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China has long been plagued by an extreme income gap between a few coastal provinces and the inland

The national average wage was not representative of either the high-wage coast or the low-wage interior

Yet this regional income gap has narrowed significantly in recent years as the interior has caught up

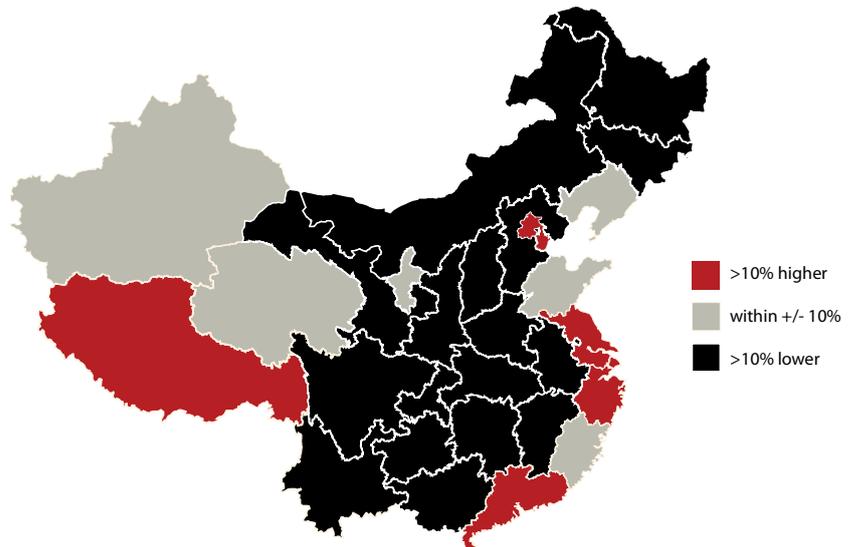
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The Rise Of The Middling

The gap between a thriving coast and a backward interior has been a fixture of China's geography for decades, and led to many doubts about whether the country is capable of sustaining a broad-based consumer economy. While the nation's average income has been rising steadily, that average was nearly a mathematical fiction—an imaginary midpoint between the high wages earned in the coastal provinces with thriving export sectors and the low wages paid in the inland provinces. Yet few observers appreciate how much this pattern has changed recently, and what this shift means for the composition of China's consumer spending.

Inequality between Chinese provinces was extreme in 2005

Average urban wages relative to national average



The gap in wages between coastal and inland provinces has narrowed substantially, as migration has accelerated and growth has picked up in the interior. As a result, rather than being split between a few high-income enclaves and a low-income hinterland, China is now much more a country of the middling income. There are clearly still significant income gaps within individual provinces, and between the city and countryside. But the spread of incomes across the country's geography is much more even, and something close to the average wage is paid in more places. As our [recent tour](#) of the poor province of Guizhou showed, retailers have recognized this change and are increasingly targeting the mass of inland consumers rather than just the coastal elite.

Deng Xiaoping's famous dictum that "some people and some regions should be allowed to prosper before others" set the stage for the divergence of regional fortunes in the 1980s. As China opened up to foreign trade, the coastal provinces were better placed to take advantage of the new

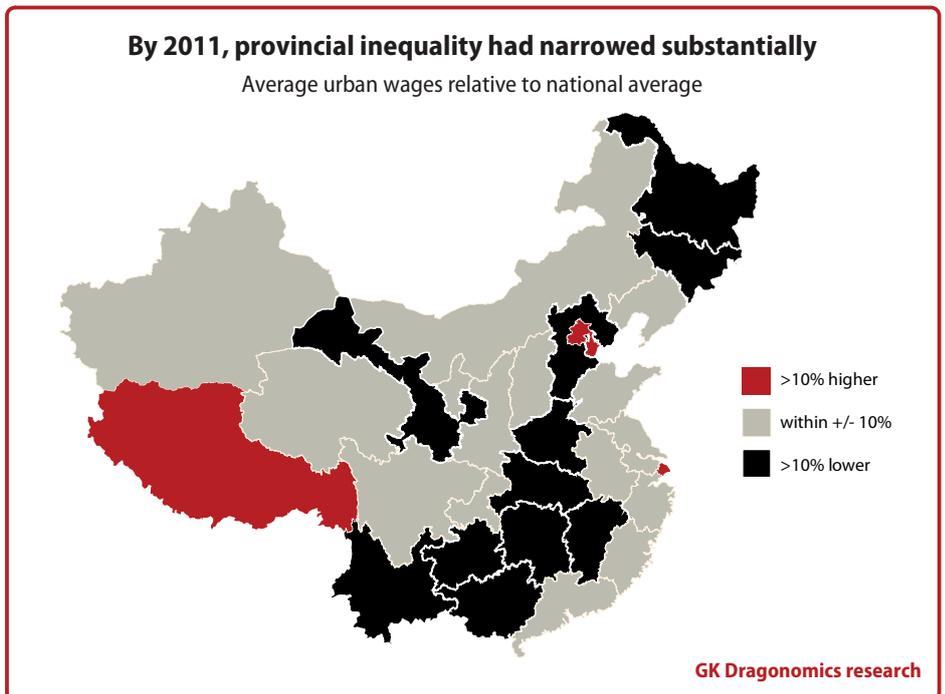
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Wage growth in the interior has outstripped that on the coast for several years

These days, the national average wage better represents what is earned across most of China

opportunities, and grew much faster. Official data on average wages paid in urban areas show almost all provinces paid wages close to the national average in 1985; by the 1990s and 2000s the divergence between the coast and inland meant only a handful of provinces did. High wages were earned mainly in China's two largest cities, Beijing and Shanghai, and in the coastal export powerhouses, particularly Guangdong, Jiangsu and Zhejiang. Tibet also had above-average wages, but these figures reflect the hardship rates paid to attract Han Chinese to work in its isolated conditions, rather than high local incomes. The map above for 2005 is representative of this period.

