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# Political Institutions and Regional Inequality in China: 1949 to 2005

Qiang Yan

*University of Missouri-St. Louis*, [tomyanqiang@yahoo.com](mailto:tomyanqiang@yahoo.com)

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**Political Institutions and Regional Inequality in China: 1949 to 2005**

**Qiang Yan**

**M.A. Applied Economics, Clemson University, 2009**

**M.A. Political Science, University of Memphis, 2003**

**M.A. History, Yangzhou University, 2000**

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**Advisory Committee**

**Dr. David Robertson, Chair**

**Dr. Kenneth Thomas**

**Dr. David Kimball**

**Dr. Hung-Gay Fung**

## Abstract

Patterns of economic inequality across three Chinese regions-- the West, the Inland, and the Coastal area-- changed twice from 1949 to 2005. During the period 1949 to 1979 regional inequality decreased, and after 1979 inequality increased.

Previous studies, including economic models, cultural studies, and international relations theory, cannot fully explain changes in Chinese regional inequality after 1949. This dissertation uses Institutional Theory (IT) to analyze the changing patterns of Chinese regional economic inequality after 1949.

Analyzing economic data and political documents with IT, the dissertation shows that changes in Chinese political institutions, including political parties, policy-making agencies, and institutionalized ideologies, affected these two changes in regional inequality after 1949.

The dissertation concludes that IT is necessary and sufficient to explain the shifts of regional inequality in post-1949 China; that is, the changes in political institutions influenced economic institutions which in turn affected economic outcomes. Moreover, this dissertation also indicates that IT may also be useful to explain regional inequality in countries that have institutional similarities with China.

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China has developed greatly since it launched economic reform in 1979. The average annual growth rate of the Chinese GDP (Gross National Product) has exceeded nine percent in the past two decades (Table 1.1).<sup>1</sup> Economic progress, however, differs greatly across the three main Chinese regions: the Coastal, the Inland, and the West (Figure 1). According to the Chinese Statistical Bureau, the GDP per capita of the three regions in 2005 was: the West (9536 *yuan*), Inland (11493 *yuan*), and the Coastal area (23042 *yuan*).<sup>2</sup> In other words, the per capita income of the Coastal area now is about two and half times as that of the Western area.

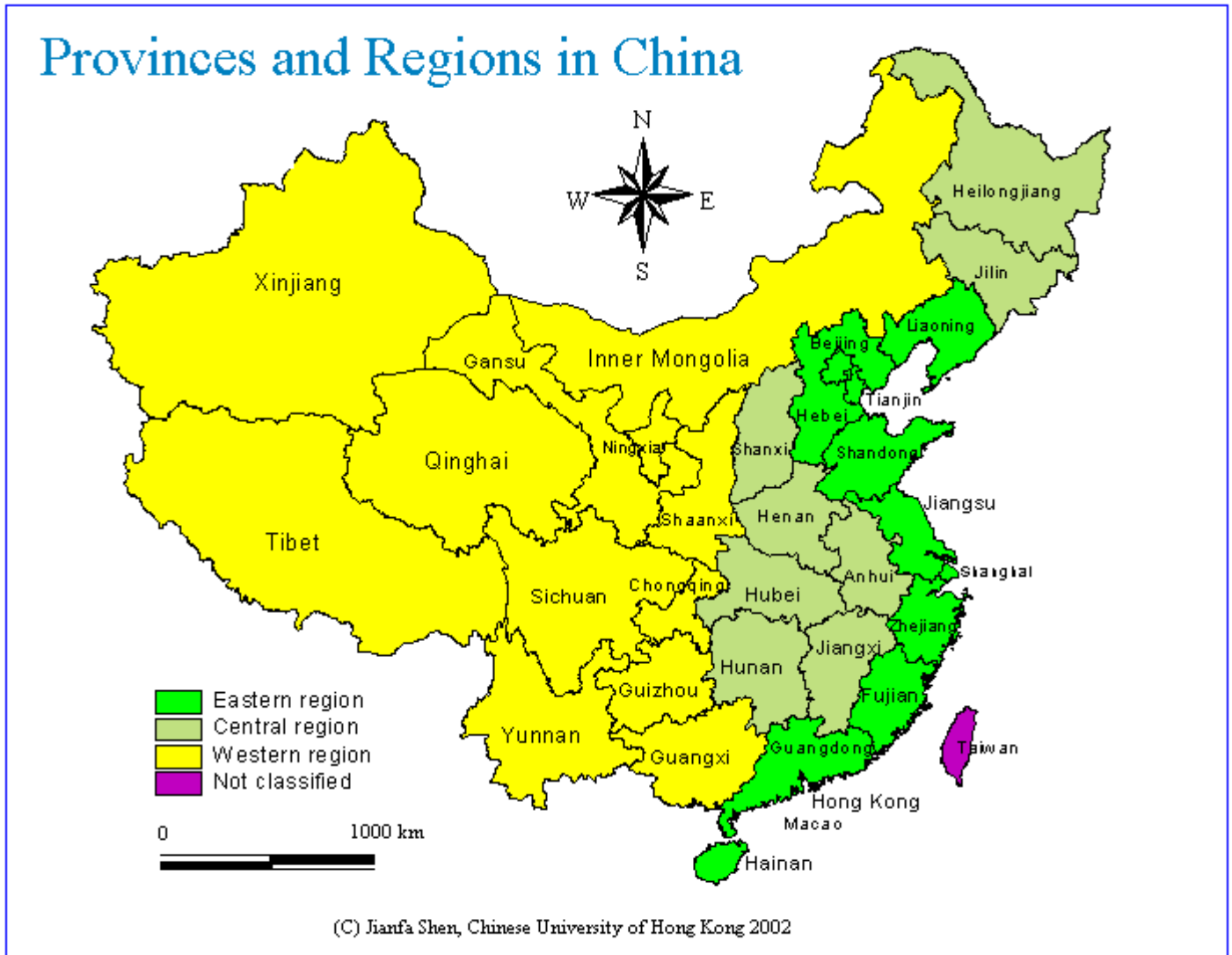
Chinese regional inequality has not simply grown in a linear way since the Communist accession to power over a half century ago. Between 1949 and 1979, economic inequality across the three Chinese regions declined, but since the early 1980s, such inequality has begun to increase. Table 1.2 shows the changing ratio of GDP per capita across the three regions. In 1949, the GDP per capita in the Inland constituted about sixty four percent of that in the Coastal area. In 1965, the figure rose to about eighty two percent. In 1979, that figure was still higher than that in 1949, while in 2000 and 2005 respectively, each figure decreased to fifty six percent and forty nine percent. The GDP per capita shift in the West shows the same trend.

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<sup>1</sup> Chinese National Statistics Bureau. Yearbook 2006.

<sup>2</sup> In 2005, one US dollar equaled to about eight *yuan*.

Figure 1 Three Geographical Regions of China



Data Source: Chinese University of Hong Kong

**Table 1.1 Chinese Economic Growth in the Past Two Decades (1979-2005)**

|                        |      |      |      |      |     |      |      |      |     |      |      |     |      |     |
|------------------------|------|------|------|------|-----|------|------|------|-----|------|------|-----|------|-----|
| Year                   | 1979 | 79   | 80   | 81   | 82  | 83   | 84   | 85   | 86  | 87   | 88   | 89  | 90   | 91  |
| <i>Growth Rate (%)</i> | 11.7 | 7.6  | 7.8  | 5.2  | 9.1 | 15.9 | 10.2 | 13.5 | 8.8 | 11.6 | 11.3 | 4.1 | 3.8  | 9.2 |
| Year                   | 1992 | 93   | 94   | 95   | 96  | 97   | 98   | 99   | 00  | 01   | 02   | 03  | 04   | 05  |
| <i>Growth Rate (%)</i> | 14.2 | 13.5 | 12.6 | 10.5 | 9.6 | 8.8  | 7.8  | 7.1  | 8   | 8.3  | 9.1  | 10  | 10.1 | 9.9 |

Sources: Chinese National Statistics Bureau.

**Table 1.2 The Changing Ratio of GDP per capita across Chinese Regions**

|                | 1949 | 1965  | 1979  | 1990  | 2000 | 2005 |
|----------------|------|-------|-------|-------|------|------|
| <b>Coastal</b> | 1    | 1     | 1     | 1     | 1    | 1    |
| <b>Inland</b>  | 0.64 | 0.818 | 0.672 | 0.655 | 0.56 | 0.49 |
| <b>West</b>    | 0.42 | 0.71  | 0.549 | 0.558 | 0.43 | 0.41 |

Sources: Chinese National Statistics Bureau: Yearbooks. Xia, 2006. Gao, 2004. Wei and Ma 1996.

According to Albert Hirschman and Gunnar Myrdal, regional inequality is likely to increase during economic take-off stage. The authors argue that in developing countries, like China regional inequality will widen, as developed areas will have competitive advantage in attracting most resources and hence in achieving higher growth rate than less developed areas (Hirschman, 1958: 184; Myrdal, 1957: 23-32).

Although some researchers show that rural-urban inequality across Chinese regions increased in some pre-1979 years and the trend of regional inequality was not smooth, they agree that averagely regional inequality in China between 1949 and 1979 had been reduced and such inequality began to increase again after the 1980s (Kanbur and Zhang, 1999, 2004; Wan and Zhang, 2006; Wei and Ma, 1996; Yu and Wei, 2003). Jones, Li, and Owen examine Chinese economic inequality at the city level and find that annual growth rates of Coastal cities are, on average, three percentage points higher than cities in

other areas after 1979 (Jones et al. 2003). Analyzing data at the provincial level, Jian, Sachs, and Warner find that inequality across the Chinese provinces increased during the period 1965-1979, and provincial inequality began to decrease after 1979 (Jian et al. 1996). This finding seems to be different with my finding that at regional level Chinese inequality during the period 1949 to 1979 had decreased, while the inequality began to increase after 1979. I will discuss the seemingly diverged findings in Chapter 2.

Indeed, the pattern of Chinese regional inequality is puzzling. Why did Chinese regional inequality decrease when it began its economic take-off in the 1950s, and only to increase again after 1979? What are factors that shaped the pattern of Chinese regional development after 1949? What light does this case shed on regional inequality in developing nations generally? This dissertation answers these questions by exploring institutions that shaped the path of uneven development in China between 1949 and 2005.

### Implications of Regional Inequality on the Three Chinese Regions

Regional inequality can profoundly affect a country's political stability and its sustainable development. First, large regional disparities can elicit local people's feeling of "relative deprivation" even if they also benefit from the overall economic development (Gurr, 1970). Increasing regional inequality threatens political integration of China, because it stimulates political unrest and instability in relatively poor areas populated by ethnic minorities. For example, Islamic fundamentalists mobilize supporters in Xinjiang, a large Western provincial area with millions of ethnic minority residents, by charging the Chinese central government with deliberately suppressing Xinjiang's local growth to serve Han majority's interests. Radical activists claim without evidence, that the Chinese



government willingly extracts raw materials and skilled workers from Xinjiang to other areas, and Xinjiang's development requires secession from China (Chen, 2007).

Second, regional inequality can obstruct the integration of a national market, and hence future economic growth, in a large country like China. Fearing that local capital and technology would flow to developed areas for higher economic return, the Inland and West try to reduce the free flow of these resources across regions (Wedeman, 2004: 83-156). In addition, the Coastal area sells a large proportion of its manufactured goods to the West and Inland, so the weak purchasing power in the two areas will choke the selling of Coastal products and hence stall the further Coastal development.

Third, the Western and Inland areas also provide well-trained workers to Coastal enterprises. If the uneven development worsens substantially, local authorities will also prohibit the inter-regional flow of human resources. For example, the residential registration system (*Hukou*) authorizes local governments to restrict labor mobility. Local governments can also encourage skilled workers to stay home by offering them political positions or giving them preferential loans and tax breaks. All these policies distort efficient resource allocation across regions and thus hinder China's development.

Fourth, increasing economic inequality has affected the balance of political power among national political leaders. The Politburo, the dominant institution in making Chinese public policies, allows senior national leaders to retain their regional positions. Since the mid-1980s, Politburo leaders from the Coastal area have increased their political power because they represent a superior stream of revenues for the central government. After the mid-1980s, most Politburo members have been from the Coastal area. Leaders from the other two areas often find it difficult to directly challenge their

Coastal rivals because regional economic prosperity has increasingly become the main standard for evaluating Chinese leaders' governance. It is thus common that regional economic conflicts often extend to the Politburo and affect the making of economic policies.

In sum, regional inequality vitally affects Chinese political economy. The CCP (Chinese Communist Party) and the Chinese central government also believe if they cannot reduce the centrifugal tendency in local areas caused or exacerbated by regional inequality, China's national integration will be undermined (Xinhua News Agency, 2006). Thus, a better examination of the causes and process of regional inequality is essential for understanding China's current and future development.

#### Conventional Explanations for Economic Inequality across Chinese Regions

There are several explanations for Chinese regional inequality, but all have difficulty in explaining the changing pattern of the inequality since 1949. Some economists argue that initially unequal distribution of natural endowments caused unequal development in China (Huang, 1990; Wang and Hu, 1999). These scholars argue that the Coastal area owns advanced technologies, skilled workers, and a geographic proximity to international business, while other regions have comparative disadvantages in these areas. Thus, these studies hypothesize that endowments differences engendered regional inequality. These researches however do not explain the reason the West and Inland could not effectively utilize their comparative advantages such as abundant natural resources and low-cost human capital to develop, while the Coastal area could do so.

Second, some politicians and political scientists maintain that international structures caused or enlarged regional inequality in China (Mao, 1956; Goodman, 1994; Oi, 1992; Wu, 2002). For example, Mao Zedong maintained that imperialism laid the basis of uneven development in China and such inequality could be path dependent. Mao maintained that Shanghai and some other Coastal cities had prospered at the expense of other areas. These Coastal cities did not help China develop, in Mao and other Chinese leaders' analysis, because they only served the interests of imperialists by extracting raw materials to, and importing manufactured goods from, developed countries. Jean Oi and Frederic Wu both maintain that the Cold War significantly determined China's uneven development after 1949. They argue the Cold War hindered the Coastal area in engaging in international trade and encouraged the CCP to strengthen interior economy as a strategic move in confronting with Russia and the U.S.

Oi and Wu are partly correct in pointing out that the Cold War pressured the Chinese government to pay more attention to the West and Inland. But they downplay important evidence that does not support their thesis. First, even during the Cold War, China still developed international trade with newly independent countries, most socialist states, and Western countries such as France, West Germany, Japan, Canada, and Scandinavian countries. Coastal cities such as Dalian, Tianjin, Qingdao, Shanghai, and Guangzhou were still main ports for international trade during the Cold War. Second, if the Cold War was the major factor in impacting China's uneven development, why did Chinese regional inequality began to increase in the early 1980s when the Cold War was

still underway?<sup>3</sup> Indeed, as following chapters will show, the reduced regional inequality before 1979 was resulted from shifting institutions and the implementation of CCP's specific policies to realize the political and strategic goal of "equality".<sup>4</sup>

The third explanation of uneven regional development in China emphasizes cultural factors in shaping regional inequality. Cal Clark and C.C. Roy, for example, argue that the extent of local adherence to Confucianism helps to explain the difference of economic achievement among some developing countries. Those areas that advocate Confucianism would develop more slowly because Confucianism opposes the pursuit of material interests (Clark and Roy, 1997).<sup>5</sup> Yang Zongmei argues that local culture strongly affects domestic inequality. Yang observed that people in Shanxi and Guizhou, two underdeveloped provinces in the West, thought it shameful to engage in business, and they would rather retain their "pure" life style than adopt an entrepreneurial one. Local

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<sup>3</sup> The Sino-US relationship began to change in the early 1970s, but Sino-US trade did not fully developed until the mid 1980s. Hence, before the mid-1990s the Sino-US trade did not contribute a lot to the development of the Coastal area. Technical and financial assistance from the Japanese, Taiwanese, and overseas Chinese provided the main source to modernize the Coastal area before the mid 1990s.

<sup>4</sup> In the 1930s, the CCP stressed that all regions should be at the same economic level. Such idea might be unrealistic, but it did affect the CCP's intentions to reduce regional inequality.

<sup>5</sup> This argument is incomplete. Confucianism does not oppose prosperity. What it stresses is to get rich legally and morally. Confucianism indeed encourages the pursuit of material interests to realize "*Ren*" or the eternal progress of human beings. The widely referenced misinterpretation of Confucianism might have been originated from Max Weber who argued that Confucianism obstructed the development of capitalism. But this assertion clearly does not conform to the development history of the Asian Tigers and other East Asian countries. Moreover, Weber's definition of capitalism has been oft-criticized as ethno-centered, which is based on experiences in the evolution of capitalism in Western countries.

residents in Shanghai and other Coastal cities, however, perceive poverty to be a most shameful thing in the world, and as a result they are more likely to work hard or even take risks to pursue prosperity (Yang, 2002: 126-66). These cultural identities, according to Yang, contributed to the more rapid development of the Coast but low growth in the other two regions. The cultural explanation, however, still cannot explain the way Chinese regional inequality changed direction twice since 1949. Indeed, if cultural factors do partially account for the *emergence* of regional inequality, they cannot explain *shifts* of such inequality in China when culture adherence is relatively stable across Chinese regions.

All these explanations downplay the critical role played by Chinese political institutions in affecting uneven development in China. Political choices have significantly affected uneven development across Chinese regions. For example, neither economic evolution nor cultural influences can explain the implementation of the “Third Front” project designed by the CCP. The “Third Front” project assumed that during the war, the Coastal area was the first front, while other big cities constituted the second front and rural and mountainous areas in the Inland and West became the third front. The CCP believed that the war would easily destroy Coastal industries, and to maintain China’s defense power, heavy industries must be developed in the other two areas. The party thus designed the “Third Front” project to develop heavy industries in the Inland and West. The project terminated in 1991, but it facilitated economic development of the two interior areas. The “Great Leap Forward” movement in the late 1950s offers another example of a deliberate policy design. The CCP initiated the movement to reduce the perceived power discrepancy between China and its potential rivals, mainly the U.S. or

the Soviet Union, by building a modern industrial system in China, especially in the less developed Inland and West.

The “Third Front” project and the “Great Leap Forward” movement affected the uneven development in China as they artificially altered Chinese regional development paths. Starting from the early 1960s, the central government shifted investment focus to the West and Inland because the Coastal area was perceived to be easily destroyed by potential enemies. The CCP also managed to relocate skilled workers and modern industries from the Coastal area to the other two areas between 1949 and 1979. All these policies reduced regional economic inequality in China.

These examples suggest that China’s uneven development owes less to regional endowments, international structures, or cultural differences than the existing literature suggests. To better understand regional inequality in China, it is necessary to study the role played by the shifting Chinese political institutions.

### Central Hypothesis

My central hypothesis in this dissertation is that shifts in key Chinese political institutions, especially the shifts of CCP’s power structures and policies, affected China’s uneven regional development more significantly than other factors. The dissertation shows that the shift of Chinese political institutions impacted Chinese regional inequality by affecting factor mobility and resource allocation across the three Chinese regions.

### Dependent Variable

The *Dependent Variable* (DV) in this dissertation is the changing pattern of economic inequality across the three Chinese regions since 1949. I take several steps to accurately measure regional economic differences. First, I use GDP per capita to measure economic levels across various areas at a given time period. Second, I also compare relative changes in GDP across Chinese regions, meaning to measure the changing ratio of GDP per capita across the three regions. Although there are several problems with using only GDP to measure economic achievement, it still is the main indicator used and accepted by academics and national governments to measure economic growth.<sup>6</sup>

### Central Independent Variable: Changing Political Institutions

The most important *Independent Variables* (IVs) in this dissertation are fundamental or durable changes in formal political institutions, including power shifts among different government agencies and party restructuring in 1949 and 1979.

In this dissertation, “political institutions” mainly refer to formal institutions such as political parties, formal rules, and laws. In China, political leaders sometimes also try to execute their will via *Ren Zi*, meaning governing by individuals rather than laws or rules. During Mao’s leadership (1949-1979) and Deng’s governance (1979-1992), top leaders

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<sup>6</sup> For example, scholars argue there are three basic standards to evaluate economic development. The first one is Nozick standard, which argues that the process of economic development should be just. The second is Rawls model, maintaining that economic development should at least not be achieved at the expenses of the poorest groups. The third one is Varian criterion, positing that a real economic development should make every citizen satisfied by what he/she gets and will not be jealous of the others’ situation (Walters and Layard, 1978). But it is still very difficult to measure the subjective indicators as these scholars suggested.

also tried to build *Ren Zi* but failed because institutions did not develop as they expected, meaning leaders had to be constrained by institutions.

Political institutions matter because they help to determine the path and transaction cost of social activities via two mechanisms: first, they provide a basic context in which these activities takes place; and second they determine the scope and rules under which various activities can be carried out.

Durable shifts of political institutions can increase or reduce regional inequality. Political scientists Karen Orren and Stephen Skowronek define political development as “a durable shift in governing authority.” They refer “governing authority” to the exercise of control over individuals or things that are designated and enforced by the state. By “shift” they mean “a change in the locus or direction of control, resulting in a new direction of authority among persons or organizations within the polity at large or between them and their counterparts outside”. The term “durable” suggests “that the distribution of authority is not fixed and that its stability or change in any given historical instance must be regarded as contingent” (Orren and Skowronek; 2003:123).

The process of American economic development illustrates the way durable shifts affected regional inequality in a country. In 1876, Reconstruction ended and Republican candidate Rutherford Hayes became the president. This shift strengthened the U.S. government’s commitment to three economic policies that facilitated uneven regional development in the U.S.: the political construction of a national market, the adherence to gold standard, and tariff protection for industry (Bensel; 2001:1-18). The political shift marked by the bargain of 1876 resulted in policies that intensified economic differences among the Northeast, Midwest, and the West.



There have been at least two fundamental shifts of political institutions in China in the last sixty years. The first shift in 1949 endowed the CCP authoritarian power to develop China's economy with a socialist development model. First, the party assumed that to realize equity among the people, the central government had to design policies that assured each social stratum and geographic area to converge to the same economic level. Second, the fear of potential war with the U.S. or Soviet Union pressured the party to transfer huge amounts of capital and other resources from the Coastal area to the Inland and Western provinces. Third, the preparation for war with other countries in the 1950s helped China reduce economic and technological differences across regions. The CCP assumed that if the sudden attack from the U.S. or Soviet Union destroyed the central government, each region should be able to engage in war independently. To do so, each region had to build heavy industries and maintain productive capacities deemed essential for economic and military independence. Institutionalized ideology also affected policy-making between 1949 and 1979. For example, Shanghai and other Coastal cities were criticized as having been severely influenced by the "debauched Western life-style". Thus, the central government believed it should try to balance the economic power of these areas by transferring funds and technologies to inland areas. These policies helped Chinese government reshape the unbalanced regional economy and laid a solid foundation for future development for the Inland and West. However, such arrangement undermined the realization of economic comparative advantage and partially exacerbated the effects of some natural disasters, especially the catastrophic famine in 1960 which starved millions of Chinese people.

The second shift occurred in 1979 when the CCP began to launch economic reform. The post-1979 CCP discarded Maoism and suggested economic development instead of the *class struggle* as the dominant goal of the party and government. The party also agreed to act according to laws and rules. The CCP pragmatically acknowledged that to develop all the regions simultaneously was unrealistic, and the CCP believed that the Coastal area had comparative advantages in capital, technologies, market, and human resources, although not in natural resources. Since China could not develop all the regions at the same time, resources should first tilt toward these areas that had better foundations. The CCP thus designed the Special Economic Zones (SEZs) in the Coastal area in 1979, expecting the Coastal area to develop faster and then help the West and Inland develop in the future (Yang, 1991; Yabuki and Harner, 1999: 149-55). The state also designed preferential tax and fiscal policies for the Coastal area to facilitate its economic development. These policies enlarged economic inequality across Chinese regions, because mainly the Coastal area could benefit from these preferential policies.

In both 1949 and 1979, fundamental shifts of political institutions contributed to economic shift, first toward convergence, then economic divergence. To measure shifts in these institutions, I study different versions of laws, changing construction of political structures, and institutionalized political ideologies that affected policy-making process. These indicators are crucial in understanding the evolution of modern Chinese politics at the national level, and they also impacted local governments' activities.

### Alternative Hypotheses

To examine the possibility that other factors may play a greater role in shaping China's uneven development, I also examine the alternative hypotheses identified earlier in this chapter. The first hypothesis is that natural endowments caused regional inequality. I examine this hypothesis by using models based on the Cobb-Douglas function, which argues that labor, technology, and capital investment determine economic achievement. To strengthen the examination, I also compare other resources such as raw materials across the three regions to see whether a greater stock of raw materials disproportionately advantaged the new developed regions.

The second alternative hypothesis is the change in international structure greatly affected uneven development in China. I compare regional inequality during the Cold War era when China's foreign policies and its relations with other countries changed. If the inequality changed when international context did not change, or if the inequality did not change while international structures shifted, then this hypothesis is not supported.

The final alternative hypothesis of this dissertation is that cultural differences caused regional inequality in China. I use historical and cultural analyses to examine this hypothesis. If cultural difference across regions did not show a large shift, as indicated by historical analysis, while economic inequality across regions shifted, the hypothesis cannot be sustained.

### Methodology and Sources of Information

This dissertation uses both qualitative and quantitative methods. I primarily use the Historical Comparative (HC) approach, a method often used in qualitative studies, for my

analysis. The HC is a dynamic and comprehensive approach because it is able to compare historical events overtime or across borders (Mahoney and Rueschemeyer, 2003: 93-99).

