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Regional Inequality in China

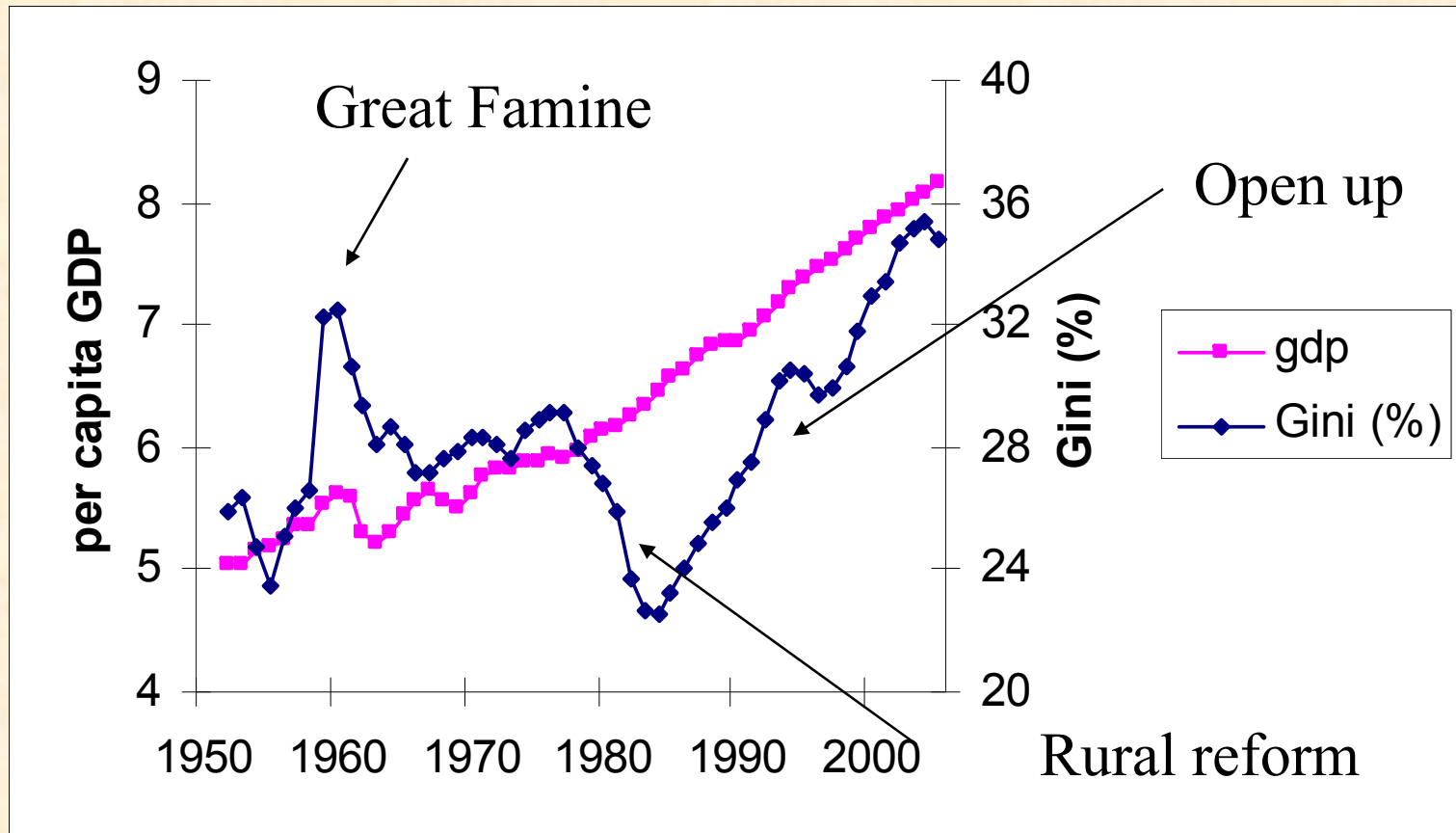
