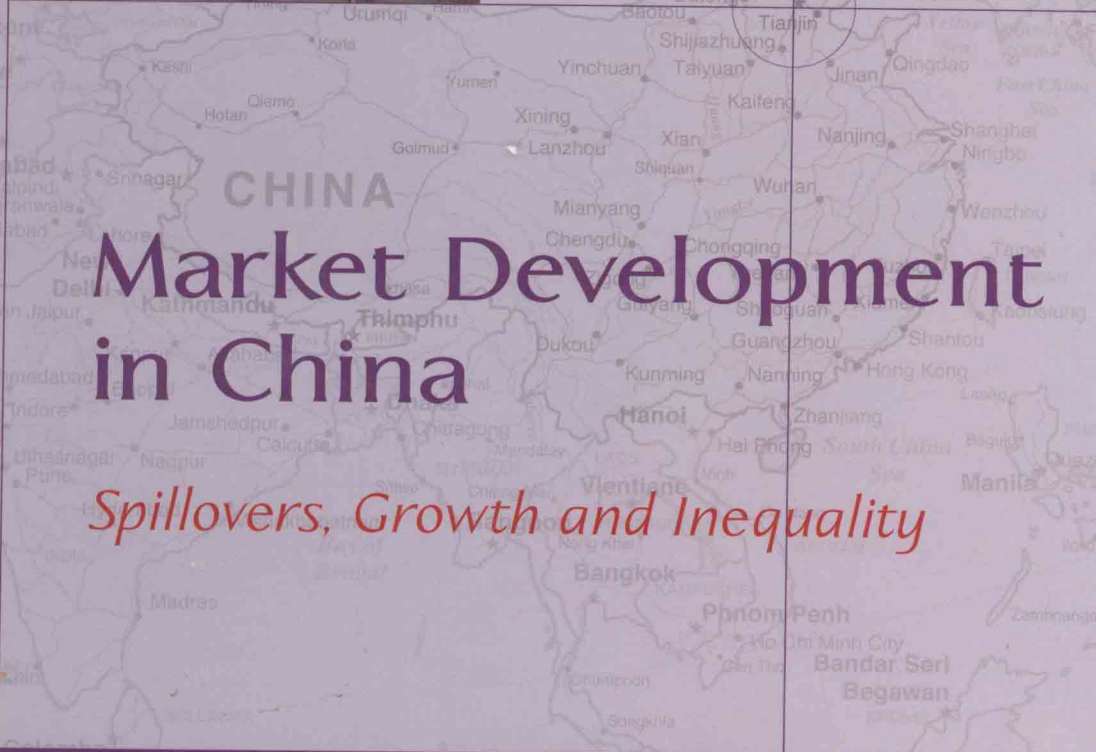


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AND
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Market Development in China

Spillovers, Growth and Inequality

ADVANCES IN CHINESE
ECONOMIC STUDIES

Market Development in China

Spillovers, Growth and Inequality

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- J. Huang and S. Rozelle, The Emergence of Agricultural Commodity Markets in China, 266–80
- Y. Hu, S. Oppor and S.M.L. Wong, Political Economy of Labor Retrenchment: Evidence Based on China's State-Owned Enterprises, 281–99.
- M. Lai, S. Peng and Q. Bao, Technology Spillovers, Absorptive Capacity and Economic Growth, 300–20.
- H. Li, J. Luo and P. McCarthy, Economic Transition and Demand Pattern: Evidence from China's Paper and Paperboard Industry, 321–36.
- Z. Lu and S. Song, Rural–Urban Migration and Wage Determination: The Case of Tianjin, China, 337–45.

The following is reprinted from *China Economic Review*, 16(2), 289–304.

- X. Zhang and R. Kanbur, Spatial Inequality in Education and Healthcare in China.

Introduction

It is generally recognized that despite possible upward biases in the data, in the last 25 years China has achieved a rate of economic growth unmatched in any of the world's major countries. However, this growth has been unequally shared, so that by the year 2000 China also exhibited what to many observers was an alarming degree of income inequality at the individual, sectoral, and regional levels (Yang, 2002). The 12 chapters in this book address different facets of the causes and effects of the related issues of China's growth and inequality. Each paper was originally presented at the conference of the Chinese Economists Society, 'Technology, Human Capital, and Economic Development,' held 31 July to 1 August 2004 at the Georgia Institute of Technology. After careful review and with the generous assistance of external referees, the editors selected these papers among 60 papers presented at the conference as significant contributions to the literature on China's economic growth and market development.

