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China's Income Inequality

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In mid-January China's National Bureau of Statistics announced that China's income inequality had declined over the period 2008 to 2012. The measure of inequality used was the Gini coefficient (named after its Italian inventor), which dropped from .49 to .47 over that period. The Gini coefficient varies from zero to one, with a higher number indicating greater inequality (see the appendix for a more technical explanation). The news was greeted with incredulity throughout China, and in the rest of the world, since many Chinese believe that inequality has increased sharply during the past three decades, and continues to increase. China's Gini coefficient for 1984 was .28. One reputable Chinese scholar has reckoned that the true figure in recent years has been .61, which would put China among the most unequal countries of the world, exceeded only by some countries in Africa (such as South Africa) and a few in Latin America (such as Honduras). The largest Latin American country, Brazil, has seen its Gini coefficient fall from over .60 several years ago to a still high .55. Allegedly there is much income that goes unreported in China, with one scholar having estimated that among the top ten percent income is under-reported by a factor of three. Certainly the large accumulation of wealth by some Chinese cannot be explained by adding up their alleged income over many years.

Even the new official figure would put China above the United States, the seat of capitalism, with a recent coefficient at .41, highest among the rich countries. Japan and Sweden vie for having the most equal distribution of income among rich countries, at around .25, probably the lowest in the world. But income-based Gini coefficients can mislead, and some analysts would prefer coefficients based on consumption, which are not widely available. For instance, Japanese businessmen enjoy a wide range of "perks" from their companies, such as cars, expensive meals, and memberships in golf clubs, which are not formally counted as income; and in the United States the government provides food stamps to poor people (permitting purchases of food at a discount) and a negative income tax for low earners. Allowing for such policies and practices would raise the coefficient for Japan and lower it for the United States.

Does income inequality (as distinguished from poverty, a related but fundamentally different concept) make a difference? It turns out to be a complicated question, even though many hold strong views on the subject. My view is that the source of inequality is extremely important in judging its social and political importance. Movement into a period of rapid growth, such as China has experienced, is bound to increase inequality initially, as some people are in a better position than others, due to training, location, or simply luck, to take early advantage of the new opportunities permitted by higher growth, or by the changes in policies that permit higher growth. Depending on the nature of the growth, inequality may or may not subsequently fall. China's growth, for instance, has permitted millions of low income peasants to move into higher-income unskilled factory jobs, thus reducing poverty greatly and

potentially reducing overall inequality, although the latter seems not to have happened. Persons who make great contributions to society that can be monetized, such as patentable inventions or widely popular singers or movie stars, are likely to have out-sized incomes. But large incomes can also be garnered through financially-rewarding favors by government officials, or by outright corruption in the distribution of government permits. Views differ on such matters from society to society, but in most societies there are earnings, even high earnings, that are considered legitimate and thus deserved (even though perhaps envied) and there are earnings that are not considered legitimate and thus undeserved. The greater the portion of the undeserved earnings, the greater the potential political problems from income inequality.

Whatever the current levels of income and wealth, the People's Republic of China presumably does not want to repeat the pre-PRC pattern in which (mainly landed) wealth was concentrated in relatively few hands and passed down from generation to generation. Inheritance will become an increasingly important issue as China ages rapidly in the coming decades. Parents of course want their children to do well in society. But their main contribution to their children should be to pass on good values and provide for a good education, not to provide enough wealth that they can live, even live luxuriously, without effort. Each generation should be able to make its own way in society; that is good for society, and it is good for the (now adult) children.

The United States has just recently revised its federal legislation on estates. It is not ideal, but it reflects a desirable concept. Under the new law, estates of over \$5 million are to be taxed by the Federal government at rates in steps up to 45 percent. Individual US states can and do also tax estates, but the state taxes can be credited against the Federal tax, so there is no double taxation. The \$5 million limit is rather high, but is meant to permit on-going small businesses (including farms) to be passed from parents to children without disrupting the businesses. Any wealthy person can however avoid the estate tax by giving his/her wealth to charities that are approved as being in the public interest, such as universities or orchestras or churches. Thus people are encouraged through this provision to accumulate wealth during their lives, but they are discouraged from giving it to their children or grandchildren at death.

China should consider now how it wants to handle accumulated wealth at the death of the accumulator. To allow such wealth to pass to children will over time establish a class of people who live on the earnings of their wealth, earned not by them but by their parents or grandparents.

Appendix: Imagine a chart on which the population, ranked by income or consumption, is measured along the horizontal axis and cumulative income is measured along the vertical axis, and a line relating the two variables is drawn on the chart. It will slope upward, but its pace of upward movement will depend on the distribution of income (or consumption). If income is distributed perfectly evenly, the line will be straight at 45 degrees from the chart's origin. If income is all concentrated in the hands of one family, the line will be horizontal until it reaches the last family, at which point it will rise vertically. The Gini coefficient is defined as the ratio of the area between this line and the 45 degree line to the total area under the 45 degree line. Thus the Gini coefficient will vary between zero (if income is distributed perfectly evenly) and one (if all income is concentrated in one family).