**Mind the Gaps: A Political Economy of the Multiple Dimensions of China’s Rural-Urban Divide**

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<th>Journal:</th>
<th><em>Asian-Pacific Economic Literature</em></th>
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<tr>
<td>Manuscript ID:</td>
<td>APEL-07-2012-054.R1</td>
</tr>
<tr>
<td>Wiley - Manuscript type:</td>
<td>Original Article</td>
</tr>
<tr>
<td>Subject Classification:</td>
<td>110 - Economic development studies &lt; 100 - Economic development, fluctuations, planning, 910 - Income distribution &lt; 900 - Income distribution and social welfare</td>
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<td>Abstract:</td>
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Abstract

China’s impressive growth has been accompanied by high inequality and a wide rural-urban divide. This paper identifies and examines some of the major dimensions of this divide: income, consumption, education, employment, healthcare, pensions, access to public services and environment. The paper attributes the main causes of the divide to China’s urban biased development strategies and the resulting lack of social provision of public goods in rural areas. This paper highlights the severe and multi-dimensional constraints on the Chinese peasantry and argues that increased equality and efficiency can now be pursued simultaneously.

Keywords: Poverty, Inequality, Rural-urban Divide, China

JEL Classification: I320, I380, R130, R230, R280
1.0 Introduction

Since the start of the reforms in 1978, China’s real GDP has been growing at an average of around 10 per cent per annum, and more than 200 million people have been lifted out of ‘extreme poverty’ (National Bureau of Statistics (NBS), various years). This impressive growth in national income has, however, been accompanied by increased income inequality. Estimates of the Gini coefficient, measuring income inequality, have increased steadily from 0.33 in 1980 to 0.49 in 2008 and only slightly been reduced to 0.47 in 2012 (NBS 2013). These figures indicate that, in terms of income, China has moved from being among the most equal to nearly the most unequal of the developing countries and has for some time been above the widely recognized UN-Habitat’s ‘international alert line’ of a Gini coefficient of 0.4. By the end of 2012, there were still around 100 million people in China, almost exclusively in rural areas, living on less than US$1.25 a day – these account for around 15 per cent of the world’s extremely poor.

While income inequality has risen nationally, it is the increase in rural-urban income inequality that is the main reason for this. Indeed the disparity between rural and urban incomes in China has been among the biggest in the world (Chang 2002, Eastman and Lipton 2004). Income inequality is however only one aspect of urban-rural inequality and the urban-rural gap is even greater when other dimensions are taken into account (Sicular, Yue, Gustafsson and Li 2007).

A feature of the institutional landscape peculiar to China is the Household Registration (Hukou) system, which effectively divides the population and this has contributed substantially to different development levels of wellbeing in urban and
rural areas. This system has severely reduced the extent to which rural people can migrate to urban areas for a higher income and a better livelihood.ii iii

There are two issues in the literature that need to be more fully addressed. First, although there has been considerable interest in the literature in inequality and the rural-urban divide, studies have tended to focus on inequality mainly in terms of income and consumption and there have been few studies that have recognized the importance of other dimensions of this divide.iv These other dimensions can be thought of as other gaps which might be more severe, in terms of welfare, than the income and consumption dimensions, and these have evolved and trended in their own ways. Second, most of the analysis (for example, Yang and Cai 2003; Lin and Liu 2008) attribute the rural-urban divide to inappropriate government intervention, arguing that by reducing such government intervention, the income gap can be narrowed through growth. However they are unable to explain the fact that the rural-urban income gap was increasing up to 2009 and became much bigger on average in the reform period, when the government intervention became less.

To sum up, there are still many questions that need to be answered and many mechanisms that need to be better understood with regards to rural urban inequality. However to study the gaps in these other dimensions is highly problematic and there are severe measurement problems. It is difficult to offer precise measures of most of these indicators, how they change over time, and how each of them contributes to an overall measure of rural-urban inequality. In this paper, we do not intend to offer such precise measures, nor provide a comprehensive literature review on these gaps.v Instead, our aim is limited to indicating the importance of taking the multiple
dimensions of inequality into account and highlighting some of the important features and possible similarities or differences in the trends of these dimensions. A fully documented and detailed discussion of these gaps is too much for a short paper and, indeed, could provide a lifetime’s work. This paper might be seen as contributing to a framework for such an endeavour.

The rest of the paper is structured as follows. Section 2 examines the many dimensions of the rural-urban divide and Section 3 investigates their causes. Section 4 discusses the difficulties faced by rural residents, the mechanisms by which equality and efficiency might be achieved simultaneously and the inadequacy of only eliminating existing discrimination. Section 5 concludes.

