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Impacts of the Open Door Policy and Globalization on Income Inequality in China

Between the 20th century and the early 21st Century

by

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Adviser: Charles R. Britton

An Honors Thesis in partial fulfillment of the requirements for the degree

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- **Introduction**

Before economic reform, the Chinese economy experienced a long period of recession. The creation of Open Door Policy re-introduced globalization to China, modernized the country's economy, and boosted citizens' standards of living, especially for people who live in the Special Economic Zone and Tier 1 cities. As globalization re-emerged, extreme income inequality became one of the hottest topics. Prior research leads to the hypothesis that re-introduction of globalization led by the Open Door Policy increased income inequality in China. While international inequality focuses on the unequal distribution on a global scale, domestic income inequality is defined as the how material resources are distributed across society, households, and individuals. This paper will focus on income distribution and income inequality in China across individuals and households, and the correlation between income inequality and economic growth.

In order to further test the hypothesis, this paper will first present a history of globalization in China as well as research on income inequality before the creation of the Open Door Policy. Second, research will be conducted on the impact of globalization in China post Open Door Policy using multinationals as case studies. The research results will provide evidence that the process of globalization led by the economic reform has changed the Chinese economy outlook, and caused income inequality comparing to how it was before the economic reform. Third, research will be conducted on income inequality in China, specifically in developed cities, developing cities, and underprivileged villages. Lastly additional factors will be analyzed such as social reasoning conditions with new trending emerging from the study.

- **History of Globalization and Income Inequality in China before Open Door Policy**

Interdependences of economic and cultural activities are on the rise with advancements in transportation, telecommunications infrastructure, and technology. These interchanges of perspectives, products, services, and other aspects of culture formed the process of international integration which is called globalization. The concept of globalization originated long before the Silk Road, the European age of discovery, the voyages to the New World, and the treasure voyages. Between the late 13th century and early 14th century, European countries had made their connections to Asian countries. Marco Polo was the most famous voyager to China during this period; he exchanged culture, livestock, and many other products between the two worlds during his travel (Larner, 1930). During the Han Dynasty, the Silk Road consisted of a series of trade and cultural routes through regions of Asian countries to the West. These routes linked countries with traders and merchants from China to the Mediterranean Sea. Trade on the Silk Road was influential to the development of the civilizations of China, India, Persia, and Europe. The early 15th century was the age of discovery where many European countries had global explorations, expeditions, and discoveries. Some examples include Portuguese expeditions to Africa, India, as well as Spanish discoveries of America. The age of discovery between the early 15th century and 18th century bridged the Old and the New World, produced the Columbian Exchange that transferred culture and products, and initiated the first step of globalization. Christopher Columbus' voyages in 1492, followed by the Columbian Exchange, consisted of an exchange of livestock, culture, human populations, diseases, and technology between the American and Afro-Eurasian (McNeill & Mering). These exchanges contributed to America's revolutions, economic output, and rising individual standards of living. On the other side of the globe in the early 15th century, the treasure voyages, which consisted of seven Ming dynasty maritime voyages, reached the South China Sea, Indian Ocean, and beyond. While the purposes of these voyages are still debatable, the impacts made were significant to Chinese history. Since then, other significant

voyages and expeditions have brought global mapping of the world. For many scholars, these global events bridged the Middle Ages and the Modern Era with significant impact on countries' political and socioeconomic movements. Through a rapid increase in cross-border movements of goods, services, technology, and capital, globalization increased economic interdependence of national economies across the globe. Between the late 19th century and the beginning of the 20th century, the connectedness of the world's economies and culture grew even more quickly. With the telecommunications infrastructure advancement in the late 19th century, all continents and even distant people are connected with direct communication. The above economic trading events made significant impact on globalization and countries' economic development.

Although the process of globalization was making positive impacts, China was excluded because of World War II and political reforms. World War II started in China with the Japanese invasion which caused Chinese economic development to stagnate. After the end of World War II in 1945, the Chinese government restricted contacts with outside countries and foreign companies. The economy suffered from warfare that limited resources were allocated amongst population and lowered the standards of living. During the recovery period, the Chinese government took ownership and control over industries ranging from agricultural to banking. The Chinese economy reached price stability, commerce was restored, and production was improved in the industry & agriculture sectors. The first Five-Year Plan introduced economic and country development strategy to the world, and intensively focused on industrialization and socialization in 1953. Under the influences of the first Five-Year Plan, the Chinese government controlled and maintained the stability of citizen's standards of living.

