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Sessão Ordinária

Wealth Accumulation in China: Comments on the Recent Cycle

Isabela Nogueira de Morais[·]

Abstract

A growth model pulled by investments has opened the possibility for some new wealth concentration drives to emerge into China's economic scenario. This article analyses the rather recent formation of big fortunes in China, millionaires whose wealth derives mainly from the urbanization process and the resulting boom in civil construction, real estate markets, land expropriation from farmers, and capital appreciation and appropriation from related industries. In order to do so, we focus into two new trends of Chinese economy: wealth derived from land expropriation from farmers and wealth concentration caused by private capital transfers from large corporations.

[·] PhD candidate in Economics from Universidade Federal do Rio de Janeiro (UFRJ) and lecturer of China's political economy at the Institute of International Relations (PUC-Rio).

In the last few years there has been a rising number of Chinese and Western scholars devoted to the debate about China reaching its peak of income inequality around the end of the first decade of the century, and possibly starting to stagnate or reduce its level of imbalances[1]. After emerging as one of the top unequal countries in Asia and approaching the inequality levels of those of Latin American champions in the 2000's[2], China could, according to these speculations, be close to reach its maximum level of income disparities. In part this debate has been fulled by policies implemented by the pair Hu Jintao-Wen Jiabao since the beginning of the 2000's which advocate towards "building a new socialist countryside" and inequality reduction[3]- although many of these policies have been partially implemented due to low funds. In any case, the abolishing of agricultural tax in 2006 and a new rural cooperative medical system are the main rural development initiatives, while the (still rudimentary) social safety net in the cities include the Minimum Living Standard Assurance (MLSA) system, living subsidies to laid-off workers, and the increase in pension income (Qin, 2006)[4].

Additionally, survey done by the combined team of researchers from CASS (Chinese Academy of Social Science) and Western scholars suggests that income inequality within rural areas and within urban areas decreased between 1998 and 2002, although the huge and increasing gap between rural and urban areas kept the national

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[1] Chen & Zhou (2005), leading a study team on income inequality at Nankai University, forecast that China should get to the top of the Kuznets U-inverted shape by the end of this decade, meaning that after this inequalities should start to decline. Also Riskin (2007), motivated by the data from the CHIP project (see footnote 5) showing declining intra-urban and intra-rural inequalities, asks if China has reached the top of the Kuznets Curve, although concluding that "it is far too early to predict that China is becoming a more egalitarian society". Both analysis are derivations of Kuznets (1955) original case studies that showed levels of inequality within different countries rising as growth improves, up to a maximum point when the development of national economy allowed inequalities to decrease. Finally, Saich (2009) reports that the intention of policy-makers in China is to hold the Gini coefficient to 0.45 by 2010 and reduce it to 0.40 by 2020.

[2] According to the Human Development Report (2007) from the United Nations, China's Gini national coefficient had reached 46.9 in 2004, much worst than India (36.8) or Indonesia (34.3) and around the same level as Philippines (44.5), Mexico (46.1) and Malaysia (49.2).

[3] Around 1998-99, some central state programs were introduced in an effort to reduce existing inequalities (like the Go-West Policy), strengthen social protection and press for greater equalization in access to resources. But it wasn't until the 16th Party Congress (Nov. 2002) that the government called for people-centered development, rather than quantitative growth rates, as a core target of its policy (Shue & Wong, 2007).

[4] Also important were the measures taken after the 2008 financial crises intended to boast internal demand. The $ 4 trillion yuan stimulus package included investments in rural infrastructure, low-income housing, water and electricity, and once the main factor behind China's national inequality coefficients of income is the urban-rural gap, policies intended to boast rural investment and demand tend to have positive impact on overall inequalities. In the first nine months of 2009, the gross domestic product (GDP) of western regions rose 12.5%, 4.8 percentage points higher than the national rate. About 43% of investment allocated by the central government to expand domestic demand had been invested in western regions (Xinhua, 11.19.2009).

