
The Income Distribution Policies of the Xi Jinping Administration in China —The Limits of Minimum Wage Increases—

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Summary

1. The income distribution reforms initiated by the Xi Jinping administration include comprehensive and innovative policies that are indicative of a strong desire to make fundamental changes to China's income distribution structure. Background factors driving these reforms include the political need to achieve a "comprehensive well-off society" by 2020, the economic need for a change in the economic development model, and society's need for the correction of a polarized social structure symbolized in the phrase "rich country, poor people."
2. The power base of the Xi Jinping administration is somewhat lacking in strength, and the aim of the income distribution reforms is to attract public support and enhance the unifying force of the administration. The feasibility of these reforms should not be underestimated. The economic management policy of the Xi Jinping administration appears to call for a change in the economic development model, including income distribution reforms, while maintaining an annual average growth rate of 7.2% as a line in the sand. The main goal of these reforms is to increase the income of migrant workers, who make up 44.4% of the urban workforce.
3. China's minimum wage has risen by 64.1% compared with 2009 levels, with a real annual average increase of 18% during the past three years. However, because the rate of increase in the average wage for urban units was substantially higher than the rate of increase in the minimum wage, there was almost no change in the income distribution structure. To achieve the income distribution reform goal of raising the minimum wage to 40% of the average wage between 2013 and 2015, it will be necessary to continue raising the minimum wage at the same rate as in 2009-2012 while at the same time significantly curbing growth in the average wage. Yet given the difficulty of raising the minimum wage any further in inland regions, it seems inevitable that efforts to reform income distribution through minimum wage intervention will reach a dead end.
4. If the Xi Jinping administration seriously wants to correct income disparities and bring about a shift to a consumption-led economy, it will be necessary to raise minimum wages in coastal cities. The success or failure of the reforms will also depend on whether migrant workers can be incorporated into official urban social insurance systems through reforms that extend the easing of household register acquisition requirements to include not only small and medium-sized inland cities but also coastal cities. To date there have been no specific moves to curb wages in state-owned enterprises and state-owned holding companies. Until the state government takes the lead by reviewing wages in centrally-administered state-owned enterprises, local governments will not have the opportunity to review wages in state-owned enterprises and state-owned holding companies.

Introduction

The Chinese economy was expected to bottom out in 2012, but the low growth rate has continued into 2013. The real GDP growth rate was only 7.7% in the January-March quarter and 7.5% in the April-June quarter compared with the same periods in the previous year. This is the first time since 1992 that growth has remained below 8% in five consecutive quarters. In its World Economic Outlook for July, the International Monetary Fund (IMF) predicted that China's growth rate would reach 7.8% in 2013. The growth rate predictions in January and April were 8.2% and 8.1% respectively, which means that the IMF has been continually reducing its estimates.

Although investment trends are firm, an analysis of demand items reveals that consumer spending has been sluggish. This suggests that there has been no actual progress toward the economic development model change that has been promoted since the start of the Hu Jintao administration. This change in the economic development model consists of five concepts: (1) a shift from investment- and export-led economic growth to a consumption-led economy, (2) a shift away from a resource-wasting economy to one based on resource recycling and conservation, (3) an increase in the growth contributions from innovation and human capital, (4) the promotion of modern service industries and strategic emerging industries, and (5) the improvement of social stability through the reduction of disparities between rural and urban areas. There has been absolutely no progress on two of these goals: the correction of income disparities, and the shift to a consumption-led economy.

How is the Xi Jinping administration trying to address this problem? In February 2013, the State Council (government) revealed its roadmap for this purpose by releasing "Several Opinions on Deepening Reform of the Income Distribution System" ("the Opinions"). The Opinions call for efforts to stimulate growth in the incomes of low-income earners through changes to wages, taxation and social insurance. The goal seems to be to create an environment in which middle and low-income earners can experience a real sense of af-

fluence even when the growth rate is only 7-8% by radically modifying the existing income distribution structure.

The international community is waiting to see whether China can continue to achieve steady economic growth. While a growth rate of over 10% can no longer be expected, the international community is hoping for a scenario in which China moves toward political and social stability while maintaining a growth rate of 7-8%. However, China has wide income disparity, and the shift to a consumption-led economy may stall due to political and social instability caused by the halving of growth in the incomes of middle and low-income earners at an economic growth rate of 7-8%. It is no exaggeration to state that the success or failure of the income distribution reforms will determine whether or not this scenario is achievable.

After years of headlong pursuit of its goal of becoming a superpower, China has reached an historic turning point. Part I of this paper will analyze the content and background of the Opinions. Part II will provide a more detailed analysis of the feasibility of the issues identified in Part I, including the feasibility of the Opinions. In Part III we will consider a scenario by adjusting the focus on minimum wages that played an important roll on income distribution. Finally, in Part IV we will show that reforms of household registration systems and state-owned enterprises will be essential in order to change income distribution structures.

I. Positioning of the Income Distribution Reforms

We will begin by looking at the income distribution reforms that are about to be implemented by the Xi Jinping administration, including the nature of the reforms, why the administration decided to carry out these reforms, and their feasibility.

1. What are Income Distribution Reforms?

One of the characteristics of the Opinions is that they represent a comprehensive set of wide-

ranging policies covering such areas as wages and labor, taxation, social insurance and finance (Table 1). Reforms were also implemented under the Hu Jintao administration from the perspective of changes to income distribution, but the primary aim of these reforms was to reduce the burden on rural communities through the abolition of agricultural taxes and other measures⁽¹⁾. In contrast, the Opinions focus on cross-sector reforms, starting with an analysis of the factors that created today's distorted income distribution system, and how this situation can be improved.

Interest rate liberalization is symbolic of this cross-sector approach to reform. At first glance interest rate liberalization seems to have nothing to do with income distribution, but in China it has some very important implications. Because interest rates in China have not been liberalized, real interest rates are frequently negative, yet even in this environment the savings rate has risen steadily. Saving is considered to be a secure method of preserving assets, and the Chinese also believe that one can never have too much savings because of the need to provide for expenditure on educa-

tion, health care and other services, the costs of which are rising rapidly.

By setting loan interest rates simply by subtracting roughly 3% from deposit interest rates, financial institutions have been able to make profits without any effort. Under this interest rate structure, income has been transferred from households, which are the biggest depositors in China, to banks, or from banks to businesses, which are the biggest borrowers⁽²⁾.

Interest rate liberalization is nothing less than an attempt to end these income transfers. The liberalization process has already begun, with the People's Bank of China (China's central bank) resuming measures to increase the range of fluctuation in deposit and loan interest rates in June 2012. The interest margin income of the big five state-owned commercial banks began to decline in 2012 as a result of these measures.⁽³⁾

Another feature of the Opinions is the fact that they go further than the 12th Five-Year Plan and the Report to the 18th National Congress, which forms the policy basis for the Xi Jinping administration. For example, the Opinions refer to the use of profits from State-owned enterprises under the direct control of the central government to fund social insurance, a concept that is also mentioned in the 12th Five-Year Plan. However, the Opinions provide the first reference to a specific figure, 5% of earnings. Furthermore, neither the 12th Five-Year Plan nor the Report to the 18th National Congress contains any reference to a taxpayer identification number system or an inheritance tax. It can be regarded as unusual and revolutionary for State Council Opinions to go beyond a Five-Year Plan or National Congress Report.

The aim of the taxpayer identification number system is to strengthen the collection of personal income taxes by assigning taxpayer numbers under a uniform national system. Such systems are generally introduced as a way of expanding the taxation base, but the Opinions stress that the system is intended as a taxation measure targeting high-income earners. Amendments to China's Personal Income Tax Law in September 2011 resulted in changes designed to reduce the tax burden on middle-income people, including a substantial

Table 1 Key Policies Presented in the "Several Opinions on Deepening Reform of the Income Distribution System" (State Council Circular 6 [2013])

Wages/Labor
<ul style="list-style-type: none"> • Increase in the minimum wage in each region to 40% of the local average wage by 2015 • Increase in the percentage of workers covered by collective labor contracts to 80% by 2015 • Controlling total wages and per capita wages in state-owned enterprises and state-owned holding companies
Taxation
<ul style="list-style-type: none"> • Introduction of taxpayer identification number system • Reinforcement of taxation on real estate ownership and trading • Introduction of inheritance taxation at the appropriate time
Social Insurance
<ul style="list-style-type: none"> • Allocation of 5% of revenue from central government state-owned enterprises as funding for social insurance • Integration of basic medical insurance systems for rural and urban residents
Finance
<ul style="list-style-type: none"> • Acceleration of interest rate liberalization, protection of depositor rights

Source: *Several Opinions on Deepening Reform of the Income Distribution System* formulated by the National Development and Reform Commission of the State Council (February 5, 2013) (http://www.gov.cn/jzwgk/2013-02/05/content_2327531.htm)

increase in the taxation threshold from 2,000 to 3,500 yuan per month. High-income earners appear to have been mentioned to show concern for middle and low-income people, probably with the aim of facilitating the introduction of the system.

The inheritance tax concept was introduced as a something that should be researched and introduced when the time was right, and both the details of the system and the timing of its introduction remain uncertain. However, increased taxation of real estate is identified in the Opinions as a way of taxing high-income earners through the development of an integrated system based on the taxation of ownership as well as transactions. The fact that China has not yet developed an effective system for taxing real estate ownership⁽⁴⁾ is one of the reasons for the expanding gap between rich and poor in China. The expansion of the scope of taxation to encompass inheritance as well as ownership would not only be highly effective in terms of income redistribution, but would also make a major contribution to economic stability by curbing speculation.

2. Why are Income Distribution Reforms Needed?

Why has the Xi Jinping administration decided to embark on a program of income distribution reforms? The most important reason is probably a political imperative. The Xi Jinping is under an obligation to achieve moderate prosperity for all by 2020, which has been consistently advocated as a target by the Communist Party and the government. Moderate prosperity, or *xiaokang*, is defined as the next development stage after the elimination of poverty so that everyone is adequately clothed and fed. It suggests a situation in which people can enjoy a certain amount of ease and comfort.

It was Deng Xiaoping who first identified moderate prosperity as a goal for the Communist Party and the government. His aim was to achieve moderate prosperity by 2000 by doubling GDP every 10 years relative to the 1980s level. The real GDP growth rate averaged 9.7% per annum between 1981 and 1990, and 10.6% between 1991 and

2000. Since the average growth needed to double GDP in 10 years is 7.2%, the target was attained. However, at the 16th Party Congress in 2002, then General Secretary Jiang Zemin stated that the China had not achieved moderate prosperity. What he meant was that while moderate prosperity for all had already been achieved in coastal regions and cities, the goal had not yet been reached in inland regions and rural communities. Jiang Zemin set the goal of achieving moderate prosperity for all in these regions by 2020. Hu Jintao and Xi Jinping inherited the goal of moderate prosperity for all when they became General Secretary. If Xi Jinping serves the normal 10-year term of office, he will be held responsible as leader for the achievement of the goal.