A study done by the World Bank indicated China's GDP was low but sustainable during the recovery period. However events like the Great Chinese Famine occurred during 1959 and 1961, and the Great Leap Forward between 1958 and 1960, caused economic development of China to reach another low point. The Great Chinese Famine was caused by governmental social

pressure and economic mismanagement and led to the death of nearly 36 million people (Yang, 2013). During the period between 1961 and 1965, China announced its initiative of Agricultural First, shifted its strategic focus to agricultural, and abandoned resources were capitalized during the previous recovery period. These changes led Chinese economic development to stagnation or even moved the economy backwards during this period. However the income distribution was fairly equal under these governmental influences over economic development and political reform events.

As previously discussed, trading activities and economic growth were stagnating in China due to World War II in the early 20th century. In addition to economic downturn, China also experienced many political reforms and movements such as the Tiananmen Square Protest in 1984 (Suettinger, 2003) that caused the Chinese government to change its political direction. Despite the depressing economy, the Open Door Policy created the Special Economic Zone in 1978 which profoundly changed China and re-introduced globalization to China.

- **Globalization's impact in China post the Open Door Policy**

Developed countries were becoming stronger with the process of globalization while developing countries such as China were still behind in development because of their focuses on agricultural activities. Not only was the Chinese economy insignificant during this period, but citizens' income was stable and nearly equal. In addition to the Tiananmen Square protests, Open Door Policy developed by Xiaoping Deng in December of 1978 also fundamentally changed the outlook of China. The Open Door Policy in Chinese history is referred to as the economic reform by Xiaoping Deng ("Open door policy,"). Open Door Policy opened China's door again to globalization, modernized Chinese economy, and encouraged foreign trade & foreign business investment. Special Economic Zone was specifically created under this policy for foreign businesses' investments and establishments, cities within this economic zone are later defined as Tier 1 cities. According to the Chinese government's official definition, Tier 1 cities include

Beijing, Shanghai, Guangzhou, and Shenzhen. These cities were the first ones to open up to competitive economic development by the government. Similar strategies for economic development started to other cities in waves which created second, third, and fourth Tier cities.

The very first multinational that was established in China after the Open Door Policy was Panasonic Corporation in 1978, and then Coca-Cola later that year. These multinationals in Tier 1 cities were from a variety of industries in both high-end and low-end segments, and accelerated the growth of Chinese economy. Most multinationals in developing countries falls into three categories including “export of natural resources, export of manufactured goods or serving the domestic market of the country” (Caves 2007). For example, multinationals in the retail industry leveraged low cost labor opportunities and a large consumer base to successfully establish their existences in China, especially in the Special Economic Zone. Nearly all Fortune 500 companies have established their headquarters in Tier 1 cities such as Beijing, Shanghai, Guangzhou, and Hong Kong. According to People’s Daily (Ma , 2001) “more than 470 of the top 500 global enterprises have settled in China”.

Case Study 1: Walmart China

Walmart is one of many of multinationals that established their existences in China and impacted the economic development of China. The case study on Walmart will demonstrate multinational’s movements and their impact to the Chinese economy. On May 23rd, 2012 nearly two decades after Open Door Policy, during my interview with Walmart China CEO, Greg Foran, he stated that “Wal-Mart China opened its first store and first Sam’s Club in Shenzhen August 1996. Now, Wal-Mart China is operating many varieties of stores and brands in China including shopping centers, Sam’s Club, community stores, etc.” In February 2002, Wal-Mart Global Purchase Center started to operate in China. In February 2007, Wal-Mart China purchased 35% shares of Trust-Mart. Wal-Mart China had 172 super centers, four Sam’s Club, two community stores, and two special stores located in 94 cities in China. On March 1st 2012, Wal-Mart China

had 370 stores in 140 cities in 21 provinces in China, and 4 cities that are municipality directed under the central government. Wal-Mart China also created 106,500 career opportunities all over China. Walmart, like any other multinationals in China, set up their first operation either in Shenzhen or Hong Kong. As globalization further influences the economic environment of China, multinationals expanded their operations to inner costal China. Under the impacts of globalization and multinational's expansion, Tier 1, 2, and 3 cities' standards of living significantly increased year over year. According to the Shenzhen Government's official news article ("Rong wang meets," 2010), Walmart China contributed the most to the city development of Shenzhen through setting new standards and accelerating economic development of Shenzhen this past 20 plus years. (See Figure 1 & 2 ("Chinese Statitics Breau," Chinese Statitics Breau Shenzhen)). The before and after pictures further proved multinationals that were re-introduced by Open Door Policy accelerated the growth of these Tier 1 cities as well as the rise of Chinese economy.

