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**CHINA'S REGIONAL DISPARITY
AND ITS POLICY RESPONSES**

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Summary

Since the reform and open-door policy of the late 1970s, China has achieved magnificent economic growth. The fruits of this growth, however, have not been distributed fairly across China's regions. In the early stages of the reform, the Chinese government gave preferential policy treatment to coastal regions and greatly promoted their development. China's regional inequalities are to a great extent due to regional development policies by the government.

In order to control rising regional inequality, China has shifted its focus from the coast onto the interior regions. The central government put the "western development strategy" into practice in 1998, with the "north-east revival strategy" following in 2003. Most recently, the "rise of central China" strategy has been implemented.

China's early reforms were focused mainly on the development of the coastal areas, with the aim of attracting investments from abroad. China's foreign direct investment (FDI) inflows have contributed enormously to economic growth in general and to export industry in particular. However, FDI has been highly concentrated in the eastern coastal areas and this has caused unequal development among regions.

The Deng Xiaoping leadership expected that by supporting the growth centres in the eastern regions first, these centres would ultimately lead the rest of the economy to expand. However, the spill-over effect from growth centres in the coastal provinces to inland areas has not happened as expected.

The central government has made enormous efforts to control regional disparities. In 1998, the Zhu Rongji government launched the western development programme. The programme was expected to boost domestic demands by promoting economic development in the western part of the country. At the beginning of this century, the government started to revive the economy in some old key industrial bases, especially the north-east region, in order to ease growing social conflict caused by laid-off workers. Furthermore, under Wen Jiabao, the central government initiated the "rise of central China" programme to balance regional economic development. It is hoped that all these regional development policies will also support the development of minority peoples, especially in remote areas.

The interior regions of China have benefited substantially from these regional development programmes. Inland China also gains from shifting comparative advantages, as the land and labour prices in the east have risen significantly. Interior China is a potentially huge market for foreign and domestic investors.

However, in spite of this great endeavour, it is becoming increasingly difficult for the government to control and direct the economy, as market economy mechanisms now have a far greater influence than the government. Central government's policies and various administrative methods cannot easily reach the bottom level of the economy. Unsurprisingly, compared with Deng's opening up policies, the later development policies initiated by both Zhu and Wen are becoming less and less effective in terms of their implementation.

Regional inequality in China continues to be serious. The lessons learned by the eastern economic centres should be taken into account during the development of the non-coastal provinces as well as all the non-growth-centre areas within the eastern provinces.

Whether or not China's trickle-down approach to development and the consequent increase in regional inequality will eventually lead to a higher *per capita* income for all regions depends on whether or not the Chinese government's regional development policies can enhance efficiency of production and increase the rate of returns on investment. Overall, if China ultimately could employ equitable policies all over the country, the process of growth in China would generate income convergence and more regional equality.

The people-centred approach of the current Hu-Wen leadership has paid increasingly substantial attention to regional development disparities in its attempt to build a "harmonious society" in China. Nevertheless, China needs further extensive reforms if all these measures for reducing regional disparity are to be effective.