The income doubling plan was developed as a means for achieving the goal of moderate prosperity for all. The report to the 18th National Congress called not only for the doubling of GDP, but also for the doubling of incomes in the 10 year period to 2020. This goal, which was carried over into the 12th Five-Year Plan (2011-2015), was in fact mentioned for the first time at the 18th National Congress (Table 2). The reference to income doubling is a clear indication that there was strong awareness among the party leadership of the need to achieve moderate prosperity for all by 2020.

However, it will be difficult to lead inland and rural regions toward moderate prosperity at a time when growth is slowing. How will the falling growth rate affect incomes? Table 3 estimates changes in income growth rates according to the economic growth rate by calculating elasticity values, which indicate the percentage increase in the per capita incomes of urban and rural households for every 1% of GDP growth, for each income level. If the growth rate slows to around 7-8%, income doubling will be limited to urban households in the third to fifth quintiles. The achievement of moderate prosperity for all will require income distribution reforms based on radical changes to existing distribution structures.

Table 2 Targets and Actual Figures for GDP and Income

(Yearly averages, %)

Name	Period	GDP growth rate		Increase in per capita GDP		Increase in per capita income			
		Target	Actual	Target	Actual	Urban		Rural	
10th 5-Year Plan	2001-05	7.0	9.5			5.0	9.6	5.0	5.3
Report to 16th National Congress	2000-20	7.2							
11th 5-Year Plan	2006-10	7.5	11.2	6.6	10.6	5.0	9.7	5.0	8.9
Report to 17th National Congress	2000-20	7.2							
12th 5-Year Plan	2011-15	7.0				> 7.0		> 7.0	
Report to 18th National Congress	2010-20	7.2				7.2		7.2	

Notes: The figures are all actual. The GDP growth rates for the 16th and 17th Nation Congresses were calculated based on a statement that GDP would quadruple between 2000 and 2020.

Source: Compiled by JRI using Five-Year Plans and National Congress Reports

Table 3 Real GDP Growth Rate and Income Growth Rates

— Urban disposable incomes — — Rural net incomes —

(Average annual increase, %)

Real GDP growth rate	1st quintile	2nd quintile	3rd quintile	4th quintile	5th quintile	1st quintile	2nd quintile	3rd quintile	4th quintile	5th quintile
	<i>0.6658</i>	<i>0.8246</i>	<i>0.9192</i>	<i>1.0122</i>	<i>1.1986</i>	<i>0.6769</i>	<i>0.7589</i>	<i>0.8009</i>	<i>0.8292</i>	<i>0.8110</i>
6.5	4.3	5.4	6.0	6.6	7.8	4.4	4.9	5.2	5.4	5.3
7.0	4.7	5.8	6.4	7.1	8.4	4.7	5.3	5.6	5.8	5.7
7.5	5.0	6.2	6.9	7.6	9.0	5.1	5.7	6.0	6.2	6.1
8.0	5.3	6.6	7.4	8.1	9.6	5.4	6.1	6.4	6.6	6.5
8.5	5.7	7.0	7.8	8.6	10.2	5.8	6.5	6.8	7.0	6.9
9.0	6.0	7.4	8.3	9.1	10.8	6.1	6.8	7.2	7.5	7.3
9.5	6.3	7.8	8.7	9.6	11.4	6.4	7.2	7.6	7.9	7.7
10.0	6.7	8.2	9.2	10.1	12.0	6.8	7.6	8.0	8.3	8.1
10.5	7.0	8.7	9.7	10.6	12.6	7.1	8.0	8.4	8.7	8.5
11.0	7.3	9.1	10.1	11.1	13.2	7.4	8.3	8.8	9.1	8.9

Notes: The upper figures in italics are elasticity values. The elasticity value α was obtained using the regression formula $\ln \text{ per capita income} = \alpha \ln \text{ per capita GDP} + \beta$. Urban and rural per capital incomes and per capita GDP were all calculated using actual figures.

Source: Compiled by JRI using *China Statistical Yearbook* (2012)

3. Increasing Economic and Social Pressures

The urgency of income distribution reform for the Xi Jinping administration is not solely the result of political pressure. There are also mounting economic and social pressures.

One source of economic pressure is the fact that there are now clear indications that the existing economic development model pursued during the 10-year tenure of the previous Hu Jintao administration has reached a dead end. The 4 trillion yuan stimulatory measures implemented in response to the Lehman shock caused a serious decline in investment efficiency, and China is now reaching the limits of economic growth driven by

investment (Watanabe [2013], Miura [2013a]). Investment can be stimulated, leading to a short-term improvement in the growth rate, by injecting government money and easing legislation on finance and real estate. However, these measures cause investment efficiency to worsen still further and could even lead to the collapse of the Chinese economy. At the Boao Forum for Asia in April 2013, General Secretary Xi Jinping said that China could no longer maintain super-high economic growth and had no desire to do so⁽⁵⁾. He also stated to China and the rest of the world that he was fully aware of the risks of a return to investment-led growth.

Another source of economic pressure pushing the Xi Jinping administration toward income dis-

tribution reform was the emergence of discouraging indicators about external demand, which had been the driving force for economic growth. China still maintains its role as the world's factory, but its competitiveness in labor-intensive industries, such as textiles, is being eroded by rising wages and the accelerating dispersal of production operations to Vietnam and other countries. In the medium- to long-term perspective, the rising value of the yuan will also affect the situation, and there is likely to be a gradual decline in the potential of external demand as a growth driver.

Social pressure for income distribution reform is starting to become as important as economic pressure. Chinese society has traditionally been tolerant of income disparity. Even though the Gini coefficient, an indicator of inequality in income distribution, is believed to have exceeded 0.4%, which is the warning level at which social unrest can easily occur, China has not actually experienced social destabilization. Yet this situation may be changing rapidly. This change is symbolized in the phrase *guofu minqiong*. *Guofu minqiong* literally means "rich state, poor people." However, the definition selected as the best answer by Baidu, a major search site, was that *guofu minqiong* is a situation in which wealth is monopolized by state-owned enterprises and the government, which have monopoly control over resources, with the result that the benefits of economic development do not trickle down to the ordinary people. The phrase, which began to appear frequently in the media from around 2009, expresses fierce criticism of China's polarized social structure, in which the benefits of economic development are monopolized by state-owned enterprises and the government, while the lives of ordinary people never become easier.

Vice President Han Kang of the Chinese Academy of Governance observes that while it may have been possible to legitimize the concentration of capital in the hands of state-owned enterprises and the government because of the need to strengthen China as a nation in the early stages of development, China has now moved beyond that stage to a level at which *fumin qiangguo* (enriching the people and strengthening the nation) has become

an historical imperative. He warns that unless China can achieve this goal, the people may use extreme methods to express their views. In other words, there is a danger of social turmoil⁽⁶⁾.

In the three decades up to 2010, it was taken for granted that China would double its GDP every 10 years. A virtuous circle was established in which the Communist Party and the government were able to demonstrate their legitimacy within and beyond China by achieving growth in excess of that level. However, this virtuous circle no longer exists. The transition to a consumption-led economy has become the destiny of the post-Hu administration, regardless of whether or not it is led by Xi Jinping.

II. The Indomitable Resolve of the Xi Jinping Administration

In Part II we will show that the Xi Jinping administration is firmly committed to income distribution reform by examining a number of questions raised in Part I. Are the income distribution reforms achievable? How far will the growth rate fall? Whose incomes are the reforms supposed to double?

1. Are the Income Distribution Reforms Achievable?

Some observers have expressed doubts about the achievability of such comprehensive and revolutionary income distribution reforms. Although General Secretary Xi Jinping may be firmly committed to the reforms, there is a real possibility that the changes may be watered down because of resistance from vested interests within the administration, or that existing systems and practices will prevent the implementation of the reforms. The situation surrounding the anti-corruption measures can be seen as an excellent example of this. Searches for "Xi Jinping" and "anti-corruption" on the Baidu search site yield hits on 2.39 million websites. A similar search in which "Xi Jinping" is replaced with "Hu Jintao" produces 3.53 million hits (both searches performed on May 13,

2013). Given the length of time since Xi Jinping became General Secretary, these figures are indicative of the intensity of his concern about this issue. In fact, curbs on spending on overseas travel by government officials, expenditure on official cars, and official hospitality—known as the “three public consumptions”—during the 2013 lunar New Year period appear to have spread to spending not only on luxury items, such as cigarettes, liquor and restaurant meals, but also to everyday consumables⁽⁷⁾.

However, there are signs that the effects of anti-corruption efforts under the auspices of the new General Secretary will not last long. In April 2013, the government announced a 2013 budget of 7,969 million yuan for the “three public consumptions.” While this is 126 million yuan below the actual expenditure in the previous year, the reduction is a mere 1.6%⁽⁸⁾. This means that moves to curb the “three public consumptions” were simply temporary measures introduced to coincide with the launch of the Xi Jinping Administration.

The question of achievability also applies to *yinxing suode* (hidden income) and *feifa suode* (unlawful income). Hidden income includes allowances, bonuses and income from secondary occupations. Unlawful income is income obtained by illegal means, such as bribery. The Opinions state that high-income people are clearly receiving these types of income, and that hidden income should be standardized (made subject to taxation), and that unlawful income should be regulated more stringently. However, the regulation of unlawful income is extremely difficult not only in China, but in any developing country where there is no guarantee of judicial independence.

Basically, there is often no accepted definition of what constitutes unlawful income in a developing country. For example, where is the boundary between legality and illegality in the case of wedding gifts given to the children of senior government officials by executives of companies whose interests depend on those officials? In China income that straddles boundary lines in this way is called “gray income.” Gray income is a widespread phenomenon in developing countries in which governments with enormous pow-

ers to grant approvals and permits exist alongside cultures that are still deeply entrenched with gift-giving traditions. It is not something that can be eliminated simply by raising moral standards and imposing tougher penalties.

Clearly there will be many twists and turns on China’s path to income distribution reform. However, it would be wrong to conclude from this that reforms are unlikely to be achievable. This is because the reforms could help the Xi Jinping administration, which does not have a strong power base, to enhance its unifying force by turning public opinion into an ally. Supporters and opponents of the reforms will need to discover a point of compromise, since their interests are linked by the fact that confidence in the Communist Party and the government will ultimately depend on popular support for the Xi Jinping administration.

No-one can directly oppose the aims of the income distribution reforms, which are to maintain social equity, justice, harmony and stability, and to build a society in which there is moderate prosperity for all and all people can enjoy the benefits of economic development. From this perspective, the reform scenario adopted by the Xi Jinping administration can perhaps be summed up in the following three steps. First, adopt a top-down rather than a bottom-up approach by waiting for the formation of a consensus within the Communist Party and the government. Second, promote the reforms to the people by implementing measures in areas where immediate changes can be made. Third, channel support for the administration into impetus for the next stage of the reform process.

