of structural change is well under way, but continued restructuring is on the horizon. (see Naughton, 2007, pp137-158)

There is also theoretical debate on the growth model of China. Based on the rising savings, low population growth (ranking number 153 from a total 232), high increasing of GDP and output, the growth pattern of China could be explained by the neoclassical paradigm to some extent. (Herr, 2011) Besides, Herr (2010) identifies China's economic emergence by a "sustainable Schumpeterian-Keynesian credit-investment process" which means the central bank has to accommodate a credit investment- income-savings process by refinancing commercial banks, because part of the central bank money will trickle away in additional cash holdings of the public and additional reserve holdings of banks. It is obvious that credit expansion has to be used for investment, to stimulate development. If credit expansion is used to finance real estate bubbles or it leads to an over-indebtedness of private households, there will be no positive long-term effect" (Herr 2011). Thus, "large central bank interventions

and sterilization policies as well as the strategy to defend current account surpluses and to follow export-led growth are part of the Chinese economic regime” (Arestis and Paula, 2008, p6)

Apart from that, the rapid economic growth in China is also characterized by the driving of investment and export. To begin with, the rapid growth in China is closely related to enormous investment effort. Attracting the investment inflow including the foreign direct investment (FDI) and foreign indirect investment is the most important source power for China's economic growth. From Figure 3.1, it can be noted that the proportion of gross capital formation in GDP increases remarkably since the beginning of the economic reform. It increases sharply from the year of 2001. Entering 2010s, it occupies nearly 50 percentage of the total GDP, which indicates the important role of investment in the economic growth. The share of gross capital formation in China is much higher than the world average. Besides, FDI played an important role in China's GDP growth. During the 1990s China became by far the largest recipient of FDI among developing countries. In 1995-2001 China absorbed about 290 billion USD FDI, more than the most OECD countries. By taking the large population of China into account, however, China's FDI per capita was still smaller than that received by any OECD country. (Chang, 2010, p66) “A Key element of the Chinese experience is one of consistently high investment that appears to be sustained by a gradual increase in the production performance of the economy. High investment rates “cause” economic growth, in a mechanical sense, but are also themselves a symptom of productivity improvements that are the ultimate source of economic growth.” (Naughton, 2007, p148)

Figure 3.1: Share of gross capital formation in GDP in China, %, 1970-2011



Source: UN data,

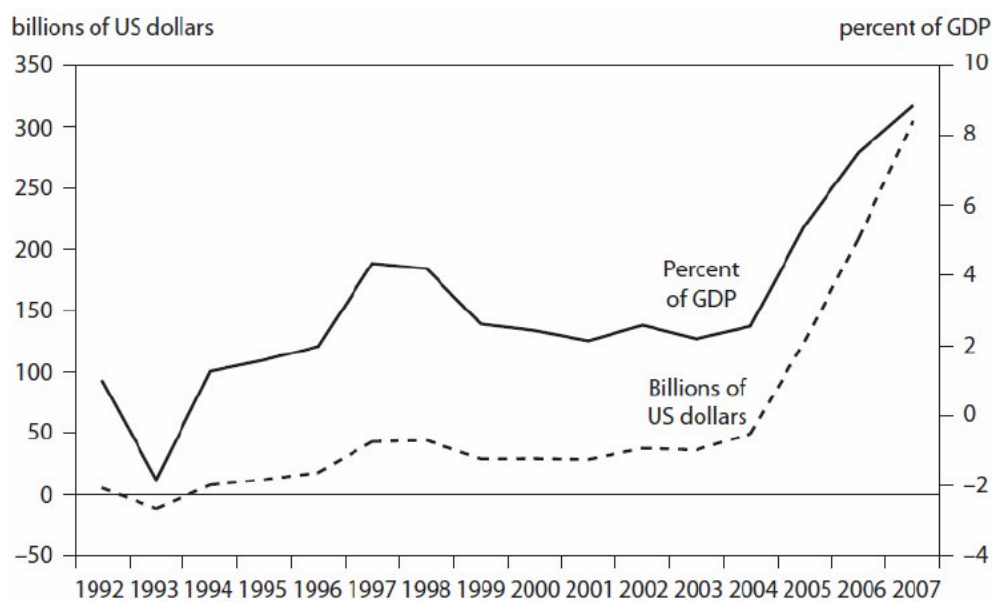
http://kushnirs.org/macroeconomics/capital_formation/capital_formation_china.html

