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**Understanding the Pattern  
of Growth and Equity in the  
People's Republic of China**

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**Abstract**

There are likely to be many factors which have together shaped the current pattern of growth and equity in the People's Republic of China (PRC). Among them are the foundations laid in the pre-1978 era, especially in respect of land-related institutional reforms and social sector investments. These factors successfully complemented the subsequent export and foreign direct investment promotion strategies the PRC followed in the post-1978 years. However, given the large size of the PRC, while these strategies have helped to kick-start its economic take-off, the long-run growth of the country cannot depend on it. It will be important for the PRC in the forthcoming decades to expand its own domestic demand and renew social sector investments. Among other things, it will need to improve on its current income distributions. In particular, as well as wage increases, it will be important for the PRC to expand its social protection programs. This will help not only to boost its domestic demand, but also, more importantly, to contribute to a renewal and expansion of its human capital accumulation. In the long run, there is nothing more important than this if the PRC is to continue on its growth track, to modernize, and to catch up with today's developed nations. Superior pre-1978 human capital accumulations have helped the PRC to compete with and outperform other similarly positioned economies in the decades before; continued growth of the economy and continued improvements of the living standards of its people in the forthcoming decades will require vast amounts of new investment in human capital. And to this, increased investments by the government, whether through direct spending or increased levels of social protection, may well prove to be of special importance.

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## 1. INTRODUCTION

In addressing the current pattern of economic growth and equity in the People's Republic of China (PRC), its causes and implications for sustained human and economic development, it is not possible to avoid tracing some of the origins of this pattern to a time before the economic reforms and opening-up, that is, to the period before 1978, or, as they call it in the country, the first 30 years of the PRC. As I shall argue, important ruptures as there may have been between the first and second 30 years of the PRC in terms of development strategy, there have also been important complementarities between the policies pursued in the two periods. In particular, I shall argue that without the institutional reforms, especially those related to land and social sector investments in the first 30 years, it would be difficult to explain the sheer pace of economic growth in the latter 30 years and its concomitant record on equity following the adoption of a market-oriented and export-led development strategy in 1978. At the same time, the sheer size of the PRC economy vis-à-vis the rest of the world also has, I shall argue, played an important role in shaping the recent pattern and trajectory of economic growth and equity in the country.

It may be noted at the outset that it has been common for observers and researchers to attribute the record economic growth of the PRC in the last three decades to factors such as market oriented reforms, ownership changes, and the adoption of an export and foreign direct investment (FDI) led development strategy. While these have undoubtedly contributed to the PRC's growth success since 1978, to attribute the entire post-1978 economic performance to these factors would not seem to be justified. One has to ask if each of these factors singularly, or together, constituted a necessary and/or sufficient set of conditions for the PRC's subsequent economic success. And if they were a necessary set of conditions, what other crucial factors were involved to ensure this success. If, however, they represent a sufficient set of conditions, then why are there countries whose economies have, in fact, been much more market oriented, whose ownership structure has been a lot more privately based, and which have similarly followed an export and FDI-led development strategy, have not recorded as resounding a success as the PRC in terms of economic growth, whether contemporaneously with the PRC, or before it, or after it?

When one ponders over these questions, then it clearly dawns that other additional factors will need to be identified, not necessarily as alternatives to the above mentioned ones, but as complementary to them, but factors which are nevertheless important, and perhaps even critical, to explaining the PRC's recent growth success, or, indeed, its less sanguine record on equity. The two factors that I shall highlight in this paper are the PRC's pre-1978 legacy and its large economic size.

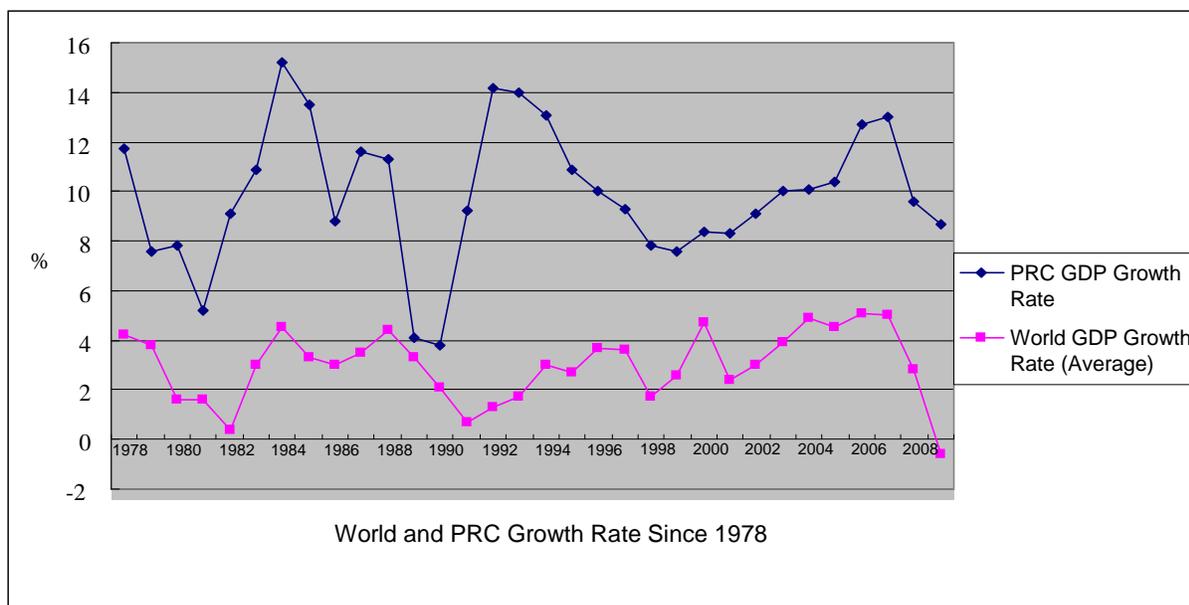
In what follows, I shall begin by briefly outlining the recent pattern of equity and economic growth in the PRC in Section 2, then point to some important pre-1978 origins of this pattern in Section 3, and discuss how these have interacted with the subsequent market-oriented and export-led development strategy, on the one hand (Section 4), and what I shall call the "burden" of a large economy, on the other (Section 5), to give rise to the present pattern of equity and growth such as we see. Section 6 provides some brief remarks on the implications of this reading of the recent history for future economic development of the PRC. Section 7 completes the paper.

## 2. RECENT PATTERN OF ECONOMIC GROWTH AND EQUITY

The PRC has had unprecedented rates of economic growth over the last three decades and longer, when compared with both its own past record and those of most other countries, developing and developed, over the same period. Figure 1 shows its annual gross domestic product (GDP) growth rates for the three decades 1978–2009, against the world average growth rates. As can be seen, they lie consistently above the latter, sometimes with a gap of over 10 percentage points. Except for the two years 1989–1990, generally the gap has been between 5 and 10 percentage points in favor of the PRC. Over the period of roughly three decades, the PRC’s own average growth rate is 9.90%, while the average of the world growth rates is 2.98%.

At the same time, there has been a steady worsening of income distribution, both within the rural and urban sectors separately, and for the country as a whole. Table 1 provides the Gini coefficients for the PRC as estimated by the World Bank for the period 1980–2004. As can be seen, there has been a steady rise in the value, implying a worsening trend in income distribution for both the rural and urban sectors separately, and for the country as a whole. Indeed, for the country as a whole, the value has surpassed the widely recognized international warning level by the mid-1990s, and the latest estimate has shown it to be above that level by a quite significant margin.

**Figure 1: Growth Rates Compared, the PRC and World Average**



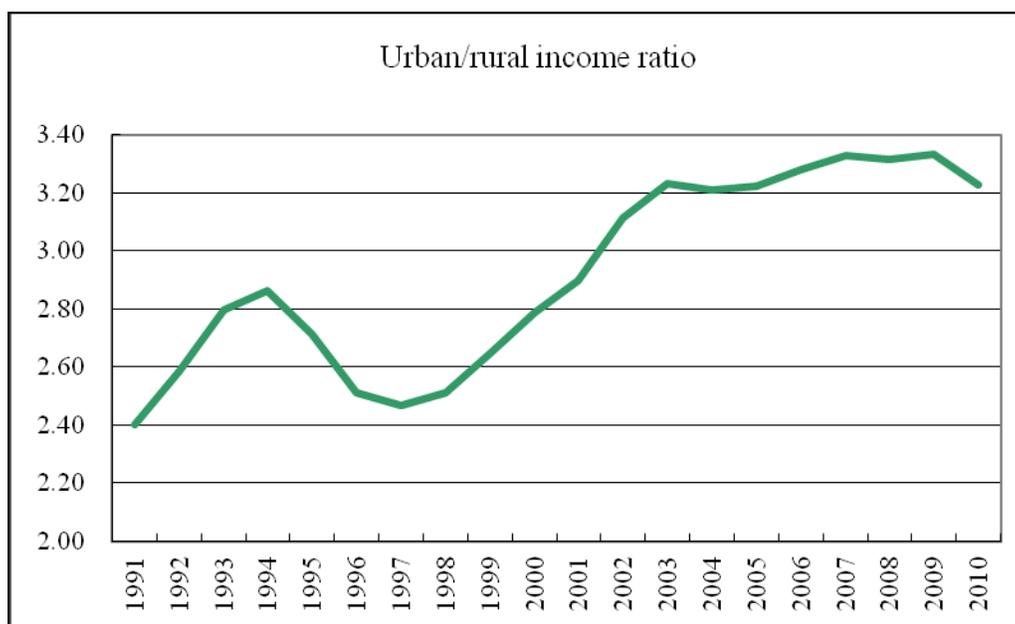
Source: China Statistical Yearbook, various issues.

