

The Effect of Urbanization on Income Inequality

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Abstract: China has been burdened with the issue of income inequality which has been an ongoing conundrum for many decades in the vast majority of the world. Urbanization, which at first glance may seem like the ultimate solution may not provide the adequate effects many believe it brings forth. This raises the question: how does urbanization affect income inequality and specifically in China? While urbanization was thought to have been a way to mitigate this problem it has in turn further harmed the most vulnerable stakeholders, those on the lower receiving end. In order to effectively benefit and accurately pinpoint where the theories and reality differ, it is crucial this question is answered. This paper will take the analyses and data collected from various studies. An explanation of the initial perspective on urbanization will be brought up followed by the studies of the current situation and polished up with a discussion and some suggestions for the future.

Keywords: urbanization, income inequality, effect

1. Introduction

It is no secret that the rural-urban income gap has increased in China with the growth of the economy [1]. For China to effectively combat this issue there is a need to gain a full understanding of what is happening in the country down to the small mechanisms of the reason behind this occurrence. Income inequality remains a problem existing in the homes of millions of rural families, a problem that has inevitably brought about hardships and one that has stumped government officials over and over. This study aims to gather existing research on how urbanization has affected income inequality in China and hope to find a solution to the issue. China's urbanization occurred from 2000 to 2010 [2]. This is supported by the fact this was the time in China's history when many young people from rural areas decided to move to urbanized areas in hopes of better opportunities. As a result, the Chinese economy transformed into the manufacturing powerhouse it is known as today [3]. However, many doubt whether this development in the economy has benefited the young peasants who take up the majority of the jobs in factories. Empirical evidence from the change of the Gini coefficient with an increase from the original 0.3 in 1980 to 0.55 in 2012 [4]. Previous researchers have all come up with the same conclusion when it came to answering this question that is the relationship between income inequality and urbanization is in an upside-down u-curve [4-5]. This paper will take the analysis provided by these sources behind the united conclusion combined with papers that specifically talk about the evolution of the factors affecting the relationship. The paper will begin with an overview of how urbanization was originally viewed and branch out to the actual effects of what urbanization has done for

and against income inequality. To finish off there will be a suggestion section where possible solutions will be discussed.

2. Effect

2.1. Background

Urbanization has prompted the flow of countless capable young adults to move from the rural countryside where they reside to the busy cities where they hope to lead a better future. It has been recorded that in 2022, 65.22% of the Chinese population live in urban areas compared to that 19.39% in 1980 [1].

As can be seen in Fig. 1. urbanization occurred the fastest between 2000 to 2010 and in the present, the change has leveled off.

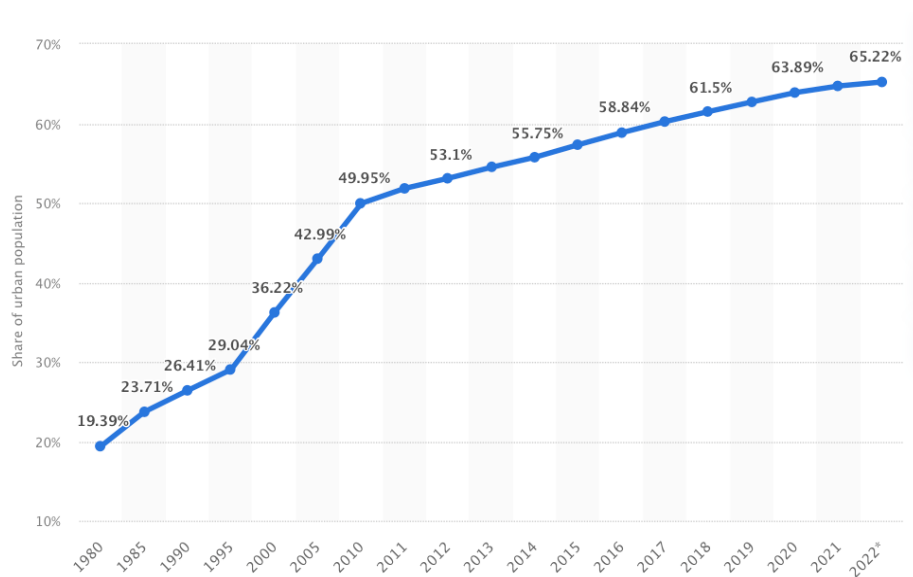


Figure 1: Percentage of urban population in China from 1980-2022 [2].