Gini coefficient growing in the same period[5]. They conclude that the spread of wage income in rural areas (because of rising wage employment opportunities) and a reduction in the regressiveness of net taxes allowed the Gini ratio for rural income to fall by almost 10% between 1995 and 2002. On the other hand, the urban ratio fell by 4% due to the reduction in inter-provincial inequality, increase in social-protection payments, and housing reform (subsidies that were appropriated by better-of households were sharply reduced). However, declining terms of trade for agriculture and faster rising income in urban areas kept the Gini ratio for overall national income in 0.45 due to the sharply widened urban-rural divide (Khan & Riskin, 2005). In fact, by the end of 2008, per capita income disposable in rural areas were finally growing in a pace closer to that of urban households (8.4% in cities, against 8.0% in the countryside). However, due to more than two decades of important growth divergence, urban households income was still 3.3 times bigger in 2008 - $ 15,781 yuan, against $ 4,761 yuan in rural areas.

It is not part of the scope of this article to speculate on future scenarios and the evolution of Chinese income distribution in the next years. However, no matter what is the trend according to different income distribution measures, a new pattern in terms of social stratification has been established in the last decade, and deeply related to the growth cycle. That is the formation of big fortunes, millionaires whose wealth derives mainly from the urbanization process and the resulting boom in civil construction, real estate and financial markets, land expropriations from farmers, and capital appreciation and appropriation from related industries. In 2009, Chinese media reported that 453,000 citizens possessed at least one million US dollars, with assets under management reaching US$1.73 trillion. In the same year, the known number of billionaires in the country was the second highest in the world - 130 citizens, against 359 in the US and 32 in Russia – an impressive figure if one considers that six years before the country had not one known billionaire[6]. The formation of a class "the winner takes all" is an

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[5] The so called CHIP Project (China Household Income Project), or CASS survey, has done three sets of income survey nationally in China (1988, 1995 and 2002, being the 2009 one done by the time we write this article) and has used different methodology if compared to the official survey done by the National Bureau of Statistics (NBS). They have also come to different results. For a discussion of CHIP Project data and results, see Khan & Riskin (1998 and 2005).

[6] *China Daily*, "Millionaires club expands in China", 11.20.2009, and *The New York Times* "China's growing economy mints billionaires", 10.13.2009. According to another report, using Chinese currency, China has 825,000 individuals with more than 10 million yuan and 51,000 individuals with more than 100 million yuan (*China Daily,* "Beijing tops Hurun rich list with 143,000 millionaires", 08.24.2009).

absolutely new trend in Chinese social configuration, and may persist even if we start to watch a reduction in the urban-rural gap in the coming years.

This rising number of millionaires has been followed by a declining share of low and middle income groups in the total national income. Data from the World Institute for Development Economics Research (WIDER) indicates that from 1991 to 2004, the share of the middle 60% income group in the total dropped from 57,5% to 43,9%, while the share of the poorest 20% fell from 6,4% to 4,5%. On the contrary, the 20% richest group watched its income share rise from 36,1% to 51,9% in the same period, virtually more than half of national income (table A).

Table A – Income share of total income

	Lowest 20%	Middle 60%	Highest 20%
1982	8.5	53.9	37.6
1983	8.7	55.8	35.5
1984	10.1	55.9	34.1
1985	8.7	52.5	38.8
1986	7.6	53.8	38.6
1987	6.9	55.5	37.6
1988	6.6	55.9	37.5
1989	6.5	51.5	42.0
1990	7.0	52.0	41.0
1991	6.4	57.5	36.1
1992	6.0	52.3	41.7
1995	5.0	44.4	50.6
1998	5.9	47.5	46.6
2001	4.7	45.4	50.0
2002	4.6	45.5	50.0
2004	4.3	43.9	51.9

Source: World Income Inequality Database V2.0 (WIID)

Like in many other developing and developed countries, wealth distribution in China is much more unequal than income distribution. The Gini coefficient for per capita net total wealth was in 0.50 in 2002, while the coefficient for per capita income was 0.40 according to CHIP Project data (table B). The particular wealth-income correlation that we want to highlight, however, is that average wealth growth rates have been much faster than income growth (around three times bigger). Between 1995 to 2002, household per capita real income increased by 8.8% per annum, while net total wealth increased by 27% per annum between 1995-1999, and 22% between 1999-2002 (table B). This suggests the existence of important non-saving wealth, or wealth coming from other sources than income, as Meng (2007) has pointed out.