The book consists of two parts. Part One, *Inequality in China*, addresses the critical economic, social, and political issues of rising inequality. The alarming degree of sectoral, regional, and household inequality that now characterizes much of China is due in large part to the wide dispersion of economic growth rates across regions. It is also due to the movement away from a system in which health, schooling, pensions, and other human-capital and safety net programs were guaranteed by the State and state enterprises. Now, enterprises, provinces, municipalities, and government agencies can no longer rely on infusions from the central government to support vital social programs. Part Two, *Market Development and Sources of Growth*, focuses on several of the factors contributing to China's rapid growth and to its unequal pattern. The chapters address the ways in which specific industries, markets, and their interrelationships have affected the growth and distribution of wages, prices, and incomes in China under reform.

Part One has four chapters. In Chapter 1, Zhihong Chen addresses the question: How should poverty thresholds be calculated for China? Her answer is that equivalence scales are ideally suited for providing answers to this question, because they establish comparable poverty lines for

households of different sizes and compositions and in different regions. A foundation for this study, and an important contribution to the literature on consumption behavior in China, is a specification and estimation of a consumption demand system for Chinese households, in which Chen adopts the Almost Ideal Demand System approach. Chen uses the Urban Household Survey data of China to estimate the equivalence scales for Chinese urban households and then anchors them to World Bank poverty line calculations. The methodology and the equivalence scales estimated in this chapter can be used to determine the appropriate subsidy levels for households with different demographic characteristics, given the subsidy standard specified by a poverty-reduction program.

Emily Hannum and Meiyan Wang write in Chapter 2 that two of the byproducts of China's development of a market economy have been decentralization of the administration of education and finance and increased financial burdens on families to pay for the education of their children. The authors argue that geographic origins are a significant element of educational stratification, and find that geographic disparities in education have increased over time and been an important contributor to China's rising regional economic disparities. Using 2000 census data on year and location of birth and educational attainment, they compare the links between birth province and educational outcomes across five-year birth cohorts to illuminate trends in these region-based inequalities.

Hannum and Wang show that the variation in years of schooling explained by birth province declined for cohorts born through the early 1960s, and then increased thereafter. Additional analyses using a dissimilarity index indicate that the link between geography and access to primary school has greatly increased across cohorts, as those people without access to primary school are ever more concentrated in poor areas. The link between birth province and access to subsequent levels of schooling shows mixed trends through cohorts born in the early 1960s. Thereafter, the dissimilarity index increased, substantially for junior high school and slightly for senior high school and college. Their chapter attests to the enduring significance of geography as an educational stratifier in China.

Inequality in support for social services as a source of social inequality is confirmed in Xiaobo Zhang and Ravi Kanbur's chapter. As Zhang and Kanbur emphasize, the stability of China's future economic and political progress depends in large part on a belief that it is better to be part of the economic reform than to revert to a system in which shares in the economic pie were determined more by political status than by economic success. However, in the era of market reforms, the old foundations of education and healthcare provision have eroded, and increasing competition has doomed most traditional SOEs, which formed an important foundation of the social

support system under planning. They show that social inequalities in rural, urban, inland and coastal areas all have increased since the economic reforms. In particular, the rural-urban gap in illiteracy and infant mortality and the gender gap in literacy remain large.

In the fourth chapter, Gongcheng Zheng provides a view of the development of China's education system from the perspective of both an academician and policymaker. He argues that equal opportunity to obtain education is a necessary condition for the currently disadvantaged to participate in the rising standard of living available to those who have been able to attend and graduate from high-quality secondary schools and post-secondary educational institutions, which should include not only traditional academically-oriented curricula, but also courses aimed at students who wish to develop expertise in technical occupations and professions. He advocates encouraging individuals and firms to participate in the funding of education so that government funds can be used to foster the reduction of inequality of educational opportunity.

Part Two has eight chapters. In Chapter 5, Yifan Hu, Sonja Oppen and Sonia M.L. Wong tackle a negative side of reform – the problem of retrenched workers in China's SOEs. They address these questions: Which SOEs successfully took on the challenge of restructuring? Are SOEs following economic reasoning in their labor decisions? Can we still observe evidence of government control in SOEs' labor decisions? Did corporatization actually tie the government's hands and end political interference in the labor decisions of corporatized SOEs compared to traditional SOEs? The two major results of their study are: (1) The degree of labor retrenchment is negatively related to enterprise performance; (2) decisions about labor retrenchment in traditional SOEs are related to the local government's fiscal position and to local reemployment conditions for laid-off workers, whereas labor decisions in corporatized SOEs are not related to these two variables. In other words, hard budget constraints appear to lead to hard decisions, and there appears to have been significant depoliticization effects for China's partially privatized, listed enterprises.

