

Abstract

Title: The Granger Causality between Economic Growth and Income Inequality in Post-Reform China

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Ever since economic reform has been carried out in China, its economic growth rate has been remarkable. Its annual growth rate of per capita GDP was about 8.07% for the period 1978-2002, but its income inequality level presented a different moving trend during this time. In the 1980s, it seemed that economic reform decreased this inequality successfully, but the situation of income distribution started to deteriorate beginning in 1990. The purpose of this study is to research if the relationship between economic growth and inequality exists in post-reform China.

According to previous literature, economic growth and inequality can influence each other, but their influential directions are uncertain. This study adopts the Granger-causality test as a methodology to estimate their relationship and influential directions. This study tests Granger-Causality with the chi-square statistic, which was proposed by Toda and Yamamoto (1995). They wrote that researchers could estimate a $(k+d_{max})$ th-order VAR where d_{max} is the maximal order of integration. Only the first k coefficients have to be jointly tested with the chi-square statistic, and the last d_{max} coefficients are ignored. This study finds the following results: (i) growth positively influences inequality; (ii) inequality does not influence growth; and (iii) the results are sturdy no matter what inequality index or what lag lengths are used in the empirical test.

The result (i) can be attributed to the biased central government policy. Differencing from previous studies, which focused on democratic or undemocratic economies, this study researches a transitional economy. It could be the reason why this study finds no evidence of the effect of inequality on growth.

The policy implications of this study are that China's government has to give up biased policies and increase the incentives of investing in inland regions. Besides, in order to promote sustainable economic growth, some policies like fiscal transfers, which can reduce inequality quickly, are not recommended.