China's Regional Disparity and Its Policy Responses

Yongnian Zheng and Minjia Chen*

Introduction

- 1.1 Since the reform and open-door policy of the late 1970s, China has achieved magnificent economic growth, with its real gross domestic product (GDP) growing at an astounding 9.6% per year during 1978-2006. Real *per capita* GDP rose nine-fold and real *per capita* income more than six-fold over the same period. The fruits of growth, however, have not been distributed fairly across China's different regions. Regional disparities are closely associated with the development policies of the Chinese government, which gave preferential treatment to certain regions in the early stages of the reform. Preferential policies have had a direct effect on growth by creating an environment that is more responsive to market concerns and by encouraging international trade and profit-driven foreign direct investment (FDI) that itself has been a crucial factor leading to higher growth rates.
- 1.2 Given China's size and geography, the regions have played an important role in promoting the country's economic development. In fact, most of China's regional development policies are based on three zones: east, central and west.¹ A regional dimension has been a crucial component of China's development policies. The open door policy and coastal development strategy of the 1980s and 1990s strongly favoured the coastal areas and have increased inter-regional inequality significantly.
- 1.3 Regional inequality is a multidimensional phenomenon in China. Income disparity in terms of *per capita* GDP between China's coastal and interior provinces has been on the rise since the early 1980s when China's urban and industrial reform started, and has accelerated since the early 1990s when larger scale and more intensive reforms began to take place after Deng Xiaoping's southern China tour in 1992. As in many other countries, the growing inequalities among regions as well as social groups resulting from the deepening process of globalisation are increasingly becoming a serious source of social conflict in China, especially when effective state policies are not in place. How to control and reduce regional disparities has been one of the top agendas for the Chinese leadership for many years.

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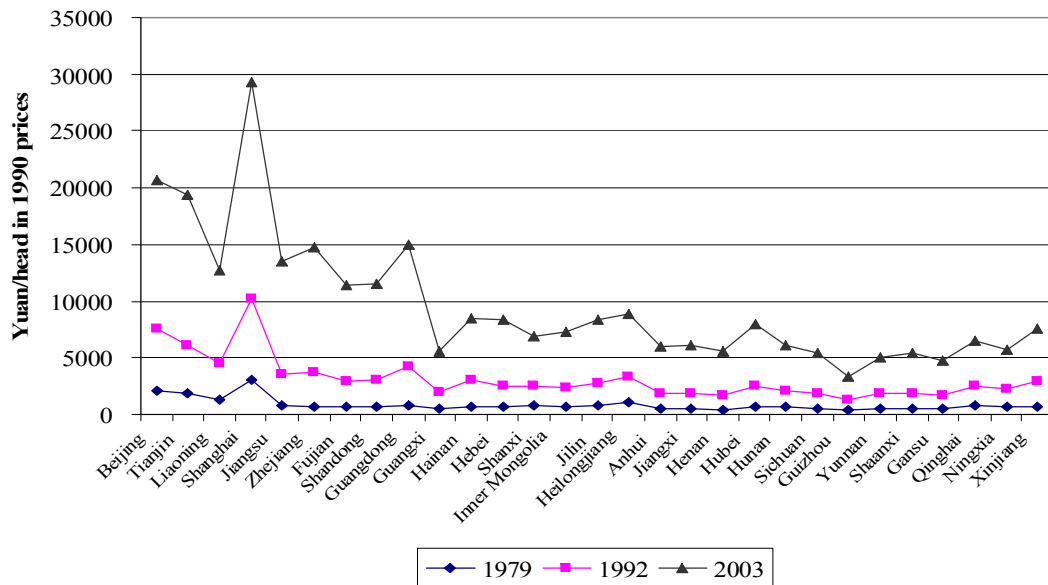
¹ There are a few definitions of the three zones, which are changing over time. Academic and official definitions are also sometimes inconsistent. Generally, the eastern region includes the following 11 provinces and municipalities: Beijing, Fujian, Guangdong, Hainan, Hebei, Jiangsu, Liaoning, Shandong, Shanghai, Tianjin, and Zhejiang. The central region includes the following 8 provinces: Anhui, Heilongjiang, Henan, Hubei, Hunan, Jiangxi, Jilin and Shanxi. The western region includes the following 12 provinces and municipalities: Chongqing, Gansu, Guangxi, Guizhou, Inner Mongolia, Ningxia, Qinghai, Shaanxi, Sichuan, Tibet, Xinjiang, and Yunnan. Since the implementation of the development strategy of "Revitalising the North-east" in the early 2000s, four regions are occasionally referred to: east, central, west and north-east, which includes the three provinces of Heilongjiang, Jilin and Liaoning.