2. Dimensions of the divide

There are many dimensions to the rural-urban divide. This section briefly discusses some of the major gaps and some of the common pitfalls in the literature when discussing these.iii

It should be noted that the concept of a rural-urban divide in China has both similarities and differences with the concept’s use in other developing countries. At one level the divide can be considered simply in terms of rural areas and urban areas – comparing livelihoods of people in those areas. But in China an individual rural or urban status is legally defined by their Hukou. This means that despite some rural people moving to urban areas and even remaining there for a prolonged period of time, they are not able to gain an urban Hukou or the right to stay in urban areas as permanent residents and thus are still officially classified as rural people.iv In 2011
figures indicate that 158 million people with rural Hukou status were resident in urban areas (NBS 2012). The income of these migrants are generally much lower that the incomes of those with urban Hukou status, but higher than those still in rural areas. Where they are allocated has big implications for measuring the size of any gaps.

Many researchers include income figures for rural migrants in their calculation of urban income and thus find a smaller rural-urban income gap (for example, Sicular et al 2010). They claim that if household surveys either do not cover the rural-to-urban migrants or count them as rural residents, then this would effectively overstate the income of urban residents and understate the income of rural residents, and then lead to an overstating of the urban-rural income gap in China. However, as migrants and their family usually are not entitled to healthcare, a pension or free education for their children and many other public services where they live in the urban areas, there is a logic to allocating them to where their Hukou is.

In any discussion of the rural-urban divide, the distinction between ‘rural areas’ and ‘rural people’ (as defined by their Hukou) needs to be born in mind and the context should make it clear whether it is the area or the people that are being referred to.

i) The income gap

It is generally agreed that the rural-urban income gap was increasing, at least up 2009, and is now amongst the largest in the world (for example, Sicular et al., 2007). In addition to the inequality within both areas the rural-urban income gap is one of the major contributors of China’s overall inequality. If an urban household’s family
income falls below a locally specified minimum income level, the local government offered to finance the shortfall. However, there is no such guarantee in rural areas and the very poor still largely rely on private savings and family support or simply have to do without. x

Despite the importance of this issue, there is still no consensus as to the most appropriate measure of the income gap. To provide an intuitive view of the income gap, we show this using the average per capita income for urban and rural households using the NBS’s data.

< Figure 1 >

Figure 1 shows the average per capita income for urban and rural households on the left axis and the ratio of urban to rural average income on the right axis. From the figure it is clear that the rural-urban income gap has increased over time up to 2009. xi It is noticeable that from 2002 although rural-urban income inequality was still increasing, the rate of increase was slowing and from 2009 it started to decrease. By the end of the period, 2011, urban average income had reached 21.809 Yuan while rural average income was only 6.977 Yuan. This is a ratio of 3.13:1.

It is important to note that these calculations use the standard published figures for household disposable income and they may only capture a small amount of the difference between average real income of individuals in urban and rural areas and they do not take into consideration the differences between different rural areas and between different urban areas. There are, for example, substantial differences between rural western average incomes and rural incomes in coastal provinces.
When all other non-monetary factors are included (Fan 2008), and if the trillions of Renminbi of grey income is included (Wang 2010), the ratio of urban income to rural income would be significantly higher than the above official figures indicate.

Another complication is that much of the literature takes into account cost of living differences, which are generally higher in cities and use a bigger price inflator for urban areas. This results in a much smaller income gap. However, this literature ignores differences in the quality of the goods that are typically consumed by urban and rural consumers (Johnson, 2002). As a result these studies overstate the price index appropriate in urban areas and understate the real income and consumption level compared with the rural areas.

**ii) The consumption gap**

Although consumption levels are often used in estimating household poverty and vulnerability, there is very little discussion on the consumption gap, mainly due to the lack of appropriate measurement at the macro level. We argue that a good indicator of the consumption gap is the difference in the urban and rural Engel coefficients, that is, the percentage of expenditure on food in total consumption expenditure. Because food consumption has smaller income elasticity, this is a good indicator. These are shown in Figure 2, which again uses NBS data published in the Chinese Statistic Yearbook from 1978 to 2012. It can be seen that, although the Engel coefficients for both urban and rural households decreased by about 40 per cent, there is a constant 15-20 per cent difference between the two groups. This measure suggests that there is a substantial gap but it isn’t worsening over time.
In addition to the gap indicated by the Engel coefficients, another aspect of the consumption inequality is the differential burden born during “unusual times”. One example is the Great Famine period 1959-62, where there was a fall in the national population of at least 30 million that largely resulted from hunger and malnutrition (Lin, 1990). This tragedy happened overwhelmingly in the rural areas. Urban areas were guaranteed a supply of food by the state, and the strict enforcement of the Hukou system prevented, or substantially reduced, rural-urban migration during the period of the famine. In this sense, the conventional view - that in the pre-reform period both urban and rural areas were equally poor so that consumption inequality was not a problem - may not be so accurate.