Figure 1 Shenzhen before the Open Door Policy



Figure 2 Shenzhen post the Open Door Policy



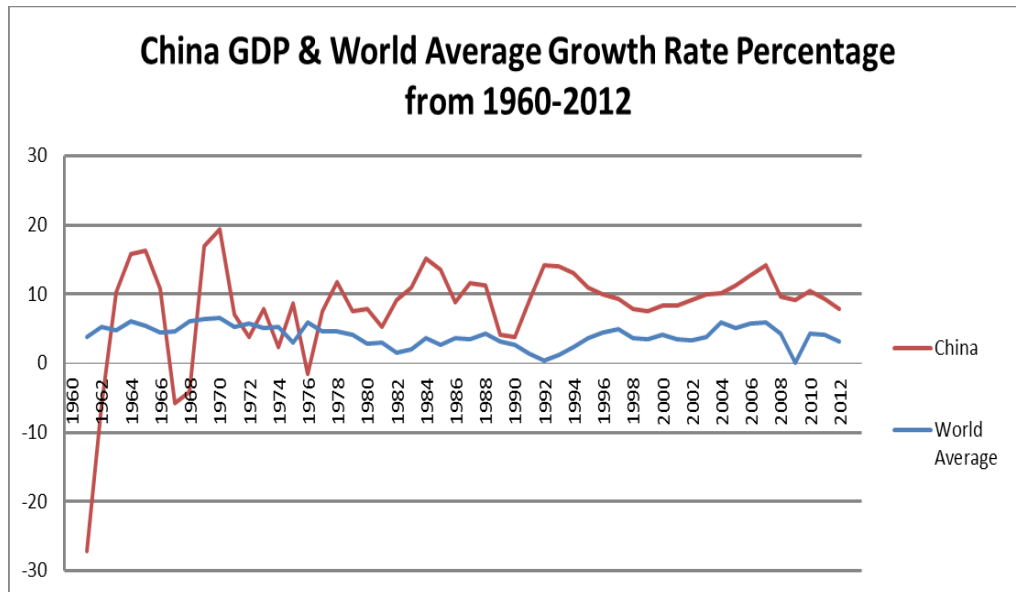
Case Study 2: Li & Fung

Another great example is an international supply chain company called Li & Fung Ltd, which sources, contacts, and owns manufactures across China. It is the largest supplier to foreign multinationals including apparel companies, retailers, manufactures, and luxury companies. On May 25th 2011 during my interview with Li & Fung SVP, Sean Loomam, he stated that “Li & Fung started as a small company back in 1906. After World War II, Li & Fung faced the same challenge as many other foreign multinationals. They had re-strategized themselves to be the exporter of manufactured Hong Kong goods, and now Li & Fung has become one of the largest leading global sourcing companies in the world.” Li & Fung currently is headquartered in Hong Kong with offices, distribution centers, and a network of third party suppliers in forty plus countries. In 1997, Hong Kong was returned to Mainland China and played a critical role in the business of the special economic zone. With globalization’s impact, China became one of the hubs for major global productions. Sean Loomam also stated that “Li & Fung also does an extensive research and coordination with the Chinese government on global trading, and Li & Fung has a center called Li & Fung Research Centre with a mission to create thought leadership

in China trading and distribution and modern management philosophies”. The rise of Li & Fung indicated the impact of globalization to China and Chinese economic development’s impact to Chinese population’s standard of living.

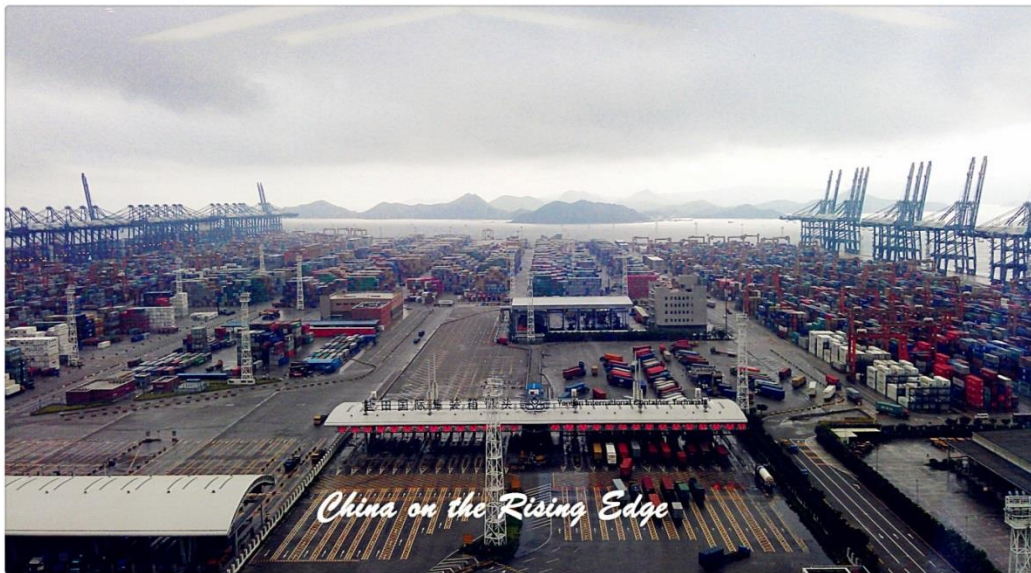
As previously research results have shown, these robust foreign investments and foreign companies help changed the outlook of cities and expedited Chinese economy. Under globalization, China’s GDP rose from 3,645 billion in 1978 to 397,983 billion in 2010 while GDP per capita rose from 381 RMB per person to 16,084 RMB. According to the World Bank, China’s GDP annual growth in 1978 was 15.1%, which outran other countries and the world average of 4.63% GDP growth rate in 1978. (Shown in figure 3)