- 1.4 To achieve this goal, China has shifted its regional development focus from the eastern coast to the interior and the north-eastern regions. In the late 1990s, the central government put into practice the "western development strategy". In 2003, it began to implement the "north-east revival strategy". In recent years, it has enacted the "the rise of central China" programme. Through all these government-sponsored development programmes, a huge sum of state funds has been invested in infrastructure, energy, environment and resources projects in those areas.
- 1.5 Indicating the political significance of regional disparities, China's National People's Congress (NPC) listed regional inequality as one of the most pressing problems to be targeted during the Ninth Five-Year Plan (1996-2000). At present, narrowing the regional development gap between the east and the west, and the south and the north, is a top priority of the central government, as highlighted in the current Eleventh Five-Year Plan (2006-2010). In doing so, the Chinese leadership hopes that a "harmonious society" can be built.

China's Regional Disparity and Its Sources

- 2.1 China's rapid growth is associated with high income disparities. The unevenness of regional development in such an enormous country is evident. Historically, the coastal areas of China have always been ahead of the interior in terms of development and modernisation, even before the People's Republic was established in 1949. In the pre-reform period (from 1949 to the late 1970s), the Chinese government led by Mao Zedong added substantial industrial support to the inland provinces. However, the rigid central planning system seriously distorted the market mechanism, misallocated resources, and made the economy very inefficient. The Mao era made very few advances in reducing inequality in regional development.
- 2.2 The unequal pattern of development has been an even more troublesome issue for China since it embarked on its bold programme of reforms and opened itself up to the outside world in the late 1970s. In its adoption of new development strategies, the Chinese government under Deng Xiaoping put much emphasis on the role of market mechanisms in resource allocation and production efficiency, and on decentralisation in economic decision-making. This strategy was in direct opposition to Maoist egalitarianism and was designed to "let some people and some regions get rich first". With radical decentralisation, this strategy rapidly resulted in great regional disparities.
- 2.3 Figure 1 shows the changes in the real *per capita* GDP of China's provinces. The real *per capita* GDP of all the provinces increased significantly during 1979 to 2003. At the beginning of the reform period, the real *per capita* GDPs of most of the provinces were similar, and only a few eastern provinces had slightly higher real *per capita* GDP than others. By 1992 the differences among provinces had grown. In 2003, China's regional income distribution was clearly unequal in terms of real *per capita* GDP. The real *per capita* GDP of the richest region, Shanghai, was about ten times that of the poorest region, Guizhou.

Figure 1: Regional Inequality in Real *per capita* GDP: 1979, 1992 and 2003



* Data source: National Bureau of Statistics

2.4 The early period of China's reform focused mainly on the development of the coastal areas, which traditionally had a relatively well-developed infrastructure and a strong economic base. Since the coastal areas assured a much higher rate of return on investments compared with the rest of China, and was supplied with a great deal of low-cost labour from the interior provinces, the Chinese central government established five special economic zones², along with fourteen open cities in 1984, Shanghai Pudong District in 1990 and seven regions along the coasts such as the Yangtze Delta and the Pearl River Delta with the aim of attracting investments from foreign sources.

2.5 Indeed, China's FDI inflow increased dramatically thanks to the development policies. China is currently either the world's first or second largest FDI host country. FDI contributes enormously to economic growth in general and to export industry in particular. Between the late 1970s and the end of 2006, China utilised over \$704 billion worth of FDI from over 200 countries and territories.³ However, FDI destinations in China are highly concentrated in the eastern coastal areas and large cities. These large investments promote regional economic development and generate a great number of employment opportunities. This further attracts migrants, in the form of both low skilled labourers and highly skilled talents, from the less developed interior regions to the prosperous coastal areas, and again adds to unbalanced development among the regions.

2.6 These development policies promoted rapid and continual growth in the coastal areas, but had little impact on the inland provinces. The gap between the coastal and interior areas continued to widen, which also brought many economic, social and political repercussions. In the 1970s

² Shenzhen, Zhuhai, Shantou and Xiamen four cities was set up as special economic zones in 1980 and Hainan province in 1988.