(accessed 2014/2/28)

In regards to the other main feature of China's development miracle is export-oriented. Under the situation of strong investment with weak domestic consumption, "the Chinese economy had to rely on exports to absorb the excess capacities. To promote the growth of exports, the Chinese government has been maintaining a significantly undervalued RMB exchange rate." (Zhang, 2011) From figure 3.2, one can observe that the net exports of goods and services of China started to jump up roughly from the year of 2004. In 2007 it peaked to over 300 billions of US dollars accounting more than 8 percentage of GDP. The contribution of export to economic growth has become large. The composition of China's export has undergone a dramatic transformation since 1992. There has been a significant decline in the share of agriculture and soft manufactures, such as textiles and apparel, with growing shares in hard manufactures,

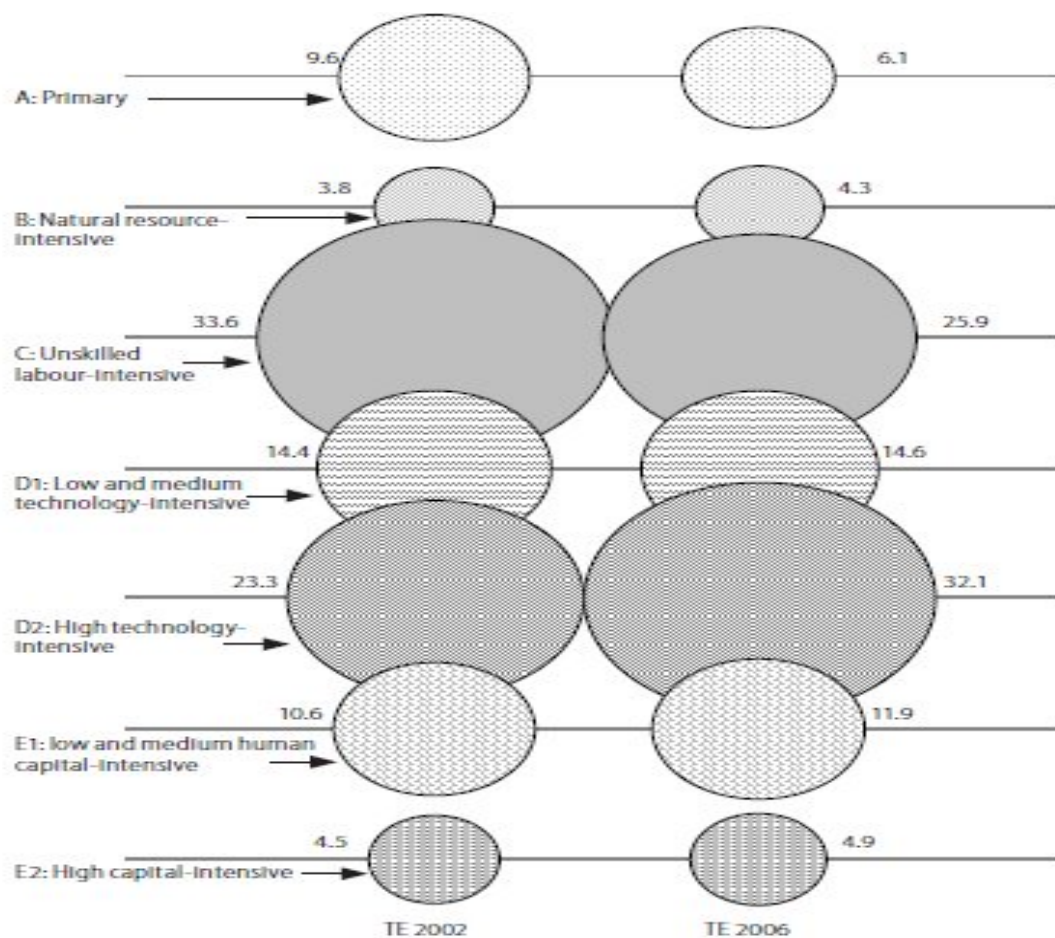
such as consumer electronics, appliances, and computers. (Amiti and Freund, 2007) Figure 3.3 illustrates the changes of China's export composition in 2002 and 2006, which can indicate the changing tendency of the export structure. From this figure, the high technology intensive product and low and medium technology-intensive products turn to be the main part of China's export structure. Meanwhile, the share of unskilled labor intensive products reduced largely with the rapid rise of high technology intensive good export like mobile phone and computer.