Figure 3



Another great example of globalization's impact in China and rising Chinese production is the large volume of trading activities and output at Yantian International Container Terminals, one of the largest deep-water container terminals across the globe (see figure 4). During my interview with managers at Yantian International Container Terminals on May 26th 2013, managers revealed that Yantian International Container Terminals is getting busier year over year following the positive economic reforms in China and active trading across borders and between enterprises.

Figure 4

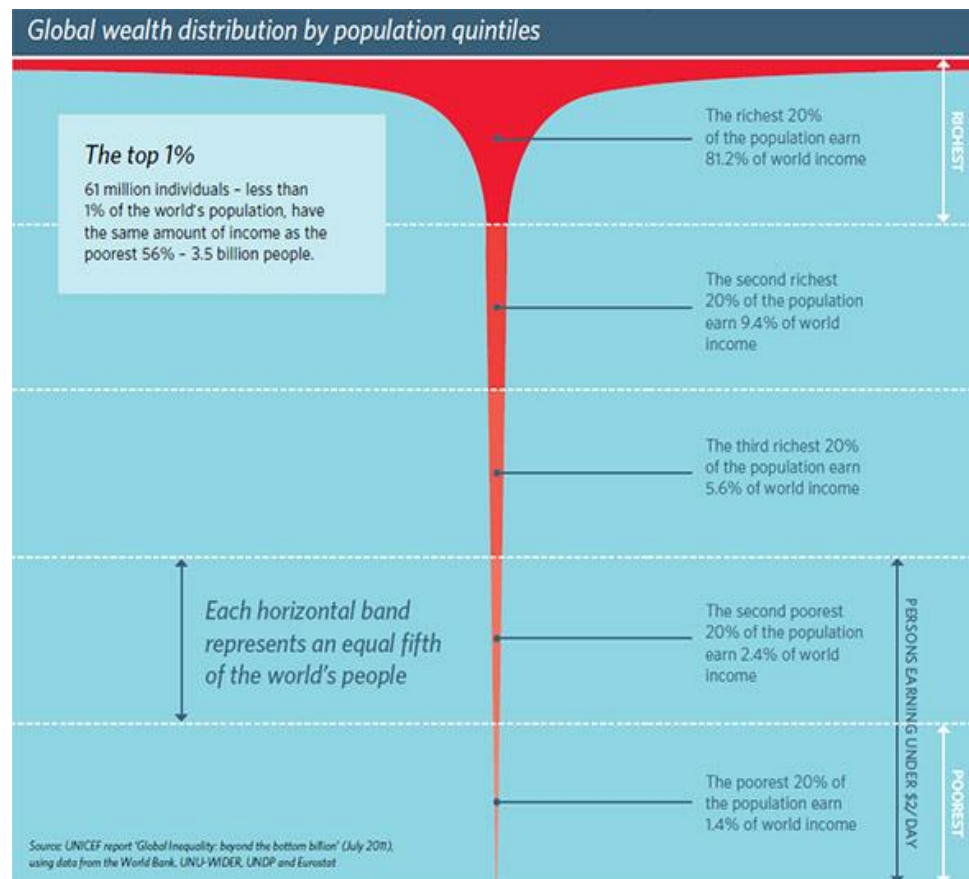


In 1978, China was only ranked thirty-second in the world in terms of export volume, and then in 1989 China was the thirteenth largest exporter (Shang, 1993). The growth of export and import activities are growing year over year, and China was the second in merchandise trading by 2011, based on WTO's data. Unfortunately along the positive economic outputs, the influences of globalization, and implications of multinationals, income inequality is on the rise at the same time.

- **Overview of income inequality in China post the Open Door Policy**

From an international perspective, income equality is defined by many well-known and authorized organizations as the considerable economic differences between rich and poor countries. It is described as the wealth distribution internationally that the bottom half of the world adult population owned barely 1% of global wealth. International income inequality is still an important topic in many international discussions. [See image below based on a study done by United Nation (Smarasinghe, 2012).]