2. Falling Potential Growth Rate—Is 7.2% the Line in the Sand?

General Secretary Xi Jinping is the first leader to take over China’s economic helm at a time when the economic growth rate is expected to follow a long-term downward trend. What is the outlook for China’s growth rate?

Research institutes in China and overseas have produced estimates of China’s potential growth rate, which is defined as the growth rate that could be achieved if all existing production factors were

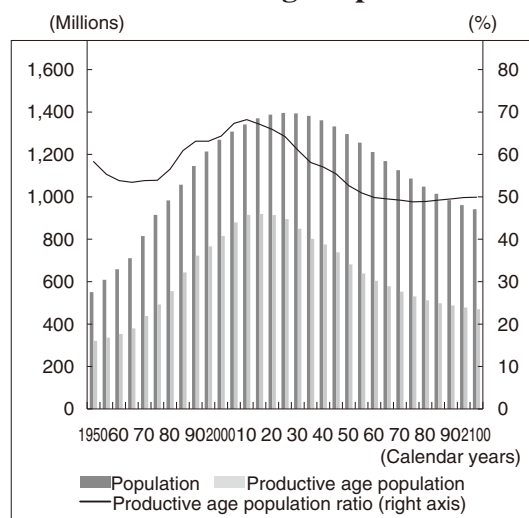
used to their maximum potential. It is calculated by predicting changes in the various factors, including capital stocks, the labor force and productivity. According to the Chinese Academy of Social Sciences, which is a government think-tank, China's potential growth rate will fall from an average of 9.5% per annum in 2010-15 to 7.3% per annum in 2016-20 and 5.8% per annum in 2021-30 (Zhang and Wang [2011]). A report compiled jointly by the World Bank and the Development Research Center of the State Council (DRC) predicts that the potential growth rate will fall from an average of 8.6% per annum in 2011-15 to 7.0% per annum in 2016-20, 5.9% per annum in 2021-25 and 5.0% per annum in 2026-30 (World Bank and Development Research Center of the State Council [2012]).

This decline in the potential growth rate appears to reflect the shrinking contribution from two production factors that have hitherto supported growth. The first of these changes is the shrinkage of the labor force. Data published by the National Bureau of Statistics shows that the productive age population (aged 15-59) in 2012 was 937.27 million, a year on year decline of 3.45 million. This is the first time in China's history that the productive age population has fallen while the total population is growing. This decline in the productive age population was already anticipated, in part because of the introduction of the one-child policy.

Fig. 1 traces long-term trends in China's population and productive age population based on United Nations estimates. It was predicted that China's productive age population would peak in percentage terms at 68.2% in 2010 and decline gradually thereafter. This forecast became reality in 2012.

The other change is a decline in productivity. In its coastal regions, China has developed infrastructure comparable with that in advanced countries. It was in these regions that China built its reputation as the "world's factory" by combining cheap rural labor with foreign direct investment. This growth model enabled China to exploit the "latecomer's advantage" to the full by importing technology from advanced countries. However, latecomer's advantage disappears as economic

Fig. 1 China's Population and Productive Age Population



Source: United Nations Statistics Division 2010 (median estimates)

development progresses. This is because supplies of cheap labor start to shrink, and because there is reduced scope to improve productivity by copying general-purpose technologies from advanced countries.

Estimates by the Asian Development Bank (ADB) indicate that China's potential growth rate will fall from 10.4% in 2000-2010 to 8.0% in 2010-2020 and 6.0% in 2020-2030 (Zhuang, Vandenberg, Huang [2012]). While these estimates are somewhat higher than the two forecasts cited above, the ADB takes a more pessimistic view of the decline in productivity. It states that labor productivity in China's industrial sector is one-tenth that of the United States in 2009 and predicts that growth contribution from total factor productivity (TFP), which reached 6.2 percentage points in 2000-2010, will fall to 5.0% in 2010-2020 and 4.2% in 2020-2030.

There is a consensus not only among foreign China experts, but also within the Communist Party and the Chinese government that high growth in excess of 10% will actually erode the sustainability of growth. Even so, there is a persistent pressure from within regional governments and state-owned enterprises for a return to the high-growth economy. Some observers doubt whether the Xi Jinping administration will be able to ignore these

expectations indefinitely. In the People's Daily (overseas edition) of May 27, the government expressed its determination not to take any hasty action to raise the growth rate in the short term, saying that there was no need for stimulatory measures like the 4 trillion yuan package implemented in 2009 in response to a feeble recovery.

The economic management stance of the Xi Jinping administration was perhaps defined at the 18th National Congress, when Xi Jinping stated that his government would introduce changes to the economic development model, including the reform of income distribution systems, while identifying an average yearly growth rate 7.2%, which is equivalent to the doubling of GDP, as a line in the sand.

3. Whose Income will be Doubled?

The goal for the income distribution reforms is to turn China into a strong country with prosperous people through income doubling. However, there is wide income disparity in China, and the meaning of a "strong country with prosperous people" varies widely according to the standard on which income doubling is based. It would not be appropriate to target the doubling of average incomes. High-income and low-income people have become increasingly polarized, and it is possible that the government will claim to have achieved the doubling of income based on the incomes of China's small middle-income population, which represents the average.

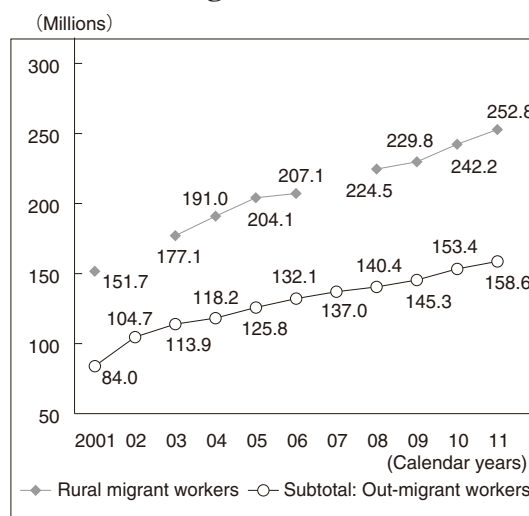
This question was tackled head-on in the Opinions, which clearly define whose incomes should be doubled. The target group is lower-middle income earners, specifically rural migrant workers, or *nong-min-gong*, who have left rural areas to find work, and farmers. As shown in Table 1, the Opinions focus in particular on measures to lift the incomes of rural migrant workers, such as minimum wage increases and an increase in percentage of workers who sign group labor contracts. This contrasts sharply with the approach taken by the previous Hu Jintao administration, which simply focused on measures that showered benefits, such as tax cuts and electrical appliance

subsidies, on rural communities.

Why are the incomes of rural migrant workers being targeted? One reason is the fact that the urban lower-middle income group now consists of rural migrant workers. According to United Nations estimates, the urban population ratio will rise from 35.9% in 2000 to 49.2% in 2010 and will reach 61.0% in 2020. This rapid increase in the urban population is the result of inflows of rural migrant workers. Fig. 2 traces trends in the number of rural workers employed in industries other than agriculture (rural migrant workers) and the rural workers who have moved away from the locations in which their household registers are located to find work (rural out-migrants). In 2011, there were 250 million rural migrant workers, including 160 million out-migrants. The numbers in both categories have approximately doubled since 2001. In 2011, there were 360 million urban workers. Since most of the out-migrant workers are included in the total for urban workers, this means that 44.4% of urban workers are rural migrant workers. China cannot become a "strong nation with prosperous people" unless there is growth in the incomes of these people.

One of the reasons why growth in the incomes of rural migrant workers is significant for the real-

Fig. 2 Rural Migrant Workers and Out-Migrant Workers



Source: Compiled by JRI using World Bank [2009], *China Household Survey Yearbook* (2011) and other sources

Fig. 3 Effect of Rural Wage Incomes on Net Incomes

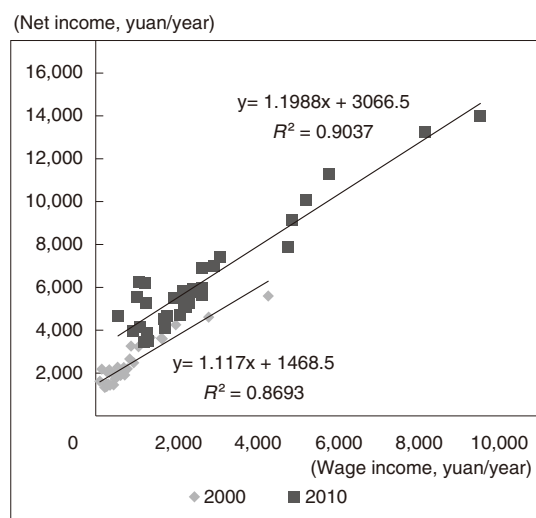
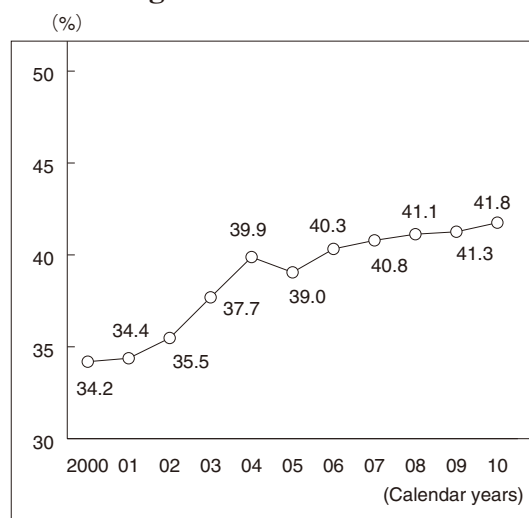


Fig. 4 Wages of Rural Out-Migrant Workers as Percentage of Rural Wage Incomes



ization of a strong nation with prosperous people is the fact that it will lead to income growth in the rural communities from which the migrant workers come. Fig. 3 compares income data for 31 provinces, cities and autonomous regions in 2000 and 2010. Rural per capita wage incomes are plotted in the horizontal axis and rural net incomes on the vertical axis. This shows that growth in rural incomes has been driven by wage incomes⁽⁹⁾. The group that has contributed to the growth of wage incomes is rural migrant workers. In rural household budget surveys, household wages are recorded as total wages earned by households, including out-migrant workers. The contribution of out-migrant workers to total wage income rose from 34.2% in 2000 to 41.8% in 2010 (Fig. 4). The selection of urban lower-middle income earners as the target for the income doubling policy can therefore be seen as a logical decision. Increases in minimum wages are expected to be very effective in driving growth not only in the incomes of urban lower-middle income people, but also in the incomes of people in the inland rural communities that supply migrant workers. The income doubling plan was not a spur-of-the-moment initiative designed to court mass popularity. Instead it was based on projections concerning the channels

through which income growth would permeate.

