

# A Test of the Kuznets Inverted U Hypothesis: Income Inequality Behind the Rapid Economic Growth in China

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## **Introduction**

When we think about measuring the economic growth of a country, per capita income is usually the first indicator that comes to our minds. Of course, this indicator is a very important number to evaluate the level of development of a country. However, per capita can only tell us one side of the picture because it does not show how the income is distributed among the population. Therefore, an increase in per capita does not necessarily mean that all (or not even majority of the) people are better off.<sup>1</sup> Therefore, in order to get a clear picture of how well economy is developing, we should take the problem of income inequality into account.

Many economists have developed theories to explain the phenomenon of income distribution in an economy, prominent amongst them are the theories discussed in Kalecki's model (1971) and the human capital approach (Mincer, 1958 and Becker, 1962). However, all these theories fail to say anything about the state of development and the equality of income distribution.<sup>2</sup> In 1955, Simon Kuznets made a significant contribution to suggest that when economic growth occurs, the level of capita income and inequality in the distribution of income may initially increase and may decrease only in the long run. According to this hypothesis, when the per capita income rises, inequality

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<sup>1</sup> Kishore G. Kulkarni. "Economic Growth and Income Distribution in Malaysia: A Test of the Kuznets Inverted U Hypothesis". *Readings in International Economics*. New Delhi: Serials Publications, 2006. p.194.

<sup>2</sup> Alfred Greiner, Willi Semmler, and Gang Gong. *The Forces of Economic Growth : A Time Series Perspective*. Princeton, NJ : Princeton University Press, 2005. p.131.

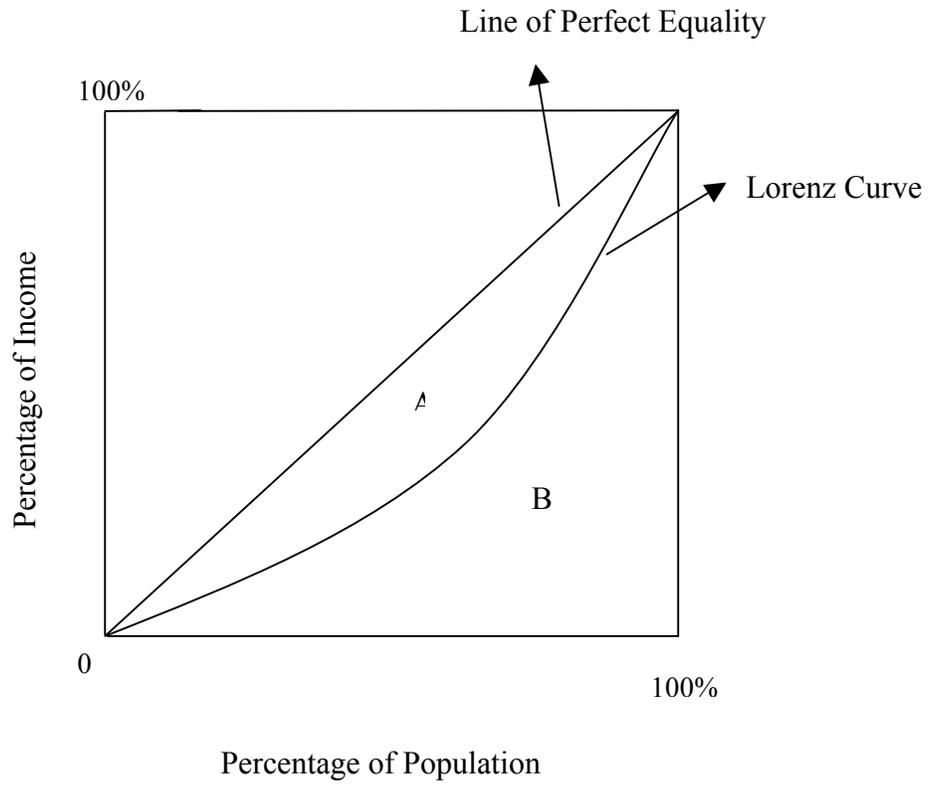
of income distribution may also rise initially. Only when the level of aggregate income has reached a certain level, the trend reverses. Thus the universally observed phenomenon is that economic growth can never be equally distributed.

China, with a nine per cent annual GDP growth since 1980, is regarded as one of the countries with fastest economic growth. In this essay, we test the Kuznets Inverted U Hypothesis, together with the Lorenz Curve and Gini Coefficient, in the case of China. First we explain the meaning of the Lorenz Curve, Gini Coefficient and the Kuznets Inverted U Hypothesis. Second, the income distribution situation in China in the pre-economic reform period and the post-economic reform period, especially the introduction of Foreign Direct Investment (FDI), is discussed. Finally, we will conclude why we still have no clear-cut evidence that whether the Kuznets Inverted U Hypothesis can be applied to China or not.

