

Strategic Directions

PART I

1

THE MACROECONOMY

This chapter provides an overview of recent economic growth and social development in the Western Region.

It lays the foundation for sector-specific studies in the following chapters, and explains the strategic considerations that should influence policy directions. Fiscal policy is discussed in Chapter 2 and the financial system is discussed in Chapter 3.

The Western Development Strategy

Since embarking on an economic reform and liberalization program in 1979, the People's Republic of China (PRC) has made impressive progress in all areas of economic growth and social development. An annual average economic growth rate of 9.6 percent (1979–2000) makes the PRC the fastest-growing economy in the world. The country has also achieved a significant reduction in poverty—in the last 15 years 250 million people have come out of poverty. The Government recognizes, however, that the PRC still faces serious development challenges. Income disparities are growing between the poorer Western and Central regions and the more

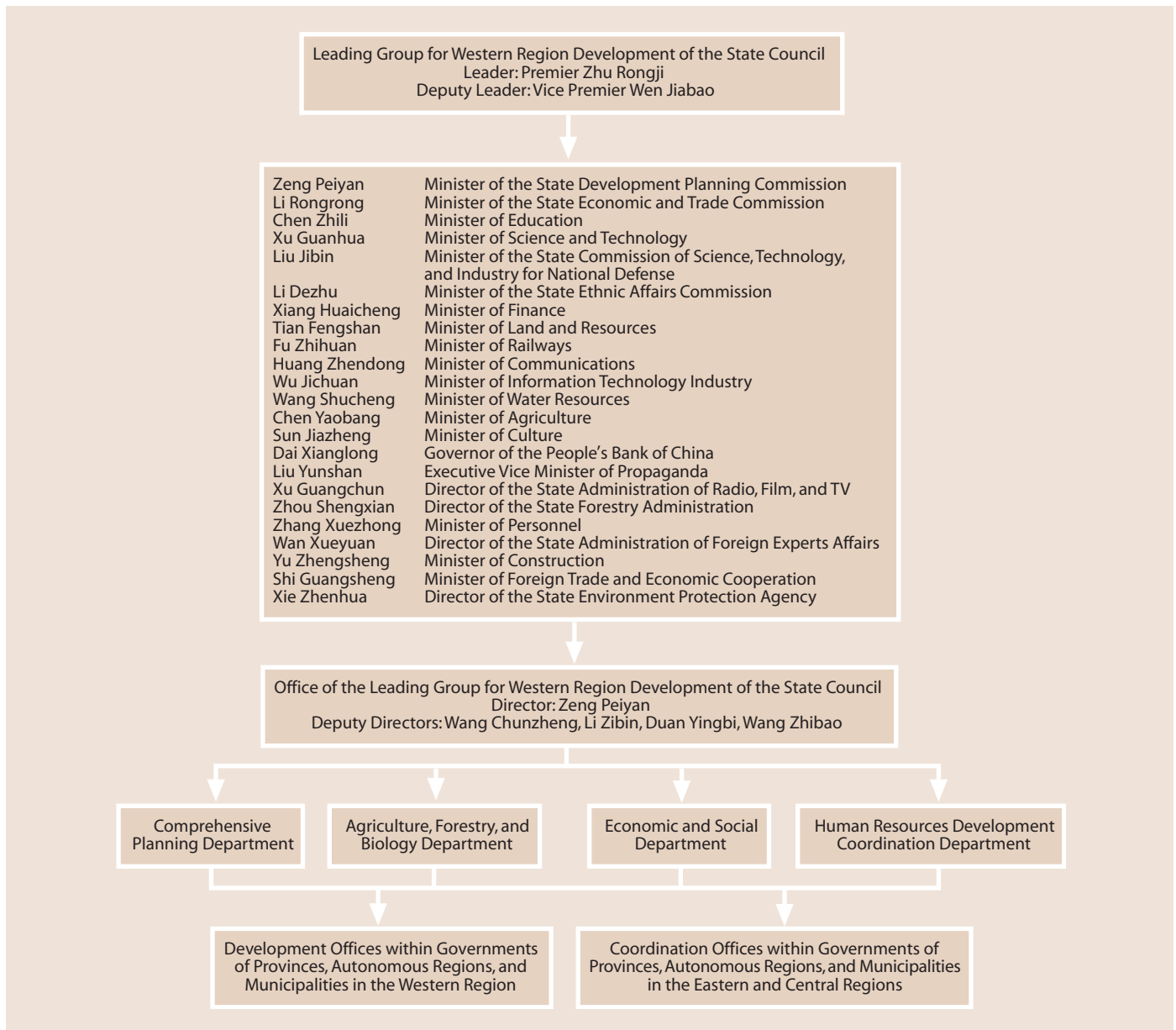
developed Eastern Region. Ecological degradation has gradually become a major constraint on long-term sustainable economic growth and social development.

Accordingly, in February 2000, the State Council adopted a long-term strategy (the Western Development Strategy) to support the development of the Western Region, which consists of the municipality of Chongqing (Chongqing), Sichuan province, Guizhou province, Yunnan province, the Tibet Autonomous Region, Shaanxi province, Gansu province, Ningxia Hui Autonomous Region (Ningxia), Qinghai province, and the Xinjiang Uygur Autonomous Region (Xinjiang). The Inner Mongolia Autonomous Region and the Guangxi Zhuang Autonomous Region will enjoy the same policy treatment as the Western Region for their relatively

Figure 1-1 Western Region of the PRC



Figure 1-2 Organization of the Leading Group for Western Region Development of the State Council



poor economic development, although they belong geographically to the Central Region.¹

The PRC Government recognizes the importance of geographical targetting and transportation systems in the development of the Western Region. The development of the Western Region will rely on three major transport routes: the Asia-Europe continental bridge, the Yangtze River waterway, and the routes to the sea in southwestern PRC. These three major transport routes will serve the Western Region by linking up major cities into a network of

three interprovincial economic zones: the area spreading along the Western Longhai Railway and the Lanzhou-Xinjiang Railway, the Nanning-Guiyang-Kunming areas, and the upper reaches of the Yangtze River.

The Leading Group for Western Region Development, chaired by Premier Zhu Rongji and with Vice-Premier Wei Jiabao as the Deputy Leader, is developing the strategies and coordinating the implementation of the Western Development Strategy. Besides the Premier and the Vice-Premier,

23 Ministers or equivalent-level leaders are members of the Leading Group. The Office for Western Region Development, chaired by the Minister of the State Development Planning Commission (SDPC), Zheng Peiyuan, is responsible for the program (Figure 1-2).