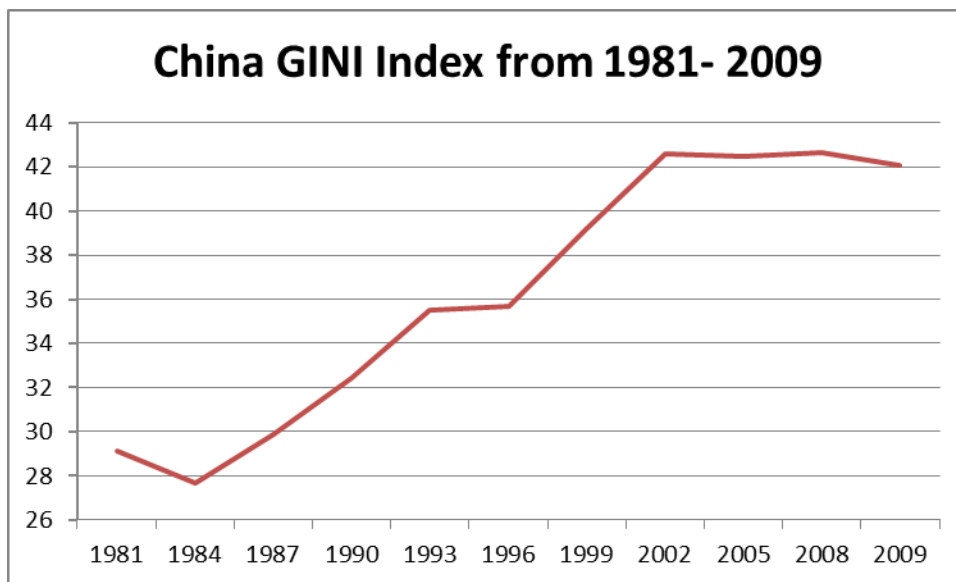
Figure 5



In addition to international income inequality, domestic income inequality in China is also an important topic among many discussions. As preceding research results have shown, income inequality was nearly non-existent before the Open Door Policy. This was due to governmental influences and centralized economic developments. However, things have changed

after the creation of Open Door Policy and re-introduction of globalization. It is an undeniable fact that over time, income disparity or income inequality will become more of a crucial topic and problem to solve. Income inequality as a topic drew political and social attention in many international discussions. Despite Krongkaew's study which showed that income inequality experienced a decrease in the 1980s, another study done by the World Bank showed China's GINI Index is increasing drastically from 29.1 in 1981 to 42.6 in 2009, after the creation of the Open Door Policy in 1978. (Figure 6)

Figure 6



The unequal distribution of wealth and standards of living disparity are even more significant in China. As previous economic data has shown, Chinese economic development had improved drastically and brought standards of living up for many citizens under globalization's influences. Many assumptions have been made containing income inequality in emerging markets because of problems in infrastructure, politics, and cultural differences. It is common to see major cities in emerging markets reaching to a mature stage of development, while places in rural areas are being left behind the growing curve. Even just a few miles outside of those developed cities,

effects of urban poverty are devastating. Based upon these examples, income inequality is an even more serious problem in emerging markets such as China. To measure income distribution, economists use a measure defined to as a GINI coefficient. The GINI coefficient is a measure of statistical expression to represent the income distribution of a country's residents, and it was developed by the Italian statistician and sociologist Corrado Gini. With a GINI index, 0 represents perfect equality while 1 means total inequality. The unequal distribution of growth among the population is one of the factors. According to the United Nation, approximately 150 million people in China are living below the UN defined poverty line of 1 U.S. dollar a day and a GINI coefficient of 0.447.

- **Income Inequality in China across Developed Cities and Developing Cities post the Open Door Policy**

Income Inequality in Developed Cities:

Income and wealth in developed cities are not equally distributed shown by the fact that only a few percentages of the urban Chinese population hold a large portion of the resources and material. As previously data shown, the hyper growth of Special Economic Zone and Tier 1 cities caused by globalization further increased income inequality. The GINI index for rural areas is nearly 0.39 (Rapoza, 2013). This means despite the fact that Tier 1 cities are developing under globalization's influences and multinational establishments, other cities that are not developing are experiencing less opportunities for economic growth. GINI coefficients for other regions such as the central and western part of the country were much lower (Gan, 2013). See figure 7 below