The HC approach examines the hypothesis by comparing the effects of two durable changes in Chinese political institutions in 1949 and 1979. First, I compare independent variables through historical periods. I specify institutional arrangements and policy content before and after each political shift. I also explore differences of assumptions and ideologies that came about as a result of these institutional shifts. I compare the changes in regional economies that followed these shifts. I mainly check absolute figures of economy such as GDP per capita and the percentage of industries in economy through different periods, but I also compare relative changes in these data across Chinese regions between 1949 and 2005.

I collect data from two types of sources. The first one is from government documents, including laws, regulations, white papers and statistics issued by the Chinese central and local governments. This category of data includes yearbooks and yearly data reports published by the Chinese National Statistics Bureau (CNSB) and its regional branches. This dissertation also adopted data from other governmental departments, such as the Chinese Commerce Department (CCD), the General Customs of China (GCC), the Chinese Agriculture Department, and the People's Bank of China (PBC), the nation's central bank. Moreover, I also review related communist party documents such as party annual reports and committee briefs, because the party is powerful in affecting the Chinese political economy.

This dissertation also uses secondary sources such as related records in books, journals, newspapers, and websites. These sources help to understand the way policies

and laws were formed and carried out. They can also provide information about the process of decision-making at the central government that official documents often do not contain. However, one should be very cautious to use such sources because politicians or other authors may intentionally add or subtract some materials from their memoirs due to political or personal considerations. For example, some officials may exaggerate the positive effects of policies they designed or implemented, and they may also intentionally underreport mistakes caused by their policies. Political considerations may also cause distortions in some memoirs. One example is that the CCP clearly stipulated that any severe criticisms against senior leaders are prohibited. Thus, in China it is difficult to determine the individuals who initiated specific policies and why they did so. To address this problem, I compare different sources of materials and then choose the data that are most close to facts. This process is to build up *Intercoder Reliability*, meaning two or more analysts, using the same procedures and definitions, agree on the content categories applied to the material analyzed. The more the agreement, the less personal biases heavily distort the content of the material (Johnson et al. 2001: 257).

#### Expected Contributions of this Study

Incorporating institutional factors into the analysis of Chinese development, this dissertation examines political and economic impacts of the two durable institutional shifts in 1949 and 1979. The study hence analyzes whether related theories about economic development and regional inequality are still applicable to China's case. Specifically, this dissertation explains the way institutions impact Chinese regional inequality. This study differs with scholars who posit that economic development is predestined by certain economic structures or those who argue that politicians are the

main actors in impacting the orientation of economic development. Instead, this study explores the interactive functions between political institutions and unequal development in China.

This new framework uses and develops Institutional Theory (IT). By using IT, this dissertation explores the reasons of why in the past five decades the CCP designed and implemented some seemingly irrational policies. In addition, this study illustrates the way the change in Chinese political institutions affected economy, at regional or national level, making the analysis more complete than previous analyses.

In sum, this research helps clarify whether internal politics is crucial in affecting Chinese regional inequality than culture, natural endowments, or international structures. Specifically, the dissertation examines the role played by Chinese political institutions in deciding the shifts of Chinese regional inequality between 1949 and 2005.

### Outline of the Dissertation

After introducing an overview of the study in Chapter One, Chapter Two provides an overview of China's regional inequality. This chapter briefly illustrates historical and economic background of the three Chinese regions. The chapter discusses regional inequality in Chinese history and explains its implications on traditional and modern Chinese politics. Chapter Two also illustrates shifts of Chinese economic development since 1949, and elaborates on the puzzle of Chinese regional inequality.

Chapter Three provides a comprehensive review of scholarship that addresses regional inequality. This chapter explores prior and current theoretical works on durable shifts of Chinese political institutions and regional inequality since 1949. The chapter

concludes that current literature on this topic does not adequately explain patterns of regional inequality in China. Thus, IT is suggested to fill the gaps in the literature.

Chapter Four explains political institutions and policy-making process in communist China. This chapter first details Chinese governmental structures and the CCP and analyzes their roles played in economic policy-making. Second, the chapter elaborates the relationship between the Chinese central government and local authorities. This relationship is crucial in deciding effectiveness of economic policies designed by the central government. Third, the chapter discusses laws and rules that are essential in affecting the Chinese economy. Finally, the chapter also explores institutionalized values and ideologies that impacted Chinese regional inequality.

Chapter Five discusses the durable institutional shift in 1949 and elaborates the way the CCP and the Chinese government tried to reduce regional inequality. The chapter compares the difference between Chinese political institutions before 1949 and after. The chapter also argues that Mao's influence on economic policy-making was significantly constrained by institutions. With the help of statistical data, this section evaluates the decreasing regional inequality after 1949, showing that institutional factors effectively explain patterns of uneven Chinese development during this period better than culture, economic history, individual leader's intervention, and international influences.

Chapter Six explores the durable shift of political institutions in 1979 and its impacts on China's uneven development thereafter. The main task of this chapter is to explain the mechanism that these new political institutions increased regional inequality, again taking culture, economic history, and international influences into account. This section also studies the "Developing the West" strategy, designed by the CCP and the Chinese central

government in 1998 to reduce regional inequality, and finds that new institutions built after 1979 constrained the effectiveness of this policy.

Chapter Seven concludes findings of the entire research and summarizes policy and research implications. The section concludes that IT is necessary and sufficient to explain the shifts of regional inequality in post-1949 China; that is, the changes in political institutions shaped economic institutions which in turn shaped economic outcomes. Moreover, this section also concludes that IT may also be useful to explain regional inequality in countries that have institutional similarities with China.



## Chapter Two Changes in Chinese Regional Inequality in Historical Perspective

This chapter studies the way Chinese regional inequality has been affected by political, economic, and international factors across Chinese history. This chapter first introduces economic and geographic conditions of the three Chinese regions: the Coastal, Inland, and West. Second, the chapter explores internal and external factors that affected the tendency of regional inequality in traditional China. Third, the chapter discusses regional inequality in Nationalist China. The chapter also briefly introduces the shifts of regional inequality in communist China between 1949 and 2005. These introductions trace the historical background of the uneven development in China, helping us understand regional inequality shifts in post-1949 China.

### One China with Three Regions

Many studies analyze Chinese inequality at the provincial or city level (Jian, Sachs, and Warner, 1996; Jones, Li, and Owen, 2002). They find that during some period before 1979, Chinese inequality was reduced. These studies also find that after 1979, rural inequality across Chinese regional increased.

These findings are consistent with the pattern I have illustrated in Table 1.2. First, the findings by Jian, Sachs, and Warner can be mainly explained by their own observations; that is, before 1990, much of the average reduction in provincial inequality resulted from the strong trend of convergence across Coastal provinces, meaning that only the *intra-regional* inequality might have decreased before 1990 but the *inter-regional* inequality might not have decreased at all.

Second, the authors also noticed that Coastal provinces continuously develop faster than interior provinces after 1990, indicating that economic inequality between the Coastal area and the other two regions has been increasing since then. Susumu Yabuki and Stephen Harner also find that although there was a trend of reducing inequality across Coastal provinces, economic inequality across the three regions increased in the 1980s and 1990s (Yabuki and Harner, 1999: 97-99).

Third, what Jian, Sachs, and Warner also focus on is that rural reform had partially reduced regional inequality in the 1980s. It could be the case. However, it was also possible that the increasing difference of industrial product across regions, were too large to offset the decreased inequality in agricultural sector, so the net economic inequality across Chinese regions would still increase (Jian, et al. 1996; Yabuki and Harner, 1999: 93-102; 149-69).

Fourth, even the temporary increase in rural-urban inequality in 1959 and 1960 was strongly correlated with a short-period fiscal decentralization in 1959, supporting my argument in the following chapters that Chinese institutions significantly affected Chinese regional inequality (Lardy, 1979: 124-32; Wei, 2000: 48-50).

Finally, sample size may influence research results. Jian, Sachs, and Warner's analysis is based on provincial data, but my analysis of Chinese economic inequality is at the regional level, which is mainly determined by two factors. The first and most important reason is to reach the contribution of public policy to inequality. During the past several centuries, macroeconomic policies designed by the Chinese central government were based on regional level (Skinner, 1977: 211-20, 1985; Li, 1996; Hendrischke and Feng, 1999: 4). Second, the change in intra-region administrative units

may also distort data analysis at the sub-regional level. For example, Chongqing, one provincial area, had been a city under Sichuan province till 1997, while Hainan province was a city-level area under Guangdong province before 1988. In addition, the Chinese central government shifted some cities from one province to another in the past decades, and many new cities were only established after the late 1950s, so I do not analyze inequality at the city level as Jones, Li, and Owen did.

Therefore, my analysis deals with the regional level. This dissertation classifies mainland China into three regions endowed with different natural and social resource endowments: the Coast, Inland, and West (Table 2.1).

**Table 2.1. The Administrative Units of the Three Chinese Regions 2005**

| <b>The West</b> | <b>The Inland</b> | <b>The Coastal Area</b> |
|-----------------|-------------------|-------------------------|
| Sichuan         | Shanxi            | Beijing                 |
| Guizhou         | Heilongjiang      | Tianjin                 |
| Yunnan          | Jilin             | Hebei                   |
| Shaanxi         | Anhui             | Liaoning                |
| Gansu           | Jiangxi           | Shanghai                |
| Qinghai         | Henan             | Zhejiang                |
| Ningxia         | Hubei             | Fujian                  |
| Tibet           | Hunan             | Jiangsu                 |
| Xinjiang        |                   | Guangdong               |
| Chongqing       |                   | Hainan                  |
| Inter Mongolia  |                   | Shandong                |
| Guangxi         |                   |                         |

Data Source: Chinese National Statistics Bureau (CNSB)

### *The Coastal Area*

The Coastal area is mainly constituted by river delta and scattered low hills. The area occupies about only about twelve percent of China's total land area but contains more than half of Chinese population (Chinese National Statistical Bureau [CNSB], 2001). The land and environment in this area is well-suited to intensive agriculture as long as labor

and capital are available (Cheng, 1985). The Coastal area also enjoys the geographical proximity to international trade because with many ports along the long coast. Chinese history also recorded that Coastal residents formed and entrenched the norm of openness and economic aggressiveness (Gu, 2001; Gu, 1998). Thus, although the Coastal area lacked many natural resources for development, its geographic proximity to foreign trade helped it modernize after China had to reluctantly open door to Western countries after the Opium War (1839-1842).

**Table 2.2 Regional Distribution of China’s Major Mineral Resources (%)**

| Mineral    | Coastal area | Inland Area | Western Area | Inland and the Western Areas |
|------------|--------------|-------------|--------------|------------------------------|
| Chromium   | 12.5         | 7.1         | 80.4         | 87.5                         |
| Iron       | 47           | 27.9        | 25.1         | 53                           |
| Manganese  | 8.8          | 21.9        | 69.3         | 91.2                         |
| Gold       | 27.6         | 47.5        | 24.9         | 72.4                         |
| Silver     | 24.1         | 45.3        | 30.6         | 75.9                         |
| Nicker     | 0.8          | 9.8         | 89.4         | 99.2                         |
| Lead       | 25.6         | 31.1        | 43.3         | 74.4                         |
| Zinc       | 21.3         | 31.6        | 47.1         | 78.7                         |
| Copper     | 10.5         | 37.2        | 52.3         | 89.5                         |
| Bauxite    | 4.4          | 58.8        | 36.8         | 95.6                         |
| Phosphorus | 8.5          | 38.1        | 53.4         | 91.5                         |

Data Sources: Chen, 1996; Joseph, and Zhang, 1999.

From 1839 to 1949, the Coastal area was well ahead of the other two regions because it had well-developed industries and agriculture. The Coastal area continued to lack some necessary resources for industrialization during the pre-1949 period, and had to import these resources from the other two areas (See Table 2.2). In addition, the Coastal area was able to attract a well-educated labor force from other two areas with higher wages.

### *The Western Area*

Much of the huge Western area is mountainous. The West also has limited arable land with low annual precipitation, obstructing the development of intensive agriculture in this area (Zhao, 1994). The Western area contains about seventy four percent of total Chinese land, but only about nine or ten percent of the Chinese population lives in this area (CNSB, 2001).

The two great rivers in China, the Yellow River and the Yangtze River, originate in the mountainous areas in the West. The abundant water resource in the West enables it to develop hydroelectric power. In addition, the area also has abundant oil, natural gas, and Coal, which are necessary for industrialization (Table 2.3).

**Table 2.3 Regional Distribution of Energy Resources in China (%)**

| Energy Resources           | Coastal area | Inland Area | The West |
|----------------------------|--------------|-------------|----------|
| <b>Hydroelectric Power</b> | 7.5          | 14.7        | 77.8     |
| <b>Coal</b>                | 5.3          | 56.2        | 38.5     |
| <b>Oil</b>                 | 43.8         | 40.5        | 15.7     |
| <b>Natural Gas</b>         | 21.9         | 6.9         | 71.2     |

Data Sources: Chen, 1996. China Association for the Study of Natural Resources (CASNR) ed. 2001. Joseph and Zhang, 1999.

Indeed, in traditional China, whoever controlled the Western area had an advantage in controlling other Chinese areas. This was because the Western area had plateaus at a higher altitude than the other two regions, so that ancient armies in this area could easily attack the other two regions but effectively resist the other two regions' attack by controlling the choking points into the West (Shima, 1986; Gu, 1998). When barbarians controlled this area, they threatened the security of the central government. Thus, to secure political control of China, some Chinese dynasties established capitals in the West

and laboriously imported resources from other two regions. Chinese dynasties which built their capitals in the Inland area would also assign a large number of soldiers to the West (Gu, 2001). To reduce financial burden, the central government ordered these soldiers to cultivate arable land in the West, a practice which facilitated Western growth.

### *The Inland Area*

The Inland area contains plains and mountains with an elevation of between one thousand to two thousand meters. This area has abundant arable land and natural resources such as coal, copper, and iron ore. The Inland area used to be the bread basket of China and it still produces a large amount of cotton, rice, wheat, and tea due to the favorable climate, nourishing soil, and powerful irrigation system in this area (Qi, 1999). After 1840, the Inland area exploited its natural resources to gradually build some industries, including textile and tobacco factories, iron and steel companies, lumber firms, and firms that cultivated coal, iron ore, gold, and other minerals (Shi, 1989; Yan, 2001).

Many Chinese dynasties were established in the Inland area because the abundant Inland resources offered powerful assistance to those dynasties to control the entire China. The Inland area had a developed educational system, relatively developed transportation, and a cultural adherence to traditional Chinese norms, which in turn attracted elites from other regions. During the traditional era, most Chinese leaders arose from this area and would often make favorable fiscal and tax policies for the Inland region. All these factors had consolidated the leading status of the Inland area in Chinese politics for almost one thousand years (619 to 1644).

### Regional Inequality in Traditional China (before 1839)

The physiography of Chinese regions does not entirely determine the relative prosperity of each region's economy. Other factors, such as political intervention and economic policy, also affected China's regional development.

Economic inequality across Chinese regions is a historical phenomenon and has changed several times. During the fifth century BC, the Inland area was the economic center of China in that the Zhou dynasty and several successive dynasties had transformed this area into a political center and extracted huge resources from other regions. The cultural advantage of the Inland area also helped it to attract well-educated labor force and investments which reinforced its economic superiority. The satellite kingdoms perceived the conquering of this hinterland as a crucial step in controlling the whole of China. When a Western kingdom, Qin, conquered other six major kingdoms located in the Inland and Coastal areas, it intended to transform the West into a political and economic center by transferring resources from other Chinese regions. The West Han Dynasty maintained this policy until its downfall in the early first century A.D. (Shima, 1986; Qian, 2007: 111-26). During the following five centuries, economic centers in China shifted. The Southeastern area, which previously was deemed as culturally and economically underdeveloped, made much economic progress when large number of citizens escaping incessant Inland civil wars immigrated to this area. When China's powerful dynasty Tang was established in 619, it made every effort to develop the West where the Chinese national capital was then located (Zhu, 1993; Qian, 1997: 415-22). Interregional roads and canals were built under the guidance of the Tang government to

convey necessary resources to the West. The central government also levied heavy taxes on other areas, especially the Yangtze Delta, to support Western development (Ouyang, et al. 1981; Zhu, 1993). Nevertheless, because of the over-cultivation of land and the deterioration of local environment, economic growth in the West began to decrease in the mid-eighth century.

In the beginning of the tenth century, the Inland area (or *Zhongyuan*), once again became the economic and political center of China. Transportation facilities and agricultural skills were greatly improved in *Zhongyuan* due to the Song government's effort. The Song government also established many schools in the Inland which provided well-educated human capital for economic development. The government even created specific financial agencies to develop regional commerce (Zhang, 2005: 78-98; Deng, 2007: 128-86). Nevertheless, this regional ascendance did not last long. In the early twelfth century, central China's economy was almost destroyed by continuous invasions from northern nomadic tribes. After the twelfth century, the relatively peaceful Southeastern area became the most developed region in China due to continuous government investment (Chi, 1936; Qian, 2007:623-26).

External and internal factors contributed to these shifts. The rapid development of the South in the eighth and twelfth century was affected by external shocks, especially aggressions on Northern China by northern nomadic tribes, which moved economic growth to the South. The ever-developing financial system in the South and Southeast in the late sixteenth century, for example, also consolidated growth in these areas.

Specific government policies hindered Coastal development before the nineteenth century. Most traditional Chinese governments, for example, forbade Coastal residents to



build or own ships, fearing that they collaborate with foreigners. The Ming dynasty (1368-1644) enacted laws to punish any Coastal residents who would dare to engage in foreign trade (Zhang, 1981). The Qing Dynasty (1644-1911) also ordered residents along the Coast to move fifty miles inside to prevent them from assisting foreigners, especially the Japanese, smuggle contraband or weapons into China (Xie, 2006: 218-66). These laws made it difficult for the Coastal area to fully employ its geographic advantages in foreign trade, although navigational and shipbuilding technology in China was well developed during the period from the twelfth to the seventeenth century (Qian, 2007: 830-32).

Despite these limits, the Coastal region still developed agriculture, handicraft plants, and domestic trade. Intensive agricultural technology and advanced irrigation systems were developed in this area in the early twelfth century. The relative infrequency of war in the Coastal region also helped it amass enough capital and skilled workers to further develop its economy. The area attracted abundant resources, whether by governmental financial transfers or private investment, and developed at a faster rate than that of the other two Chinese regions.

#### Regional Inequality in Modern China (1839 to 1949)

External factors increasingly impacted Chinese regional inequality between 1839 and 1949. The Opium War (1839-1842), which broke out between China and Britain after the Chinese Qing government punished British businessmen who smuggled opium into China, fundamentally changed the Chinese regional economy. Before the war, there was only one licensed port in China for international trade; and there were strict limits on

the volume of foreign trade, and on trading partners. For example, the Chinese government stipulated that only thirteen government-controlled companies could deal with foreign trade and the total amount of annual imports were also strictly regulated. The Qing government believed that China did not need foreign goods, and deemed foreign trade as a political tool to retain the political hierarchy system with China as the center while other countries as the periphery.<sup>7</sup> In most cases, only countries that were classified by the Chinese government as “civilized” could be granted the rights to do business with China.

Therefore, the Chinese economy was not influenced much by external factors before the Opium War. However, after 1840, the Qing government lost a series of wars to France, the Britain, the U.S., Russia, and Japan. The treaties followed the wars forced the Qing government to open more trading ports to foreign countries (Li, 1996). All these ports were located in the Coastal area or along the Yangtze River. This shift changed Chinese economic geography, with the Coastal area benefited greatly from foreign trade and became the most developed area. Coastal cities like Shanghai, Tianjin, Qingdao, Dalian, Amoy, and Hong Kong developed rapidly and became growth centers in the Chinese economy (Rawski and Li, 1992).

The trade potential of Coastal area significantly affected major Western countries’ policy toward China by increasing their stake in this region of the country. During the Taiping Revolution (1851-1864), a revolt launched by some Chinese Christians to oppose

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<sup>7</sup> Traditional China built a center-periphery system in East Asia and foreign trade was used as an effective way to control small countries that needed Chinese products. If small countries obeyed Chinese orders, they would get very preferential trade term, while those violators would elicit trade sanctions from China.

the corrupt Qing government, Western countries at first declared neutrality and would not support either side. When the rebels, who proposed the appropriation of private property, marched to the Coastal area, Western countries immediately helped the Qing government suppress the rebellion to protect their own interests (Li, 1996; Qian, 2007: 871-77).

During the first two decades in the twentieth century, the Coastal area steadily developed export-oriented industries.<sup>8</sup> The Coastal area imported raw materials from other Chinese areas and produced industrial goods mainly for export.

The Qing government's successor, the Nationalist (KMT) government, had planned to develop the West and other poor Chinese areas. In 1923, Dr Sun Yat-Sen in his *The Strategy of Building a New China (Jian Guo Fang Lue)* laid out a detailed plan to develop the West assuming that a centralized government were able to solve regional inequality in China (Sun, 1986). Nevertheless, China dissolved into several warlord-controlled regions between 1912 and 1928. Each region did build some weaponry or war-related factories, but this fell far short of industrializing.

In 1928, the Nationalist Party declared the unification of China under the control, but some areas were still controlled by local elites. The KMT government designed a comprehensive plan to develop China. The government incorporated the development of the West and Inland into this policy agenda, but it gave preference to the Coastal area because the government believed this relatively developed area was a foundation for developing the entire Chinese economy by attracting needed capital and technology from Western countries. This strategy later was criticized by KMT's political rivals, including

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<sup>8</sup> In this regard, China was increasingly, although somewhat reluctantly, tied to the international economic and political system.

the Chinese Communist Party (CCP) and some intellectuals, as a policy to serve international capitalists' interests. With this strategy, however, China grew steadily between 1928 and 1936, holding an average annual growth rate of 6.5 percent (MacFarquhar, 1991). During the eight-year period, all three regions developed rapidly, but regional inequality in China enlarged with the Coastal area grew faster than the other two regions.

Before and during the Sino-Japanese war (1937-1945), the Nationalist government made a great effort to develop the Inland and West, trying to fortify them as reliable war bases. The Chinese central government began to reallocate Coastal factories, machines, capital, and well-trained workers to the Inland and West in the mid-1930s (Chen et al. 2006: 186-89). Historians estimated that about one third Coastal industries, with their machines and workers, were successfully reallocated to the hinterland before the full-scale war broke out in July 1937. More important, many Coastal universities had also been moved to the West, helping the area acquire a more competitively labor force for local economic growth.<sup>9</sup> The reallocation of resources to the interior areas before and during the Sino-Japanese War (1937-1945) motivated the two regions' industrialization.

When the Sino-Japanese war ended in 1945, the Nationalist government once again started to encouraging Coastal growth. The Coastal area, especially the Yangtze Delta and the Pearl Delta region, received major capital investments. The CCP, which was powerful in the West and Inland, criticized the KMT for serving the Coastal area's interests while neglecting the backwardness of the other two regions. The CCP enhanced its power during the eight-year Sino-Japanese war and began to challenge the KMT's rule

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<sup>9</sup> This was mainly motivated by patriotism among Chinese intellectuals.

after 1945. The civil war between the CCP and the KMT, mainly waged in the West and Inland, continued for four years (1945 to 1949) and almost destroyed the economy of the two regions.<sup>10</sup> The war had less impact on the Coastal economy, so the government as well as private investors shifted most of their resources to this relatively peaceful area, which enhanced Chinese regional inequality.

By 1949, when the KMT lost the civil war to the CCP and fled to Taiwan, huge regional economic discrepancy had already entrenched itself in China, with the Coastal area most developed and the West least developed. About eighty percent of modern industries were concentrated in the Coastal area (Dong, 2005a). Other areas functioned to provide the Coastal area with primary goods or raw materials and to purchase Coastal goods.

#### The Shifts of Regional Inequality in Communist China (1949-2005)

When the CCP won the war and established the People's Republic of China (PRC) in 1949, it inherited a nation that had been tortured by decades of continuous wars. Believing that an unindustrialized China would be easily invaded and humiliated by other countries, the party decided to industrialize China as quickly as possible. Worrying that the Coastal area would be most easily attacked by foreign powers, the CCP focused on developing the other two regions (Gao, 2003; Dong, 2005a; Lu, 1990; Yang, 1997:15-26; Yang, 2001). This decision was mainly based on political and military considerations by the CCP, but it also reflected economic requirements of China's industrialization.

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<sup>10</sup> Some battles were also engaged in the Coastal area, but it ended immediately and did not bring severe damage to industrial bases, a goal that expected by the CCP.

Between 1949 and 1976, averagely the PRC directed about sixty percent of its investment on average to the West and Inland regions (Bo, 1998; Gao, 2003). By administrative orders, the government also assigned experts and well-trained workers from the Coastal area to the West and Inland. Moreover, the poor transportation system had obstructed economic transactions between the interior and Coastal area (Bo, 1998). Hence, the Chinese central government also greatly improved transportation facilities in the two areas (Pang, 1984). Because of these policies, the West and Inland developed faster than the Coastal area and regional inequality significantly reduced during the pre-1979 period, although some authors find that the trend of regional inequality was not smooth before 1979 (Kanbur and Zhang, 2004).

Chinese regional inequality again increased after 1979. Believing that Chinese regions could not develop at the same pace, the CCP and the Chinese government altered its development strategy in 1979. The party and the government thought the Coastal area could develop faster because it owned solid industrial basis, highly trained workers, and a geographic proximity to international market (Xiong, 2005; Yang, 1997: 26-39). Advocated by senior leaders, such as the CMA (Central Military Association) chairman Deng Xiaoping and the National Planning Committee chair Chen Yun, the CCP and the Chinese government designed preferential policies such as tax breaks and progressive government investment for the Coastal area. Numerous Coastal cities were gradually defined as Special Zone Areas to attract Foreign Direct Investment (FDI) and advanced technologies. The government also reduced financial assistance to the less efficient State Owned Enterprises (SOEs) in the West and Inland, putting the two areas' economy at further disadvantage (Gao, 2003; Yang, 1997: 28-36).