Premier Zhu Rongji explained the importance and the position of the Western Development Strategy in the PRC's long-term development strategy toward 2020 in his Report on the Outline of the New Five-Year Plan at the fourth session of the ninth National People's Congress on 5 March 2001.²

History of efforts to promote the development of the Western Region³

In the pre-reform era, the Government supported the Western Region through public investment in infrastructure, State-owned enterprises (SOEs), and fiscal transfer payments. Other measures included

the relocation of human resources, e.g., universities and colleges, scientists and technicians, schoolteachers, and other specialists. There was no significant private sector investment until well after the national economic reforms program was begun in 1977–1978. The economic reforms also brought in institutional innovations that accelerated economic development in the Western Region.

GOVERNMENT INVESTMENT

From the inception of the PRC in 1949 to the end of the 1970s, the Government followed a “balanced regional and industrial development” policy. The first project was from the “economic recovery period” to the end of the 1950s, and the second was the “three frontiers construction” period in the 1960s and 1970s. During these periods, the Government invested heavily in the Western Region out of a consideration for balancing regional and industrial structures, national security, and other noneconomic concerns. From the first five-year-plan (FYP) of 1953–1957, the Western Region and the Central Region consistently received more government capital construction investment (within budget)⁴ than the Eastern Region (Table 1-1).

The Western Region's share peaked in 1966–1970, when it accounted for 64.7 percent of total government capital construction investment (within budget). Only after 1981, the first year of the Sixth FYP, did the Eastern Region start to catch up. After that, the Eastern Region gradually received more privileges in terms of the share of government capital construction investment (within budget). The effectiveness and efficiency of the government investment in the Western and Central regions under the planned economy are summarized as follows:⁵

- Government investment during the 1950s, especially investment in infrastructure, was an effective way to establish industrial bases in the Western and Central regions to exploit comparative advantages; it reduced the income disparity by 12.6 percent between 1952 and

Table 1-1 Regional Shares of Government Capital Construction Investment (Within Budget), 1953–2000

Period	Eastern Region (%)	Inland Regions (%)	Central Region (%)	Western Region (%)
1953–1957 (1st FYP)	36.9	46.8	28.8	18.0
1958–1962 (2nd FYP)	38.4	56.0	34.0	22.0
1963–1965	34.9	58.2	32.7	25.6
1966–1970 (3rd FYP)	26.9	64.7	29.8	34.9
1971–1975 (4th FYP)	35.5	54.4	29.9	24.5
1976–1980 (5th FYP)	42.2	50.0	30.1	19.9
1981–1985 (6th FYP)	47.7	46.5	29.3	17.2
1986–1990 (7th FYP)	51.7	40.2	24.4	15.8
1991–1995 (8th FYP)	54.2	38.2	23.5	14.7
1996	53.8	38.2	23.4	14.7
1997	53.3	39.3		
1998	47.8	39.9		
1999	41.3	58.7	30.6	28.1
2000	36.8	63.2	30.6	32.6

Source: Various issues of the *China Statistical Yearbook*.

Note: Because of unspecified cross-regional investments, especially in the earlier years, the ratios may not add up to 100%.

1965. The resource industries later contributed significantly to the rapid economic growth of the Eastern Region.

- However, this achievement came at a high cost. For example, in 1955, the government investment in Shanghai and Tianjin, two traditionally industrialized municipalities, accounted for only 76 percent and 108 percent of capital depreciation for that year, respectively. This non-market-oriented investment mechanism resulted in the slowdown of national economic growth and inefficient use of capital.
- The “three frontier construction” in the 1960s represented another boost for economic development in the Western Region. Unlike the government investment policy in the 1950s, “three frontier construction” started to emphasize “complementarity” of government investment: the Government relocated universities and colleges, skilled workers and managers, as well as capital to the Western Region. As a result, thousands of firms with fixed assets valued in the hundreds of billions were established rapidly in the Western Region.
- The resource misallocation was even more severe than in the 1950s:
 - Each industry base was independent and self-sustained, ignoring the complementary network effect, the production chain, and the comparative advantages of each region.
 - The Government emphasized rationales for the defense industries, but ignored the production of consumption goods.
 - The choice of location and technology was not purely economic, but included consideration of national security, balanced (meaning similar) industrial structures, etc.
- Paradoxically, government investment in the 1960s, initially intended to reduce regional imbalance, has actually been enlarging the income disparities from the end of the 1960s.

GOVERNMENT INDUSTRY POLICY

The Western Region has been traditionally regarded as having comparative advantages in resource and raw material industries. In the selection of “pillar” industries during the Ninth FYP, the economic plans of the local governments and the policy recommendations of Central Government experts both reflected this tradition and understanding, and were highly consistent (Table 1-2).

The plans all list the following industries as having comparative advantages: energy (coal or hydroelectricity), mineral resources, petrochemicals, building materials, and agriculture and livestock products. A notable exception is the tourism industry, which only appears twice.

The Outline of the Ninth FYP of Economic Growth and Social Development related four out of the five strategies to the resource industry in the Western Region:

- Strengthen resource exploration in the Western and Central regions.
- Adjust industry structure and induce resource-intensive and labor-intensive industries to relocate in the Western and Central regions.
- Reform the price structure of resource-intensive products and enhance the self-development capability of these regions.
- Improve investment in the environment in the Western and Central regions and attract more foreign direct investment (FDI).

PRIVATE INVESTMENT

Only after economic reform started in 1977–1978 was large-scale private sector investment legally permissible and attracted into the massive market of the PRC. However, because of better infrastructure and higher rates of return, the Eastern Region attracted the majority of private investment, especially FDI. From 1978 to 1998, 16,243 FDI projects commenced in the Western Region with a total contract value of \$21,690 million and actual value of \$8,770 million, accounting for 5.0 percent, 3.8 percent, and 3.3 percent of national totals in the

Table 1-2 “Pillar” Industries in the Western Region During the Ninth FYP

Province, Autonomous Region	Based on Local Government Plans
Southwest	
Chongqing	Automobiles, metallurgy, chemicals, and food processing
Sichuan	Metallurgy, chemicals, food, machinery, electronics, automobiles, and building materials
Guizhou	Food (tobacco and spirits), aluminum, electricity, automobiles, coal and coal chemistry, phosphor, and building materials
Yunnan	Tobacco, biological food, phosphor, and tourism
Tibet	Agricultural products, mineral resources, forest products, tourism, and building materials
Guangxi	Sugar cane, metallurgy, automobiles, and building materials
Northwest	
Shaanxi	Machinery, electronics, medicine, food, and building materials
Gansu	Petrochemicals, building materials, machinery, textiles, food, and medicine
Qinghai	Electricity, salt products, crude oil and gas, chemicals, and metallurgy
Ningxia	Aluminum and coal
Xinjiang	Oil and gas, petrochemicals, textiles, food, and building materials
Inner Mongolia	Agriculture and livestock products, energy (coal), metallurgy, and automobiles (truck)

Source: Hu (2001).

