

# China: The Evolution Trends for Multiple Transitions and Income Gap Widening

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## Abstract

*With the implementation of reform and open-door policy, the income gap of Chinese people has been becoming wider and wider gradually, which can be approached from the perspective of the multiple transitions in the fields of economic system, economic development and social development. The article explores the process of economic gap widening in the rural areas, in the urban areas, between the urban and rural areas and between regions, and furthermore analyzes the influence over the income gaps exerted by the factors like economic system, economic development, government policies and open-door policy. Finally, the paper surveys the future trend for the income gap of Chinese people by considering the multiple transitions in the fields of system, economy, society and policy etc.*

## Profound Transitions

China is now undergoing some profound transitions, which include the multiple transitions connected with economic system, economic development, social development, culture and values. Specifically, the economic system of China is now transferring from the traditional system of a planned economy to the modern one of market economy. Its economic development is undergoing the transition from the traditional economy dominated by agriculture to the modern economy centering on industry, service and knowledge industry. Social development is now transferring from the traditional agriculture-oriented society to the modern urban-

ized society. With the transitions occurring in these aspects, the profound and complex changes in social culture and values are also taking place.

Under the condition of the multiple transitions, the income gap of Chinese people has been changing greatly and obviously. From 1980s on (since the implementation of reform and open-door policy), the income gap of Chinese people has widened considerably, which takes on a general trend of becoming wider than before. This type of trend seems to exist now. The society is now paying more attention to and discussing heatedly the widening of people's income gap. The author attempts to survey the evolution of the income gap of Chinese people since reform and opening to the outside world

and to explain this kind of evolution in terms of system, economic and social transfers in this paper. Finally, the future evolution trend of Chinese people's income gap is explored in this paper by combining the multiple transitions in the respects of system, economy, society and policy.

### 1. The Evolution of Income Gap of Chinese People since Reform

Since the reform in China, the income gap of Chinese people has taken on a general trend of becoming wider and wider, which is agreed by the majority of institutions and scholars. There are many methods and standards used to measure the width of the income gap, among which Gini Coefficient is the most widely used. According to the international standard, if the Gini Coefficient is below 0.2, it indicates that the income distribution is in an absolute equality. If the Gini Coefficient is between 0.2 and 0.3, it shows that the income distribution is in a relative equality. If the Gini Coefficient is between 0.3 and 0.4, it indicates that the income gap is relatively reasonable. If the Gini Coefficient is between 0.4 and 0.5, it indicates that the income gap is wide. If the Gini Coefficient is more than 0.5, it demonstrates that the income distribution is polarized. Some relevant data show that the Gini Coefficient of the Chinese people's income distribution has risen from below 0.3 shortly after the reform in China, up to 0.45 in recent years. The income gap has changed gradually from rationality to polarity.<sup>1</sup>

China is a large country with a large population and area, in which the rural areas and urban ones are polarized and the development of each region is greatly unbalanced. Therefore, in order to get a general idea about the evolution trend of the people's income gap in the period of economic transfer, we should survey the changes in the income gap respectively, in the rural areas, in the urban areas, between the rural and urban areas and between regions.

#### (1) The Evolution of Income Gap in Rural Areas

Before market reforms in China, the

income distribution in rural areas was in a high equality. Accordingly, the income gaps between the farmers were still very small. Based on the data collected by the rural branch subordinate to the National Statistics Bureau, it is estimated that the Gini Coefficient in rural areas in 1978 was between 0.21 and 0.22 and the income gap was in a range of relative equality. Since the reform, the income gap in the rural areas has been generally widening. The Gini Coefficient of the rural income distribution in 1981 was 0.24, that of 1990 to 0.30, and that of 1999 up to 0.33, with an obvious trend of rocketing up. The income distribution panel from the economy study branch of the China's Social Science Academy - based on the data accumulated from the two sampling surveys in 1988 and 1995 in the rural residents - estimated the Gini Coefficient of 1988 was 0.34, that of 1995 to 0.42, and the income gap has developed from a relatively reasonable range in the late 1980s to a fairly large range in the mid-1990s.