After the introduction of the Household Responsibility System (HRS) in 1979-84 and the resulting more efficient and higher agriculture production, most rural areas were freed from hunger. However, despite these improvements many in rural areas have still been struggling to meet the bare necessities of life. Conversely, urban consumption has risen massively. So, perhaps while there may be only a small gap in terms of calorie intake, there may be huge differences in terms of consumption patterns, quality of goods and services and the overall quality of life (Johnson 2002).

There are two common problems in the study of rural consumption, as with income. First, many people take for granted the use of a lower price index for rural areas, which results in a lower consumption gap. Again, differences in the quality of
goods are ignored and if these were taken into account measures of the consumption gap would be bigger.

Another problem is a possible error in the attribution of production expenditure for consumption expenditure. Rural households not only consume grain but also retain some to plant for next year’s harvest. If all grain purchased were treated as consumption, this would clearly be overstating rural consumption. Or more generally if expenditure on farm inputs is deducted from total income, the amount left for consumption or savings in rural areas diminishes, increasing the rural-urban consumption gap still further.

In summary, the consumption inequality may be much bigger in the pre-reform period than people normally thought, and although the gap is big in the reform period, it is not necessarily worse than income inequality.

iii) The education gap

There is a huge gap in terms of childcare and education (see Li et al 2012). Although under the constitution Chinese children are entitled to free state education, the reality is that millions of migrants’ children cannot be enrolled into the schools in the cities they work and live because they do not have urban Hukou there. Instead, many of these children have to attend private schools that run on fees, donations and voluntary teachers. These schools often have poor infrastructure and provide education of low quality which results in disappointing academic performance compared to that of city children.
The gap between urban and rural education manifests itself in many ways, including cost, level, quality and returns on education (Tsang 2000; Hannum and Park 2007). Schools in urban areas receive a large amount of support from the government while those in rural areas get strikingly little.\textsuperscript{xiii} Rural residents are also required to contribute via taxation to the maintenance of the physical infrastructure of schools and the teachers’ salaries (Yoxall 2006). Many rural areas are so deprived that tax revenue is insufficient to pay for schools, and where they do exist, the schooling is of low quality (Tsang 2000; Yoxall 2006), not to mention that some families are not even able to send their children to school because they can not afford the tuition fees.

In China, the second most important factor influencing a person’s educational attainment or enrolment, after age, is whether that person lives in a rural or urban area (Knight and Song, 1999). In 2005, the percentage of senior-high school graduates from urban areas was three times higher than that from rural areas and the percentage of college graduates was four times higher (NBS). It has been estimated that if rural education levels were to increase to those of urban areas, the overall rural-urban income gap would be narrowed by 25-30 percent (Sicular et al, 2007).

It should be noted that returns on education in China have been found to be low when compared with other countries, but this is especially the case in rural areas (Wang and Piesse, 2008). Low returns on education particularly in rural areas and especially for high schools means that there is little incentive for families to pay for their children’s education. All these factors together trap many rural people in a state of poor-education and thus only able to get low wage employment, making inequality self-perpetuating.
It should be noted that since 2006, tuition fees were exempted for students receiving nine year compulsory education in rural areas. Textbooks have also been provided free to students in rural areas while those boarding school students from poor families also enjoy some living allowances. In addition, education investment has been increasing in rural areas.

iv) The employment and wage gap

After adjusting for education and just focusing low-skilled labour, the evidence suggest that there is a true wage gap in China (Meng 2012). The agriculture sector in general has high levels of surplus labor and very low marginal productivity. The route out from this is migration to the urban sector. Rural people are aware that higher returns to their labor exist outside agriculture but have limited opportunities to pursue non-agricultural activities and migration to urban areas remains difficult for many people.

At the beginning of the reform, rural residents needed a permit to allow them to migrate to other areas in order to work and these were issued on a quota basis. On arrival in a new city, they were required to register with the police, and both the permit and registration were subject to a fee. These fees were often very high, posing an insurmountable barrier for some and a deterrent for many.

Moreover, there are restricted employment opportunities for rural migrants as a result of city governments’ attempts to minimize unemployment for urban residents in order to maintain social order (Knight and Song, 2005, p.184). For example, in the
1990s, State Owned Enterprises (SOEs) were required to give jobs to urban residents first and to employ a certain proportion of local residents despite the fact the migrants would have been prepared to work for a lower wage. In fact, the political and institutional arrangements gave urban residents privileged access to secure employment at above market-clearing wages and controlled the flow of peasants to the cities, allowing rural migrants to fill only the jobs that urban-dwellers did not want (Appleton et al 2004).