Figure 7

Table 1: China's Gini Coefficients (2010) by Residence and by Regions¹

Overall	Urban	Rural
0.61	0.58	0.61
Eastern	Central	Western
0.60	0.56	0.54

One of the emerging trends of income inequality in developed cities is urban poverty. Urban poverty or urban poor is defined as the percentage of the urban population that are living with many challenges and deprivations including “limited access to employment opportunities...inadequate and insecure housing and services”. Statistics also revealed that regions where developed cities are located have higher poverty rate than other parts of the country (Hussain, 2013). North-West, North-East, North, and South-West regions where most of the Tier 1, 2 cities are located have the highest urban poverty rate, while East region that is less developed have the smallest poverty rate. (See figure 9 below)

Figure 8

Regional pattern of urban poverty

Regions	Poverty rate (%)	% of the National headcount of the poor
North	5.22	14.70
North-East	6.75	21.37
East	2.97	18.19
South-East	4.26	22.72
South-West	4.52	10.12
North-West	8.80	12.89
National	4.73	-

Income Inequality in Developing Cities:

Tier 4 cities and other developing cities are also on the poverty line. Standards of living for people who live in developing cities are much lower than those who live in developed cities. While developed cities that are heavily influenced by globalization accompanied by multinationals' robust acceleration, developing cities are experiencing limited economic opportunities. These developing cities tend to be more controlled by the government with centralized political power. In addition to centralization, many business enterprises are state-owned enterprises. Therefore, globalization influences were limited to the government's control which led to fewer opportunities for multinationals' resources and capital investments expansion. On June 2012, I went on a research trip to the underprivileged rural area in a province called Hunan. The capital of Hunan is Changsha which is defined by the government as a Tier 2 city. A majority of the cities in Hunan provinces are Tier 4 and 5 cities, including the rural area where I volunteered. I spent nearly a month at a village called Qiantan living with local families, teaching children, and researching the economic developments of China. In order to get to Qiantan, I had a 12-hour train ride from my base city called Wuhan to a city called Huaihua, followed by a 2-hour bus from Huaihua to the largest city nearby the village called Fenghuang, an hour minivan ride to the nearest town called Shanjiang, then finally a walk of 40 minutes to Qiantan village.

Key implication on income inequality from this research trip was how globalization in developed cities has accelerated the decline of these underprivileged cities. Children who want to get an elementary school education have to walk to Shanjiang town. Qiantan village only has a Pre-K school that combines students from age 2 to 5, and there are only two staff members for the entire class of 20 students with one of them being the teacher, principal, and administrator. People in the village stated that these children's parents had migrated to look for jobs in developed cities; leaving only the elderly and small infants behind in the village. Therefore the village can only rely on agricultural activities and limited social security for financial support. Income for these

families is relatively low because working adults' jobs in developed cities are normally not well paid. Therefore, developments of these villages are at extreme disadvantage with lack of globalization influences and opportunities for further economic development. Despite the distance between the village and the capital of this province, Changsha, being only 470 kilometers, standards of living for population at this village is much lower and at the poverty line. See figure 9 below (picture of teaching environment).

Figure 9



As previously discussed global sourcing companies and manufactures benefited most from low cost labor. Multinationals targeting China as a low cost labor resource markets have been expanding to villages in Southern China to set up manufactures and plants and attracting more and more manufacturing workers year over year. Statistics on early 21st century Table 1 showed manufacturing plants increases year over year.

Table 1

Manufacturing Employment			
	Total	Urban	Rural (TVE)
2002	85.9	30.3	55.6
2003	86.4	29.8	56.5
2004	88.6	30.2	58.4
2005	92.0	31.3	60.7
2006	94.9	32.8	62.1
2007	96.9	34.1	62.8
2008	98.5	34.5	64.0
2009	99.0	34.6	64.4

