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## China's Wealth Disparity Between City and Country and the Government's Policies Toward It

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### Abstract

This essay presents an investigation on the continuously growing wealth disparity in China between people living in cities and the vast peasant population in the countryside. As China continues its miraculous economic growth, it is apparent that coastal regions and other major metropolitan and industrial areas have reaped the benefit of the "Open Door Policy" in a more significant fashion than the western part of the country, where poor geographical conditions and the lack of basic infrastructure have kept it mainly agricultural and grossly underdeveloped. If measures are not immediately taken to narrow this gap, it will likely become the most significant roadblock to China's social stability and its emergence as a world power. This paper will look at the phenomenon of wealth disparity, prove that it exists and why it is a problem. It will then discuss the unique conditions of China that have made the wealth disparity such a hard problem to overcome. Lastly, this paper will look at the government initiatives currently taken to confront this problem, and what long-term strategies the government should take in the future.

The year 2005 proved to be another banner year for China's economy. According to the Chinese Bureau of Statistics, China's Gross National Product in 2005 increased 9.9% from its 2004 level to reach 18232.1 billion RMB<sup>1</sup>. This marks the fourth straight year where GDP growth rate has surpassed eight percent<sup>2</sup>. However, hidden underneath the surface of China's spectacular growth is a disturbing phenomenon. China's current economic growth occurs mostly in its urban centers. In the vast rural areas – where 807 million

people, 61.6% of China's population<sup>3</sup>, permanently reside – economic progress has come at a relatively slow pace. In 2005, China's primary industry output grew 5.2% in value, while the secondary industry and the service industry grew at 11.4% and 9.6% respectively<sup>4</sup>. This indicates there has been an increase in the income disparity between the urban and rural populations. According to official statistics, the annual disposable income per capita in 2004 was 9422RMB in urban areas, and 2936RMB per capita in rural areas, creating an urban/rural income ratio of 3.21:1. Compared to the ratios of 2.2:1 in 1990, 2.71:1 in 1995, and 2.9:1 in

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<sup>1</sup> The exchange rate as of April 7, 2006 is \$1 Canadian Dollar Equals 6.26 Chinese Renminbi (RMB).  
<http://www.rbcroyalbank.com/rates/cashrates.html>

<sup>2</sup> Xinhua News Agency. "China's Gross National Product for 2005," Jan. 25, 2006.

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<sup>3</sup> China Statistics Bureau. *China Statistical Yearbook*. 2005. P. 65.

<sup>4</sup> Xinhua News Agency. "China's Gross National Product for 2005," Jan. 25, 2006.

2001<sup>5</sup>, the sharp increase is both obvious and alarming. China's urban/rural income ratio has become the worst in the world (most countries in the world have a ratio of less than 1.5:1).<sup>6</sup> Furthermore, city residences enjoy many social welfare benefits such as housing subsidies, health insurance, and a minimum wage that most rural residences do not enjoy. If these benefits are counted as income, it is estimated that the urban/rural income ratio would reach a staggering 5:1.<sup>7</sup>

Growing wealth inequality between towns and country is a problem most countries face at the beginning stage of their economic development. In the last two decades, as China began its economic rise, it focused on stimulating growth in its more urbanized coastal regions. Through favourable policies, such as decreasing taxes and increasing infrastructural investment, the cities of Eastern China were able to attract foreign direct investment in abundance and flourished quickly. This uneven growth strategy concentrated the limited physical and human capital in developing parts of the country most receptive to growth in order to achieve wealth accumulation quickly and more efficiently. Because of the principle of diminishing returns to capital, it is believed that people who are earning higher incomes will invest their savings on the underdeveloped parts of the country to take advantage of higher returns, thus driving the

economic growth of these regions.<sup>8</sup> Under such strategic guidelines, rural area development, particularly the social welfare improvement for farmers, was largely overlooked. This is consistent with convergence theories of the neoclassical economic model, which suggest the convergence of income levels between urban and rural areas is the logical end result of regional economic development.

After almost three decades of exercising the Open Door Policy, the wealth disparity between people living in cities and the countryside has steadily increased. It has not shown any signs of slowing down, let alone an eventual decrease. This has become a major concern for China, as it will likely create tension and have severe political and social consequences. The number of disputes over land rights and labour compensations in the countryside has increased sharply in recent years, showing signs of social unrest rooted within the massive farming population.<sup>9</sup> By all accounts, the wealth disparity problem has become the most significant roadblock to China's long-term social stability and its emergence as a world power. It is clear that the convergence predictions of the neoclassical model have not occurred in China; it should not have relied on market forces alone to eliminate the wealth disparity. It is clear that the Chinese government needs to take a more proactive and central role in order to stimulate economic growth, rejuvenate the agriculture sector, and raise living standards in rural areas.