## Conclusion

Historical dependence, resource dispersion, specific geographic features, and administrative arrangements divide China into three regions: the Western, the Inland, and the Coastal area. Regional inequality has existed for most of Chinese history. The West and Inland took turns as the most advanced area in traditional China. However, after 1840 the Coastal area became the most developed region as China, and has been increasingly involved in international businesses.

After the CCP came into power in 1949, China experienced two changes in economic inequality across the three regions. The first change reduced the regional gap with the Inland and West developed faster than the Coastal area during the pre-1979 period. The second shift again consolidated the leading status of the Coastal area in the Chinese economy and enlarged regional inequality after 1979. The following chapters will analyze the reasons, processes, and economic consequences of the two shifts.

## Chapter Three Alternative Explanations of Chinese Regional Inequality

This chapter explores theoretical frameworks that have been used to explain regional inequality between and within nations. This chapter reviews economic, political, and cultural explanations of regional inequality. Economic analyses offer basic models for studying regional inequality, but they cannot satisfactorily account for shifts of Chinese regional inequality. Existing political models are useful in illustrating the process of Chinese regional inequality shifts, but they are weak to explain causes and mechanisms that engendered such shifts. Cultural explanations help us understand some features of Chinese institutions, but they overstate cultural effects in shaping Chinese regional inequality and cannot explain the shifts of such inequality. In short, these frameworks are incomplete in explaining the two changes in regional inequality in post-1949 China.

This chapter introduces Institutional Theory (IT), showing it can provide an effective approach to analyzing the shifts of regional inequality in post-1949 China. First, IT helps fill in the gaps left by existing theoretical frameworks when applied to the case of Chinese regional inequality. Second, IT incorporates the merits of economic and political explanations and offers a dynamic analysis of the changes in Chinese regional economic inequality in the post-1949 period.

### Economic Explanations of Regional Inequality

Economists have offered several explanations of regional inequality. Classical economic theorists such as Frederic List, William Perry, David Ricardo, and Adam Smith argue that regional differences of natural endowments determine economic achievement of a region or country (Gilpin, 1987: 12; 181-182). These economists maintain that



countries or regions with abundant endowments are more likely to advance faster than countries or regions with poor endowments.

This model assumes that absolute economic advantage will help the economic development of nations. According to classic economic theory, comparative advantage could allow a resource-scarce nation or region to develop faster than other areas if it has specific production or international trade advantages. David Ricardo detailed comparative advantages of Britain and Portugal to show this process. Although Portugal was at a disadvantage to England in natural endowments, it could still focus its production on its relatively abundant endowments and benefit from trading with Britain. Such beneficial trade could occur because of the opportunity cost of production; that is, Britain could produce its *most advantaged goods* while Portugal could produce its *least disadvantaged goods*, and trade could increase the total wealth for both countries (Ricardo, 2004).

This simplified economic model has deficiencies in explaining changing regional inequality such as that observed in China. The model ignores the changing context and the emergence of new technologies that affect comparative advantages. The model also assumes no hurdles to international or interregional trade, but tariff and non-tariff barriers are very common in the real world. In addition, the model presupposes that productive factors such as technology, skilled workers, and capital, are immobile across countries, but productive factors regularly move across borders.

Indeed, existing endowments do not fully determine a nation's prosperity; instead the way a nation or region takes advantage of such opportunities shape its prosperity. The rapid development of Japan after World War II shows that effective development policies may have a much greater impact on prosperity than natural endowments. Japan has

limited natural resources to sustain its rapid economic growth. Taiwan, Hong Kong, and Israel also lack natural resources but all have attained substantial economic achievements. Their success must depend on other factors, such as peaceful international context or effective domestic policy, which are obviously not included in the natural endowment model.

As to regions inside one country, the relative comparative advantage of each area may help to explain regional economic differences, but does not determine that areas with fewer assets will lag behind other areas. The development of Xinjiang province in China supports this point. Before 1949, Xinjiang was believed to have few natural resources and was severely underdeveloped. With the help from the Chinese central government, however, Xinjiang successfully initiated its economic growth after 1949. Although Xinjiang was technically behind other Chinese areas, the central government helped the area extensively develop agriculture, especially the production of cottons, grain, wheat, and grape. The area also established some heavy industries with financial and technological assistance from the central government. By 2005, Xinjiang had become the most developed province in the West. This case shows that effective policies can overcome the natural endowments deficiency in regional development.<sup>11</sup>

The second and most recent economic explanation of regional inequality is the *Ladder-Step Doctrine (LSD)*, which argues that due to economic constraints, domestic

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<sup>11</sup> The original intention of the Chinese government to cultivate Xinjiang was to ensure tight control over the area, which was dominated by ethnic minorities such as Uygurs, Kazak, Kyrgyzs, and Hui, officially became a Chinese province in 1884. To effectively suppress any uprisings from ethnic minorities, the Chinese government since 1884 had relocated millions of Han residents from other Chinese areas to this new province and established paramilitary units in Xinjiang (Wang, 2004).

regions have to develop gradually from the center to the periphery. Albert Hirschman suggests that it is unrealistic for a poor nation to develop all its regions at the same time. However, some areas or cities, which enjoy more economic or political advantages, can develop early. The “trickle-down” effect of the developed area will eventually push the development of other areas, so that regional inequality can be reduced in the long run.<sup>12</sup> Hirschman argues that for a country to attain high economic growth it must develop several regional centers with economic strength (Hirschman, 1958).

Another economic approach to explaining uneven economic development is the “Inverted-U” model proposed by Simon Kuznets. This model argues that regional inequality in a developing economy may enlarge initially because of polarization effects but will decrease later as economic development diffuses to other areas. Hence, the process is like an “Inverted-U” as Kuznets suggested (Kuznets, 1955). In China, the most developed cities are seen by this school as “engines of growth” or “growth poles”, and all regions will be fully developed in the future when Coastal growth will trickle down or spillover to the interior (Dong, 1999; Yang, 1997: 27-28).

German scholar Walter Christaller introduces another economic model--the “central place” theory. This theory argues that there a hierarchy of central places and nested market areas in a country, and that this hierarchy accounts for regional inequality. Christaller maintains that the tradeoff between economy of scale and transportation cost pressures producers to cluster into discrete geographic areas. The concentration of

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<sup>12</sup> This effect means the slow but continuous technology and investment transfer from developed area to the underdeveloped region as the marginal cost of using the matured technology or investment in developed area increases (Hirschman, 1958).

producers allowed “central regions” to boom, putting them at the top of economic hierarchy of that country (Christaller, 1933). Christaller’s model clearly illustrates the hierarchical structure of economy in some countries, but this model cannot explain the shifts in Chinese regional inequality during the past five decades. According to Christaller, the “central area” could retain its dominant status indefinitely (Christaller, 1933). But in China, the Coastal area had been politically and economically marginalized by the Chinese central government before the late 1970s because the expected wars with other countries would easily destroy the Coastal area. Hence, this model is incomplete in explaining the change in Chinese regional inequality.

There is no purely economic model for explaining the way regional inequality shifts or persists. John Friedman points out that the “trickle down” effect can only exist theoretically as several factors obstruct the reducing of economic inequality across regions. Two factors, the failure of the market to efficiently allocate resources and the inability of underdeveloped areas to adapt appropriately to the socio-economic changes, significantly affected regional inequality (Friedman, 1966).

Roland J. Fuchs and George Demko point out another problem in the LSD model. The relative wealth of the most developed areas attracts skilled workers from other regions, thus reducing human capital, one important factor to economic growth, in less developed areas (Fuchs and Demko, 1979:315-16). In addition, according to the LSD model, the development of interior areas should be smooth and gradual. The history of Chinese regional growth, however, does not show a smooth linear development across the three regions as this model has suggested. Both the West and Inland have experienced

rapid development for a period after 1949. Again, a major problem of the LSD model is it ignores the role played by government in regional modernization.

The third economic explanation argues that international trade and FDI (Foreign Direct Investment) essentially shape regional economic inequality. This model argues that the Coastal area engages more intensively in foreign trade and attracts most FDI, helping the area more developed than the other two areas. As Table 3.1 shows, for example, the Coastal area has enjoyed much advantage in engaging export and attracting FDI, and hence it is much developed than the other two areas.

**Table 3.1 Shares of Regions in Total FDI Inflows and Total Exports in 2002**

| Region          | % of Total FDI Inflow in 2002 | % of Total Exports in 2002 |
|-----------------|-------------------------------|----------------------------|
| Coastal         | 85.2                          | 91.7                       |
| Inland and West | 14.8                          | 8.3                        |

Sources: Chinese National Statistics Bureau (CNSB).

There are several problems in applying this model to the Chinese case. First, the model does not tell us the causality of FDI, trade, and economic development; that is, it can be the advanced economic development that facilitated exportation and FDI inflow instead of the vice versa. Second, the model does not tell us what policy has made the Coastal area much more attractive to FDI after 1979. Third, the theory cannot explain the reason that Chinese regional inequality only began to widen after 1979. The model is insufficient to explain why China's increasing international trade with other countries before 1979 did not enlarge Chinese regional inequality. We have to ascertain whether

geographic proximity in foreign trade, as Shen, Wong, Chu, and Feng argued, is the significant factor that influenced Chinese regional inequality (Shen et al, 2000).

During the pre-1979 period, China still had extensive economic communications with many countries. The major Coastal cities, such as Shanghai, Guangzhou, Amoy, Tianjin, Dalian, Ningbo, and Qingdao served as international trade ports. The Coastal area also attracted huge investments from, and engaged extensively in trade with, the Soviet Union, Eastern European countries, Australia and Japan. Nevertheless, on average, the Coastal area did not develop faster than the interior area during the pre-1979 period, entailing that international trade and FDI alone were still insufficient to account for changes in Chinese regional inequality (Naughton, 2004: 379-80).

A fourth economic explanation of regional inequality highlights differences in the concentration of manufacturing centers (Krugman, 1993; 1995; Johnston, 1999). The “*Manufacturing Zones Framework*” (MZF) model argues that the three manufacturing zones in China, which situated in Northeast, Southwest, and Southeast China respectively, drove regional inequality. Richard Auty also argues that the concentration of Heavy and Chemical Industry (HCI) greatly affected China’s regional inequality as HCIs promoted host area’s productivity and induced investment to related industrial field that supply services and components to HCIs (Auty, 1992: 418-94).

However, the three manufacturing zones or HCI zones cannot account for patterns of regional inequality in the Chinese case. Liaoning province in Northeastern coastal area concentrated about thirty five percent of manufacturing productivity in the 1950s, but for two decades since the late 1950s Liaoning province had been less developed than many inland provinces. Another problem is causality. In modern China, the level of

manufacturing concentration in each region was the result of economic development rather than the opposite. Moreover, the shifts of manufacturing zones did not in tandem with the shifts of regional inequality in modern Chinese history (Yang, 1997: 15-42).

Han Sunsheng and Clifton Pannell find that privatization has significant geographic consequences in China, which partly explains Chinese regional inequality (Han and Pannell, 1999). This research provides a new perspective of studying the shifting Chinese regional inequality after 1979 by exploring the change in property rights in various regions. The paper finds that the Coastal area was authorized to foster the development of private property rights after 1979 while the other two regions were constrained in fostering private property rights. The difference of private property rights in the three regions hence affected regional economic inequality. These authors, however, do not prove the causation between regional difference of private property rights and regional economic inequality, so they do not exclude the possibility that it is economic inequality that caused different levels of private property rights across regions. More important, these scholars do not answer the prior question of why property rights were changed.

William G. Skinner (1965: 195-228, 363-99) and Albert Feuerwerker (1963: 53-63) argue that transportation facility has been a crucial factor in affecting Chinese regional inequality. They argue that Coastal growth was caused by the area's increasing economic interaction with foreign countries. Dwight Perkins also argues that the poor transportation facility constrained the development of the West and Inland in the long run, although it helped the two areas' economy survive external shocks (Perkins, 1975).

These models identify a useful dimension of regional inequality, but they have at least two problems. First, they cannot account for initial economic situation of Chinese

regions. That is, they cannot explain why the Coastal area had enjoyed a higher growth rate despite its closure to foreign trade before 1842. Second, the model cannot explain the reason that regional inequality still enlarged after the 1980s while interregional transportation facilities had been greatly improved.

Finally, some scholars argue that regional inequality is a historical phenomenon and is path dependent. They argue that developed regions are more capable in attracting investment because investing in the developed area has less default risk and higher expected returns (Harris, 1954; Lowry, 1964; Pred, 1966). Thus, capital holders prefer to invest in the developed region, making rich regions develop faster.

The main problem of this historical account is it cannot explain why economic status of each region in Chinese history changed twice after 1949 if the cumulative effect of regional economy is irreversible. Some other elements, besides economic factors, must exist to influence Chinese regional inequality after 1949.

In sum, although economic theories can partly explain the formation of regional inequality in China, they cannot explain the shifts of such inequality after 1949.

#### International Relations and Domestic Politics Explanations of Regional Inequality

Political scientists also have tried to explain Chinese regional inequality in four different ways. The first explanation of regional inequality mainly comes from International Relations (IR) scholarship. IR argues that in the contemporary world, no country can isolate itself from the influences of world politics and economy while capitalism shapes the world system. IR posits that the expected conflict with other nations affects a country's economic policy and hence patterns of regional inequality. For



example, the Cold War pressured the Chinese government to transfer resources from the easily attacked Coastal area to the Inland and West in the 1960s (Chen, 2006). This school also argues that the soaring Foreign Direct Investment (FDI) after 1979 decisively contributed to the rapid development of the Coastal area, and greatly enlarged Chinese regional inequality. This explanation points out external factors that impacted Chinese regional inequality, but it leaves unclear domestic mechanisms that channeled those external factors into influencing Chinese regional inequality.

A second explanation, which is mainly advocated by socialists, argues that Chinese regional inequality was the intentional design of imperialism. Supporters of this theory argue that China before 1949 was not really an independent country. The imperialist countries decided, directly or indirectly, which area should develop faster. This model argues that to pursue higher returns, imperialist countries invested intensively in the Coastal area, which facilitated Coastal development (Li, 1996).

It is true that foreign investors before 1949 were more likely to invest in the Coastal area, which had a better economic basis and higher investment return rate than that of the other two regions. This pattern motivated the Chinese government to make preferential policies for the Coastal region. Nevertheless, the model is limited in helping understand Chinese economic growth during the post-1949 period when only limited foreign capital flowed to the Coastal area.

A third more recent approach argues that Chinese local governments shape regional inequality. Political scientist Chung Jae Ho classifies three kinds of local responses to central economic policies: pioneering, bandwagoning, and resistance (Chung, 2000). Pioneering areas initiated some innovative development policies, and then built support

for their efforts, which in turn pressured the central government to acknowledge the legality of local policies. Other provinces jumped on the bandwagon to avoid possible political or economic risks for initiating policies. To protect local interests, some provinces resisted policies issued by the central government. For example, some Western and Inland provinces in the 1980s often refused to implement the entire open door policy because their economic assets were insufficient to deal with possible competition. The various attitudes and strategies advocated by local areas thus influenced local policy-making and local growth, which in turn impacted Chinese regional inequality (Chung, 2000; White, 1995). The main problem of this explanation is it begs the question why the central government chose to allow local innovation after 1979.

The fourth framework argues that domestic regime reforms and subsequent policy changes determine shifts in the Chinese regional development. This approach holds that in 1979 Chinese politics changed dramatically, greatly impacting China's regional growth. Advocated by moderate Chinese leaders, such as Deng Xiaoping, Hu Yaobang, and Zhao Zhiyang, the CCP and the Chinese government during the post-1979 era shifted regional development focus towards the Coast area (Baum, 1994: 225-227).

This model is the most promising approach because it begins to consider institutional factors that might have affected Chinese regional inequality. The model is still insufficient because it mainly focuses on preferences or ideologies held by top leaders and underestimates the effects of important institutions such as the CCP and the changing power balance between the central and local governments that strongly altered Chinese regional inequality in the past several decades.

In short, works by current political scientists are helpful in explaining intentions or process of shifts of Chinese regional inequality, but they are still not enough to explain institutional and dynamic mechanisms that engendered the two shifts of Chinese regional inequality during the post-1949 period.

### Cultural Explanations of Regional Inequality

The last set of explanations emphasizes cultural factors, positing that the difference of Chinese regional culture shaped each region's behavior and hence determined the economic level among these regions. For example, Yang Zhongmei argues that different subcultures of Chinese regions strongly affected Chinese regional inequality. Yang maintains that the Coastal culture emphasizes hard work, while cultures in the other two areas believe that enjoying leisure is a more important part of one's life (Yang, 2003). Tim Oakes studies the interaction between provincial behaviors and local culture and argues that cultural factors significantly affect regional economic achievement (Oakes, 2000). Gu Zuyu and Gu Yanwu, experts in ancient China, also maintained that the difference of subcultures across Chinese areas contributed to regional inequality (Gu, 1998; Gu 2001).

Although these cultural explanations can be helpful to understand some institutional features in local Chinese areas, it is insufficient to explain the two changes in regional inequality in post-1949 China. First, it is almost impossible to empirically test these qualitative explanations. These theories are similar to Max Weber's *cultural determinism* in explaining economic development by highlighting the cultural role played in economic growth (Weber, 2001). However, Chinese culture is a constant, while patterns of Chinese

regional inequality have varied since 1949. Culture thus cannot sufficiently and necessarily explain what caused shifts of regional economy in Chinese history when subculture across regions remained constant.

### Institutional Theory (IT) and Regional Inequality

To supplement previous explanations, I draw on the Institutional Theory (IT) as an analytic tool to analyze the changes in Chinese regional inequality after 1949. IT defines institutions as “the rules of the game in a society, or more formally, are the humanly devised constraints that shape human interaction” (North 1990: 3). According to IT, human beings constructed institutions, deliberately or unintentionally, to maximize potential benefits and reduce transaction costs.

IT classifies institutions as two types: formal and informal, both of which, I hypothesize, are crucial for understanding and explaining the path of Chinese regional inequality. I further hypothesize that formal institutions greatly impacted Chinese regional inequality since 1949 because they produced specific policies and mechanisms that first shrank and then expanded Chinese regional inequality.

According to Douglass North, institutions structure incentives in human exchange, “whether political, social, or economic” (North 1990: 3). Institutions provide “the basic structure by which human beings throughout history have created order and attempted to reduce uncertainty in exchange” (North 1990: 118). Institutions also define the scope of human activities by affecting the possible transaction cost of human activities through formal laws and regulations or through value systems widely accepted in society.

One important type of formal institutions is rules, laws, or related policies designed by the government or the dominant power. According to Lance Davis and Douglas North, there are three forms of government behaviors that may affect the rate and scope of economic development: a specific law that proscribes or permits a particular institutional arrangement; a general enactment that proscribes or permits a range of possible institutional arrangements; and a law that defines the legality of actions (Davis and North, 1971: 27). Jack Knight also points out that governmental policies or rules may have strong distributional effects, whether or not they increase economic efficiency for the society (Knight, 1992).

Informal rules are established and widely accepted norms in society that govern people's actions. Although these norms may not be in written form, all people know them and act according to these norms, or they will be marginalized by the society.

Such institutions and institutional changes contributed to the shifts of regional inequality in post-1949 China despite the economic, political, and cultural continuity across the three regions. These institutions and institutional changes changed transaction cost that determined Chinese regional development. The "Great Leap Forward" policy in the late 1950s, for example, helped the West and Inland develop but suppressed economic growth of the Coastal area. The "Special Economic Zone" policy implemented after 1979 encouraged the development of the Coastal area (Yang, 1997: 26-39).

IT can help address the gaps in understanding the changes in Chinese regional inequality since 1949 that are not fully explained by economic, political science, or cultural theorists. First, it helps to comprehensively illustrate the *mechanisms* that drive economic changes. The analyses of institutional games among different participants are

crucial in understanding the way some policies were made at specific times rather than at other times, and how these policies specifically affected outcomes (Downs, 1957; Buchanan and Tullock, 1962; Riker, 1962). Economic theories may stress the cost-and-benefit trade-off in the market, while political studies mainly focus on the role played by political parties. IT incorporates merits of the two analyses by simultaneously exploring the cost-and-benefit aspect and political institutions that affected decision-makings. IT thus helps to clarify context, behaviors, decisions, and outcomes.

Second, IT can help us analyze shifting relations between economic and political factors that are essential for shifts in regional development. Chinese political institutions, for example, have extensively determined the operation of the market. The state not only provides needed goods such as security and transportation for the market, it also defines transaction cost of goods and services in the market by laws or political orders. For example, each Chinese local government in the mid 1980s had the power to forbid the entry of non-local goods to the local market, which undermined the formation of an efficient national market and thus China's economic growth (Wedeman, 2003). Such an institutional arrangement also reduced the effectiveness of policies designed by the central government aimed to reduce regional inequality.

The CCP and the Chinese government use institutions to promote or inhibit markets. For example, political rewards can discourage or encourage market, driving economic development and thus affecting regional inequality. During Mao's leadership (1949 to 1979), although realizing political goals had higher priority than economic growth, the central government would still promote local officials in the Inland and West to develop

their local economy (White, 1998; Yang, 2001).<sup>13</sup> Since the late 1980s, local leaders who had achieved a higher local economic growth rate would more likely to get promoted, encouraging local governments to develop local economies (Yang, 2001).

Therefore, Chinese politics and markets strongly influence each other. Chinese political institutions directly controlled economic activities by stipulating which actions are allowed or prohibited. The market exerted its influence via the price system and set constraints on political leaders or parties. For example, the party and the central government, irrespective of their political preferences, had to deal with economic recession during the late 1950s. When the nationwide famine starved millions of citizens in 1960, the CCP had to temporarily allow the free market to revive in rural areas in exchange for political support from the grudging cadres and masses (Yang, 2001).

Third, IT also analyzes the “path dependence” mechanism to explain the trajectory of structural changes. Path dependence means that previous structures or institutions can determine the trend of structural changes in the future. It also indicates that even if previous institutions are inefficient, they may still be retained because of the four self-reinforcing mechanisms, as defined by Brian Arthur: large fixed costs, learning effects, coordination effects, and adaptive expectations (Arthur, 1988: 10). Large fixed cost acts like a threshold to obviate the initiation of small challenges, and the unit costs decrease as output increases. Learning effects improve product quality or reduce product costs. Coordination effects confer advantages to cooperation with other economic agents who

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<sup>13</sup> Mao died in September 1976 and his supporters “the Gang of Four” were arrested by moderate leaders in October 1976, but the major political institutions were kept intact until the end of 1979. This dissertation thus defines the closing year of Mao’s leadership as 1979.

are acting in the same way. Adaptive expectations mean that the accepted beliefs of the current arrangement elicit beliefs of further prevalence. These four mechanisms together strengthened the power of current options and suppressed the possibility of taking alternative options that lack these advantages. The four mechanisms thus build a lock-in for adopted arrangement; that is, once the solution is taken it is difficult to exit. Arthur's model is powerful for accounting for institutional changes in China because it explains that the institutional strength of the CCP allowed it to alter the priorities of regional economic development. Although Chinese institutions were considered by many as inefficient in the past decades, they still dominated China's economic development due to the entrenched lock-in system resulted from the four mechanisms suggested by Arthur. After 1949, it was impossible for another political regime to replace the communist governance because the CCP forbade the existence of any other political parties. Party propaganda helped it mobilize strong support from the masses. The well-built party system in the CCP successfully coordinated activities of party branches. The CCP also gradually improved its governance by learning from its own experiences. The four mechanisms hence well explain whatever policies the CCP might take and whatever resulted from these policies in the past several decades.

In sum, to fully understand the reasons, processes, and outcomes of Chinese regional economic changes in the past decades, researchers have to study the way Chinese political institutions affected two such economic shifts in regional inequality. IT, accordingly, provides a framework for understanding shifts of economic development, and for Chinese regional economic inequality.



## Conclusion

This chapter has analyzed alternative theoretical frameworks that may be able to explain changes in regional inequality in post-1949 China. Economists propose several explanations about regional inequality, but they cannot account for both changes in regional inequality in post-1949 China. International relations theorists and some political scientists effectively analyzed external context that contributes to the change in regional inequality in post-1949 China, but these explanations do not account for the mechanisms of such change. Cultural explanations argue that different regional values elicited different behaviors in each region, which indirectly affected Chinese regional economic inequality. But they are still insufficient to explain the abrupt changes in regional inequality between 1949 and 2005 when culture was held constant across the three regions. Finally, the chapter shows that IT offers a powerful alternative model for explaining political and market mechanisms that had affected regional inequality in China since 1949.

## Chapter Four Political Institutions and Chinese Regional Development in Post-1949 China

This chapter discusses political institutions which impacted patterns of Chinese regional inequality during the post-1949 period. I first analyze economic influences of Chinese political institutions on regional inequality. Second, I specify government institutions and market mechanisms that were crucial in driving these institutional changes. Third, I analyze key political institutions in post-1949 China, particularly the Chinese Communist Party (CCP), the constitutional relationship between the central and local governments, and official laws and rules. These formal institutions provided legal context for Chinese regional development during the post-1949 era. In addition, this chapter also discusses informal institutions such as institutionalized norms and values that also affected the making and implementation of policies that shaped the tendency of regional development in post-1949 China.