Sixth, Seventh, and Eighth FYPs. In 1998, the Western Region attracted only \$1,370 million, or 2.9 percent of total FDI in that year.⁶

LABOR MARKET AND HUMAN RESOURCES DEVELOPMENT

During the early FYPs, the Government relocated several universities and vocational training colleges to the Western Region to accompany its investments in heavy industries. Some western cities, such as Xi’an, Chengdu, and Lanzhou, thereby gained some of the best scientists and engineers in the country. By the end of 1998, the Western Region had 1,178 State-owned, above-county-level research and development (R&D) institutes, accounting for 20.4 percent of the national total. The Western Region also hosted 20 percent of universities and colleges, 23.3

percent of polytechnics, and 18.1 percent of vocational education institutes. The Academy of Science has 26 research branches and employs about 6,000 scientists in the Western Region.

INSTITUTIONAL INNOVATIONS

During the last two decades, the Government has experimented with various institutional innovations, including special economic zones, the opening up of port and border cities, stock exchanges and other capital market developments, commercial and policy banks, free-tariff development zones, and tourist recreation parks, among others. Most of these institutional innovations took place in the Eastern Region, and only a few were in the Western Region. For example, out of the 422 newly established state-level development zones, 360 are in the Eastern

Region, 36 are in the Central Region, and only 26 are in the Western Region. The Government also granted local governments more flexibility in the approval of FDI, foreign currency retention ratios, credit/capital ratios, and others. The willingness to accept and implement these innovations has been keenest in the Eastern Region.

The economy of the Western Region today

A fundamental precept of the Western Development Strategy is the reduction of disparities between the PRC's regions and the prevention of further degradation of the ecological environment. Despite impressive economic growth in the last two decades and the Government's consistent efforts to promote balanced regional development, the Western Region still lags behind in almost all aspects of social and economic development.

FACTOR ENDOWMENT

The Western Region does not have comparative advantage in factor endowment. The common assumption that it is very rich in natural resources relative to the rest of the country is not really correct; it is very hard to put high mountains and deserts to productive use. The vast area is not an asset; the distances that separate population centers are a liability. The knowledge and skills of its workforce are comparatively backward, and its stock of capital assets is relatively small (Table 1-3).

The drawbacks of the Western Region are its geographical isolation and harsh living conditions. With regard to the low capital stock, even if total factor productivity (TFP) improves, it may not be practicable to increase industrial production in capital-intensive industries, such as resource processing. It makes more sense to concentrate on labor-intensive industries.

The Western Region does have vast deposits of minerals, such as crude oil, gas, coal, gold,

Table 1-3 Factor Endowment of the Western Region, 1999

Item	Western Region		PRC	Western Region as % of PRC	Remarks
	Northwest	Southwest			
Natural resources					
Cultivated land (km ²)	140,155	166,134	949,709	32.3	See Chapter 4
Forest land (km ²)	357,603	487,945	2,633,000	32.1	See Chapter 4
Grassland (km ²)	208,127	99,097	314,797	97.6	
Nature reserves (km ²)	297,000	392,900	770,800	83.0	
Water (10 ⁹ m ³)	234.4	1,335.4	1,569.8	21.2	See Chapter 16
Mineral resources					
Oil (Mt)	28,100	–	101,800	27.6	See Chapter 7
Coal (Mt)	529,700	89,000	999,500	61.9	See Chapter 7
Natural gas (GL)	21,010	7,360	65,220	43.5	
Gold (t)	742.4	611.7	4,157.5	32.6	
Chromium (Mt)	5,408	3,796	10,270	89.7	
Human resources					
Higher education graduates	3,973	3,649	34,747	21.9	See Chapter 11
High school graduates	12,580	15,578	120,424	23.4	
Primary school graduates	37,174	101,000	432,928	31.9	
Preschool population	8,733	21,035	87,462	34.1	
Capital stock					
Roads (km)	327,635	205,015	1,351,691	39.4	See Chapter 6
Railways (km)	8,419	12,927	57,922	36.9	See Chapter 6
Gross capital formation (10 ⁶ yuan)	250,861	392,395	3,796,541	16.9	
Enterprise total assets (10 ⁶ yuan)	865,782	1,160,389	11,696,889	17.3	

Source: Various statistical yearbooks; Lu (2000).

chromium, and other precious metals. The exploration and processing of mineral products, however, need capital-intensive production facilities, water, and transportation links. Water is necessary for processing coal and all mineral products, and is therefore an additional constraint. Rail transport cost and rolling-stock capacity are major impediments to developing mineral industries even if the track infrastructure exists. Exploration may also result in environmental and social costs that need to be mitigated. In the development of resource processing industries, the Government in cooperation with the private sector, needs to assess, both in the short term and in the long term, the availability of substitutes, the international market, the cost of exploitation and the establishment of transportation network, and the possible negative effects on the environment and minority peoples.

INCOME DISPARITIES

Despite the dramatic fall in the incidence of poverty in the PRC during the last two decades, poverty remains a major concern in the Western Region. The persistent poverty has various causes and reflects the widening development gap between the rural and urban areas in the economically disadvantaged provinces and counties.

The 11 provinces and municipalities in the Eastern Region, with 29.2 percent of total cultivated land and

37.9 percent of the total population, contributed 57.3 percent of gross domestic product (GDP), while the Central and Western regions, with 75.0 percent of total cultivated land and 59.5 percent of the total population, contributed only 42.7 percent of GDP (Table 1-4).

Since the mid-1980s, per capita GDP has exhibited significant disparity and the income disparity is widening. In 1980, per capita GDP in the Eastern, Central and Western regions was 488 yuan, 337 yuan, and 274 yuan, respectively. The absolute disparity was 0, -151.4 yuan, and -214 yuan, and the relative disparity was 1:0.69:0.56. In 2000, per capita GDP in the Eastern, Central, and Western regions became 11,335 yuan, 5,982 yuan, and 4,687 yuan, respectively. The absolute disparity became 0, -5,353 yuan, and -6,648 yuan, respectively; and the relative disparity became 1:0.47:0.41. As an extreme example, Shanghai, a municipality in the east, had a per capita GDP of 25,739 yuan in 1999 while the western province of Guizhou had only 2,207 yuan. In other words, Guizhou's per capita GDP in 1999 was only 9 percent of Shanghai's.

In terms of average GDP growth rate, there was no significant difference between regions in the 1980s. In 1991–2000, however, the relative disparity between the Eastern, Central, and Western regions increased.

Income disparity between the urban and rural populations is more severe. This is so even when we

Table 1-4 Some Economic Indicators of the Various Regions, 2000

Region	Population (%)	GDP (%)	Primary Industry GDP (%)	Secondary Industry GDP (%)	Tertiary Industry GDP (%)	Per Capita GDP (yuan)
Eastern	37.9	57.3	43.0	59.8	60.0	11,335
Central	32.1	25.6	32.1	25.1	23.5	5,982
Western	27.4	17.1	25.0	15.1	16.5	4,687
Southwest	18.5	11.0	16.9	9.5	10.5	4,468
Northwest	8.9	6.1	8.1	5.6	6.0	5,143

Source: China Statistical Yearbook 2001.

use per capita consumption figures that have taken into account government transfer payments and therefore are a more accurate proxy for measuring consumers' actual purchasing ability. Table 1-5 shows that rural consumption is 30 percent of urban consumption in the Western Region, below the national average of 31 percent, and well below the Eastern Region figure of 42 percent.