³ Data source: *China Statistical Yearbook*, various issues, National Bureau of Statistics, and Ministry of Commerce.

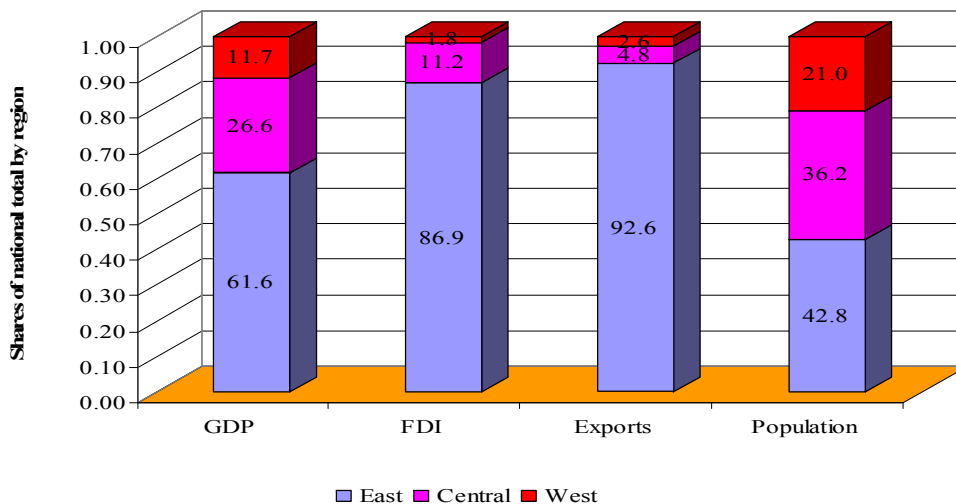
and 1980s, as a vast developing country where technology and capital were scarce, China did not have much choice and its initial economic growth had to depend on the development of some growth centres. By design, the Chinese government adopted a trickle-down growth strategy to develop a few regional centres, beginning with those that possessed initial advantages such as location, infrastructure, human and natural resources. According to this plan, disparity of growth would inevitably occur.

2.7 The government under Deng hoped that by supporting the growth centres in the eastern regions first, these centres would ultimately lead the rest of the economy to expand. While Deng and his policy makers were unclear about the steps that the state would take to shift its regional emphasis from the coast to the inland, they had guidelines and distinct policies for gradually opening up. However, the spill-over effects from the growth centres to inland areas diminish as distance increases. The strategy of “fanning out from point to area” (*yidian daimian*) has not had the expected results.

2.8 In light of widening regional inequality, the annual sessions of the National People’s Congress have repeatedly debated numerous issues pertaining to it since the late 1980s. The central government has faced similarly increasing pressure from the inland provinces. Nevertheless, the central government’s efforts to open up in all directions and favour the development of interior regions were in vain throughout most of the 1990s. China’s development has led its provinces to diverge into three geo-economic clubs corresponding to three regions, i.e. east, central and west. The rich areas become richer and the poor poorer. There is strong evidence that unbalanced regional growth has been aggravated by the uneven geographic distribution of exports and FDI, two powerful drivers of China’s economic growth.

2.9 Figure 2 shows the shares of GDP, FDI and exports among eastern, central and western regions in 2006. Taking the population of each region into account, the east had disproportionately large shares of GDP, FDI and exports. The western region in particular had negligible percentages of FDI and exports, 1.8% and 2.6% respectively.