### Political Institutions and Their Economic Implications in Post-1949 China

Chinese political institutions during the post-1949 era affected the path and outcome of Chinese regional economic development in six ways. First, Chinese political institutions provided public goods for regional development. Between 1949 and 1979, the CCP and the Chinese government directly allocated about one third of the nation's entire investment in developing transportation, public schools, and hospitals in the Western and Inland area, which facilitated the two areas' growth.

Second, political institutions in post-1949 China allowed the government to regulate the economy extensively through the operation of State Owned Enterprises (SOEs) or

governmental purchasing, which endowed the government substantial power to manipulate the economy. Before the late 1970s, the CCP also established party branches in each SOE. SOEs such as Beijing Iron, Dongfeng Vehicle, Daqing Oil, and Taiyuan Heavy Machinery, etc, not only produced commodities under the guidance of the CCP, but also helped the party govern. Many SOEs during Mao's leadership were organized as military units, and workers were grouped into para-militia groups. In Western and Inland areas, administrative committees of SOEs also acted as police departments or councils. This situation began to change only after the mid-1980s (Chu, 2003; Yang, 2001).

Third, Chinese political institutions after 1949 set the legal context for economic activities by issuing and enforcing series of laws, including the Law of Land, the Enterprises Law, the Law of Investment, and the Regulation of National Planning. These laws defined which kind of economic activities was legal and specified the extent to which the state would encourage different types of economic behavior. These laws stipulated that all productive resources, including land and capital, belonged to the state and only the National Planning Committee (NPC) had the authority to arrange production. Local enterprises must act according to rules and orders issued by the NPC. Believing that the free market challenged the communist doctrines, the CCP also prohibited the free market before 1979; officially sanctioned collective economic activities, meanwhile, received every support from the government. Beginning in 1979, however, the CCP altered institutions to encourage marketization to fuel economic growth (Baum, 1994: 66-69; Yang, 1997).

Fourth, political institutions in post-1949 China directly affected regional growth by increasing or decreasing transaction cost of many economic activities. For example,

before the early 1990s it would be very difficult to get a license for starting a company in many Chinese areas. It was also common for local governmental agencies to use extorting so that private enterprises and investors routinely had to bribe local officials to circumvent the slow bureaucratic process (Yang, 2001).<sup>14</sup>

Fifth, political institutions in post-1949 China designed policies to affect regional economic development. The CCP and the central government in the 1950s, for example, had designed the “scissor gap” policy to intentionally suppress prices of agricultural products and to increase industrial goods’ prices to amass enough capital for China’s further industrialization (Pang, 1984).<sup>15</sup> Starting from the early 1950s, the Chinese government and the CCP also initiated the Five Year Plans (FYPs) to streamline the Chinese industrialization, although the effectiveness of the FYPs during each historical period varied (Dong, 2003 a and b; Pang, 1984; Yang, 1997).

Finally, the *centralization* and *decentralization* of Chinese political institutions during the post-1949 period affected the trend of Chinese regional inequality. The centralized or decentralized power structure directly affected the authority of local regions and subsequently determined regional economic achievements. The centralized system between 1949 and 1979 stipulated that regions could not design policies for regional development but only to implement policies designed by the central government.

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<sup>14</sup> He Qinglian also argues that the cost of bribing officials constitutes a large proportion of the total business cost for private enterprises. Yang Xiaokai’s research shows similar result (He, 2005; Yang, 2001).

<sup>15</sup> The term “scissor gap” was coined by the Russian revolutionary leader Trotsky to refer to the enlarging price gap between agricultural and industrial goods. Trotsky suggested increase prices of industrial products but suppress prices of agricultural goods, helping the Soviet government amass capital from agricultural sector to support industrialization.

In such a centralized regime, regional governments did not have sufficient incentive to develop their local economies. When decision-making was decentralized after 1979, regional governments were motivated to develop local economies using material rewards. Therefore, areas that had more economic advantages could develop faster than those that lacked these advantages.

To explain interaction between Chinese governmental institutions and the market, and the effects of this interaction on regional inequality, it is necessary to consider several vital institutions in post-1949 China. These institutions include the CCP, dualism that defines the power relationship between the Chinese local and central government, formal laws and rules, and some vital institutionalized norms.

#### The Chinese Government and Chinese Regional Inequality after 1949

Understanding uneven economic development among regions in a nation like China requires an explanation of governmental mechanisms that drive the regional economy to develop at different rates. As economist Walt Whitman Rostow argues, in many cases “the initial impulse to economic modernization is generally seen to arise from basically non-economic motives.” Rostow maintains that the driving force of economy often originates from the government, which is more powerful than the market to induce technology importation (Rostow, 1971:3-4).

Governmental forces may foster economic development by decreasing costs of some economic transactions. The government, for example, may guarantee political stability that markets need to thrive. The government issues laws to help citizens protect their property and designs policies to encourage investment or technology acquisition. The

government also provides necessary public goods, such as transportation facilities and national defense, to propel economic growth. In addition, government spending can also fuel economic growth.

Not all government behaviors, however, are helpful for economic growth. Some governmental activities increase transaction cost of certain economic activities, and consequently limit economic growth. Heavy taxes, for example, obstruct the development of national enterprises. Government regulations may also lead to inefficient provision of goods. For example, North argues that policies designed by the Spanish royal government undermined that country's long-term competitive advantage (North, 1990). Yang Xiaokai compares the patent law system in Britain and France in the eighteenth century and concludes that Britain achieved higher technological level due to its better designed and implemented patent laws (Yang, 2001).

What the Chinese Nationalist (KMT) government did between 1912 and 1928 provides a clear example of the way that political institutions shape economic growth. Scholars claimed that the KMT government protected the interests of social elites at the expense of the Chinese masses and obstructed Chinese economic development.<sup>16</sup> The KMT government frequently trampled private property rights to serve the interests of the party or party leaders (MacFarquhar and Fairbank, 1971). In addition, Chinese investors often had to pay higher taxes than foreign firms because the Nationalist government wanted to garner more revenues but dared not to offend foreign powers. Local government often extorted Chinese businessmen or pressured them to hire officials' incompetent relatives. The KMT government often charged violators as *intending to*

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<sup>16</sup> In this dissertation, contemporary China refers to the period after 1919.

overthrow the government or *trying to* avert taxes. Many allegations were false, but convictions of these small property owners were almost inevitable because judicial system was controlled by the KMT. To avoid political and legal problems, Chinese businessmen often had to bribe Nationalist officials. These institutions hence increased transaction cost of Chinese investors, putting them at further disadvantage in competing with foreign companies (Wang, 1995: 12, 76-89). The concentration of social wealth in the hands of very few social elites, mainly senior officials, also limited the development of an effective Chinese market because the demand was mainly focused on luxury goods while the purchasing power from the masses remained very low.

#### The Chinese Communist Party ----The Key Political Institution in Post-1949 China

The CCP is the most important institution in determining China's economic development. The Chinese Constitution states that the CCP is the founder of, and hence the "sole governing party" in, the People's Republic of China. The CCP is a "proletarian party based on the worker-peasant coalition" and "represents the interest of all Chinese people" (The People's Congress of China, 1982). In traditional China, the emperor was the source of authority and the representative of the nation; in post-1949 China, the CCP plays a similar role in managing political and social issues.

To control the country effectively, the CCP transformed itself into a systematic governing entity after 1949. At each government level, the party committee had the final decision power (Teiwes, 2000). Local party committees controlled local government agencies and were responsible for its upper committees and finally were responsible for the national Politburo (Yabuki and Harner, 1999). The national Politburo, which usually

comprised five to nine standing members, was the ultimate authority on important issues such as designing foreign policies, appointing senior officials, and making important economic policies (Yabuki and Harner, 1999). The decisions made by the Politburo must be transmitted to the National Congress, a nominal legislative branch, and to be publicized as laws or administrative orders.

Unlike political parties in democratic countries, the legitimacy and authority of the CCP is not based on popular votes, but is generated from its revolutionary achievements. The CCP was established in 1921 but it was suppressed by the KMT after 1927 and most communist partisans were executed by the KMT government. The CCP finally established rural bases in northern Shaanxi (*Shaanbei*), a poor area in the Northwest of China, in 1936 (Wang, 1995). The CCP claimed it sincerely represented the interests of the masses, and it successfully mobilized continuous support from poor peasants and unemployed city residents. The KMT government, which mainly served the interests of urban businessmen and large landlords in the rural area, had tried to annihilate the CCP by encircling *Shaanbei* with about half million well-trained and equipped soldiers.

However, the Japanese invasion in 1937 helped the CCP to grow. Chinese local elites urged the national KMT government to unite all Chinese power to resist Japanese aggression. The KMT then legalized the CCP and ordered the Red Army to engage in the war against the Japanese. The increasing corruption of KMT officials during the Sino-Japanese War (1937—1945) provided great political opportunities for the CCP to build



popular support, especially in the West and Inland.<sup>17</sup> The CCP successfully enlarged its army during the war to more than one million well-trained soldiers (Wang, 1996; Spencer, 1998). In addition, with series victories in guerrilla wars against the Japanese invaders, the CCP also reoccupied a large bulk of rural area that had been occupied by the Japanese. Thus, at the end of the Sino-Japanese war, the CCP had significantly enhanced its power by building solid trust in rural areas, especially in the Western and Inland areas.

The CCP defeated the KMT during the civil war between 1946 and 1949. To mobilize wide support from peasants and poor urban residents, the CCP alleged the KMT government as the lackey of the “American Imperialism” because the KMT had intentionally developed the Coastal area but let the Inland and West underdeveloped (Wang, 1995). Intensive Coastal development, the CCP argued, mainly served the interests of Western countries and helped them exploit the Chinese people. This strategy helped the CCP mobilize support from the poor, especially Chinese peasants, by promising them a patch of private land or stable employment (Wang, 1995). The KMT finally lost the civil war in 1949 and fled to Taiwan.

Once in power, the worker-peasant coalition consolidated CCP’s deep penetration in the Chinese society and strengthened the party’s advocacy of populism before 1979 (Tsao, 1987). Since the CCP defined itself as the representative of the masses and the rural population constituted more than eighty percent of the Chinese total population, it

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<sup>17</sup> Some historians argue the war began in 1931 when the Japanese attacked the Northeastern area of China, but conventional scholarship thinks 1937 as the starting year of the war when the KMT government decided to stage a full-scale resistance against the Japanese aggression.

tried to develop its support in rural areas. Thus, for many years before 1979, the CCP had believed that economic inequality among the three Chinese regions undermined its peasant base in the two interior areas and hence became a political threat to the legitimacy of the party. When making policies to develop regional economies, the CCP had to ensure that these policies would not enlarge inequality among the regions.

After 1979, however, the CCP began to emphasize its urban constituency, especially to cities in the Coastal area. The CCP after 1979 argued that populist policies implemented between 1949 and 1979 had greatly limited China's development because they did not conform to economic laws of efficiently allocating resources. Thus, the CCP proposed that China could develop faster by allowing resources to move to more productive areas--the Coastal cities (Pang, 1984; Wei and Ma, 1996).

The CCP essentially determined Chinese economic development after 1949. Before the late 1990s, the party did not only control economic resources via SOEs or collective farms, it also supervised all governmental agencies. Since then, privatization and foreign investment have weakened the party's direct control. In 1999, for example, about seventy percent of investment was from non-state investors (Deng, 2001). The CCP, however, also controlled most banks, especially the People's Bank, and retained the authority of taxation (Yabuki and Harner, 1999: 159-79).

The CCP hence dominated the government and thus defined the legality of all economic activities after 1949. At each level of the government, the CCP decided policy-making via the party council (The CCP also decided the essence of related laws or decrees in regulating the economy, which nominally were issued by the National Congress (Yabuki and Harner, 1999: 33-39). Most government officials were required to

be party members and each local government should not only follow the orders from upper level governments but also were required to responsible to local party committees. The party council helped the CCP control the state tightly before the late 1990s; but it also caused inefficiency as local officials and bureaucrats frequently shirked their responsibilities to the central government.

As an authoritarian party, the CCP institutionalized many important political ideas and social norms in China between 1949 and 2005. To strengthen the party's governance, the CCP tried to define norms and values of the society. The CCP defined socialism and Marxism as dominant values in Chinese society and forbade competing values to emerge. The CCP stipulated that all people should serve national interests; that is, each individual person's activities should conform to collective interests of the nation. The CCP also stressed the role of the central government instead of regional or local functions. The public educational system instructed the people, at least in form, to accept norms advocated by the CCP. Doctrines of socialism and Marxism, for example, are tested in most admission exams from middle school to post graduate institutions. In addition, Chinese laws also ordered that each government official should advocate principles of socialism, a basic requirement for his or her future promotion.

These institutionalized social norms, in turn, constrained policy options for the party and the government. The gradual publicizing of the free market in post-1979 China provides a good example.<sup>18</sup> To address concerns of party hardliners or workers who strongly believed that the market was an evil, the CCP had to label the market system as

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<sup>18</sup> The labeling of political goals or events was important in traditional china because it was a discursive power of politics and affected the legitimacy of related policies.

“socialist economy with some free market” when it decided to initiate economic reform in 1979. In 1987, the party changed the name as “socialist planned commodity economy”, which still stressed the dominant role of SOEs in the Chinese economy although non-collective economy was allowed. In 1992, the party termed the market system as “socialist market economy with different forms”, which maintained the equal status of state-owned and non-state-owned enterprises (Yang, 2004: 7). In 1998, the CCP defined the “market economy with Chinese characteristics”, which allowed the free market with some governmental adjustments. In 2002, the CCP stipulated that private enterprise owners could become party members, and private property rights would be deemed legal by the new Chinese Constitution.<sup>19</sup> These changes show that the CCP and the Chinese government gradually chose the market as the means to adjust economy in post-1979 China; and direct regulations over regional inequality, as the CCP and the government did during the pre-1979 era, were not preferred.

In sum, the CCP continued to significantly impact Chinese economic development and regional inequality even though the party diminished its direct involvement in economic affairs after 1979.

#### Dualism---- Power Balance between the Central and Local Governments

Political dualism is a second institutional factor that shapes Chinese regional inequality. In this dissertation, political “dualism” means the power balance between the

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<sup>19</sup> In China, a CCP membership means the higher likelihood of building good relations with the government or acquiring personal promotion in the future, entailing more material interests. The recruit of capitalists into the party therefore is actually a material reward.

two coexistent political entities—the local and central government in China. Dualism is important in Chinese political economy for several reasons. First, dualism shapes the scope of governance of the central government. The central government may allow local governments some discretionary authority to deal with local affairs. Most Chinese local governments, for example, have the power to develop local economy and levy local taxes. Dualism also defines local governments' authority to control local resources, hence impacting the growth of local economy.

Second, dualism also influences the effectiveness of policies designed by the central government because local governments are the agents that implement these policies. Dualism may cause conflicts between the central and local government because the two entities may have different interests and preferences (Nee and Mozingo, 1983). The central government has to negotiate with local governments in exchange for their effective implementation of national policies (White, 1998: 81-83). For example, after 1979, local governments could retain a percentage of national taxes they levied, facilitating them to effectively carry out national taxation policies (Wong, 2003: 6-22).

Third, dualism also denotes that the central government sometimes lacks sufficient power or incentive to resolve regional conflicts. As Andrew Wedeman and Yang Xiaokai pointed out, the weak coordination of the Chinese central government, accompanied with the fiscal and budgetary decentralization after the 1980s, intensified the irrational “trade war” across Chinese regions in the 1990s (Wedeman, 2003: 93-101; Yang, 2001). Therefore, dualism on the one hand increases the efficiency of governance, but on the hand it may elicit conflicts among various authorities in a country and thus reduce policy efficiency and effectiveness.

Dualism is a legacy of traditional Chinese politics. Historically, the central Chinese government was never able to fully control sub-national governance. Traditional national Chinese leaders experienced this governance dilemma. In periods of weak central governments, local governments often had much more power to pursue local interests. Even a powerful central government often had to adopt local suggestions, because local or provincial governments had more direct or clearer knowledge of the localities and they were expected to implement policies designed by the central government. Local or provincial units might also initiate or experiment with potentially risky policies. If the outcome was desirable, then the central government would incrementally expand the implementation of the policy to other areas. If the policy failed, the central government could still limit losses (Yang, 2001).

Indeed, an effective central control over China requires that the central Chinese government give local government substantial political power. One example was the Qing government's suppression of the Taiping Revolution (1851 to 1864). When the central Qing government found it difficult to suppress the revolution with the national army, it had to allow local governments to build military forces to defeat the revolutionaries. Chinese local governments retained the power to recruit soldiers and levy taxes even after the Qing government collapsed in 1911 (Qian, 2007: 886-88). With local warlords effectively controlled many provinces, the KMT and the central government had never effectively united China during the period 1912 to 1949.

After the CCP united China in 1949, the central government also had to struggle with local power and interests. The CCP incessantly tried to curtail local powers but found that local governments and bureaucrats often shirked their responsibilities. The

CCP would firmly punish deviant local leaders or local bureaucrats who were ineffective in realizing central government's will, but often found it difficult to find agencies to execute such punishment. The CCP and the central government had to acknowledge that dualism was a fact of Chinese political economy (MacFarquhar, 1999).

In post-1949 China, local and provincial governments played an important role in pushing the design of effective central policies (Huang, 1990; White, 1998: 81-83). Because of their regional biases, local officials' demands aimed to benefit their region disproportionately. For example, Coastal provinces preferred low resource prices but higher product prices, while inland provinces often sought higher resources but low price of manufactured goods from the Coastal area. The central government had to frequently balance these conflicting demands. This fact showed that local or provincial influences could be powerful for shaping Chinese economic growth during the post-1949 era, although the central government still retained great power in economic policy-making.

The strategic exploitation of dualism affected changes in Chinese regional inequality, both before and after 1979. When the central government decided to equalize local economies before 1979, it reduced regional autonomy via political orders, mass movements, and ideology indoctrination, to tilt the balance of power to the central government. When the central government gave more power to local governments and reduced its control over regional economic policy-making after 1979, regional gaps enlarged. Some areas could develop faster than others with inefficient local policies or poor economic bases (Yang, 1997; Wei, 2000). In Chapter Five and Six, I detail the way specific policies changed political and economic dualism and hence affected regional inequality in China between 1949 and 2005.

## Laws and Rules that Affected Regional Inequality in China

In principle, the central Chinese government designs all the nation's laws and rules, affecting Chinese economic development. In practice, the CCP controls the policy-making process, which determines the form and substance of these laws or rules, while provincial and local governments implement many of them. Laws and rules have to get approval from the CCP before they are officially issued.

The CCP issues laws and rules to govern China effectively. Official media, especially the newspaper *RenMin RiBao* (*People's Daily* or *RMRB*) and CCTV (The Chinese Central Television), are important for publicizing and proposing laws and rules. These laws and rules can constrain senior leaders' personal interference. For example, during the pre-1979 period, Mao often found his personal orders could not be carried out at all if these orders deviated from formal laws or rules (Yang, 2001).

Between 1949 and 1979, the CCP and the Chinese central government designed specific laws and rules to reduce regional inequality. One example was the making of the Five Year Plans which designed a detailed blueprint to push China's economic development and to reduce regional differences in wealth. Laws and rules affected the shift of Chinese regional inequality. When the CCP tried to reduce regional inequality in 1952, it first issued the Five Year Plans (FYPs), which regulated the progress of Chinese regional development by defining investment and growth rate of each area (Pang, 1984). The CCP and the government also set up other plans, such as the "Develop the Northwest Plan" and the "Third Front Project", to reduce regional inequality in the 1960s. All these plans were written laws or government orders, which instituted the legality of those policies to change Chinese regional inequality during Mao's leadership. The CCP and the



central government made FYPs every five years and stipulated that leaders' personal preferences should be excluded from these plans.

After 1979, the Chinese government believed that technically laws and rules would improve the CCP's governance and could help China develop faster. Therefore, many laws and rules were updated in the early 1980s to drive economic growth (Yang, 2001). However, interventions from senior leaders were greatly reduced. Chinese top leaders, including Deng Xiaoping, after 1979 found themselves more constrained than before by laws because there was no individual leader with the charisma that Mao once had (Baum, 1994; Yang, 2003). Due to the fading influences of political ideologies, these new laws or rules also provided pragmatic and effective support for Chinese development. For example, series of laws and rules were issued to support the Special Economic Zones (SEZs) policy after 1979, which established a legal and stable context for the unbalanced regional development in China (Yang, 1997).

In sum, the main function of these laws and rules is to limit personal interference from political leaders and to provide an institutional context for effectively implementing central policies designed to develop China's economy.

#### Informal Institutions and Their Economic Implications in Post-1949 China

Informal institutions also play a major role in shaping Chinese regional inequality because they affect the making and implementation of related policies. According to North, informal institutions include conventions and codes of behavior (North, 1990: 4). In the absence of the state or other formal institutions, informal institutions become "a dense of social network leads to the development of informal structures with substantial

stability” (North, 1990: 37). Informal institutions are important in the society because “the governing structure is overwhelmingly defined by codes of conduct, norms of behavior, and conventions” (North, 1990:36).

Informal constraints such as conventions and social norms can lower transaction cost by decreasing uncertainty among actors (Axelrod, 1986; North, 1990). For example, Chinese people’s loyalty to their hometowns helped local areas attract investments from their own affluent residents who made their fortune elsewhere. Some norms may increase transaction costs by circumventing laws and rules. In a society that tolerates substantial corruption, economic transaction costs will be high because businessmen have to bribe government officials or bureaucrats to get licenses. Enterprises can transfer the cost to customers, but this only transfers the cost of economic inefficiency within the society.

Informal institutions have been essential in affecting Chinese regional political economies. One example is the influence of *equity*, a norm that has dominant status in shaping Chinese people’s way of thinking and public policy-making. This norm influenced the operation and policy choice of the CCP and Chinese government (Huang, 2001). The term *equity* in Chinese culture first means the equal process of social competition, a norm on which the traditional Chinese civil exams (*Keju*) were built to evaluate and promote individuals. Whoever passed the exam would become an official and receive social respect. Nevertheless, civil exams only assured a very limited extent of social *equity* because some citizens, especially women, were prohibited from taking the exam. Second, *equity* in traditional Chinese society mainly referred to the will of the Heaven, and the government and the emperor would lose legitimacy if they failed to meet this goal. In addition, a radical interpretation of *equity*, mainly advocated by

revolutionary peasants, stressed equal income of every social member. This utopian interpretation of *equity* had successfully helped peasant leaders mobilize the poor Chinese during the three major revolts occurred in 881, 990, and 1636 respectively (Bai, 1991). Hence, most traditional Chinese governments would claim they had behaved accordingly to the rule of *equity*, which was also the will of the Heaven, to maintain or consolidate their legitimacy.

The CCP inherited and institutionalized this norm of *equity*. It affected economic policy-making in post-1949 China as it was an informal institution and one fundamental source for making related economic policies (Wei, 2000). This institution in modern China mainly requires that economically no one should be far better than others, which vitally motivated the central government and the CCP during the pre-1979 period to design policies to reduce regional inequality when the Coastal area was believed as far more developed than other regions.

Collectivism is another institutionalized Chinese norm that affects modern Chinese society. The norm maintains that individual interests could only be retained after collective interests were defended and enhanced. Collectivism affected economic policy-making in communist China by limiting policy options that decision-makers could choose, and it also helped decide the substance of related policies. For example, the Chinese government did not believe that local autonomy could produce a powerful China. Instead, it posited that the more power the central government had, the more likely for China to develop. When making policies to develop China, the CCP thus preferred to concentrate all power in the national government. Collectivism partially explains the reason that the CCP after 1949 insisted that regional economies serve the interests of

national economy. This norm was incorporated into the Chinese political institutions and allowed the central government to ask individual local regions, if possible, to sacrifice for national interests. During Mao's leadership, the Chinese government designed policies to support the rapid development of the Inland and West although Coastal economic efficiency was suppressed (Yang, 2001). After 1979, the Chinese central government and the CCP also designed policies to urge the Inland and West to sell raw materials and electric power to the Coastal area at low prices despite great discontent from the two regions (Dong, 1999).

### Conclusions

This chapter discusses political institutions, such as the CCP, dualism, and laws that were important for shaping Chinese economic development in post-1949 China. The chapter explores the way the power balance between the Chinese central and local government affected the implementation of policies that intended to change the Chinese regional inequality. This chapter also analyzes the CCP's role in the shift of regional inequality through making laws, government rules, and policies.

The CCP significantly determined Chinese economic development through designing economic policies and providing resources to implement these policies. Dualism affected the actual effectiveness of policies designed by the Chinese central government or the CCP. Even powerful leaders such as Mao, often found it hard to change dualism in the post-1949 period. Finally, institutionalized norms, such as *equity* and *collectivism*, were important in affecting the reduction of regional inequality in post-1949 China.

## Chapter Five Changing Political Institutions and Chinese Regional Inequality during Mao's Leadership

This chapter explores the way the changes in Chinese political institutions contributed to the reduction of Chinese regional inequality during Mao's leadership (1949 to 1979). This chapter illustrates the shifts of political parties, relations between the communist party and the state, the changing dualism between the central and local governments, and institutionalized ideologies for economic policy-making in post-1949 China. The chapter finds that although senior leaders such as Mao exercised some political power, they were constrained by Chinese political institutions. The chapter then studies the way Chinese political institutions reduced Chinese regional inequality during the pre-1979 period. The chapter shows that specific institutions and strategies, including the Five Year Plans (FYPs), the 156 Project, and the Third Front Project (TFP) furthered both institutional interests and regional equalization. The main finding is that Chinese political institutions and institutional shifts are necessary and sufficient for explaining Chinese regional inequality during Mao's era.