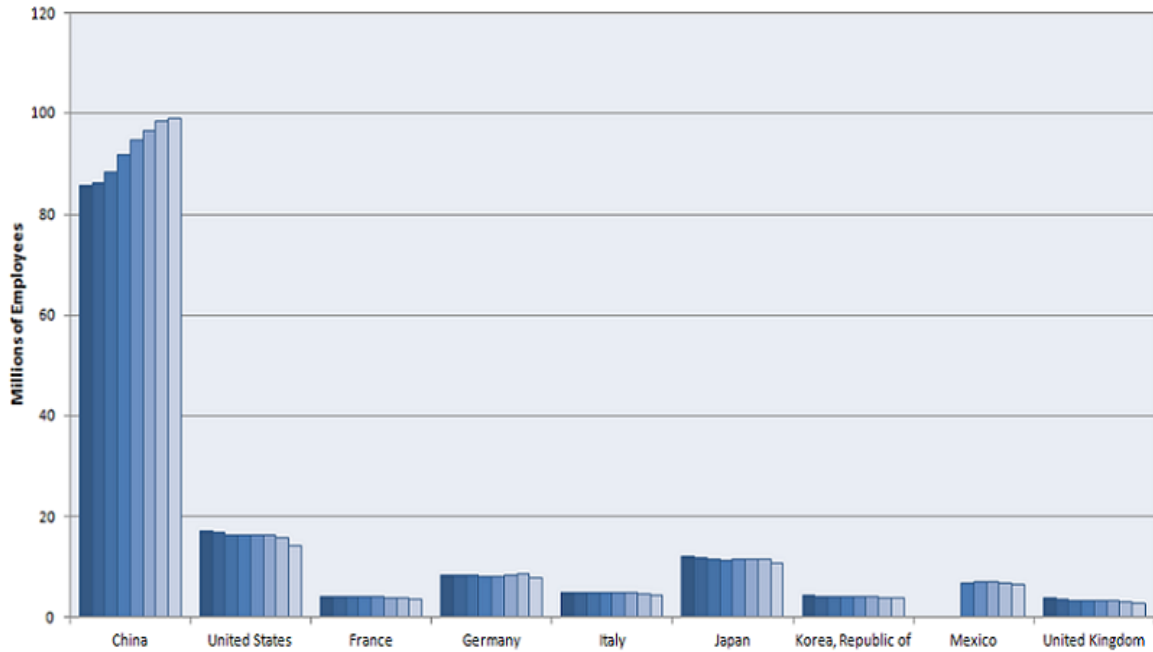
Note: TVE refers to town and village enterprises.

Source: U.S. Bureau of Labor Statistics, International Labor Comparisons.

Under the impact of globalization and multinationals, especially by early 21st century, manufacturing workers in China had exceeded many other countries (see table 2 below).

Table 2

**Employees in the manufacturing sector,
selected economies, 2002-2009**



Source: U.S. Bureau of Labor Statistics, International Labor Comparisons.

With multinationals’ demand for low cost labor, people in Tier 4 and 5 cities view this demand as opportunities for them to succeed in developed cities. Therefore job opportunities that exist in special economic zones and developed cities caused adults with working abilities to leave their developing cities. The combination of this factor along with limited economic development opportunities, caused Tier 4 and 5 cities’ income to be much lower than developed cities.

According to the World Bank, the GINI coefficient in 2012 for China is nearly approaching 0.5 with the urban and rural income ratio increases year over year. The developed cities are experiencing faster and higher growth than rural cities, see figure 11 below for details (Sicular, 2013)

Figure 10



In summary, research on income inequality in developed cities, developing cities, and even underprivileged rural areas reveals income inequality increased drastically post Open Door Policy. Individual household income distribution was controlled by the government before Open Door Policy, while people lived in Special Economic Zone had the opportunity to become rich after Open Door Policy. Open Door Policy re-introduced globalization to certain cities in China, while the rest of the country was excluded from the development. Urban poverty and extreme urban rural income ratio showed that Open Door Policy and globalization caused the variations of income distribution, as well as income inequality in China.

- **Analysis on other factors**

Under globalization's impact and influences, income inequality experienced a significant increase since the economic reform and open door policy in 1978. However other factor such as the population may also impact income inequality in China. Since 1978, population in China grew from 956.2 million to 1.351 billion. Income inequality in economics is referred to as GDP and resources distributed amongst population. When comparing large population to limited economic growth and opportunities, China had a nearly 41% population growth with limited

variety of job opportunities available across the country. While there may be many minimum paid wages job available in China, other types of jobs are very limited. According to the World Bank, “Official data shows that about 98.99 million people still lived below the national poverty line of RMB 2,300 per year at the end of 2012.” Even for college graduates, a larger portion of them cannot find a well-paid job upon graduation “A record seven million students will graduate from universities and colleges across China in the coming weeks, but their job prospects appear bleak—the latest sign of a troubled Chinese economy.” (BRADSHER) It is becoming more common that college graduates are not even getting paid as high as factory or manufacturing workers. Even under the one-child policy, population is still growing at a rapid rate with limited future growth opportunities in China which is another contributor of income inequality.

- **Conclusion**

In conclusion, based on the research of the Chinese economy before Open Door Policy, and research of Chinese economy post Open Door Policy using multinational case studies and enterprise visits, as well as research conducted on income inequality in developed and developing cities, we can conclude that re-introduction of globalization led by Open Door Policy significantly influenced income inequality in China.