2.2. Initial Thoughts on Urbanization

Conventional wisdom supports the notion that urbanization will benefit those at the low end of the income spectrum. The reason for urbanization in and of itself is due to the incentives the cities provide. Moving to the four large fast-developing cities, Beijing, Shanghai, Guangzhou, and Shenzhen meant more opportunities to succeed, and even if one does not at least the options in the city are better compared to agriculture back at home in monetary terms. This means that if one living in the mountains has sons and daughters employed somewhere in those four cities the family has a higher amount of income overall and naturally this would decrease the income gap between families. Not only that, but the movement of workers from rural to urban areas also allows the flow of capital and advanced technologies to the less developed areas which encourages greater productivity and eventually higher income [5]. Large numbers of studies have also found that urbanization promotes the accumulation of human capital and increases income overall. This is not the only argument for the possible positive effect of urbanization. Another, more technical, reason for the reduction of income inequality due to urbanization is due to economic growth. In just under 40 years, China's urbanization rate increased from 17.9% to 56.10% in the period from 1978 to 2015 [6]. that is not a small number considering China's massive population. Basic economics supports the idea that this directly increases one of the

factors of production which is the number of laborers leading to an outward shift of the production possibility curve, creating products and services which would eventually result in economic growth. The influx of rural workers into urban areas allowed China to become the manufacturing powerhouse it is known as today [3]. Plus, as more people move into cities the demand for goods and services increases as well which fuels economic growth and development. Furthermore, China has made great improvements in manufacturing as well as producer services and multiple other services which translates to the significant increases in real GDP China has year after year indicating the large growth of the Chinese economy [5].

2.3. The Reality of Things

However, while all that stated above makes sense and all, the real question comes when studies show that income inequality has in turn increased since the urbanization boom. A study has found that the Gini coefficient has increased to 0.55 in 2012 from the original 0.3 in 1980 [4]. Multiple studies have concluded that the urban-rural income inequality gap and correlated with urbanization in an inverted U-shape [4-5]. That is to say, there is an initial increase in income inequality until the threshold point where the province has a Gini coefficient of 0.53 then there is typically a reduction in income inequality [5]. The reasons behind this trend are mainly due to the provincial restrictions each of the twenty-three provinces have. The Hukou system especially places many limitations on rural residents, not only can they not move freely in terms of migrations but once they do transfer to another more urbanized area, they face significant amounts of systematic discrimination [7].

To start, the education received by the peasants is uncomparable to that received by urban-raised workers. Due to the overly populated state China is in many resources including education are harshly regulated by the government. The Hukou system plays a role in how the government is able to restrict children from rural areas from receiving education from places other than where their Hukou belongs to including schools in urbanized cities that are often provided with more resources and quality education. Many teachers are also unwilling to relocate to the countryside and teach there as they may wish to seek greater opportunities in urbanized cities and view rural areas as inconvenient, further hindering the quality and quantity of education children living in rural areas can receive [7]. These unfair disadvantages from childhood would follow the entire demographic until they grow up into adults and go into the big cities hoping to find jobs. In the highly competitive society in which China has developed, in order to get jobs that offer medium to high-income one would have to have outstanding academic achievements and stand out from the other applicants which is far harder for young adults coming from rural areas to do even if they have the skills and are more capable than those who do have had the opportunity to receive education from better institutions and more opportunities from the starting line [4]. Not only that, urbanization raises new concerns in the urbanized cities for example problems such as overcrowding and pressure on services just to name a few [8]. In order to protect the employment opportunities of urban residents the government has implemented a specific urban-biased policy that limits the opportunity and scope of peasant households' ability to obtain jobs with higher administrative power and other economic means [9]. This is one of the key factors for the U-shape mentioned previously [5]. Moreover, empirical studies show that every 1% increase in urbanization leads to a 0.011% reduction in the rural-urban income gap as a whole [5]. With that said, when the urbanization rate reaches above 50%, urbanization seems to hurt the income gap between the differently developed sectors of China [10].

Additional studies have shown that urbanization not only affects the rural-urban income gap in the province itself but also in neighboring provinces as well. Reasons for this phenomenon can include policy-making that eventually affects the entire region such as an urbanization strategy implemented in Beijing would inevitably affect the strategies in cities in close proximity such as Tianjin and Hebei creating a spillover effect [4].