III. Limited Scope for Income Distribution Reform through Minimum Wage Increases

The Opinions contain clearly defined schedules and numerical targets for increases in the minimum wages and coverage ratios for labor agreements. Increases in minimum wages are especially important for middle-income and low-income earners. In Part III we will analyze minimum wage increase rate between 2009 and 2012 and their impact on income distribution. We will then estimate the extent of increases that can be expected between 2012 and 2015 based on two scenarios. This will be followed by an analysis, using a scenario for the period up to 2015, to ascertain whether or not the targets in the Opinions are achievable, based on actual minimum wage increases in 2013.

1. No Change in Distribution Structure Despite 60% Increase Relative to 2009 Level

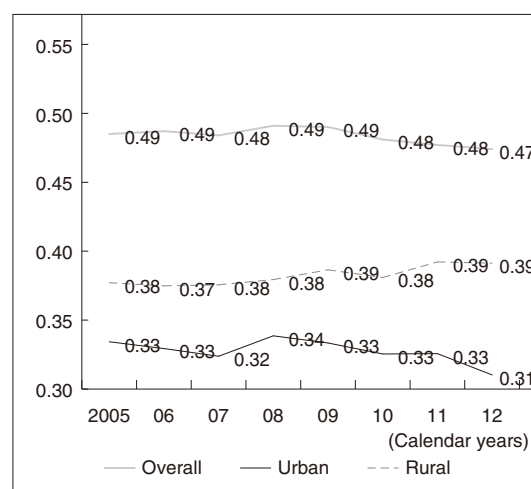
From around 2002, shortages of unskilled workers were starting to occur in individual locations in coastal China. By 2004 there were shortages throughout coastal China. Known in China as *minggong huang* (shortage of rural labor), this phenomenon led to increases in minimum wages. These labor shortages are no longer limited to coastal regions and are also starting to occur in inland cities. Minimum wages have been raised aggressively since 2010, and additional gains have resulted from an increase in the average rate of increase in urban and rural incomes to 7% under the 12th Five-Year Plan (2011-2015), compared with 5% under the previous plan (see Table 2).

In 2010, minimum wages were increased by an average of 22.8% year on year in 30 provinces, cities and autonomous regions. In 2011, there were increases averaging 22.0% in 30 provinces, cities and autonomous regions, and in 2012 minimum wages rose by an average of 20.2% in 25 provinces, cities and autonomous regions. Urban consumer prices meanwhile rose by 3.2% in 2010, 5.3% in 2011 and 2.6% in 2012. If we assume that these average increases represent national averages, then minimum wages have risen by an average of 18.0% per annum in real terms over the past three years, or by 64.1% compared with the 2009 level. This has obviously contributed to growth in the incomes of medium and low-income earners.

However, there has been almost no change in China's income distribution structure. Fig. 5 shows Gini coefficients for all China and urban and rural areas. None of the coefficients show any significant change as a result of minimum wage increases. For example, the disposable income for the first quintile of urban dwellers was 17.4% in 2005 and only 21.2% in 2012. The corresponding ratio for rural dwellers actually fell from 13.8% to 12.2%.

Why has the income distribution structure remained almost unchanged despite increases in minimum wages? The reason is the fact that the wages of employees in the sector known as "urban

Fig. 5 Gini Coefficients



Notes: Urban and rural Gini coefficients were calculated from quintile data. The fact that the overall Gini coefficient is higher than the urban and rural coefficients reflects the large income differential between urban and rural areas.

Source: Compiled by JRI using *China Statistical Yearbook* (various years) and National Bureau of Statistics data

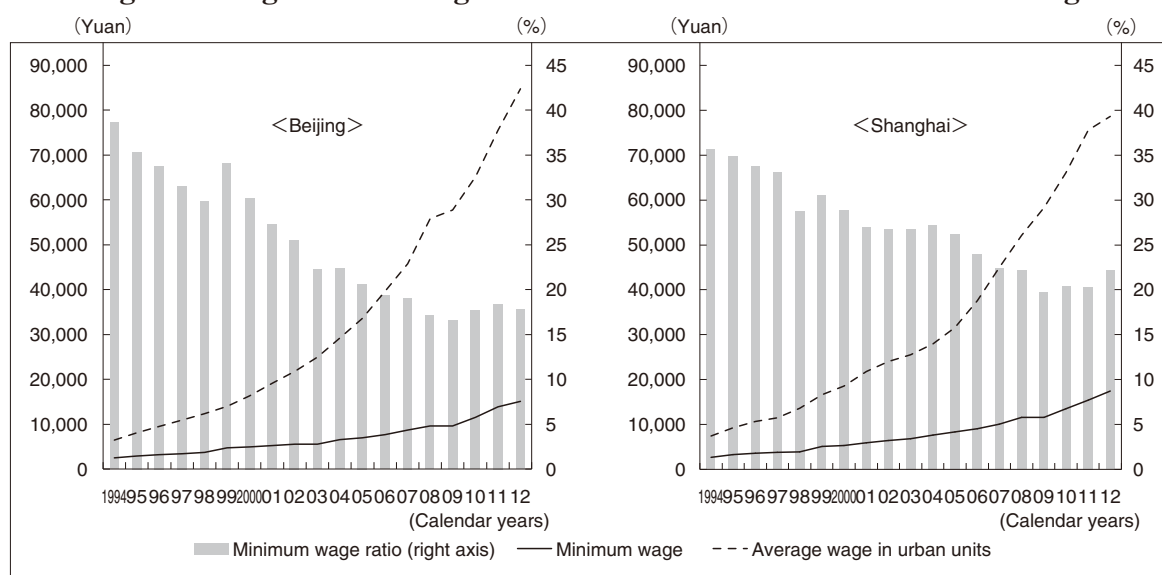
units," which includes state-owned enterprises, joint stock limited companies, limited liability companies and foreign companies, have risen much faster than minimum wages. In other words, high-income earners have enjoyed greater income growth than middle and low-income earners.

This issue is clearly illustrated in Fig. 6. Average wages in urban units have continually risen at a much faster pace than minimum wages in both Beijing and Shanghai.

Urban units are part of the formal sector made up of major corporations that operate in core industries. Regular employees of these companies are an elite group. At the other end of the scale is the informal sector, which consists of private enterprises and self-employed people. Most businesses in this category are small and medium enterprises or micro-enterprises, and employees' wages are close to the minimum wage level. The division of the urban labor market, as symbolized in the wage gap between these two groups, is one of the factors that have distorted income distribution in China.

In 2011, the formal sector accounted for 39.2% of total urban employees. While this is lower than the 2000 level of 50%, this figure still represents a

Fig. 6 Average Annual Wage in Urban Units and Annual Minimum Wage



Notes: Minimum wages were calculated by multiplying monthly figures by 12. Bonuses and allowances are not included.
Source: Compiled by JRI using CEIC data

large share. The percentage of workers employed by state-owned enterprise has fallen from 35.0% in 2000 to 18.7% in 2011, but this is the result of corresponding increases in the percentages for joint stock limited companies and limited liability companies. All new urban jobs are being created by the informal sector, and their share of total workers' remuneration is also rising. However, the gap between per capita incomes in the two groups continues to expand.

2. Minimum Wages to Double between 2012 and 2015

According to the Opinions, minimum wages will be raised to 40% of the average wages for each region concerned by 2015. Although both the size of the increase and the period over which it will be achieved are clearly defined, there has been little debate within China over the effect that such an increase would have on income distribution.

If minimum wages are raised as stated in the Opinions, the resulting increment would exceed the increases implemented in most provinces, cities and autonomous regions between 2009 and 2012. In the Opinions, "average wage" means the

average wage in urban units (i.e., the formal sector), while "each region concerned" refers to regions that have stipulated minimum wages. For example, Beijing and Shanghai have only one minimum wage, but Guangdong Province is divided into Shenzhen City and four other districts. Unfortunately data limitations make it difficult to carry out analyses based on these categories. For the purposes of the following estimation of the extent to which minimum wages have been increased, 31 provinces, cities and autonomous regions are therefore treated as "regions concerned."

Using Fig. 6, we will first ascertain what is implied by a 40% increase in minimum wages in the regions concerned. The bar graph in Fig. 6 shows minimum wages in Beijing and Shanghai as percentages of the average wages in each city (minimum wage ratios). The minimum wage ratio for Beijing fell from 38.6% in 1994 to 16.6% in 2009. Although the ratio has subsequently rebounded, it still remains below 20%. The level in Shanghai is similar.

To raise the minimum wage ratios in both cities to 40%, it would be necessary to double minimum wages between 2013 and 2015. This issue needed to be examined in a little more detail. The 31 provinces, cities and autonomous regions were

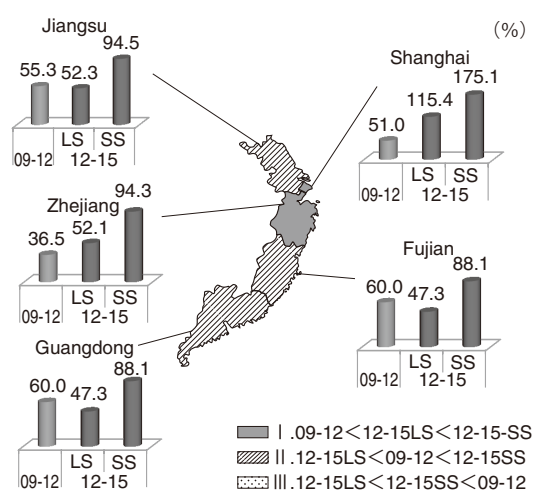
divided into six regions, and rates of increase in minimum wages between 2009 and 2012 and the increases relative to 2012 needed to raise minimum wages to 40% of average wages by 2015 were estimated. The latter estimates were calculated using a low scenario (LS), in which average wages rise by an average of 6% per annum, and a standard scenario (SS), in which the average rate of increase is 15%. These scenarios were based on the 2013 Wage Guidelines for Business Corporations⁽¹⁰⁾ (Table 4), which were issued to a number of regional governments from February to June 2013.

Based on comparisons among 2009-12, 2012-15(LS) and 2012-15(SS), we can divide the 31 provinces, cities and autonomous regions into (I) regions in which minimum rates are likely to be raised further under either scenario, (II) regions in which the increase in 2012-15 is likely to be smaller than in 2009-12 under the low scenario and greater under the high scenario, and (III) regions in which the rate of increase in minimum wages was highest in 2009-12, followed by the low scenario and the high scenario.