POVERTY AND FRAGILE ECOLOGY

About 70 percent of officially designated poverty counties are in the Western Region. The Western Development Strategy recognizes the interrelationship between poverty and environmental constraints. According to a recent study by the Chinese Academy of Social Sciences (CASS), there is a close relationship between the locations of poor populations and fragile ecological systems. In all western provinces except Yunnan, the overwhelming majority of the people who live in poverty in the poverty counties reside in ecologically fragile areas (Table 1-6). These estimates for 1988 have probably worsened in the intervening period, owing to population growth.

COMPARATIVE ADVANTAGES AND INTERNATIONAL TRADE

The PRC's exports have grown rapidly and now account for 3.6 percent of world exports. The growth rate has exceeded that of GDP (Figure 1-3).

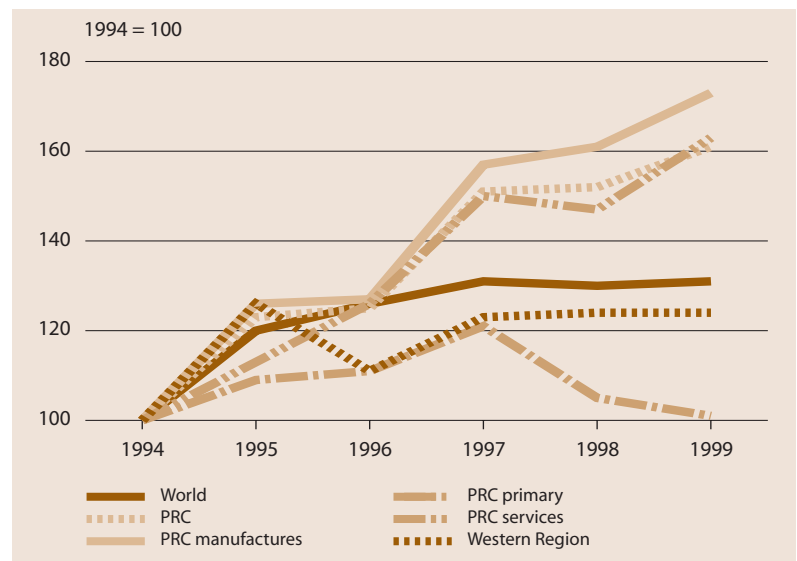
The Western Region accounts for less than 4 percent of the PRC's exports, and its share has been falling.

Table 1-5 Urban and Rural Consumption

Region	Rural Population (yuan per capita)	Urban Population (yuan per capita)	Absolute Disparity (yuan per capita)	Relative Disparity (yuan per capita)
Eastern	1,502	6,117	-3,703	0.39
Central	1,306	4,167	-2,665	0.36
Western	1,308	4,619	-3,313	0.28
Southwest	1,304	5,049	-3,741	0.26
Northwest	2,414	4,190	-2,886	0.31
PRC average	2,414	4,998	-3,328	0.33

Source: *China Statistical Yearbook 2001*.

Figure 1-3 Exports of the Western Region, Compared with Other Export Categories



Source: Calculated from *Almanac of China's Foreign Economic Relations and Trade 2000*.

Table 1-6 Relationship between Poverty Counties, Poverty Populations, and Fragile Ecological Systems in the Western Region, 1988

Province	(1) Poverty Counties (no.)	(2) Population in Poverty Counties (millions)	(3) Poverty Counties in Fragile Areas (no.)	(4) Poverty Population in Fragile Areas (millions)	(5) (3)/(1) (%)	(6) (4)/(2) (%)
Sichuan	51	28.0	39	26.0	76	93
Guizhou	31	12.0	11	7.1	35	60
Yunnan	42	10.7	21	4.5	50	42
Shaanxi	34	7.9	26	5.7	76	72
Gansu	30	8.7	22	6.0	73	69
Qinghai	12	2.4	10	2.2	83	92
Ningxia	8	1.9	6	1.7	75	86

Source: Chinese Academy of Social Sciences (1999).

The following categories of goods dominate the PRC's commodity exports:

- Manufactures, most (89.8 percent) of which the Eastern Region produces
- Products of "processing trade" industries⁷ (56.9 percent of commodity exports), which usually cannot locate in the Western Region
- Products of foreign investment enterprises⁸ (FIEs) (45.5 percent of commodity exports), which are rare in the Western Region

The Eastern Region has a comparative advantage by reason of its easy access to markets and to suppliers.

The Western and Central regions are in a similar disadvantageous position relative to the Eastern Region. In per capita trade volume, the Western and Central regions achieved 14 percent of the national average and about 5.7 percent of the volume achieved by the Eastern Region (Table 1-7). The Western Region is also a less attractive place for FDI. Two best performers, Guangxi (a coastal province and close to Guangdong) and Chongqing, achieved only roughly 50 percent of the national average in per capita FDI, and less than a quarter of the level in the Eastern Region.

Government measures to promote exports or attract FDI have tended to help the Eastern Region and have served to divert fiscal resources that the Government might otherwise have applied to the Western Region. For example, equipment imported for import processing (for export) projects is tax-exempt.

PRICES

There used to be a "dual track" pricing policy in the PRC. The Government controlled the price of resources and raw materials at below-market rates, while the price for consumption goods was more flexible in the domestic market and reflected prevailing market rates. One consequence was that the Western Region subsidized the costs of production in the Eastern Region. Although the PRC has officially abandoned the "dual track" pricing policy and leaves the price determination to market mechanisms, various forms of implicit price control and price fixing still prevail, especially for products in the upstream production chains, like resources and mineral products. Through SOEs, the Government has monopoly powers in some "pillar" industries, such as telecommunications, airlines, banking and insurance,

Table 1-7 Imports and Exports of the Western Region, 2000

Region	Total Trade (\$ million)	Export (\$ million)	Import (\$ million)	Per Capita Trade (\$)	FDI (\$ million)	Per Capita FDI (\$)	FDI/GDP (%)
PRC	474,296	249,203	225,094	366	40,715	31	2.59
Eastern	436,820	226,878	209,942	889	34,886	71	5.86
Central	20,310	12,398	7,912	49	3,594	9	0.71
Western	17,166	9,927	7,240	48	1,852	5	0.43
Southwest	8,968	5,588	3,380	37	1,359	6	0.47
Chongqing	1,786	996	790	58	244	8	0.65
Sichuan	2,545	1,394	1,151	31	437	5	0.43
Guizhou	660	421	239	19	25	1	0.06
Yunnan	18,128	1,175	638	42	128	3	0.25
Tibet	130	113	17	50	0	0	0.00
Guangxi	2,034	1,489	545	45	525	12	0.96
Northwest	8,198	4,339	3,860	71	493	4	0.35
Shaanxi	2,140	1,310	830	59	288	8	0.66
Gansu	570	415	155	22	62	2	0.20
Qinghai	160	112	48	31	0	0	0.00
Ningxia	443	327	116	79	17	3	0.26
Xinjiang	2,264	1,204	1,060	118	19	1	0.08
Inner Mongolia	2,622	970	1,652	110	106	4	0.37

Source: China Statistical Yearbook 2001.