3. Possible Solutions

With that said, although the relationship between urbanization and rural-urban cities in China requires a greater extent of research and data collection, what is clear is the trend of urbanization where rural residents continuously seek an open door to more developed areas of China in hopes of a broader future. A concern brought up previously was the issue with the Hukou system and how the restrictions make it almost impossible for the rural born citizens from competing with those born in urban cities. The simple solution to solve this issue would be to reform the Hukou system, but that is where things get more complicated. Recently large developed cities such as Shanghai have announced that they would allow those graduating from the city to receive the Shanghai hukou [11]. This opens a greater range of possibilities for youngsters. Additionally, in 2014, the Chinese State Council introduced the “National New-type Urbanization Plan” that aims to transition 100 million citizens supposedly in the floating population from rural to urban hukou which allows a great number of new migrants to access public education. However, the situation did not go as planned due to the large influx of rural migrants which has now widened the social service gap compared to the start of the plan in 2014 [12]. China even went to the extent where they attempted to completely eliminate the hukou system in 2005 which was championed by the western media. It is now evident that those efforts were futile as no major change has happened possibly due to the limited number of measures that were taken [11]. As of 2023 many of the hukou grants from the government to rural residents are mainly serviced to the wealthy and skilled migrants while the rest are left behind [11]. This system is justified when the ability of rural residents to survive in urban cities is considered. The price for commodities in urban areas is inevitably higher than those in rural places which makes sense for the government to only allow hukou transfers for the rich. A poor rural resident beginning life in the cities would go through a painful transition. The burdens not only include the need to pay for food and clothes on their back but also housing. The Chinese housing market is famous for the sudden surge in prices including rent, especially in popular urban cities such as Beijing and Shenzhen which would only make life harder for those with fewer. Furthermore, choosing from highly skilled migrants is also a suitable choice when considering the massive amount of competition citizens are faced with. To compete with the urban residents who have had a great advantage over rural citizens as well as with other migrants seeking the same jobs and positions, the potential of the migrant should be up to par to receive a job offer.

4. Advice

It can be seen that hukou reforms have been a large part of the Chinese government’s attention as almost every after year there are new policies, plans, and systems being introduced and tested. In the state that China is in now, the system they have in the status quo with prioritizing hukou transfers of well-off and decently skilled migrants is a positive step towards encouraging urbanization that does not harm rural migrants’ abilities to achieve their highest potential in the new city. This paper would advise not eliminating the hukou system as it is beneficial to some degree in organizing the various cities and provinces of China. What this paper does encourage is for gradual changes and softening of the limitations such as promoting access to public education by allowing certain rural hukou-holding families to attend schools in urban cities along with other social services. Another thing the government can do is to provide more incentives for teachers and social workers to locate in rural areas. This can look like increasing the income of these social workers or providing them with benefits additional benefits such as an honorary award. The system Shanghai has taken with offering hukou to graduates is also a great solution urbanized cities can implement. However, if it is the case that hukou reforms are too complex for Chinese society to solve in recent years there are other ways to combat income inequality. Urbanization is known to benefit rural areas through the flow of human

capital, advanced technology, and the like [4]. Improvements in each of these areas would greatly aid the less developed cities in improving their infrastructure, efficiency, and overall production. This would directly lead to higher productivity which translates to higher income thus reducing income inequality to a certain extent. In short, the reason for urbanization not being able to reduce the income inequality gap between rural and urban areas mainly lies in the hukou system. There have been many attempts to reform the hukou system however all have not achieved the impact China is looking for. Nevertheless, there have been policies that have taken action that one could argue are suitable for the country's current state such as filtering rural residents with certain characteristics can receive hukou from urban areas. Undeniably, the reformation of the hukou system will take a great amount of time and human resources to achieve so in the meanwhile, not only can China continue with the efforts it has been doing now, but China would also focus on improving the situation in the rural areas itself. Creating a better rural environment would not only increase the income level and allow rural residents to experience a better standard of living but it would also attract others from moving to these areas and even keep its residents from immigrating which would further improve the situation.

5. Conclusion

In conclusion, the relationship between urbanization and income inequality is a complicated one. What initially seems like a window for opportunity to solve income inequality worsens it in most cases. The main factor is due to the hukou system to which all Chinese residents are subjected. The system cuts off rural citizens' access to better education and opportunities in the early stages of life and leaves them vulnerable to the hukou discriminating policies in the latter stages. What makes matters worse is even without the discriminating policies, peasants are still at a disadvantage in Chinese society which values the quality of education and previous experience in the field highly. That is not the say measures have not been taken to mitigate this phenomenon because that is simply not true. What is true is that the vast majority of proposed policies have not worked in terms of reversing this effect. More recently big cities such as Shanghai offering hukou mobilization to well-performing university students may be a start for young rural citizens to compete with their urban counterparts in the Chinese market. It is a great start that major urbanized cities are taking matters into their own hands however this solution will only apply to those graduating from Shanghai universities alone and the problem of income inequality remains a problem that troubles the entire nation of China. Eliminating such a problem burdening the poor in the rural areas as well as the youngsters would greatly ease the lives of people which is what this paper hopes to achieve. The timing of when such a change would come is uncertain, but what is certain is that it will require the commitment of the government and the cooperation of all parties involved including province leaders, urban dwellers, and rural citizens for a large quantity of time to reverse the effect of income inequality.

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