

The Industry Origin of China's Inequality: An Exploration of the Impact of Government Industrial Policies on Income Distribution

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Unlike the postwar experiences of its East Asia counterparts, China's post-reform rapid growth has been accompanied by a rapid rising of inequality, from a Gini coefficient of around 0.3 in 1978 to 0.47 in 2016 (NBS, 2020). Despite the slowdown of the trend over the past decade, China's 10% of the population still received more than 40% of the national income, surpassing many OECD countries according to WID (2021). The conventional wisdom, based on a large number of studies over the past two decades, is that such a high inequality is attributable to China's market-oriented reforms, yet the government fails in designing and implementing effective redistribution policies especially in the fastest growth period (Zhang, 2021). However, the argument for the reform-induced inequality is misleading without a proper understanding how the market is affected by government interventions (Xu, 2011; Wu, 2019). On one hand, growth-motivated government at all levels intervene resource allocation through industrial policies, which may render larger skill premiums and wage gaps between sectors of different capital intensity (Acemoglu, 2020). On the other hand, the intervention also tends to cause efficiency loss due to the misallocation of resources, which may make the economy relied more on capital growth (Wu, 2019). This problem cannot be properly addressed by the widely used, household survey-based inequality measurement approach that does not consider industry specific policy problems as well as the impact of resource reallocation across industries. We propose a national accounts approach that fully integrates the productivity accounts of all industries with both quantitative and compensation matrices for labor input, as well as for capital input. This allows us to separate the effect of policy interventions from the effect of market competitions in the measurement of inequality. We use newly constructed Chinese labor metrics of economy-wide 37 industries with an ownership dimension for 40 years since the beginning of the reform. By far, we have done the data work, performed growth accounting to examine the productivity problem, and now we are moving into the stage of the methodology for policy effect on inequality.