

Why Rural-urban Migration Has Not Brought Down Income Gap between Sectors?

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1. Migration Expansion and Income Gap Widening

Since the economic reform, especially since the 1990s, the rural-to-urban and interior-to-coastal labor flows have been dramatically expanded. Total numbers of migrants having left hometown for more than one month increased from 61 million in 2000 to 103 million in 2004. Meanwhile, the rural and urban income gap has been increased as well since the mid 1980s. In nominal terms, the ratio of urban to rural income declined from 2.6 to 1.8 between 1978 and 1983, then went up again after 1984, by 2003 reaching to 3.3 and surpassing the level once reached in 1978. After deflating the nominal ratio by rural and urban consumer price indices, we get the ratio in real terms. In real terms, the gap of urban to rural income had narrowed down from 2.6 in 1978 to 1.5 in 1988, and then continued to diverge until the present time. The ratio in 2003 reached to 2.4. Some researchers argue that the contents of farmers' income are different from that of urban residents. If one converts into urban households' income all benefits and income in-kind they exclusively enjoy, the actual income gap would have been much bigger, and China now witnesses the largest rural-urban income gap in the world (Li et al., 2004). The joint upward movements of migration scale and income gap magnitude seem to be inconsistent with economic theory.

It is worth noting that the actual income gap between rural and urban areas is not as large as it is revealed statistically. The argument is that current income per capita and GDP per capita are calculated based on formally registered residents in regions, the inconsistency between registered and permanent inhabitants — that is, the large flock of long-term rural-to-urban floating population has enlarged permanent residents in cities, there is tendency that overestimates urban income per capita and underestimates rural income per capita. However, this factor only moderates the income gap between rural and urban areas, but is not sufficient to eliminate the gap revealed in statistics (Wan, Cai and Wang, 2005).

Theoretically, labor mobility tends to narrow down income disparities between rural and urban sectors and among regions, because it changes both equilibriums originally existed in rural and urban labor markets. The labor mobility shifts labor demand curve in urban areas left downward and labor supply curve in rural areas left upward. While that happens, however, if the force of labor migration is not as strong as to push labor supply curve in urban areas right downward and/or labor demand curve in rural areas right upward, or even the labor markets go in opposite directions, income gap between rural and urban areas still insists or even enlarges. We can examine the actual income convergence effects of labor mobility in perspective of urban and rural labor markets.

2. Explaining the Simultaneously Increased Mobility and Gap

By examining the response elasticity of migration to income differentials, Lin et al. (2004) find out that migration is a mechanism of narrowing income gap. They also observe that the existing hukou system prevents rural laborers from migrating fully and the growth of coastal regions is too fast for migration to respond so as to narrow the income gap. The factors deterring labor migration to reach its should-be scale are those that prevent labor supply curve in urban labor markets from shifting right downward. Once after a period of industry structural adjustment between 1980s and mid 1990s, heavy industry once again takes lead in economic development,

which reduces the employment absorptivity of growth, the foregoing effects become more apparent.

Since the late 1990s, mass employees have been laid off from state-owned enterprises and as a result, unemployment rate in urban China increased from 4 percent in 1995 to 6 percent in 2003, while labor force participation rate dropped from 72.9 percent to 63.4 percent during the same period. In coping with the severe unemployment, the government has actively implemented a pro-employment policy package, including policies stimulating macroeconomic boom, providing basic social security and social protection, creating public and community jobs, and offering employment training and other services. However, some tendencies have partially cancelled out the effects of those government efforts.

In recent years, the GDP chasing motivation and the incentives generated by current taxation system have induced an industrial development strategy focusing on heavy industry developments even in those regions that have so far gained fast growth from labor-intensive industries. And machinery, automobile, steel and other heavy industries became major impetus of regional GDP generation. As a result, investments disfavor light industries that have strong capability of creating employment opportunities and employment growth is unable to keep pace with the rapid economic growth.

Liu et al. (2004) find an increasing trend of capital intensification in industrial development since the mid 1990s. Especially after 1998 when the government initiated its expansionary fiscal and monetary policies, the investment costs of large-scaled enterprises and projects have become low, as interest rates decline and insist at low level. In addition to that, faced by rapid increase in individual savings on the one hand, and by strictly tightened lending responsibility, the state commercial banks have strong motives to lend loans to large-scaled, state-owned enterprises, or state supported projects. In fact, during this period, a dominant part of state banks' loans were lent out by following the projects, in which the state bond was invested. In the meantime, small and medium-scaled enterprises, whose expansions are more labor intensive in general, encounter severe difficulties of receiving loans from state banks. In short, in the period when hundred of thousands laid-off and unemployed are eager for new employment opportunities, investments were directed by distorted interest rates and institutions to capital-intensive sectors.

Since the mid 1980s, the developments of agriculture and rural sectors have lagged behind that of non-agricultural and urban sectors, which retards the increase of farmers' income. Given that surplus laborers have not fully migrated out of the rural sectors and the total amount of migrants' earnings is not sufficient for rural households to catch up with their urban counterparts, if agriculture and rural sectors cannot provide with bigger proportion of income, one cannot expect a reduction of income gap between rural and urban sectors. International comparison shows that China's investment into agriculture is small in relative terms. Developed countries, for example, invest more than one percent of agricultural GDP into agricultural research, while most developing countries invest between 0.5 to 0.8 percent. China, however, invests less than 0.4 percent (Huang, et al., 2004). In 2003, the share of agriculture in GDP was 14.8 percent, but agriculture only used less than 6 percent of total loans (Chen, 2004). In the entire planning period, the government extracted 600 to 700 billion yuan capital funds to support industrialization, through explicit taxation, price scissors, and outflows of savings (Cai and Lin, 2003, p. 129). During the reform period from 1980 to 2000, China extracted a total value of about 1289 billion yuan (at 2000 price) of capital from agriculture and about 2297 billion yuan from rural sector (Huang, et al., 2004).

Those financial flows from rural to urban sectors brought about an investment shortage in rural sectors. A report by World Bank (2004) finds that the marginal returns to capital in rural non-agricultural sectors were 2.1 times as that in urban industries in 1990 and increased to 3.7 times in 1995 and 5.2 times in 2001. The growth rate of marginal returns to capital in rural sectors was 4.3 times as that for urban industries in the same period of time.

The existence of hukou system and other urban-biased welfare regime set institutional barriers and increases the costs of rural to urban migration. For example, migration distance in transition China represents those institutional obstacles that increase costs of

migration while migrants move across regional boundaries. Cai et al. (2003) find that keeping other variables constant, a 1% increase in migration distance will lead to a 1.08% decline in migration rate. Based on 2000 Census data, of the total 131 million migrants defined as those who moved out of their home towns or townships, 56.3 percent migrated across counties or county-level cities, 42.7 percent migrated across prefectures or prefecture-level cities, and 26.4 percent migrated across provincial boundaries.

Being in the transition from planned economy to market one, the imperfection of labor markets causes unique discriminations in job entry and pay. While a large flood of rural laborers migrate to cities, but the hukou system that segments rural and urban labor markets still functions, rural-to-urban migrant workers, as the latecomers of the urban labor market, face a treatment different from their urban counterparts – entry discrimination when they try to obtain a job and wage discrimination if they luckily have a job. According the CULS, migrant workers got paid 1.65 yuan less (or 28.9 percent lower) than their urban counterparts did hourly. Of the wage difference between migrant and urban workers, 15.96 percent come from intra-sectoral discrimination and 26.93 percent from inter-sectoral entry discrimination (Wang et al., 2005).

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