Table 1-8 Evolution of Industrial Structure in the PRC, 1978–2000

Region	1978				2000			
	Primary Industry (%)	Secondary Industry (%)	Tertiary Industry (%)	Total GDP (%)	Primary Industry (%)	Secondary Industry (%)	Tertiary Industry (%)	Total GDP (%)
PRC	28.4	48.6	23.0	100.0	15.3	47.1	37.6	100.0
Western	35.2	45.6	19.2	100.0	22.3	41.5	36.2	100.0

Source: *China Statistical Yearbook 2001*.

electricity, gas, and water. Consumers are paying higher and distorted prices for the use of these facilities and services. This price fixing will have the same effect as “dual track” pricing, as the consumers cross-subsidize producers who are mostly located in the Eastern Region.

INDUSTRIAL STRUCTURE

In the last 20 years, primary industry in the PRC has declined relatively by 13 percent from 28.4 percent to 15.4 percent, secondary industry has been roughly constant, and tertiary industry has picked up the most gains, from 23 percent to 37.6 percent. The Western Region has followed the same trend, but in different magnitudes. Most significantly, secondary industry declined by 4.1 percent and tertiary industry gained 17 percent (Table 1-8).

Table 1-9 lists the relative weights of industrial outputs in the Western Region in the last 15 years.

While GDP declined by 2.3 percent in total, primary industry increased its weight by 0.3 percent, and tertiary industry decreased slightly, by 0.4 percent. Secondary industry is the major victim of the economic development in the last 15 years; its weight decreased by 3.5 percent. The numbers combined with those in Table 1-8 imply that secondary industry in the Western Region has become less important for the region and the national economy. Another picture comes from looking at the industrial structure and comparing the percentages of industries exhibiting different growth patterns (Table 1-10).

In 1997, 34.7 percent of firms in the Eastern Region were in industries with a constantly higher-than-average growth rate, while in the Central and Western regions less than 21 percent of firms were in these industries. Moreover, the growth rates in western PRC were declining.

The northwest and the southwest have different industrial structures. Heavy industry dominates the northwest, and accounts for 75.1 percent of industrial

Table 1-9 Industrial Outputs in the Western Region, as Percentage of National Total, 1985–2000

	1985	1990	1995	2000
Primary industry	24.7	25.6	24.5	25.0
Secondary industry	17.5	16.8	15.1	15.1
Tertiary industry	16.9	20.1	18.7	16.5
GDP	19.4	20.2	18.9	17.1

Source: Various issues of *China Statistical Yearbook*.

Table 1-10 Percentage of Firms in Industries with Different Growth Patterns

Region	Constantly Above-Average Growth		Constantly Below-Average Growth		Other
	Rising	Declining	Rising	Declining	
Eastern	34.7	7.4	15.9	40.1	2.1
Central	20.7	9.5	21.3	46.9	1.7
Western	20.4	6.9	29.3	42.5	0.9

Source: Feng Chen (2000).

Table 1-11 Heavy/Light Industry Structure of the PRC, 2000

Region	Output of Heavy Industry (%)	Output of Light Industry (%)
Eastern	54.5	45.5
Central	66.9	33.2
Western	64.4	35.6
Southwest	57.6	42.4
Northwest	75.1	24.9
PRC	58.0	42.0

Source: *China Statistical Yearbook 2001*.

output; among the heavy industries, mining and raw material industries account for over 70 percent of output. The southwest has a roughly equal share of heavy and light industry (Table 1-11).

This reflects differences in natural endowment and government investment policy. The northwest is rich in mineral resources (such as aluminum, crude oil and gas, and other metals), and the southwest is rich

Table 1-12 Percentage of Industry Output Produced by Various Ownership, 2000

Region	SOEs	COEs ^a	SHEs ^b	FIEs ^c	Funded by Hong Kong, China, Macau, and Taipei, China
PRC	47.3	13.9	11.8	15.0	12.3
Eastern	37.5	14.8	8.7	19.2	16.3
Central	67.9	14.5	19.8	5.9	3.5
Western	73.4	7.6	17.1	4.6	3.0
Southwest	68.4	8.4	13.2	5.7	2.8
Chongqing	67.9	6.0	19.1	9.1	4.3
Sichuan	60.2	7.4	15.4	5.4	2.7
Guizhou	79.3	8.0	6.9	2.2	0.8
Yunnan	80.4	8.1	9.1	3.1	2.6
Tibet	76.8	20.4	11.6	0.4	0.0
Guangxi	66.2	13.2	11.6	8.4	3.0
Northwest	80.5	6.5	22.6	3.0	3.2
Shaanxi	78.3	6.4	18.3	6.4	4.8
Gansu	76.4	15.3	11.6	0.7	2.8
Qinghai	89.1	2.8	5.7	0.0	2.5
Ningxia	73.0	3.2	6.5	6.3	1.2
Xinjiang	88.2	3.2	50.4	0.8	0.8
Inner Mongolia	79.9	2.7	19.9	2.5	4.7

Source: *China Statistical Year Book 2001*.

^a Collective-owned enterprises.

^b Shareholding enterprises.

^c Foreign investment enterprises.

in agricultural products, such as tobacco, tropical fruits, forest products, and building materials. Heavy industry has been under state control because of the huge initial investment and its perceived importance to the national economy. Accordingly, SOEs still dominate the northwest, producing 78.4 percent of GDP.

Table 1-12 documents the ownership structure in various regions of the PRC. While over half of industry output in the country is produced by the nonstate sector, the Central and Western regions are still dominated by SOEs (67.9 percent and 73.4 percent, respectively). In particular, foreign-funded economic units, and economics units funded by Hong Kong, China, Macau, and Taipei, China are all concentrated in the Eastern Region. The Central and Western regions have only attracted less than a quarter of these investments.

INDUSTRIAL PERFORMANCE AND UNEMPLOYMENT

With the exception of Yunnan, where the tobacco industry dominates, all provinces and autonomous regions in the Western Region have a lower ratio of profits to industry costs than the national average (Table 1-13). This implies that profitability is rather weak. In terms of labor productivity, the situation is

the same. With the exception of Yunnan province, labor productivity is lower in the Western Region than the national average.