Past research has shown that labor markets in China have been highly segmented for many years (Appleton et al 2004, Knight and Song 2005 and Wang and Piesse 2008). Despite the recent relaxation in regulations, barriers in the form of government restrictions on labor movement remain. The opportunities for labor are much greater in the urban areas, where only between 3.6 and 4.3 per cent are registered unemployed from 2000 to 2005 (NBS). Those with urban Hukou that are unemployed can claim minimum income subsidies and enjoy pensions and unemployment insurance. This is not so in for those with rural Hukou for whom none of these security nets exist.

v) The pension gap

In addition to discrimination in employment opportunities and wages, rural peasants were excluded from pension plans and as a result a far lower proportion of people in rural areas have pensions than in urban areas. For example in 1987, while 63.7 per cent of the elderly living in urban areas received pensions the figure for the countryside was only 4.7 per cent (McCarthy & Zheng, 1996). This hadn’t improved much until the mid 2000s. Thus, while elderly people may not wish to be
dependent on their children for support the continued scarcity of social-welfare benefits and limited economic development in rural areas in the absence of appropriate policies is likely to be a continuing problem.

The government introduced the New Rural Pension System in 2009 to provide social support to rural communities. This is sponsored mostly by local government and is of a varying amount according to certain areas’ income standards. By the end of 2010, the system has had 103 million participants, 29 million rural elderly people over the age of 60 are able to receive a small monthly endowment. It is planned to cover all rural population by 2020 (Zhong 2011).

vi) The healthcare gap

During the pre-reform period, China’s health insurance system provided virtually free coverage for people employed in urban state enterprises and the public sector and relatively inexpensive coverage for their families. However, in the rural areas widespread and free healthcare only became available towards the end of the pre-reform period. Taking the country as a whole the collective health care system in the pre-reform period impressively reduced infant mortality rate and increased life expectancy at birth from around 40 in 1950 to 65 in 1978.

In the reform period, while most of the urban population have still been provided with various kinds of subsidised healthcare, the system collapsed in the rural areas. The system in the countryside had been tied to the collective farms. When these were abolished there was almost a complete lack of investment and subsidy and access to healthcare was massively reduced. The situation in rural areas stands in
sharp contrast to the increasingly high-quality care in China’s relatively more affluent urban areas.

Many rural people are caught in a poverty trap whereby when they suffer from poor health their inability to pay medical costs prevents their recovery and ability to return to work. In the 2003 National Health Survey, 30 per cent of poor households identified a large healthcare expenditure as the reason that they were in poverty (Ravallion and Chen 2007). According to Yip (2010), in 2003, among rural residents, fear of the high cost of medical care led 23 percent to refuse to be hospitalized when ill, 32 percent to request early discharge from the hospital against their doctors’ wishes, and 18 percent not to seek care when ill, much higher the comparable numbers for urban residents. As a result, many poor households either forego treatment, exacerbating illnesses in increasing the inequality in life expectancy, or face devastating financial consequences. Thus ill-health is not only a consequence but also a leading cause of poverty.

In an effort to prepare for future epidemics and seeking to address growing economic divisions, the government has been undertaking a reform of its health care system with the stated aim of improving the quality of health care in the countryside. Although the New Rural Co-operative Medical Care System initiative was introduced in 2003 to overhaul the healthcare system, and in particular to improve access and make it more affordable for the rural poor, patients still have to pay about 40 percent of hospital charges. In 2009, participants in this system have reached to 800 million (Zhong 2011).
vii) The public goods and services gap

Large amounts of government revenue are invested in urban development projects, while there is relatively speaking far less per capita in rural areas. What is defined as a public service in a city may not be considered so in the countryside. Much of the public sector infrastructure that does exist in the rural areas is provided by the rural population themselves.

China has a highly decentralized fiscal system in which local governments rely primarily on local tax collection to provide basic public sector goods and services. However, some have argued that many such services are never received or the work is not done (Knight and Song, 1999). Furthermore, the social security net is almost none-existent in rural areas. In the reform period, the Household Responsibility System created a huge boost in agriculture productivity, production and rural income, but the disintegration of the collective farms meant the dismantling of almost all social provision.

This can be best described as taxation without social provision. In the reform period price controls on agricultural output were gradually relaxed in the early 1990s, however, the tax and subsidy system remained unchanged until 2003-06. Many urban households have avoided having to pay much direct tax. This was because of both a high income tax threshold and the lack of enforcement of the tax laws. The rural population has had to pay agriculture taxes regardless of their income status and ability to pay. This has put an additional burden on many already impoverished households (Bernstein and Lu 2000, Tao and Liu 2005, Wang and Piesse 2010) and these typically have received very little in terms of public services. Various studies
including Imai et al (2010) and Wang and Piesse (2010) have confirmed the finding that the system of regressive taxation and subsidies have contributed to the persistent and widening rural-urban income gap.

If tax revenues are spent in a way that enhances output, or are redistributed effectively back to those on low incomes in the form of subsidies, the negative effects of tax may be minimized. In the pre-reform period, in return for paying agricultural tax, rural areas received some government support for education and healthcare and some other public goods. However, things got worse for the rural areas in the reform period up to 2003-06. Farmers continued to pay taxes, but the social prevision was stopped. This unfairness of the tax system increased poverty and vulnerability in the rural areas and partly explains the increasing rural-urban divide in the reform period.