Table B – Inequality measures of real per capita income and wealth, 1995, 1999 and 2002

	Per capita income	Per capita total wealth	Per capita net total wealth	Per capital financial wealth	Per capita net housing wealth
1995					
Mean	1,705	32,094	10,641	3,902	3,552
Gini coef.	0.36	0.50	0.52	0.60	0.88
1999					
Mean	2,501	82,744	30,341	9,183	17,790
Gini coef.	0.38	0.53	0.56	0.64	0.68
2002					
Mean	3,068	151,735	48,621	14,437	29,823
Gini coef.	0,40	0.47	0.50	0.61	0.58
Anual growth rate 95-99 (%)	10.05	26.71	29.95	23.86	49.60
Anual growth rate 99-02 (%)	7.04	22.40	17.02	16.28	18.79
Anual growth rate 95-02 (%)	8.75	24.85	24.24	20.55	35.52

Source: CHIP project, calculated by Meng (2007)

This amount of non-saving wealth has also been much higher for households with above-average income levels. In 1999, households with bellow 20 percentile income levels derived 18% of wealth from non-saving sources, while those with income levels above 80 percentiles this ratio was 42%. According to Meng's hypothesis, these results suggest that the rich strata might have been given more wealth than the poor in the form of direct wealth transfers, such as housing, and that there might be a sizable non-saving wealth coming from a rapid rate of appreciation of assets, also here considering the importance of housing markets in China. However, the market selling price for the unit residential housing increased by 28% from 1995 to 1999, and 37% from 1995 to 2002, according to NBS data for the provinces studied, still lower than the actual net total wealth levels. As Meng himself concludes, housing wealth was the primarily responsible for the fast wealth growth in 1999 and 2002, but it represented a little more than half of the average total wealth. Therefore, besides housing appreciation and advantages during the process of housing reform[7], additional non-saving methods were responsible for the another half of recent wealth accumulation.

[7] The housing reform introduced in the early 1990's permitted those who were renting government housing to buy their occupied house at a heavily subsidized price. Those in better political position or with good relations were able to acquire better located residences with larger purchase price discounts. By 1988, before the housing reform, less than 15% of urban households owned their own home. In 2002, this number had increased to 78% (Meng, 2007).

Besides wealth derived from housing appreciation, the Chinese investment-led growth pattern has led to two other core wealth concentration drivers that we intend to explore bellow: wealth derived from land expropriations from farmers and from private ownership or shareholding participation in large corporations[8]. Open data on Chinese wealth holding is highly difficult to access, but from the top-12 list of known Chinese billionaires in 2009, eight of them were in property development business (the three exceptions were in automotive sector, paper recycling and aluminum[9]). And very few of the Hurun top 1,000 richest ones were on export-related business. In face of the massive process of urbanization and related investments discussed before, it is not surprising that the vast majority had their business related to property development and industries that come along, as steel, aluminum and car makers[10].

Wealth derived from land expropriation

Ever since the dissolution of the communes in the beginning of the 80's, universal and egalitarian distribution on land among rural population (by that time this implied 800 million people) became the main social safety net that substituted the old system in the countryside. In the process of implementing the Household Responsibility System, land was distributed in an impressive egalitarian base to villagers, and the concentration ratio (pseudo-Gini coefficient) for land distribution was virtually zero for over two decades up to 2002 (Khan & Riskin, 2005). This universal and equitable access to land was an impediment to the creation of a class of landless poor, like the classical pattern of many other developing countries, and has been the main subsistence guarantee rural workers have in face of a non-existent social welfare system. Not only rural migrants return to their land in situations of no job offers in the cities, but also

[8] There is, also, a macroeconomic driver related to the perpetuation of this concentration: a regressive fiscal system, that guarantees low cost of carrying wealth in the country. The most basic distorted element is the inexistence of inheritance tax - authorities have been arguing that the country doesn't have a reliable wealth-reporting system. Besides, house property tax is only 1.2% over the tax base (that being the residual value after the subtraction of 10% to 30% of the original value of property). Owners that rent their property pay more: the tax payable is 12% the rental income from the property.

[9] They were owners of the following property developing companies: Shimao, Country Garden, Xinhu, China Oceanwide (also in financial services), Hopson, Wanda, Ruoy Cha (also an energy drink), Suning (also in retail). From automotive sector there was the owner of BYD (an electric battery maker), from paper recycling there was the owner of Nine Dragons, and in aluminum, East Hope (Hurun Report, 2009).