Figure 3.2: Net exports of goods and services, 1992-2007



Source: Chang, (2010), citing Bergsten, et al., 2008, p.109; National Bureau of Statistics of China, China Statistical Year book 2007

Figure 3.3: China's Groupwise Export Composition (%)



Source: Nataraj and Tandon. (2011).

3.2 Interactions between income inequality and the growth model of China

Many researches study the shortcoming of the growth model in China. Most criticize focus on its unsustainability. The export-led model heavily relies on the external environment and the external demand could be shrinking by the bust of global financial crisis. (Zhang, 2011) The high capital inflows through capital could engender the overheat for of economic development along with many economic bubbles which would undoubtedly hidden trouble behind the superficial economic prosperity. As argued by Galbraith (2007) the phenomenon of an exports boom

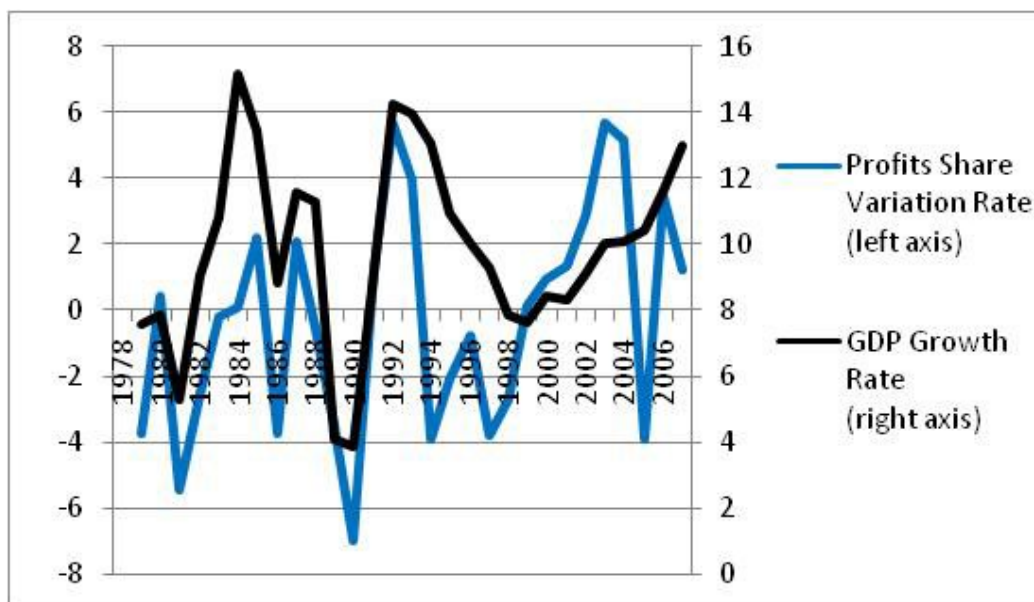
leading to a profits boom leading to a speculative bubble has some disturbing implications in a country as concerned as modern China is with stability and sustainability.