**Table 1: Income Inequality in the Reform Decades of the PRC (Gini Coefficients)**

Year	Rural	Urban	Country	Year	Rural	Urban	Country
1980	0.25	n.a.	n.a.	1993	0.34	0.27	0.42
1981	0.25	0.18	0.31	1994	0.34	0.29	0.43
1982	0.24	0.16	0.29	1995	0.34	0.28	0.42
1983	0.26	0.17	0.28	1996	0.33	0.29	0.40
1984	0.27	0.18	0.29	1997	0.33	0.29	0.40
1985	0.27	0.17	0.29	1998	0.33	0.30	0.40
1986	0.28	0.21	0.32	1999	0.34	0.30	0.42
1987	0.29	0.20	0.32	2000	0.36	0.32	0.44
1988	0.30	0.21	0.33	2001	0.36	0.32	0.45
1989	0.31	0.24	0.35	2002	0.36	0.32	0.46
1990	0.30	0.23	0.35	2004	—	—	0.47
1991	0.31	0.23	0.37	2007	0.38	0.34	0.49
1992	0.32	0.24	0.39				

Source: Estimates for 1980–2001 are from Ravallion and Chen (2007), for 2004 from the World Bank databank, and for 2002 and 2007 from Li, Luo, Sicilar (2011).

A significant aspect of the income distribution in the PRC is, indeed, the income gap between the rural and urban sectors. In 1978, the year when economic reforms started in the country, the ratio of average urban to average rural income was at just over 2.5 times. The gap then narrowed in the early 1980s to around 1.7, widened substantially thereafter to reach above 2.8 in 1994 (Li and Luo 2007), then fell briefly again to below 2.5 in 1997, and thereafter rose consistently to over 3.3 by 2009, with a slight dip in 2010 (Figure 2). The short-run fluctuations this trajectory exhibits have to do with the particular reform policies carried out by the government at various stages of the reform course, but the general upward trend until only very recently is unmistakable. It simply reflects the fact that the PRC, in spite of the long period of unprecedented growth, has been deeply amidst its growth phase, the long and often arduous process of absorbing rural surplus labor into the more productive sectors of industries and services, and of transforming a country from a predominantly agrarian to a predominantly industrial or even post-industrial economy, in terms of both output and employment shares. And this is, indeed, the story I intend to tell, in the way I interpret it, in the rest of this paper.

**Figure 2: Per Capita Urban-Rural Income Ratio, The PRC**

Source: Li and Luo (2011).

### 3. PRE-1978 ORIGINS

History matters, but often in ways more intricate and subtle than one thinks. An important case in point has to do with the land reform in the PRC. After the founding of the PRC, the new government pushed through a nationwide land reform program (as they had done before in areas under their control), whereby all private holdings of land above a certain ceiling were confiscated and turned over to the landless or those who had little land. While the ethical ground of such outright confiscation itself may be open to debate, the incentives and distributional consequences of the move should be obvious: self-ownership of land should and would typically give farmers more incentives to cultivate land, so it should have had a productivity-boosting effect, and farmers would of course see their income increasing compared with if they remained a wage laborer, a fix-rent or share-cropping tenant.<sup>1</sup>

However, such incentive effects were severely moderated when the new government then tried, starting in the mid-1950s, to collectivize land. As a collective farm member, a farmer would receive an even smaller share of the produce of his own labor than, say, under share-cropping (where, throughout history and across the globe, a farmer would typically receive around half of his produce). And of course the farmer was not a residual claimant (as under fixed rent) either, even though all of the produce of the collective would, after all, be shared by the members according to some measure of labor inputs of each (see Liu 1994).

This heavy lid on the production incentives of the farmers, which had been boosted immediately following the land reform, was not removed until after the “agricultural reforms” in the late 1970s and early 1980s when the collective system was fully dismantled. However, it is important to note that this subsequent reform did not, in fact, return land to full-scale private ownership. Land

<sup>1</sup> Working on land one owns oneself entitles one to all the produce of one’s labor (after deductions for tax, if any). However, self-ownership and full entitlement to the product of one’s labor (and concomitantly with this, full responsibility for cost-bearing) may also bring with it the increased burden of risk bearing for any crop or output failure.

in theory was and still is (even now) collectively owned, although under the new system it is allocated, on a more or less egalitarian basis, to private use. Specifically, each farmer can use the land he is given to cultivate whatever he likes and receives full fruits from his labor, but he cannot sell or buy additional land (as he has no ownership claims over his land nor can he establish such ownership over any additional land through purchase). Called the Household Responsibility System, this collective tenurial system has had, as we shall see in the next section, enormous implications for the pattern of equity and growth in the rural PRC, the pattern of rural-urban labor migration, and ultimately the pattern of equity and growth for the PRC as a whole.

From our account of the pre-1978 rural collective system above, one might draw the conclusion that the system was entirely ill-designed and had a completely negative effect on rural and agricultural, and by extension, overall development in the PRC. However, to think so would be a mistake. For, while the system had its serious drawbacks, it also had an important plus side, which has to do with its role in facilitating rural social sector and physical infrastructural investments.

The key to seeing this side of the matter lies with the payment system of the collective, whereby each member would be paid (or his share of the collective income would be determined) according to his labor contribution vis-à-vis that of other members. If a person's labor contribution were measured in "workpoints" (which was, in fact, the actual practice), then that person's income from the collective would simply be the number of workpoints he earned multiplied by the monetary worth of each workpoint, the latter being given by the total collective income divided by the aggregate number of workpoints earned by all the members in the collective.

Such a payment system had two important properties that turned out to be highly beneficial in terms of facilitating social sector and agricultural physical infrastructural investments. First, not all collective income had to be distributed to members; part of it could be set aside for social welfare and other purposes. As it happened, two such set asides were regularly made, called the "accumulation fund" and "welfare fund", respectively. The former was used for "expanded production", while the latter for social sector investments such as in education and health. Indeed, it was the collective funds such as these, rather than government funding, that were principally responsible for the rapid development of rural health services and rural primary and secondary education in the PRC during the period.

But the system did not only contribute to investments in rural health and education in this way. The collective payment system described above also enabled collectives to finance such investments in yet another crucial way. For any labor inputs related to these investments, be they the hours contributed by paramedical professionals such as bare-foot doctors or certain categories of teachers (e.g., the so-called *minban* teachers), or hours contributed by still others to public health projects and the building of local schools and clinics, could similarly be paid in workpoints, with the effect of increasing the aggregate number of workpoints in a collective and hence reducing the dividend rate of each workpoint. In effect, the practice amounted to spreading the labor cost in question over all members of the collective proportional to their labor contribution. In this sense, it is very much like a form of income tax.

As well as social sector investments, the collective also facilitated rural physical infrastructural investments in a big way. Typically, such investments included building new, and/or improving on existing, irrigation and drainage systems to ensure timely irrigation and drainage of farm plots, building and improving rural road systems to ensure direct access by machinery and personnel to plots to improve the transport of farm produce and inputs and to facilitate crop management, and standardizing the size and shape of plots to facilitate mechanization. I will

explain shortly why these improvements in what may be called the basic agricultural infrastructural conditions were important for subsequent patterns of equity and growth. For now, suffice to note that the same mechanism that financed much of social sector investments noted above could be put to use for financing and making possible such physical infrastructural investments as well. Again, the material costs related to such investments could come from one of the set-asides from the collective income mentioned above (the “accumulation funds”), and the labor cost, which typically accounted for a much greater proportion of the total cost, could be financed by remunerating people making such contributions in workpoints.

Could these investments be carried out to the same level without the collective system? Could it be done differently through, for example, a formal system of central and local government taxation and budgetary allocation? If the answer is yes, then the collective system would be redundant even as far as these investments are concerned. My view is that without the collective system some such investments could have occurred but they could not have been on the same scale, nor have achieved the same level of efficiency and effectiveness. But I shall not go into the reasons here. It should also be noted that in addition to collective investments in social sectors and in physical infrastructure, local and central governments did also contribute some funds, but their contributions usually catered for only the “top-end” needs (e.g., in the case of health, local and central government contributions might cover, or partly cover, the costs of building and maintaining county-level or sometimes also township-level health facilities, but typically not village level facilities and staff costs). So there were efforts from all parties, but by far the largest single contribution was made by the collectives, without which the extensive scale of the investments during the period would simply not have been possible.