### Institutional Approach and Chinese Regional Inequality (1949-1979)

As Chapter Three argues, in addition to institutional analysis, there are at least three alternative explanations for Chinese regional inequality. However, as I have discussed so far, they are incomplete in explaining the reduction of Chinese regional inequality during Mao's leadership.

Economic theories focus on the difference of regional resource endowments and posit that it is the main source of regional inequality. As for the case of China, economic

models cannot fully explain the shifts of regional inequality after 1949. The difference of regional resource endowments partially affected Chinese regional inequality, but it is still insufficient in determining the frequent changes in regional inequality in post-1949 China when regional endowment difference is held constant.

International relations theories also cannot explain the shifts of regional inequality in post-1949 China. The main problem of these theories is that since China had changing international surroundings long before 1949, why did regional inequality only begin to change after 1949?

Moreover, cultural studies can partly explain some historical changes in Chinese regional inequality, but again they cannot explain post-1949 changes in regional inequality while culture was relatively stable across Chinese regions after 1949.

None of the three explanations can fully account for mechanisms that affected shifts of Chinese regional inequality between 1949 and 1979. Institutional Theory (IT), however, can fill this gap. First, IT comprehensively explains reasons and elements that drove changes in Chinese regional inequality after 1949. Political party dominance, dualism that defined the power balance between the central and local governments, and specific rules and plans such as the 156 Project and FYPs, constituted institutional factors that directly or indirectly affected changes in Chinese regional inequality. Second, IT successfully explains the mechanism that shaped patterns of Chinese regional inequality; that is, the change in political parties and power structures between the central and local government affected the making of policies and rules that brought about Chinese regional inequality. This is evident by the comparison of the KMT and CCP's governance in this chapter. Most important, the KMT national government had limited power to effectively

implement redistributive policy from the center, but the CCP had stronger centralized power to do so. In sum, IT rejects explanations that Chinese regional inequality was mainly determined by differences in regional cultures or resources, unexpected events such as the Cultural Revolution, or changes in international relations.

### The CCP: A New Powerful Political Party in post-1949 China

The CCP was almost an omnipotent institution that dominated the making and implementation of policies designed to reduce regional inequality during Mao's leadership. The CCP, unlike the nationalist party KMT, was much more powerful and effective in shaping the path of regional development in China.

The Chinese political system before 1949 was characterized by a weak central government and governing party. The KMT never effectively controlled China. First, the warlords who controlled local areas only nominally acknowledged the legitimacy and authority of the KMT central government. Second, the KMT government could not effectively resist aggression from Japan or other countries, and it had to acknowledge local authorities in exchange of their financial support (Wang, 1995).

The pre-1949 political system permitted or even slightly encouraged economic regional inequality to grow. Before 1949 the Coastal area developed faster due to its specialty in international trade. The Inland and West based their economic development on exporting natural resources, such as coal and iron ore, to the Coastal area. Compared to the Coastal area, the Inland and West were relatively underdeveloped, and the central government could not effectively reduce Chinese regional inequality. There was no integrated national market in pre-1949 China, although the KMT central government had

tried to build one. The pre-1937 civil wars and the Sino-Japanese War (1937 to 1945) were mainly engaged in the Coastal and some Inland areas and they slowed the formation of a national market (Wang, 1995).

During Mao's leadership (1949 to 1979), however, the CCP made every effort to exert control over policy-making and regional growth. The Chinese political institution *statism* (*Guojia Zhuyi*) helped the centralization of power in Chinese politics. *Statism* stressed that a strong centralized government is essential to build a strong China. Chinese history seemed to prove that China was powerful only when it was united under a centralized government. China would often draw attacks from northern tribes or descend into internal chaos when it had no powerful central government. Therefore, many Chinese supported a strong central government in principle.

The CCP incorporated *statism* into its policy-making during the pre-1979 period, which suggested centralized economy can effectively modernize a backward country (Naughton, 2004: 59-62). The CCP stipulated in 1956 that the CCP and the central government were the dominant authority to guide China's development (Yang and Chen, 2006:191-205). The central government retained the power to appoint and remove government leaders at every local level. Unlike those in the KMT government, local leaders during the post-1949 period would lose their jobs if they disobeyed central government orders. This control oversaw that central policies could be effectively implemented at local levels.

*Statism* also helped the CCP effectively control local economy through State-Owned Enterprises (SOEs). In the early 1950s, the CCP denied private property rights and transformed all private companies into collective enterprises or SOEs (Pang, 1984). The



CCP centralized the fiscal system by stipulating that major local revenues would be allocated by the central government (*Tong Shou Tong Zhi*). The Chinese national bank, the Central People's Bank (CPB), also helped the Chinese government or the CCP allocate funds effectively. The CCP ordered the CPB to set financial branches in most Chinese areas, and implement monetary policies to further regional growth of the West and Inland. Therefore, the CPB existed as a governmental agency to fulfill Chinese regional development policy during Mao's era.

The CCP also tightly controlled the media to propagate the party's policies and preferences (Chiu and Leng, 1984). The CCP instructed individuals from their childhood that all the Chinese obey the CCP's rule to modernize China. The CCP also prohibited the formation of any independent organizations. Any social organizations were incorporated as subsidiaries of the CCP. The CCP also controlled people's political participation by setting party units in every working unit (*Danwei*). Urban citizens were controlled by their working units, the schools, or residential committees. In the 1950s, the CCP also established millions of *Shengchandui* (working team) or *Gongshe* (agricultural community) in rural areas to control peasants and manage agricultural production (Li, 2003; Perkins, 1975).

By the mid-1950s, the CCP had successfully institutionalized the ideology that ranked collectivism above individual interests, and stressed that individuals should serve collective interests. But the CCP during Mao's leadership never eliminated all local resistance to central communist rule. The Chinese dualism, as mentioned in Chapter Four, provided a venue for local governments and officials to bargain with the central government to defend or enhance local interests. The central government periodically had

to decentralize its power when its policies failed and aroused discontents. The more difficulties the central government met, the more likely it would assign power to local governments (Dittmer, 1992). After the Great Leap Forward Movement (1958-1960) caused the starvation of millions of people, for example, the central government had to temporarily decentralize economic policy-making to steer the recovery from economic depression (Xiong, 2003; Gao, 2004; Li, 2006:172-176).

### Mao's Limited Role in Chinese Economic Policy-Making

It is possible that some individuals tried to affect the trajectory of Chinese development. In contrast to what previous literature had asserted, detailed study shows that during Mao's leadership, powerful leaders did not significantly control economic policy-making. Institutions such as the Chinese National Planning Committee (*Guojia Jiwei*) and the power balance among top leaders constrained individual leader's ability to affect economic development during Mao's leadership. In addition, Mao's apathy to economic affairs after 1961 also constrained his influence on economic policy-making.

Unlike Jiang Kai-shek, Mao built high prestige in post-1949 China. Between 1927 and 1949, Mao led a series of important wars to defeat the Japanese and the KMT armies, which won him great authority in the CCP and the government in post-1949 China.

Mao and many other top leaders were deeply influenced by the traditional Chinese norm *Shi* that stressed elites had the obligation and capacity to help the "ignorant" masses. This norm helped to consolidate the patriarchal rule which defined masters' patronage and subordinates' loyalty (Shih, 1995: 2-7).

Mao thought that the humiliating history of China after the Opium War (1839 to 1842) was caused by weak leadership, which Mao defined as “a group of selfish or unskilled top leaders” (Mao, 1945). Mao argued that Western countries had bullied and exploited China through those weak Chinese leaders. To help China restore its glory and enable the country to develop quickly, China must have a powerful leadership.

Mao stressed that political power must be highly concentrated in the hands of senior party leaders. Mao ordered that his will should be fully implemented, but Mao often had to revise or even abandon his plans due to institutional constraints, including effective resistance from other party veterans or government agencies (Yang, 2001; Liu, 2008).

Mao tried to totally control the power by building personal allegiances from top military leaders because Mao thought that “political power is out of gun barrel”, meaning that military power is the basis of political governance (Mao, 1930). Mao built good relations with some powerful Marshals, such as Lin Biao (before 1971), Chen Yi, and Ye Jianyin, who enjoyed high prestige and had entrenched personal networks in the army. To construct an effective institution that prevented the concentration of military power in the hands of a small number of leaders, the CCP divided China into eleven Military Regions (MRs) and then reduced them into seven.<sup>20</sup> Mao occasionally tried to change leaders in each MR, expecting to concentrate the military power by his own hands. However, these plans often failed because of opposition from senior Marshals. Another example was that five Marshals in 1971 successfully pressured Mao to change policies that might threaten the interests of these party veterans (Gao, 2004).

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<sup>20</sup> The number of regions changed to seven and then to eight in the 1970s. In 1983, the CCP redefined the number to seven.

Mao's power also was balanced by other institutions. The Central Politburo, which was constituted by senior party leaders, could veto Mao's policy. In a 1961 meeting attended by seven thousand cadres, due to pressures from the Central Politburo, Mao had to acknowledge his miscalculation in the making of economic policies that led to economic loss and famine between 1958 and 1961 (Gong, 1992). Mao's meddling in economic policy-making decreased after that meeting because Mao also thought he was not adept at economic management and any errors in making economic policies would only provide opportunities for his rivals to attack him. In addition, the cumbersome process of making policies such as the Five Year Plans also discouraged Mao from influencing economic policy-making.

In sum, although Mao had great prestige in post-1949 China, institutions such as laws and rules, as well as power balance among senior leaders, greatly limited Mao's personal influence on Chinese economic development.

### Institutionalized Ideologies during Mao's Leadership

Institutionalized ideologies also affected making policies that reduced Chinese regional inequality during Mao's leadership. First, the CCP institutionalized the "Communist Man" ideology, which assumed, although unrealistically, that every citizen was altruistic and sought to serve the interests of the society or the CCP. The CCP incorporated this idea into most policy-making and stipulated that all governmental agencies and individuals act for collective interests (Gao, 2004; Yang, 2001). According to this institutionalized ideology, each region must firmly obey central orders even if regional interests would be undermined. Thus, the ideology urges regional or local

governments to loyally implement economic policies designed by the CCP and the central government.

Second, the institutionalized Chinese norm *equity* also limited choices of the CCP and the Chinese government. Partly influenced by Chinese populism which highlighted the absolute *equity* across all social strata, the CCP defined *equity* as social justice and was an inalienable part of socialism or communism. The *equity* also indicated that in a system no individual part could be stronger than any others (Gong, 1992).

The institutionalized norm *equity* motivated the CCP and the central government to design specific policies to equalize Chinese regional development during the pre-1979 period (Gong, 1992; Pang, 1984). The CCP stipulated that no region should be more developed than the others. The CCP knew that natural endowments were important in pushing regional development, but it also posited that if the CCP allowed each region to develop by itself, the Chinese economic system sooner or later would be in chaos. The CCP argued that regional inequality would destroy “economic balance” on which the Chinese economic system was based (Mao, 1956; Bo, 1998). Hence, to attain a balanced development, the central government should strengthen weak areas and slow the growth of the more developed region via economic or political intervention. These ideas helped the CCP design policies such as the 156 Project and the Third Front Program to reduce regional inequality despite regional differences in natural endowments (Yang, 2001).

#### Institutions and Policies that Moved Regional Inequality during Mao’s Leadership

During Mao’s leadership, the CCP designed economic policies through specific agencies such as the National Planning Committee (NPC) and related departments in

charge of the issuing, publicizing, and implementation of these policies. Such an economic institution is termed as “command economy” which basically defined the dominant role of the CCP and the Chinese central government to adjust economy via orders, laws and rules, SOEs, and tightly controlled party systems (Naughton, 2004:59-62). The following sections detail institutions of the command economy that affected dualism and reduced regional inequality during the pre-1979 period.

### *Three Mechanisms that Drove Regional Inequality in China*

There were three policy initiatives that indirectly affected China’s regional inequality. The first one was the *Hukou* or Residential Record System (RSS) policy, which terminated free *labor mobility*. In 1955, three years after the land reform, the CCP issued laws to prohibit free labor mobility across rural and urban areas because the CCP thought such mobility would erode the party’s political control (Chi and Wang, 2005). In 1956, labor mobility across regions was also limited by the RSS. Those who violated the rule would be labeled as “aimless migrants” (*Mangliu*) and soon found themselves policed by local government (Ding, 1995).<sup>21</sup> The RRS limited the free flow of migrants and it endowed the government power to allocate human resources across regions.

Second, the CCP and the government also strictly limited interregional trade during the pre-1979 period. The CCP and the government espoused separate regional markets although they had aimed to build a strong integrated national market. Based on the idea that regional interests should be subject to national interests, the CCP required each

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<sup>21</sup> In fact, during the reform era, the number of *Mangliu* has largely increased and they had to accept low wages and endure bullies from policeman or bureaucrats.

region follow the laws or orders issued from the central authority and all mobility of resources and goods across regions must be regulated by central governmental agencies. Most economic transactions were conducted through one particular institution that the government called *Tong Gou Tong Xiao* (collective purchasing and selling). Citizens had to get special tickets (*Piao Zheng*), most of which were issued by local governments, to buy necessities. Citizens traveled to other regions could not buy anything because *Piao Zheng* was designed only for local use (Pang, 1984). These regulations helped local enterprises sell their goods, often with inferior quality or high prices, to local residents.

Third, central governmental agencies such as the Central People's Bank (CPB) and the NPC also tightly controlled *capital mobility* across regions. The CPB decided the amount of investment to each area and the NPC had the authority to ratify development projects reported from local areas (Pang, 1984). This institutional arrangement indicated that capital could mainly be allocated for political instead of economic reasons.

The control over capital mobility limited Coastal development, but helped the other two regions receive needed capital for local development because the control allowed them to amass capital, which previously would have flowed to the Coastal area to pursue higher rates of return (Dong, 2005b). Investment to the Coastal area hence slowed because the area could not attract funds from the other two regions any longer after 1949, and also because the Coastal area received less investment from the central government.

### *The Centralization and Socialization of the Chinese economy*

The ultimate goal of the CCP was to establish communism by centralizing and socializing economic resources. The CCP believed that China's poverty was caused by

the uncontrolled economy during KMT's governance. Almost all private enterprises, especially those supported by the KMT government, were described as the lackey of imperialism and only enriched themselves at the expense of Chinese national interests. The CCP thus claimed all private properties, such as land, capital, and natural resources, should be socialized.

Between 1949 and 1952, the CCP had successfully completed land reform by having confiscated all private-owned land and reallocated seven hundred million *mu* (each *mu* equals to 667 square meters) of land in equal parcels to three hundred million peasants regardless of the peasant's agricultural productivity (Li, 2003).<sup>22</sup> The successful land reform not only laid an economic foundation for the CCP to continue its socialization, it also inspired the CCP to transform China's other economic structures by political means. One example was the plan to reduce Chinese regional economic inequality (Pang, 1984).

Another important socialization policy implemented in the early 1950s was to transform private industries into SOEs. The CCP and the government set heavy taxes for, or constricted loans to, private enterprises. The CCP and the government also limited the legitimate scopes of private enterprises' activities. For example, in 1951, the government directed that no private companies were allowed to participate in the production and distribution of food, cotton, salt, and chemical products, claiming these products were crucial to people's daily lives (Pang, 1984; Xiong, 2005; Yang, 2001).

The CCP also sued many private-enterprise owners between 1950 and 1953 for crimes including: tax evasion, selling inferior goods, profiteering, manipulating market

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<sup>22</sup> The rural communes were finally established in 1958, but the public property rights of land were built in 1952 (Pang, 1984).



prices, bribing government officials or party members, and amassing food in the famine between 1950 and 1952 (Yang, 2001). Some private businesses were confiscated by the government, while others were “donated” to the government by their owners (Pang, 1984; Yang, 2001).

The CCP and the Chinese central government affected the Chinese economy through SOEs. Before the mid 1990s, SOEs, though many of them were inefficient, dominated the Chinese economy. SOEs affected dualism and helped the central government gain economic power relative to the local government. SOEs enabled the CCP and the central government to strategically arrange the production, distribution, and even consumption of products. For example, before the early 1980s almost all heavy industries were SOEs and were controlled by the central government. The state also required SOEs to hire more workers than needed to help the CCP secure city residents’ “rights to work”, although the requirement had reduced economic efficiency of SOEs (Sun, 1991; Chen, 1998).<sup>23</sup>

By the mid 1950s, the Chinese government had completed its effort to socialize Chinese rural and urban economies. In 1953 the CCP ordered all remaining private land in the rural area to be transformed into collectively-owned property before 1956. The rearrangement of property rights might be economically inefficient, but it established the basis of socialist economy as the CCP had expected. The socialization of urban economy was attained in 1956 and no private enterprises remained in China. Most private owners were hired by the government as managers or economic consultants.

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<sup>23</sup> Szelenyi et al also argues that the low efficiency of SOEs in Eastern European countries was due to the soft budget constraint and other mismanagement (Szelenyi and Szelenyi, 1994).

The CCP found it effective to change China's economy by issuing political orders. The free market was almost abandoned in China during Mao's leadership (Sachs and Yang, 2002; Naughton, 2004: 59-62). Almost all prices were set by the NPC or other governmental agencies. For example, the NPC set the prices of soaps, bicycles, film tickets, hair-cutting, and other services. Beginning in 1953, the NPC also governed the monopolistic purchasing and selling of important resources such food, cotton, and coal, etc. (Xiong, 2005). According to a study, during the pre-1979 era, about sixty percent of all industrial goods and seventy percent of agricultural goods were directly priced by the NPC. Other governmental agencies, including the Textile Department and the Coal Department, also controlled the pricing of other commodities (Liu, 2008). Thus, when the CCP found it necessary to support interior development, it used a "price transfer" policy by ordering Coastal products sold at low prices, while increasing the prices of the two regions' commodities.

Economic centralization after 1949 also meant that the CCP and the central government mobilized enough technological and managerial resources to facilitate economic development in the Inland and West. The establishment of SOEs in the West and Inland vitally facilitated industrialization in the two areas and reduced Chinese regional economic inequality. Enterprises that previously could not be set in the Inland or the West due to the lack of profitability, funds, or economic endowments could be built in or relocated to these two areas after 1949 by state intervention. Table 5.1 shows that in post-1949 China, especially during the period 1965 to 1971, the Chinese central government invested the major proportion of investment in the Western and Inland SOEs.

Without the central funding, industrialization of the two areas could not advanced so quickly

**Table 5.1 Capital Construction Investment in SOEs by major periods (Percent)**

| Regions | 1953-64 | 1965-71 | 1972-77 |
|---------|---------|---------|---------|
| Coastal | 40.1    | 27.9    | 40.7    |
| Inland  | 32.5    | 31      | 31.6    |
| West    | 27.4    | 41.1    | 27.7    |
| Total   | 100     | 100     | 100     |

Source: Wei, 2000: 80-81.

*The FYPs and the Reduction of Regional Inequality*

The Chinese government knew that it could not industrialize China and reduce regional inequality in a short time. So beginning in the early 1950s the CCP and the government initiated the Five Year Plans (See Table 5.2) to gradually build heavy industries and realize socialist economy in China via central planning (Dong, 2005 a).

All the FYPs during Mao’s leadership provided an institutional context for reducing regional inequality. The FYPs were mainly designed by the NPC to modernize China and reduce regional inequality at a steady pace over years. The CCP began to implement the first FYP in 1953 when the Korean War was over (Xu, 2005).

The CCP’s eagerness to build a modern agricultural sector in China, especially in the West and Inland, was also reflected in the early FYPs. Many factories, schools, or irrigation projects were built in the Inland and Western region to support agricultural development in the two regions.

**Table 5.2 The Five Year Plans and Their Impact on Chinese Regional Inequality**

| <b>The Five Year Plans</b> | <b>Dates</b> | <b>Main Projects Related with Regional Development</b>  | <b>Results</b>  |
|----------------------------|--------------|---|---|
| First Five Year Plan       | 1953-1957    | The 156 Project   | The 156 Project pushed the rapid industrialization of the two areas and reduced Chinese regional inequality.  |
| Second Five Year Plan      | 1958-1962    | The Great Leap Forward (GLF)  | Between 1963 and 1965 the FYP was suspended due to the disaster caused by the GLF   |
| Third Five Year Plan       | 1966-1970    | The Cultural Revolution; The Third Front Program (TFP)  | Local regions won more power in dealing with local economy. The TFP greatly developed the economy of the West and Inland area. Chinese regional inequality reduced. |
| Fourth Five Year Plan      | 1971-1975    | TFP   | The TFP greatly developed the West and Inland. Chinese regional inequality was reduced.   |
| Fifth Five Year Plan       | 1976-1980    | Radicalism ended and economic reform began in 1979; Special Economic Zones (SEZs) was built to develop the Coastal area | The Coastal area's economy began to take-off.   |
| Sixth Five Year Plan       | 1981-1985    | The Expansion of SEZs   | The Coastal area developed rapidly and regional inequality enlarged.  |
| Seventh Five Year Plan     | 1986-1990    | The Expansion of SEZs; Local governments got more leeway to tackle local economic development                           | Chinese regional inequality enlarged.   |
| Eighth Five Year Plan      | 1991-1995    | The Expansion of SEZs   | Chinese regional inequality enlarged. Secessionist leaders in Xinjiang and Tibet mobilized supporters.  |
| Ninth Five Year Plan       | 1996-2000    | The "Develop the West" Strategy was launched in 1998.   | Many SOEs in the West and Inland went bankrupt. Chinese regional inequality further enlarged.   |
| Tenth Five Year Plan       | 2001-2005    | More powers were given to local governments   | Chinese regional inequality kept on enlarging.  |

Data Source: Chinese National Statistics Bureau (CNSB)

The Chinese central government also tried to improve labor productivity in the other two regions by investing in civilian key-point development projects, including schools and health facilities. Table 5.3 shows the tilted investment toward civilian development projects in the Inland and West in the first FYP. As the population in each of the two regions was less than that of the Coastal area, such investment at per capita level was more tilted toward the two regions. The CCP and the Chinese government retained such investment structure till the late 1970s.

**Table 5.3 Investment in Civilian Key-point Development Projects in the First FYP (1953-57) (million yuan)**

|         | No of projects | Amount (Million Yuan) | Percent |
|---------|----------------|-----------------------|---------|
| Total   | 98             | 14261                 | 100.0   |
| Coastal | 26             | 4449                  | 31.2    |
| Inland  | 56             | 7902                  | 55.4    |
| Western | 16             | 1911                  | 13.4    |

Source: Wei, 2000:75.

To maintain economic or regional equilibrium, the FYPs during Mao's leadership aimed to reduce regional inequality incrementally because it was unrealistic to complete grand projects within one five-year schedule. One example was the construction of railways in the Inland and West, including the Chengkun and Qiangui Railway in the mountainous Southwest and the Lanxin Rail Line in the Northwest. Both projects took more than ten years to finish due to financial and technological constraints (Dong, 1999).

In sum, if the CCP's grand policy of developing China and reducing regional inequality was a comprehensive blueprint, then the FYPs during Mao's leadership

provided institutional templates for realizing the blueprint gradually. The FYPs also strengthened the power of the central government because the CCP could use the plans to concentrate economic and political resources to realize China's development goals.

### The 156 Project and Third Front Project

In each FYP before the late 1970s, specific policies were designed to reduce a regional inequality. The CCP tried to use several means to attain the goal during Mao's leadership. The first tool was the State Investment Plan, through which the central bank, the People's Bank (*Renmin Yinhang*), invested directly in each region to affect regional development. According to Chinese Central Statistical Bureau, between 1952 and 1979, the two regions received about sixty percent of all the direct investment from the central government. Since there was no private or limited foreign investment after 1952 when the CCP had almost eliminated private property rights, direct investment from the Chinese government reflected the real investment that each region could get during Mao's era. This statistic thus showed the CCP's determination to accelerate development in the less developed regions (Gao, 2003; Pang, 1984; Bo, 1998).

Another tool that the central government used to balance regional inequality was direct government spending to the two regions, which facilitated the two regions' economic development. Table 5.4 shows some important expenditures in the 1950s were paid by the Chinese central government. The structure retained until the late 1970s, which enabled the central government economic power to reduce Chinese regional inequality. For example, the major expenses related with building economic

infrastructures, reflected by the variable *economic construction* in the table, in the West and Inland were paid by the central government.

**Table 5.4 The Percentage of Expenditures Paid by the Central Government in the 1950s (Percent)**

|                                | 1950-56 | 1955 | 1956 | 1957 |
|--------------------------------|---------|------|------|------|
| Economic construction          | 83.8    | 87.3 | 79.3 | 78.2 |
| Culture, education, and health | 28.2    | 25.8 | 30.4 | 26.7 |
| National defense               | 100     | 100  | 100  | 100  |
| Administration                 | 20.1    | 16.4 | 15.4 | 11.7 |
| Credits and loan repayments    | 100     | 100  | 100  | 100  |
| Other                          | 76.7    | n/a  | 30.3 | 34.2 |

Source: Lardy, 1979:71-72.

**Table 5.5 Rate of Interregional Income Transfer in Selected Provinces, 1953-1980 (percent)**

|         | 1953-57 | 1958-62 | 1963-65 | 1966-70 | 1971-75 | 1976-80 |
|---------|---------|---------|---------|---------|---------|---------|
| Coastal | -9.4    | -15.6   | -15.7   | -20.2   | -21.2   | -20.5   |
| Inland  | -1.4    | -1.6    | -4.2    | -6.2    | -4.1    | -2.9    |
| West    | 7.6     | 8.6     | 9.1     | 20.9    | 15.2    | 10.8    |

Source: Based on Wei, 2000: 66.