#### (2) The Evolution of the Income Gap in the Urban Areas

According to the estimates of the National Statistics Bureau, the Gini Coefficient of the income distribution in the urban residents in 1978 was 0.16, which indicates that the income distribution was in a range of highly equality. In the earliest years after the reform, to the mid-1980s, the income gap in the urban area remained almost the same, and the Gini Coefficient of 1984 was still 0.16. After the mid-1980s, the focus of the economic system reform in China has been switched to the cities, so the income gap in the urban areas tended to be widening step by step. The Gini Coefficient of the urban residents' income in 1985 was 0.19, that of 1990 to 0.23, that of 1995 to 0.28 and that of 1999 up to 0.295. However, the Gini Coefficient of 1995, as estimated by the income distribution panel from the China Social Science Bureau, was 0.33, and that shows the income gap in the cities in the 1990s was remarkably higher than that of the mid-1980s, the Gini Coefficient being almost 2 times that of the early days after the reform.

### (3) The Evolution of the Income Gap between the Rural and Urban Areas

Shown by the documents from the National Statistics Bureau, the income ratio per capita in the urban and rural areas was 2.56 in 1978. The ratio became 1.84 in 1984. After the year 1985, the ratio of per capita income in the country and city has been on the rise, which lasted for about ten years. This ratio rose from 1.86 in 1985 up to 2.59 in 1994. And after three-year slight decrease, this ratio reached 2.21 in 1997. After 1998, the ratio began to soar again. In the year 2000, the ratio amounted up to 2.46 and in 2002 reached 3.1. In the year 2003, the per capita disposable income of the urban residents was RMB 8472 Yuan. The per capita net income of the rural residents was RMB 2622 Yuan. The former was 3.23 times the latter. On the whole, although the income gap between the country and the city was slightly narrowed in the early period of the reform, the income gap tended to be going up generally.

Compared with other countries, the income gap between the country and the city in China has been always high. Some relevant documents show that the countries whose income gaps between the country and the city are larger than that in China are South Africa and Zimbabwe in the world in terms of money income. If the material income and allowance are regarded as part of the personal income, it is possible that the income gap between the country and the city in China tops the list in the world.<sup>2</sup>

### (4) The Evolution of The Income Gap between Regions

Since market reforms in China, the income gaps in the East, Middle and West of China has tended to become wider. According to the investigation of the National Statistics Bureau, the income ratio between the East, the Middle and the West is 1.15: 0.88:1 by 1985, and by 1995, the ratio has been enlarged to 1.42:0.97:1. The growth of income per capita of the Eastern part is obviously higher than that of the middle and the west. And the income gap

between regions is becoming larger and larger. As far as the cities are concerned, the disposable income per capita of Chinese cities has increased 5.5 times in 1986-1999, among which that of the East has grown 5.9 times, and that of the West only increased by 4.7 times. Therefore, the difference in income growth is quite clear. As to the rural area, the net income per capita of the rural area in the West and the Middle amounts respectively to 62.88% and 74.14% of the East, the two ratios have decreased to 57.02% and 67.11% by 1995 and further decreased to 46.96% and 63.60% by 1999, which indicates that the income gap is further widened.

Based on the explorations above, we may form a fundamental judgment: the income gaps in the rural areas, in the urban areas, between the rural and the urban areas and between regions in China, on the whole, take on a trend of swelling gradually, so the general residential income gap composed of these gaps also have a trend of becoming larger all the way. The documents show that the Gini Coefficient of the national residential income in 1978 was 0.288, that of 1984 0.297, that of 1990 0.339 and that of 1998 up to 0.403, with an obvious trend of increasing.<sup>3</sup> The income distribution panel of the China's Social Science Academy took the advantage of the data from the two sampling surveys in 1988 and 1995, and calculated the Gini Coefficient of the national residential income in 1988 was 0.382 and that of 1995 rose to 0.452. Compared with the early period of the reform, the income gap was enlarged considerably. Meanwhile, the income ratio between the group of the highest income and the group of the lowest income, as calculated by the said panel, was 13.5 times in 1988 and rose to 17.7 times in 1995.<sup>4</sup> According to the estimate of the World Bank, the Gini Coefficient per capita of the residential income of China was 0.33 in 1978, 0.388 in 1988, and 0.415 in 1995, the income gap having a distinct trend of going up.<sup>5</sup> In general, it has been widely acknowledged that since the reform Chinese residential income gap takes on an evident trend of expanding gradually.

