

Abstract

Using three comparable national representative household surveys for China in 1988, 1995 and 2002, this paper provides micro level evidence of a policy of absolute regressive taxation and an inverted welfare system. It reviews the economic effects of taxes and subsidies and shows that a dual and regressive taxation system increases the urban rural income gap and enhances overall inequality. The empirical evidence indicates that the relatively poorer rural population pay net tax while those in the richer urban areas receive net subsidies. This biased system of taxes and welfare payments is one of the major causes of the persisting urban-rural income gap and is largely responsible for overall income inequality in China.

Keywords: regressive tax, subsidy, income inequality, China.

JEL Classifications: I32, I38, K34, Q12, R11, R13, R20

Xiaobing Wang

School of Social Science and Centre for Chinese Studies
The University of Manchester,
Oxford Road, Manchester M13 9PL, UK
Email: xiaobing.wang@manchester.ac.uk
Tel: +44 (0) 161 275 4871

Jenifer Piesse

Department of Management
King's College London
150 Stamford Street, London, SE1 9NH
Email: jenifer.piesse@kcl.ac.uk
Tel: +44(0)20 7848 4164

and University of Stellenbosch, South Africa

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