The poor performance of firms in the Western Region reduced the competitiveness of products in the market. When SOE reforms started, unemployment soared. Up to July 1999, Shaanxi laid off 301,000 SOE employees (15.6 percent of the total), and 112,000 employees of collective-owned units (23.6 percent). In Xinjiang, about 80,000 people lost their jobs, and in Ningxia, 34,700.⁹

PRODUCTIVITY

Inferior factor productivity in the Western Region is the principal reason for its lower economic growth rate, despite higher investment rates. In 1997, total factor productivity (TFP) was 93.9 in the Eastern Region, 82.8 in the Central Region, and 78.4 in the Western Region. Lower TFP reflects inefficiency in resource allocation or slower technological progress, or both. Market imperfection and institutional inertia contribute to inefficiency in resource allocation, and lack of investment in R&D and human resources and lack of competition in product markets contribute to slower technological progress. TFP is a comprehensive index to measure the efficiency and

effectiveness of the production process. Unless there is an improvement in factor productivity, policies to accelerate investment will not succeed.

PRIVATE SECTOR CONTRIBUTION

SOEs still dominate economic growth in the Western Region, accounting for over 40 percent of industrial growth during 1995–1997, and well above the national average of 16.8 percent. At the same time, foreign-funded economic units and economic units funded from Hong Kong, China, Macau, and Taipei, China contributed 12.9 percent and 8.7 percent, respectively, to industry growth in the

Western Region, well below the national average for these units of 29.4 percent and 17.1 percent, respectively (Table 1-14).

Implications for macroeconomic growth in the Western Region

ECONOMIC GROWTH IN THE PRC

Although the PRC achieved a remarkable 12 percent GDP growth rate during 1990–1995 and an

Table 1-13 Economic Performance of the Western Region, 2000

Region	Ratio of Total Assets to Industrial Output Value (%)	Ratio of Assets to Liabilities (%)	Ratio of Profits to Industrial Cost (%)	Productivity (yuan per person per year)
PRC	9.0	60.8	5.56	45,679
Southwest				
Chongqing	6.1	64.8	1.7	31,252
Sichuan	6.9	64.5	3.6	31,848
Guizhou	7.2	69.3	2.3	31,751
Yunnan	15.8	55.5	8.4	68,960
Tibet	5.3	27.0	22.0	31,634
Guangxi	7.8	68.4	3.9	35,494
Northwest				
Shaanxi	7.6	68.2	6.1	32,899
Gansu	5.1	65.1	1.3	26,819
Qinghai	4.8	72.9	0.4	41,175
Ningxia	5.5	60.0	1.9	32,874
Xinjiang	11.0	62.7	12.8	76,656
Inner Mongolia	6.2	59.3	2.2	32,756

Source: China Statistical Yearbook 2001.

Table 1-14 Sector Contributions to Industry Growth, 1995–1997

Sector	PRC Average (%)	Eastern Region (%)	Central Region (%)	Western Region (%)
SOEs	16.8	12.4	20.8	40.1
Collective-owned units (COEs)	19.6	12.8	41.9	10.5
Shareholding enterprises (SHEs)	12.7	9.8	17.7	22.0
Foreign investment enterprises (FIEs)	29.4	38.4	9.6	12.9
Enterprises funded by entrepreneurs from Hong Kong, China, Macau, and Taipei, China	17.1	22.4	5.1	8.7
Others	4.4	4.2	4.9	5.8
Total	100.0	100.0	100.0	100.0

Source: Feng Chen (2000).

impressive 8.3 percent during 1995-2000, such a high GDP growth rate may not be sustainable. GDP growth rate declined to 7.9 percent in the first half of 2001, while a lower 6.9 percent was recorded in the third quarter (Table 1-15).

This view reflects the following considerations:

- The rate of return of capital investment will inevitably decline because of the diminishing marginal rate of productivity of capital investment.
- Imperfections in the financial system prevent the effective utilization of domestic and foreign capital.
- The household saving rate will decline because of the increasing propensity for consumption.
- Inertia in the labor market will continue to prevent effective labor mobility.
- The aging population will impose heavier burdens on public finance.
- Investments in environmental protection will divert funds away from productive activities.
- The world economy is currently in a downturn.

However, GDP growth in the PRC will continue to be stronger than world average for the following reasons: (i) institutional innovations, especially SOE reform and the increasing competitiveness and integration of the domestic market, will continue to boost economic development; (ii) membership in the World Trade Organization (WTO) will open up monopoly markets in banking and finance, insurance, telecommunication, and domestic airlines, thus increasing market competitiveness and the efficiency of capital utilization; (iii) urbanization and industrialization in currently underdeveloped areas will increase the extent of the market and promote further specialization and division of labor and productivity; and (iv) the relatively stable economic and political environment will attract more foreign investment into the PRC market.

A recent study by the Development Research Center of the State Council projected two scenarios, summarized in Table 1-16.

It would be wise to take the lower growth rate as the more realistic one, given the closer integration of the PRC's economy with the world economy after the accession to the WTO and the current downturn of the world economy.

ECONOMIC GROWTH IN THE WESTERN REGION

Although the Government has increased investment in the Central and Western regions to boost economic growth in these two areas, the effectiveness of the investment is still questionable. Government investment in 2000 accounted for only 6.4 percent of investment in fixed assets, 11.9 percent of investment in capital construction (13.8 percent in the Western Region), and 3 percent of investment in innovations (see Table 1-17), for a weighted average of 7.5 percent.

According to the Development Research Center study, capital investment will account for 60 percent of GDP growth in 2000–2010. Even taking the rather optimistic view that the Government will continue to increase investment at the 2000 annual rate (weighted average) of 12.6 percent (thanks to the expansionary fiscal policy, increasing government bond financing, and higher tax revenues from tighter fiscal discipline) and that the Western Region will be favored with an extra 4.5 percent increase in investment per year, the GNP growth rate in the Western Region will still only gain an extra 0.2 percent ($4.5 \text{ percent} \times 7.5 \text{ percent}$ [weighted average of the contribution of government investment] $\times 60 \text{ percent}$ [capital contribution to economic growth]), if all other factors are kept constant. This reflects the declining importance of government investment in the promotion of economic growth.

Institutional innovations are hard to quantify but they will undoubtedly contribute to economic growth, especially as the Central and Western regions could enjoy the “backward advantage” of imitating institutional experiments in the Eastern Region if the Government were to adopt the policy recommendations of this report.