## 2. Explanations for the Evolution of the Income Gap

In order to understand and explain the reasons for Chinese residential income gap expanding since the initiation of reforms, we need to analyze the multiple backgrounds including economic system, economic development and social development. In fact, it is the changes and functions of the factors in the multiple transitions that have led to the evolution of the income gap. Among the many factors, there are four factors which are dominant in the evolution of China's residential income gap. The four factors are:

- a. Economic system reform, i.e., from planned economic system to market economic system.
- b. Economic development transition, i.e., from agriculture-dominated traditional economy to industry, service and knowledge industry-dominated modern economy.
- c. Government policies, i.e., the specific measures taken by the government in the residential income distribution.
- d. Opening-up, i.e., from a closed economy to an open economy.

That is to say, system, development, policy and opening-up are the four important factors in influencing and dominating the changes of the income gap during the transferring period of China. By analyzing the four factors, we may provide a persuasive explanatory structure for the reasons and mechanism of Chinese residential income gap evolution.

### (1) Explanations for the Income Gap Evolution in the Rural Areas

*System:* The reform of the system is one of important factors influencing the income gap in the rural areas. The distribution dominated by equalitarianism under the system of peoples' commune was the most important factor, which caused the high equality in the income distribution in the country before the reform. We can find the key to the constant widening of the rural income gap in the reform of the contract system of land. The distribution mecha-

nism in the contract system can be generalized simply as "enough contributions to our nation and community, surplus goods belonging to us". The income of each family in the country was determined by such factors as the amount of the residual goods. The quantity of the surplus goods or products was determined by the farmers' labor, farming conditions and management ability etc. It is inevitable that there existed some difference in the amount of labor contributed by farmers, in farming conditions as well as in their management competence. Correspondingly, the income gap between farmers was inevitably enlarged under the contract system of land.

*Development:* During the period of transition, the economic development of the rural area showed primarily the trend of transforming the traditional unitary system of agricultural economy into the modern system of pushing up the development of agriculture, industry and tertiary industry. The rapidly advancing non-agricultural industries became gradually the major sources of rural economic growth and increasing the farmers' income, whose proportion of output value exceeded rapidly that of agriculture. Because of their difference in skills, knowledge, capital and other aspects, the farmers have different chances in participating in non-agriculture industry, and therefore they have different income from non-agriculture industry, which remains a significant reason for the expansion of the income gap in the rural area. With the economic development, the peasants will be different in the accumulation of the capital and technology, and their income gap will be further expanded.

*Policy:* The tax-fee policy applied in the rural area is generally based on the number of people and the area. This type of tax-fee policy has a regressive effect on income distribution, i.e., the rich and the poor will be assigned the same tax and fee. To the rich, it is relatively low, and on the contrary, to the poor, it is too high. Hence, this type of tax-fee policy with regressive effect actually strengthens the income gap between the peasants.

*Opening-up:* In the early period of the reform, the opening-up did not have a pro-

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found impact on the income gap in the rural area. But in recent years, some peasants in some areas may to some extent have the opportunity to participate in international trade, and share the advantage of international distribution and therefore their income may grow more rapidly. Meanwhile, in the areas with more flow-ins of foreign investment, the peasants may have more opportunities to increase their income. All these factors have to some extent further strengthened the income gap in the rural area.

### (2) Explanations for the Income Gap Evolution in the Cities.

*System:* System reform plays an important role in influencing the residential income gap in the cities. For example, the state-owned enterprises reforms granted more and more distribution decision to the internal personnel of the enterprise. The income distribution decided by the internal managers may have resulted in a larger income gap than "the planned distribution" regulated by the government. With the adoption of the various systems like bonus system, job subsidy system, enterprise yearly salary system, and extra dividends system, the income gap became larger and larger. In recent years, the reform of the state-owned enterprises caused a large number of unemployed people, and led to the income declining of the unemployed people and their families, which has helped to enlarge the income gap in the cities.