However, another urgent issue caused by the current growth model in China is the rising of income inequality. "The internal imbalance – reflected in the decreasing share of consumption in GDP relative to investment and export-driven growth – is basically linked to China's widening income inequality." (Lu and Gao, 2011, p.103) In particular, China's large and rising current account surplus and weak consumption demand is linked to the rise in both functional and personal inequality. (Treeck and Sturn, 2012) Firstly, both the investment and the export drive the economy through the profit-led demand regimes with increasing profit share extruding the labor share. This reduces the functional income distribution from the fountainhead of primary distribution. (see Figure 3.4) The share of primary distribution primary distribution that goes to business and the government in China has raised from 16 per cent in the mid-1990s to above 20 per cent at present. Households' share has been declining steadily. (Fulin, 2012) The investment itself has been financed by firms' profits. At the same time, the profits have been realized through a distributive mechanism that has enlarged the urban-rural gap. This has made possible the enrichment of the richest Chinese urban families. Finally, growth has been achieved on the basis of income inequality. (Simarro. 2012)

Beside, under this growth regime, the government policy takes great part in the issue of income equality with an aim to attract persistent investment and keep the competitive advantage of exportation. "It can readily be seen that among the various contributing factors, the most important are the systems and policies that were inherited from the traditional planned economy or that have recently emerged under the impetus of sectoral and local interests, in defiance of market rules; the government's failure to act on market gaps and distortions; and inadequate capital

regulation and labor protection". (Shi and SATO, 2012)

Figure 3.4 Profit-led growth in China, 1978-2007

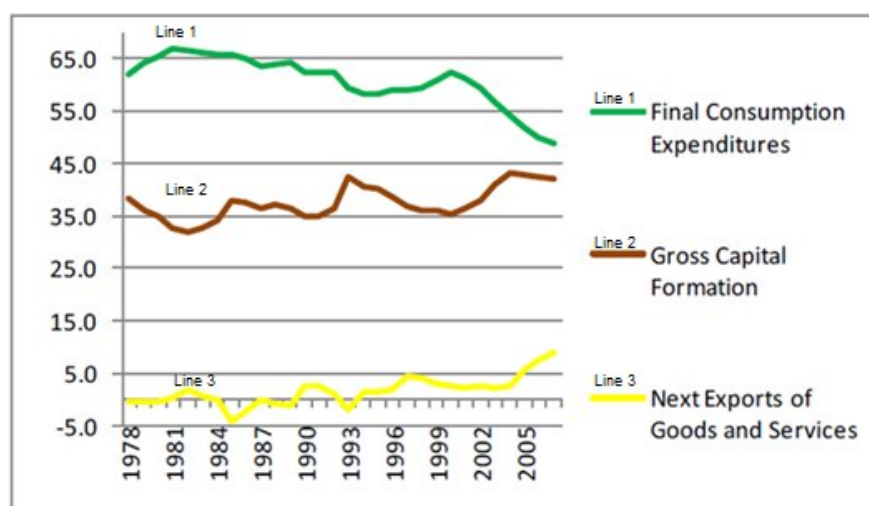


Sources: Simarro. (2012). Primary Distribution, Top Incomes and Inequality in China, 1978-2007

On the other hand, the high rising income inequality in China also has great impacts on the current economic growth. The most essential one is that it results in weak domestic consumption demand. Although the weak domestic consumption also relates to the investment and export driven growth model, it is can be seen as one main consequence of the high income inequality. Actually, the income distribution issue, growth pattern and domestic demand are interrelated and interacted with each other. "In China, lagging household income and large corporate profits have resulted in high national savings and a strong export orientation to compensate for relatively weak domestic demand."(Cited by Treeck and Sturm, 2012) We can see from Fig3.5 that the percentage of the consumption expenditure experiences a downward trend in the aggregate demand in China. The high income inequality with lower wage share, lower disposable income could induce the lower internal demand in the country comparing to the rising export demand of goods and services. In this way, the economic growth

would increasingly depend on the power of investment and export (see Figure 3.6) which highly increase the risk of crisis, because the uncertainty of these two factors is very high in the global market environment. Once there is a shock on investment or export demand for instant because of the global financial crisis, it will throw a destructive blow on China's economy.