It is not possible to provide a monetary measure of the totality of these investments, whether in social sectors (education, health, and other) or in rural physical infrastructural investments. Nor would it be possible to give a precise breakdown of the totality of investments involved into respective components (collective-funded, government-funded, etc.). No systematic data was collected at the time allowing for such analysis. But the extent of improvement in certain health and education indicators should give us an idea of the likely scale of social investments during the period. At one level, the story of healthcare improvement was well-known enough—the World Health Organization (WHO) (WHO 1978) regarded the PRC’s rural healthcare system at the time as a stunning example for other developing countries to follow, of how to maximally improve the population’s health with the few resources a nation might have (but as we know now, not all the mobilized resources were in fact accounted for in that evaluation). But our assessment need not rely on only the endorsement by WHO at the time. Figure 3 compares the PRC’s achievements in life expectancy over two periods before and after 1978, internationally with both developed and developing countries. The contrast is striking. While the PRC outperformed all other countries by a massive margin in the pre-1978 period, its performance in the subsequent period is, at best, lackluster.

As regards education, Table 2 provides the PRC’s 1990 National Census findings on achievements of each age cohort, measured by the proportion of the population in that age cohort achieving or not achieving alternative educational levels. As can be seen, there was a sharp 16-percentage-point fall in the illiteracy cum semi-illiteracy level for the 1946–1950 cohort, compared with the level of the immediately preceding cohort (data highlighted in italics). This actually coincided with the founding of the PRC in 1949. But other aspects of the table are also of much interest. Thus one observes an 11-percentage-point jump in junior secondary education for the 1961–1965 cohort, and an even larger 12-percentage-point increase in senior secondary education for the 1956–1960 cohort. In the latter case, though, this sharp rise was followed by an equally sharp fall (10 percentage points) for the cohort 1966–1970. Note that under the

PRC's education system, generally senior secondary education completes at the age of 18,<sup>2</sup> and that the Cultural Revolution began in 1966, officially went on until 1976, but its influences were not really full terminated until the early 1980s. Thus, with some careful scrutiny of the data presented in the table, it would appear that in spite of its apparent negative impacts in other respects, education (and health) did not appear to do too badly in those years at all. In fact, it would appear that the opposite may even have been true.<sup>3</sup>

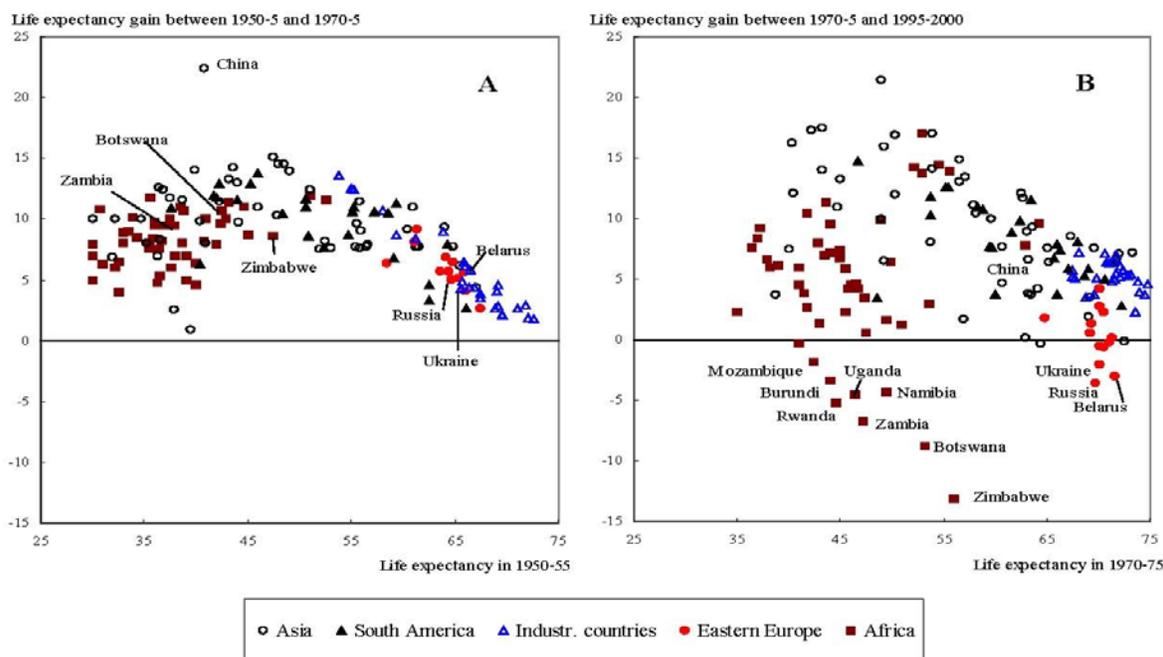
In respect of physical infrastructural investments, Liu, Wu, and Liu (1998) provides a detailed study of the scale and the contributions they made to rural and agricultural development in the PRC during the period and thereafter.

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<sup>2</sup> Under the PRC's education system, typically primary education begins at the age of 6 and completes at 12; junior secondary education starts at 12 and ends at 15; senior secondary education begins at 15 and finishes at 18, upon which a kid may then, if qualified through entry examinations, enter into higher education. However, school durations were generally shortened during the Cultural Revolution years, often by one full year in each case (primary, junior secondary and senior secondary), depending on time and location.

<sup>3</sup> Not much attention and scrutiny was, in fact, ever paid to the data given in Table 2, before the views on the Cultural Revolutions years quickly coalesced into a complete negation. Some, though, might argue that even though "quantitatively" education may not have done too badly during the Cultural Revolution years, "qualitatively" all that education was sub-standard. By some measure, this critique may well be valid. The emphasis on education then was on practical knowledge acquisition. However, given our focus on the role of general education rather than specialized tertiary education, that critique, while true, would not seem to carry much force. Of course, this does not imply that tertiary education, which does appear to have suffered greatly during the Cultural Revolution years even by the data in Table 2, is unimportant. Rather, as I shall stress later in this paper, it is of course important and will especially be so to the PRC in the forthcoming decades. Note also that the data given in Table 2 refer, in fact, to the whole PRC, and not just its rural areas. However, given that its rural population share then was well over 80%, and that urban children were already enjoying near universal access to primary and junior secondary (although not senior secondary) education at the time, the principal part of the improvement must have come from the rural sector. Further, see Goldman et al. (2008) who compare investments in education and educational outcomes in China and India for periods both before and after 1978, and find that while India has generally performed better than China in tertiary education, China has done much better in primary and secondary education.

**Figure 3: Relationship between Initial Level and Life Expectancy Gains during Two Periods: A) from 1950–55 to 1970–75; B) from 1970–75 to 1995–2000**



Source: Caselli, Meslé, and Vallin (2002).

**Table 2: Educational Achievements by Age Cohort, PRC 1990 National Census (%)**

Age cohorts	Age in 1990	Illiteracy and semi-illiteracy	Primary	Junior Secondary	Senior Secondary	Higher Education
1981–1984	6–9		100.00			
1976–1980	10–14		83.50	16.50		0.05
1971–1975	15–19	5.50	35.91	46.78	11.25	0.40
1966–1970	20–24	6.00	34.31	44.65	12.27	2.82
1961–1965	25–29	7.00	25.11	43.71	21.95	3.07
1956–1960	30–34	12.00	32.56	32.56	20.77	1.89
1951–1955	35–39	17.25	44.69	27.72	8.61	1.74
1946–1949	40–44	20.50	50.28	21.07	6.24	1.87
1941–1945	45–49	36.50	37.31	17.46	6.19	1.94
1936–1940	50–54	41.00	39.24	11.80	5.58	2.45
1931–1935	55–59	54.50	33.22	7.51	3.39	1.46
1926–1930	60–64	62.50	28.22	5.91	2.40	0.94
1925 & earlier	65+	73.50	21.07	3.84	1.30	0.53

Note: The figures given in the Table are based on corresponding charts from the source book. While every effort is made to ensure an accurate rendering of the original bars into numbers, no accuracy of the numbers provided is assured.

Source: National Center for Education Development Research of the PRC, 1995.

## 4. THE POST-1978 REFORMS

Let us now turn to the post-1978 reforms. Beginning in 1978 and in the ensuing years, the PRC embarked on a series of economic reforms, the first of which took place, in fact, in agriculture, which saw the dismantling of the collective system as noted above. That reform released the pent-up productive capacity made possible by the collective system, on the one hand, but which was also denied an outlet by it, on the other, as witnessed by the sharp rise in agricultural production immediately following the system's demise. Soon thereafter, the reform spread to industries and urban areas as well, accompanied by major export- and FDI-promotion drives. Together, these reforms ushered in a period of rapid and sustained economic growth in the country, but not without worsening income distribution, as seen in Section 2.