*Development:* Since the opening and reform, besides the traditional state-owned economy and collective economy, individual economy, private economy, foreign economy and complex economy have also developed rapidly. These "system exterior economy", dominated by market-oriented distribution mechanism is abundant in forms of distribution, which has made the employees have a larger income gap. So this to some extent expanded the income gap in the cities. In addition, with the development of market economy, the gaps of the capital and properties accumulated by the urban residents are gradually widening, which gave rise to the obvious expansion of the capitalized income gap of the urban residents.

*Policy:* There are various policies affecting the income distribution of the urban residents either directly or indirectly, among which some are for widening income gap and others are for minimizing it. To be specific, many policies, which were adopted mainly to break the distribution system of equalitarianism and to promote the system reform in income distribution, such as entitling units to more power in distribution decision and wage fluctuation, have the function of enlarging income gaps. And the progressive individual income tax policy, the recently adopted policy of minimum guarantee of living and the re-employment policy for laid-off workers have a function of narrowing the income gap.

*Opening-up:* It is hard to judge the influence of this aspect over the income gap of the urban residents so there is much more exploration that needs to be done. For example, it is hard to make sweeping generalizations when it comes to the influence on the urban residential income gap exerted by the expansion of foreign trade, the absorption of the foreign capital, and entry to WTO.

### (3) Explanations for the Income Gap Evolution between the Rural and the Urban Areas.

*System:* The traditional rural and urban census system has contributed to the systematic divisions of the labor market and the market of other key elements, and furthered the income gap between the urban and the rural area. In recent years, with the reform in the urban and rural census system, there is alleviation in the systematic divided situation of the markets of labor and other key elements. Millions of rural labor forces pour into cities for employment, which to some extent has narrowed the income gap between the urban and rural area. The current social welfare system and social guarantee system have strong identity discrimination because they provide certain social welfare and social guarantee only for the urban residents, but not for the rural ones. So these systems clearly have the effect of further widening the income gap between the urban and the rural residents.

*Development:* The development of market economy has an effect of expanding the income gap between the urban and the rural area. The residents of the city and the country are quite different from the starting point when participating in market economy, and the urban residents have more capital, property, knowledge and skills, etc., than the rural residents. This is a race with different starting points, so it is easy to predict the result. With the gradual accumulation of capital, property, knowledge and skill in the economic development, the "Matthew Effect" will be intensified - that is to say, the income of the richer people will be much more than that of the poor people and the income gap between the rural and urban areas will be further enlarged. On the other hand, the development of the market economy seems to have certain influential power on narrowing the gap between the country and the city. With the development of the market economy, such production factors as labor force, capital, technology and information etc. flow constantly between the rural and urban areas. The employment of rural labor force in cities may narrow the income gap between the rural and the urban areas. The extending of capital, technology and information from cities to the rural area may be conducive to narrowing the income gap between the rural and the urban areas.

*Policy:* In the long run, the taxation policy of China caused the urban residents with a relatively high income to burden a low tax rate, while the rural residents with a relatively low income to burden a high tax rate. The figures from the sampling surveys in 1995 indicate that the income per capita of the rural residents is equal to 40% of that of the urban residents, and as far as tax is concerned, the average amount they paid was 9 times that of the urban residents. If all the kinds of fees that peasants burden are taken into consideration, the tax and fees that the rural residents have to burden would be nearly 30 times that of the urban residents.<sup>6</sup> Therefore, this type of tax and fee policy will undoubtedly expand the income gap between the rural and the urban residents. The price policy of the government have a considerable effect on the income gap between the rural

and the urban, for example, the rapid increase in the purchasing price of the agriculture and sideline products in the early period of the reform narrowed the income gap, but the effect was of short term. Furthermore, since the reform, governments gave many subsidies to the urban residents, but few for peasants, so the subsidy policy had a strong effect on the income gap between the rural and the urban areas.

*Opening-up:* The effects of the aspect on the income gap are not very stable, but as far as the specific factors are concerned, some are effective in widening the income gap between the rural and the urban. For example, since China's entry to WTO, agricultural products are opened to the international market step by step, which has had a great impact on agriculture, so the price of agricultural products tends to go down. The income of the peasants will be affected and the income gap between the rural and the urban will be further expanded.