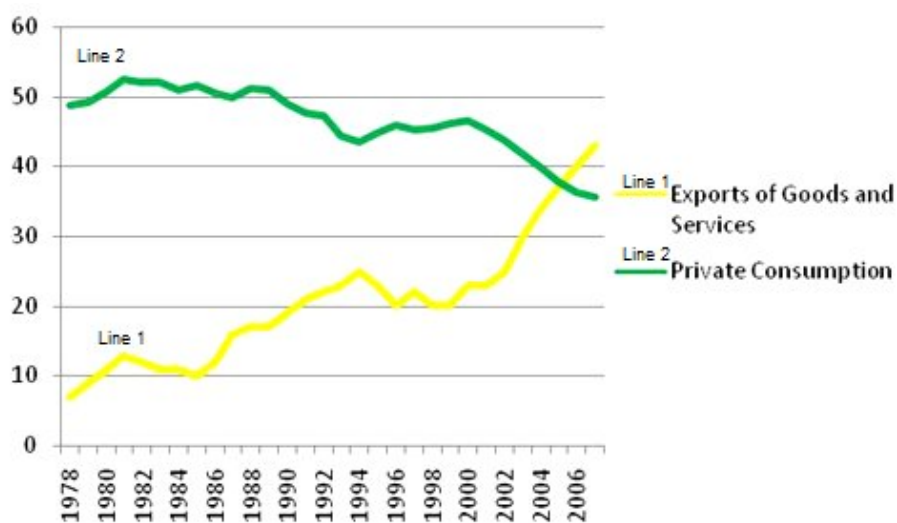
Figure 3.5 China's Aggregate Demand Components of GDP, 1978-2007



(percentage of GDP)

Source: Simarro Ricardo Molero. (2011). Functional Distribution of Income and Economic Growth in Chinese Economy, 1978-2007.

Figure 3.6 Internal and External Demands in China, 1978-2006



Sources: Simarro. (2012). Primary Distribution, Top Incomes and Inequality in China, 1978-2007

Therefore, a new regime, which is more driven by the internal demand, is supposed to add in the current growth model for the sake of sustaining or stabilizing the economic development and balancing contradiction between current growth model and income distribution. As Palley (2005) argued, “the solution to the contradictions posed by China’s emergence as a global export powerhouse is to build a robust internal Chinese market that supports domestic demand led growth”. This requires developing structures, institutions, and economic relations that generate sustained stable internal demand growth. (Palley, 2005)

4. Introducing wage-led growth model in China

China’s 12th Five-Year Plan (2011-15) places unprecedented emphasis on achieving a new balance - in terms of economic growth and income distribution - in order to narrow down the gap between the rich and poor. This indicates that the government removes their policy priority to the issue of economic growth and income distribution. Simply improving the wage level would not be a reliable strategy to modify the current condition of the income inequality inside the country. Actually the wage average in China has improved with a high rate. According to the National Bureau of Statistics, the net income of rural residents increased by 10.7 percent in real terms in 2012, and wages for urban residents increased by 13.5 in the same year. However the income inequality still remains increasing. Policy pointing at improving the income distribution must be taken.