## **Section 1: Theory: The Lorenz Curve and the Gini Coefficient**

Before we explain what the Kuznets Inverted U Hypothesis is, we should introduce the concept of a Lorenz Curve. A Lorenz Curve is commonly used to analyze personal income statistics: essentially it is the curve that shows the relationship between the proportion (or percentage) of population receiving percentage of income in an economy. Consider Figure 1.

Figure 1: The Lorenz Curve



The horizontal axis shows the percentage of income recipients. The vertical axis shows the share of total income received by each percentage of population, which is also cumulative up to 100 per cent.<sup>3</sup> In order to draw a Lorenz Curve, both the income recipients on the horizontal axis and percentage of income on the vertical axis must be ranked from the lowest to the highest. The line of perfect equality, which is the diagonal (45 degree line), represents a perfectly equal income distribution in an economy where every household has the same income. On the contrary, the line of perfect inequality, which coincides with the horizontal and vertical axes, represents a perfectly unequal income distribution in an economy where one household has all the income and everyone else has none.<sup>4</sup> In other words, the inequality of the distribution of income is more serious if the actual line bends further away from the 45 degree line.

The Gini Coefficient is also developed from Figure 1, which is named after the Italian statistician Corrado Gini who first formulated it in 1912 and known as a measure of inequality of a distribution.<sup>5</sup> If “A” represents the area bounded by the 45 degree line and the curve, while “B” is the area that is not covered by “A”, then the Gini Coefficient can be calculated by using the formula  $A/A+B$ . Gini Coefficient can vary anywhere from 0 (perfect income equality) to 1 (perfect income inequality). The bigger the area covered

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<sup>3</sup> Alfred Greiner, Willi Semmler, and Gang Gong. *The Forces of Economic Growth : A Time Series Perspective*. Princeton, NJ : Princeton University Press, 2005. p.131.

<sup>4</sup> The Legislative Council of Hong Kong.  
<<http://www.legco.gov.hk/yr04-05/english/sec/library/0405fs07e.pdf>>

<sup>5</sup> Michael P. Todaro. *Economic Development* (7<sup>th</sup> Ed.) Reading, Mass. : Addison-Wesley, 2000. p.159-160.

by “A”, the higher the Gini Coefficient and thus higher income inequality.<sup>6</sup> We will see in a minute that both the ideas of the Lorenz Curve and the Gini Coefficient are closely related to the Kuznets Inverted U Hypothesis.

### **The Kuznets Inverted U Hypothesis**

In 1955, Kuznets published an article “Economic Growth and Income Inequality” on *The American Economic Review*. He was the first person to introduce the idea of a link between inequality and development. Kuznets argued that in the early stages of development, the rich accumulate more wealth than the poor. As a consequence, the income distribution becomes more unequal.<sup>7</sup> Kuznets pointed out that development involves the shift of population from traditional to modern activities. This process of population shift from participating in agricultural productions to industrial productions allowed Kuznets to predict the behavioral of inequality during the course of development:

An invariable accompaniment of growth in the developed countries is the shift away from agriculture, a process usually referred to as an industrialization and urbanization. The income distribution of the total population, in the simplest model, may therefore be viewed as a combination of income distributions of the rural and of the urban populations. What little we know of the structures of two component income distribution reveals that: (a) the average per capita income of the rural population is usually lower than that of the urban; (b) inequality in the

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<sup>6</sup> Kishore G. Kulkarni. “Economic Growth and Income Distribution in Malaysia: A Test of the Kuznets Inverted U Hypothesis”. *Readings in International Economics*. New Delhi: Serials Publications, 2006. p.195.

<sup>7</sup> Alfred Greiner, Willi Semmler, and Gang Gong. *The Forces of Economic Growth : A Time Series Perspective*. Princeton, NJ : Princeton University Press, 2005. p.131.

percentage shares within the distribution for the rural population is somewhat narrower than in that for the urban population..... Operating with this simple model, what conclusion do we meet? First, all other conditions being equal, the increasing weight of urban populations does not necessarily drift downward in the process of economic growth: indeed, there is some evidence to suggest that it is stable at best, and tends to widen because per capita productivity in urban pursuits increases more rapidly than in agriculture. If this is so, inequality of the total income distribution should increase.” (Kuznets, 1995, pp.7 – 8)

However, Kuznets claimed that when the level of aggregate income has reached a certain level, income inequality levels off and diminishes finally during the latter stages.<sup>8</sup> This relationship between the distribution of income and the degree of development forms an inverted U-shaped function as shown in Figure 2.