The CCP and the Chinese central government used national income transfer to suppress the Coastal development but encourage the Western growth. Table 5.5 shows that before 1980, the central government transferred income to the Western area through direct subsidies, preferential prices for goods and services, or direct appropriation. For example, the Coastal area after mid-1960s had more than twenty percent of its income transferred out of this region, while the West had at least more than ten percent of income

transferred in. Since Beijing had the positive transfer from the central government, the actual wealth outflow from most Coastal areas was even larger. The central government also transferred wealth out of the Inland, but most of the money was invested back into the Inland area in the form of newly-built SOES.

Moreover, before 1979, the central government designed a higher tax rate for the Coastal area than for the other two areas. Such tax code was economically inefficient, because high tax suppressed further development of the productive Coastal area. The tax policy, however, helped to finance the development projects of the two regions with revenues garnered from the Coastal area (Dong, 2005a and b).

### *The 156 Project*

The Chinese central government also reduced the regional gap by directly establishing industries in the Inland and West. The most famous program was the 156 Project that established about 160 big factories in the two regions.

The 156 Project was initiated as a grand strategy to strengthen China's war potential in the early 1950s with the help of the Soviet Union and other Eastern European countries. Beginning in 1950, after the Korean War broke out, the CCP asked the Soviet Union to transfer advanced technologies related to military applications. After several years of negotiation between China and the Soviet Union, the Soviet Union agreed to help China build about 160 factories while in return China would export agricultural products and raw materials to the Soviet Union and Eastern European countries in the following decades. The Soviet Union and China expected these projects would modernize China quickly and increase the total power of the "socialist camp" (Dong, 2003).



Due to the vulnerable strategic location of the Coastal area in potential wars, the CCP decided to set most factories in the Inland and West. According to an official report, the number of projects that the government could finally complete was 156. Of all these factories, 124 were built in the Western and Inland area. Of the thirty two projects built in the Coastal area, twenty one were built in Liaoning, a northeastern province which already had a strong industrial base and was seen as China's logistic base for the Korean War (Dong, 2003; Gao, 2003).

The 156 Project greatly reshaped the industrial geography of China. In most of the Inland and Western provinces, these factories were the first modern heavy industries ever constructed (Dong, 2005 a; Chen, 2006). To secure effective operation of these projects, China also built schools, hospitals, roads, and other related facilities in the Inland and West which advanced the two areas' economic growth.

These projects indeed motivated the two regions' industrialization by successfully transferring modern technologies, managerial skills, and skilled workers to the two regions (Dong, 2005a). Although most of these factories were expected to produce military products, they also produced goods for civilian use. Automobile and air force factories, for example, in the two Inland provinces Hubei and Jiangxi also produced tractors, buses, and electric fans.<sup>24</sup> Chemical plants built in two Western provinces Gansu and Shaanxi had continuously provided local peasants fertilizers and pesticides ever since (Bo, 1998).

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<sup>24</sup> In fact, these factories were established by experts, workers, and the masses with more political fervor than economic motivation. Since the 1950s, economic motivation was perceived by the CCP as an effective way to realize capitalists' property rights. Thus, political motivation became main tool to mobilize the masses for economic development.

Another contribution of these factories to the two regions was they directly employed more than one million local residents. For several decades of operation, these factories had helped the two regions train skilled workers, which was essential for further industrial growth. These factories also generated about half of total revenues in the two regions and fostered the development of related enterprises such as transportation, raw material cultivation, and necessary facilities with technical and managerial assistance. More important, these factories diversified and modernized Chinese economic structure, and the two regions' economic growths did not rely solely on agriculture after industrial bases were successfully built in these regions (Dong, 1999; Dong, 2003).

#### *The Third Front Program and the Changing Regional Inequality*

Besides the 156 Project in the 1950s, the Chinese government also staged another grand project that profoundly affected Chinese regional inequality in the 1960s. This was The Third Front Program. Mainly initiated to enhance China's military potential, this project eventually pushed economic development of the Inland and West and reduced the economic gap across the three Chinese regions.

The CCP designed the "Self-Reliance" strategy, stipulating that each region should develop a strong, self-sufficient, and independent economic system to survive a long war with other countries. The "Self-Reliance" strategy was first proposed by the CCP in 1938 as the CCP strategy for managing the war against the Japanese. In the 1950s, the CCP interpreted the strategy as "to develop China on its own resources" (Pang, 1984). In the late 1950s, the CCP began to believe that each Chinese region should have power to sustain a long-term war with other countries (Mao, 1938; 1956; 1964; Pang, 1984, Dong,

1999). In the 1960s, the CCP increasingly perceived an incoming war with the Soviet Union or the US when relations with the two countries were in trouble. To strengthen China's military resilience, the CCP began to transform the Inland and West into war bases as soon as possible and gradually reduce Chinese regional economic inequality (Mao, 1964; Pang, 1984; Bo 1998).

On August 30<sup>th</sup> 1964, the CCP initiated the "The Third Front" project to ready China's economy for the expected war. This policy defined the Coastal area as the First Front that could be easily destroyed by the war, which had been demonstrated by the Sino-Japanese War (1937-1945). The policy designated cities in the other two areas (excluding those border provinces) as the Second Front and mountainous and rural areas in the Inland and West as the Third Front.<sup>25</sup> The policy stipulated that future investment would be mainly focused on the Second and Third Front, and important Coastal factories, schools, and government agencies should be relocated to the other two regions to avoid the war shock. The policy stipulated that Third Front factories and related facilities should be built in the "mountainous, remote, and cavernous" (*Shan, San, Dong*) areas. Although this policy also allowed the Coastal area to retain and even develop some light industries, the main investment orientation had changed toward the West and Inland. Between 1965 and 1979, the Inland and West received more than sixty percent of all direct investment from the Chinese central government (Chen, 2006; Chu, 2003).

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<sup>25</sup> In the Sino-Japanese War, China lost almost all of the Coastal area to Japan in about one year. In addition, about ninety percent of all heavy industries were destroyed by the Japanese in the first year of the war. The CCP leaders in the 1960s thus believed it was unwise to invest heavily in the Coastal area.

The Third Front program lasted for sixteen years (1964-1980). The Chinese government had invested more than 205 billion *yuan* to the project during that period. About eleven hundred conglomerated enterprises, many of them heavy industries, such as machinery manufacturing, iron and steel factories, and chemical plants, were built in the Inland and Western area (Chen, 2003).

Although some of the Third Front Enterprises (TFEs) were economically inefficient, they greatly facilitated economic development of the Western and Inland area. The Third Front Program consolidated the industrial base in the two areas built during previous years, and it also significantly developed transportation facilities for the two poor areas. More than sixty percent of newly built Chinese railways and about fifty-five percent of newly built Chinese highways were placed in the Inland and West (Chu, 2003). At least 1.5 million Coastal skilled workers were assigned into these TFEs. Schools and research institutions were also built to serve TFEs. The government thus increased human capital in the two areas (Chen, 2003).<sup>26</sup> Moreover, the Third Front program developed medical services in the Inland and West, which increased the two areas' productivity by supplying healthy workers for the two areas' modernization (Wu and Dong, 2001).

#### Regional Development Policies during Political Upheavals

Even during periods of political disruption during Mao's leadership, political institutions consistently reduced the regional gap. The two most disruptive periods were the Great Leap Forward (1958-1961) and the Cultural Revolution (1966-1976). During

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<sup>26</sup> These schools and institutions were managed by TFEs. The moving of these TFEs out of the remote and mountainous area in the 1990s cost Chinese central government dearly.

these periods, normal operations of government agencies were frequently disrupted by struggles among top leaders, but policies to reduce regional inequality continued. In other words, despite widespread political upheaval, the Five Year Plans and other institutions guaranteed effective implementation of policies designed to reduce regional inequality.

*The Great Leap Forward Movement and the Uneven Regional Development*

The Great Leap Forward (GLF) movement started in 1958, the year the second FYP began. Enchanted by the first FYP’s success in establishing an industrial basis and brining quick recovery from the war destruction, the CCP thought that China could do better in the second FYP and China’s economy would “exceed that of the UK in fifteen years and that of the US in fifty years” (Pang, 1984). The economic growth of China would be used to show that socialism was superior to capitalism (Teiwes and Sun, 1999).

**Table 5.6 Regional Shares of Chinese Government Investment, 1953--1975 (Percent)**

| Year            | 1953-56 | 1958 | 1969 | 1975 |
|-----------------|---------|------|------|------|
| Coastal         | 45.9    | 39.2 | 36.2 | 39.5 |
| Inland and West | 54.1    | 60.8 | 63.8 | 60.5 |

Source: CNSB, 1987.

To equalize the development rate across Chinese regions, the CCP invested more in the Inland and West. Table 5.6 shows the distribution of government investment before the mid-1970s. During the period 1953-1956, the Coastal area received about 45.9 percent of all government investment. In 1958, however, the Coastal area received only 39.2 percent, and in 1969 the figure decreased to 36.2 percent. Investment in exploring

oils in the Coastal region beginning in the late 1960s had only increased that figure slightly to 39.5 percent by the end of 1975 (CNSB, 1987).

Besides direct investment to the two areas, the central government also encouraged the Inland and Western areas to develop small enterprises that only needed limited technology and capital. However, the Great Leap Forward (GLF) plan set unrealistically high goals because the CCP overestimated the importance of human capital and underestimated the importance of physical capital and technology in economic development. For example, one slogan in the early 1958 claimed that “the higher the people’s ambitions, the higher the productivity of the land”, regardless of the actual productivity potential of the land (Ding, 1995; Gao, 2004).

The slogan soon guided China’s economic policies at all levels. Trying to cater to the central government, local governments often reported the inflated agricultural and industrial production to the central government that in turn facilitated the setting of unrealistic national goals for regional development.

First, Chinese peasants were forced to engage in local industrial production, especially in small steel furnaces (*Xiao Gaolu*), which diverted them from managing crops. Second, during the GLF, the Collective Purchasing (*Tong Gou*) policy required peasants to sell about fifteen percent to twenty five percent of their total agricultural products to the government. More important, the central government and the CCP evaluated local officials by using local agricultural production as measure of success. To get a good evaluation, local officials often over-reported production. Typically, they reported about five times the real agricultural production to the central government. Peasants thus had to sell the majority of products to the government and they had

insufficient food left for themselves (Song, 1998). Such policy accelerated the severity of the famine, which was initiated by a drought, in 1959 and 1960.

The destruction of agriculture due to the GLF not only temporarily constricted the quick development of the Inland and West, but also depressed the Coastal growth. The average growth rate of the Chinese economy between 1961 and 1963 was only 1.2 percent while the rate before that period was about seven percent (Bo, 1998; Pang, 1984).

One unexpected outcome of the GLF was that small enterprises survived throughout China and helped to develop regional economies. The Five Smalls (*Wuxiao*), for example, had developed the Western and Inland economy and reduced Chinese regional inequality during Mao's leadership (Chu, 2003; Yang, 2001). The Five Smalls referred to small iron and steel factories, mechanical plants, chemical factories, coal mines, and cement plants. Some of these small factories were initiated in 1953, but they did not win much support because then the central government focused on large-scale factories. It was the GLF that facilitated the development of such small enterprises in the West and Inland and transformed them into essential part of the two areas' economic growth.

#### *The Reduced Regional Inequality during the Cultural Revolution*

According to official propaganda of the CCP after 1979, the Cultural Revolution (1966—1976) was “Ten Years of Chaos”. According to this definition, civilian protests or revolts advocated by Mao greatly undermined the authority of the CCP. Military conflicts among various factions between 1966 and 1968, which caused half million deaths nationwide, had almost terminated governmental operation and the Chinese economy was mired in economic recession at the end of 1976 (Bo, 1998).

These general facts exaggerate the negative influences of the Cultural Revolution, because these characterizations were used to enhance the legitimacy of new leaders after 1979. Indeed, the CCP still designed effective policies to develop the Inland and West economy between 1966 and 1976. To realize the CCP's consistent goal of building a powerful China as soon as it could, some economic policies were designed and effectively implemented during the Cultural Revolution. Advocated by Mao, the CCP in August 1966 called for the Chinese to “encourage revolution but also increase production (*zhua geming, cushengchan*),” and shirking would be severely punished because it was interpreted as to “destroy socialist production”. This policy indicated that economic growth was still an important goal for the communist party. Even during the most tumultuous years between 1967 and 1968, the CCP also managed to help large SOEs operate effectively although the rural economy underwent temporary recession. Soldiers often were sent to these SOEs to limit destruction from fighting factions.

In 1969, after two years' stagnation, the Chinese economy began to grow. Indeed, the Chinese economy still developed during the Cultural Revolution, and the average annual growth rate between 1966 and 1976 was 6.8 percent (Chu, 2003; Meisner, 1996).

During the Cultural Revolution, besides the ongoing construction of the Third Front Programs in the Inland and West, the CCP also designed some policies, which were incorporated in FYPs, to facilitate economic development of the West and Inland. The first policy was designed in 1968 which required all youth with high school education to go to rural areas to accept the “Socialist Education”. The main goal of this policy was for the CCP to relocate about four million well-educated students from urban to rural areas (Liu, 1998). This policy helped to relocate millions of “educated youths” (*Zhiqing*) to



rural areas in the Inland and West, greatly increasing the human capital for these areas. According to a report, in 1972 alone about four hundred thousand students from other areas were moved to Xinjiang, a poor and underdeveloped provincial area mainly occupied by ethnic minorities.<sup>27</sup> At least one million middle school graduates were also relocated to poor areas such as Inner Mongolia, Qinghai, Gansu, Ningxia, Heilongjiang, Yunnan, and Guangxi, which increased average education level of labors and hence productivity in these areas (Liu, 1998).

Due to the influence of the institutionalized value of national “self-reliance”, China tried to develop its own sources of raw materials in the 1960s. Hundreds of resources searching teams were formed, and the Cultural Revolution did not interrupt their work. In 1966, the Chinese Oil Department also sent about two hundred teams to the West to search oil or natural gas. The resulting growth of China’s oil industry was astounding. Between 1966 and 1979, major new oil fields were found in the Inland and West, and crude oil production increased with an average annual rate of 18.6 percent. In 1979, China’s oil production exceeded one hundred million tons, which helped China become the eighth largest oil producing country in the world. The development of oil industry in the Inland and West increased revenues to the two areas, and it also helped other related industries, such as mechanical industry, transportation, and chemical refining, develop in the two regions (Jiao, 1988).

To improve the irrigation system and increase electric power in China, the post-1949 Chinese government built many reservoirs, especially in the Inland and West. Table 5.7

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<sup>27</sup> Besides to relocate skilled workers to Xinjiang, the CCP also believed this policy would help the ethnic majority Han to control the area firmly (Xinhua News Agency, 2000).

shows there were 444 large reservoirs built in China between 1949 and 1979. Of all these reservoirs, the Inland and West combined constituted about sixty two percent. Considering the central government also funded the building of many smaller reservoirs in the Inland and West, the irrigation capacity and electric power production in the two areas had been largely enhanced during the period 1949 to 1979.

**Table 5.7 Distributions of Newly-Built Large Reservoirs in China, 1949 to 1979**

| Areas   | Numbers | Percent |
|---------|---------|---------|
| Coastal | 170     | 38.29   |
| Inland  | 181     | 40.76   |
| West    | 93      | 20.95   |
| Total   | 444     | 100     |

Source: Yubendaodi, 2008. <http://economy.guoxue.com/article.php/18700>.

The CCP also developed small hydroelectric power plants in the West and Inland where there were abundant water resources. Before 1949, there was limited demand for electric power in the two areas, because local industries were very few and local residents could not afford to use electricity. Thus, only a few big cities in the two areas such as Luoyang, Xian, Lanzhou, and Chengdu, had small electric power plants funded by the KMT government (Chen et al, 2006: 170-92). With the development of the two regions after 1949, the need for electricity increased. Because the CCP perceived that the Coastal area was very vulnerable to attack, it did not think electric power conveyed from the Coastal area would be reliable in wartime. Therefore, since China did not have enough funds to develop many large electric power plants in the Inland and West simultaneously, the CCP strongly encouraged developing small hydroelectric powers in the two areas.

During the Cultural Revolution, small hydroelectric plants boomed in the Inland and West as they not only solved regional needs, but they were also viewed as a test of local loyalty in implementing central policies. By the end of 1974 these small hydroelectric plants had constituted about one third of all electricity that China produced in that year (Xinhua News Agency, 2000).

Hence, even during the Cultural Revolution, effective policies were designed and effectively implemented to reduce Chinese regional inequality.

#### Conclusion: Reduced Regional Inequality during Mao's Leadership

Political institutions during Mao's leadership (1949 to 1979) had fundamentally reduced regional inequality in China. The CCP made policies to reduce regional economic inequality. The CCP and other agencies constrained individual leaders such as Mao in affecting economic policy-making. Affected by the institutionalized norm of *equity*, the CCP's institutional interests, and the urgent need to industrialize China in a perceived dangerous international context, the Chinese central government had designed a series of policies, such as the 156 Project, to reduce regional inequality during Mao's leadership. The FYPs built an institutional mechanism to assure the consistent implementation of such policies. Even during the periods of political upheavals, such as the Great Leap Forward (1958--1961) and the Cultural Revolution (1966--1976), policies to develop the Inland and West were effectively implemented.

The policies aimed to reduce Chinese regional inequality during Mao's leadership brought some positive results. First, the economic infrastructure was greatly upgraded. Before 1949, the Inland and West only had very few modern industries and local

residents were less educated than Coastal residents. The ruptured economic structure in pre-1949 China was not helpful for the establishment of a consolidated national market. Before 1949, the Inland and West could not enjoy the benefits from Chinese economic growth, and the Coastal area won almost all of the economic advances. The CCP's policies, however, helped the West and Inland successfully build modern industries. The development of education in the two areas also provided large number of skilled workers for the two regions' future modernization.

In addition to Table 1.2 in Chapter 1 that shows that regional inequality had been reduced during the pre-1979 period, Table 5.8 also shows that most Inland and Western provinces had increased per capita industrial output during that period, which helped to reduce regional inequality. Some underdeveloped interior provinces such as Gansu, Xinjiang, and Hubei built and developed heavy industries and increased per capita industrial output. The industrialization in Jilin and Helongjiang also intensified, although the per capita industrial output in the two provinces decreased due to the large inflow of migrants that were arranged by the CCP.

Second, the policies that reduced Chinese regional inequality also helped to integrate a Chinese national market that was crucial in driving China's further modernization. The development of transportation facilities was aimed to improve the central control over remote areas, but fostered regional communication. Railroads and highways built during Mao's era made it more convenient and economical than before for the two regions to convey natural resources to the Coastal area, helping the two areas amass precious capital for economic growth. For example, between 1973 and 1979, the Coastal area imported about seventy eight percent of needed coal from the Inland and West. The

industrialization of the two areas also increased local residents' income, helping them affordable for more Coastal goods (Lu, 1990: 33).

**Table 5.8 Distribution of Per Capita Industrial Output by Province (Yuan)**

| <b>Province/Year</b> | <b>1952</b> | <b>1965</b> | <b>1974</b> | <b>1979</b> |
|----------------------|-------------|-------------|-------------|-------------|
| Coastal Area         |             |             |             |             |
| Liaoning             | 385         | 334         | 300         | 257         |
| Beijing              | 481         | 385         | 617         | 513         |
| Tianjin              | 1112        | 572         | 663         | 498         |
| Hebei                | 55          | 86          | 122         | 84          |
| Shandong             | 62          | 58          | 77          | 87          |
| Jiangsu              | 84          | 93          | 113         | 138         |
| Shanghai             | 1517        | 1165        | 1404        | 1106        |
| Zhejiang             | 76          | 72          | 58          | 85          |
| Fujian               | 69          | 56          | 48          | 59          |
| Guangdong            | 84          | 94          | 85          | 79          |
|                      |             |             |             |             |
| Inland Area          |             |             |             |             |
| Heilongjiang         | 222         | 195         | 127         | 141         |
| Jilin                | 161         | 148         | 109         | 120         |
| Shanxi               | 92          | n/a         | 72          | 91          |
| Henan                | 30          | 41          | 43          | 50          |
| Anhui                | 36          | 40          | 36          | 51          |
| Hubei                | 74          | 64          | 58          | 86          |
| Jiangxi              | 54          | n/a         | 49          | 51          |
| Hunan                | 40          | 41          | 44          | 63          |
|                      |             |             |             |             |
| Western Area         |             |             |             |             |
| Xinjiang             | 82          | 86          | 46          | 54          |
| Gansu                | 51          | 87          | 100         | 92          |
| Shaanxi              | 56          | 73          | 64          | 80          |
| Qinghai              | 45          | 73          | 99          | 78          |
| Shichuan             | 55          | 53          | 41          | 54          |
| Guizhou              | 33          | 48          | 34          | 36          |
| Yunnan               | 48          | 38          | 32          | 40          |
| Tibet                | 7           | 13          | 14          | 11          |
| Ningxia              | 10          | 24          | 35          | 80          |
| Guangxi              | 33          | 32          | 37          | 57          |
| Inter Mongolia       | 60          | 251         | 187         | 63          |

Source: Yang, 1997:22.

Despite these achievements and the wide support from the two regions, the policies still engendered many social and environmental problems. First, these policies inhibited the development of the Coastal area. According to a report, between 1964 and 1971, about 380 large factories, 38,000 suites of machines, and 1.45 million skilled workers were relocated from the Coastal area to the West and Inland (Gao, 2004). The CCP's unbalanced investment policy also put the Coastal area in disadvantage during Mao's leadership as this area lacked enough capital to develop its economic potential (Wang, 1986). Table 5.8 also shows that the Coastal area endured slow industrial growth. Indeed, per capita industrial output in previously developed industrial bases, including decreased greatly during the period between 1952 and 1979. For example, per capita in Liaoning, Shanghai, and Tianjin during this period decreased 33.25%, 26.96%, and 55.22% respectively. This change was caused by the institutional changes that motivated the Western and Inland growth but suppressed the Coastal development. These problems had elicited strong discontent in the Coastal area. Some economists also argued the "equity" had undermined the overall economic efficiency although the West and Inland developed (Dong, 2005 a; Gao, 2003).

Second, environmental problems generated by these policies were also severe. One example was the agricultural cultivation of Xinjiang, a Western province dominated by deserts. In 1949, the arable land in Xinjiang was about 13,005 square kilometers. Led by the government-sponsored paramilitary unit, the Xinjiang Productive and Cultivation Corp, migrants from other areas constructed new oases by conducting water from mountain snowmelt or underground aquifers. At the end of 1979, Xinjiang proudly announced it owned about 58,000 square kilometers of arable land to produce abundant

cotton, rice, and other crops. However, the extensive cultivation has severely undermined the eco-system in Xinjiang. Due to the over-extraction of underground water, about twenty five percent of land has been irreversibly alkalized. The snow-melt water flow from mountains also alkalized valleys along the Talimu River (Wang, 2004).

Another problem occurred in the Southwestern province of Yunnan in the late 1960s. The local government filled many local lakes to increase arable land. But most of these newly engineered lands could not produce crops because of high concentration of alkali in soil and the inefficient drainage system (Shapiro, 2001).

In sum, using institutional theory, this chapter explains institutional structures, especially economic and political centralization, which affected the making and implementation of development policies in pre-1979 China. These policies reduced Chinese economic inequality and helped the Inland and West construct a solid industrial and social basis for further development. These policies, however, also caused some problems, such as economic inefficiency and environmental degradation in the Inland and West, and partially motivated economic reform in 1979. Therefore, when the CCP initiated economic reform in 1979 to increase economic efficiency, the preferential policies for the Inland and West were to be abolished and the growth of the two areas began to slow down, which increased Chinese regional inequality.

## Chapter Six Political Restructuring and Changes in Chinese Regional Inequality during the Reform Period (1979-2005)

This chapter examines the way Chinese political institutions and institutional changes increased regional inequality in post-1979 China. The chapter first introduces vital changes in political institutions, including the shifts of dualism--power distribution between Chinese central and local governments, the altered policy-making process, and new policy-making agencies. The chapter then extends the study to the essential economic institutions that affected Chinese regional inequality. The chapter tries to show political institutional changes after 1979 engendered new economic institutions and policies, including decentralized decision-making system, marketization, specific taxation rules, targeted investment policy, and the two-track price system; these policies further impacted regional inequality in post-1979 China.

After 1979, the CCP claimed that “it is unrealistic to develop China’s three regions at the same speed” (Dong, 1999). The chapter hence studies specific strategies such as the Special Economic Zones (SEZs) policy that were aimed to develop the Chinese economy but eventually enlarged Chinese regional inequality after 1979. All these institutional strategies altered policy-making and affected factor mobility across Chinese regions, which affected Chinese regional inequality. In addition, the chapter also studies the “Developing the West” policy that was initiated by the CCP in 1998 to reduce regional inequality, finding that institutions constrained the effectiveness of the effort.



### Institutional Approach and the Changing Chinese Regional Inequality since 1979

As far as I have discussed about the change in Chinese regional inequality, Institutional Theory (IT) seems to be the most powerful approach to explaining the shift of regional inequality after 1979 as it focuses on institutional changes that fundamentally drive the change in regional inequality. The three alternative explanations--economic, cultural, and international relations theories--are insufficient to explain these changes, and Institutional Theory provides a powerful approach to solving this problem.

First, as I have mentioned in Chapter three, conventional economic theories argue that the difference of regional resource endowment is the main reason that generates regional inequality. But these theories cannot effectively explain the enlarging regional inequality in post-1979 China. That is, according to conventional economic models, if the difference in resources remains the same, regional economic inequality should not change a lot. But in the past several decades, Chinese regional inequality did change twice.