Before World War II and Open Door Policy, many trading events that occurred in Chinese history accelerated the impact of globalization and rose Chinese economy. However after World War II, economic development and standards of living in China were low which led to a low income inequality. Although World War II weakened the Chinese economy and diminished globalization’s impact on China, the economic reform in 1978 accelerated the growth of China again. Economic reform attracted multinational’s investments to China and re-introduced globalization which caused the rise of China’s GDP. Many other multinationals like Walmart accelerated the growth of Tier 1 cities by creating new jobs, investing capital, and increasing income opportunities, while Li & Fung a global sourcing company focused on sourcing

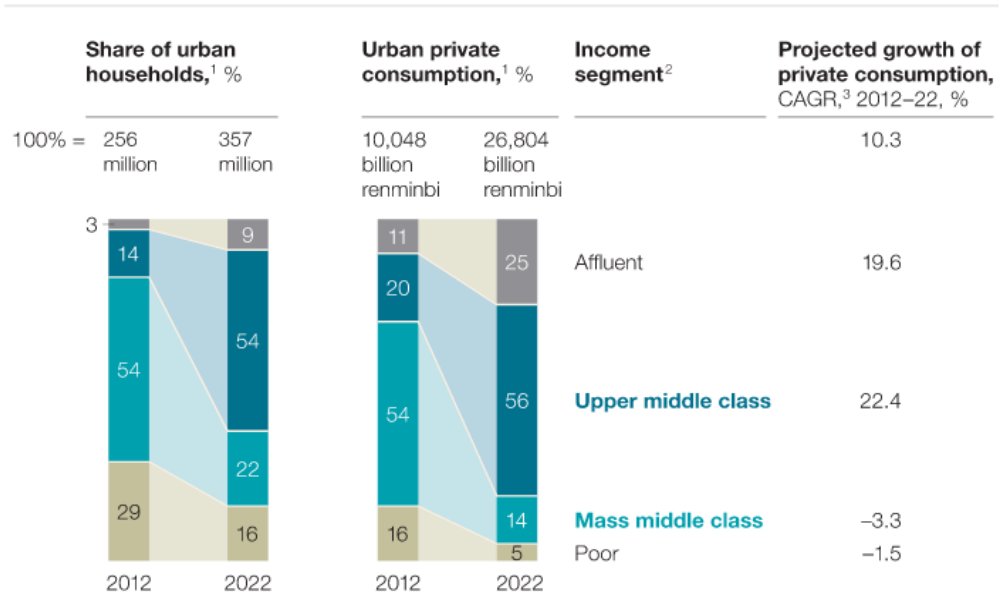
manufacturing labors by providing low paid factory jobs. Multinationals made significant economical contribution to the growth of Chinese economy.

The implication of globalization is that developed cities are experiencing hyper growth but developing cities are left behind. While developed cities are growing, urban poverty and low growth in developing cities show evidences and proof of income inequality. Based on the research trip done in the underprivileged area in Hunan, evidences showed globalization's limited impact towards these developing cities. With the village only being 470 kilometers away from the capital of Hunan, people are living on the poverty line and less than \$1 dollar a day. In the end due to limited economic opportunities, working adults left developing cities to seek better job in developed cities. This trend caused developing cities only have low income return relying agricultural activities as main sources of income.

Extreme income inequality of Chinese economy indicated controls and policies need to be in place to build a sustainable economy growth in China. China can no longer rely on macroeconomic output to increase standards of living for developing cities and the poorer groups. In recent years, labor wages are rising in China and the growth rate of economy output is decreasing in China. With China's new leaders Jingping Xi and Keqiang Li and the launch of the new five year -plan, Chinese government's focuses now are on reducing the income gaps of urban and urban, as well as urban and rural. A good example is the rising middle class in China such that the "Middle-class growth will be stronger in smaller, inland cities than in the urban strongholds of the eastern seaboard." See figure 11 below (Barton & Jin)

Figure 11

The magnitude of China's middle-class growth is transforming the nation.



¹Figures may not sum to 100%, because of rounding; data for 2022 are projected.

²Defined by annual disposable income per urban household, in 2010 real terms; affluent, >229,000 renminbi (equivalent to >\$34,000); upper middle class, 106,000 to 229,000 renminbi (equivalent to \$16,000 to \$34,000); mass middle class, 60,000 to 106,000 renminbi (equivalent to \$9,000 to \$16,000); poor, <60,000 renminbi (equivalent to <\$9,000).

³Compound annual growth rate.

And it further suggested “that within the burgeoning middle class, the upper middle class is poised to become the principal engine of consumer spending over the next decade.” Luxury retailers such as LVMH are already targeting at these groups of consumer and their overseas sales are largely based on these emerging middle class consumers based on a study done by KMPG retail group “Brands like Louis Vuitton or Gucci do have about 30 percent of their sales made by Chinese consumers. Regarding China's native consumers, and based on available data, luxury purchases overseas should be around 55 to 60 percent of the total” (LING,2013). Further research on China’s future is suggested as labor wages increase year over year

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