There have been some improvements in government policies to reduce distortions. For example the agricultural tax, fees and administrative charges for rural people were waived across the country in 2006. Although there are still some small fees introduced by some local government, rural residents’ tax burden has been greatly reduced.

viii) The environmental gap

Although air pollution in urban areas is often far worse than in rural areas, the lack of any regulation in the latter has meant that there are some rural industries which are imposing severe environmental threats. There are the so-called ‘cancer villages’, where the occurrence of cancers are many times the national average. Most of these ‘cancer villages’ can be seen to be the result of local government’s eagerness to build factories but lack of knowledge, experience or will to establish environmental controls.
The reluctance or inability to implement environmental regulations has resulted in the proliferation of factories using dangerous chemicals, causing many deaths in rural villages. In addition to this according to the Chinese Ministry of Health, at the end of 2007, fewer than two-thirds of rural villages had access to piped water and only just over half had hygienic toilets (Holdaway 2010).

It is difficult to conclude definitively the overall trend on environmental gap as the development of both rural and urban industries have not taken environmental costs into consideration in their calculations and thus there has been a worsening of the environment in both areas.

Despite the major differences discussed above, there are others dimensions of the rural-urban divide, such as the digital divide (Murphy 2010), differential access to media, culture, and travel, on which beyond the scope of this paper.

3. The causes of the divide
This section explores the fundamental causes of the overall divide. Although the specific causes of each gap may vary, their fundamental causes may have similar roots.

Diminishing returns to land due to its fixed supply and diminishing returns to labor due to China’s high levels of surplus labor in the rural areas means that the agricultural sector is intrinsically inferior to industry in terms of productivity. However, these “natural differences” explain only a very small part of the divide as in many other countries. The fundamental cause lies in the effects of urban-biased government policies.
3.1 Policy distortions in the pre-reform period

The inferiority of the agricultural sector arising from “natural factors” has been exacerbated by some elements in agricultural policy, which were part of the development strategy in the pre-reform period. This strategy explicitly sought to exploit the agricultural sector and the rural population in order to support industrial development concentrated in urban areas. This prioritized capital intensive heavy industry over support for agriculture and for many years, capital was taken from the agricultural sector to provide for high investment in heavy industry (Lin, Cai and Li, 2001).

Under the system of central planning, the government used a policy whereby industrial products had higher prices and agricultural products lower prices, a policy known as the ‘price scissors’. Because the free trade of agricultural products was forbidden by law, the rural population had no means of realizing the market value of their products. This kind of exploitation is well documented in the literature (for example, Lin, Cai and Li 2001; Whyte and Sun 2010). As Whyte (2010a) points out while pledging to promote social equality the socialist planners systematically discriminated against rural peasants in China. It was hoped by the planners that the transfer of income from rural to urban areas and the prioritization of the industrial sector would have been able to generate enough growth that would positively affect the entire country, including the rural areas. That is, that this growth effect would outweigh the negative impact of the rising inequality and result in an improvement of living standard in rural areas.
The government institutionalized the rural-urban divide through the Hukou system, because it wanted to implement its heavy-industry oriented development strategy without causing the excessive rural-urban migration that is seen in many other developing countries. To what extent this strategy has achieved some of its goal and helped make China better off in the long run is beyond the scope of this paper, but it is clear is that it has resulted in a very large rural-urban divide and it still has detrimental effects on the livelihood of rural residents. As Whyte (2010a) points ‘It is one of the cruel ironies of modern Chinese history that a revolution led by a son of the soil that came to power by appealing to peasants and through a predominantly peasant-based army, ended up producing a social order that made urban privilege and peasant exclusion its cardinal organizing principles.’

3.2 The growth orientation in the reform period

Apart from the initial focus of the reforms which were on the rural area and involved dismantling collective farming in 1979-1984, the reforms focus quickly moved to the urban sector. Many of the practices from the centralized planning era were left untouched and remained largely responsible for the rural-urban divide.

Although the pursuit of a heavy industry strategy was replaced by a more market oriented one, the growth path remained urban biased. The government’s allocation of capital and investment was, and still is, largely concentrated in urban areas. The restriction of rural urban migration continued and this not only reduced the competition faced by urban workers, but did so at the cost of rural residents who were excluded from the possibilities of higher income.
Many studies (for example, Yang and Cai 2003; Lin and Liu 2008) argue that government intervention has harmed efficiency and that China should really have left things up to the market and produced according to the theory of comparative advantage. From this point of view the heavy industrialization strategy and the associated ‘distortions’ were a mistake. Removal of these distortions should improve efficiency and equity.