#### (4) Explanations for the Income Gap Evolution between Regions

*System:* In the planned economy system, the planning authorities would consider the balance in development between regions when assigning resources, which was beneficial for narrowing the income gap between regions. However, in the market economy system, the proportion of distribution of resources by the government is declining gradually. Due to the effect of the market mechanism, large quantities of inland resources flow into the coastal regions with a high earning ratio. Accordingly, the income gap between regions is enlarged gradually. In addition, the coastal regions are the forerunners of the "trial" reform in economic system in China, which have benefited from the system reform early. With the continued reform of the economic system, the system in the coastal regions bears the characteristic of "advantage of taking lead in reform". Therefore, the market system in the coastal regions is more advanced than that in the hinterland. All these mentioned above are conducive for the fast development of the coastal regions and inevitably enlarge the income gap between

regions.

*Development:* Firstly, compared with the Midwest of China, the coastal regions enjoy the advantages in such aspects as economic foundation, locational conditions, labor power and technology etc. It is certain that the economic development in the coastal regions is faster than that in the inland areas and the income gap between regions becomes wider. Next, due to the "Polarization Effect" in the field of economic development, the economic growth pole in the coastal regions attracts greatly the production factors in the inland areas. These factors are bound to flow into the coastal regions, which enlarges the income gap between regions naturally. Thirdly, in a long run, with the economic upgrade and structural adjustment in the coastal regions, part of industries are transferred from the coastal regions to the inland areas gradually and the "Spreading Effect" in the economic development will exert its impact, which help narrow the income gap between regions.

*Policy:* Since the initiation of reform in China, the Chinese government has been carrying out the strategy of speeding up the development of the coastal regions firstly and has taken many preferential measures in developing special economic zones and coastal regions, which has promoted the development of the coastal regions at a high speed. So to speak, the development strategy and preferential policy adopted by the government are the important influential forces upon the widening of the income gap between the regions. However, at the turn of the century, the Chinese government began to implement the strategy of developing the West zones and the economic development in the backward areas was also accelerated. Correspondingly, the development gap between East and West areas became smaller. But it is still uncertain that whether the trend of gap narrowing will continue or not.

*Opening-up:* The coastal regions have benefited much more from the open-door policy, because they enjoy a natural locational advantage and are gifted with some other advantages in economic base, manpower and technology etc over the inland areas. So far the foreign capi-

tal absorbed by China has been primarily used in the coastal regions. Similarly, the coastal provinces have provided a great volume of the foreign trade of China. The inland areas lag far behind in respect of absorbing foreign capital and foreign trade. Therefore, the open-door policy has, to a high degree, widened the gap between the coastal regions and inland areas.

### 3. The Future Evolution Trends toward The Multiple Transitions and Income Gap

How will the income gap of Chinese residents evolve in the future, continue to widen or become smaller? This is an object that deserves further study. Economists have carried out extensive investigations into the long-term evolution trend of the income gap in the economic development. The most famous is the "Inverted U-shaped Hypothesis" concerning the evolution of the income gap raised by Kuznets, an American economist and statistician. He thought, "the long-term trend toward the inequality in the income distribution could be considered in the following way: in the period of transition from pre-industrial civilization to the industrial civilization, the income gap was enlarged rapidly at the early stage of the economic growth. And then, the gap kept steady for a short time. At the later stage of the economic growth, the gap became smaller and smaller gradually." <sup>7</sup> According to Kuznets, during the long transitional period from developing countries to developed countries, it is inevitable for the residential income distribution gap to deteriorate first, and then improve.

It is always disputed in the economics field whether the "Inverted U-shaped Hypothesis" posed by Kuznets is universal because of the inadequate documents possessed and cases of individual countries. Since the last half-century, there has been extensive exploration and heated discussion over the "Inverted U-shaped Hypothesis" in the economics field. Then, will the residential income gap of China take on the same evolving trend as the "Inverted U-shaped Hypothesis" of Kuznets? To discuss and predict the coming trend of Chinese residential income gap, it is necessary to combine tightly the back-

grounds of multiple transitions, to analyze the potential influence over the income gap exerted by the various factors like economic system transition, economic development transition, social development transition and government policy changes.