The reforms, in essence, constituted a sharply new and different development strategy. In place of the old emphasis on socialist planning, it now stressed the role of the market in resource allocation; instead of former dictums of self-reliance, it now actively sought for foreign markets, alternative management models, and capital and technology. However, sharply different as it may be from the PRC's former development strategy, important complementarities exist between the two. Much of the subsequent success may, in fact, be seen to have arisen on the basis of the foundations laid in the prior period.

Just how did the pre-1978 developments outlined above feed into the post-1978 process of development to give rise to the pattern of growth and equity such as we see today? First, much of the growth in the post-1978 period can be thought of as a process of sustained expansion of the industry and service sectors drawing on an extensive pool of rural surplus labor, helped by expanding export markets and FDI inflows. While low labor costs have often been highlighted in explanations of such export and FDI expansions and the PRC's growth performance in general, of crucial importance is, in fact, the fact that by the time when economic reforms began and when exports and FDI assumed a major role, the PRC had already had a literate and reasonably educated workforce, thanks to the social investments made in health and education in the period before 1978 (as discussed in Section 3).

The importance of this latent labor force only waiting to be mobilized and employed, as it were, cannot be overemphasized. Without it, growth would be stalled even though market opportunities might be there. While this labor force may not have been exceedingly well-educated and highly-skilled, the level of literacy and education they received, and the generally good health conditions they had, nevertheless quickly enabled them to learn the new skills required of them, and to have the physical stamina to work very long hours.<sup>4</sup> True, the relatively low income they would have otherwise received if they had stayed back in their village may have set a rather low (reservation) wage for them, which in part helped attract investments that offered them the new job opportunities in the first place. The fact of the matter remains that if they had in fact lacked their literacy and basic educational accomplishments, or the ability to quickly learn new skills, a mere willingness to accept a low wage may not have enabled them to both contribute to and benefit from economic growth, in the way they did.

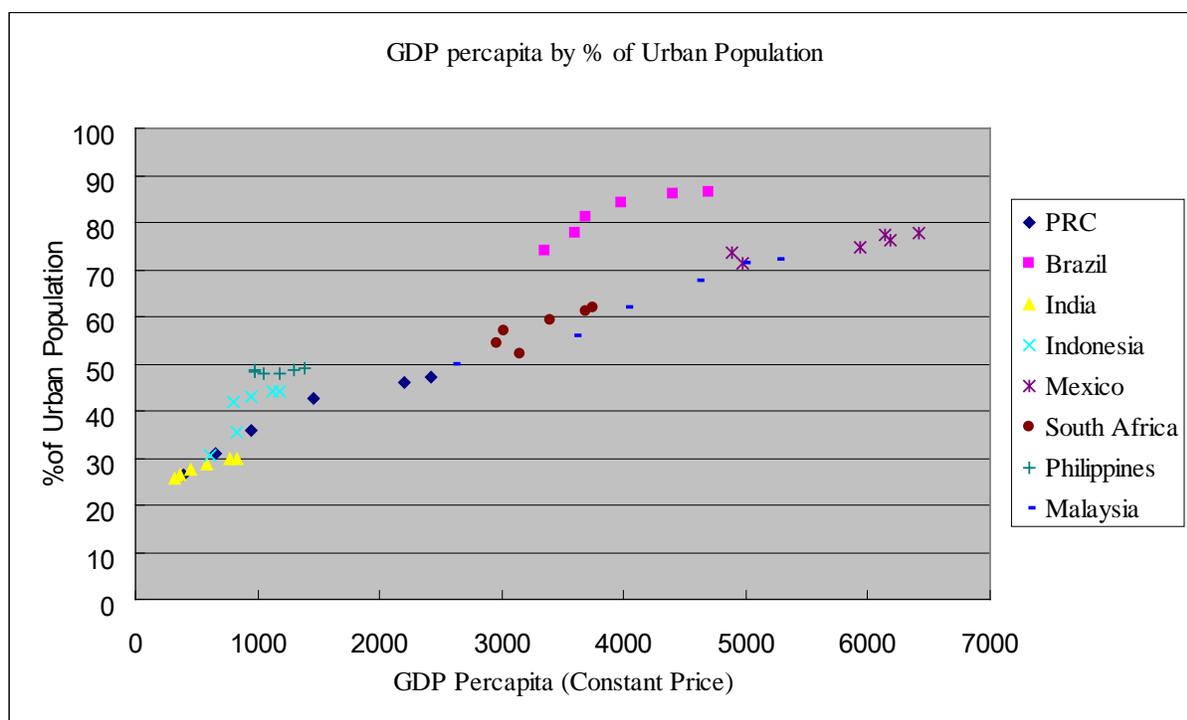
Secondly, much of the post-1978 economic growth process has, at the same time, been one of rural-urban migration. However, this process has progressed at a quite moderate pace in the

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<sup>4</sup> It might appear somewhat far-fetched to emphasize the implications of good health and nutrition for workers' physical (and mental) stamina for long hours of work, to those who have perhaps never experienced or observed any major health and nutrition-related calamities, caused by economic destitution (the PRC was, of course, very much a destitute country at its founding). It might be unthinkable to some that health and nutritional factors could ever be a major obstacle to economic growth and development of a country. If one indeed has doubt about it, see Dasgupta (1997).

PRC, compared with in other economies going through similar kinds of change (Figure 4). It has been customary to attribute this to the PRC’s *hukou* system, an administrative legacy from the pre-1978 period whereby people, including farmers, were restricted to their registered place of residence (often the place where they were born!) in respect of such entitlements as to land, job opportunities, and other social benefits (e.g., school places, health insurance, etc.). While it must have had a downward effect on urban-bound migration, how this should be comprehended and evaluated is an issue. In fact, upon closer examination, it turns out that a prime factor keeping farmers back in their village—or, if they have left their village for work in an urban place, even keeping parts of their family there or making them periodically returning to their village—is the land they are still entitled to there. That is, they have by no means become uprooted and landless, and there is actually still a source of income out there for them in their village. If this factor were removed, then the scale of migration could have been much greater.

**Figure 4: Percentage of Urban Population and per capita GDP, Selected Countries**



Note: Observations are undistinguished by year but are for selected years 1990, 1995, 2000, 2005, 2009 and 2010 for each country. A note of caution is in order when making country comparisons as different countries may have used different criteria to classify urban and rural populations.

Source: World Urbanization Prospects: The 2009 Revision Population Database; World Bank Data Bank.

Needless to say, urbanization (as characterized by extensive rural-urban migrations) is a necessary phase of economic and social development of a country. But excessive migration at any particular point in time can be detrimental to that process. When landless farm laborers flock to the margins of cities, often unemployed or merely scraping a living by performing various “informal” work, and without having any recourse to return to their village, an economic and social underclass is created, with all the negative implications for equity and income distribution. Although some presence of such an underclass may also be observed in the PRC, the farmland entitlement system (or the Responsibility System) has exercised, it must be reckoned, an important constraining force on that, preventing an extensive dispossessed and impoverished class from emerging on the margins of cities. This point is well borne out by Table

3, which compares the extent of urban poverty in the PRC with that in India.<sup>5</sup> And, as we saw previously, albeit reformed by the post-1978 rural reforms, such a farmland entitlement system owed its very origin to pre-1978 land-related institutional reforms.

**Table 3: Urban and Rural Poverty in the PRC and India, Selected Years**

Year	Country	Urban	Rural	Total	Urban Share of Poor	Urban Share of Population
1993	PRC	3.3	39.1	29.1	3.2	29.8
	India	40.1	48.9	46.6	22.5	26.2
1996	PRC	1.7	24.8	17.4	3.1	32.2
	India	40.5	46.8	45.1	24.1	26.8
1999	PRC	1.6	27	18.2	3	34.9
	India	37.4	44.3	42.4	24.2	27.5
2002	PRC	0.8	22.4	14	2.2	37.7
	India	36.2	42	40.3	25.2	28.1

Note: Headcount index using a poverty line of \$1.08/day in 1993 purchasing power parity (PPP).

Source: Ravallion, Chen, and Sangraula (2007)

Thirdly, while some surplus farm laborers may have moved away from their village for jobs in cities, many have remained behind. But even they did not solely engage in farming. Given the extremely scarce land resources per person in a typical PRC village, to solely engage in farming would be tantamount to inviting poverty. Diversification (that is, to simultaneously engage in both farming and non-farming activities) is essential. In most cases, it would not be a good idea for a farmer to wholly abandon farming either, as even non-farming activities may not be sufficiently lucrative or may not readily come by. A rational strategy would be to utilize all of one's available income opportunities.