Despite the old development strategy being abandoned and the associated government intervention being reduced the rural-urban gaps worsened and inequality increased for much of the reform period. One explanation for this is that the removal of these distortions and the associated rapid growth in the reform period led to new inequalities. This is because growth is rarely uniformly distributed. If one starts off with equality and has any growth that is less than equally distributed then overall inequality increases. The Kuznets inverted U-curve tells this story well.

The existence of surplus labor in rural areas and restriction on migration made the development more uneven. For Hukou residents in urban areas, the unemployment rate was around 4 percent (NBS), however, huge amounts of surplus labor exists in rural areas (Kwan 2009; Wang and Weaver 2013a). When there exists surplus labor, the wage income for rural people, whether migrant or not, would tend towards the subsistence level (Lewis 1954; Wang and Piesse 2013). The large amount of surplus labor and constant low wage income, contrasted with quick urban development and an increasing urban, institutionally determined, wage for those who have urban Hukou. This resulted in an increased rural-urban income gap.
In the pre-reform period, income inequality was low across urban and rural areas and this led many to believe that China was egalitarian. However, using only income as a measure of the size of the rural-urban gap is likely to be misleading. The divide was very big in the pre-reform period when other gaps, such as consumption gap, are taken into consideration. Furthermore, different policies have had different impacts on specific dimensions of the divide. Government intervention for rural healthcare and education and public goods in the pre-reform period had a positive impact but the removal of the support for public goods prevision in the reform period has made the situation worse in rural areas. In essence, China created a system of virtual serfdom for rural residents marked by gross disparities in social status, mobility opportunity, and basic citizenship rights and this system of rural discrimination has long lasting effects on the reform era (Whyte 2010a).

3.3 Inequality of opportunity

Another feature, and in a sense the most fundamental feature of the divide, is inequality of opportunity. Inequality of opportunity relates not only to differences in access to education and employment, but to the inequality in all factors affecting the individual’s welfare, over which they have no control.

China has a high degree of inequality of opportunity and this is partly due to the Hukou system that has allowed economic advantage or disadvantage to be transmitted from one generation to the next. Zhang and Eriksson (2010), found that more than half of the inequality of income was caused by inequality in opportunity.\textsuperscript{xviii}

Based on Zhang and Eriksson (2010), the evolution of both the income Gini coefficient and the opportunity Gini coefficient is shown in Figure 3. From this, it is
clear that the increase in income equality is largely following an increasing inequality of opportunity. If freedom of movement is allowed, rural populations can migrate to urban areas to increase their income and avoid the exploitation that frequently occurs in the countryside. However in China this is difficult because of the Hukou system.

As discussed above the rural-urban divide is mainly due to policy distortions which have restricted opportunities for rural people. Government intervention can not only influence outcomes but also opportunities. And where the government intervention has restricted opportunities this may lead to strong feelings of dislike for government actions in general. Whyte (2010b) in the Social Inequality and Distributive Justice Project finds that in responding to survey questions rural residents, who are typically poor and might be expected to be demanding greater equality, are in fact significantly less likely than those in urban areas to express demands for equality and for government intervention to make China a more egalitarian society. This might be because the main experience of the rural population is that government intervention has resulted in a series of policies which have widened the rural-urban divide and they are very mistrustful of further interference by the state.

The segregation caused by Hukou itself may not have mattered much if there had been equal investment in the rural areas and opportunities there had been developed. But this has not been the case as discussed above, particularly in the areas of education, health, employment, pensions, etc. The reform has now reached a stage
where there should be an emphasis on the importance of redressing past inequities in investment.

4. Achieving equality and efficiency

One of the arguments for the long neglect of rural areas is that attempting to achieving rural-urban equality might sacrifice economic efficiency. Much of the literature claims there exists a trade-off between achieving equality and efficiency. For example Prescott (2004) argues that in many developed countries the widespread provision of welfare reduces inequality but also reduces the incentive to work and thus reduces economic efficiency. This undermines the essential dynamics and rationale of the market. Thus less redistribution from government can potentially encourage harder work and improve efficiency but may be morally problematic and possibly cause social instability. At a certain stage, it is argued is impossible to improve equality without harming efficiency.

It is claimed that the difficulties for China in achieving harmony and sustainable growth simultaneously lie in just such a trade-off between efficiency and equality. However this is not necessarily the case at all stages of development. There are some macroeconomic mechanisms by which efficiency and equality can be improved simultaneously and these might well now be available to policy makers in China.

Our analysis indicates that, although market forces would result in some degree of rural-urban divide, the rural-urban divide and the associated inequity has increased rather than been reduced by government interventions. If this is correct then the
removal of government interventions should increase efficiency and reduce the rural-urban divide.

There might have been some poverty traps created by either the market or the government. Where there are poverty traps even a small amount of intervention can help break the vicious circles. Spending on education and primary healthcare and reducing taxes on those in such traps is comparatively cheap and has the potential to be highly effective in raising both productivity and output.