Table 1-15 GNP Growth Rate (Using Comparable Prices), 1997–2001

Region	1997	1998	1999	2000	2001		
					1st Quarter	2nd Quarter	3rd Quarter
PRC	8.8	7.8	7.1	8.0	8.1	7.8	6.9
Eastern	9.1	8.3	7.8	8.7			
Central	9.0	7.2	6.3	7.3			
Western	7.7	7.1	5.9	7.1			
Southwest	7.8	7.0	5.6	6.8			
Chongqing	8.8	6.8	6.1	7.1			
Sichuan	8.2	7.3	4.5	7.5			
Guizhou	7.2	6.8	6.7	7.3			
Yunnan	7.5	6.4	5.8	5.9			
Tibet	9.0	8.2	7.7	7.8			
Guangxi	6.5	7.3	6.2	6.1			
Northwest	7.6	7.1	6.4	7.5			
Shaanxi	7.4	7.3	6.8	7.5			
Gansu	6.8	7.4	6.7	7.3			
Qinghai	7.2	7.2	6.6	7.5			
Ningxia	6.1	6.8	7.0	8.2			
Xinjiang	8.8	5.9	5.7	6.8			
Inner Mongolia	7.8	7.7	6.3	8.1			

Source: *China Statistical Yearbook 2000, 2001*; figures for 2001 are from the *People's Daily* (<http://www.peopledaily.com.cn/GB/jinji/36/200011121/609881.html>).

Note: National-level gross national product (GNP) figures do not match the aggregate regional-level GNP figures. Best estimates were used to calculate the weighted average GNP growth rate at constant price level.

Table 1-16 Scenarios of Annual GDP Growth (Constant Prices), 2000–2020

Scenario	2000–2005 (%)	2005–2010 (%)	2010–2015 (%)	2015–2020 (%)	2000–2015 (%)	2000–2020 (%)
Base case	8.1	7.8	7.1	6.2	7.6	7.2
Lower-growth case	6.9	6.4	5.6	4.7	6.3	5.7

Source: Li, Ju, and Hou Yongzhi (2000).

Table 1-17 Government Investment, 1999–2000 (Current Prices)

Type of Investment	1999 (million yuan)	2000 (million yuan)	Growth Rate (%)
Investment in fixed assets			
PRC	2,985,470	3,291,770	10.3
Government budgetary appropriation	185,210 (6.2%)	210,950 (6.4%)	13.9
Investment in capital construction			
PRC	1,245,530	1,342,720	7.8
Government budgetary appropriation	147,890 (11.9%)	159,410 (11.9%)	7.7
Western Region	261,300	298,400	14.2
Government budgetary appropriation	34,700 (13.3%)	41,300 (13.8%)	19.0
Investment in innovations			
PRC	448,510	510,760	13.9
Government budgetary appropriation	10,750 (2.4%)	15,530 (3.0%)	44.5

Source: *China Statistical Yearbook 2001*.

Opportunities

The main opportunities for the development of the Western Region are as follows:

- Globalization and accession to the WTO will push the PRC into irreversible economic reform and market openness. Institutional inertia and obstacles will face more competition in domestic and international markets. Competition will also exert pressure on local governments to adopt international best practices in administration and the provision of public goods.
- The experience with institutional innovations in the Eastern Region could help the Western Region to leapfrog some stages of development and take short cuts in experimenting with and implementing new institutional arrangements.
- Market competition would also reveal the real comparative advantages of the Western Region and adjust its industrial structure to fully utilize and explore its advantages in trade with other regions in the PRC and in international markets, such as its enormous potential in tourism and other labor-intensive service industries.
- Modern information and telecommunication technology (ICT) allows easy flow of information into isolated areas and significantly reduces the cost of knowledge diffusion and education. It will also reduce transaction costs in the exchange of goods, services, and knowledge in the Western Region and thus deal with one of the major disadvantages of the region.
- After two decades of economic reform, the PRC has become a demand-oriented economy in which there is excess supply of most goods and services. The budget constraints are less tight and shortages of goods are less severe. This provides a more feasible foundation for the implementation of the Western Development Strategy.
- The market mechanism is functioning in the Eastern Region and most public servants have gained experience in modern macroeconomic management. The Central Government is therefore more capable of using both market

mechanisms and central planning techniques to support the implementation of the Strategy.

Threats

Globalization and the ICT revolution will also pose a significant challenge to the economic development of the Western Region for the following reasons:

- For the Western Region, globalization is a reality rather than a choice. Accession to the WTO will require that the PRC in general, and the Western Region in particular, actively participate in global economic competition so as to utilize the gains from trade. It will also require the Western Region to speed up its economic restructuring to catch up with the industrialized Eastern Region. The information revolution goes far beyond the popularization of personal computers. It requires profound economic restructuring.
- Many SOEs in the Western Region, which are still under the protection of the planned economy, now have to face worldwide competition. Restructuring is inevitable and this will increase unemployment and bring in other social problems.
- Membership in the WTO will challenge the existing comparative advantages of the Western Region:
 - Primary industry will encounter competition in the international market, especially in food, cooking oil, sugar, and cotton—the so-called four “pillar” products of the Western Region.
 - Secondary industry will face competition from wholly foreign-owned enterprises (WFOEs) in the Eastern and Central regions.
 - Tertiary industry may gain comparative advantages, for example, in tourism and other labor-intensive services.
- In the international market, the cost of resource exploration and extraction is increasing while the price of resource-intensive products is decreasing for the following reasons:
 - Primary industries are subject to decreasing returns to scale.

- The prices of mineral products in the international market are unstable and gradually declining.
- R&D will uncover more substitutable goods and therefore reduce the demand for mineral goods.
- Resource-oriented economic planning, as in the Ninth FYP, is inconsistent with sustainable economic growth for the following reasons:
 - Historically, resource-oriented industry policy failed to increase the wealth of the people in the Western Region.
 - Overexploitation of natural resources has resulted in ecological degradation, which will jeopardize sustainable economic growth.
 - Many basic industries are too capital-intensive to absorb the labor force.
- In addition, local governments in the Western Region may not have sufficient capacity to take on the new responsibility of facilitating economic restructuring.

The net effect of these factors could reduce the gap between regions, but the Central and Western regions may still lag behind the Eastern Region in GDP growth. A rough estimate is for the growth-rate gap to narrow from the current 0.7–0.9 percent to 0.2 percent.

POPULATION

The Development Research Center study expects that the natural growth rate will drop to 0.82 percent by 2010. Migration between regions will probably continue the current trend. Table 1-18 gives a rather conservative estimate, based on population census data for 1990 and 2000.

ECONOMIC GROWTH IN THE PRC, 2000–2010

Combining all previous forecasts, the projections for GDP, population size, and per capita GDP are summarized in Table 1-19.

IMPLICATIONS OF ECONOMIC GROWTH PROJECTIONS

Table 1-19 presents a realistic picture of the economic growth in the PRC in the next 10 years. Three points stand out and deserve further discussion:

- In spite of the Government's continuous effort to promote economic growth in the Western Region, its GDP growth rate will still be lower than that of the Eastern Region, although the gap is narrowing. This result indicates the importance of private sector participation (PSP) and calls for the repositioning of public administration in the process of development.
- With a more flexible labor market, labor forces will continue to migrate from the Western and Central regions to the Eastern Region. Moving people out of harsh environments and relocating labor forces in line with economic principles may be the most effective way to increase per capita income, although labor movement may not by itself increase GDP in the Western Region. The social impact of migrating on both the originating and receiving communities merits further study.
- Income disparities will continue to exist and so will the relative poor. To assist the poor, a suitable income distribution mechanism, either a nationwide social assistance program or a suitable manner of government transfer payment, must be put in place to achieve even income distribution.