But without certain conditions being met, it would actually have been difficult for one to combine both farming and non-farming activities (that is, to concomitantly pursue them). Here lies the important role of the rural physical infrastructural investments carried out during the collective period, as already noted above. In a nutshell, these investments did not only raise farm yield and increase labor productivity, important as these may be, they also changed the farming infrastructure (mainly farm road systems and plot configurations) in such a way that part-time farming became both possible and viable. First, improved farm road systems both improved transportation conditions and reduced travel time to one's plots. Secondly, this together with the improved farm-plot configurations made mechanization of a wide range of farming operations possible and viable (a good road system enabled farm machinery to more easily reach each plot, and a larger plot size and better plot configurations also facilitated such mechanization). In total, these reduced the amount of time farmers needed to spend on farming, allowing them to have still plenty time to pursue other activities, and doing both in a viable manner.

Indeed, part-time farming has become a wide-spread phenomenon in the rural PRC. But the important role played by rural physical infrastructural investments carried out in the former period has often been neglected. After decollectivization, rural physical infrastructural investment, in fact, ceased for a time, as the collective that had formerly financed and organized

<sup>5</sup> While the contrast between the PRC and India in urban poverty as this table presents is sharp, it has to be noted that the estimates for the PRC may have underestimated the extent of urban poverty there. The source of discrepancy has to do with the possible underrepresentation of the migrant population in the PRC's urban poverty surveys, who as a group would generally be poorer than the locally registered urban population. Nevertheless, even with the full inclusion of the poor from this group, it is unlikely to overturn the basic contrast revealed by the table.

them in the first place no longer existed. It was not until the late 1980s that such investments were resumed through central and local government budgetary funding, but they achieved a scale in no way close to that accomplished during the collective period (Liu, Wu, and Liu 1998).

Thus whether migrating to cities but still entitled to a piece of land in their home village, or remaining behind in their village but diversifying to other non-farming activities, PRC farmers have enjoyed much better income opportunities than otherwise, thanks to the above-mentioned institutional arrangements and social sector investments made before the reforms. The role of these pre-1978 inputs has generally been downplayed in accounts of the causes of the post-1978 growth and equity, but in a fuller examination of the factors contributing to the current pattern of growth and equity in the country, these factors are too important to be ignored.

## 5. THE BURDEN OF “SIZE”

By the size of an economy I shall primarily mean its population, rather than its geographical expanse, although the latter can also matter in that a larger geographical expanse is often correlated with a greater abundance of natural resources (but also a greater distance to cover, transport-wise). However, while geographical expanses primarily impact an economy through the supply side, population affects it through both the supply and demand side. On the supply side, other things being equal, a larger population means a greater labor force and a greater abundance of human resources necessary for the economy to grow. On the demand side, a larger population should provide a greater internal market for the goods and services that the economy produces. With high trade barriers and economies of scale and scope, a case can be made that a larger population will, on average, allow an economy to grow faster, in per capita GDP terms, than otherwise.<sup>6</sup>

And both the geographical size (and terrains) and population can have important implications for the distribution of income within an economy as well. Natural resources (including accessibility to seaports, etc.) may not be equally distributed geographically, and in general the greater the geographical expanse of a country is, the larger such variations tend to be. Similarly, not all human resources may be equally educated and trained, and in a developing economy especially, some portions of its labor force may exist as unskilled or semi-skilled rural “surplus labor”, whose absorption into the more productive sectors of the economy is a key objective of development. In general, as is argued below, the larger this surplus labor force is, the longer it will take an economy to absorb it. And this has important implications for the pattern of income distribution in that economy.

It is not possible to go into these issues at length here. Perkins and Syrquin (1989) provide an extensive review of the early literature, drawing on the work by Kuznets and Chenery. However, while early economists had considered the size as an important factor in explaining cross-country patterns of growth and income inequality, subsequent generations of economists have not given the matter nearly as much attention. Nevertheless, it would seem that the size of an economy does matter, and in addressing issues of growth and equity of a country such as the PRC, it holds a particular level of significance that we simply cannot afford to ignore.

In what follows, I shall consider the effect of the size of the PRC on its pattern of growth and equity by primarily looking at the impact its size appears to have had on its export expansion and FDI inflows, both key engines of its recent economic miracle. On the whole, the PRC’s large size has offered rather mixed blessings. On the one hand, it has clearly made a significant

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<sup>6</sup> Needless to say, there may be a limit to such economies of scale and scope. Beyond a certain point, these factors may no longer matter.

positive contribution to the country's export expansions. To begin with, of the PRC's total exports, processing trade has accounted for a significant share, especially in the early years of the reform period (Figure 5). But one of the factors that made this possible is the availability of a *large* pool of cheap but sufficiently literate and semi-skilled labor force, as noted previously. Without this, it would be unthinkable, for example, that the whole of the Pearl River Delta region, and other regions in the eastern PRC, could have developed and eventually become one of the world's leading locations of processing trade. Next, in addition to the availability of a large pool of cheap but sufficiently literate labor force, the country's potential as possibly the world's largest consumer market has helped to attract much of the FDI inflows to it (Figure 6). At a time when many state owned enterprises were forced to close due to market forces over the course of economic reforms (as in the 1990s), these inflows of FDI represented a much welcomed source of exports, employment, income, and growth (see Figure 4 for share of foreign invested enterprises in the PRC's total trade). Moreover, FDI also provided a much needed source of market competition, impetus for management and enterprise culture change, and, of course, new technology. According to some studies,<sup>7</sup> it may even have played a role in facilitating labor market and other reforms in the country. Thus the effects of FDI on the PRC's economic reforms and growth are many and major. But while paying tribute to the role of FDI and trade in these matters, one should not forget the important contribution made by the country's huge pool of cheap but relatively well-educated labor force, and its potential market size, in attracting these investments to it in the first place.

On the other hand, although the PRC's size has contributed significantly to its success with an export-led development strategy, it has also imposed important limitations on the extent of this success, in terms of both growth and equity. First, in terms of growth, after the initial period of rapid growth of exports and the economy in general over quite many years, thanks to the factors mentioned above (among others), the volume of exports in its main exportables (those for which the PRC has had a comparative advantage) has reached a level where it accounts for a rather high proportion of the total world exports in those goods and services (see, e.g., Table 4 on textiles and clothing), and this has had the effect of driving down export prices.<sup>8</sup> Besides generating an escalating number of trade disputes, low export prices have meant low wages for domestic workers. We will explore the implications this may have had for income distribution in the PRC shortly. For the moment, the point to stress is that there are important limits to a large country such as the PRC in pursuing an export-led growth strategy. Export growth may help kick-start the PRC's economic take-off, but its long-run growth cannot depend on it.<sup>9</sup>

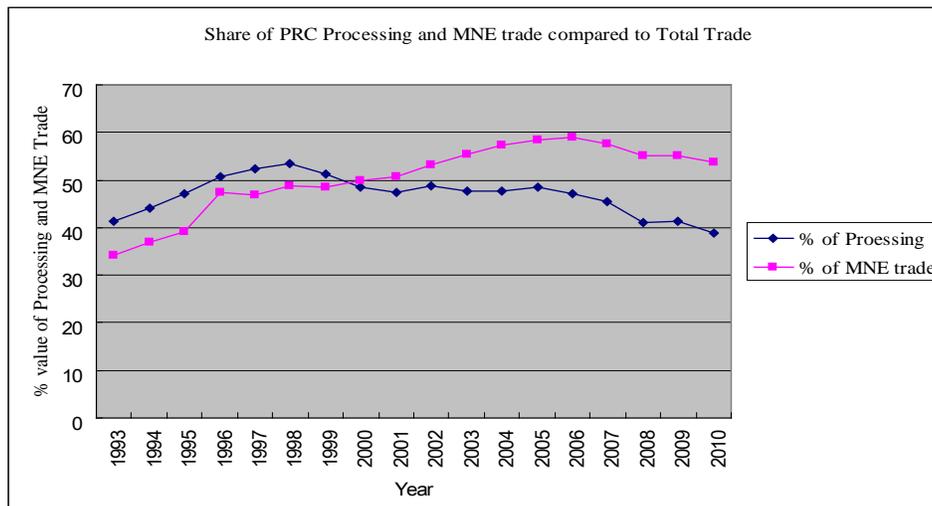
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<sup>7</sup> See, for example, Liu, Xu, and Liu (2006) on FDI and its role in the PRC's labor market reforms.

<sup>8</sup> PRC exports in these goods and services have in particular accounted for a significant market share in some destination markets (United States, the European Union, Japan, etc.). Consumers in those markets have never had it so good—the large volumes of exports from the PRC (and other developing countries) have helped to keep the prices of a wide range of final consumer goods in those markets low (sometimes very low), thereby significantly keeping down the living costs of an average consumer in those countries, and raising his/her real income and wellbeing.

