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Book Review

Book Review: Inequality and Growth in Modern China

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**Guanghua Wan (2008):
Inequality and Growth in Modern China**

Oxford University Press, United States, 256 pages

ISBN13: 9780199535194; ISBN10: 0199535191; GBP 56.00 / USD 60.00 (hardback)

It is well accepted that economic growth and/or improved income distribution reduce poverty. However, it is not clear whether growth increases or decreases inequality, or which impact (rising or declining) inequality has on growth. Hence, changes in growth and inequality are likely to take place simultaneously, making it difficult to identify their separate effects on poverty. This complex interrelationship – called poverty-growth-inequality (PGI) triangle in literature – poses an important challenge and dilemma for world's policymakers: should growth or inequality be prioritized in the design and execution of development policies?

Post-reform China serves as one of the best examples for studying the PGI triangle. On the one hand, the Chinese economy has experienced close to double-digit growth over the past three decades, which has helped to lift millions of rural poor out of poverty. On the other hand, income inequality (or inequality in terms of other welfare indicators) has dramatically risen at various levels during the same period. Guanghua Wan, the editor of this book, argues that this must have contributed to the recent slowdown in poverty reduction in rural areas and to the emergence of urban poverty in China, since the economy has maintained its growth path.

This book aims to give a better understanding of the causes and consequences of rising inequality in China, which is essential for undertaking future policy initiatives. "Inequality and Growth in Modern China" is part of the output of a three-years project (that started in 2004) of United Nations University's World Institute for Development Economics Research (UNU-WIDER) on Inequality and Poverty in China¹. Contributors to this volume are prominent experts in their respective areas, including Justin Lin, Xing Meng, Kaiyuen Tsui, and Guanghua Wan.

Chapter 1 by Wan, Lu, and Chen tackles the short and long run impacts of rising inequality on China's growth, and vice-versa. Using a system of equations framework the authors find that inequality is harmful to growth no matter what time horizon is considered, but growth does not affect inequality in their study. Complementary to the first chapter, Whang focuses on the impact of growth on inequality by testing the Kuznets hypothesis in the second chapter. His results predict further rises in income inequality in China in the short and medium run – or in other words, the Kuznets hypothesis is rejected.

A particular innovation is given in the third chapter. Using the so-called Shapley value technique to disentangle the contributions to poverty changes of income growth and inequality, Zhang and Wan show that both income growth and favourable distributional changes can explain China's significant achievement in combating poverty in rural areas at the beginning of the 1990s. However, towards the end of the 1990s, rural and urban China experienced sharply rising inequality and stagnant growth, which has slowed down poverty reduction or even increased poverty.

1 Other publications related to this project can be found at http://www.wider.unu.edu/research/projects-by-theme/poverty-inequality/en_GB/inequality-and-poverty/ (as of February 15, 2010).

The next four chapters focus on income inequality across China's regions. Lin and Liu investigate the impact of China's development strategies on regional inequality. They conclude that poor regions have typically followed comparative advantage defying (CAD) strategies by adopting capital-intensive technologies. As opposed to affluent regions, which have followed comparative advantage following (CAF) strategies by emphasizing the development of labor-intensive industries. Hence, different development strategies are responsible for China's disparities. Liang, in Chapter 6, eyes regional inequality from the financial development perspective. He shows that financial deepening, in particular lending to the private sector, tends to facilitate economic growth in the coastal regions. However, central bank lending to the provincial governments is found to be negatively correlated with economic growth. Thus, less government intervention in credit allocation may promote growth.

Up until now inequality was measured in terms of income. The next two chapters deviate from this practice and investigate regional inequalities in innovation capability (Chapter 8 by Fan and Wan) and education (Chapter 9 by Lee). Fan and Wan reveal major factors driving inequality in innovation capability, such as location, industrialization and urbanization, human capital, and openness. In chapter 9, Lee's study shows that rapid expansion of education in the last decade has benefited younger students and decreased or eliminated the gender bias against girls. However, his results also point to persistent and deteriorating regional inequality. He concludes that the causes of inter-provincial educational inequality are quite complex and cannot simply be explained by the urban bias hypothesis.

Finally, Wan reminds the reader that policymakers must face the pragmatic question, what type of output – growth or redistribution – is more crucial for fighting poverty. To help answer this question, he develops different procedures for attributing total poverty and a change in poverty to growth and redistribution effects of individual income generating factors. Using data from rural China, Wan shows that redistribution is more important than growth as a policy instrument in combating poverty.

This volume provides a comprehensive coverage of inequality and poverty issues in China. State-of-art econometric methods to identify the causal linkages within the poverty-growth-inequality triangle are used, which ensures that the policy recommendations are reliable and robust. The book is worth reading for academics, students, policymakers, and others with an interest in distributional issues in general and the development of China in particular. However, readers with little knowledge of statistical methods may only focus on the conclusions of the different chapters.

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