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<sup>8</sup> Kishore G. Kulkarni. “Economic Growth and Income Distribution in Malaysia: A Test of the Kuznets Inverted U Hypothesis”. *Readings in International Economics*. New Delhi: Serials Publications, 2006. p.196.

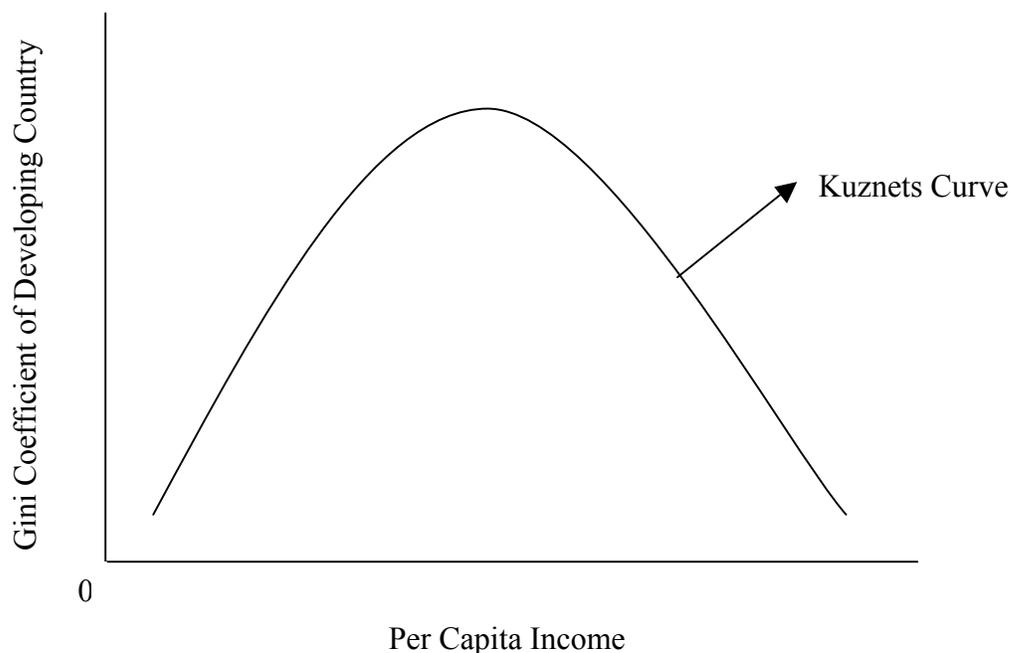


Figure 2: The Kuznets Inverted U Hypothesis

### **General Economic Development Picture in China**

#### *Pre-Economic Reform Period (1949 – 1978) – A Period with low Income Inequality*

Geographically speaking, the central part of China was with a comparative advantage in producing energy, materials and machineries; while the western part was with comparative advantage in producing primary products, such as grain, forestry and livestock etc. As the eastern part of China is close to the sea, they had a comparative advantage in producing consumers and industrial goods, and industries there could export their products to the rest of the world easily. However, during a Maoist era (1949 – 1976), Mao deliberately got rid of these kinds of comparative advantages and accepted an

approach named “Maoist development strategy” by Dali Yang.<sup>9</sup> In other words, Mao tried to develop Chinese economy in a way that was contrary to the economic rule.

Mao refused to develop China according to efficiency was because he thought that China should be a truly socialist country. Mao believed that if the economic development of China is based on the regional comparative advantage, regional income disparity would appear. Therefore, in Mao’s April 1956 speech, he openly express that he was favor of building most of heavy industry, “90% or perhaps still more”, in the interior.<sup>10</sup> Obviously, he wanted to avoid income inequality in China. During the First Five Year Plan (1953-1957), almost two-thirds of the major projects were located in these areas.<sup>11</sup> However, “Maoist development strategy” was not as idealistic as Mao thought. Since the interior parts were with poor infrastructures and facilities, it was really hard for them to develop industries. At the same time, as Mao did not allow any foreign direct investment (FDI) and the state investment in the coastal region was highly limited, this area could not make use of the comparative advantage and as a result, the Chinese economy did not develop at all during this period.