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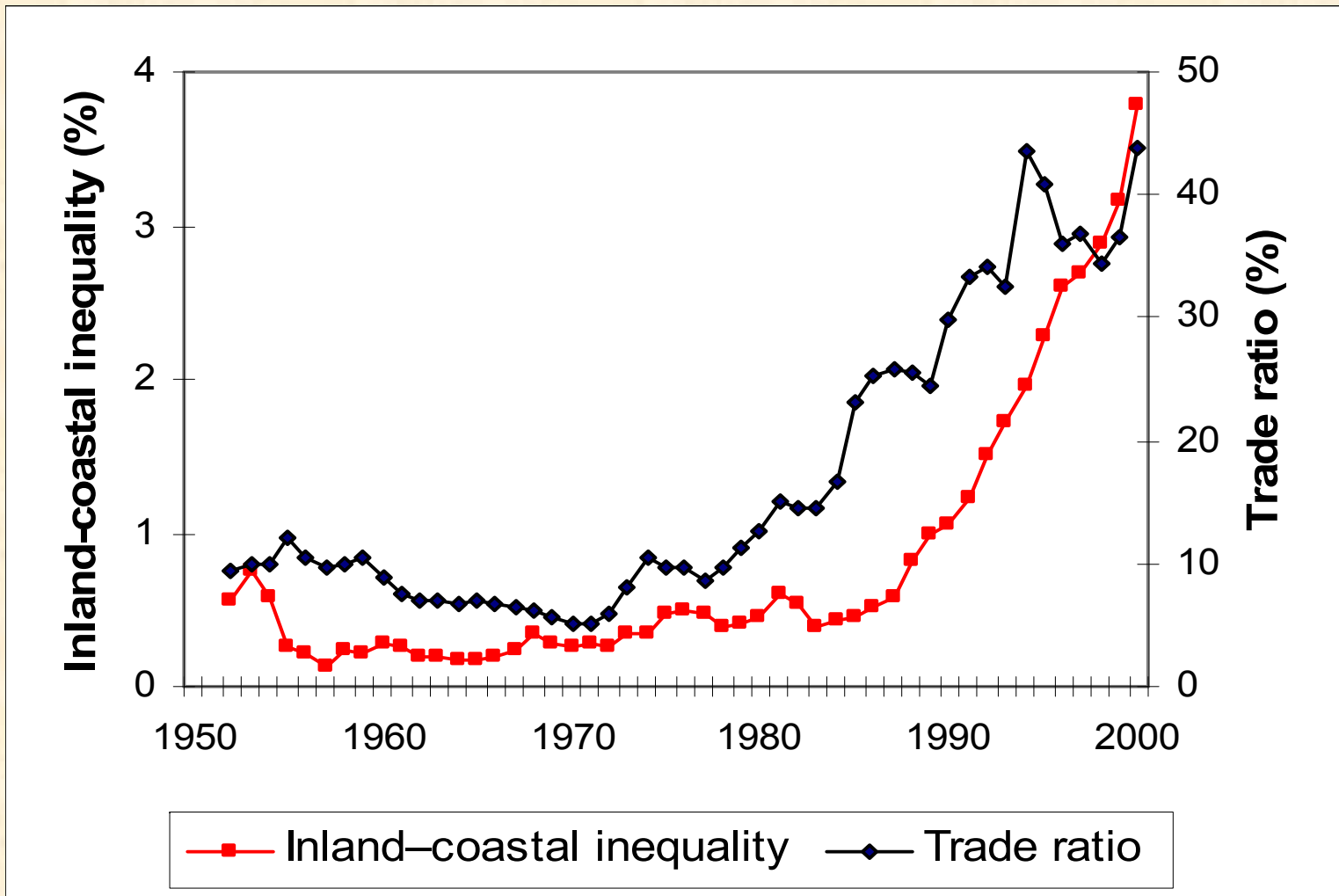
Why Concern Regional Inequality?