Although the tax revenue taken by the government from the rural poor was relatively small in terms of total government revenue in the later stage of the reform period, for the individuals the burden was high and has potentially had a serious detrimental effect on people’s vulnerability by putting them in the vicious cycle of low net wealth/low investment. The small agricultural tax may have prevented many rural households from moving from low productivity agriculture to high productivity.

A little investment in education would be able to break the low education trap. Many rural people have had anything other than a very basic education and this has been identified as a major mechanism for making inequality self-perpetuating. If rural people cannot educate their children well, then that group is likely to remain impoverished, and they will be trapped in the low-income group permanently.

Income losses due to illness and medical expenditure are major contributors to poverty. This and the burden of environment-related diseases falls disproportionately on the rural poor (Holdaway 2010). Addressing access to, and costs of, the poors’...
medical services and the environment-related sources of disease will not only improve health but also via increases in productivity and output contribute to poverty reduction and the reduce inequality and the possibilities of social conflict.

As analyzed above, the current rural-urban divide is fundamentally caused by specific national policies not by the operation of the market alone. That is it is not based mainly on the inequalities in productivity but rather more by the inequalities in investments and opportunities. Since most of the inequality in China is caused by unequal access to resources and the lack of equal opportunities (social exclusion and institutional segregation such as the Hukou restrictions), progress towards more equal opportunities is likely to provide further impetus for both efficiency and growth. Toxix Thus, there is still space for Pareto improvements. Achieving harmony with sustainable growth in China may not be as hard as some may believe.

However, the removal of the biased policies is not enough. More should be done to improve the competitiveness of the rural economy. Improving the infrastructure and social provision in rural areas and reducing the discrimination would allow the rural people to improve the dynamism of the rural economy.

5. Conclusions
China has been experiencing both an increasing inequality and a widening rural-urban divide for many years. This paper is among the first to have emphasized the multi-dimensional nature of the rural-urban divide. It examines the discrimination against the rural sector and reveals the economic hardship of rural residents: those born to peasants were denied many fundamental freedoms and choices enjoyed by urban residents. Rural people have had to pay a large amount of taxes while receiving
relatively little public investment and have largely been required to provide their own public sector goods. Rural people have been treated in general as second class citizens and a possible route of escape migration to urban areas has been restricted by their rural Hukou status.

The rural-urban divide has developed within the context of the Hukou system, which divided the population in China into urban and rural groups and made it difficult to migrate to urban areas. However, while the Hukou system might be seen as an impediment to the long run convergence of urban and rural incomes, it has not been the cause the rural-urban divide in the first place. Rather the rural-urban divide is a legacy of the heavy industry oriented development strategy, which was pursued in the pre-reform era, supported by exploiting rural agriculture. This was the case for many developing countries, but China has been the extreme case.

Thus the fundamental source of the divide is to be found in two things: the extraction of surplus from rural areas, and the lack of investment in infrastructure broadly defined in rural areas. This resulted in differences in the lives and livelihoods of these two groups in several respects, which have been exacerbated by institutional barriers to restrict labor mobility.

Some of the rise in inequality was almost inevitable as China introduced a market system, but inequality and the rural-urban divide have been exacerbated rather than mitigated by a number of policies. While the tax and fees continued to be paid up to 2003-06, social provision had largely stopped. This withdrawal of the limited but vital
support in the rural areas increased the vulnerability of rural people and partly explains the increasing rural-urban gap in the reform period.

There is great urgency to address this issue not only for the sake of political stability, but more importantly, for the ethical reason that China’s further growth should not carry on being built on the exploitation of rural peasants. After the introduction of a range of new policies in the late 2000s, the rate of the increase in the divide has been slowing down or even slightly reversed. All these changes – the removal of the agriculture tax, the abolition of tuition fees for nine years of education, the introduction of basic healthcare insurance and pension reforms for rural residents – represent a fundamental shift in rural-urban relationship in China: instead of extracting surplus from rural areas to be invested in urban areas, the central government reversed the surplus transfer and now has begun to show real care for rural development (Zhong 2011).

Finally it should be noted that the simple rural-urban divide of the early reform period has become part of a more complex geographical divide across regions and between core and peripheral cities. At present, the eastern provinces have a much higher real income than the central and western provinces, despite the fact that the income difference between the three regions was relatively small in 1978.
References


Appendix

Figure 1. Evolution of Rural-urban Income Gap

Notes: Calculated by authors based on China Statistic Yearbooks. It breaks where the data is not available.
Figures based on average per capita annual income of urban and rural households at current prices (left axis). The rural-urban income gap is the ratio of average urban per capita income level to average rural per capita income level (right axis).
The ratio does not eliminate the effect of price differentials between urban and rural areas on consumption expenditure.
Figure 2. Evolution of Rural-urban Consumption Gap

Notes: Calculated by authors based on China Statistic Yearbooks. It breaks where the data is not available.
The rural-urban consumption gap is illustrated here by the difference between the urban and rural Engel's coefficients.