Since 2004, however, the trend has turned. Regional gaps have started to narrow rather than widen. From 2005-11, the average urban wage in the coastal exporting provinces (defined here as Guangdong, Fujian, Zhejiang, Jiangsu and Shandong) grew an average of 13% a year. In the inland provinces, urban wages grew faster, averaging 16% annually. By 2011, this meant that 13 provinces paid wages near the national average, up from just five in 2005, and actually outnumbering the 12 provinces whose wages were more than 10% below the national average. This looks like a fulfillment of Deng's plan: he never intended to create wealth just for "some regions and some people," but for the coast's prosperity to spread inland and "enable all of them to prosper eventually," as he said in 1986.



Thanks to this increasing convergence between coastal and inland wages, the pattern of provincial inequality in China has altered significantly. Rather than above-average wages being spread along the entire coast, they are increasingly concentrated in the megacities of Beijing, Shanghai and Tianjin. Once the special case of Tibet is excluded, these three cities are in fact now the only provinces in China to pay urban wages more than 10% above the national average (though called cities, these three areas are treated as provinces in China's administrative system, and include both urban and rural areas). First-time visitors to China are routinely told that Beijing and Shanghai are not representative of the whole country; the

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Beijing and Shanghai's advantages have persisted even as the gap between the coast and interior narrows

The narrower regional gap reflects both more integrated labor markets and policy support for inland provinces

relevance of this old adage has if anything only become stronger in recent years. The growth in the rest of the country has not diminished the advantages that residents of the megacities gain from the concentration of economic and political power.



What caused this turnaround in a two-decade long trend of rising regional inequality? The most obvious candidates are changes in the labor market and government policy. As the latest census revealed, urbanization and migration accelerated in the past decade, with the share of the population living in urban areas rising 13.3 pp from 2000-2010, compared to a 9.5 pp gain from 1990-2000. With the developed coastal cities being most attractive to migrants, this huge population movement put pressure on wages to converge, by increasingly the supply of workers on the coast and decreasing it inland. At the same time, the government was putting more money into inland provinces, supporting their growth. The 11th Five Year Plan, for the years 2006-10, set a major goal of “reducing regional gaps in public services and living standards,” primarily through a series of development plans targeting the far west, the northeastern rustbelt and the central provinces. “Promoting balanced development among regions” has for several years been listed as one of the major policy goals in Premier Wen Jiabao’s annual work report.

Though the government never gave itself a specific numerical target for this goal, all statistical measures of regional inequality have declined in recent years. In the chart below, we show our calculations of the Theil index of inequality between provinces in terms of both average urban wages and per capita GDP. We use the Theil index because it is relatively simple to calculate (see this excellent [explanation](#)), but this trend is not a product of just one statistical technique. The same decline shows up in calculations of the Gini index of inequality between provinces (as in this [ADB report](#)), and in the National Bureau of Statistics’ [own figures](#) for the variation in its regional development index. Though it is now popular to criticize the policies of Hu Jintao and Wen Jiabao for exaggerating China’s

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Provincial income gaps are not the whole story of inequality

The government has made good on its pledge to narrow regional gaps, but faces a tougher challenge in reducing other forms of inequality

Inequality in China now is less about geography and more about access to jobs and assets

economic imbalances, the country's regional imbalances have in fact become less severe since they took office in 2003.

All of these measures refer only to inequality between provinces considered as a whole, and not to inequality between households in those provinces. So this analysis does not mean that other forms of inequality are not on the increase in China. And as we have reported [before](#), the leading researchers of inequality believe that China's overall income inequality has in fact risen substantially in recent years. So what our analysis shows is that regional differences in wages are not responsible for the increase in overall inequality. The key culprits must instead be: 1) inequality in the wages paid by different types of businesses, which in practice comes mainly from the high wages paid in the finance and technology sectors; and 2) inequality in non-wage income, meaning the income earned from financial assets, property and businesses.



There is some independent evidence of the new importance of these differences. On our calculations, average urban wages in the finance, insurance and real estate sectors were 157% of the national average in 2011, a record premium. While regional wage gaps peaked around 2003-04 and then declined, the average wage in finance is well up from 140% of the national average in 2003 and 112% in 1993. Income from assets is less easily tracked over time, but a recent household survey by the Southwestern University of Finance and Economics in Chengdu provides one data point. In their sample, the top-earning 10% of households made 57% of total income, but held 85% of total assets.

China's government has recently renewed its pledge to narrow regional gaps, in its plan for the years to 2015. And inland provinces are still growing faster than coastal ones, as their lower costs attract more manufacturing investment, so these gaps can continue to narrow. But with inequality increasingly driven less by place and more by access to assets and high-paying jobs, this trend on its own will not enough to avoid what Deng Xiaoping called the "polarization of society" between rich and poor.