- 86% of the poor concentrate in the interior region.
- Most ethnic minority groups live in lagging regions.
- Inadequate domestic demand and excessive export. A “threat” to many other countries.

Economic Growth and Regional Inequality



Openness and Inland-coastal Inequality in China



Kanbur and Zhang (2005, RDE)

A Puzzle

Despite

- Product and labor market integration
- Increasing infrastructure investment in the west
- Rising labor and land cost in the coast
- Favorable terms of trade for the interior region

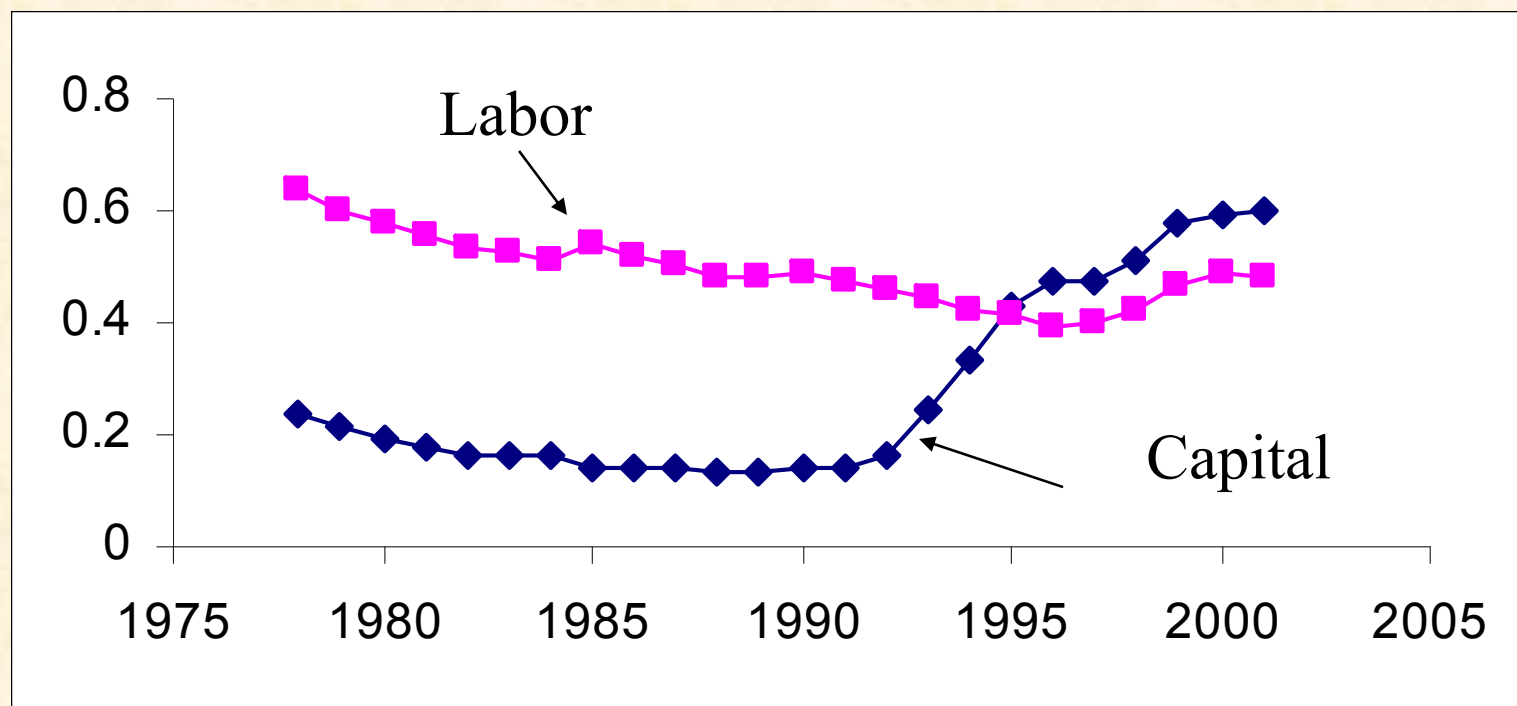
Regional inequality keeps rising. Agglomeration is for sure one of the causes. But there are more factors...



