

Sources of Income Inequality in China: Individual's Effort or Circumstances?

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Paper Abstract:

Our study examines the extent to which the dynamics of income inequality in contemporary China is driven by individual's effort and circumstances at the national and regional levels. The framework we use is inequality of opportunity. Under this framework, the factors contributing to income inequality are categorized into either circumstances or effort. No existing Chinese datasets, however, has sufficient information for examining the contribution of inequality of opportunity to the variation of inequality over time. To circumvent this issue, we make use of information in cross-regional variation in development and inequality. Our data come from the China Family Panel Study, which contains 33,600 individual observations for years 2010 and 2012. Our empirical analysis allows zero-income observations using a hurdle model, parameterizes and estimates the heteroskedasticity the indirect effect of circumstances through maximum likelihood estimation (MLE), and implements the Shapley decomposition to identify the contribution of each circumstance and effort to income inequality respectively. We find that at the national level, inequality of opportunity accounts for around 31% in 2010 and 43% in 2012, a higher figure than U.S. and most Latin American countries. At the regional level, as we move from low-income regions to high-income ones, inequality of effort decreases significantly while the level of inequality of opportunity increases slightly, with a net effect of small total income inequality.