#### (1) Economic System transition and the Coming Trend of the Income Gap

China is transitioning to the modern market economy system and the further market reform will promote the market-orientation of the income distribution mechanism. Compared with traditional planned distribution system, the market-oriented income distribution system may further expand the residential income gap. In the planned distribution system, the planning authorities decide the distribution principles, distribution forms, distribution grades and so on. The distributions in the rural area and the urban area are both of equalitarianism. Though the income gap between the rural and the urban areas is fairly large, the residential income gap of the country as a whole is restricted to a rather small range. Since the reform and opening, with the China's transition from planned economy system to market economy system, the proportion of resources allocated through the planned system has been declining, while the proportion of resources allocated through market system has been on the rise. With the continuous development of the markets of various productive factors, the proportion of the productive factors, such as labor force, capital, land, technology, and management, being allocated through market channels has been increasing constantly. Because of the difference in the labor capacity, knowledge, skills, etc., between residents, and because of the noticeable difference in the capital, land, technology and management residents possess, market-oriented distribution will undoubtedly result in a considerable expansion of the income gap. This expansion has been very noticeable in the past 20 years.

In the future, it is irreversible for the market orientation of China's economic system, and that means it is also irreversible for the income distribution system to be market-oriented. The

market system itself will further expand the income gap of the Chinese residents, which seems to be unavoidable.

#### (2) Social Development transition and the Coming Trend of the Income Gap

China's economic development is moving from the agriculture-dominated traditional economy to the modern economy dominated by industry, service and knowledge industry, and the influence upon the income gap exerted by the transition takes on different characters in different phases. Usually, in the early period of the transition, social economy takes on the evident character of dual structure. There is much difference between industry and agriculture, and the production rate in agriculture is much lower than that of industry, so the income gap between peasants and workers is very obvious. With the rapid promotion in industrialization, the income gap between the urban and the rural areas will be further enlarged continuously. This trend has been quite evident in the past 20 years.

In the mid-term of the economic development transition, it is more industrialized, the proportion of agriculture decreases rapidly and industry and service will be dominant in the national economy. In this phase, even though the income gap between the urban and the rural remains large, with many labors benefiting from industry and service, the proportion of the income gap between the rural and the urban areas in the total income gap of the society is declining. So the expanding trend of the total income gap of the society will slow down, different from the rapid growth in the early period of the industrialization.

At the end of the economic development transition, the society will be totally industrialized, and the proportion of agriculture in the national economy will be reduced to about 5%-10%. The social economy has switched successfully from agriculture-dominated traditional economy to a modern economy dominated by industry, service and knowledge industry, with most labors employed in industry, service and knowledge industry. In this phase, the income

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gap between the urban and the rural areas will be trivial or will almost disappear, and thus the income gap of the society is likely to be minimizing.

China is currently at the stage of transition from the early period of industrialization to the mid-term, with very evident dual structure, and the income gap between the rural and the urban areas is in a phase of rapid growth. It is easy to forecast that with more and more rural labor transferring into industry and service, the widening trend of the income gap between the rural and the urban will be decelerated gradually. However, it will take another 20 or 30 years or more for the income gap to be reduced noticeably.

### (3) Social Development transition and the Coming Trend of the Income Gap

China is currently switching from an agriculture society mainly composed of rural residents to an industrial society mainly made up of urban residents. The life styles and the mode of production are undergoing profound changes, and so are the social structure and the social classes. The social transfer will undoubtedly have strong effect on the evolution of the income gap. First of all, the employment and residence of more and more rural residents in cities will be beneficial for narrowing the social income gap. In cities there are many conveniences, which are not available in the country, such as basic infrastructure, sanitary conditions, information and employment channels, education and training conditions, etc. When more and more rural residents settle down in cities (which itself is a process of urbanization), the issue of the income gap between the rural and the urban areas will be settled step by step, and the social income gap is expected to minimize.