(1) Southeast China

Fig. 7-1 shows minimum wages in southeast China, which has attracted concentrated foreign investment. If we apply the standard scenario to minimum wage increases by regional governments, we find that minimum wages would need

Fig. 7-1 Minimum Wages in Southeast China



Source: Compiled by JRI using various data

Table 4 2013 Wage Guidelines for Business Corporations

(%)					
No.	Region/City	Promulgation date	Lower limit	Standard	Upper limit
1.	Qingdao City (Shandong Province)	2/27/2013	5.5	14.0	21.0
2.	Shandong Province	2/27/2013	6.0	15.0	22.0
3.	Jiangxi Province	5/23/2013	6.0	13.0	17.0
4.	Wendeng City (Shandong Province)	3/8/2013	6.0	15.0	22.0
5.	Dezhou City (Shandong Province)	3/27/2013	6.0	15.0	22.0
6.	Tianjin	5/15/2013	7.0	16.0	22.0
7.	Xinjiang Uyghur Autonomous Region	4/18/2013	6.0	16.0	19.0
8.	Jinan City (Shandong Province)	5/10/2013	6.0	15.0	22.0
9.	Ningxia Huizu Autonomous Region	4/3/2013	0.0	15.0	19.0
10.	Longde Xian (Ningxia Huizu Autonomous Region)	5/13/2013	0.0	15.0	19.0
11.	Yunnan Province	5/15/2013	3.0	14.0	20.0
12.	Dongying City (Shandong Province)	4/25/2013	6.0	15.0	22.0
13.	Shaanxi Province	6/2/2013	6.0	13.0	19.0
14.	Beijing City	6/3/2013	5.0	12.0	16.5
15.	Yantai City (Shandong Province)	5/21/2013	6.0	15.0	22.0
16.	Yichun City (Jiangxi Province)	5/27/2013	6.0	13.0	17.0
17.	Sichuan Province	6/5/2013	7.0	14.0	20.0
18.	Jiangxi Province	5/23/2013	6.0	13.0	17.0
Average			5.2	14.3	19.9
Median			6.0	15.0	20.0
Mode			6.0	15.0	22.0

Notes: The level to be applied is mainly determined by the financial performance of businesses.
 Source: Compiled by JRI using local media reports

to be doubled by 2015 relative to 2012 levels in most provinces and cities in southeast China. This is higher than the increases implemented between 2009 and 2012 and indicates that it would be extremely difficult to reach the goal of 40% of average wages. Under the low scenario, minimum wages could be raised more slowly than in 2009-2012 in all regions except Shanghai City and Zhejiang Province. Even so, the increase between 2012 and 2015 would reach about 50%.

(2) Bohai Rim

In the Bohai Rim region, there are considerable differences between the situation in the two cities of Beijing and Tianjin and that in Hebei and Shandong Provinces (Fig. 7-2). Even under the low scenario, it would be necessary to increase minimum wages in Beijing and Tianjin by 187.0% and 86.4% respectively compared with the 2012 levels by 2015. These figures are substantially higher than the increases implemented in the three years up to 2012. However, the gap between minimum wages and average wages has already shrunk significantly in Hebei and Shandong Province, and the minimum wage increases required under the low scenario would be considerably reduced. Even under the standard scenario, increases com-

parable to those implemented between 2009 and 2012 would be sufficient.

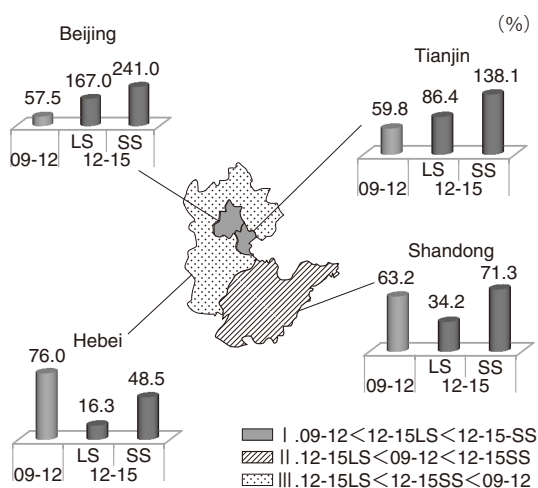
(3) Northeast China

The gap between minimum wages and average wages is shrinking in the northeast, and the pace of increase in minimum wages required under the low scenario in Heilongjiang and Jilin Provinces would be considerably slower than in 2009-2012 (Fig. 7-3). Even under the standard scenario it would not be necessary to exceed the 2009-2012 rate of increase in 2012-2015. In Liaoning Province, however, the pace of increase would need to remain high. Under the low scenario, the increases would need to match increases implemented between 2009 and 2012, while under the standard scenario minimum wages would need to double. Like Hebei Province, Heilongjiang and Jilin Provinces are among the few provinces that belong to Category III. The present situation is attributable not to aggressive increases in minimum wages, but rather to the fact that average wage levels were low.

(4) Central China

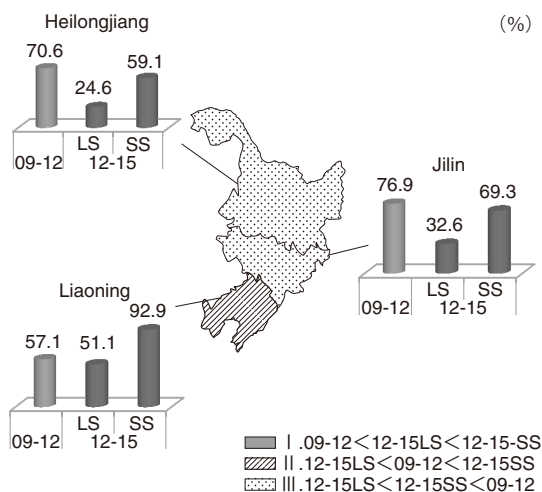
Central China has achieved the most conspicu-

Fig. 7-2 Minimum Wages in Bohai Rim Region



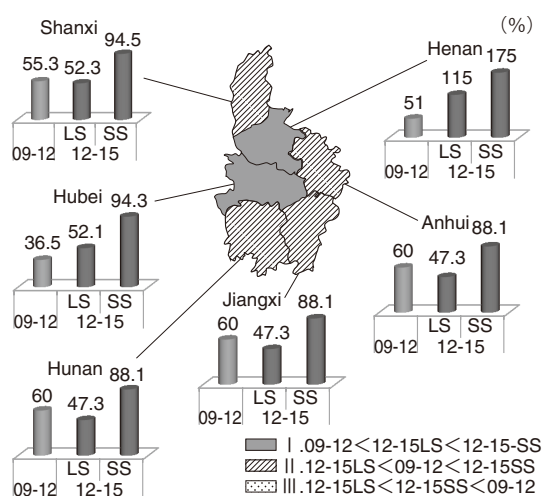
Source: Compiled by JRI using various data

Fig. 7-3 Minimum Wages in Northeast China



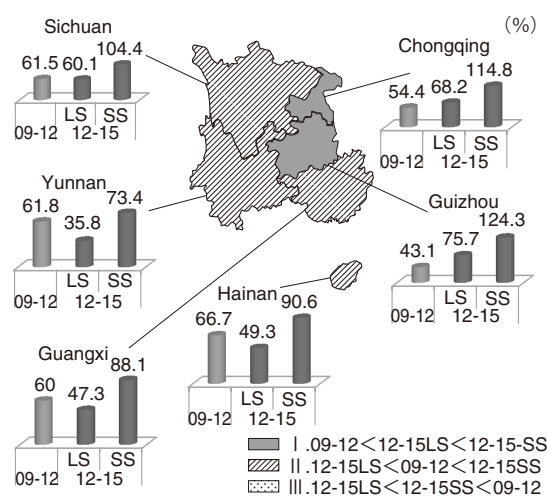
Source: Compiled by JRI using various data

Fig. 7-4 Minimum Wages in Central China



Source: Compiled by JRI using various data

Fig. 7-5 Minimum Wages in Southwest China



Source: Compiled by JRI using various data

ous economic growth in recent years (Fig. 7-4). Henan and Hubei Province form one group, and the rest of the region another. Minimum wages are expected to rise continuously in the first group. The gap between minimum wages and average wages is particularly wide in Henan Province, and minimum wages would need to be more than doubled even under the low scenario. The rate of increase required in Anhui, Shanxi, Hunan and Jiangxi Provinces under the low scenario between 2012 and 2015 would be moderately lower than the level in 2009-2012. However, minimum wages need to be almost doubled under the standard scenario.

(5) Southwest and Northwest China

Many southwestern provinces, notably Sichuan, are suppliers of *nongmingong* (rural migrant workers), and minimum wage increases would be likely to have the effect of slowing the migration of labor to major coastal cities. Under the standard scenario, minimum wages would double in almost all provinces between 2012 and 2015. Under the low scenario, the rate of increase would be lower than in 2009-2012 in Sichuan Province, Yunnan Province, the Guangxi Zhuang Autonomous Region, Guizhou Province and Hainan Province.

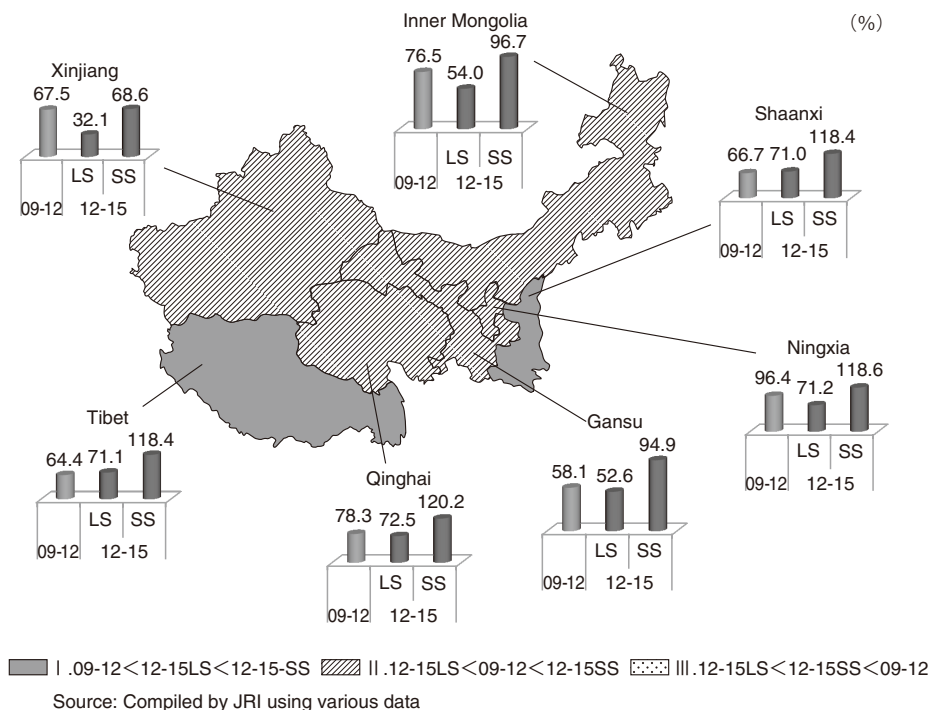
However, the rate of increase would need to be moderately higher than the 2009-2012 level in Chongqing City and Guizhou Province (Fig. 7-5).