Mao also tried hard to root people to their place of birth through the household registration system (*hukou* system).<sup>12</sup> It is a system that when a person was born in a province, his or her name was recorded in that provincial government and he or she was qualified to receive subsidies from the government. However, if the person moved to another province, he or she was not qualified to receive any subsidies from that

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<sup>9</sup> Dali Yang. “Patterns of China’s Regional Development Strategy”. *China Quarterly*. No. 122 (Jun 1990) p.230.

<sup>10</sup> Ibid. p.234.

<sup>11</sup> Ibid. p.234.

<sup>12</sup> James E Nickum. “Broken Eggs in the Market: The Rise of Inequality in China”. *The China Journal*, Vol. 49 (Jan ., 2003). p.120

provincial government. Clearly, the household registration system tried to prevent the migration of the rural population into cities,<sup>13</sup> and thus from the agricultural sector to the industrial sector. The income inequality problem was not serious in China at that time.

During the ten-year Cultural Revolution (1966-1976), Chinese were suffered from class struggles and most people did not go to work. The Chinese economy was seriously destroyed, not to say development. Therefore, before the death of Mao in 1976, the level of income inequality remains low since Mao believed in egalitarianism and the economy had not developed at all during the Maoist era. Before Deng Xiaoping came to power in 1978, the Gini Coefficient of China remains relatively low and it was 0.23.<sup>14</sup>

#### *Post-Economic Reform Period (1978 – 2005 )- A Period with high Income Inequality*

Deng Xiaoping came to power in 1978 and the main and primary objective of him was to develop the economy of China since it is the only way to retrieve the mistakes and problems caused by the Cultural Revolution. There were many economic reforms, such as Special Economic Zones (SEZs), township and village enterprises and foreign direct investment (FDI) etc. However, in this essay, I will concentrate on discussing FDI since it was the most important economic reform in China and has the greatest influence on Chinese economic development.

Economic development can never be started without capital. Therefore, Deng cleverly adopted the approach of “reform and openness” in order to attract the capital from foreign investors. Here comes to the question: how can China attract the foreign

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<sup>13</sup> Renwei Zhao. “Increasing Income Inequality and Its Causes in China”. Carl Riskin, Zhao Renwei, Li Shi, (Ed.). *China's Retreat from Equality : Income Distribution and Economic Transition*. Armonk, N.Y. : M.E. Sharpe, 2001. p.26.

<sup>14</sup> Yanrui Wu. “Regional Disparities in China: An Alternative View”. *International Journal of Social Economics*. Vol. 29, No. 7( 2002). p. 578

investment? The answer was that the government of the People's Republic of China (PRC) must issue new economic policies in order to show their determination in opening up China.

### **Introduction of Foreign Direct Investment**

Unsurprisingly, the east costal area in China was chosen as the region that should be firstly developed. The central government tended to use the coastal area to attract the foreign investment because it was with better infrastructures. Since the eastern part of China is close to the sea, the port facility there has been developed and it was extremely easy for the foreign investors to access these areas. Moreover, closer to the sea meant that the finished goods could be easily exported to other countries. Furthermore, the transportation facilities in these areas were much better than the interior parts of China. Therefore, the PRC government has chosen to develop the coastal area first and they believed that the better infrastructure condition could definitely help to attract the foreign investment.

Other than the above, the central government also issued many favorable policies to enhance the development in the costal areas. For example, it established four Special Economic Zones (SEZs) in 1980, including Shenzhen, Zhuhai, Shantou and Xiamen<sup>15</sup> and the further opening of 14 coastal cities in 1984.<sup>16</sup> Moreover, the PRC government

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<sup>15</sup> Jean-Francois Brun and Mary-Francoise Renard. "International Trade and Regional Specialization in China" in Mary-Francoise Renard. *China and Its Regions: Economic Growth and Reform in Chinese Provinces*. Cheltenham, Massachusetts: Edward Elgar Publishing Limited, 2002. p.90.

<sup>16</sup> Qiumei Yang. "The Regional Distribution of Foreign Direct Investment in China: the Impact of Human Capital" in Mary-Francoise Renard. *China and Its Regions: Economic Growth and Reform in Chinese Provinces*. Cheltenham, Massachusetts: Edward Elgar Publishing Limited, 2002. p.219.

also granted many privileges to the foreign investors of the coastal areas, such as lower tax rates or even tax exemption.<sup>17</sup> Therefore, it seemed that developing the coastal area was the only way to attract the foreign capital. Obviously, what the Chinese government did was trying to use the coastal area as an “engine of growth”, so that the economic development of and capital gained from the eastern part of China could also help the interior parts.