4.1 Wage-led growth model

A wage-led growth strategy aims at establishing a full-employment growth model in which sustained wage growth drives demand growth via consumption growth and via accelerator effects of investment growth as well as productivity growth via labor saving induced technological change. A wage-led growth strategy will result in stable or rising wage shares. (Stockhammer and Onaran, 2012) Eckhard and Mundt (2012) explains the wage-led regime as a medium- to long-run recovery strategy embedded in a “Global Keynesian New Deal”, which means that “wages will have to rise broadly in line with (potential) output; labour income shares have to be at least roughly stable in the medium to long run, and may even rise if distribution claims of firms, rentiers, the state or the foreign sector are falling and permit the increase of the labour income share without triggering cumulative inflationary processes”. In this case, the economy may also benefit from wage-push effects on productivity growth, i.e. rising real wages and labour income shares pushing firms to speed up the introduction of labour saving innovation into the production process and thus increasing potential growth. (Eckhard and Mundt 2012)

For China the wage-led growth model targets to balance the economic growth and make the development more sustainable. It is more like an “income-balanced” growth regime, which is able to reduce the income inequality and at the same time stimulate domestic demand for a sustainable development. Jointing the wage-led growth regime with current development model could be an option for China to handle the issue of unsustainable economic growth and rising income inequality. The basic logic is that the improvement of income distribution through wage policy and redistribution policy could lead to the rising of domestic consumption demand which is a sustainable driving power comparing to investment and export. Conversely a sustainable economic development owing to the wage-led regime would promote the reasonable income distribution as a resolution to the issue of highly income inequality. Palley (2005) suggested that the demand-led growth in China requires reforming the

investment allocation process, free trade union and minimum wages in the aspect of income distribution. In order to pursuing the object of implementation of the wage-led model, the policy of labor market and government must be involved first.

4.2 Labor market strategy

In a broader sense, the starting point for pro-labor distribution policies is minimum wage policies in combination with legislation that strengthens the status of labor unions and collective bargaining institution. With such policies implementation, it is more likely that labor and labor unions are more motivated by distributional goals of the labor movement. (Stockhammer and Onaran, 2012)

4.2.1 Minimum wage

According to the ILO minimum report of China, the so-called minimum wage is the legal working hours of workers in the labour contract law or agreed to provide the normal working hours, working under the premise; the employer shall be paid a minimum remuneration. Minimum wage policy plays a significant role in narrowing the wage dispersion. It also has a modest effect on household consumption. During this period, the minimum wage in Beijing more than doubled, from RMB270 per month in 1996 to RMB640 in 2006. In the Shenzhen special economic zone the minimum wage doubled from RMB398 to RMB810 over the same period.(Lardy, 2007) Minimum wage regulations have been in place in China since 1993, when China enacted the Regulations Concerning Minimum Wages in Enterprises (“1993 Regulations”).The 1993 Regulations arose from the international minimum wage-fixing obligations that China assumed upon ratifying International Labor Organization (“ILO”) Convention No. 26. Convention No. 26 obligated China to

create a minimum wage-fixing mechanism for its workforce.(Lin, Downey and Sonerberg, 2004), Paul Hasting Attorneys, In March 2004, the Rules of Minimum wages (“2004 Rules”) took effect in China, which remarkable broaden protection for work including migrant and part-time worker and identify with greater specificity the classes of employers and types of work subject to minimum wage regulations. The twelfth Five-Year Plan (2011-2015) in principle recognises the need for a change of course and speaks of inclusive growth; accelerate expansion of the welfare state and a significant increase in minimum wages. (Traub-Merz, 2011)

In the first place, the minimum wage legislation in China needs to be acquired, the Rules on Minimum wage promulgated by Ministry of Labor and Social Security in 2004 is just a provision and not equal to legislation. This could weaken the implementation of wage policy especially the level of minimum wage is set by the local government of different provinces. Besides, with dramatically different development levels among regions China's continental economy suggests the need for a refined system of minimum wages in which minimum wages are set on a regional basis and take account of regional differences in living costs. Overtime, as development spreads and backward regions catch up, these settings can be adjusted with the ultimate goal being a uniform national minimum wage.(Palley, 2005) Moreover, the tripartite bodies consultations and recommendation in setting and adjusting minimum wage should be underlined. In China, the government consults with the unions and employers' associations about the amount and other aspects relating to the minimum wage. But when it comes to the final decision, it is the government that makes it autonomously. (see Herr and Kazandziska, 2011 b) Both the government and trade union should higher involve in implementation, monitoring and improving the minimum wage. Trade unions in company level should use their advantages in monitoring the minimum wage implementation in the enterprises. And also the minimum wage could be connected to the wage bargaining by trade unions.