Because of its relatively small population and urban labor market, northwest China has little impact on the distribution structure. Under the low scenario, the rate of increase would be lower than in 2009-2012 in the Xinjiang Uyghur Autonomous Region and Inner Mongolia Autonomous Region, and around the same level in the other provinces and autonomous regions. Under the standard scenario, minimum wages would need to approximately double in most of the provinces and autonomous regions (Fig. 7-6).

An overall analysis indicates that the 31 provinces, cities and autonomous regions can be categorized as follows.

- (I) Regions in which minimum wages are likely to be raised further under any of the scenarios: 10 provinces, cities and autonomous regions
- (II) Regions in which minimum wage increases in 2012-2015 would be smaller than in 2009-2012 under the low scenario and greater under the standard scenario: 18 provinces, cities and autonomous regions
- (III) Regions in which minimum wage increases would be highest, followed by the low scenario and the high scenario: 3 provinces

Fig. 7-6 Minimum Wages in Northwest China

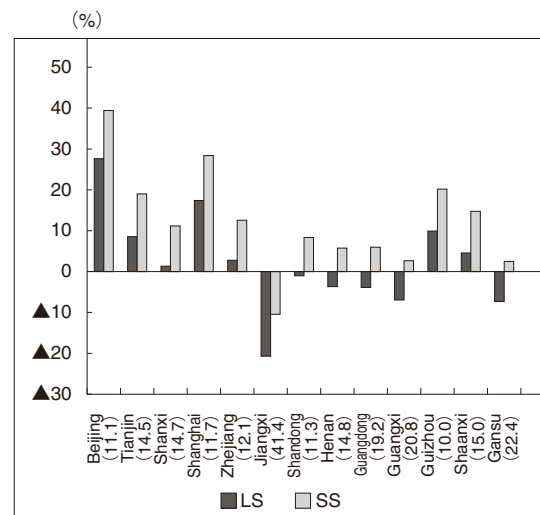


The achievement of the target is in doubt in Category I regions. However, there is little difference between the minimum wage increases required in cities, provinces and autonomous regions other than Beijing, Shanghai, Tianjin, Henan Province and Guizhou Province under the low scenario and the rates of increase between 2009 and 2012. In other words, the target will be achieved in regions other than these three cities and two provinces, provided that two conditions are met: that minimum wages are raised between 2012 and 2015 at the same rate as in 2009-2012, and that increases in average wages are kept within the low scenario.

3. Scenario to 2015-Conflict with Urbanization Policy

Will minimum wages continue to be raised? In April 2013, minimum wages were increased in 13 provinces, cities and autonomous regions. The size of the increases can be used as an indicator of the extent to which regional governments are committed to the achievement of the targets set forth in the Opinions, and whether or not they are working systematically toward those goals. In Fig. 8,

Fig. 8 Progress toward of Target Increases in Minimum Wages as of April 2013



Notes: Figures in parentheses represent year on year increases (%) in minimum wages in 2013.
Source: Compiled by JRI using CEIC data and other sources

we have calculated the average rates of increase in minimum wages that will be required from 2012 onwards under the low scenario (LS) and standard scenario (SS). The differences between those rates

of increase and the actual increase implemented in 2013 have been plotted on the graph.

A negative value on the graph indicates that the rate of increase in 2013 is greater than the target rate of increase in the scenario, while a positive figure indicates that it is smaller. Since minimum wages are reviewed twice each year, Fig. 8 does not indicate the size of increases over the whole of 2013. Judging from the figures for the first half of the year, however, the provinces, cities and autonomous regions do not appear to be working with commitment toward the achievement of the targets in the Opinions.

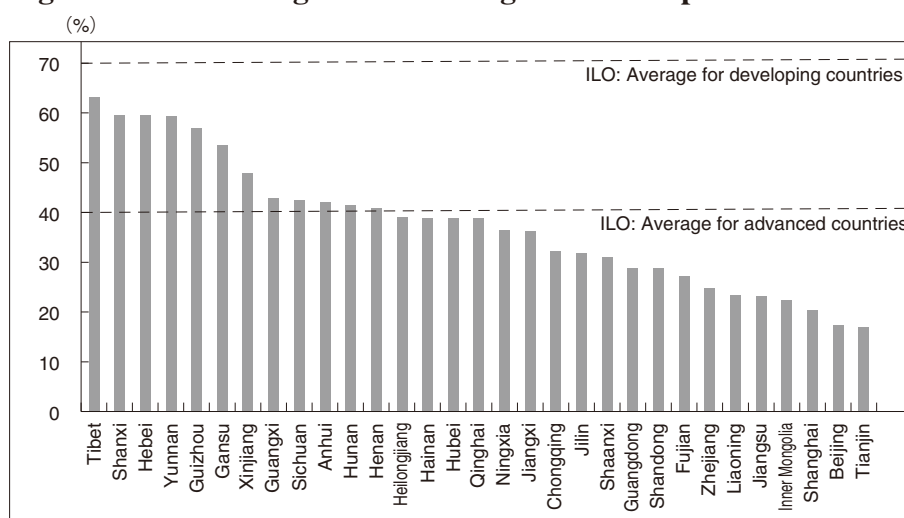
Regardless of the scenario that is applied, only Jiangxi Province appears likely to reach the targets in the Opinions. The targets could be reached under the low scenario in seven provinces: Shandong, Henan, Guangdong, Guangxi, Gansu, Shanxi and Shaanxi. However, Beijing and Shanghai have no hope of attaining the targets. It would be reasonable to conclude that this is not because these two cities have ignored the Opinions, but rather because minimum wage increases are being curbed with the approval of the central government.

Fig. 9 shows minimum wages in 31 provinces, cities and autonomous regions as percentages of per capita GDP. Based on cross-country data compiled by the International Labor Organization

(ILO) comparing minimum wages and per capita GDP between 2000 and 2007, these percentages are equivalent to around 40% of the average for advanced countries and about 70% of the average for developing countries. If these figures are seen as an indicator of minimum wage levels in relation to economic development stages, minimum wages in the coastal provinces and cities that make up southeast China and the Bohai Rim are still low, and there is considerable scope for further increases.

Despite this, increases in minimum wages are being restrained in these regions with the aim of preventing urban problems, such as the spread of coastal cities and slum formation. Under the 12th Five-Year Plan, China is believed to be promoting urbanization in inland regions in order to facilitate balanced economic development. By setting minimum wages at relatively high levels in inland regions, the government is trying to encourage migration to inland cities rather than coastal cities. In 2012, monthly minimum wage levels in the Xinjiang Uyghur Autonomous Region and Tibet Autonomous Region reached 1,340 yuan and 1,200 yuan respectively, which is comparable with the figures for Shanghai (1,450 yuan), Beijing (1,260 yuan) and Guangdong Province (1,300 yuan). Regional gaps in minimum wages are being reduced rapidly compared with urban units (Fig. 10).

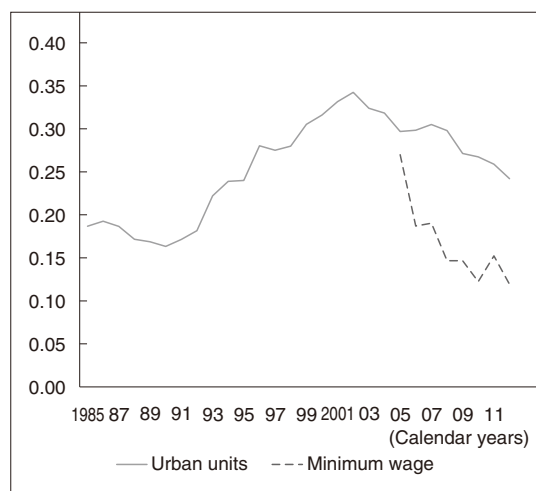
Fig. 9 Minimum Wages as Percentages of Per Capita GDP



Notes: 2012 values.

Source: Compiled by JRI using CEIC, *China Statistical Abstract* (2013), and ILO (2008)

**Fig. 10 Regional Variation in Wages
(Coefficient of Variation)**



Notes: Where there is regional variation in minimum wages within provinces, such as in Guangdong Province, the highest value has been used. Coefficient of variation = Standard deviation/arithmetic average.
Source: Compiled by JRI using CEIC data

If high minimum wages are maintained in inland cities, the incentive for rural labor to migrate to coastal cities will certainly be reduced. However, high wages will also erode the comparative advantage of inland cities, which will ultimately hinder private sector investment and urbanization in these regions. Fig. 9 shows that minimum wages in inland provinces, cities and autonomous regions are approaching 70% of per capita GDP, and that there is little scope for further increases. The policy of unilaterally raising just minimum wages has clearly reached a dead end, since not only will it be difficult to raise wages further in inland regions, the scope for further increases in coastal regions is also being reduced.

In recent times, the situation has been compounded by a slowing growth rate, which will make it even more difficult to raise minimum wages. In May the National Bureau of Statistics indicated small and medium enterprises were under financial pressure due to minimum wage increases⁽¹¹⁾. As of April 2013, minimum wages had been raised in 13 provinces, cities and autonomous regions. This represents a major decline compared with 2010 and 2011, when 30 provinces, cities and autonomous regions implemented

increases, and 2012 (when 25 provinces, cities and autonomous regions implemented increases).

IV. Household Register Reforms and SOE Reforms Hold the Key

Has the scope for minimum wage increases been exhausted? In Part IV we will show that China's efforts to correct income disparity and shift to a consumption-led economy will require minimum wage increases in coastal regions, and reforms to the household register system and state-owned enterprises.

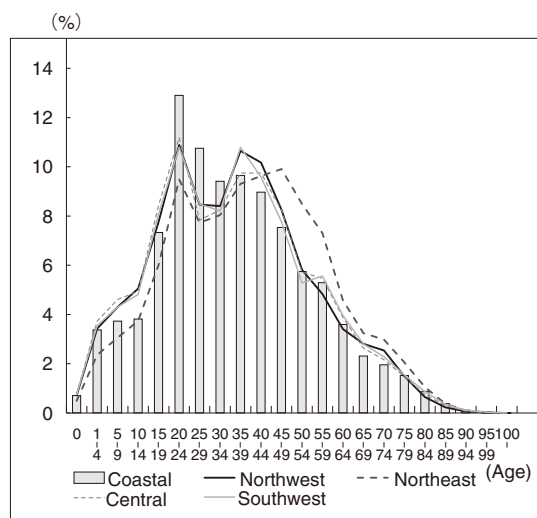
1. Further Increases in Minimum Wages Possible in Coastal Regions

Urbanization is progressing rapidly in China. China's urban population rose from 36.2% of the total population in 2000 to 50.0% in 2010 and 52.6% in 2012. Moreover, there is no evidence of extreme concentrations of population in the Bohai Rim and southeast China, which accounted for 34.7% of the total population in 2000 and 37.3% in 2010. The same is true of the urban population. Because of statistical limitations, comparisons are only possible after 2005. However, the percentage of people living in coastal China has risen only marginally from 43.3% in 2005 to 44.1% in 2011.