Two Additional Factors

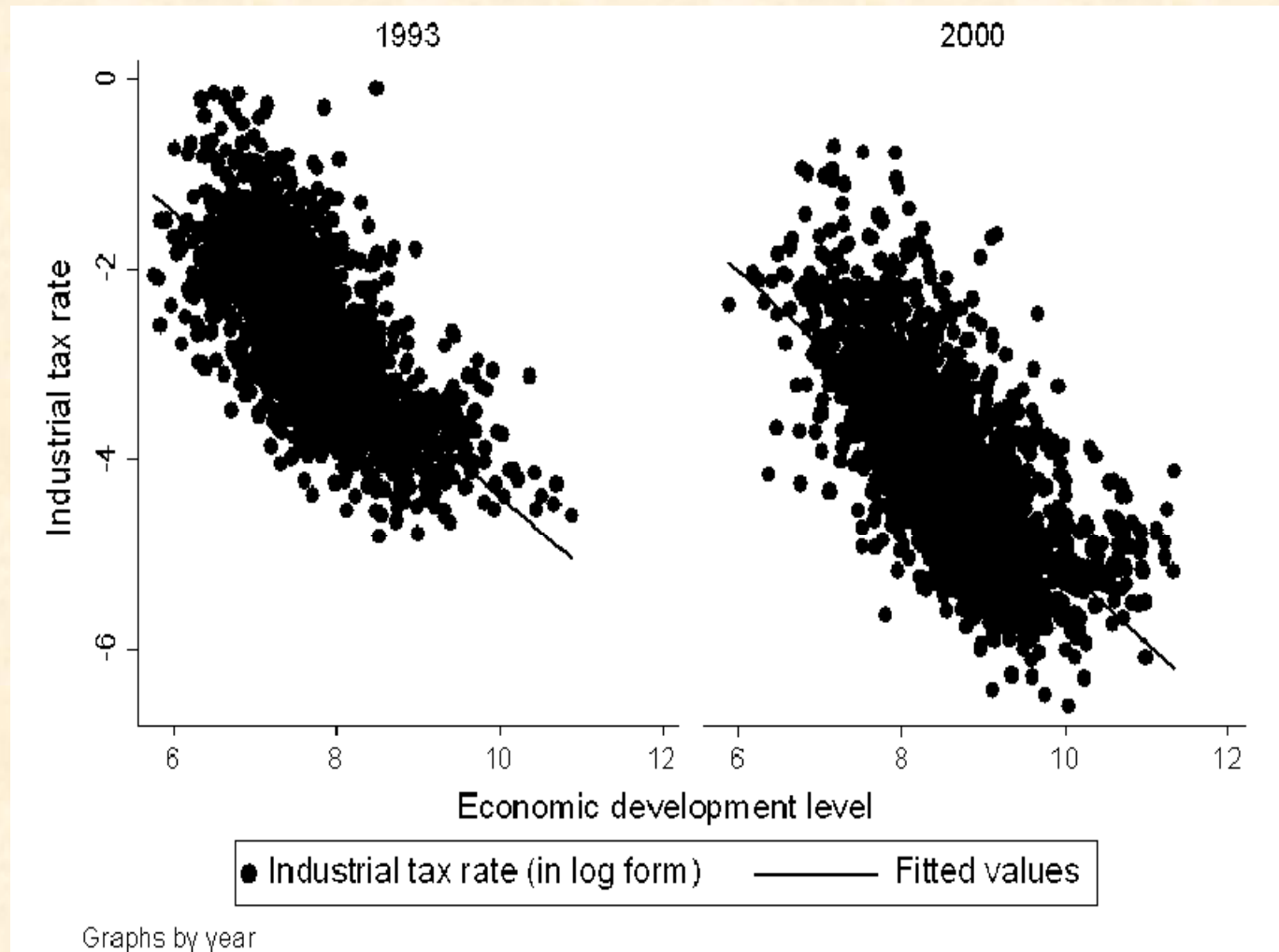
- Increasing fragmentation of the capital market.
- Uneven allocation of natural resource rents.
- The above two factors are related to China's governance structure and property rights arrangement.

Variation in Marginal Product of Capital and Labor



The higher is the value, the more fragmented the capital market.

Regressive Tax Rate



Zhang (2006, JCE)