The Communist Government of China has realized the severity of the wealth inequality problem. In its eleventh "Five

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<sup>5</sup> China Statistics Bureau. *China Statistical Yearbook*. 2005.

<sup>6</sup> Wang, Dewen. "Some Strategies on Solving the Wealth Parity between City and Country." China's Social Science Academy. April 21, 2005

<sup>7</sup> Wang, Mengkui. "The Two Challenges of China's Modernization: Wealth Disparity and Regional Disparity." *Agricultural Economics* 5 (2004): P. 6.

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<sup>8</sup> Sit, V.F. and Dadao, Lu (Editors). *China's Regional Disparities: Issues and Policies*. Huntington, N.Y. : Nova Science Publishers, 2001. P. 27.

<sup>9</sup> Elliott, Michael. "Small World, Big Stakes," *Time Magazine*. June 27, 2005.

Year Plan”, established in September 2005, rural development was made the government’s number one priority.<sup>10</sup> However, the unique geographic, environmental, economic, social, and historical characteristics of China’s countryside make the government’s task of reducing the wealth disparity difficult. A thorough understanding of these issues is crucial for overcoming the challenges facing rural economic development. Three major issues – the government’s agricultural expenditure, the rural labour market, and the difficulties to industrialize the countryside – will be looked at in the following text.

The Chinese Government does not have the financial capacity to substantially increase the living standards in the countryside. When a country suffers from regional income inequality the most common way to solve it is through government transfer payments. These draw resources from richer regions of the country and give them to the poorer areas. Countries such as Great Britain in the 1920s, Japan in the 1960s, and Canada in the 1970s have all conducted government policies in regional development that emphasized transfer payments.<sup>11</sup> In China, government expenditure on agricultural regions has always been a large and essential component of its annual spending. In 2004, such expenditure totaled 235.8 billion RMB, including 169.3 billion RMB on agricultural transfer payments to support rural production, and 56.5 billion RMB on infrastructural construction. This is a 61.9% increase in the value of agricultural

expenditure from the 2001 total of 145.7 billion RMB. Further, it is a 7.4% increase in its share of annual government spending, from 7.7% in 2001 to 8.3% in 2004. In particular, agricultural transfers increased 84.5% from 2001.<sup>12</sup> However, the urban/rural income ratio shown earlier has clearly indicated that the dramatic increase in agricultural transfer has not been effective in solving the wealth disparity. It is reasonable to argue that since a large portion of the transfer payment is capital investments, the benefits of the government’s increase in agricultural expenditure are yet to be reflected in farmers’ living standards after such a short period. The bigger concern however is the fact that China’s rural population is too large for urban areas to support. Dividing the government’s total agricultural expenditure by China’s farming population, the result is a very small number of 292.1RMB per person, which does not provide any significant help for individual farmers. Furthermore, government transfers only solve the immediate issues for farmers; they do not enhance the productivity of China’s agricultural regions in the long run. China, for all its recent development, is still a developing country with limited finances; the total government revenue for 2004 was 2639.6 billion RMB.<sup>13</sup> Increasing government spending on rural development to the point of significantly reducing the wealth inequality between city and country is just not a viable option for the Chinese government.

The excess supply of China’s massive rural labour force has kept agricultural prices and low-skilled labour

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<sup>10</sup> The Chinese State Council. Suggestions on the Building of the New Socialist Countryside. Xinhua News Agency. Jan. 21, 2006.

<sup>11</sup> Sit, V.F. and Dadao, Lu (Editors). *China’s Regional Disparities: Issues and Policies*. Huntington, N.Y. : Nova Science Publishers, 2001. P. 30.

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<sup>12</sup> China Statistics Bureau. *China Statistical Yearbook*. 2005. P. 203.

<sup>13</sup> China Statistics Bureau. *China Statistical Yearbook*. 2005. P. 124.

wages at a very low level. China has 130 million hectares of cultivated land,<sup>14</sup> which is small considering its population size. Other factors, such as the lack of technology and machinery use in agricultural cultivation, the poor geographical conditions of many rural areas, and the constant threat of losing farm land to urban expansion, have made it a constant challenge for the Chinese government to ensure that there is enough food produced for the entire country. To do so, the government purchases a large amount of grain products from farmers each year as its reserve, and purposely sets prices at low levels. These prices drive down market prices for all farming products, which in turn keeps the farmers' income at low levels.<sup>15</sup> Pushed by the low profitability of farming and the increasing scarcity of land, and pulled by the gradual relaxation of the government's residence registration policy and the increase in capital construction projects, there has been a dramatic flow of rural workers to the cities in the last decade. Since most of these workers are uneducated and unskilled, they most often work on construction sites and factories as general labourers, and are generally considered to be in the lowest income bracket in cities.<sup>16</sup> The enormous number of migrant rural workers available – an estimated 150 million in today's China<sup>17</sup> – have kept the market for work extremely

competitive and the wages very low for a long period of time.