Second, the cultural model argues that the pro-business cultural values dominant among Coastal residents might have facilitated Coastal development, but it still cannot explain the way regional inequality increased after 1979 while cultural variables remained constant.

Finally, international relations theories explain that improved relations with other countries helped the Coastal area to develop, but they cannot explain well of the dynamics and deep structures that determined regional inequality in post-1979 China. The question is: China had greatly improved its relations with most foreign countries since 1971, but why did Chinese regional inequality only begin to change after 1979?

In short, these three approaches neglect endogenous factors, such as specific policies and economic institutions, which drove and enlarged regional inequality.

As this chapter shows, IT effectively explains *changes* in Chinese regional inequality that other models cannot explain. IT explores changing institutions, such as the change in economic policy-making, the shift of power structure between the central and local government, and SEZs, etc., which increased Chinese regional inequality. By exploring these changing institutions, IT successfully traces correlations between Chinese institutions and the changing pattern of Chinese regional inequality.

#### Reforming Political Institutions after 1979

A series of fundamental changes in Chinese political institutions occurred after 1979 that significantly affected Chinese political and economic development. Mao died in October 1976, and his death opened opportunity window for reformers in the party when many top political leaders tried to end the Cultural Revolution and alter old institutions that they claimed to have inhibited Chinese economic development..

The Cultural Revolution directly undermined the interests of party veterans, military leaders, and many influential Chinese when the CCP tried to realize the institutionalized goal of *equity*. Those victims strongly opposed the CCP's *equity* goal and urged the party to design preferential policies for well-developed areas to develop faster and then develop the entire Chinese economy. Advocated by post-Mao leaders Hua Guofeng, Ye Jianyin, and Deng Xiaoping, who had strong desire to develop the Chinese economy to mobilize people's support, the CCP successfully terminated the Cultural Revolution by arresting the "Gang of Four", the loyal supporters to old institutions in the central government, in

October 1976 (Baum, 1994: 27-29).<sup>28</sup> However, because of institutional inertia, the CCP did not break with old institutions immediately. Indeed, the CCP and the government had to change the entrenched institutions gradually.

The fundamental institutional change occurred in December 1979 when the CCP started to stage economic reform at the third plenum of the party's eleventh committee. The CCP believed that the reform could enhance the party's decreasing legitimacy caused by high-handed political control. The CCP first set some new governing rules such as decentralization and collective leadership in decision-making (Baum, 1994:14-18). After 1979, the party allowed local regions to have more economic autonomy which changed the dualism of power balance between the central and local governments. The central government and the CCP also encouraged private investment, which was perceived an essential to develop China quickly (Pang, 1984). More important, the CCP and the central government perceived uneven development an effective way to develop the Chinese national economy, so by introducing the SEZs to develop the Coastal area the CCP and the Chinese central government began to gradually discard previous policies that aimed to reduce regional inequality (Gao, 2004).

These institutional changes developed China but also reversed the trend of regional inequality after 1979. The following section discusses changes in political institutions, economic implications of changing institutional structures, and the shifting policy-making processes after 1979.

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<sup>28</sup> This group included Mao's wife Jiang Qing, the CCP's vice Chairman Wang Hongwen, the vice premiere Zhang Chunqiao, and the leader of the state Propaganda Department Yao Wenyuan. The Gang of Four strongly advocated policies designed between 1949 and 1976. The group won some support from the Inland and Western areas that benefited from these policies.

### *Partial Reform to Reestablish the CCP's Legitimacy*

The slow economic growth and social chaos during the Cultural Revolution (1966 to 1976) undermined the legitimacy of the CCP. In the late 1970s, many Chinese, especially those Coastal residents, complained that the CCP did not increase people's income as the party had promised. Millions of educated youths assigned to work in rural areas wanted to come back to their hometown cities. Workers in SOEs also wanted higher incomes. In addition, social discontents and pro-democracy movements, initiated by intellectuals in Beijing, pressured the CCP to reform. Professors and college students posted their political claims in parks near Beijing University to mobilize mass support and insisted the CCP modernize China via economic reform and democratization (Baum, 1994: 107-09).

All these problems undermined the Chinese belief that the socialist road was beneficial for China's modernization. To restore its decreasing legitimacy, the CCP began to launch partial reform, which the CCP believed could avoid possible social and political risks (Wu, 2004; Yang, 2003).

The CCP did acknowledge that political reform was beneficial, but it had to be gradual and must be limited to an acceptable scope. According to the CCP, a full-scale political reform would undermine the political authority of the communist party.<sup>29</sup> Some administrative reforms would be allowed or even encouraged, but the CCP leadership must be retained. The CCP maintained that the introduction of Western liberal democracy to policy-making did not serve the Chinese interests because it would weaken central

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<sup>29</sup> The new CCP of course removed some political officials such as the Gang of Four and many local officials from the government in 1976. But strictly speaking, the change was not a reform because it was only a political struggle among leaders. Such struggles had occurred many times during Mao's leadership.

authority in China. The party correlated the chaos during KMT's governance (1912 to 1949) with the weak central authority. The CCP thus posited that Western democracy would engender a weak central government in China because it distributed power across various political organizations.<sup>30</sup> Because of such fear, although the CCP strongly advocated the "Four Modernizations" to develop China, only gradual political reform was suggested in post-1979 China.<sup>31</sup> As for economic reform, it posed little threat to the CCP but it could increase general prosperity, which would increase mass support for the party (Harding, 1987). Thus, the CCP avoided major political changes but supported economic reform by reducing the party's intervention in economic affairs.

#### *Collective Leadership and the Power Balance among Top Leaders*

Although the CCP opposed major political reforms after 1979, the new situation helped to change the CCP into a very difficult governing institution after 1979. Thomas Baylis argues that after the departure of charismatic leaders in communist countries, "political leadership appeared to become less personal and more institutionalized" (Baylis, 1989: 92-93). This was the case in post-1979 China. Although Mao had already been constrained by Chinese institutions, Mao's successive CCP leader Deng Xiaoping and his successors had to share more powers with other leaders, which Deng labeled as

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<sup>30</sup> This argument was untenable and elicited many criticisms from intellectuals, but since the CCP tightly controlled the media and educational system, the argument was soon accepted by the masses.

<sup>31</sup> The "Four Modernizations" referred to the modernization of industry, agriculture, national defense, and technology. The slogan was first proposed by the Premier Zhou Enlai in 1973, but political struggles among top leaders between 1974 and 1979 obstructed the implementation of it.

the “Collective Leadership” (Deng, 1993). This new institutional arrangement further constrained senior leaders’ influences on Chinese political economy.

The coalition that governed post-1979 China included party reformers, opportunists, and party veterans with no definite political inclinations (Baum, 1994). All these participants had top positions in the party and government. This generated the “rise of a set of relationships among leaders in the party that can be characterized as a balance of power” (Baylis, 1989; 117-118). This situation meant that Deng, who was seventy four years old in 1979, had to share power with other veteran leaders in policy-making.

The reformed power structure after 1979 had several important characteristics. First, the collective leadership increased efficiency of decision-making. Due to the power balance among top leaders, different opinions had to be considered in decision-making, which expanded the range of policy options they considered. To avoid attacks from political rivals, the Chinese leaders also must be cautious in designing policies. Grand policy changes were thus replaced by incremental adjustments which entailed smaller risks and less uncertainty (Naughton, 2007:86-91). In addition, when “greater expertise had been brought into the regime’s deliberations” to enhance the efficiency of policy-making, the Chinese government began to adopt more suggestions from experts when making economic policies during the post-1979 era. In many SOEs (State Owned Enterprises), engineers and technicians also constituted the majority of the governing committee and determined SOEs’ operation (Baylis, 1989: 105-106).

Second, power struggles among top Chinese leaders or different factions sometimes obstructed the making or implementation of effective policies. The leaders came “to see their survival and their ability to dominate policy in their own field of specialization as

dependent upon their preventing any one of their number from being too powerful” (Baylis, 1989: 117-118). When there was a political stalemate among leaders with roughly equal power, it became difficult to pursue large changes in economic policies. Top leaders might ask or signal their provincial supporters to resist the policies designed by their rivals. For example, the 1986 price reform advocated by CCP’s general secretary Zhao Zhiyang was aborted due to the strong opposition from Zhao’s rivals, including premiere Li Peng, and vice premiere Yao Yilin, the head of Chinese Planning Committee (Zhang, 2001). Between 1990 and 1991, economic adjustment initiated by party hardliners to halt corruption was also vetoed by moderate leaders who feared such adjustment was intended to stop China’s economic reform (Baum, 1994: 317-318). Third, with more local leaders being promoted to national policy-making positions after 1979, regional development policies often reflected conflicts of regional interests in the central government. Leaders promoted from different regions fought for their own area’s preferential policies to cater to regional interests. After 1979, economic growth became a major criterion for evaluating and promoting local officials. Leaders from the Coastal area were more likely to be promoted to the central government, therefore, because the area experienced higher GDP growth rate than the other two regions. During Jiang Zemin’s leadership (1993 to 2002), of the seven top leaders in the Politburo, six came from or had long working experiences in the Coastal area. During Hu Jintao’s governance (after 2002), all of the nine members in the Standing Committee of the Central Politburo (SCCP) came from the Coastal area.

Because Coastal leaders became the majority in the SCCP, they were more likely to make preferential policies for the Coastal region. This is path dependent for strengthening

institutional advantages of the Coastal area. For example, in 1993 Jiang and other Coastal leaders in the SCCP issued policies to develop Pudong, a district in Shanghai that Jiang once governed. The central government not only allocated plentiful funds to Pudong, it also reduced investment taxes in Pudong. The policy helped Shanghai to become the leading growth area in China after 1995 (Yabuki and Harner, 1999: 211-13).

These new institutional arrangements weakened the central government's ability to reduce regional inequality. Regional policies made after 1979 were mainly preferential to the Coastal area. Although the CCP had also to consider claims from the other two regions, the central government often found it difficult, due to the pursuit of local interests, to encourage the Coastal area to advocate policies preferential to the other two regions (Yabuki and Harner, 1999: 219-26; Wedeman, 2003: 247-52).

Thus, as Baylis argued that collective leadership may "correspondingly exert conservative effects on policy", the new political institutions in post-1979 China are necessary for explaining why the Chinese central government could not effectively reduce regional inequality even if it had tried to (Baylis, 1989: 119).

#### *Decentralization: The Changing Process of Policy-making after 1979*

Another important change in Chinese political institutions after 1979 was that dualism changed with policy-making increasingly decentralized; that was, more sub-national actors began to directly or indirectly participate in the process of policy-making and local and provincial actors had more veto power (Baylis, 1989: 106; Baum, 1994).

There were several reasons for the CCP to introduce decentralization into the process of public policy-making. The first reason was because of the strong support from



Deng and some other top leaders who perceived the centralized planning system as too rigid to move China's industrialization. These leaders thought it was more efficient for local agencies to design policies for their own areas because local officials obtained more accurate local information than the central agencies. Thus Deng and some other central leaders support the CCP decentralize key economic policy choices. The CCP and the central government also believed that the decentralization could develop local economy, arguing the more economic autonomy local governments enjoyed the more effectiveness for economic policy-making (Yang, 2001; Deng, 1993; Jiang, 1993).

Second, incremental reform in economy had a cumulative effect that pressured the central government to consider more of developed regions' interests. After 1979, the central government became more dependent on revenues from developed areas, which in turn increased these areas' power in shaping policy-making at the central level. Provincial leaders from the Coastal provinces such as Guangdong, Jiangsu, and Shandong, who produced higher revenues to the central government than other local leaders, had great power in affecting decision-making in the central Politburo as the central government had to win local areas' financial support. In addition, the increasing power of private enterprises and the inefficiency of Chinese SOEs also limited the central government's capacity to acquire sufficient economic resources to direct China's development (Yang, 2001).

Third, the CCP began to admit that neither the communist party nor the central government were omnipotent in managing economic policy or reacting promptly to local market conditions. The CCP thought that each region should be responsible for its own development, while the central government only acted as a coordinator to mitigate

regional conflicts. Thus, after 1979 although the CCP insisted that the Politburo still had the absolute authority in making major policies, the party allowed local party branches and governments to retain enough power to manage regional economic issues (Baum, 1994; 11-12).

The decentralization of economic policy-making in post-1979 China reduced central government's intention and ability to intervene in economic policy-making (Wu, 2004). Decentralization gave local governments more power in levying taxes and managing local SOEs. Decentralization also overcame the insufficient information problem in managing local economy because local governments could get prompt and direct local information (Stiglitz, 1994). For example, with increasing economic autonomy after 1979, the Coastal area successfully developed the Town and Village Enterprises (TVEs) (Wei, 2000; Yang, 2001; Zhao, 2006). The central government supported the developed of TVEs in the Coastal area for several reasons. First, foreign investors wanted to invest in Coastal TVEs because they believed such investment would bring high return. Moreover, the investment to TVEs did not require large amount of money, which attracted many small investors (Pang, 1984). Second, TVEs hired many workers which enhanced the power of the "working class" (*Gongren Jieji*). Third, TVEs added new revenues for the local and central government (Wei, 2000; Yang, 2001). Local governments in the Coastal area assured that TVEs would be treated as state-owned firms, which further alleviated some central government concerns (Yang, 2001).

Decentralization increased Chinese regional inequality after 1979. Although the central government also allowed the West and Inland to develop local TVEs, the support to them was trivial and the TVEs in the two areas were at a disadvantage in competing

with Coastal TVEs. The Coastal area had more educated and capable officials and was more flexible and efficient than the other two areas in designing and implementing regional development policies. Even if the West and Inland could design policies for regional development, some disadvantages still constrained the two areas' economic development. For example, after the early 1990s, the West and Inland tried to use low tax incentives to attract potential investors. However, the two areas still could not effectively compete with the Coastal area in attracting investment, because potential investors preferred investment in more developed areas. As Table 6.1 shows, Coastal TVEs contributed to most TVE exports between the 1980s and 1990s, partially contributing to the enlarging regional inequality after 1979.

**Table 6.1 Total Value of Exports by Chinese TVEs: 1985-1993**  
(Amount in billion Yuan; Shares in percentage)

| Year |        | National | Coastal | Inland | West | Inland+West |
|------|--------|----------|---------|--------|------|-------------|
| 1985 | Amount | 3.90     | 3.23    | 0.57   | 0.10 | 0.67        |
|      | Share  | 100.0    | 82.8    | 14.6   | 2.6  | 17.1        |
| 1990 | Amount | 48.56    | 43.09   | 4.77   | 0.70 | 5.47        |
|      | Share  | 100.0    | 88.7    | 9.8    | 1.5  | 11.3        |
| 1991 | Amount | 66.99    | 59.78   | 6.26   | 0.96 | 7.22        |
|      | Share  | 100.0    | 89.2    | 9.4    | 1.4  | 10.8        |
| 1993 | Amount | 235.05   | 217.56  | 15.43  | 2.05 | 17.48       |
|      | Share  | 100.0    | 92.6    | 6.5    | 0.9  | 7.4         |

Source: Dali L. Yang and Houkai Wei (1995).

### Institutional Innovations to Adjust Economy in Post-1979 China

The changes in political institutions after 1979 helped the CCP and Chinese government to institutionalize several tools that strengthened markets. The partial reform, the collective leadership, and the decentralization made it viable for the CCP and Chinese

government to largely reduce direct intervention and allow more free economic transactions. These institutionalized tools included the deliberate expansion of the free market, the diversification of tax rates, and targeted investment policies. All of these tools enhanced local autonomy, and increased Chinese regional inequality after 1979 when the CCP and Chinese government increasingly believed that policies of reducing inequality were economically inefficient.

### *The Gradual Marketization in Post-1979 China*

The CCP after 1979 gradually came to believe that the market, instead of administrative orders, could be an effective tool to allocate resources. This new perception arose from the CCP's increasing technocratic governance after the 1970s. The CCP began to listen to suggestions from domestic and foreign economic experts. The economic difference between China and developed countries also convinced the party that the market was an effective tool to help China develop quickly (Deng, 1993).

However, due to institutional constraints, the market system had to phase in gradually in the Post-Mao period (Zhao, 2006). Some party veterans, for example, insisted that the market signaled the resumption of capitalism in China and only served the interests of very few social members, which undermined the basis of socialism. To appease such complaints, the CCP had to implement and designate economic reforms carefully. In 1979, the Chinese market system was defined as "socialism market". In 1988, the name was changed to "the market under the guidance of socialism". In 1992, the CCP renamed the market as "planned commercial economy". In the late 1990s, the CCP termed the market as "market economy". The changing names on the one hand

showed the intensification of economic reform and the expansion of the market system in allocating resources in China; on the other hand it showed the importance of “problem definition” in making Chinese economic policies when ideological issues are still important factors to affect policy-making (Baum, 1994; Xiong, 2005: 52-58).

The expansion of the free market widened regional inequality in post-1979 China because economic deficiencies of enterprises in the West and Inland put them at a comparative disadvantage in competing with Coastal enterprises. As Chapter Five shows, many enterprises in the two underdeveloped areas were set in remote and distant areas to increase their survivability in possible wars. After 1979, the huge transportation costs for acquiring resources and selling manufactured goods substantially increased enterprise costs in the West and Inland. Indeed, many enterprises in the two areas were built to produce military products before the late 1970s. The highly specialized technology designed to produce military products also made it difficult for these enterprises to produce profitable goods (Zhu, 1999).

On the other hand, the marketization policy offered a good opportunity for Coastal enterprises to regain momentum to expand and develop their competitive advantages. In the late 1970s, China continuously introduced advanced technologies, mainly mechanical and chemical engineering skills, from Western countries, but most of them were transplanted to the Coastal area.<sup>32</sup> The Coastal area also benefited from international trade as it owned all major ports. Investment from foreign countries or overseas Chinese,

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<sup>32</sup> The importation of technologies from Western countries began in 1973 after China had reached a rapprochement with the US and other major Western countries. However, due to the constraint of the “self-reliance” ideology, the scale of such technological importation was limited before 1979.

who expected a higher investment return in the Coastal area, provided sufficient capital for the area's economic take-off when the open-door policy was implemented after 1979.<sup>33</sup> The higher wage level in the Coastal area and the loosened restrictions on travel after 1979 also attracted well-educated workers from the Inland and West, which further increased the Coastal area's productivity (Iredale, 2000).

### Diversified Tax Rates across Regions

One important economic policy that affected Chinese regional inequality after 1979 was the permission for tax rates to differ geographically. In 1979, the CCP stipulated that each provincial area should act as an independent economic unit. To encourage local governments to develop their local economy, the central government required each province submit a fixed proportion of tax to the central government and keep the rest of its income. This institution was called *Baogan*, which motivated local areas to develop economy as they could retain more for local use when aggregate local income increased.<sup>34</sup>

The tax federalism was based on the assumption that it was inefficient for the central government to design a standard tax rate for provinces with different economic levels (Qian, 2003). The Chinese central government in the 1980s believed that standard tax discouraged regions to develop their economic potential. By using different tax rates and

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<sup>33</sup> The geographic proximity to international trade motivated many Coastal residents to migrate to other countries before 1949. When they got rich, they invested back home, partly for showing off but also for helping their hometowns. After 1979, oversea Chinese became the main FDI provider to the Coastal area.

<sup>34</sup> This policy was first implemented in rural areas to encourage peasants to increase agricultural products in the late 1979. The success of this policy encouraged Chinese leaders to apply it to other areas.

allowing each province keep the local income after the tax, provinces were motivated to develop local economy (Chowdbury, et al, 2000). For example, Coastal enterprises enjoyed a fifteen percent tax rate on profits, but tax rate in the Inland and West was thirty five percent. Foreign Direct Investment Enterprises (FDIEs), most of which were set in the Coastal area, paid at an even lower rate than domestic enterprises.

Differentiating tax rate further unbalanced regional economies in China (Wedeman, 2003: 27-57). The policy put the Coastal area in advantaged status in competing with the other two regions for investment (Wedeman, 2003; Wong, 2003). In addition, since the absolute profits in the Coastal area were much higher than those the other two areas, Coastal authorities could garner more revenues than other areas (Tsai, 2004). This policy thus enabled the Coastal government to improve local infrastructures to induce further investment. The Inland and Western areas were at a severe competitive disadvantage because they had to impose higher taxes than the Coast, provide fewer services, or a combination of the two.

The tax policy also reduced central government's capacity to redistribute funds across regions to adjust regional inequality. In 1979, the central government was responsible for about forty six percent of local expenditures, but in 2001 that figure fell to only ten percent (Wong, 2003).

#### *Targeted Investment Policies after 1979*

The targeted regional development policies gave the Coastal area great discretion in attracting investment or technologies. After 1979, public investment policy by the Chinese central government greatly favored the Coastal area. Between the 1980s and

1990s, about fifty four percent of all government investment went to the Coastal area, higher than that to the other two areas combined (Zeng, 1999: 397).

**Table 6.2 Regional Distribution of Investment in Capital Goods (billion yuan), 1979-2005**

| Year    | 1982             | 1990             | 1995             | 1982-1995           | 1979-2005                                    |
|---------|------------------|------------------|------------------|---------------------|--|
|         | Volume (Percent) | Volume (Percent) | Volume (Percent) | Change in Share (%) | Share of fixed investment in each region (%) |
| Total   | 114.5 (100%)     | 433.3 (100%)     | 1937.5 (100%)    |                     | 100  |
| Coastal | 62.3 (54.4%)     | 256.4 (59.2%)    | 1277.3 (65.9%)   | 11.5                | 58.5   |
| Inland  | 34.2 (29.9%)     | 111.4 (25.7%)    | 421 (21.7%)      | -8.1                | 22.5   |
| West    | 18 (15.7%)       | 65.5 (15.1%)     | 239.2 (12.3%)    | -3.4                | 19   |

Source: Wei, 2000. p89. Chinese Statistic Yearbooks.

**Table 6.3 Cumulative Distribution of Direct Investment across Regions, 1979-2005**

| Year    | 1979-2005   | 1979-2005  |
|---------|---|--|
|         | Per capita amount of cumulative direct investment in each region (yuan) | Share of cumulative direct investment in each region (%) |
| Total   |   | 100  |
| Coastal | 1144  | 83.7   |
| Inland  | 189   | 11.4   |
| West    | 93  | 4.9  |

Source: Chinese Statistic Yearbooks.

Table 6.2 also shows that the major proportion of the investment in capital goods, such as machines, was allocated to the Coastal area, and table 6.3 shows per capita



cumulative direct investment and the share of cumulative direct investment in each region between 1979 and 2005.<sup>35</sup>

The central government also designed preferential policies for the Coastal area to successfully attract foreign investment (See Table 6.4). Inspired by the rapid economic development of the Asian Tigers (Taiwan, Hong Kong, Singapore, and South Korea), the CCP argued in 1979 that foreign investment and foreign trade were indispensable factors to Chinese development (Dong, 1999). Hence, in 1979 the CCP opened some special Coastal zones for engaging foreign trade or attracting foreign investment. Local governments in the Coastal area had the authority to offer Foreign Direct Investment Enterprises (FDIEs) and foreign trade companies three years of free tax, free land use, and guaranteed assistance of infrastructure facilities. The other two areas, however, were not authorized to design similar policies to attract investment and technology.

**Table 6.4 Regional Distribution of FDI (%), 1983-2005**

| Region  | 1983 | 1985 | 1988 | 1990 | 1993 | 1995 | 2000 | 2002  | 2005  |
|---------|------|------|------|------|------|------|------|-------|-------|
| Coastal | 92.9 | 89.6 | 88.7 | 93.9 | 87.5 | 87.7 | 86.3 | 86.05 | 87.74 |
| Inland  | 1.1  | 5.2  | 5.7  | 8.8  | 8.8  | 9.2  | 7.64 | 8.86  | 7.51  |
| West    | 5.9  | 5.2  | 5.7  | 3.7  | 3.7  | 3.1  | 6.05 | 5.09  | 4.75  |

Source: Wei, 2000. p89. Chinese Statistic Yearbooks.

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<sup>35</sup> Direct investment means investment directly invested in building factories, infrastructures, or any projects that are intended to produce something. Direct investment can be classified as domestic direct investment (DDI) and foreign direct investment (FDI).

### The “Two-Track Price” System

Although the market gradually became the main agency to decide prices in post-1979 China, the Chinese government still controlled the pricing of some important goods. The CCP and the central government after 1979 implemented the “Two-Track Price” (TTP) policy to encourage the development of the Coastal area. The TTP set two prices for the same goods in different areas. The central government first ordered SOEs to provide a certain amount of important resources or goods, including coal and electrical power, to the central government with low fixed prices. The central government then reallocated these resources or goods to places where it perceived necessary. The SOEs were allowed to sell products or resources in the market only when they had fulfilled the product quota designed by the central government.

This policy benefited the Coastal area at the expense of the other two regions. All through the 1980s SOEs in the other two areas provided the Coastal area with coal, electric power, iron ore, agricultural products, and other resources at low prices. The regulated prices of these goods sometimes were only thirty percent of the market prices, although SOEs in the two regions received subsidies from the central government to cover some of the price discrepancy. Before 1979, however, most of these resources were sold to the Coastal area with much higher prices (Chen, et al. 1992; Wong, 2003).

This system guaranteed that the Coastal area could acquire resources with low price. Even after the mid-1990s, the Coastal area still acquired electric power, agricultural products, raw materials, and other important resources from the other two regions through the fixed price system.