4.2.2 Wage bargaining

Of great importance in wage setting policy, wage bargaining plays an essential role in the wage-led growth model and its main actor – the trade union. Wage bargaining is of great importance in balancing the primary distribution between capital and labor and increasing wage level. One thing has to be mentioned that there are a lot of “hopeless” critiques on the trade union in China. “ACFTU hopes to acquire a legal monopoly with regard to wage negotiations that workers will respect. This is unlikely. Operating under the supervision of the Party it cannot become an actor in the conflict; and if the enterprise trade unions do not obtain operational autonomy they cannot commit themselves to workers’ interests and negotiate in their name”. (Traub-Merz, 2011) It has to be admitted that the trade union in China indeed owns special obstacle because of the political system, which hinders it from working as supposed to. The increasing number of strikes and labor unrest wave without participation of the official trade union could be one of the best evidence. However, when the priority of development strategy of the state is being transferred to wage-led growth regime and increasing domestic demand, it provides an opportunity for trade union to play real part by collective bargaining. Since stimulating the demand in domestic market becomes one important part of the political and economic objective of the government and the ruling party, now the trade union and the government possess the same interest in improving wages and wage bargaining.

4.3 Government policies

4.3.1 Shifting the emphasis of development policy

One could say that the whole process of economic reform in China is dominated by

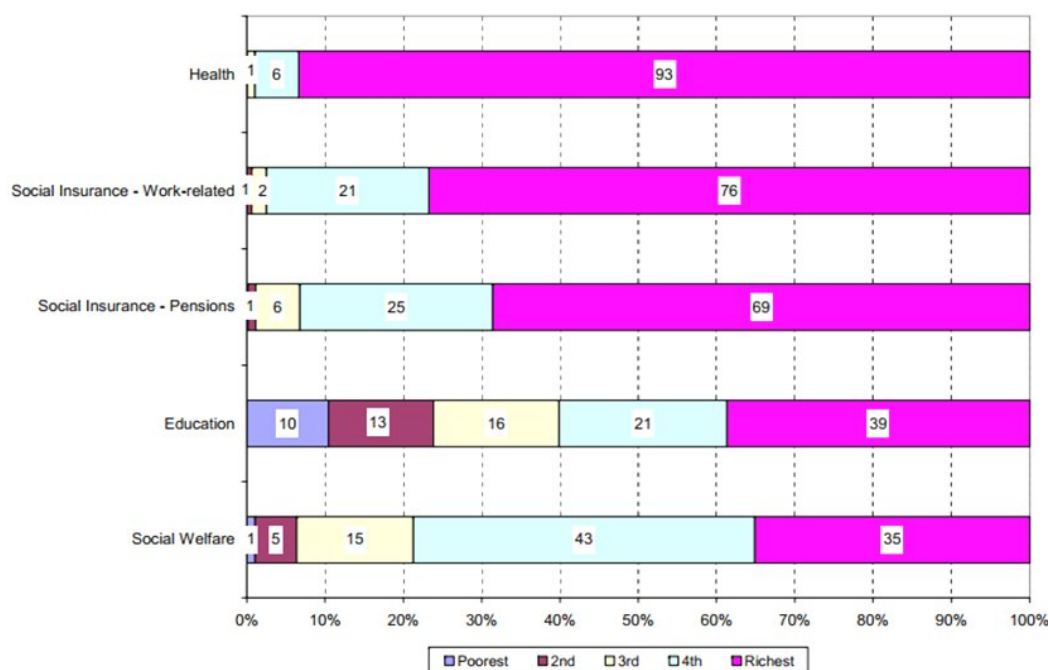
the government. Thus in the transformation of the development model we cannot emphasize too much the importance of the government. The first step towards to sustainable development model is to involve the wage-led growth regime into the development strategy of national economy. Fortunately, in the Outline of the 12th Five-Year Plan for National Economic and Social Development of the People's Republic of China published in March 2011, the Chinese government clearly stated their policy direction on "establishing long term mechanism of expanding domestic demand". Create positive consumption environment by actively yet steadily accelerating urbanization, implementing the strategy of employment as priority, deepening the distribution reform and improving social security system, gradually make the overall size of our domestic market ranks among the largest internationally. (see China's 12th Five-Year Plan 2011-2015) Besides, it also points out that standardized, orderly, fair, reasonable, win-win, harmonious and stable labor relations should established in China and the mechanism dominated by the Party and government for safeguarding the masses' rights and interests should be strengthened and improved, accordingly forming scientific and effective interest coordination mechanism, expression mechanism of interest appeals, mediation mechanism of contradictions, and security mechanism of rights and interests to safeguard the legitimate rights and interests of the masses effectively.