Second, the switch from the country society to the city society means that more and more people take part in the social guarantee system, so it is helpful for minimizing the social income gap. The current social guarantee system of China only covers the urban residents, but the rural residents of more than 60% of the total population are excluded. So this type of social

guarantee system actually expands the income gap between the urban and the rural areas. With the urbanization progressing, the urbanization rate of China will be rising rapidly. Predictably, the urbanization rate will rise from the current 40% to 50% up to 60% in 10 to 20 years. More than half of the population will be included in the social guarantee system, which will be effective in slowing down and minimizing the social income gap.

Additionally, the social structure and social classes of China are changing, maybe evolving toward helping narrowing the social income gap. With the expansion of the middle class of the society, the social class structure is expected to evolve from the current "pyramid" to "olive", and the social income gap is likely to be reduced.

### (4) Policy Transition and the Coming Trend of the Social Income Gap

The income re-distribution policy of the government is vital to the residential income gap. In the next period, to meet the demands of social and economic development the Chinese government will strengthen the capacity of the income re-distribution policy gradually, so as to control and minimize the social income gap. During the more than 20 years after the opening-up and reform, with an obvious growth in the residential income gap, the Chinese government will change its policy orientation of "efficiency-priority", and start to give more consideration to fairness. In a long period at present and in the future, Chinese government will strengthen its regulation of the income distribution and coordinate the incomes of large gaps, and at the same time, standardize distribution process, adjust the extremely high income of some monopoly industry, and prohibit illegal income. Aiming at prosperity for all, the government will enlarge the proportion of medium income, and raise the income standard of the low-income residents. Predictably, with the strengthening of the government income re-distribution policy, the widening trend of the residential income gap is expected to be controlled.

Since 2003 the Chinese government has strengthened the strength of tax-fee reform in

the country, and alleviated the peasants' burden of tax and fee by a wide margin, and is planning to abolish the agricultural tax thoroughly within 5 years. Meanwhile, the Chinese government has added more subsidies to grain production in the country, and added more capital investment in the infrastructure construction, education, medical care and sanitation in the country. All these measures and policies have brought great benefits to peasants, and are conducive to minimizing the income gap between the rural and the urban areas.

According to the above analyses of economic system transition, economic development transition, social development transition, and government policy transformation in China in the near future (about 5-15 years), because of the dominant role of the factors tending to widen the income gap, the inhabitant income gap will continue widening. But in the medium term (about 15 years later), with the economic development transition, social development transition, and government policy transformation, the factors tending to narrow the income gap will be more and more important, and it is hopeful for the widening trend of income gap to slow down. After a still longer term (about 30-40 years), the factors tending to reduce the income gap will gradually play a dominant role, and the inhabitant income gap might be narrowed. So the evolution trend of the Chinese inhabitant income gap will be widening at first and then gradual narrowing. The evolution track of it might be similar to Kuznets Curve, like an inverted U-shaped.

a. In the near future (approximately between 2005-2020) the income gap will continue to widen

In the next 5-15 years, the progress of China's transformation from traditional planned economy system to modern market economy system will speed up, and the marketization reforms will be more deepened. According to the above discussion, the marketization reforms will continue widening the inhabitant income gap. At the same time, with the speeding up of economic development and industrialization, the income gap between the inhabitants of cities and countryside will continue

widening. Furthermore, the gap of development between regions might be widened in the near future. The economic development of the Eastern region has already been greatly ahead of the Middle and Western regions, and with the accumulated advantage, the Eastern region will keep its leading place in economic development. Besides this, since the reform and opening to the outside world, the gap of wealth accumulation among inhabitants of China had been rapidly widening. Under the effect of the market mechanism, the gap of wealth accumulation will change into an income gap, and will thus widen the income gap again. So, these factors tending to widen the income gap will continue playing dominant roles in the next 5-15 years, and as a result, the inhabitant income gap will continue widening in this period. The Gini coefficient of the inhabitant income might go up from the present approximate 0.45 to 0.50.

