Accompanying rapid economic growth, China has experienced one of the fastest increases in income inequality ever recorded. What does this mean? Does it imply more workers were pushed into the poverty trap or all workers gained during the economic growth? The former increases the poverty while the latter may decrease poverty by increasing the average income.

Policy makers and researchers paid great attention to the rising of income inequality, some of them have portrayed schooling as the best tool to erode the supposedly globalization-related forces that increase earning inequality. Although we’re clear about the channels through which the effects of education are exerted on the inequality, we actually do not know the real effect until carefully examination are undertaken.

This study contributes to the above two goals, focusing on evaluating the effects of education on earning inequality in urban China during the country’s transition period.

The first finding is that along the wage distribution all percentiles experienced wage gains during the period, but higher percentiles experienced larger wage gains. Thus, inequality in urban China has not been a story of the rich getting richer and the poor becoming poorer, but rather the rich getting richer faster than the poor. This finding implies that the rise of earning inequality in urban China failed to push some workers into the poverty trap while the situation of all workers improved during this process. The positive effect of average income increasing overwhelmed the negative effect of rising inequality on poverty.

The second finding is that a substantial fraction of the increase in overall earnings inequality is attributable to changes in within-group inequality and the increases in within-group inequality are concentrated among workers with higher levels of formal education. Our analysis also tested the effect of education expansion on the rise in earning dispersion but find the rise of male earning dispersion between 1988 and 2003 is almost entirely accounted for by changes in prices rather than compositional shifts.

Our findings show that education expansion might not be an effective policy option to decrease inequality in areas like urban China although it remains an important solution to reduce absolute poverty. Considering that the increases in within-group inequality are concentrated among workers with higher levels of formal education, we propose to improve the quality of education to help the workers better match their skills with new technology.

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