Figure 2: Regional Inequality in GDP, FDI, and Exports in China in 2006



* Data source: National Bureau of Statistics

China's Regional Development Programmes

- 3.1 The catalyst that stimulated the Chinese government's decision to shift its development focus to the inland was actually the Asian Financial Crisis of 1997. Although the crisis did not hit China as hard as it did most of its Asian neighbours, Chinese leaders realised that China's development should not rely on a fragile one-dimension economy, and China's economy needed greatly diversifying. Also after the crisis demand from the international market, especially the Asian market, was extremely weak and the Chinese RMB was under extraordinarily high pressure of depreciation. In order to find alternative sources of growth and keep a strong currency, the Chinese government led by Premier Zhu Rongji decided to use government investment to motivate domestic demand. In 1998, the Zhu Rongji government began to promote the strategy of "the great development of the western areas" (*xibu da kaifa*). This development programme in some ways represents the first real step by the Chinese government towards developing the country's immense interior. This strategy has also helped to subdue the significant social and economic discontent resulting from the disparities in the development of China's regions.
- 3.2 Data shows that despite the efforts of the central government, regional disparity continued to widen during the period from the late 1990s to the early 2000s. From 1997 to 2000 the ratio of *per capita* GDP of the central region to that of the eastern region dropped slightly, from 54.1% to 52.6%, and the ratio of the *per capita* GDP of the western region to that of the east decreased from 43.1% to 40.6%. However, during 1995 to 2001 the percentage of export by the coastal area in total export increased from 88.1% to 91.6% and the percentage of the utilised FDI by the eastern region in total FDI inflow rose from 85.5% to 86.9%.⁴
- 3.3 The economy of the inland provinces of China was dominated by the state-owned enterprises (SOEs) before the reform era. Today the state sector still has a much stronger presence in the interior areas than in the coastal areas. The radical SOE reforms initiated by the Zhu Rongji government resulted in a massive number of laid-off workers, the majority of whom were in those interior provinces. Therefore, it worsened the disparity between the coast and the inland as well as causing much social unease. In recent years, protests by laid-off workers have become a grave social issue in China. Many of these incidences happen in the north-east, which was an important base for heavy industry in China.
- 3.4 In 2002 when Wen Jiabao became the Premier-select, the central government set up a programme to revive the economy of the north-east (*zhenxing dongbei*). Since then, the north-east provinces of Heilongjiang, Jilin and Liaoning have tried to speed up their efforts to reform the SOEs in a bid to revitalise their major but backward industrial bases.
- 3.5 These main regional development programmes covered coastal, western and north-eastern areas and invited discontent from central China. To bring central China into national regional programmes, Premier Wen Jiabao declared in his government work report in March 2004 that

⁴ *People's Daily*, 28/12/2005, "Getting Rid of Uneven Regional Development, a Long Way to Go...", <http://theory.people.com.cn/GB/49154/49156/3981571.html>, accessed on 26 August 2007.

besides continuing to accelerate the growth of the east and continuing to support the development of the west and the north-east, the central government would speed up the development of central areas to attain well-balanced regional development.⁵

- 3.6 One of the main reasons that the Chinese central government has launched these regional development programmes is to ease the dissatisfaction of minority peoples and relieve development disparities among ethnic groups. China is a diverse country in terms of ethnicity. About 86% of ethnic minority people live in the western region and most of the rest are in the north-east and central areas. The places where minority peoples are concentrated are also, in most cases, in the least developed areas. Compared to the coastal provinces, the economy in these areas is extremely weak. For example, as early as 1995, the industrial output of Jiangsu province took up 10.4% of the overall output of China, which was more than the sum of other eight provinces and autonomous regions, including Gansu, Guangxi, Guizhou, Inner Mongolia, Ningxia, Qinghai, Tibet, and Yunnan. This excessive disparity will likely cause conflict between the majority and minority groups and could further harm the creation of a "harmonious society". All these development programmes to a large extent are to support the development of the minority regions and improve the living standards of minority groups.
- 3.7 However, in spite of its great endeavour, it is becoming more and more difficult for the central government to control and direct the economy, as the market economy mechanism has become stronger and stronger in China. In the planned economy era, the central government had the ability to collect and distribute almost all the resources and could easily control the economy. For example, during the first Five-Year Plan period in the 1950s, China was able to utilise all the possible resources to build a complete infrastructure of heavy industry in a very short time.
- 3.8 As the economy becomes gradually liberalised, the central government also increasingly loses its absolute control. In the early 1980s, Deng's "special economic zone" policy was extremely effective. It quickly achieved the objectives of improving productivity and people's living standards. The coastal areas were rapidly modernised and created a haven for development. However, various negative consequences of liberalisation had also appeared, such as regional inequality, income disparity, a backward social welfare system, and unemployment. The severity of these problems was beyond the expectations of the government.
- 3.9 Today, the market economy has been firmly established in China. Central government's policies, or even administrative methods, cannot straightforwardly reach the bottom level of the economy. Although the government has tried to create a favourable environment to induce foreign and domestic investments to flow into the interior regions and certain sectors, still it cannot control firms' investment decisions. Even worse, it looks like China is likely to experience economic overheating, which is largely due to investment by local governments and SOEs. These investment projects are not always efficient and are mostly debt-