The “reform and openness” policy of China successfully attracted many foreign enterprises to start their business in China. Before the economic reform, there was no FDI in China, but at the end of 2003, according to the Organization for Economic Co-operation and Development (OECD), China was the biggest recipient of FDI, receiving \$53 billion out of \$192 billion that the OECD countries invested to all emerging economies.<sup>18</sup>

### **Income Inequality Appeared and How It Showed Kuznets’s Predictions**

Due to the economic reform and the dramatic increase of FDI in the urban areas, the central government also released the restrictions on the household registration system (*hukou* system), that means rural population can move to urban areas to find jobs. In fact, FDI created a lot of employment opportunities for the urban as well as rural population. From the 1980s to 1990s, employment in the state-owned enterprises (SOEs) had increased only by 3.1 per cent, while the employment in the non-public sector (most were

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<sup>17</sup> The law that favorable to the foreign investors including: Law of the People’s Republic of China on Joint Venture Using Chinese and Foreign Investment, Chinese-Foreign Equality Joint Ventures, The Law on Chinese-Foreign Co-operative Joint Venture, The Law on Wholly Foreign-Owned Enterprises and Income Tax Law Concerning Foreign Invested Enterprises. Ibid. p.198.

<sup>18</sup> Globalization101.org . “China – The Number One Target for Foreign Direct Investment in 2003” < <http://www.globalization101.org/index.php?file=news1&id=32>>

joint-venture and foreign-capital enterprises) increased by 730.7 per cent.<sup>19</sup> From this, we can see that the economic development of China fits Kuznets's prediction on population shift started to appear during the economic reform period. The share of the Chinese population living in the rural areas has fallen from 81 per cent in the early 1980s to 71 per cent in 1996.<sup>20</sup> Obviously, it was the result of many people moved from the countryside to cities and shifted from agricultural production to industrial production. Moreover, since foreign enterprises usually paid high wages than the state-owned enterprises (SOEs), together with other non-cash benefits like pensions, housing and medical care,<sup>21</sup> the income of the urban population was higher than those living in the rural area. In 1978, the per capita income of the urban population was about USD\$33, while the per capita income of the rural population was about USD\$24. However, in 1995, the per capita income of the urban population increased to USD\$245, which was with a 700 per cent increase, while the per capita income of the rural population just increased to USD\$94, which was only with 300 per cent increase, and the per capita income of the former is 2.5 times of the latter. (Please see Figure 3 and Table 1)

Figure 3: Per Capita Income of Urban and Rural Household (in USD)

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<sup>19</sup> Shi Li. "Change in Income Inequality in China's Transition" in Mary-Francoise Renard. *China and Its Regions: Economic Growth and Reform in Chinese Provinces*. Cheltenham, Massachusetts: Edward Elgar Publishing Limited, 2002. p.149.

<sup>20</sup> Taejoon Han. "China: A shared Poverty to Uneven Wealth?" The Elliott School of International Affairs at The George Washington University. < <http://www.gwu.edu/~econ270/Taejoon.html>>

<sup>21</sup> Elissa Braunstein and Gerald Epstein. "Bargaining Power and Foreign Direct Investment in China: Can 1.3 Billion Consumers Tame the Multinationals?" *Center for Economic Policy Analysis (CEPA) Working Paper* (August 2002), p.20.