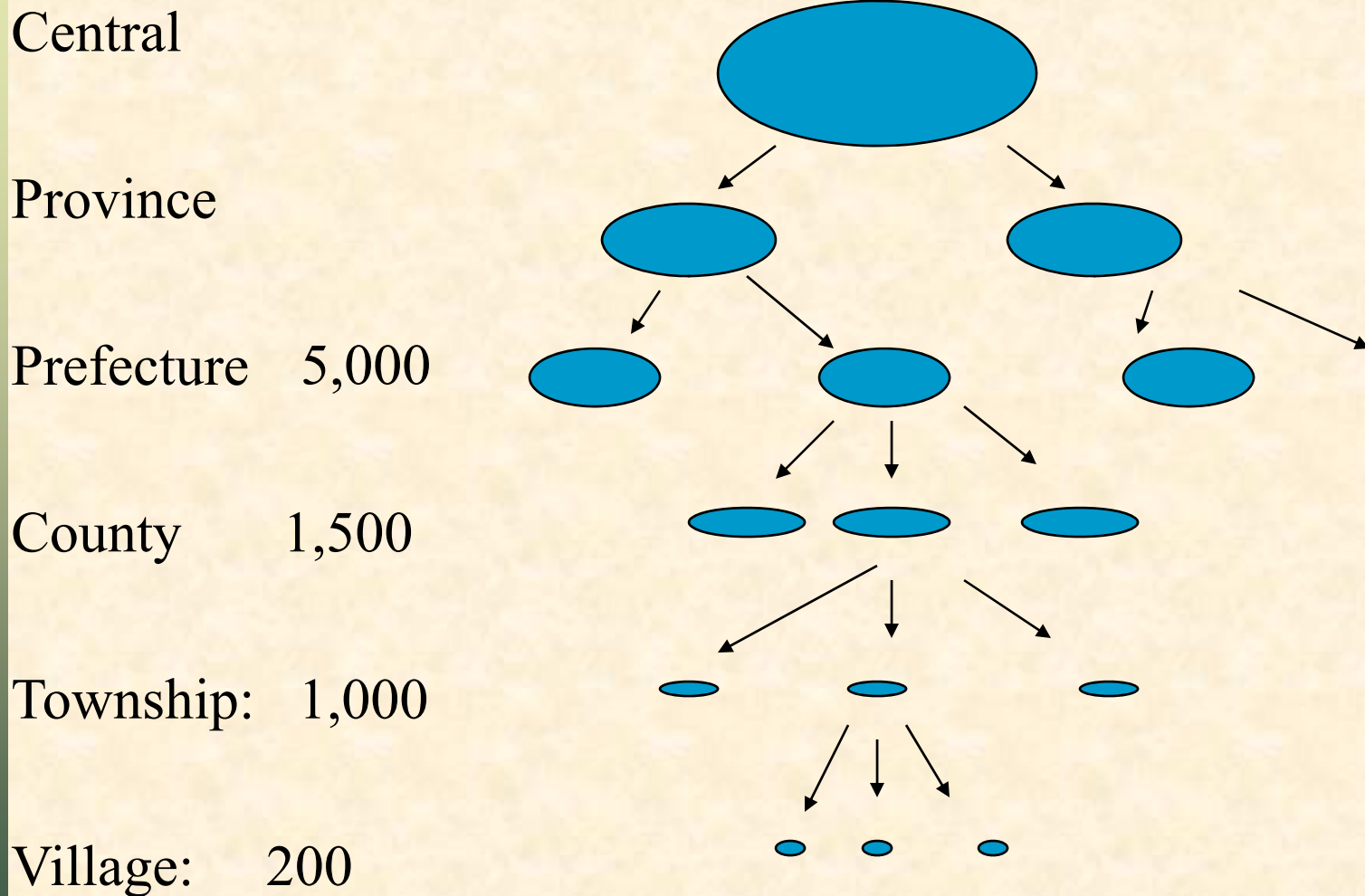


China's Governance Structure

- **Strong central mandates.**
 - Family planning
 - Social stability and safe production
 - Other central tasks

- **Vertically, replicate hierarchical structure.**

Hierarchical Structure



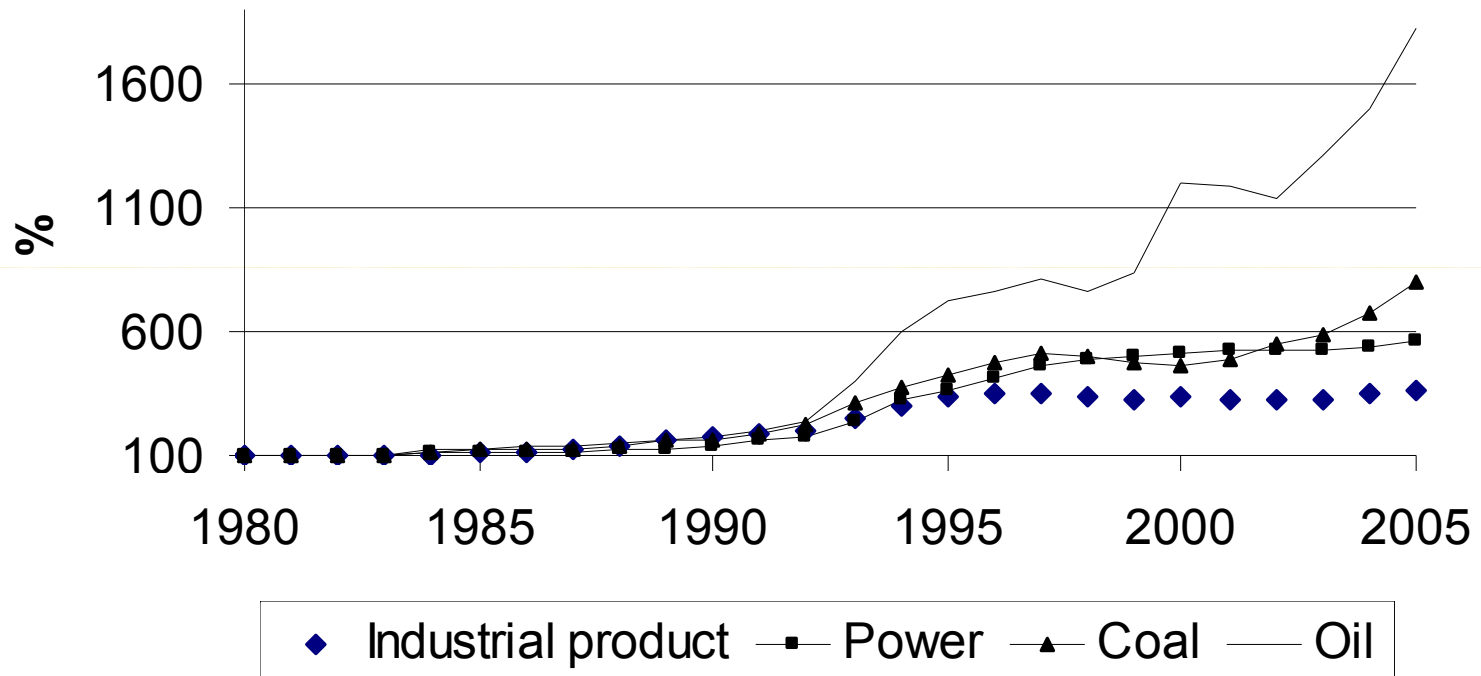
Note: The figures are per capita monthly operational budget, including salary.