⁵ *People's Daily*, 05/03/2004, "Wen Jiabao: Promote the Development of the West, Revive the Industrial Bases in the North-east and Support the Rise of the Central China", <http://news.sina.com.cn/c/2004-03-05/10321971410s.shtml>, accessed on 26 August 2007.

financed. Excessive investments could put China's economy at risk even though they also generate high GDP growth rates. Again, despite enacting several monetary and fiscal policy mixes and sending strong signals to the market, the central government could neither effectively rein in local governments' ruthless investments nor direct the funds to the inland.

- 3.10 Unsurprisingly, compared with Deng's opening up policies, the later development policies initiated by both Zhu and Wen became less and less effective in their implementation. The objectives of these western, north-eastern and central development policies are becoming more and more difficult to achieve, as the state's capacity to control the economy is decreasing. The Chinese government's decision to shift the focus of economic construction from the eastern coastal provinces to the interior region is far-reaching. It is still too early to assess this new strategic shift because, as the Chinese government officially stipulated, the development of the inland is a systematic project and a long-term task, which may take the efforts of several generations.

Prospects and Challenges

- 4.1 The interior regions of China will certainly benefit from these regional development programmes. The spill-over effects from the growth centres in the east may spread further into the adjacent areas. Capital from the already-developed coastal regions may be attracted by these preferential policies to flow to the inland. Central, western and north-eastern China could become the primary suppliers of raw materials, primary products, food and fuel, and travel and holiday destinations for the coastal regions.
- 4.2 Inland China can also gain from shifting comparative advantages. Land and labour costs in the coastal region have risen considerably in recent decades. Eastern China's economy has reached a relatively high level, and is now under market pressure to deviate from labour and land intensive sectors and develop technology and capital intensive sectors. Foreign and domestic investors may seek alternative low-cost and efficient sites in the interior regions to relocate their land and labour intensive industries in order to take the advantage.
- 4.3 Interior China itself is a huge market. It has 8.69 million square kilometres of land, and 836.84 million people at the end of 2005.⁶ As the income of the inland residents rises, more consumer goods producers have set up factories in the inland provinces to supply the local market. Besides the advantage of low operation costs in the inland, this will allow them to obtain rich and cheap local resources and materials, and reduce the transportation costs of delivering their products to consumers in the interior regions.
- 4.4 China, being a large and diverse country, will always face the challenges of equitable regional development and national economic integration. This is a phenomenon common to other developed and developing countries, such as the USA, Canada, Brazil, Russia and India. It will take a significant length of time before the less developed regions catch up with the advanced and fast-growing coastal region, if indeed it is possible

⁶ Data source: *China Statistical Yearbook 2006*, National Bureau of Statistics.

at all. It is certainly questionable whether the Chinese government will be able to control regional income disparity in the foreseeable future. Overall though, China undoubtedly has great potential for increased efficiency and economic growth if institutional barriers are removed.