[10] The list is far from perfect, and excludes some owners of evident lucrative companies (such as Haier, Lenovo, Dazhong, PingAn etc), but whose publicly-available information was not enought to be included in the ranking. Hurun Report, 2009, available at: http://www.hurun.net/listreleaseen391.aspx, last access in 11.20.2009.

older and injured people find some type of protection in their land against extreme poverty and destitution (Riskin, 2008).

Land expropriation in scale from farmers is, thus, a changing structural feature in the social configuration of Chinese countryside. Since the 2000's, China has been going through what Riskin calls an "epidemic" of land seizures by local government, stimulated both by a booming real estate market and by fiscal necessities from local governments. An estimated 66 million farmers up to mid-2004 had their land expropriated usually at grossly under-market prices (Riskin, 2008). Although land is still collectively owned in China, local governments have the prerogative to expropriate a certain number of farmers each year on the basis of "public interest"[11]. In the pace of rapid industrialization, urbanization and soaring land prices in cities, local governments have transformed their control over rural land into a revenue-generating business and in a way of attracting more industries to their area.

It is well-known that local officials depend on good growth indexes in order to get political promotions. Additionally, ever since the 1994 tax-sharing-reform, which re-centralized fiscal resources[12], local governments have faced budget constraints and have gone through land expropriation in order to alleviate their fiscal necessities. Tao & al. (2009) report some scholars estimations that land related revenues have been accounting for between thirty to fifty percent for all sub-provincial governments and between fifty and sixty percent for city level governments income. In order to improve their revenue collection, these local authorities are particularly interested in expanding business in their jurisdiction, specially industrial and residential ones. Housing projects are interesting in a revenue point of view once they lead to high (and usually fast) business taxes. However, because China has very low property tax, once the sales are done, local governments' revenues drop quickly. On the other hand, manufacturing projects tend to have a longer take-off period, but once the factories are up and running, taxes increase gradually. Therefore, these two projects, real estate and manufacturing

[11] "Legally, rural land can be converted only for three purposes: public good (transportation, water projects, public health or education), industrial use and business development (real estate or commercial development). In booming urbanization process, the restrictions from the central government have been largely ignored" (Zhou, 2009, p. 122). And some "creative ways" have been found to bypass the central government quota for yearly conversion.

[12] The Tax Sharing System determined that the central government gets 75% of the biggest income tax revenue (the value-added tax, VAT), while local governments' share was limited to 25%. But once the system re-centralized revenues but left expenditure assignments unchanged, it created an important fiscal gap for local governments. As of 2004, 70% of total budget spending was being carried out by local governments, including 70% of public spending on education and 50% of public health (Shue & Wong, 2007).

ones, are seen as complementary source of revenue generators, and land discounts or offers are the main instruments used in regional competition for investments.

To court these capitals, Tao & al. (2009) explore that local governments are often engaged in one-on-one negotiations[13] and lower land prices, including, in the most radical examples, giving away land leases free of charge[14]. In their interviews around Suzhou city, Jiangsu province, "one of the most successful host cities of foreign direct investments, the average leasing price in the early 2000's was 2.25 million yuan per hectare, and the cost of land acquisition was 3 million yuan per hectare. To compete with Suzhou, Wujiang city and Wuxi city of the same province offered industrial investors land at prices as low as 300,000 yuan per hectare" (Tao & al., 2009, p. xx).

The result is a distorted system of land appropriation that benefits industrial and civil developers, alleviates local governments' budgets, and leaves the burden of rapid urbanization to farmers. The compensation farmers get for having the land they work on expropriated is usually a small part of the price sold to developers, which is usually smaller than market prices. All the various case studies trying to measure this difference show important disparities, and usually compensation to villagers accounted for between 1% to 10% of the actual market price. In Zhejiang Province, for instance, compensation fee was approximately 30,000 yuan per *mu* (one-sixth of an acre), but agreements for land conversion varied from 180,000 yuan to 1 million yuan per *mu* (Zhou, 2009, p. 122)[15]. This does not mean that land developers always need to pay the market price for the converted land. As we pointed before, land conversions vary radically case by case, and because of disputes for attracting investors prices actually paid are often bellow market prices. Between 1987 and 2001, approximately 7 million acres of farmland were transferred to nonagricultural use, and some estimate as many as 60 million rural residents have lost their legal claim to their land. In the absence of a national survey, one has roughly estimated, based on local experiences, that 20% of the profits from requisitioned land are distributed to local governments budgets, 40% to land developers, 25% to village organizations and less than 10% to individual farmers (Zhang, 2009, p. 126).

