Getting China's regions moving

Mehmet Ögütçü, OECD Directorate for Financial, Fiscal and Enterprise Affairs, and
Professor Markus Taube, Duisburg University, Germany

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Two-speed economy

China has enjoyed unparalleled growth, but more has to be done to steer investment into the remoter regions and western provinces.

Much has been said and written in recent years about China's economic potential, with some claims that it may one day rival the United States. China's growth has certainly been impressive since the 1980s and even conservative projections point to a bright future. However, there may be a weakness: that growth has been very unevenly spread, with the bulk of the US$400 billion in new investment during 1983-2001 concentrated in the eastern and southern coastal belt. In fact, the eastern coastal region accounted for 88% of China's total inflows of foreign direct investment (FDI) during this period, but the central region attracted just 9% and the western region little more than 3%.

Why might this be a problem? For smaller countries or more advanced larger ones, regional imbalances can be managed. But China is a veritable giant and, despite being bound together by a strong central authority, is a country of several cultures and traditions. One challenge it has to face in this era of globalisation is to prevent its uneven growth pattern from jeopardising not only cohesion, but long-term economic stability too.

The Chinese government is responding with its Great Western Development Strategy (*Xibu Da Kaifa*), launched in January 2000. This is an ambitious effort to steer state investment, outside expertise, foreign loans and private capital into the regions. In fact, the government channelled $45.5 billion in 2000 to develop the west, and plans are afoot to increase that figure. But it will take more than money to make the strategy work.

The areas lagging behind are enormous: the inland provinces account for 56% of the country's total land surface, an area almost twice as big as India, and 23% of its population, spreading across 11 provinces and autonomous regions (see map). Yet per capita incomes are only 60% of the national average. And the gap has widened: in Gansu province, for instance, per capita income fell from 84% of the national average in 1980 to 56% in 1999. World Trade Organization membership offers a chance for these regions in the west and north to compete for new investment, including from abroad, but they will have to overcome massive infrastructure and employment problems first.

The Chinese authorities originally concentrated on developing the eastern coastal regions in the hope that growth would spill over into the rest of the country. Good in theory, but so far the effect has been limited. The fact that economic reforms have generally been skewed in favour of the coastal regions is one reason. Part of the result is that this vast section of the country, already handicapped by its distance from world markets and possessing only a very restricted, relatively poor, local market, has had to make do with ragged and faltering state-owned industries.

What private money there was inland has all but gone to the coast, with net capital flows moving from the lagging west to the prosperous east belt, where earnings are higher. To make matters worse, the inland region has suffered a brain drain, as skilled and entrepreneurial youth migrate east for higher salaries and better living conditions.

Mobilising those resources

On the positive side, the region does have lower costs to offer in the form of an untapped reservoir of skilled labour from former military-managed enterprises, as well as a huge mass of cheap unskilled labour. There are some research institutes and

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universities in provincial capitals such as Xian and Chengdu, abundant natural resources, with oil, gas and minerals in Xinjiang, and a strong agricultural base. In fact, Sichuan province is the main producer of rice in China. There is also great tourist potential to be tapped from such historic sites as the Silk Road, the Tibetan plateau, the archeological digs of Liuzhaigou and the desert oasis of Turpan, where much fruit is grown. But these assets have not been enough to attract foreign investors in today's hard and competitive global economy.

How can this be changed? Obviously, given their distance from the coast, the promotion of direct export-oriented industries is hardly an option for these regions; nearby countries like Russia, Kazakhstan, Uzbekistan, Turkmenistan, Pakistan and India, may offer opportunities, not least because of their proximity, though there are one or two political difficulties that could complicate matters, like ethnic questions along some borders. A less bumpy route would be to target resource-seeking FDI from elsewhere in the world market that would integrate western China into the value chains of its eastern coast's export-oriented businesses. This may mean relocating some investments as well as bringing in new ones and would focus on operations that do not have to be close to the final customer. Services would be an obvious option, such as accounting for the coast's hotel businesses, or call centres and data processing. In manufacturing, attracting producers of spare parts for technology and machinery may be useful.