- 4.5 The recent efforts to boost economic development in the west, the north-east and the central regions are encouraging. It seems that they have already had some positive results in the provinces in these regions. For example, during the first half of 2007, the increases of urban fixed assets investment in the eastern, central and western regions were 22.3%, 35.6% and 30.2% respectively.⁷ The growth of investment in the central and western regions is well above the growth in the east. During the same period, Hainan, Inner Mongolia, Guangxi, Sichuan and Jilin had the five highest growth rates of industrial value added, ranging from 40.8% to 24.4%, whereas Xinjiang, Shanghai, Beijing, Helongjiang and Guizhou had the lowest five growth rates, ranging from 11.7% to 17%.⁸ It suggests that many interior provinces are currently growing faster than their eastern counterparts.
- 4.6 However, due to the distance effect and adverse production environment in some of the most remote provinces, such as Guizhou, Qinghai, Gansu, Ningxia and Yunnan, reducing regional inequality is by no means an easy task. The central and western regions do not seem to be catching up with the east. More seriously, even within one of the most prosperous areas in the east, the Yangtze Delta region, Jiangsu province is falling further and further behind Zhejiang and Shanghai⁹. This implies that China's regional development problem is not only linked to certain places, but is a problem for the entire country. Consequently, the lessons learned from the eastern economic centres should be applied to all the non-coastal provinces as well as to all the non-growth-centre areas within the eastern provinces.
- 4.7 The Chinese central government has been trying hard to direct resources from the east to the rest of the country, but it also needs to create a more flexible environment to reduce barriers to inter-regional movement of labour and capital. However, resource relocation may undermine future growth in the east. In other words, this may bring new challenges to China's national economic, social and political integration. The real difficulty lies in how to achieve high growth and reduce regional inequality at the same time.
- 4.8 Given the policies implemented by the Chinese government aimed at enriching only a few areas, including the special economic zone policy or the western, north-eastern and central development policies, one would not expect the economy as a whole to exhibit free market behaviours. Whether or not China's trickle-down approach to development and the consequent increase in regional inequality will eventually lead to a higher *per capita* income for all depends on whether or not the Chinese government's regional development policies can enhance efficiency of production and increase the rate of returns on investment. If the Chinese government devotes itself to promoting more equitable development, China might sustain its high growth.

⁷ The three regions here are defined according to the same specifications mentioned in Footnote 1.

⁸ Data source: National Bureau of Statistics.

⁹ For example, *People's Daily*, 03/08/2005, "The Urban Income Disparity in Yangtze Delta is Enlarging, Shanghai is 70 per cent Higher than Taizhou (in Jiangsu province)", <http://finance.people.com.cn/GB/1037/3589495.html>, accessed on 26 August 2007.

- 4.9 China participates in the world economy largely through its role as a manufacturing centre for the world market and as a recipient of FDI. Globalisation has had a massive influence on China, and the trend will continue and is irreversible. The Chinese leadership needs to introduce more internal reforms in order to contain many negative social and economic consequences resulting from globalisation. The goal of the current Chinese leadership is the building of a "harmonious society". It is the first policy indicating that the Chinese government has placed a more comprehensive social, economic and political target before "promoting economic development", which was the top priority under Deng's leadership.
- 4.10 "Harmonious society" is a comprehensive concept of "scientific development"—the essence of Hu's people-centred approach—in which a balanced and systematic approach to development is favoured over a single-minded obsession with economic development. Hu's leadership has paid substantial attention to regional development disparities, environmental issues and the reduction of energy consumption. These policy initiatives have breadth of vision, though the results so far are fairly limited. Nevertheless, China needs further extensive reforms to make all these measures for reducing regional disparity effective. The leadership needs to attract broader social participation and support, so new policy initiatives can reflect the interests of the majority of the people and can be efficiently implemented.
- 4.11 The political consequences of income disparity in China could be serious. The eastern, central and western regions are diverging from each other. If the disparity continues to increase, how would the process of China's national integration be affected? How long can the people, especially in the minority areas, tolerate widening income disparities? Clearly, the control and reduction of regional disparities is not only an economic challenge for the Chinese government; more importantly, it is a political one.

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