[13] In 2003, local governments leased 200,000 hectares of land in the national market, of which 72% of them were transacted through negotiations, rather than public auctions (Tao & al., 2009).

[14] In the late 1990's and early 2000's, around the Pearl River Delta, local governments were reported to have offered "zero land prices" to compete for industries (Tao & al., 2009).

[15] For other case studies, see Guo, 2001, and Ding, 2005.

Wealth derived from private capital in large corporations

National levels of income inequality rose rapidly in the end of the 80's and along the 90's not only because of the obviously imbalanced strategy of fast industrialization at coastal areas but also because of policy choices that led to wages imbalances, rising informal sector and lack of rights to migrants workers in the cities, while the countryside kept its modernization process (both in physical as in social welfare structures) delayed[16]. Therefore, wealth accumulation imbalances are far from being an exclusive pattern of the current growth cycle. However, coupled with fast land transfers into private hands, the changing feature of the second half of the 90's was brought not only by the rapid indigenous non-state industrial sector growth, but by privatization of state assets, which rapidly broadened the possibility of private shareholding participation in Chinese large corporations, including the urbanizaton-related sectors of steel, aluminum, cement, petrochemicals, telecommunications, infrastructure building and automotive.

Among a number of key distinguishing factors between China and other former socialist countries in transition[17] lays the fact that during all the first decade and half of Chinese reform the country had kept the ownership structure of State-Owned Enterprises and Town-Village Enterprises untouched. However, following the path of liberalizing policies put in practice after Deng's “southern tour”, the policy of “grasping the big and relinquishing the small” inaugurated the privatization of small and medium SOEs and TVEs, and later allowed private capital to penetrate into “pillar” and “basic” large SOEs, which were transformed into corporations with diversified equity ownership - limited liability and shareholding companies (Lau, 2000). These processes opened two shortcuts for capital accumulation: one through the so called “insider privatization” (which gave managers capital control over former state assets, usually small and medium ones under the supervision of local governments) and another through private capital equity injection into “corporatized” large SOEs under central administration.

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[16] Although sometimes miss-stressed by the literature, economic reforms in post-maoist China did not always lead to huge inequalities. Actually the first six years of reform (until 1984) watched an important drop not only in poverty levels but also in national inequality levels of income distribution. This is due to not only the structural reform of the institutional background (with the dissolution of the commune system and the introduction of the Household Responsibility System) but also because of terms of trade frankly favorable to agriculture, which made the income of rural areas increase 14% in real terms from 1980 to 1985 (Oi, 1989, p. 157).

[17] For a comparison between Chinese and Russian transition, see Medeiros, 2008.

Chinese government, however, has never made privatization an official policy, and no national legislation was formulated to dictate the process[18] (besides a few government guidelines intentionally not clear). Even after introducing a shareholding system and instituting securities exchanges in Shanghai (1990) and Shenzhen (1991), the official policy remained one that opposes “privatization” and favors “securitization” and “corporatization” - these last two terms trying to be compatible with “socialism with Chinese characteristics” (Cao, 2001). In the absence of a national regulation, local authorities and former managers were granted with considerable discretionary power to decide how industrial property should be handled. The “insider privatization”, a concept originally used to describe institutional transformation in a number of transition economies in East Europe and typically characterized by a firm purchase by the former manager, finally began to be applied also by scholars dealing with China (see Li & Rozelle, 2001).

In the case of smaller Chinese SOEs, privatization “is often arbitrary and poorly regulated, involving complicity among SOE managers, private buyers and local officials” (Chen, 2006, p. 45). There is no national survey giving a summary of the privatization process, and thus we must rely on local study cases in order to infer a national picture. Li & Rozelle (2001) study case with 600 rural industries shows that 92% of the privatized firms were sold to their managers (in these cases, small and middle-size companies). Lau (2000) reports that of all 39 township-level enterprises privatized in a Jiangsu municipality, 63% of all shares were sold to management and their families[19]. In most cases, Lau also observes that buyers are given special conditions, such as waiving interest payments on existing debts or favorable financing conditions.