Yet this does not necessarily mean that urbanization is proceeding in line with the aims of the government and the Communist Party. There is still a conspicuous tendency for the working population to be concentrated in coastal regions. Since the National Bureau of Statistics subsequently adds over 100 million to the figures published by regional government, it is impossible to calculate accurate breakdowns for the 31 provinces, cities and autonomous regions. For the purposes of the following analysis, regional deviations in the working population have been estimated using data from the 6th population census implemented in 2010.

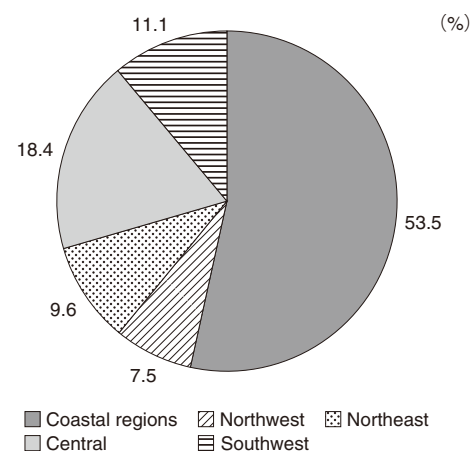
Fig. 11 analyzes the age profiles of urban populations in coastal regions and other parts of China.

Fig. 11 Age Profiles of Urban Populations



Source: Compiled by JRI using data from the 6th population census of China

Fig. 12 Regional Breakdown of 15-39 Age Group



Source: Compiled by JRI using data from the 6th population census of China

Because coastal regions have high populations in the 25-34 age group, the graph follows a bell-shaped curve, in contrast with the concave patterns for other regions. The graph shows that *nong-min-gong* (rural migrant workers) are still flowing into coastal cities, and conversely that inland cities are not attractive as alternative destinations for migrant workers. Evidence for this conclusion includes (1) the fact that there is no concentration of university students, who represent the 20-24 age group, in coastal cities, (2) the fact that the 25-35 age group makes up a large percentage of the populations of coastal regions, and (3) the fact that *nong-min-gong* normally return home at around the age of 40 (Miura [2011]).

The effects of minimum wage increases are not reflected in the population census data, which refer to 2010. Based on the expected wage hypothesis, however, there is a strong possibility that the bell-shaped and concave curves have remained unchanged. The expected wage hypothesis is a theory concerning urban-rural worker migration in developing countries. It states that the decision to migrate is motivated by the product of two variables, including not only the difference between urban and rural wages, but also the probability of finding jobs in cities (Todaro [1997]). In simple terms, this means that if urban wages are four

times higher than rural wages but there is only a one-in-ten probability of finding a job, no migration will occur. This concept can also be applied to migration from rural areas to City A and City B. If wage levels in both cities are four times higher than rural wages but the probability of finding a job is higher in City A than in City B, migrants will gravitate toward City A.

According to the expected wage hypothesis, large coastal cities are still attractive targets for migration. As we have already seen, regional variations in minimum wages are shrinking, reducing the attractiveness of large coastal cities in terms of wage levels. However, large coastal cities have an advantage over inland cities in terms of the probability of finding work. Fig. 12 shows the percentages of the 15-35 age group examined in Fig. 11 living in each region. The percentage living in coastal regions is extremely high at 53.5%, indicating that major coastal cities are the most attractive destinations for migrants.

Despite this concentrated migration toward large coastal cities, there has been no regional variation in progress toward urbanization in population terms. This reflects efforts to achieve area-wide expansion of cities in inland regions. While the number of prefecture-level municipalities (the second-ranked administrative level after the 31 provinces, cities and autonomous regions) re-

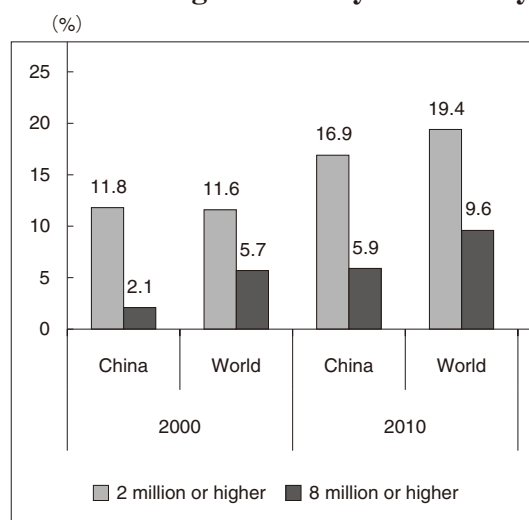
mained unchanged at 82 between 2000 and 2010, the number in northwest China increased from 26 to 40, and those in the southwest from 37 to 48. According to the *China City Statistical Yearbook* (published by China Statistics Press), the area of districts administered by prefecture-level municipalities increased by 187,000 square kilometers over the same period. Northwest China accounted for 32.4% of this increase, southwest China for 26.4%, southeast China for 25.0%, northeast China for 9.1%, the Bohai Rim for 4.9%, and central China for 2.3%. The population densities of districts in northwest and southwest China indicate that urbanization in both regions was driven by the expansion of the areas of those districts.

Even if minimum wage levels are set at relatively high levels in inland cities, there will be no reduction in the migration of labor to large coastal cities, and the impact on income distribution will also be limited. If the Xi Jinping administration is serious about the transition to a consumption-led economy, it will need to raise minimum wages in large coastal cities. As shown in Fig. 9 above, minimum wages are too low in coastal China. The coastal regions have high concentrations of informal sector businesses, such as private enterprises and self-employed people, and there are many employment opportunities for rural migrant workers. Minimum wage increases in these regions will be the real driving force for the reduction of income disparity and the transition to a consumption-led economy.

2. Household Register System to be Reformed this Year

The Communist Party and government are concerned about the emergence of urban problems, such as slum formation in large coastal cities. Slums form when inward flows of migration exceed the capacity of cities to accommodate them. Is this situation likely to occur in China's large coastal cities? Fig. 13 compares the percentages of China's population and the world population (excluding China) living in cities with populations of 2 million or higher and 8 million or higher in 2000 and 2010. There is no major difference in the

Fig. 13 Percentages of Total Population Living in Cities by Size of City



Notes: World figures exclude China.

Source: Compiled by JRI using OECD [2013]

ratios for China and the world in relation to cities with populations of 2 million or higher. However, the figures for cities with populations of 8 million or higher show that there has been less concentration of population in large cities in China.

In 2010 there were five cities with populations of 8 million or higher: Beijing, Tianjin, Shanghai, Chongqing and Guangzhou. However, by world standards these cities are still at the developing country level. Furthermore, population densities are not high in these large coastal cities. The population density in Beijing, Tianjin, Shanghai and Chongqing is 2,317 people per square kilometer. This differs little from the population density of 2,222 people per square kilometer in other provinces and autonomous regions (OECD [2013]). There is ample scope to expand the capacity of large coastal cities through development in such areas as public transport and public housing. Given the necessary determination on the part of the cities concerned, it would be possible to avoid urban problems.

Despite this, China is curbing inflows of rural migrant workers by keeping minimum wages in large coastal cities low. The reason for this is the risk that the rights of people with urban household registers could be eroded. One of those rights is social insurance. Most people who have urban

household registers and are employed in the formal sector join these social insurance schemes and enjoy extensive benefits covering healthcare, employment, workplace accidents, pensions and childbirth. Informal sector workers, especially rural migrant workers, most of whom do not have urban household registers, are excluded from these schemes.

After 2001, individual regional governments reformed their household register systems to allow transfers to urban registers. Despite this there was no increase in the number of people covered by urban official social insurance schemes. For example, Henan Province amended its household register system in 2003 and encouraged people to transfer from rural to urban registers. Yet there was no increase in the percentage of urban workers covered by official social insurance schemes. The percentage of urban workers covered by employment insurance fell from 78.2% in 2004 to 54.5% in 2011, while medical insurance coverage rose only marginally from 52.1% to 57.8%.

Why are rural migrant workers excluded from official social insurance schemes in cities? One reason is the lack of portability, which means that coverage under these schemes offers no benefits for rural migrant workers. Another problem is affordability, since insurance premiums are equivalent to about 40% of the income of an informal sector worker. In addition, the regional governments that administer the schemes have not actively encouraged rural migrant workers to join. This is because if low-wage rural migrant workers join the schemes, there would inevitably be a reduction in the level of benefits provided to formal sector workers with urban household registers, who already belong to the schemes.

However, government policy has started to focus increasingly on the provision of equal access to public services, which are directly linked to national living standards. This is gradually leading to changes in the rights of people with urban household registers. One example of this is compulsory education. In the past, it was difficult for the children of rural migrant workers without urban household registers to gain access to compulsory education at state schools in cities. The

schools maintain that they have no obligation to accept these children, since subsidies covering compulsory education are paid not to the cities but to schools in the rural villages where migrants' household registers are located. However, in recent years the government has implemented a policy of providing equal access to compulsory education regardless of where household registers are located, and today around 90% of the children of rural migrant workers are reportedly educated in urban state schools⁽¹²⁾.

These trends are likely to result in changes to social insurance schemes and the household register system under which such schemes are administered, although the process will take time. In May, Premier Li Keqiang said that reforms to the household register system would be implemented this year, and that the range of public services and social insurance schemes available to people with rural household registers would be improved. Details of these changes have not been made public. The key questions are whether the requirements for obtaining an urban household register will be eased not only in small and medium-sized inland cities, but also in large coastal cities. The easing of conditions for household registration in large coastal cities would without doubt provide increased impetus to efforts to reduce income disparity and bring about a shift to a consumption-led economy.

3. The First Step is the Most Important-Reform of Central Government Enterprises the Key

One of the benefits enjoyed by formal sector workers is high wages. An empirical study based on use of micro-data to analyze wage differences between the formal and informal sectors produced dual claims that the wage difference is attributable to differences in personal characteristics, including academic qualifications, and that reflects the monopoly status of state-owned enterprises (World Bank and Development Research Center of the State Council [2012]). There is no consensus about whether the wage gap is a problem that needs to be remedied.