China's reforms began in agriculture, and in Chapter 6, Jikun Huang and Scott Rozelle discuss the extent to which the spark that began at the level of individual production units has spread to innovation and change in market institutions, which are critical to continued economic development in transition economies. They use several sets of price data to document the marketization of agriculture by exploring spatial patterns of market price contours over time, and they examine the extent to which market prices are integrated among China's regions and linked to world commodity markets. They show that marketization has come both from commercialization of the state sector and the emergence of a private trading sector. Markets have

been integrated and transaction costs have fallen. They assert that the number of traders in agricultural markets is now so great that the constraints under which state intervention can operate have been radically altered. Local prices in the basic commodities are now determined much more by aggregate supply and demand than by regional economic conditions.

In Chapter 7, Haizheng Li, Jifeng Luo and Patrick McCarthy investigate demand patterns and structural changes in the paper and paperboard industry in China. They find that in the early stage of industrial reform, prior to 1993, the demand for paper and paperboard did not exhibit a negative price elasticity of demand. This is consistent with production and use of these products being subject to allocation by planning and directive rather than to market signals. After 1993, the markets appear to have emerged, resulting in reasonable, negative demand elasticity with respect to both domestic and international prices. Evidence from paper and paperboard industry indicate that China has become increasingly integrated with world markets.

The eighth chapter, contributed by Helian Xu, Qun Bao and Mingyong Lai, explores how export composition influenced technology spillovers to domestic production, leading to more rapid total factor productivity growth. They find that a shift away from resource- and labor-intensive exports accompanied by foreign direct investment (FDI) and a growing stock of human capital, leads to a shift in comparative advantage toward more skill-intensive manufacturing and increases the speed at which the economy can absorb technology. They conclude that policies favoring human-capital accumulation and FDI will improve efficiency and enhance growth.

In Chapter 9, Mingyong Lai, Shuijun Peng and Qun Bao analyze the connections between international technology spillovers, domestic technology absorptive capacity, endogenous technological change and the steady-state growth rate. They find that technology spillovers depend on the ability to absorb new technology, where absorptive capacity is influenced by human capital investment and degree of openness. They find that FDI is a more significant spillover channel than imports. One of the policy implications, derived from evidence of external effects on the capacity to absorb technology via FDI, is to subsidize individuals' human-capital investment.

Sarah Y. Tong and Youxin Hu provide insight into the channels and effects of technology spillovers from FDI. In Chapter 10, the authors discuss both the beneficial and detrimental effects of FDI on indigenous Chinese firms. Using firm-level data of Chinese manufacturing, they examine FDI spillover effects both within and across industries and identify differences in the impact of FDI from different countries. One of their most interesting empirical results is that FDI from countries outside the Hong

Kong–Macau–Taiwan network has a more favorable impact on productivity growth than does FDI from inside the network. This difference is likely to emanate from the greater technological level of production associated with investment from countries further away from China. They also find that FDI has a more powerful impact on productivity growth in more open segments of the Chinese economy.

In Chapter 11, Zhigang Lu and Shunfeng Song address questions concerning the rural–urban migration that has arisen in response to the immense productivity and income gap between traditional agriculture and the industrial and service sectors of the Chinese economy. Based on data derived from a survey of employees conducted in 2003 in Tianjin, they examine why some farmers migrate to cities and some do not; what are the characteristics of those who do migrate in comparison to those who choose to remain in rural areas; what factors help determine the wages of rural–urban migrants; and what evidence is there of discrimination against rural migrants in China’s urban labor markets. Their empirical results indicate that urban workers earn more than migrants with similar characteristics, indicating the possibility of wage discrimination against migrants. They find evidence that the *hukou* system increases the rural–urban wage gap, and after accounting for human-capital characteristics, females earn less than males in urban employment, but not in rural employment.

In the concluding chapter, Fan Zhang and Zuohong Pan investigate the role of increasing returns to scale in explaining the pattern of regional trade in China. They test two contrasting hypotheses concerning the direction of interregional trade: is the direction trade determined primarily by factor endowments, as implied by the Heckscher–Ohlin model, or do factors on the demand side play an important role, as implied in the more recent new economic geography framework? Their results show the existence of significant home-market effects in determining production and trade patterns across regions in China. An important policy implication is that it is likely to be difficult and costly to relocate industry from center (high demand) regions to peripheral (low demand) regions. The location of industries not linked to major resource bases in the major sectors of manufacturing are likely to be spatially concentrated in the areas with higher demand for their products.

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PART ONE

Inequality in China