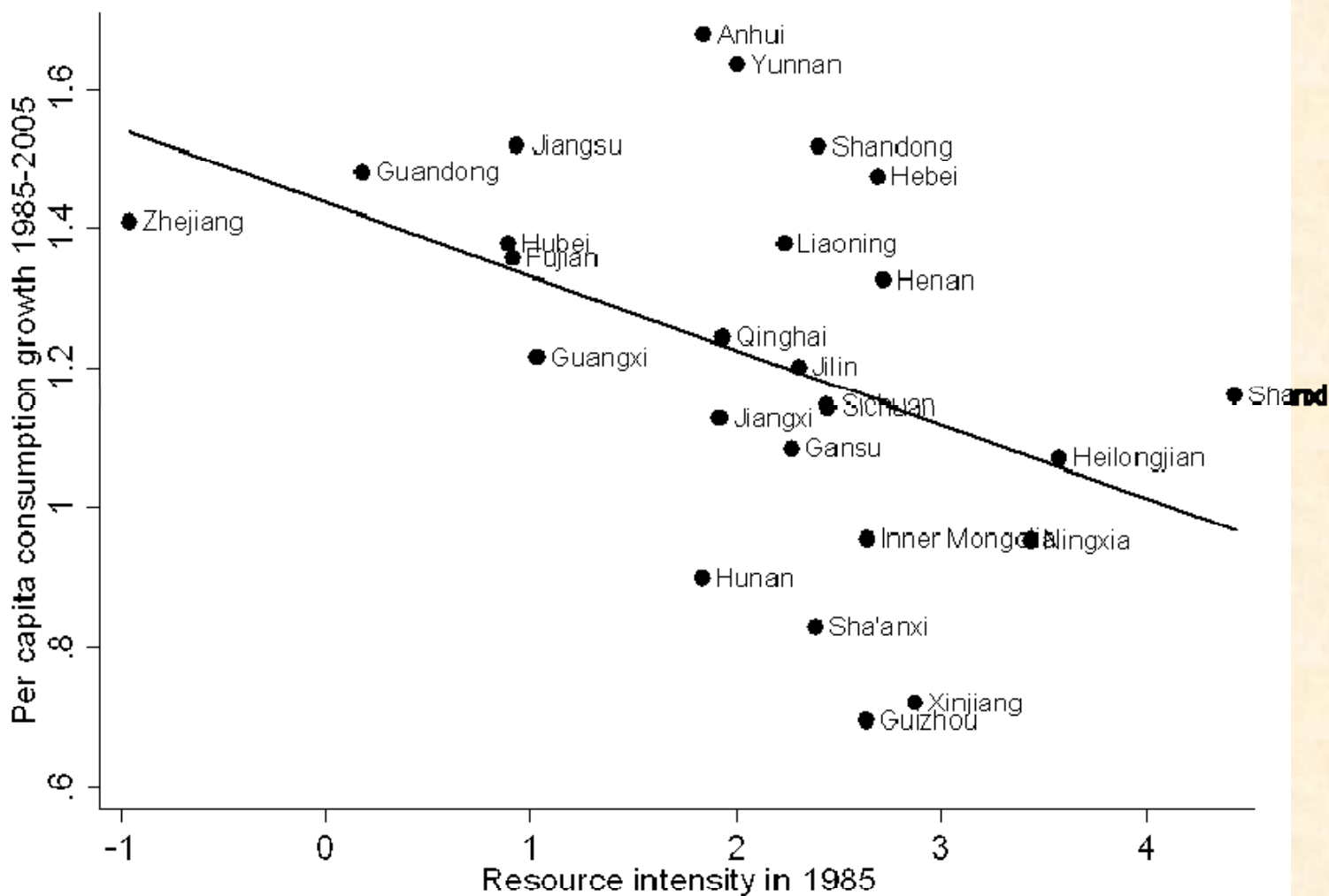
Consequence of the Imbalance

- Small government in the coast and large government in the west.
- Healthy and young in the east vs. sick and old in the west
- Higher fiscal burden to finance local public goods and support government employees in lagging regions.