It is apparent the unique conditions of China's new economy have created a huge income gap between the farmers and the rest of the population. The best way to solve this problem in the long term is through education, so that children can acquire the knowledge and skill needed in better jobs. However, most rural families in China do not have the financial liberty of sending all their children to school, and require their children to help with farm work. There is also an urgent need for improvement in school conditions; many village schools lack the basic facilities and school supplies such as desks, chairs, and even chalk.<sup>18</sup> The drop-out rate from elementary and high schools in rural areas is much higher than urban areas.<sup>19</sup> Hence these children are likely to continue the way of life their parents have led in the countryside with stagnant incomes and no viable way of improving their standard of living.

In central and western China, where most regions are underdeveloped agricultural lands, it is extremely hard for manufacturing firms to survive, and for capital investment to pour in. As a result, the industrialization process in the countryside has been stalling. Examples to illustrate this problem are the difficulties of China's Village and Town Enterprises (VTE) in recent years. VTEs are companies established by farmers hoping to shift the means of production in the countryside from agricultural to industrial. They were greatly supported by the government and enjoyed a boom period in the mid 1980s. Since then, most VTEs have endured annual losses;

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<sup>14</sup> China Statistics Bureau. *China Statistical Yearbook*. 2005. P. 350.

<sup>15</sup> Gu, Yikang, and Feng, Shao. "Solving the Agricultural Problem in China." *Agricultural Economics* 4 (2003): P. 29.

<sup>16</sup> Gu, Yikang, and Feng, Shao. "Solving the Agricultural Problem in China." *Agricultural Economics* 4 (2003): P. 31.

<sup>17</sup> Guo, Wei. "The Growing City and Country Disparity and its Causes and Possible Government Policies." *China's Economic Research* 85 (2002).

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<sup>18</sup> Hudson, Christopher (editor). *The China Handbook*. Chicago: Fitzroy Dearborn Publishers, 1997. P. 264.

<sup>19</sup> Guo, Wei. "The Growing City and Country Disparity and its Causes and Possible Government Policies." *China's Economic Research* 85 (2002).

many have shut down, while others have moved their operations to the coastal regions.<sup>20</sup> There are four main causes for this phenomenon.

The biggest reason is the awful underdevelopment of market mechanism in this part of the country. Under certain conditions market forces will determine prices such that demand equals supply, thus efficiently allocating scarce resources between uses. Firms, after knowing this information, will invest in an appropriate amount of human and financial capital in order to make profits. For the market mechanism to work, the constant availability of up-to-date and accurate information flows must be ensured. In China's coastal regions, one of the biggest reasons for the flourishing of firms was their ability to forecast the market through perfect information flows. However, in western China, the lack of infrastructure and information flow has made prices volatile and demand and supply impossible to predict. This greatly dampens the incentive for potential firms to invest in the region, even though the government has set favorable policies to attract them.

A second problem is the lack of infrastructure in place. Many villages do not have roads that would link them to the cities. Others areas of the country still do not have access to fresh water or electricity, and use methane gas and coal as their main sources of energy. In rural areas that enjoy better conditions, public systems such as drainage and waterlines still need to be put in place. It is clear that the private sector will not be investing in these areas unless the infrastructure is already in place. Their goal is to make profits immediately.

Chinese farmers' unwillingness to consume is another major concern for China's rural development. Because of their

limited income, and the absence of social programs such as health insurance in the countryside, farmers in China tend to save all their disposable income in case of future emergencies. Since 2001, the urban/rural ratio on household consumption expenditure has hovered around 3.5:1.<sup>21</sup> Household ownership of major appliances such as colour televisions, washing machines, and refrigerators in the countryside is about 30% of that in cities.<sup>22</sup> The lack of demand for consumption goods is detrimental to the development of the manufacturing sector in rural areas. The development of the manufacturing sector is key to the industrialization process in the countryside since it will provide an alternative source of income. Firms and the government need to find a way to stimulate farmers' willingness to consume. China needs its biggest consumer market, the farmers, to realize their buying potential in order to become a true economic giant.

Lastly, the outflow of human capital from the countryside to the cities has limited the countryside's developmental potential. Almost all rural students who come to the cities for university choose to stay there due to better career opportunities and earning potential. This leaves the rural areas depleted of their educated youth.<sup>23</sup> The villages of China need a large amount of talented individuals who have the knowledge and technical skills to improve the current agricultural production methods and social welfare facilities such as schools and hospitals. Firms that are looking to

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<sup>20</sup> Wang, Mengkui. "The Two Challenges of China's Modernization: Wealth Disparity and Regional Disparity." *Agricultural Economics* 5 (2004): P. 6.

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<sup>21</sup> China Statistics Bureau. *China Statistical Yearbook*. 2005.