### The Two Grand Strategies and the Growing Regional Inequality

After 1979, the CCP believed that the suppression of the Coastal development to reduce regional inequality had inhibited China's economic growth, and China should develop unevenly because of regional difference in productivity (Deng, 1993; Gao, 2003). The CCP thus decided to modernize China by first liberating the productive potential of the Coastal area and then gradually developing the other two areas.

In 1979, the CCP implemented the Two Grand Strategies (TGS) for Chinese economic development. According to this policy, China would use two methods to manage its economy. The first method was socialism, which China had already implemented. The second approach was modernism, which ventured to advanced skills or technologies that existed in developed countries (Gao, 2003). The CCP assured the public that this approach served capitalist interests, but it could also serve socialist interests because the approach itself was a value-free tool that the CCP could use (Deng, 1993).

The CCP began to implement the TGS in some Coastal cities in the early 1980s. If the policy worked, then the CCP would extend it to other areas. If it failed, then the CCP would try alternate policies for economic development (Gao, 2003). Thus the TGS also referred to the development of Chinese national economy with two steps. China should first encourage the Coastal development by implementing the SEZs policy with favorable tax, investment, and other preferential policies. After the Coastal area attained a certain economic growth, which the CCP did not define, the government would transfer its policy focus to the Inland and West by enlarging the SEZs (Chen, 1998).

The CCP implemented the Two Grand Strategies gradually (See Figure 6.1 and Table 6.5). In 1979, the policy designated only four cities to enjoy the Special Economic

Zones (SEZs) strategy. The four cities, Shengzhen, Shantou, Zhuhai, and Xiamen, thus became the “windows of reform” of China (Baum 1994: 67; Yang, 1997). In 1984, when the SEZs policy succeeded in the four cities, the CCP extended the SEZs to fourteen more cities in the Coastal area. With rapid economic growth of these cities, the Chinese government designated Hainan Island as SEZ province in 1988 (Baum 1994:227). In 1992, the CCP extended the SEZs to the entire Coastal area and a few well-developed cities in the Inland and West (Dennis, 1995; Yang, 1997).

**Table 6.5 The Expansion of Chinese SEZs since 1979**

| 1979  | 1984  | 1988            | 1992   |
|---|---|-----------------|--|
| Four cities: Shengzhen, Shantou, Zhuhai, and Xiamen | Fourteen Coastal Cities: Dalian, Yantai, Lianyungang, Fuzhou, Qinhuangdao, Ningbo, Qingdao, Tianjin, Nantong, Shanghai, Wenzhou, Guangzhou, Zhanjiang, and Beihai | Hainan province | The entire Coastal area and well-developed cities in the West and Inland |

Sources: Chinese National Statistics Bureau (CNSB). Various Years *Statistical Yearbooks*.

The CCP mentioned that the first step---to develop the Coastal area---would take about twenty years. During this period, local Coastal governments would be granted enough autonomy to develop local economy. After that, the developed Coastal area would assist the development of the other two areas; but the CCP never specified what it would do to motivate the Coastal area to fully implement the strategy.

Figure 6.1 The Special Economic Zones of The People's Republic of China (1979 to 1999)

Figure 3. China: Special Economic Zones



University of Texas at Austin Perry-Castañeda Library Map Collection  
[http://www.lib.utexas.edu/maps/middle\\_east\\_and\\_asia/china\\_specialec\\_97.jpg](http://www.lib.utexas.edu/maps/middle_east_and_asia/china_specialec_97.jpg)

### Outcome of the Changing Institutions: The Enlarging Regional Inequality after 1979

The changing institutions and policies affected Chinese economic inequality after 1979. Though all Chinese regions developed, regional discrepancy also enlarged. The economic reform and the “open door” policy benefited the West and Inland. The solid economic and technological basis laid by the Five Year Plans and the Third Front project during Mao’s leadership made it possible for the two areas to develop during the post-1979 period when constraints were removed by the CCP and the central government. The two areas consolidated the industrialization with more efficient allocation of resources via the market system. For example, private enterprises and SOEs in the two areas had to improve their operation to compete with enterprises in other areas, which partly increased their efficiency with the help of newly introduced technology and managerial skills. The improved transportation also made it more convenient for the Inland and West to communicate with the Coastal area, which helped to integrate a national market. Interior residents who worked in the Coastal area also founded their hometowns by sending a large amount of their wages home. The Western province Gansu, for example, had about twenty percent of its GDP from such remittance (Wong, 2003).

All these factors greatly helped the Inland and West develop. Modern industries developed in large interior cities, such as Xian, Lanzhou, Luoyang, Chengdu, Wuhan, Zhengzhou, and Kunmin, and the service industry also grew in the two regions. Overall, the two areas achieved an average growth rate of about 8.7 percent between 1979 and 2005 (CNSB: 1980 to 2006).

However, the Coastal area developed much faster than the other two areas. The average annual growth rate of GDP in the Coastal area between 1979 and 2005 was about

12.8 percent (CNSB: 1980 to 2006). More important, with a much strengthened industrial and technological base, the Coastal area had established a solid infrastructure for sustainable growth. The Coastal area received the majority of FDI and imported technology as it had low tax rate and excellent infrastructural facilities. With high wages, the Coastal area also attracted about sixty percent of China's highly educated workers (Yang, 2006).

**Table 6.6 Contribution to the Chinese National GDP of the Three Regions (%)**

| Area    | 1952 | 1979 | 2005 |
|---------|------|------|------|
| West    | 9    | 21.3 | 18.3 |
| Inland  | 21   | 18.7 | 17.9 |
| Coastal | 70   | 60   | 63.8 |

Sources: Wang, 2006; Xia, 2003

These advantages expanded the Coastal area's capacity to develop when the Chinese central government reduced its direct management of the Chinese economy (See Table 6.6). At the end of 2004, the GDP per capita in the West was only about forty one percent of that of the Coastal area; the figure in 1979 was about sixty percent (Chen, 2005; Lin, 2004). In extreme cases, the average income per capita for some Western counties was only about sixteen percent of that for a Coastal county (Wen, 2004).

The increasing regional inequality was also shown by the changing economic status of each region. At the end of 2005, the West only contributed to about 18.3 percent of Chinese national GDP, while to the Coastal area the proportion was 63.8 percent (Xia, 2006). At the end of 1979, the West contributed to about 21.3 percent of national GDP,

and the Coastal area contributed about sixty percent. In 1952, the West contributed to only about nine percent national GDP, while the Coastal area contributed about seventy percent. The gap of industrial productivity between each region was also large at the end of 2005. The Chinese average industrial product value per square kilometer (IPVS) in 2005 was 386,000 Chinese *yuan*. The IPVS value in the three regions showed a three-ladder difference with the West had an IPVS value of 57,000 *yuan*, the Inland 530,000 *yuan*, and the Coastal area 5,150,000 *yuan* (Chen, 2005; Wang, 2006).<sup>36</sup>

**Table 6.7 Average Annual Growth Rate of the Three Regions since 1979 (%)**

| Area    | 1979-1990 | 1991-2000 | 2001-2006 |
|---------|-----------|-----------|-----------|
| West    | 7.51      | 8.81      | 11.15     |
| Inland  | 7.16      | 9.23      | 11.90     |
| Coastal | 8.35      | 12.32     | 11.92     |

Data Source: Calculated from Fan and Sun, 2008 (As Guangxi is reclassified as a Western province).

<sup>36</sup> The difference in industrial productivity per square kilometers between the West and Inland is still consistent with what I illustrate in Table 6.6. First, according to Chinese Land Department, the West contains about 73.5 % of Mainland China's area, while the Coastal area occupies about 12.2% and the Inland Contains about 14.2% of China's total land area. The West is as about five times as large as that of the Inland area, meaning the difference of total industrial product value between the West and Inland must be smaller. Second, the figure only measured the difference in heavy industry, and the combined income from agriculture, fishery, service, and other economic departments in the West can be larger than that of the Inland. Third, large remittance into the West also helps to explain the reason that total GDP of the West is slightly larger than that of the Inland.



Table 6.7 shows the difference of growth rate, which indicates that Chinese regional inequality, is still increasing although some policies, such as the “Developing the West”, have been designed by the Chinese government to reduce such inequality. As Table 6.7 shows, although the growth rate of the Coastal rate during 2001 to 2006 was only slightly higher than that of the other two regions, we still need to consider two facts. First, since the absolute economic value in the Coastal area was much larger than that of the other two areas, the slight difference in economic growth still meant a large discrepancy in absolute value in economic growth. Second, the West and Inland economic growth included their migrated workers’ remittances from the Coastal area, so the economic growth rate reported by the two areas did not really reflect their economic development.. In other words, the economic structures in the West and Inland did not really get improved to reduce economic inequality after 1979.

#### Reducing Regional Inequality after 1998: “Developing the West” Strategy

The CCP and the Chinese government during Mao’s leadership designed policies to reduce regional inequality. Believing that government intervention would choke China’s growth and the market would automatically adjust the inequality, the Chinese government after 1979 reduced direct interference in reducing regional inequality. This new institutional arrangement changed dualism and accelerated China’s economic growth but it also enlarged Chinese regional inequality after 1979.

The widening regional inequality after the early 1990s troubled the central government and the CCP. One problem was the unstoppable migration of peasants from the Inland and West to the Coastal cities to seek higher wages when travel restrictions

were loosened after 1979. The Coastal area had established strong Town and Village Enterprises (TVEs) before the late 1970s when the Cultural Revolution reduced central control over local issues. The TVEs' development in the Coastal area laid a solid basis for the area's rapid growth after 1979. As to the other two areas, they depended their economies mainly on the large SOEs and local TVEs did not develop very much (Yang, 2001; Harvie, 2000). After the early 1980s the higher wages in the Coastal area and the lessening control over the residential record system (*Hukou*) attracted skilled workers from other areas to the Coastal area. Even workers without skills or education also swarmed into Coastal cities to look for higher paid manual jobs (Iredale, 2000).

After the mid-1990s, because of the slower expansion of Coastal enterprises, many new migrants from the West and Inland found it very difficult to get a job. Some of them committed crimes in Coastal cities. Those who found a job still faced other problems. For example, they had to work more than twelve hours a day and only earn about thirty dollars a month. Sometimes bosses who had good relations with local officials would refuse to pay workers wages to reduce business costs (He, 2005).<sup>37</sup> The Chinese central government frequently urged local governments to solve disputes between workers and business owners but rarely succeeded as local officials had little motivation to implement labor laws. Due to the lack of effective personal evaluation systems, local public officials' career path was often based on local GDP growth or their personal loyalty to senior patrons. Local officials thus would not offend businesses that could increase the

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<sup>37</sup> These bosses could declare a false bankruptcy to refuse the payment to workers; they could also hire gangsters to suppress workers. These bosses often had good relations with local leaders, which also helped them always win the wage dispute cases with workers.

local GDP level. In addition, the extensive inflow of labor force to the Coastal area also exerted great pressure on the underdeveloped interregional transportation network in China, which inhibited the mobility of other needed resources across the three regions.<sup>38</sup>

Second, regional inequality had worsened ethnic relations in China that subsequently would hold back China's national integration. Western provinces, especially Xinjiang and Xizhang (Tibet), were heavily populated by ethnic minorities. Local minorities complained that the Western backwardness was caused by the ethnic Han policy designs. In areas with poorly educated local residents and with strong attraction to radical ideologies, economic inequality encourages secessionist leaders, especially Islamic fundamentalists, to mobilize support against the Chinese central government. For example, radical Islamists in Xinjiang, the province with the largest ethnic minority in the West, had already instigated discontented residents to support the "East Turkistan" movement after the 1980s.<sup>39</sup> Although the CCP had successfully suppressed all the riots, the party knew well that regional inequality was an important reason that caused discontents and riots (Chen, 2007).

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<sup>38</sup> The government claimed the extensive migration exerted great pressure on Chinese transportation system. The government had tried several means, including increasing transportation fares and building residential report system in host cities for newcomers, to control mobility of workers across regions, but with limited effect. In each Spring Festival, more than one hundred million workers migrate across the three regions.

<sup>39</sup> The "East Turkistan" movement was initiated in the 1930s by the ethnic minority Uighurs and was supported by the Soviet Union. After 1949, the movement was suppressed by the CCP, and some of its survived members fled to Turkey. The Leaders of this movement claimed they were decedents of ancient Turkey and Xinjiang was their motherland but was occupied by the Han majority. After 1979, because of the relative backwardness or the feeling of "relative deprivation" among the Uighurs, the movement revived (Chen, 2007).

The final problem is the increasing economic conflicts across the three Chinese regions (Wedeman, 2003). After 1979, each region had greater autonomy in managing local economic affairs. To protect or develop regional interests, each region often implemented policies that conflicted with those made by other regions. For example, the West and Inland also competed with the Coastal area for purchasing cotton in the 1990s. The two regions believed cotton exportation to the Coastal area had obstructed the development of their own textile industries, so they prohibited the flowing of cotton to the Coastal area. In 1998, the Inland province Hubei prohibited the selling of Shanghai-produced automobiles in its market in response to Shanghai's exclusion of selling Hubei-produced taxi-cabs in Shanghai market (Wedeman, 2003: 231-232). The commercial conflict across Chinese regions also spread into other businesses such as DVD, iron, cotton, tobacco, and chemical products, which severely constrained efficient allocation of resources and hindered the formation of a national market in China.

The Chinese government after the mid-1990s pursued several approaches to addressing these problems. One was to urge local governments in the Inland and West to control their residents, and prevent so many migrating to the Coastal area. The two areas, however, resisted this pressure because migrant workers to the Coastal area would send back home a large proportion of earned wages, which facilitated the two regions' economic development. The central government also asked Coastal cities to donate money or relocate some skilled workers to work in the other two areas. The Coastal area did transfer some money to the West and Inland, but the money was often used to subsidize to the poor people's living expenses rather than invest in productivity growth.

In addition, due to the relatively lower wages in the other two areas, Coastal skilled workers would not move to the West and Inland.

To reduce regional inequality, the central government tried to mount a more comprehensive strategy. In 1998, the central government proposed the “Developing the West” policy to facilitate Western growth by calling for domestic and international investment and technologies (Jiang, 2006). The policy also applied to the Inland area. The central government gave local leaders more discretionary power than before to attract investment to the West or the Inland. Before 1998, any investment larger than thirty million dollars had to be approved by the central government, the approval process of could be as long as two years (Gao, 2004). The new policy terminated this limit and encouraged private investors to invest in the West and Inland by offering them low interest rate loans from the central bank.

The new policy also aimed to improve the transportation system in the West and Inland. The CCP believed the poor transportation stalled the two regions’ further development. With improved and adequate transportation, it was believed, the two areas could more easily import needed technologies or products from other areas, and deliver their products or resources to the Coastal or international market. Thus after 1998, the Chinese central government invested billions of *yuan* annually to the two areas to improve local transportation, which reduced interregional transportation cost (Xia, 2008).

In response to the grand strategy, regional governments in the West and Inland also designed policies to attract investment and advanced technologies. Low taxes and low land prices, for example, were set for potential investors. The two areas also tried to call

for well-trained or highly educated workers by offering them higher wages or providing good jobs for their family members (Fan, 2003; Gao 2003, 2004).

Despite these policies, the resources input into the two regions after 1998 was still small compared to input into the Coastal area. More than half of new investment flowed into the Coastal area. Regional inequality still increased although a few scholars argued that the increasing rate began to slow down after 2002 (Gao, 2003, 2004; He, 2005). The main reason was because investors had already established profitable enterprises in the Coastal area. The expected lower returns or uncertainties of policy changes in the two regions discouraged real investment.

This case supports the argument that strong central intervention is necessary for the reduction of Chinese regional inequality. It also indicates that economic, cultural, and international relations theories, which usually neglect the role played by institutions, cannot effectively explain the frequent changes in Chinese regional inequality in the past decades. Only institutional theory, which studies changes in Chinese political institutions and hence governmental intervention, necessarily and sufficiently explain the real causes of, and solutions for, Chinese regional inequality.

### Conclusion

Institutional changes in post-1979 China vitally affected the making of related policies to change Chinese regional inequality. The end of radicalism and severe economic problems triggered China's economic reform in 1979. These effects to save the flagging legitimacy of the CCP also fostered political pragmatism after 1979. The CCP became more concerned with the practical management than ideological purity.

Economic policies were designed to develop the Coastal area that was perceived by the party as the best prepared to develop quickly. The collective leadership made it less likely for individual leaders to control the making of economic policies at national level (Baum, 1994; 9-10, 20-22). The decentralization of policy-making after 1979 tilted the power distribution from the Central to local governments, and enabled local governments to design policies based on local interests, which often lead to increasing economic conflicts among competing regions.

After 1979, the CCP undertook various institutional strategies to develop China, but with the main intention to develop the Coastal area. The Chinese central government implemented the free market, the two-track price system, and tilted investment and tax policies to develop or adjust China's regional economy. But the dominance of Coastal leaders in the central Politburo encouraged the making of policies that were mainly preferential to the Coastal area. Even the "Developing the West" policy was implemented, the weak central intervention constrained its real effectiveness.

In sum, these institutions changes helped China achieve great economic growth but Chinese regional inequality also increased after 1979, causing severe problems that the Chinese government urgently needs to solve.

## Chapter Seven Conclusions: Institutional Constraints and the Two Shifts of Modern Chinese Regional Inequality (1949-2005)

This chapter summarizes main findings of this dissertation, maintaining that changes in Chinese political institutions vitally affected regional inequality in post-1949 China. The chapter also discusses policy and research implications of this dissertation, showing that IT (Institutional Theory) may also help us understand the way institutional changes impact the pattern of regional inequality in other economies.

### Institutional Changes and the Shifts of Regional Inequality in Post-1949 China

This dissertation shows that institutions, including political parties, institutionalized norms, marketization, and dualism, significantly affected the shifts of Chinese regional inequality between 1949 and 2005. Durable changes in these institutions, especially political party and the power balance between the central and local governments, altered the policy-making process and policy outcomes.

Political organizations, especially the Chinese Communist Party (CCP), were significant in shaping the pattern of Chinese regional development because they drove changes in economic institutions and thus indirectly affected the implementation of economic policies. For example, the Chinese National Planning Committee (NPC) was the direct design by the CCP and it effectively constrained Mao's influences on economic policy-making. The operation of the Special Economic Zones (SEZs) was also under the guidance of the CCP. In addition, economic policies such as the Five Year Plans, the Third Front Project, and the Two-Track price system were also generated by the shift of



the Chinese political institutions. As I have shown in these chapters, these economic institutions subsequently affected Chinese regional inequality.

As a dominant actor in Chinese political economy, the CCP directly impacted Chinese regional inequality. The party's goals determined the policy repertoire that Chinese government could rely on between 1949 and 2005. Before 1979, the CCP highlighted the value of social equity and war preparation and fostered the making of policies that reduced regional inequality. After staging economic reform in 1979, the CCP was more concerned with economic efficiency, and designed preferential policies for the Coastal area that was perceived to have better prepared for modernization. In addition, because of the CCP's strict control, the market had limited effect on regional development before 1979. After the CCP starting economic reform in 1979, the control was loosened and potential investors' pursuit of higher return helped the Coastal area attract the majority of foreign and domestic investment.

Dualism, or power structures between the Chinese central and local governments, which were important institutional elements in modern Chinese political economy, also impacted Chinese regional inequality. The CCP's centralization policy and its tight control over the market constituted the essence of economic policy-making in pre-1979 China. These institutional arrangements enabled the state or the CCP to be the sole actor in shaping the path of Chinese development. The CCP thus had the capacity to directly impact Chinese regional inequality. For example, the Five Year Plans (FYPs) and the Third Front Project drove the development of the Inland and Western areas before 1979. In contrast, the CCP's political support to economic reform starting at 1979, though gradually, reduced direct governmental intervention and motivated marketization. The

post-1979 CCP encouraged private property rights to develop, which essentially changed the pattern of Chinese economic development. This policy enabled the market to increasingly become the main venue to allocate resources across Chinese regions and fostered the better-prepared Coastal area to develop faster than other areas. Hence when the central government loosed economic control, it became difficult for the government to correct regional inequality. This has been exemplified by the Chinese government's inability to reduce regional inequality by implementing the "Developing the West" strategy in 1998. Moreover, with increasing autonomy of local governments, the Coastal area was free to consolidate its advantageous status in regional competition for capital, technology, market, and skilled workers, which in turn reinforced economic inequality across the three regions.

#### Looking Back and Ahead: Policy and Research Implications of This Study

Chinese regional inequality has caused some severe problems in China. First, regional inequality strengthened regional identification and intensified regional conflicts, which in turn obstructed the formation of an integrated national market. The "automobile war" between Shanghai and Hubei province as I have mentioned supported this argument (Wedeman, 2003). Second, the intention to develop the local economy motivated the West and Inland to build industries that had already been established in the Coastal area, a development that caused redundancy in the Chinese economy (Yang, 2006). Third, the striving for the given amount of FDI triggered the "race to the bottom" process among the three regions, meaning local governments would sacrifice the long-run Chinese

interests to attract investment. Finally, as I have mentioned, regional inequality intensified ethnic conflicts in the West, which engendered political instability in China.

For these reasons, the Chinese government has to be more attentive to managing regional inequality because it affects Chinese economic development and political stability. The Chinese government on the one hand has to cultivate comparative advantages of each region, but on the other hand has to limit the growth of regional inequality as it is a threat to political stability. Designing effective institutions may be a powerful way to help the Chinese government balance development and regional inequality in the future, because institutions matter greatly in affecting Chinese regional inequality as this dissertation has shown. These institutions drive development with the help of the market, and they also provide assistance to the less developed region when market itself cannot redress the problem of regional inequality.

This dissertation uses the comprehensive framework---- IT---- to analyze the reasons and process of the changing Chinese regional inequality. Although previous studies can explain some initial conditions that affected Chinese regional inequality, they offer only incomplete explanations for the changing inequality across the three Chinese regions after 1949. That is, they cannot successfully explain the two changes in Chinese regional inequality between 1949 and 2005.

IT is powerful for analyzing the shift of Chinese regional inequality because it explores specific reasons and mechanism that drove regional inequality shifts. For example, the theory successfully explains the way the shifts of Chinese political institutions vitally led to the change in Chinese economic institutions, which subsequently affected Chinese regional inequality after 1949. The main findings in this

dissertation hence show that IT is useful theoretical framework for analyzing the shifts of Chinese regional inequality.

Another major implication of this study is that IT theory may be applied to the study of regional inequality in other countries. My study shows that changes in political and economic institutions are more important than other factors in explaining uneven development in China.

Therefore, IT may also be expanded to study regional inequalities in three types of economies that have some similar characteristics as those in China. First, IT can be an effective approach to understanding regional inequality in communist or socialist countries that have similar political institutions as those in China. Indeed, the equalization of regional economy was often seen as an important feature of socialism (Wei, 2000:8-9). Socialist countries often institutionalized the ideology of egalitarianism to achieve the goal of poverty relief and equal distribution of wealth among social members (Murphey, 1976; Simmons, 1979; Szelenyi, 1981; 12). These countries also built centralized fiscal and investment institutions to regulate economic development (Kornai, 1980, 1992; Wong 1991; Naughton 1995). Although empirical findings of the real effectiveness of policies to reduce regional inequality differed in former socialist countries, including the Soviet Union and Eastern European countries, related studies all agree that institutions were important, if not the sole, factors to affect regional inequality in socialist countries (Clark, 1983; Liebowitz, 1987; Turnock, 1984; Ozornoy, 1991; Petrakos, 2001; Dienes, 2002). Moreover, IT may also be an important tool for analyzing the dynamic relations between regional inequality and secessionist movement in China or formal socialist countries such as Yugoslavia and the Soviet Union (Plestina, 1992).

Second, IT may be also useful to examine regional inequality in large developed countries such as the US, Australia, and Germany. Those countries have large areas and have regional inequality for historical, ethnic, political, and economic reasons. Thomas Courchene finds that the highly effective budget transfer system in Australia helped the country to reduce regional inequality, while Allan Morris finds that a specific relationship between Australian federal government and state government enabled the federal government to successfully transfer money to poor states such as Western Australia and Tasmania (Courchene, 2004: 24-25; Morris, 2004:127-147). Richard Bensele also shows that specific institutions, including the Republican Party and specific developmental policies such as gold standard, the protective tariff, and the national market affected the trend of regional inequality in the US (Bensele, 2000). Finally, Paul Bernd Spahn studies regional inequality between Eastern and Western Germany and finds that besides historical reasons, the differentiation of power between German federal, state, and local governments significantly impacted regional development and the real effectiveness of policies designed to reduce regional inequality (Spahn, 2004: 166-176).

Third, IT may be used to examine regional inequality in developing and transitional economies. Brazil and India, for example, are transitional economies and also facing problems resulted from the widening regional inequality. The policies designed by these countries to reduce regional inequality may provide each other useful experience. Thrift and Forbes, for example, also reveal the institutional arrangement for welfare and national defense largely impacted spatial development policy and hence regional inequality in Vietnam (Thrift and Forbes, 1986).

In sum, this dissertation first expands the theoretical application of IT by powerfully explaining a development puzzle in China, a large but transitional economy. The study finds that two fundamental changes in Chinese political institutions were the main factor that greatly impacted Chinese regional inequality after 1949. Other factors such as regional difference in natural resources, changes in international relations, or regional culture are insufficient to explain the shifts of Chinese regional inequality after 1949. Second, this dissertation also entails policy implications, arguing that instead of leaders' personal preferences, regional cultures, or regional resource differences, it is institutional constraints that decision makers should pay more attention to in the future effort to change Chinese regional inequality. In addition, this study also indicates that IT may be useful in explaining regional inequality in countries that have some similar political and economic institutions to those in China.

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