Price Index for Industrial Products and Energy

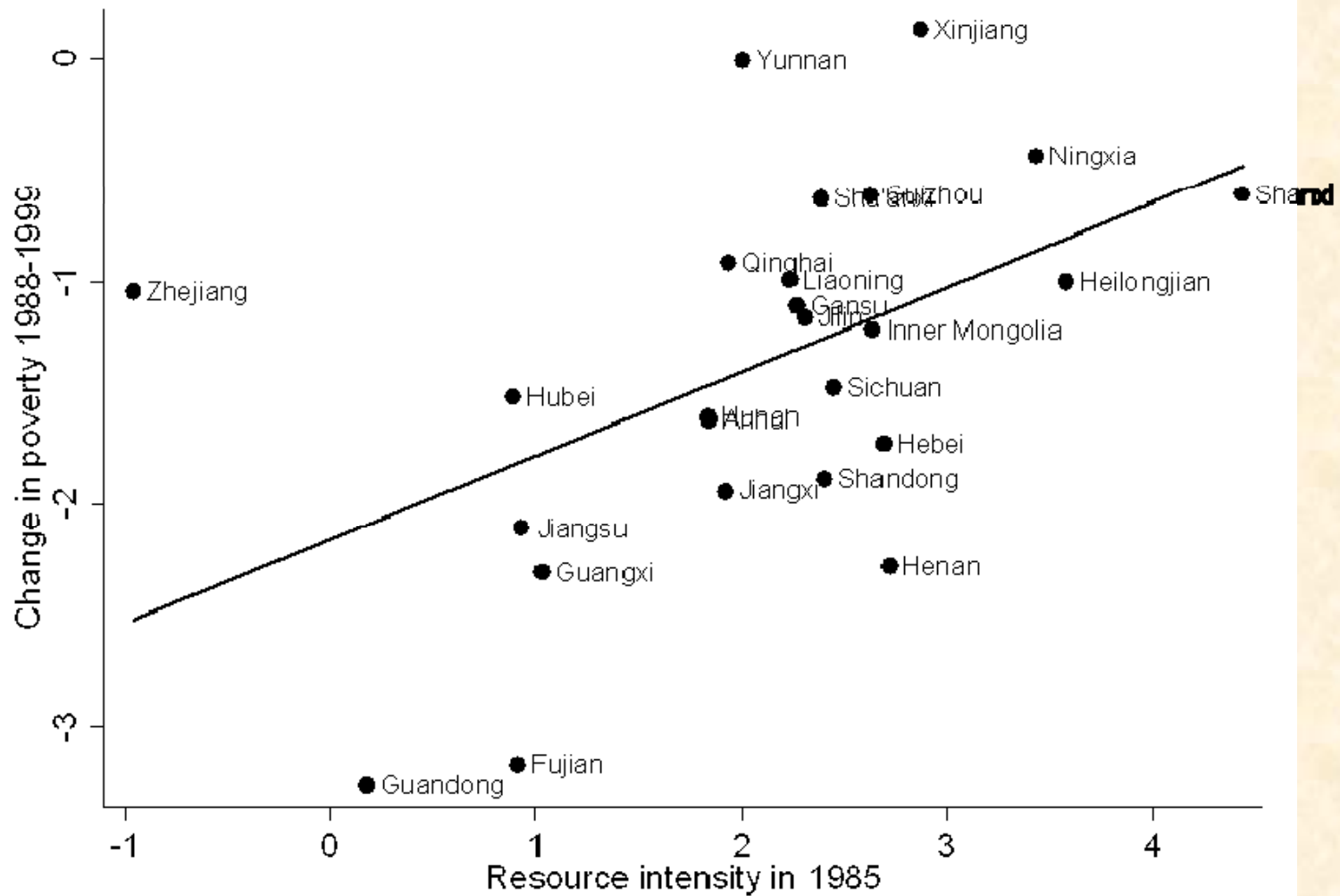


Negative relationship between consumption growth and resource abundance



Zhang et. al. (2007)

The speed of poverty reduction in resource-rich regions is low



Zhang et. al. (2007)



Property Rights of Natural Resources

- All the natural resources underneath the land belong to the state.
- Prior to 1986 (the Mineral Resource Law), the State Owned Enterprises enjoyed monopolized mining rights.
- After 1994 when the Implementation Regulations on the Mineral Resource Law were introduced, the mining rights for small-scale reserves are allowed to sell to private investors.



Natural Resources as Quick Cash

- Under the pressure of fiscal decentralization, the local government has a strong incentive to generate more revenue.
- Selling exploration and mining rights is a quick way to create revenues.
- In the absence of checks and balances, the interest of government officials may not be aligned with the interests of local residents.

Little Voice from Local Residents

- When conflicts arise between developers and local residents, the Natural Resource Law stipulates that mediation and resolution are the responsibility of local courts.
- Because the local court is not independent of local governments, it is difficult for local courts to ensure that resource rents are fairly allocated.