<sup>22</sup> Guo, Wei. "The Growing City and Country Disparity and its Causes and Possible Government Policies." *China's Economic Research* 85 (2002).

<sup>23</sup> Zhang, Guorong. "The Income Differences between the City and Country and the Policies for it." *China Statistics* 4 (2003).

invest in the countryside will also need educated individuals to manage their business. However, other than government assignments, the countryside simply cannot compete with the cities in attracting human capital. This creates a vicious cycle that drains the countryside's best and brightest individuals to the cities, thereby increasing the gap in education and skill level, and leaving rural development at a standstill.

After discussing the problems facing China's rural development, it is appropriate to follow up by looking at the government's policies aimed at overcoming them. In January 2006, the Chinese government issued its policies and goals for agricultural development for this year. The Chinese government labelled its new initiative as "Building the new socialist countryside". It aims to increase rural infrastructural development, build rural social welfare systems, and reduce the city and country income disparity.<sup>24</sup> The government hopes to use these three measures as means to achieve its eventual goal of completing the industrialization and urbanization process of China's countryside.

The government's main idea of solving the wealth disparity is to let the industry sector help the agricultural sector, and let the cities support the countryside. The government plans to do so in three ways: 1) increase government expenditure in rural areas; 2) reduce the amount of taxes and fees farmers pay; and 3) give more flexibility to the farmers in their production means.<sup>25</sup>

The government plans to substantially increase its agricultural transfers. The 2006 budget included a 22.1%

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<sup>24</sup> The Chinese State Council. Suggestions on the Building of the New Socialist Countryside. Xinhua News Agency. Jan. 21, 2006.

<sup>25</sup> The Chinese State Council. Suggestions on the Building of the New Socialist Countryside. Xinhua News Agency. Jan. 21, 2006.

increase in transfers from the previous year.<sup>26</sup> There will also be an increase in expenditure on infrastructure investments such as farmland, irrigation facilities, roads, hospitals, schools, and small town centers. These investments will greatly help the productivity of farmers and their quality of life.

At the same time, the Chinese Government aims to reduce the taxes and fees farmers have to pay yearly so they have some extra cash in their pocket that could be used for consumption. By the end of 2005, the Government had eliminated its agricultural tax, amounting to 24 billion RMB in government income,<sup>27</sup> which gave farmers some breathing room. The government is now aiming at the elimination of schooling fees for all nine years of compulsory education in the central and western part of China over the next two years.<sup>28</sup> This means that children in these areas will go through elementary and high school entirely free of charge. This is a great strategic move as it will increase the rate of students attending schools in the countryside and increase overall human capital.

Finally, the government is gradually increasing the freedom of farmers to choose their own means of production. Farmers are now encouraged to choose alternative ways of earning income, such as opening stores and moving into manufacturing, which will ultimately increase the industrialization process. Farmers will also enjoy more

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<sup>26</sup> Xinhua News Agency. "China's Gross National Product for 2005," Jan. 25, 2006.

<sup>27</sup> China Statistics Bureau. *China Statistical Yearbook*. 2005.

<sup>28</sup> The Chinese State Council. Suggestions on the Building of the New Socialist Countryside. Xinhua News Agency. Jan. 21, 2006.

relaxed controls by working in cities.<sup>29</sup> China will focus on building more educated and better informed local governments. This will help generate the flow of information (instead of market forces) to determine the demand and supply mechanisms in the countryside.

Lastly, the government will push for better social welfare programs and entertainment facilities in rural areas, so that farmers can enjoy their life in many more ways.<sup>30</sup> These measures are aimed at improving the standard of living in the countryside. It is hoped this will drive up the demand for consumption among farmers, which will ultimately increase the economic prosperity in the rural areas.

These government policies are focused on the needs of the countryside and its farmers. If executed properly and without corruption, they will go a long way towards helping reduce the wealth disparity in China. In the long run, the Chinese government may need to raise the prices on agricultural goods. This will increase the income of farmers by a large margin, which may imply a significant increase in the government's financial burden. The government also needs to finally eliminate the residence registration policy, and allow free mobility between the urban and rural areas to ensure perfect human capital flow. It needs to also continue increasing infrastructural investment in the countryside, until it reaches a level comparable to that of the city, at which point the government could turn villages, especially those in central and western China, into small cities and towns, and speed up China's urbanization process. Ultimately, the Chinese government needs

to stay committed to reducing wealth inequality and the industrialization of the countryside over the long run. These are the only ways China's countryside's development can catch up to that of the cities, and finally eliminate the wealth disparity.

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<sup>29</sup> The Chinese State Council. Suggestions on the Building of the New Socialist Countryside. Xinhua News Agency. Jan. 21, 2006.

<sup>30</sup> The Chinese State Council. Suggestions on the Building of the New Socialist Countryside. Xinhua News Agency. Jan. 21, 2006.

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