4.3.2 Social security

Social security is an indispensable method of redistribution, and it is also a key strategy to increase the household and personal consumption. By reducing the uncertainty of disease, unemployment, old age etc, the social security increases the desire and the possibility of the household or individuals to consume. The Chinese citizens have today a very low consumption rate because of the unstable revenue expectation which result mostly from employment pressure and expected risk on social security, housing and education. Promoting stable growth and enhancing

consumption should begin with optimizing social security system and expanding employment. (Chang, 2010) The current social security system built up by the government mainly contains the old-age insurance, unemployment insurance, working-injury insurance, health insurance. However the coverage and the distribution are the central problem requiring resolution. As can be seen from Figure 4.1, the resources of social benefit system are highly unequal distributed between social strata. Most of the social insurance schemes are administered at a decentralized level (e.g., county, municipality) and contribution rates often vary across provinces or even within the same province, thus limiting the scope for risk-pooling. Until recently, social insurance schemes covered only urban areas, but efforts have been made to widen coverage in rural areas under different types of schemes, which are largely subsidized. According to Zhu (2009), coverage rates in 2008 were 55% for the urban basic pension and 85% for urban and rural medical care. A means-tested minimum subsistence benefit (Dibao) is also provided in urban and rural areas.(OECD, 2011)Thus the social security system should be improved with an aim of better income distribution and increasing domestic consumption demand.

Figure 4.1 Quintile Shares of Social Benefit Programs in China in 2002



Source: Gao, Evans and Garfinkel. (2009)

Apart from the social security system, other distributive policies should also be implemented, such as tax and social transfers are also required. Tax and transfer systems reduce overall income inequality in all countries. On average across the OECD, three quarters of the reduction in inequality is due to transfers, the rest to direct household taxation. (OECD, 2012) For example, as another key for achieving social justice, regulating income distribution and narrowing down the income gap, the current tax system in China lags far behind the pace of market economic reform. For instance personal income tax, excise tax, property tax and urban land use tax can affect the distribution of income, but rather related to the adjustment of income distribution to the gift tax, inheritance tax and social security tax has not levy the same time, due to levy several taxes tax system design is not perfect, does not play an active regulator. (Sun and Sun, 2012)

5. Conclusion

In this paper, the increasing income inequality of China is analyzed through the research of every income contribution factor. With the decreasing labor share, widening wage dispersion, reducing household market share and descending household disposable income distribution, China has changed from a country with a fairly even income distribution into a country with wide income disparities. (Han, 2004) Moreover, when linking the rising income inequality to the growth model of China, the interaction between each other drives the thinking of changing the current growth model to wage-led model through reducing the income inequality. An abrupt model transformation is impracticable, thus it is suggested that adding the wage-led regime to the current growth model of China. In the labor market, the improvement on minimum wages and wage bargaining is required. At the same time, the role of

government needs to be highly underlined in China, with an aim to transfer the growth model and reduce the income inequality.

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