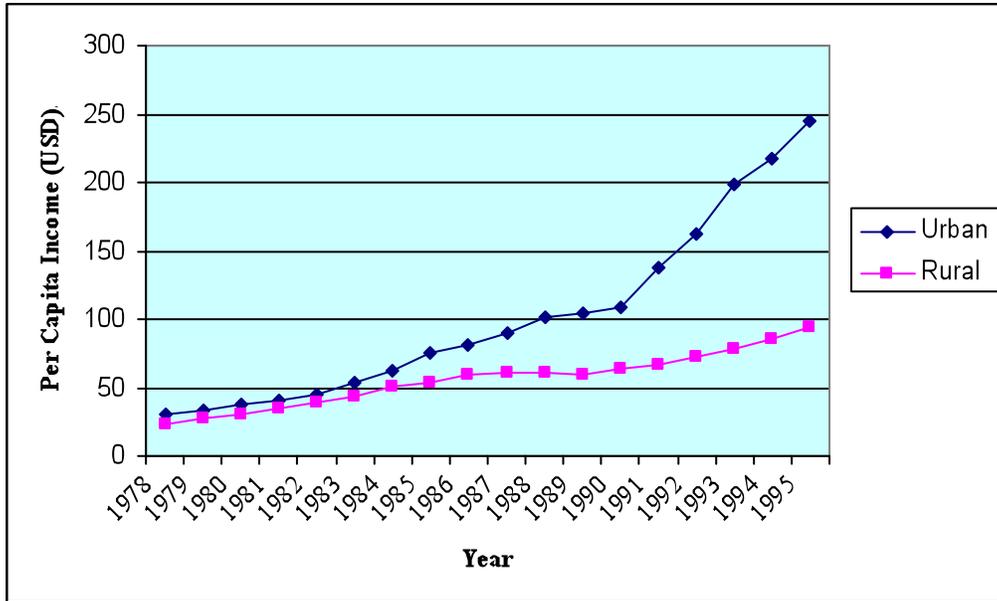


Table 1: Regional Disparities of per capita GDP and Per Capita Income (in US Dollar)

	Per capita income (Urban)	Gini Coefficient (Urban)	Per capita income (Rural)	Gini Coefficient (Rural)
1978	31	0.2438	23	0.1261
1979	34	0.2394	28	0.1174
1980	38	0.2394	31	0.1119
1981	40	0.2391	35	0.0998
1982	45	0.2335	39	0.1003
1983	54	0.2404	44	0.1057
1984	63	0.2323	51	0.1123
1985	75	0.2324	54	0.1106
1986	81	0.2355	59	0.1198
1987	90	0.2467	61	0.1271
1988	102	0.2463	61	0.1326
1989	105	0.2419	59	0.1394
1990	108	0.2414	64	0.1452
1991	137	0.2435	67	0.1407
1992	163	0.2538	73	0.1484
1993	198	0.2613	78	0.1685
1994	217	0.2747	86	0.1658
1995	245	0.2747	94	0.1670

Sources: Justin Yifu Lin, Fang Cai, and Zhou Li. "Social Consequence of Economic Reform in China: an Analysis of Regional disparity in the Transition Period" in Mary-Francoise Renard. *China and Its Regions: Economic Growth and Reform in Chinese Provinces*. Cheltenham, Massachusetts: Edward Elgar Publishing Limited, 2002. p.36.

From the figures form Table 1, we can see that the rural income in China was just about 40 per cent of the urban income. Compared with most of the other countries, where the percentage was about 66 per cent in 1995,<sup>22</sup> we can see that the income inequality problem in China was more serious than in the rest of the world and the income gap between urban. Moreover, the economic development situation in China also reflects the Kuznets's prediction that "the average per capita income of the rural population is usually lower than that of the urban".<sup>23</sup>

Other than the difference of average per capita income between the urban and rural areas, Table 1 also shows the second prediction of Kuznets, that is "inequality in the percentage shares within the distribution for the rural population is somewhat narrower than in that for the urban population"<sup>24</sup>. This prediction can be shown by looking at the Gini Coefficients of the urban and rural areas. We can see that since the economic reform in China, the income inequality in the rural area, with Gini Coefficients ranging from 0.1261 to 0.1670, is smaller than the urban areas, with Gini Coefficients ranging from 0.2438 to 0.2747.

If we take the larger picture of the entire economy by looking at the national Gini Coefficients, we can also see that the income inequality problem has also been getting more serious and more serious in the past thirty years. Table 2 shows the national Gini Coefficients from 1978 to 2005.

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<sup>22</sup> World Bank. *China 2020: Sharing Rising Incomes: Disparities in China*. The International Bank for Reconstruction and Development (IBRD), 1997. p.16.

<sup>23</sup> Simon Kuznets. "Economic Growth and Income Inequality". *The American Economic Review*, Vol.45, No. 1 (March, 1955). P.7.

<sup>24</sup> *Ibid.* pp.7 – 8.

Table 2: Gini Coefficients During the Economic Reform Period (1978 – 2005)

Year	Gini Coefficient	Year	Gini Coefficient
1978	0.230	1992	0.314
1979	0.233	1993	0.320
1980	0.238	1994	0.330
1981	0.239	1995	0.340
1982	0.232	1996	0.394
1983	0.246	1997	0.408
1984	0.258	1998	0.414
1985	0.264	1999	0.418
1986	0.288	2000	0.421
1987	0.292	2001	0.447
1988	0.301	2002	0.450
1989	0.300	2003	0.456
1990	0.310	2004	0.465
1991	0.307	2005	0.470