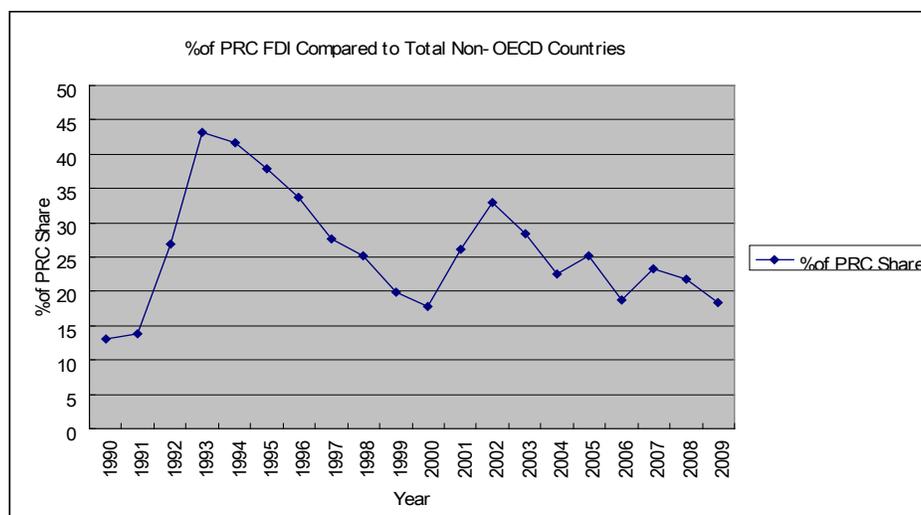
<sup>9</sup> Export successes may, of course, also lead to growing amounts of current account surplus, but this need not necessarily be true, if imports also rise *pari passu*. As it happened, for various reasons high amounts of current account surplus were accumulated by the PRC, generating severe upward pressures on its exchange rates. With appreciations in the yuan, domestic margins of profits for its exporting firms are further squeezed, reinforcing the falling-price effect due to its large volumes of exports. But, as noted, this need not be a necessary consequence of a country's size.

**Figure 5: Share of Processing Trade and Trade by Foreign Funded Enterprises in the PRC's Total Trade**



Source: CEIC data.

**Figure 6: The PRC's Inward FDI as Share of Total FDI to Non-OECD Countries**



Source: CEIC data.

**Table 4: Share of the PRC's Exports/Imports of Textile and Clothing in World Exports and Imports**

Year	Clothing Exports	Clothing Imports	Textile Exports	Textile Imports
1980	4.0	0.1	4.6	1.9
1990	8.9	0.0	6.9	4.9
2000	18.3	0.6	10.3	7.7
2009	34.0	0.6	28.3	6.7
Value (2009)	107	2	60	15

Note: 2009 trade value in billions of United States dollars.

Source: World Trade Organization, International Trade Statistics 2010.

Indeed, for a large country such as the PRC, prolonged pursuits of export expansion, by driving down export prices and keeping the home wages of the workers down, can have a severe negative effect on the growth of domestic demand for the goods and services it produces. Ideally, when foreign exports of its goods and services reach a plateau, its internal demand should step in, to keep the total demand for its goods and services up, and the economy on the growth track. This can be made possible if, during the export expansion phase, the incomes for the workers as well as other stakeholders also grow. However, prolonged pursuits of export expansion, by unduly driving export prices and workers' wages down, have the effect of depressing domestic demand. Lacking continued demand growths, economic growth may well, then, be stalled.

Secondly, in terms of equity, the unfavorable effect of undue export expansions on export prices and workers' incomes has already been noted, but this can have implications for income distribution as well, if one also recognizes the fact that, when prices of exports go down, almost certainly the loss of revenue will not be borne equally by all stakeholders (workers, managers, creditors, and owners), proportional to their incomes so to speak. Often, the principal burden may actually fall on workers, especially when finding a replacement worker is not difficult—even when an incumbent worker wants to leave their job after a wage cut (or when the expected wage increase does not materialize). And as long as there remains a large quantity of surplus labor waiting to be absorbed, it should, indeed, not be difficult to find replacement workers. However, these are also precisely the people whom we expect to be in low-income brackets already. So for a large country, over-dependence on export expansion can have a detrimental impact not only on domestic demand growth (as already noted), but also on income distribution.

There are yet other possible channels whereby the size of a country may negatively affect its pattern of income distribution. Thus if one conceives development in the way Lewis (1954) did (that is, as a process of absorbing surplus labor from less productive activities such as agriculture into more productive activities such as industry and services), then FDI inflows should clearly help a country to do that, especially when domestic capital is scarce. However, such a reliance on FDI inflows also clearly has its limits when a country is very large and its pool of surplus labor is extensive. While for a small country, a relatively small amount of favorable FDI inflows may well have helped absorb a significant portion of its surplus labor force, and over perhaps a relatively short period of time may help to absorb its entire surplus labor, for a large country to achieve the same level of developmental progress, it will certainly have to receive many more times of such inflows, and very likely over a much longer span of time. For at any point of time, there must be a limit to the total availability of FDI flows.

This line of analysis has immediate implications for thinking about the pattern and trajectory of growth and income distribution of a large developing country. By definition (but empirically also largely true), before their absorption into some more productive sectors of industry and services, a surplus laborer is poor, possibly living only at a subsistence level. Now if it is going to take longer for them to be so absorbed, then they will remain poor for longer by being in a large rather than in a small country. In terms of the country pattern of income distribution, an improvement in income distribution following their absorption into a high-income occupation will occur, but it will occur much later in a large country than in a small country. The two countries might start their developmental process more or less at the same time, but along their respective paths, the pattern and trajectory of income distribution will behave rather differently.<sup>10</sup>

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<sup>10</sup> The discussion here strictly concerns only the time it takes for income distribution eventually to improve, assuming development indeed to proceed fully eventually in both large and small economies. With falling relative availabilities of FDI inflows as the country size gets larger, it may be argued that the terms of such inflows may also worsen for large compared with for small host countries, squeezing the remaining income margin left for these countries more

And if one further considers the possibly larger geographical variations in endowments of natural resources in a large than in a small country, then not only is it likely for high income inequality to persist longer, but also its severity may be greater in a large than in a small country.<sup>11</sup>

Much of this analysis, in fact, directly applies to the PRC. In spite of the three decades of rapid growths of exports, FDI inflows and the economy as a whole, large pockets of surplus labor still remain,<sup>12</sup> and with it the associated poverty; for a very long time and only until very recently, wages in export processing factories in Guangdong and elsewhere did not experience material change (Figure 7),<sup>13</sup> while income distribution in the country has consistently worsened over the last three decades (as seen in Section 2), now well surpassing the internationally recognized warning level. For a small economy, similar levels (in absolute amounts) of export expansion and FDI inflows might well have absorbed all available surplus labor, wiped out the associated poverty, increased workers' wages by a huge margin, and put the country on the path to greater income equality. But because of its large size, the PRC has not yet been able to do any of these. One only hopes that given time, it eventually will.

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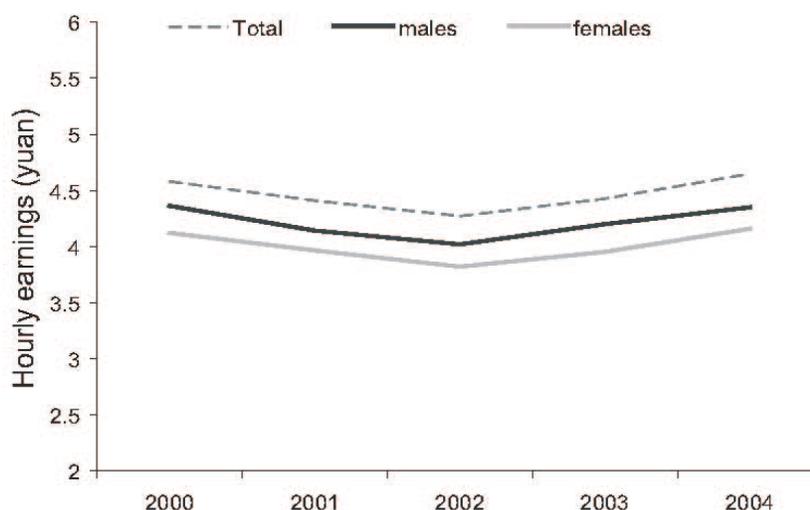
than they do for small ones. And by the same reasoning made before in relation to export price falls, such income margin falls due to unfavorable changes in the terms of inward FDI flows are similarly likely to bear disproportionately on workers as opposed to other stakeholders, that is, those already in low-income brackets, thereby worsening income distribution in large compared with in small countries. However, recall the arguments made previously that large countries should also hold greater attractions for FDI inflows compared with small ones by offering a greater pool of surplus labor and a greater potential market. Presumably, other things being equal, these could mean larger income margins for host economies, with contrary implications for income distribution. Thus it would appear that the net effect of country size on income distribution of a host country through changes in the terms of FDI inflows is, in fact, unclear.

<sup>11</sup> It should also be recognized, though, that a large country has an "equalizing effect" over its parts as well, in that if its parts remained as separate nation states, then the income difference between them might well be much greater, than if they were parts to the same country. But this is a different issue from comparing the situation of income distribution in a large as opposed to a small economy, when the two economies are otherwise the same except in size.

