CHAPTER 6 CONCLUSIONS AND IMPLICATIONS

This study aims to investigate the Granger-Causality between economic growth and income inequality in post-reform China. The official annual time-series data provided by the ***China Statistical Yearbook*** and ***Comprehensive Statistical Data and Materials on 50 Years of New China*** is adopted to conduct the empirical investigation.

After employing Granger-Causality test with the Toda and Yamamoto procedure, this study finds two primary results: income inequality does not affect economic growth and economic growth positively and significantly influences income inequality. The results do not change no matter what inequality index is applied in an empirical model or *k+1* and *k+2* lagged lengths are used. Furthermore, while adjusted economic growth is a substitute for official growth, the results do not vary much.

This study infers that post reform China is in a transitional process, and government isdecreasing its intervention in economic activities and income distribution. Besides, poor people do not access political channels to put pressure on the government. Barro (1999) thought poor countries would execute redistribution policies to promote economic growth, and Clarke (1995) thought both democracies and non- democracies would employ distortional policies and affect economic growth. However, the situations of transitional China are different from their predictions, which make the effect of income inequality on economic growth insignificant. In addition, China's rapid growth expands its market size and development potential so foreign capital is attracted to invest in it. The central government policy determines the location choice of foreign capital and technology mostly. The cluster of foreign capital and technology in east provinces makes their average output increase more. Therefore, economic growth positively influences income inequality through the channel of foreign investment flow and technology.

Previous chapters had illustrated that inequality level revealed an increasing trend since 1990s. And in the year 2002, the GDP per capita in Shanghai was as 12.89 times as it was in Guizhou. As indicated by Huang et al. (2003), inequality would promote the probability of social unrest or turmoil and increase the risk of economic recession in China. Because the issues of growth and inequality are so important that the remainder of this study will provide some policy implications.

Krongkaew and Kakwani (2003) classified growth into three categories: pro-poor growth, trickle down growth and immiserising growth.[41] According to their thoughts, pro-poor growth is the best economic situation in a growing economy and is sustainable growth. This study does not and cannot confirm if the following policy implications can promote pro-poor growth, but can lessen the pressure of increasing inequality at least.

As the explanations of empirical results in the last chapter, the relationship of growth and inequality is closely related to government policies and factors spatial distribution. Consequently, it is essential to cancel biased policy and let production factors move freely for income equality.

During the reform period, the central government authorized coastal local governments to execute preferred policies to encourage trade and absorb foreign

[41] Pro-poor growth means poor people or regions can enjoy a higher growth rate than the national average. Trickle down growth means richer people enjoy higher growth rates than poor people do although they all benefit from economic growth. The theory proposed by Kaldor (1956) is always called a trickle down theory. Immiserising growth means poor people get hurt in the growing process. According to the above definitions, economic growth in China should be categorized as trickle down growth.

capital. Although these policies promote rapid growth, the effect of foreign investment will tend to decrease if it continues to cluster in eastern region. As the findings of Zhang and Kristensen (2001) illustrated, investment multipliers decline as an increasing income and that the benefit of a given investment is greater in poor regions than that in rich regions. That is to say, it will produce more outputs if that government invests more in central and western regions. In other words, giving up biased policy will promote both national growth and equality.

In addition to distributing capital efficiently, the central government has to find some ways to overcome the problem of low saving rates in central and western regions or even attract capital inflow to poorer regions. Wang and Hu (1999) found richer provinces had a higher saving rate and it was positively related to the investment rate. This implies rich provinces hold greater momentum to push their growth than poor provinces. Public investment is not enough for central and western regions to promote long-term growth if private investment is still at a low level. Chen and Fleisher (1996) thought government should enhance the development of the interior infrastructure. They considered that it would not only raise the incentives for coastal business and foreign direct investment, but also would facilitate the transfer of know-how. As inland regions absorb this physical and human capital, it will grow faster and promote regional equality.

It is expected that public capital redistribution and private investment encouragement will be helpful for even growth, but it involves the re-centralization of taxation power.[42] It could take a long time for the central government to give support to poor provinces. Promoting labor migration between regions and

[42] The issues about the relationship between public investment and taxation system can be found in Wang and Hu (1999).

provinces could be a shortcut and easier method to lessen inequality promptly. Although the restriction of rural-urban migration had weakened in the late 1980s, it was only helpful for convergence within region and province rather than in a regional convergence. The inter-provincial migrations are still far from over.

One of the most important reasons that creates a migration barrier is local protectionism. Cai et al. (2002) indicated that local governments have an intention to restrict migration in order to protect local labor's employment opportunity. This study believes inequality is unavoidable under market economic institutions and it can encourage working incentives and growth, but supposes it is reasonable for the central government to enforce regulations to remove artificial obstacles that lessen the inequality level. Blocking production factor mobility freedom, such as local protectionism, is both inefficient and unjust and should be prohibited.[43]

Fiscal transfers might be the most efficient way for government to lessen regional inequality. As the research by Tsui (1991) showed, China's government transfer contributed to reduce regional growth significantly during the period of planning the economy. Output of richer provinces, such as Guangdong and Shanghai, was levied and then subsidized poorer provinces. Since economic reform was introduced, not only did the central government decentralize its fiscal authority to local government, but also transferred fund to coastal region.[44] Some scholars also recommend the central government to re-centralize fiscal authority to carry out fiscal transfer.[45] Although its effect of decreasing inequality is swift, this study does not

[43] Although migration would raise labor marginal output in the poorer provinces as that would decrease it in rich provinces, Chen and Fleisher (1996) did not support a numerous numbers of labors move to coastal region. They worried that such migration would overwhelm the burden of infrastructure, such as transportation and sanitation. Besides, it is worthy to note that labor migration will deteriorate inequality level if human capital flows out of poor provinces.

[44] As Raiser (1997) pointed out, fiscal transfers were still existing during the reform period. However, the receivers of fiscal subsidies are richer western provinces.

[45] See Wang and Hu (1999), for example.

suggest using fiscal transfers as a primary tool to decrease inequality in post reform China. The major shortcoming of fiscal transfer is that it could frustrate local investment and thereby hurt growth. This result infringes on the purpose of economic reform. This section emphasizes in inequality reduction, but growth is as important as equality. China's government should seek some ways to keep them in balance rather than promote any one side.

Finally, this study has to recognize that the weakness of this study is the number of observations. Since quarterly data is not available and longer yearly time-series data is not complete, empirical results of this study are restricted with fewer degrees of freedom. In the future, more observations will be provided, and the above difficulty can be conquered and a more accurate conclusion regarding the causality between economic growth and income inequality in post-reform China can be made.