Conclusions

- The patterns of regional inequality in China are related to its development strategies and institutions.
- Market reforms may not be enough to reduce the widening regional gap.
- Equally, increasing interregional transfer may breed more rent-seeking and aid-dependency behavior.
- The solutions lie on more indigenous innovations as done in previous reforms.



Some Policy Innovations

- Zhuji (Zhejiang Province) practice of “borrowing” police officers and family planning officers from the origin places of migrants.
- Water rights and environment payments.



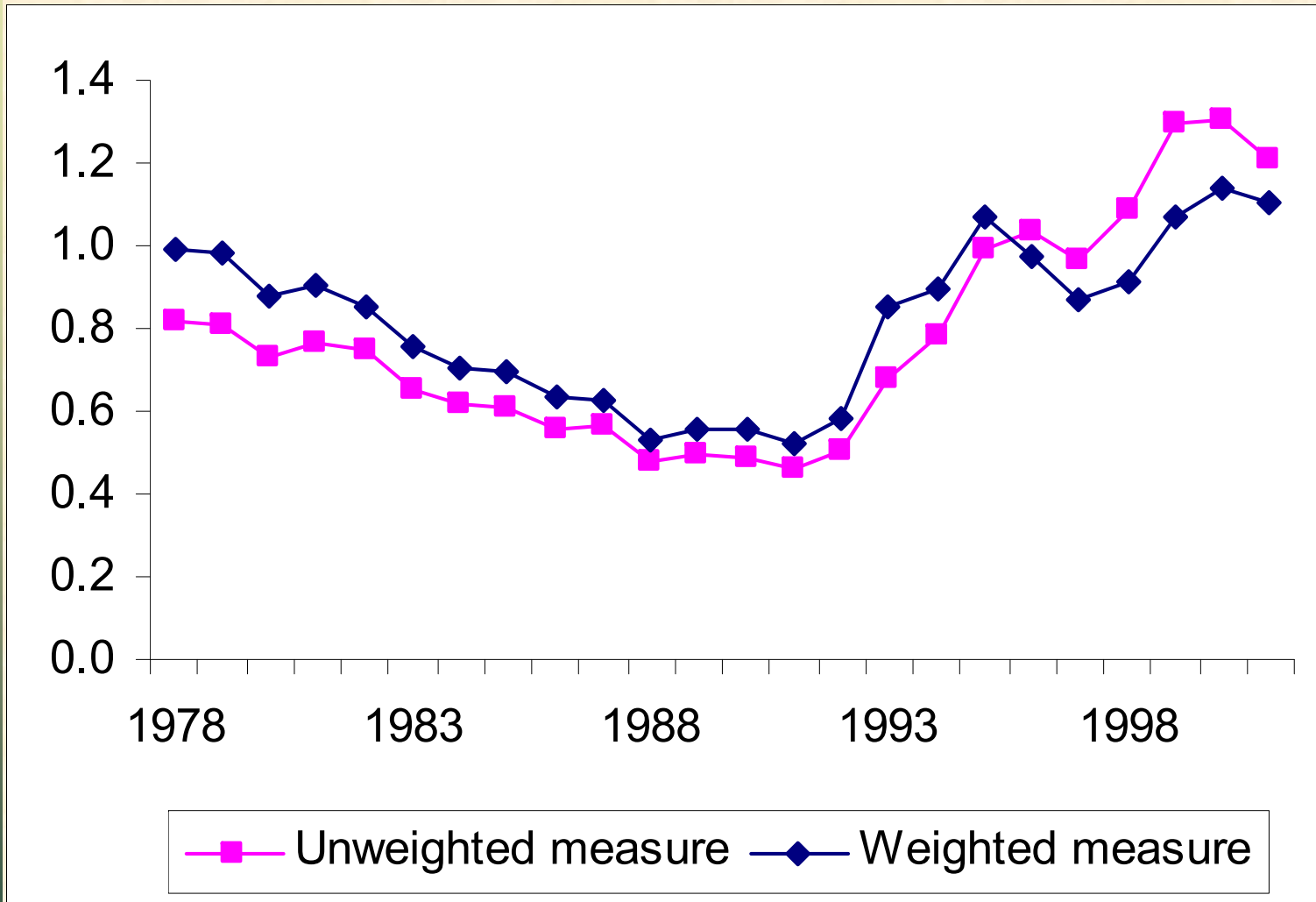




Government Buildings and Farmers' Houses in an Oil-producing County



The Product Market Has Become Increasingly Integrated



Zhang and Tan (2007, WBER)



A Walk Through History

- A transition from a rather controlled to a more liberalized economy.
 - Heavy industry development strategy in the 1950s

- Opening up and decentralization since the 1970s

- Rural reform from 1979 to 1984