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Multinational enterprises and regional inequality in China

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ABSTRACT

We examine spatial inequality in incomes and in the activities of multinational enterprises (MNE) in China from 1999 to 2013. We consider both interprovincial and urban-rural inequality using improved measurements of both regional average incomes and MNE activities. Although we find some common trends between spatial inequality in incomes and spatial inequality in MNE activities, our analysis of the determinants of urban-rural income inequality finds no evidence that MNEs are to blame for this type of inequality. We find limited evidence that MNEs reduce urban-rural income gaps, but mostly we conclude that they have no significant effect on these gaps.

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1. Introduction

China's rapid economic growth in recent decades has been accompanied by equally rapid increases in income inequality. From 1990–2013, China's post-taxes-and-transfers Gini coefficient increased by 20 points, from 33 to 53, the largest increase of any country included in the Standardized Income Inequality Database (SWIID).¹ Regional inequality in economic growth in China has induced a large floating population of migrant workers seeking better economic opportunities in faster-growing regions. Migrants flow from rural to urban areas within regions and from poorer to richer regions, where the latter often involve eastern and coastal regions. Multinational enterprises (MNEs) also tend to locate in urban areas and in eastern regions in China. Since MNEs typically pay wage premiums relative to domestic enterprises,² it seems reasonable to ask whether MNEs contribute to increasing spatial income inequality in China, even though they also contribute to China's economic development.

The linkages between foreign direct investment (FDI), growth and inequality are difficult to analyze due to endogeneity issues and other factors that make each country's experience unique. Cross-country studies often are flawed in not properly controlling for the many other influences involved in these relationships. With city-level data for China at our disposal, our inquiry into the trends and determinants of income inequality will focus on spatial inequality, which includes both

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¹ The next largest increase was for Bulgaria at 14 points (from 22 to 36) and the next largest change for an Asian economy was for Indonesia at 10 points, from 32 to 42.

² See [Lipsev and Sjöholm \(2004\)](#) and [Greaney and Li \(2014\)](#), for example.

inter-provincial inequality and urban-rural inequality. We seek to answer the following questions: 1) What has been the trend in spatial inequality in incomes and in MNE activities in China in recent years; 2) Have MNE activities contributed to the trends in spatial income inequality; and 3) Do the answers to these questions depend upon whether the MNE is owned by overseas Chinese investors versus other foreign investors? We consider two types of MNEs identified in Chinese statistics in our analysis: Hong Kong, Macao, Taiwan-invested enterprises (HMTEs) and other foreign-invested enterprises (FDIEs). Greaney and Li (2012, 2014) find evidence that HMTEs and FDIEs have different impacts on China's labor market. For example, HMTEs tend to pay lower wage premiums than FDIEs. The potential advantages that HMTEs may have over FDIEs in China include having closer language and cultural linkages, closer geographic proximity, and greater ease in obtaining visas and other government approvals.

By separating MNEs into two ownership types, we make a new contribution to the growing literature that examines China's spatial income inequality. We also contribute to this literature by using improved methods of measuring spatial income inequality and MNE activities. We use average labor income rather than GDP per capita by region and we measure regional MNE activities by their actual production activities rather than by aggregate or regional FDI inflows. Although we find some common trends between spatial inequality in incomes and spatial inequality in MNE activities, our analysis of the determinants of urban-rural income inequality from 1999 to 2013 finds no evidence that MNEs are to blame for this type of inequality. We find limited evidence that MNEs reduce urban-rural wage gaps, but mostly we conclude that they have no significant effect on these gaps.

Li and Gibson (2013) criticize many papers on this topic that have used GDP per capita at the regional level, as reported by the Chinese government, because these figures mistakenly use registered population rather than actual resident population in these calculations. By counting only official "hukou" residents as the population for each region, the data tend to under-count urban and coastal populations and over-count rural, interior populations. That tendency biases the regional per capita GDP figures towards larger inequality, rather than a truer measure. After correcting for this bias, Li and Gibson conclude that China's inter-provincial (IP) inequality has not increased between 1978 and 2011, and in fact the only period of sustained increase in inequality was from 1990 to 1993. In earlier work, Tsui (2007) documents the overestimates of IP inequality starting in the 1960s and growing especially large from the mid-1970s due to this problem with using official GDP per capita data. He also finds that the only period of sustained increase in IP inequality is the early 1990s, using corrected population data.

Jian, Sachs, and Warner (1996) find that regional inequality in China increased during the Cultural Revolution from 1965 to 78 as development strategies favored the already richer industrial areas over the poorer agricultural ones. The market-oriented period from 1978 brought about some income convergence through 1990, but a return to divergence from 1990 to 3. They attribute much of the convergence to faster productivity growth in rural areas due to the spread of light industries, and to faster growth in coastal regions due to more open trade and investment policies. But they admit their analysis might be biased due to the migrant worker issue that is important in their more recent years.

Several studies have examined the determinants of regional inequality within China, including the impacts of FDI and trade. Fleisher, Li, and Zhao (2010) estimate provincial aggregate production functions to analyze the links between human capital, growth and inequality in China. They conclude that regional differences in physical capital and human capital contribute the most towards explaining regional inequality. They find that FDI had a much larger effect on TFP growth before 1994, while the effect after that year was negligible.

Yu, Xin, Guo, and Liu (2011) use a simultaneous equations model to explore the relationship between regional GDP per capita and regional FDI per capita while accounting for the endogeneity problem between the two variables. They conclude that regional inequality in physical capital per capita explains 50% of China's regional income inequality and 65% of the increase in income inequality from 1990 to 2005. Province location accounts for 33% of inequality (and 63% of the increased inequality) and education levels account for 12% of inequality (while contributing to decreasing inequality by 13%). They estimate that FDI stocks account for only 2% of regional income inequality. Wei, Yao, and Liu (2009), however, find that FDI has been a key factor in regional growth differences in China, which has contributed to increased regional inequality between 1979 and 2003. They estimate an augmented Cobb-Douglas production function using panel data for China's regions to show FDI having a positive growth effect on the east and central regions in China but not on the western region, where FDI is scarce. They argue that the regional disparities in FDI distribution are to blame for regional inequality, rather than the FDI itself. Our analysis further examines this line of reasoning.

Wan, Lu, and Chen (2007) decompose regional inequality in China and produce an inequality decomposition result for each factor for each year using province-level data for 1987–2001. FDI is found to be one of the smallest contributing factors, accounting for shares of inequality that ranged from a low of 4.5% in 1987 to a high of 7.1% in 1998. Trade is estimated to contribute 11.7% of inequality in 1987 and 14.3% in 2001, but the largest contributing factors over their study period were capital, urbanization and location.

Lessmann (2013) uses data for 55 countries, including China, to examine the relationship between FDI inflows and regional inequality within host countries over time.³ He finds that FDI inflows tend to increase regional inequality in

³ Jain-Chandra et al. (2016) is another recent cross-country inequality study but they focus on overall income inequality rather than spatial income inequality. They find that trade openness tends to lower income inequality while financial openness increases inequality except in Asia, where financial openness also lowers inequality. Their measurement of financial openness sums FDI outflows and inflows relative to GDP.

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