b. Medium term (approximately between 2020-2040): income gap become stable

After 15-20 years, the factors that is helpful in narrowing the income gap will gradually exert more and more effects, the widening trend of income gap will slow down, and the general inhabitant income gap will become stable from widening. First, with China's industrialization entering its midterm phase, more and more country labor force will enter into industry or service, and the income gap between cities and countryside will be gradually narrowed down. Second, with the social development transition, the urbanization ratio of China will rise rapidly and may reach 50%-60%. China's society will gradually change into a society in which the urban people are the majority. And according to the above discussion, this will help narrow social income gap. Third, with the China Western Development strategy being put into practice, the economic development of Mid and Western regions will speed up. This will be helpful in narrowing the regional gap. Furthermore, with the economic and social development, the policy of Chinese government will change gradually from "efficiency first" to "balancing efficiency and equity", and more effective income redistribution policy will be adopted to control or narrow the social income

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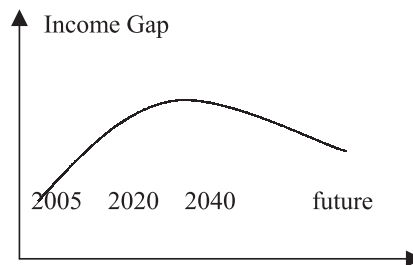
gap. These factors tending to narrow the income gap will gradually counteract the effects of those tending to widen it, a balance will be obtained to make the inhabitant income gap become stable, and the Gini coefficient will slightly fluctuate around 0.50.

c. The Long term (approximately after 2040): the income gap will began to narrow gradually

After 30-40 years, China will enter into the late phase of industrialization, the Chinese economy will become a economy with industry and service in dominant position, most of the labor force will be employed into industry and service, the dual economic structure in between cities and countryside will gradually fade away, the gap between cities and countryside will become insignificant compared with the general inhabitant income gap, and the general inhabitant income gap will thus narrow down. At the same time, the ratio of urbanization will continue rising, which might reach 65%-70%, and China will enter into a new era of urban civilization. Most of the inhabitants in China will enjoy the advantage of urban civilization, especially that of the modern social security system. This will help narrow the social income gap. Again, with the advance of the economic modernization tide from the coastal region to the inner region, the regional economic development will be well balanced and more harmonious, and the regional gap will be further narrowed. Besides this, with the strengthening power of national economy and state finance, the Chinese government will put social equity into a more preferential position, and will take more effective redistribution policy to help the low-income class and to build up social justice and harmony. This will help narrow social income gap too. China is a country with age-old history that advocates social equity, and there is in-rooted social equity value and culture tradition (such as "prefer lack to inequality", the dream of Great Harmony, and so on) in Chinese civilization. This will definitely affect China's policy choice and social choice in the future, and thus help narrow the social income gap. In the long term, after 2040, especially after the mid 21st century, with the factors tending to narrow

the income gap taking up the dominant station gradually, the general income gap of the Chinese inhabitants might take a narrowing trend.

In conclusion, the evolutionary trend of the Chinese inhabitant income gap will be widening at first, then, after a relative stable period of time, gradually be narrowing down. The development track of it might be as the chart below (similar to the "inverted U-shaped Curve" of Kuznets):



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### Notes

1. See: Lin Youping, *A General View on Income Gap of Chinese Residents in Recent Years*, *Economic Review*, No.6, 2002.
2. See: Li Shi, *Retrospect and Prospect on The Study of Personal Income Distribution in China*, *Economics (Quarterly)*, P387, No.2, Volume 2, Research Center on Chinese Economy of Beijing University, Jan., 2003.
3. See: Lin Youping, *A General View on Income Gap of Chinese Residents in Recent Years*, *Economic Review*, No.6, 2002.
4. See: Zhao Renwei, Li Shi, *Re-study on Income Distribution of Chinese Residents*, Chinese Finance and Economy Press, 1999, P.11.
5. Quote from a secondary source: Zhao Renwei, Li Shi, *Re-study on Income Distribution of Chinese Residents*, Chinese Finance and Economy Press, 1999, P.102.

6. See: Li Shi, *Retrospect and Prospect on The Study of Personal Income Distribution in China, Economics (Quarterly)*, P.398, No.2, Volume 2, Research Center on Chinese Economy of Beijing University, Jan., 2003.
7. Kuznets, *Economic Growth and Income Inequality*, *American Economic Review*, Vol.45, No1, March, 1955, P.18

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