- Sources: 1. Qunjian Tian. "Agrarian Crisis, WTO Entry, and Institutional Change in Rural China". *Issues & Studies*, Vol.40 No.2 (June 2004) p. 24  
 2. *United Nations 2005 Development Programme Report*, p.271  
[http://hdr.undp.org/reports/global/2005/pdf/hdr05\\_HDI.pdf](http://hdr.undp.org/reports/global/2005/pdf/hdr05_HDI.pdf)  
 3. China Economic Net, "Closing Gap between Haves and Have-Nots"  
[http://en.ce.cn/National/Government/200512/17/t20051217\\_5548387.shtml](http://en.ce.cn/National/Government/200512/17/t20051217_5548387.shtml)

According to the international standard, the "Gini Coefficient" below 0.3 means the "optimal state"; the figure between 0.3 and 0.4 refers to the "normal state", the one above 0.4 refers to the "warning state" and the one reaching 0.6 means the "dangerous state" and a social turmoil is about to happen at any moment.<sup>25</sup> In 2005, the Gini Coefficient of China has reached 0.470 and it is regarded as in the "warning state" and in the words of *Asia Times*, China is headed with a social "red alert".<sup>26</sup> In fact, 66 percent of all total bank deposits belong to 10 per cent of the population, with 20 per cent of all population

<sup>25</sup> China Economic Net, "China's Rich-Poor Gap have been Closed to the Warning Level"  
[http://en.ce.cn/Insight/200408/05/t20040805\\_1425648.shtml](http://en.ce.cn/Insight/200408/05/t20040805_1425648.shtml)

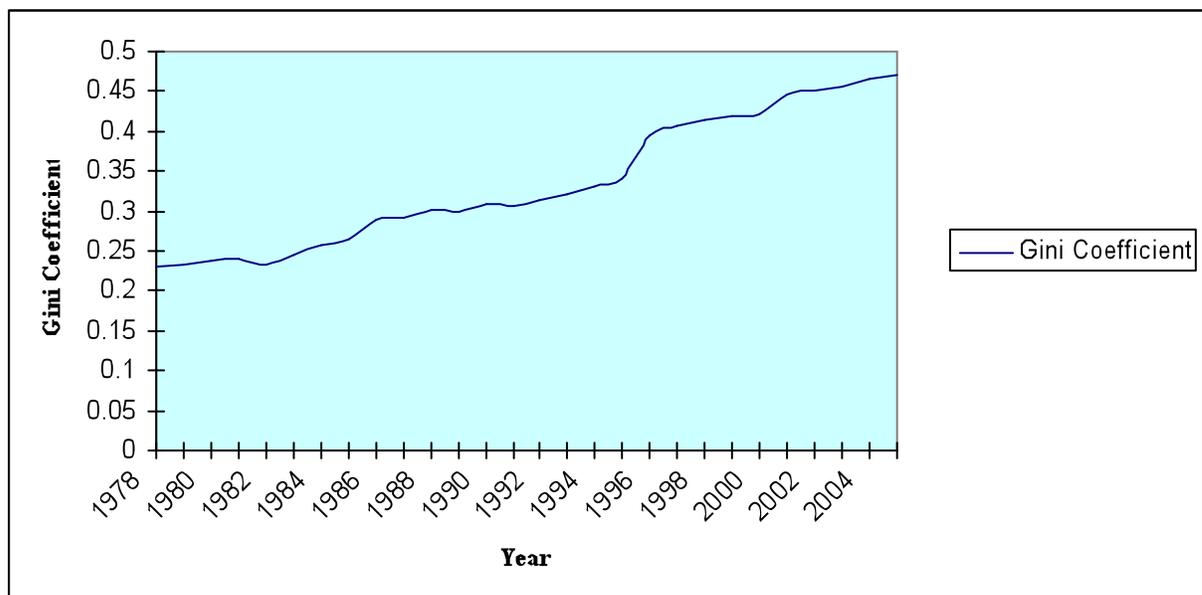
<sup>26</sup> Francesco Sisci. "Is China Headed for a Social "Red Alert". *Asia Times Online*. (October 20, 2005).  
[http://www.atimes.com/atimes/China\\_Business/GJ20Cb01.html](http://www.atimes.com/atimes/China_Business/GJ20Cb01.html)

holding 80 per cent of total deposits. China's urban areas, home to some 0.23 per cent of the total population produces about 70 percent of China's GDP.<sup>27</sup> We can see that the income distribution in China is highly unequal.