However, the wage gap is identified in the Opinions as an issue that should be corrected by curbing both per capita wages and the total amount of wages paid by state-owned enterprises and their holding companies. There is no statement in the Opinions attributing high wages to monopoly situations. However, awareness of the wage gap has been heightened among middle and low-income earners by media reports, including reports that senior executives in state-owned enterprises earn 4,553 times more than rural migrant workers⁽¹³⁾, and that average wages in government state-owned enterprises under central government control are 4.2 times higher than in private enterprises⁽¹⁴⁾. As a result, the government will be forced to take action not only on hidden income and unlawful income, but also on wages per se.

As of June 2013, however, there were no indications that either the central or regional governments were taking specific steps to curb wages in state-owned enterprises and their holding companies. As shown in Table 4 above, one regional government after another has announced the size of wage increases in 2013. It is not possible to generalize, since the level of increase applied depends on the financial performance of the company concerned, but in many regions the increases are larger than those implemented last year, despite the fact that the growth rate has slowed. For example, the Beijing Wage Guidelines for Business Corporations set a floor of 5.0%, a standard of 12.0% and a ceiling of 16.5%. This is higher than the corresponding figures of 5.0%, 10.5% and 15.5% respectively in 2011, and 1.5%, 11.5% and 16.5% in 2012.

Regional governments have failed to curb wages in state-owned enterprise and their holding companies because there have been no moves to control wages in state-owned enterprises under central government control (hereinafter referred to as “central government enterprises”). Table 5 shows wage levels in private enterprises, urban units and central government enterprises. Wages in central government enterprises are by far the highest. Even in the forestry, livestock farming and fisheries sector, which has the lowest wages among state-owned enterprises, the wage level

Table 5 Wages by Industry and Sector (2011)

(Yuan)

Industry	Private (informal)	Urban units (formal)	
			Central
Average	24,556	42,452	102,965
Agriculture, livestock farming, fisheries	19,223	20,393	71,083
Construction	26,108	32,657	118,894
Manufacturing	24,138	36,494	84,418
Real estate	27,017	43,345	143,979
Transportation, warehousing, postal services	25,949	47,646	158,373
Mining	25,519	52,569	106,864
Production/supply of electricity, gas, water	22,091	53,723	113,160
Scientific research, technical services, geological surveys	31,320	65,238	104,807
IT, computer services, software	35,562	70,619	96,685
Finance	28,664	91,364	260,035

Source: Compiled by JRI using *China Statistical Yearbook* (2012) and 2011 *Zhongqi Zhigong Gongzi Baogao* [2011 Report on Wages in Central Government Enterprises] (<http://money.163.com/communications/special/2011ygzbg/>)

is 71,000 yuan, which is more than double the 35,000 yuan figure for the top private enterprises in the IT, computer services and software sector.

A comparison of wage levels in private enterprises and central government enterprises in the same industries shows that the disparity is greatest in the financial and real estate industries and smallest in the manufacturing and IT, computer services and software industries. At the beginning of Part IV we noted that there was no consensus about whether the wage gap was attributable to the characteristics of employees or the monopoly status of state-owned enterprises. Table 5 eloquently proves that wage differences are linked to the level of barriers to participation and are determined by the extent to which state-owned enterprises monopolize markets and their ease of access to approval and licensing authority. Even within China, there has been criticism that the failure of the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council to supervise central government enterprises has allowed them to divert profits into their own wages instead of returning them the government as the shareholder.

As the proverb says, “the first step is the most important.” Unless the central government takes the initiative in reviewing the wages paid by cen-

tral government enterprises, regional governments will not be motivated to look at wage levels in state-owned enterprises and holding companies. State-owned enterprises and urban household register holders are the strongest forces opposing efforts to reduce income disparity and bring about a transition to a consumption-led economy. However, Chairman Xi Jinping and Premier Li Keqiang have so far said nothing about the reform of state-owned enterprises. Have they put off the decision to carry out reforms because they see state-owned enterprises as sacred cows, or are they preparing to implement decisive reforms when the time is right? The answer to this question will have a major bearing on China's ability to correct income disparity and transform itself into a consumption-led economy.

Conclusions

—Is China's Role as the World's Factory about to End?

In this article, we have focused on income distribution reform, especially minimum wage increases, from the perspective of income disparity reduction and the transition to a consumption-led economy. The analysis has highlighted both benefits and limitations. We have identified essential steps that will need to be carried out in order to modify the income distribution structure. First, it will be necessary to raise minimum wages in coastal regions, where there is a high concentration of informal sector activity. Second, the household register system will need to be reformed to eliminate disparity in access to official social security systems based on differences in household register status. Third, China will need to reform its state-owned enterprises, especially those under central government control, which are able to pay high wages because of their monopoly status and easy access to approval and licensing authority.

Minimum wage increases are also an important issue for Japanese companies operating in China. We will conclude this paper by looking at the implications of income distribution reforms for Japanese companies. There is concern that minimum wage increases will reduce the advantages

of remaining in China for companies in labor-intensive industries. Results from the latest questionnaire survey of Japanese manufacturers with overseas subsidiaries conducted by Japan Bank for International Cooperation (JBIC) show that China is still seen as the most promising target for the establishment of business operations in the medium-term future (approximately three years), but that rising labor costs are seen as a problem. The percentage of companies citing this issue has been rising since China began to implement major increases in minimum wages in 2010 (Japan Bank for International Cooperation [2012]).

There is also statistical evidence of the dispersal of labor-intensive industries that were previously concentrated in China. In 2010, China accounted for 82% of Japan's imports of apparel and apparel accessories. The ratio has since fallen rapidly to 79.8% in 2011, 77.1% in 2012, and 74.7% in 2013 (Jan-May). The countries that have emerged to take China's place include Vietnam, Indonesia, Bangladesh and Myanmar. Labor costs will rise further if the government starts to tackle the issues identified in this article by raising minimum wages in coastal regions and reforming the household register system to eliminate disparity in access to social insurance schemes. This will inevitably cause the exodus of labor-intensive industries from China to accelerate.

However, it would be premature to assume that China will immediately relinquish its role as the world's factory to the countries listed above. China has advantages that other countries cannot match, including high labor productivity, supporting industries capable of supplying parts and low transportation costs. While a decline in competitiveness is inevitable, it seems unlikely that labor-intensive industries will atrophy in the short-term perspective. According to the World Trade Organization (WTO), China's share of world apparel exports rose steadily from 23.8% in 2004 to 37.3% in 2011, despite minimum wage increases. Over the same period, the share of the four countries listed above showed a much smaller increase from 5.9% to 10.1%.

Emerging economies, especially China, are struggling to cope with low growth and face a

daunting outlook. However, the Xi Jinping administration has shown its determination to deal with reforms that were never tackled by the Hu Jintao administration. The reform of income distribution, which was studied in this article, is just one of these, and there are parallel efforts to reform government administration⁽¹⁵⁾ and financial systems⁽¹⁶⁾. In all of these areas, the Xi Jinping administration deserves credit for emphasizing to regional governments and state-owned enterprise that there will be no return to the traditional high-growth path, and that the reforms will not end as mere slogans. The Chinese economy in this transitional period cannot be understood simply from the growth rate. We need to take a more panoramic view of the sustainability of economic growth in the medium and long-term perspective, while carefully monitoring the progress and achievements of the reform process.

End Notes

1. The previous Hu Jintao administration was very concerned about the “three rural issues” (low agricultural productivity, the collapse of rural communities, rural poverty). These problems were always included in the first policy document, which identifies the most important issues each year. Under Hu Jintao, the government began to implement a series of measures targeting rural people, including the abolition of agricultural taxes in 2006, the extension of minimum living standard protection (previously provided only in urban areas) to rural areas in 2007, the introduction of free compulsory education in 2007, and the promotion of the New Cooperative Medical Scheme and New Rural Pension System through the introduction of premium subsidies in 2008 and 2009 respectively. These measures caused the government budget for the “three rural issues” to rise from 214.4 billion yuan (8.7% of total expenditure) in fiscal 2003 to 1,228.7 billion yuan (9.8%) in fiscal 2012. Measures targeting rural migrant workers included the enactment of an amended Labor Law strengthening workers’ rights in 2008.
2. For example, Ferri, G. and Li-Gang Liu [2009] suggest that state-owned enterprise would generate almost no profits if they had to borrow money at market interest rates.
3. China’s Big State-Owned Banks Saw Rising Defaults, Shrinking Loan Profitability in 2012, April 23, 2013, International Business Times (www.ibtimes.com/china's-big-state-owned-banks-saw-rising-defaults-shrinking-loan-profitability-in-2012-1157293)
4. One of the policies contained in the Opinions states that the real estate tax on newly purchased houses, which was introduced on a trial basis in Shanghai and Chongqing in January 2011, should be extended nationwide. However, the tax was originally introduced to curb real estate investment and would not function as an income distribution policy.
5. Chugoku no Chokodo Seicho wa Owatta [China’s Super-High Growth has Ended], Chairman Xi at the Forum for Asia, April 9, 2013, AFPBB News (<http://www.afpbb.com/article/politics/2937846/10552515>)
6. Fumin Caineng Zhenzheng Qiangguo [The Country will be Truly Strong when the People are Prosperous], in News of the Communist Party of China, October 25, 2010 <http://theory.people.com.cn/GB/40557/206292/13072169.html>
7. An article posted on February 27, 2013 on Xinhua’s Japanese economic news website suggests that restrictions on the “three public consumptions” may impact on consumption of luxury goods. (<http://www.Xinhua.jp/socioeconomy/economy/335547/>)
8. China’s central government had started to release details of the 2013 budget, indicating that there would be cuts in expenditure on “three public consumptions,” including official entertainment. (<http://www.xinhua.jp/socioeconomy/economy/342127/>)
9. In Chinese this is referred to as “gongzixing shouru,” which can be translated literally as “salary.” However, since gongzi includes bonuses and allowances, the word “wages” has been used throughout this article.
10. The Wage Guidelines for Business Corporations indicates three rates of increase: low, standard and high. The high scenario was excluded from this analysis because (1) based on actual results for 2010, the average rate of increase is close to the standard rate of increase in the Wage Guidelines for Business Corporations (Liu, Li-Gang [2012], and (2) it would be impossible to achieve the target of raising minimum wages to 40% of average wages in most regions under the high scenario.
11. “Manufacturers Unable to Raise Wages Further because of Rising Average Wages and the 2012 Slowdown,” Xinhua Business, May 21, 2013 (<http://www.xinhua.jp/socioeconomy/economy/345709/>)
12. Li Weihong Chuxi Liangeguo Jiaokewenzuzhi Quanmin Jiaoyu Gaocenghuiyi [Li Weihong Attends Meeting of UNESCO High-Level Group on Education], February 26, 2010, (http://www.gov.cn/gzdt/2010-02/26/content_1542266.htm)

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