<sup>12</sup> For claims to the contrary, see Cai (2007), and the discussions it generated.

<sup>13</sup> Figure 7 provides simulation results based on detailed payroll information the authors collected from seven participating firms in Guangzhou, Dongguan, Shenzhen, and Zhongshan, after controlling for other factors (e.g. education) that may have affected workers' wages over time. Out of an initial sample of 25 firms, 18 either did not respond to invitation to participate in the study, or refused to provide payroll information when requested. The authors therefore warn that their results may overestimate actual wages in export-processing factories in the region, since non-participating firms are likely to have offered even lower wages.

**Figure 7: Hourly Wages of Unskilled Workers,  
Guangdong, the PRC (Yuan/Hour)**



Source: Meng and Bai (2007)

It is not possible to correctly predict exactly what might or might not have happened to the PRC in the last three decades if it had been a small country. Many factors would be involved and have to be considered in such an exercise. In the above discussion, I have only considered those factors related to export expansions and FDI inflows, factors that have, in fact, figured significantly in the treatment of the issue of country size by the early economists. In relation to the PRC, the effects just discussed are, I believe, also the ones that merit special attention.

## 6. IMPLICATIONS

Many factors have contributed to the PRC's present pattern of growth and equity. Some of these have routinely been cited and discussed in the current literature: market-oriented economic reforms, ownership reforms, export promotion and FDI, and the role of the state, among others. In this paper, I have highlighted the importance of those factors that have less often been mentioned in the literature, not in order to present a deliberately idiosyncratic reading of the history, but to argue that, although often neglected, these factors are nonetheless important. They are, so to speak, basic parts to a larger "iceberg". Although they may lie below the surface and hidden from view, without them the top contour of this "iceberg" would, in fact, not have figured so prominently on the skyline.

### 6.1 Growth and equity

What, however, are the implications of this reading of the events for the future? First and foremost, due to its size the PRC, in fact, has to break an entirely new path for sustained future growth of the economy while simultaneously achieving an adequate level of equity. In particular, given the limitations its large size imposes on the role of export expansion and FDI inflow in its developmental process, the PRC will have to rely, much more than other successful but smaller newly industrialized economies have done before it, on expanding its domestic demand. And this also means that, quite early on in its developmental process, it will have to simultaneously tackle issues of income distribution and, more generally, social equity. For, besides being

important in their own right, income distribution and equity also have a crucial bearing on domestic demand expansion. That is, other smaller economies might feasibly rely on a growth-first-and-equity-later development strategy, whereby they might pursue export expansion and FDI promotion right until their “growth phase”, so to speak, is more or less over (i.e., right until more or less all their surplus labor is absorbed into the more productive sectors of the economy), and only then adopt policies to tackle income distribution and equity.<sup>14</sup> As it is a large country, this option is denied to the PRC.

Needless to say, as an economy develops, the question of when is the time to address issues of distribution and equity, and to what extent it should do so, will depend on the circumstances of each economy, including levels of social tolerance of inequities. Thus even a small economy may be forced to act on this front well before its growth phase is over. Nonetheless, in the case of the PRC, the imperatives of growth itself would actually demand that effective steps be taken on the distributional and equity front as well, and quite soon into its course of development.<sup>15</sup> That is, quite early on during its course of development, the PRC may reach a point where growth cannot be sustained unless it simultaneously addresses distribution and equity issues. And in my view, the PRC may have already reached this point.

The issue of domestic demand growth has, in fact, been widely recognized among researchers and policymakers in the PRC for some time. However, the understanding of its role has been rather limited. A temporary fall in foreign demand was believed to have occurred, which was in turn thought to be due to a combination of the PRC’s domestic trade policy changes and RMB appreciation, or more recently to the international financial crisis. As a consequence, policy responses have been, on the whole, *ad hoc*, and have primarily taken the form of increased government expenditures on infrastructural investments. While these measures did indeed temporarily boost domestic demand, the efficiency of such investments is seriously in question. In any case, the extent to which they can be used as a long-run solution to what is a *systemic* domestic demand gap problem is seriously in doubt. Yet such a long-run solution has to be found. It needs to be clearly recognized that the current demand gap reflects, in fact, something more structural, and needs to be tackled as such.

My own view is that there needs to be increased household demand, and this means increased household disposable income. Wage increases can help achieve this aim, especially if they are for low-wage earners. Increased transfer incomes through better social protection programs can raise domestic demand, too. There has, however, been a great reluctance on the part of the government to do either of these. In the first case, it is feared that a rise in wages could reduce firms’ competitiveness and adversely affect exports and inward foreign investment. This may be true. But it needs to be recognized that continued reliance on the current strategy of expanding exports, in many cases of the rather cheap and low-tech kind, cannot be in the PRC’s short or long term interest. In the short term, as noted, such a strategy may well further drive down export prices. In the long run, it may even cause the country to be “trapped” in a dependence on cheap and low-tech exports without being able to extricate itself, that is, to fall into the so-called “middle-income trap”, a term that has become fashionable only recently. Since I will say more on this in the context of discussing the crucial role of education in particular and social

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<sup>14</sup> The underlying reasoning here is that once the “growth phase” is over, as is understood here, further growth will mean wage increases, and it will be easier to address issues of income distribution and equity when wages are already on a path of increase.

<sup>15</sup> A country may be forced to move on the distributional and equity front for reasons of social cohesion and tolerance, but such imperatives are rather different from those coming from the need to expand demand. In the former case, success lies in effectively managing such social tolerance. In the latter case, success lies not only in effectively managing such tolerance, but more importantly in effectively managing demand.

investments in general in ensuring longer-term development potentials of the country, I shall say no more on this for now.

Secondly, there appears to be much reluctance on the part of the government to commit itself to anything like the long-term obligations of income transfers (in cash or kind) to households, through various social insurance and protection programs. The need for increased social protection has long been recognized, and quite a few studies have recently been carried out to look into its level and scope. But thus far no major concrete steps have actually been taken. While prudence in this respect is no doubt needed, excessive prudence is, however, unwarranted. At the heart of the matter is that many policy makers in the PRC appear to see such transfers principally in negative light. Perceived failures of similar attempts in certain countries (e.g., some Latin American countries), where social protection appears to have outpaced economic growth, are often cited. The positive role of these transfers, on the other hand, has generally received little attention. However, it would actually be difficult to imagine, for example, how a developed western nation might look, not only in respect of social equity, but also as a systemic component of aggregate demand, without such transfers. At times, social transfers do appear to cause severe strains to the macro-economy. But, equally, it would be difficult to see how without such transfers these economies could have fared better. It is curious to see that, while many in policy circles would have no hesitation that the country should emulate the west in a great many things, when it comes to social transfers, this emulation comes to an abrupt end.

## **6.2 Social sector investments and middle-income trap**

But an even more important role of such transfers is their effect on human capital accumulation. Without such government spending, especially on education but more generally on health and other social protection programs, it would be difficult to see how education, from basic to tertiary, could have been as extensively popularized in the developed nations today. And human capital accumulation, through the innovations and technological progress that this gives rise to, has of course been widely recognized to be the most important factor responsible for today's developed economies achieving their "developed" status, and is also widely thought of as the solution for today's successful developing economies (the so-called middle-income economies) to avoid falling into, as has recently been dubbed, the "middle-income trap".

There is really nothing more important than human capital accumulation to an economy or nation if it wants to develop, to modernize, and to catch up with today's developed countries. Without it, it will not be able even to learn to use the available technology, and to join existing regional or global production networks, let alone to imitate and adapt, and, hopefully, eventually to innovate itself and to move into the high value-adding segments of a production or value creating process. The human capital accumulation made in the pre-1978 era enabled the PRC to complete the first phase of this arduous transformation process (that is, learning to use available technologies and to join international production networks). The country may right now have reached the second phase of the process, namely, imitation and adaptation. But to move the country into the third phase of own-innovation and into the really high value-adding segments of a value chain requires a lot more human capital stock than the PRC currently has, and this means that more, and a lot more, investment in education, training and other processes of knowledge and skills development is needed. As well as increased levels of financial inputs, it may also require appropriate institutional changes to the existing formal, and informal, education and training systems.