### **Income Inequality in China and the Kuznets Inverted U Hypothesis**

By studying the Gini Coefficients before and after the economic reforms launched by Deng Xiaoping, we can see that in the past fifty-five years, the income inequality problem in China has been getting more and more serious. After the introduction of economic reforms in 1978, the Gini Coefficient increased from 0.230 to a historical high at 0.470 in 2005. If the Kuznets Inverted U Hypothesis really holds in China, it seems that China is still in the first half of the “U curve” since in the past twenty-seven the Gini Coefficients increased in a consistent way, except in 1982 and 1989. (Please see Figure 4)

**Figure 4: Gini Coefficients of China during 1978 to 2005**



<sup>27</sup> Ibid.

Undoubtedly, income inequality is a side-effect that a country cannot avoid during the economic development and China is not an exception. However, what makes the income inequality problem more serious is that China has adopted a relatively *gradual* approach to economic reform, which led to the coexistence of two economic systems (planned system and market system; and planned system is more commonly found in the rural areas), and a dual price system (planned prices and market prices; and planned prices are also more commonly found in the rural areas)<sup>28</sup>. These kinds of economic policies hinder the Chinese economy goes toward a truly mature market economy and thus the income inequality problem is still very difficult to solve.

### **Suggestions for Decreasing Income Inequality**

Although it is not uncommon for a developing country like China to have the income inequality problem, the level of income inequality in China is so serious that many scholars warn that if the current gap exceeds certain limits, it is very likely that people may become severely psychologically distressed and question the sense of fairness leading to a challenge on domestic stability.<sup>29</sup> Therefore, in order to tackle the problem effectively, here are three suggestions:

#### *Speed up the economic reform toward a mature market economy*

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<sup>28</sup> Renwei Zhao. "Increasing Income Inequality and Its Causes in China". Carl Riskin, Zhao Renwei, Li Shi, (Ed.). *China's Retreat from Equality : Income Distribution and Economic Transition*. Armonk, N.Y. : M.E. Sharpe, 2001. p.37.

<sup>29</sup>Taejoon Han. "China: A shared Poverty to Uneven Wealth?" The Elliott School of International Affairs at The George Washington University. < <http://www.gwu.edu/~econ270/Taejoon.html>>

Since China is a country with a huge population, i.e. 1.3 billion, it is hard for them to change the economy overnight. Therefore, it is reasonable for them to adopt a dual economic system approach and a dual price system. However, these policies can only be used during a transitional period. In other words, the Chinese government should not use the huge size of population as an excuse to slow down the further progress of reform toward a mature market economy. Since under a mature market economy, it can usually adjust itself. As a result, the problem of income inequality can be improved.

*More efforts should be put in the rural areas*

After the introduction of the economic reform in 1978, the development of the urban areas has been quite satisfactory. However, the rural areas have just been very limitedly developed. Since about 70 per cent of Chinese population are living in these interior parts, if the central government can put more resources to develop these areas, such as building more infrastructure and schools, income inequality will certainly be greatly alleviated.

*Improve the income redistribution system*

Taxes and welfares are two important tools to redistribute income in most countries. However, the taxation and welfare systems in China are still under-developed. It makes the income redistribution system difficult to function. For example, if the Chinese government charges high-income groups by a progressive income tax, with the

intent of narrowing income inequality, while at the same time high benefits and welfares are provided to low-income groups,<sup>30</sup> it can improve the problem of income inequality.

## **Conclusion**

In past decades, some scholars tried to test for the Kuznets Inverted U Hypothesis with real-world data and resulted in different conclusions (Anand and Kanbur 1993; Ogwang 1995), but the hypothesis has still been commonly used in evaluating a country's economic development and income distribution. In the case of China, with over twenty-seven years of economic reforms, the Gini Coefficient still keeps on increasing every year in general. It seems that China does fit the Kuznets's Hypothesis so far because when the Chinese economy develops, income inequality is increasing.

Since Chinese situation is quiet different from many other countries, for example, they are with huge population, gradual economic system approach and a dual price system, the economic development path may be quite different from others. Up to this moment, we still cannot sure whether the "Kuznets Curve" will go down or continue to go up in the near future. However, one thing that we can sure about the income inequality situation in China is that if it keeps on getting more and more serious, it is bad to the social stability as well as the psychological development of the population. Therefore, after a twenty-seven years of economic reform, I believe that it is the time for the Chinese government to do something to tackle the problem by shortening the transitional period of changing the dual economy to a mature market economy, paying more attention to the rural areas and reforming the income redistribution system.

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<sup>30</sup> Renwei Zhao. "Increasing Income Inequality and Its Causes in China". Carl Riskin, Zhao Renwei, Li Shi, (Ed.). *China's Retreat from Equality : Income Distribution and Economic Transition*. Armonk, N.Y. : M.E. Sharpe, 2001. p.37

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