All of this presupposes a modern information technology (IT) infrastructure, which western China lacks. Moreover, the transport systems would have to be improved and inter-regional trade restrictions removed to give the inner regions a chance to supply the natural resources and labour inputs that eastern-based enterprises currently import from abroad. In the longer term it might be feasible to locate more market-oriented research and development facilities away from the east, where facilities tend to be military related. And more use should be made of the small pool of skilled labour until now absorbed in military and other state enterprises.

The massive concentration of funds brought in by the government's "Go West" campaign should greatly improve the region's infrastructure over the medium term, but not so the institutional and regulatory set-up. Another area requiring change is the banking system, whose current role under the planned economy focuses on handing out state grants and collecting profits. The problem of non-performing loans is acute. Freeing up the banks would not only help improve the "bankability" of projects, but would increase transparency and reduce corruption, too, which is so important to attracting investment today.

While the central government has greatly improved the environment for regional development, local governments have some work to do. There still seems to be substantial room for improvement in the design of local micro-level environments for foreign investment. The aim has to be to build up the local industrial sector and prevent capital and skilled labour from leaving the region, using market-based incentives and capacity building where possible, rather than red tape and other administrative interventions that distort management decisions.

Public intervention to attract FDI may be justified in situations where there are additional, indirect benefits that the market alone cannot yet deliver – technology transfer, bringing in skilled labour, fiscal agreements, and so on. Incentives like these

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can be a decisive element in the final choice of investment locations, but without proper management, they risk leading to corruption, rent-seeking and market distortions. Their aim has to be to improve long-term business opportunities in the region so that FDI not only flows in, but stays as well. Moreover, incentives like tax breaks and exemptions can leave local governments short of funds to invest in infrastructure and the fight against crime and corruption – precisely the elements needed to attract investment. Multinationals have to choose carefully and investment promotion agencies can help to build a region's image and attract the attention of prospective investors. China knows this well: its Shanghai Investment Promotion Agency and Yantai Investment Development Agency have been very successful out east and are no doubt seen as a model for investment promotion agencies (IPAs) to be created in the various western localities.

Given the vastness of China, changing the FDI fortunes of all regions at the same time would be impossible. Rather, the Great Western Development Strategy could concentrate more on establishing focal points of investment, as it has started to do. Industrial districts in Xian, Kunming, Luoyang, could be encouraged to become development clusters, for instance, with their greater provision of research and development and networking.

This is vital, since a region needs a minimum stock of human capital if it is to absorb the advanced technologies and management skills made available by FDI and to translate FDI-induced growth potential into durable economic development. Provinces like Sichuan and Shaanxi have very strong research institutions and facilities of academic learning. These institutions have traditionally emphasised technological research, but could become useful sources of skills for R&D-type FDI. More government effort is needed to improve education and create surroundings that will keep qualified individuals from emigrating eastwards and attract entrepreneurs from the east.

Energy investments do offer potential, of course, with pipeline projects able to deliver local economic stimulus by way of pump stations, maintenance, security and so on. Linking FDI with local enterprise development is important. But apart from energy, other mining and raw material extraction projects are unlikely to produce too many new links with local enterprises, even if foreign investors could be lured in.

The Chinese government has much to do to correct the widening income disparities between its rich coastal provinces and the sluggish interior. But Premier Zhu Rongji has stressed that the Great Western Development Strategy was a long-term programme with a timeline of 20 to 30 years. This is a realistic assessment. While China cannot afford to do everything at once, it must at least make sure that any future increase in FDI benefits the parts of the country that need it most. ■

Where investors tread

Geographical distribution of FDI stock in China

	1983-1998	1980s	1990s
Eastern region	87.8	90.0	87.6
Central region	8.9	5.3	9.2
Western region	3.3	4.7	3.2

Source: OECD

Eleven provinces: Guangxi Zhuang, Xinjiang Uyghur, Ningxia Muslim, Tibet Autonomous Regions, and Yunnan, Sichuan, Shaanxi, Guizhou, Gansu, and Qinghai provinces, as well as Chongqing Municipality in the west.

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