The recent G-20 consensus on development (the Seoul Declaration) recognizes the general importance of human capital and has human resource development included among its nine

principal pillars of development. It is important for the PRC to seize on this international initiative, by fully engaging itself in various global and regional deliberations, and in so doing to learn from and to contribute to the global and regional dialogue on the importance, functionality, and effective methods of promoting human resource development. Much can be learned from the experiences and lessons, and views and perspectives, from other countries. This will help the PRC to better face, and to formulate realistic and effective approaches to facing, the growing challenge of renewed and increased investments in human capital. One of the measures may well be to significantly increase its public spending on education, both so as to build a better delivery system on the supply side, with improved teaching quality and better relevance to the needs of the labor market, and to ensure greater access to such education and training, not only at the basic and secondary level, but also at the tertiary level. In particular, far greater investments will need to be made in rural areas and for rural children, both to improve the facilities and teaching quality at primary and secondary schools there, and to ensure much greater access by rural youths to tertiary education. It will be a loss to society at large if any rural child, with an inner potential of becoming a skilled and even an innovative worker given the right education, is not able to do so simply because of a lack of access to education. Even though this may not always be easy to prevent in practice, still it will be a huge advance if this basic point is widely recognized and acknowledged by policymakers and the society at large.<sup>16</sup>

While directly targeting education and training is important, it should not be overlooked that, often, effective human capital accumulation also requires a comprehensive range of other measures. Improvements in health are obviously an example. A wide body of literature attests to the crucial link between a young person's health status and his/her educational outcome, other things being equal. Undernourishment of children has a strong negative effect on their school performance, for example. Indeed, the link seems to begin even from the very point of conception, through the fetal stage. The implications are great. It means that better nutrition and health care for the parents now may have ample rewards both for themselves and their children, and for the society subsequently. And health, of course, also affects whether a person may or may not perform well and up to her potential with the education she has received and skills she has learned.

Once we look at the matter in these terms, then public spending on education, and health, and indeed on other social protection programs, is not necessarily a net cost to society (ignoring for the moment the direct consumption value of such spending to recipients), without as it were generating any social benefits. Far from it, such spending may generate far and wide benefits. It may not often be easy to see these benefits, as there are inevitably other factors involved, and it may well be tempting to attribute the benefits actually accruing from such public spending to other factors, while the cost of this spending is for all to see. This appears to be one main factor preventing the emergence of a public consensus for more, and much more, government spending on education, health and other social protection programs in the PRC. Further studies of the link between public spending and human capital accumulation may contribute to the eventual arrival of such a consensus and would, therefore, be especially welcome on this account.

It should be made clear that while we have emphasized the need for increased public investment in education, it does not imply that we disregard the role of private investment. Private investments in this area have been extensive in the PRC (as in many other developing or newly industrialized countries). But private investments can, unfortunately, only benefit those who can afford. Given the well-known capital market imperfections for education, those with little

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<sup>16</sup> Scott Rozelle (2010) in a recent study discusses with facts and figures gaps in educational resources and opportunities between the PRC's rural and urban regions, and between the PRC and the United States.

means to make such investment will usually be denied the opportunity of education. On the other hand, human potentials rarely abide by such neat boundaries, that is, the boundary dividing those who can and those who cannot afford the investment.

Here we are, of course, only speaking in terms of the instrumental value of education. From the viewpoint of human development, it may also be argued that education is *intrinsically* important as well, and that basic social justice demands that there is at least some level of equity in this important dimension of human development. So while private investment would be most welcome, public investment is also needed. The challenge is how to make these two types of investment complementary to, rather than substituting for, each other.

### 6.3 Land and urbanization

It is fitting at this point to return to the theme with which I started this paper, namely, the current agricultural land entitlement system in the PRC. As noted previously, this system contributed positively to the current pattern of income distribution and equity in the country by raising farmers' incomes, compared with what their incomes might otherwise have been without this system. Specifically, it does so by ensuring that all fruits of land (and labor) goes entirely to the farmer (i.e., no rent to be paid to any landlord), that farming remains a significant income source to be combined with other non-farming activities, and that there is a place and livelihood for any migrant farmer to go back to in their original village, if all hopes of making a better living in a city are broken.

The current rural land system in the PRC has, though, been subject to some considerable debate. A major defense for the system and its continuation, at least for some time to come, is that it provides some minimum level of social protection to farmers, not only in terms of income but also in terms of employment. Critics of the system, on the other hand, have pointed to the widespread underutilization of agricultural land (in some cases the complete abandonment of it for any productive use) by absentee entitlement holders often living in distant cities. Given the sheer number of such rural migrants, in aggregate terms the problem is, indeed, serious.

Land privatization has been proposed as a solution. For under the current system, who would not want to hold to a piece of land for free (literally so now, as the PRC has just abolished all agricultural land tax), without really intending to make any productive use of it? But under private ownership, there will be a price a farmer will have to pay for holding (or continuing to hold) their piece of land. The rent one could collect by leasing their land, or the price one could fetch by simply selling the land, is the cost of holding the land, per year or in perpetuity. Thus absentee land entitlement holders will have to think twice before deciding to hold, or continue to hold, their land for no productive use at all.

I am, however, not entirely convinced of the argument. For one thing, under the current system, a farmer can in fact lease out their land to another user for a fee (rent). The system may not have adequately been regulated and institutionalized, but, then, surely one response is to adequately regulate and institutionalize it. An active agricultural land leasing market may well solve the underutilization problem (if not entirely, at least go a long way in that direction). Under the current system, it is true that no land can be sold by the current holder, and no buyer can establish any ownership claim over it. This may cause some difficulties to some potential users of land, but it is not at all clear to me how serious these difficulties (because of not being able to establish straightforward ownership of the land) really are, as compared to simply renting the land.

But, even more importantly, under a private land ownership system, just as some of today's absentee land holders may thus transfer their land to some productive user, so may some

farmers make distress sales of their land, e.g. if they fell under some real economic hardship (a frequent cause of such distress sales is ill-health). Indeed, looking into history, such distress land sales appear to have made up the bulk of the sad tale of land concentrations and economic polarizations causing violent dynastic changes and social upheavals, in China certainly but also in other civilizations of the world.

This is not to contend that the PRC should, then, perpetually hold onto its current agricultural land entitlement system. Indeed, there may well exist a case for change (besides the above-mentioned efficiency considerations connected with the non-productive use of land, the current system has been subjected to considerable corruption and abuse, mostly by various local authorities in connection with urban and real estate development, an issue which cannot, however, be discussed here). But such change should happen after we have resolved the matter that motivated the current rural land system in the first place, namely, its role as a substitute system for social protection for rural residents, and not before it. And this leads us back to my early call for the government to take urgent actions in stepping up the establishment of an effective and integrated system of social protection in the country, covering education certainly, but also health, unemployment, and so on, not only for urban dwellers but also for rural residents. Provisions for such protection in rural areas may start at a modest level, and then be increased, and eventually be fully integrated with the existing urban system in respect of both the level and coverage. Unless and until this is done, no fundamental change should be made to the current rural land entitlement system.

And even if rural agricultural land does become privatized, there appears to be a need for limiting the size of land ownership by any one owner (as, e.g., Taipei, China has done). A system of small holders can accommodate a far greater number of workers, and generate much more agricultural income in total, than a system of large scale commercial farming. And it should also enable part-time farming to be practiced further and probably even be expanded. As noted, a fundamental feature of the PRC's rural development in the past decades is the spread of part-time farming, which has had a vital impact on the pattern of growth and equity in the rural areas certainly and for the country as a whole. It has, in fact, also influenced the pattern of urbanization in the PRC, but this, again, is a subject which I cannot go into in this paper.

## 7. CONCLUSION

There are likely many factors which together have shaped the current pattern of growth and equity in the PRC. In this paper, I have highlighted the role of some of these, which have generally been neglected in accounts of the causes of the PRC's economic success, or failure, in recent decades. I have highlighted their importance in this paper, not in order to present a deliberately idiosyncratic reading of the history, but to argue that, although often neglected, these are nonetheless important factors. Indeed, I would go so far as to argue that they are among the critical factors, in the sense that without a proper understanding of their role, one can neither fully understand the recent economic history of the PRC, nor advise on appropriate future strategies of economic growth and development.

Among the critical factors are, as I have argued, the foundations laid in the pre-1978 era, especially in respect of land institutional reforms and social sector investments. These legacies successfully complemented the export- and FDI-promotion strategies which the country subsequently followed in the post-1978 period. The former had a direct beneficial impact on income distribution and rural-urban migration, while the latter enabled the PRC to successfully pursue an export- and FDI-promotion strategy, which has, in fact, been a main engine of the recent economic growth in the country. However, while these strategies have helped to kick-

start the economic take-off of the country, its long-run growth can hardly depend on them. As I have argued, in both the short-run and long-run, it will be important for the PRC to expand its own domestic demand for its vastly expanded production capacities, and this means improving on the current income distribution patterns as well. In particular, in addition to wage increases, it will be important for the country to expand its social protection programs, with a view to expanding domestic demand and, more importantly, to renewing and expanding its investment in human capital. There is really nothing more important than renewed human capital accumulation for the PRC if it is to continue to develop, to modernize, and to catch up with today's developed countries. While past superior human capital accumulations have helped the PRC to compete and outperform other similarly positioned economies in recent decades, continued growth of the economy and continued improvements of the living standards of its people in the forthcoming decades will require vast amounts of new human capital accumulation. And increased investments by the government, through direct spending and increased levels of social protection, may well prove to be of special importance to this.

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