Figure 3. Income Gini and Opportunity Gini in China

Note

i The current Chinese official poverty line is a yearly net income of 2,300 Yuan, which is roughly equivalent to the World Bank $1.25 a day (in 2005 PPP) poverty line.

ii Introduced in the 1950s, the Hukou system is a de-facto internal passport and visa mechanism, where no unauthorized movement between sectors was legally allowed. It created invisible walls and administrative barriers that divided China into two: those in the urban sector with many rights and privileges, and those in the rural areas, who generally have far fewer political rights and opportunities to participate in or influence policy. Since the reforms began, although there has been a continuous loosening of controls and restrictions on rural labor moving to cities, it still remains extremely difficult for a rural person or household to become a permanent urban dweller (that is to obtain an urban Hukou). Another dimension, less frequently discussed, is that there is a strict geographical dimension to the Hukou status. An urban Hukou for a small town in the impoverished central, western regions in China is clearly less valuable in terms of welfare as than an urban Hukou for Beijing, Shanghai or Guanzhou.

iii It should be noted that it is difficult for rural people to capitalise their land ownership. Urban land belongs to the government and rural land is collectively owned by the villagers. In rural areas, although people are guaranteed to have a piece of land they are not allowed to sell it individually. Only the village collectively can sell land. Once an area is declared as urban, the previously collectively owned land becomes public land at the disposal of the city government and there is very limited compensation for farmers. See Wang and Weaver (2013b) for more discussion about this.

iv Knight and Song (1999) provide some discussion of the gaps in education, health care and housing, Whyte’s (2010) edited book traces differences in access to social resources, including primary and secondary education, health care, information communication technology, and desirable residential neighbourhoods, but there is still a need to establish a holistic view of the multi-dimensional nature of the divide. Yang and Cai (2003), Knight, Li and Song (2006), Lin and Liu (2008), Park (2008) and Sicular et al (2010) for example study the rural-urban divide from a range of different perspectives but each is limited in its approach.

v Thus, this paper may not refer to extensive literature one may expect in a typical literature review article.
Ideally, for each of the gaps, we should measure their extent and scale and their evolution over time, exploring their causes and future trends. However, because of data availability, measurement difficulties and the word constraint this paper limits itself to offering an introductory review of each gap.

In comparison were they to have migrated to another country and worked there for the same period of time they would have been eligible for full citizenship. The UK, for example, has allowed permanent residency to be gained after legally working for 5 years, or lawful residence for 10 years.

Residency here is defined as those who obtain employment outside their villages and towns for more than six months in the year.

Zhong (2011) also uses hukou-based criterion and classifies migrants as rural population and argue that it is because the disparity between entitled urban hukou residents and migrant workers within cities constitute an important dimension of China’s urban-rural duality.


There have been two periods where the rural-urban income gap decreased. In the first of these two periods, between 1978 and 1985 it fell because rural reforms boosted rural agriculture production. In the second, between 1994 and 1997, many workers in the state-owned enterprises in the urban areas were made redundant.

However this again may understate the difference because those in the urban areas tend to eat out in restaurants more than rural households, as they adopt a lifestyle enjoyed by those on higher incomes so urban food expenditure might actually be on services rather than on basic food items.

It has been noted that educational expenditure is dependent on rural households’ income (Wang and Moll 2010), and the lack of sufficient finance has led to a decline of the provision of education for many rural citizens (Yoxall 2010).

Since the late 1990s, there have been three major social insurance programs that were at the centre of the health financing reform process: one covering urban formal sector workers, one for other urban
residents, and a program for rural residents (see for example, Dong 2009). In the reform process, government initiatives made it easier for the hospitals to raise revenue from patients. As a result of this the wealthy and the insured have had an improved access to health care but this has made things more difficult for those with little or no insurance. The majority of the uninsured are from rural areas.

xv See Lora-Wainwright (2010) for a field study from an anthropologist and villager perspective.

xvi The government in a developing country, use price scissors to extract profits from peasants in the rural sector to subsidize workers in the urban sector. As a result, the government in this setting could increase capital accumulation using price scissors.

xvii For Whyte, China created a system of virtual serfdom for rural residents.

xviii According to Zhang and Eriksson (2010, ), “the proportion of inequality in opportunity to inequality in income is 0.46, 0.49, 0.48, 0.57, 0.65 and 0.63 in the years 1989, 1991, 1993, 1997, 2000, 2004 and 2006, respectively.”

xix The reforms in rural education, healthcare and pension in late 2000s demonstrated that achieving equality doesn’t necessarily sacrifice efficiency.