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[18] “Though it encourages transfers of small and medium SOEs to private hands, the Chinese government has never openly and officially called this 'privatization' (*siyouhua*) and, indeed, has remained evasive about the term. The ongoing practice of selling SOEs is often described as *minyinghua* (ownership by people), *gaizhi* (restructuring the system) or *gouyou zichan zhuanrang* (the transfer of state assets). The Party leaders have continued to maintain their verbal commitment to socialism and stressed on several occasions that the reform did not amount to privatization. For example, in 1995, Jiang Zemin, then Party secretary, stated: “We…are absolutely not going to practice privatization. This is a big principle from which we should never waver in the slightest degree.” (Chen, 2006, p. 46).

[19] One of the characteristics of insider privatization is that buyers usually pay a low price for the assets they are acquiring. Some scholars argue this is an information problem – officials are at an informational disadvantage vis-a-vis managers during the negotiation process which establishes the buyout terms for the firm – or a corruption problem – corrupted ofi cials would be more interested about the personal payments they may be able to obtain than the payment the government receives by selling the firms (Li & Rozelle, 2001).

Although practicing “insider privatization”, China's strategy differed radically from Russian or Eastern European privatization both in methods and motivations. As Cao (2001) has argued, Chinese privatization was pursued only after a vibrant non-state sector had been established, and not through a shock-therapy method, but also to make the state to exercise greater ownership and control over a vast pool of privately-held capital hidden in the non-state sector. Besides, privatization was accompanied by an effort of central government to improve its control over strategic and “pillar” industries, at the same time it opened the possibility of private capital into state-controlled shareholding enterprises.

These differences should not obscure the fact that the process opened a strong driver for Chinese wealth accumulation opportunities. In the case of these shareholding companies, investment funds and holding companies were established to allot shares to the public. The primary purpose of this “revenue privatization” of larger SOEs has been to raise capital rather than to transfer ownership rights. However, supervisory departments and state conglomerates formed the holding companies, staffing them with personnel transferred from themselves, and appointing their subsidiaries' directors. “Usually, an ex-bureaucrat (now in the guise of a holding company entrepreneur) is appointed as the managing director, sometimes to many companies concurrently” (Lau, 2000, p. 55-56). While the ultimate owner of most listed firms is the state, state-controlled legal persons are mandated to control the listed enterprise on its behalf, and they often abuse their control rights. As a result, listed firms are reported to suffer asset stripping, false disclosures and become involved in price manipulation scams. As Green summarizes, “there are a number of ways in which LP shareholders strip their companies of assets. First, they can organize related-party transactions that transfer value from the listed company to another firm under their control. A second method involves the listed company lending directly to or guaranteeing a loan to a parent or sister firm. Third, cash dividends are abused. Although dividends can be used to reward shareholders, newly listed companies – freshly injected with IPO funds – use them as a means to strip assets since LP shareholders receive funds raised at the IPO” (Green, 2004, p. 13).

Final notes

The social conflicts that have emerged from Chinese privatization were probably smaller than one would predict in face of the massive number of laid-offs (around 70 million people lost their jobs), or at least not so strong to threaten the *status quo* of the national process. In any case, although they did not amount to labour movements organized on broader class solidarity at the sectoral or societal level, some labour struggles exploded in different individual factories against schemes that workers perceived as illicit and detrimental to their interests (Chen, 2006). More numerous and with broader impact in national policies have been the "mass incidents", an euphemism the government uses to refer to manifestations and other mass movement demonstrations. They reached 74,000 in 2004 according to official figures, being held mainly in rural areas against land seizures and local governments' corruption and abuses.

Social conflicts that may emerge from a polarizing society have, so far, being kept in a manageable margin not only due to the political oppressive scenario, but also because living conditions of all major classes have been improving since reforms started. The transference of former state-asset (either land or companies) to private holders in privileging ways has, however, created a powerful wealth accumulation driver through processes that can easily be perceived as illegitimate. In face of a growth cycle pulled by real estate rapid development and high levels of investments executed also by private and shareholder enterprises, the new group of tycoon leaders has been finding numerous opportunities to build their fortunes. And now that "some got (very) rich first", China's "harmonious society" meets its brand new class of millionaires, a probably very enduring feature of its social stratification.

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