Table 1-18 Population Size and Migration Between Regions

Region	Total Population		Average Annual Growth Rate (%)	Forecast Annual Net Migration Rate, 2000–2010 (%)
	2000 (million)	1990 (million)		
Eastern	491.33	425.83	1.44	0.82
Central	415.64	382.66	0.83	-0.36
Western				
Southwest	239.83	221.03	0.82	-0.46
Northwest	115.48	100.99	1.35	0.00
PRC	1,262.28	1,130.51	1.11	0.00

Source: Compiled by consultants.

Table 1-19 Economic Growth Projections, 2000-2010

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP (10⁹ yuan)											
PRC	8,940	9,557	10,216	10,921	11,675	12,480	13,279	14,129	15,033	15,995	17,019
Eastern	5,123	6,066	6,491	6,946	7,434	7,955	8,473	9,025	9,613	10,239	10,906
Central	2,289	2,442	2,606	2,780	2,966	3,165	3,361	3,570	3,791	4,026	4,276
Western											
Southwest	983	1,049	1,120	1,195	1,275	1,360	1,444	1,534	1,629	1,730	1,837
Northwest	545	582	621	662	707	754	801	851	903	959	1,019
Population (million)											
PRC	1,262	1,272	1,283	1,293	1,304	1,315	1,325	1,336	1,347	1,358	1,369
Eastern	491	499	507	516	524	533	541	550	559	568	578
Central	416	418	420	422	424	426	428	430	432	434	436
Western											
Southwest	240	241	242	243	243	244	245	246	247	248	249
Northwest	115	116	117	118	119	120	121	122	123	124	125
Per capita GDP (yuan per capita)											
PRC	7,084	7,511	7,964	8,444	8,954	9,494	10,019	10,574	11,159	11,776	12,428
Eastern	10,433	12,154	12,797	13,474	14,186	14,936	15,652	16,403	17,189	18,013	18,877
Central	5,502	5,843	6,206	6,592	7,001	7,436	7,861	8,310	8,785	9,287	9,817
Western											
Southwest	4,098	4,356	4,632	4,924	5,235	5,566	5,890	6,233	6,595	6,979	7,385
Northwest	4,742	5,019	5,311	5,621	5,949	6,296	6,632	6,986	7,359	7,751	8,165

Source: Compiled by consultants.

Strategic considerations in the development of the Western Region

OBJECTIVES OF THE DEVELOPMENT STRATEGY

In light of the discussions in the previous sections, the Government should target the social development, rather than the economic growth, of the Western Region. The ultimate objective of developing the Western Region is to make its people better off. This can be achieved by separating efficiency objectives from those of equality. A transparent and competitive market system is essential to achieve efficiency of resource allocation, and an appropriate social assistance program must be in place to achieve equality in income distribution. Overemphasizing the GDP growth rate of that region, or even worse, setting the GDP growth rate as a political objective, will worsen the efficiency of resource allocation and reduce productivity in the Western Region.

Environmental protection is another constraint on economic growth. Ecological degradation has gradually become a major constraint on sustainable economic development in the PRC. As in many other developing countries, the PRC has run down its natural resource assets for the sake of rapid economic growth in the last two decades. Environmental quality in the Western Region is now poor. Owing to the fragility of

the environment, unchecked environmental degradation will inevitably reverse ecologically sustainable growth for the nation as a whole.

In the short term there is a tradeoff between economic growth and environmental conservation.

- Environmental protection is costly. This implies that more resources will need to be devoted to projects that are not tangibly productive in the short run.
- The damage (or the benefits) to the ecological system is difficult to measure; therefore, increased political pressure is required to implement a sound environmental policy, especially in the poor areas.
- Environmental protection exhibits positive externalities and therefore calls for proper Government intervention and coordination.

REPOSITIONING PUBLIC ADMINISTRATION

The history of government-oriented development programs in the PRC in the 1950s and 1960s indicates that the Government needs to reposition itself to improve the efficiency and effectiveness of public administration in the development of the Western Region. Essentially, the Government should take a supporting role to build a better economic environment and correct market failure. The Government should implement further institutional reforms to set the appropriate rules of the game for the development of the Western Region. Institutional

reform is a Central Government task, but such reform will have a significant impact on the provincial economies. The experience of other countries has shown that there are major benefits from reforming public institutions.¹⁰ While the Government has made great progress in reform, many rigidities and regulations still restrict the effective functioning of the price system, the financial system, the taxation system, SOEs, and public administration.

Appropriate measures that the Government could adopt include, but are not limited to the following:

- Establishing an appropriately defined decentralized public administration system to encourage the local governments in the Western Region to compete in providing better public services for the private sector
- Creating a stable and transparent legal environment to improve private sector participation in the development of the Western Region
- Committing to protect private property rights to improve the efficiency of market transactions
- Phasing out preferential policies for SOEs and WFOEs so that firms can compete on an equal basis irrespective of ownership
- Using its judicial power to level the competition field. Top priority should be given to removing barriers so that the private sector will have access to all industries and markets become competitive or contestable (Chapter 8), and extending the scope of the Anti-Unfair Competition Law of 1993 to include measures against state monopoly

The Government should also step in to provide the necessary transportation, communication, education, and public utility infrastructure in the Western Region, either through public finance or with the support of the private sector. Because of the harsh environment in the Western Region, the financial rate of return on infrastructure investment is rather low. Government investment or government-assisted private investment will be necessary to initiate these projects. To enhance the efficiency, accountability,

and transparency of government investment, if feasible, the Government should invite private sector participation (PSP) through various contractual arrangements.

The Government should abandon its control of resources that can be allocated by the market to achieve efficiency of resource allocation and therefore increase total factor productivity in the Western Region. It should take measures such as the following to establish competitive markets in the Western Region and integrate these with other domestic and international markets:

- Strictly following WTO principles to remove barriers to entry and trade restrictions
- Identifying the barriers to the integration of the urban and rural economies and regional economies

The Government should take responsibility for correcting carefully assessed market failures in the areas of natural monopoly, ecological degradation, environmental protection, education, and adverse social impacts on minorities. The concept of education should be extended to include capacity-building programs to enhance local government officials' understanding of modern economic principles. Similarly, the Government should also increase the Western Region's share of national fiscal resources to assist disadvantaged groups, including women, the poor, and minorities.

PROMOTING PRIVATE SECTOR PARTICIPATION

The private sector, the major driving force behind the economic growth in the Eastern Region, does have incentives to invest in infrastructure in the Western Region.¹¹ Fostering private investment requires reducing the risk for private investors—through stable fiscal and monetary policy, stable investment regimes, sound financial systems, well-performing local governments, and an open and transparent business environment. But to encourage private investment the rule of law must also be strengthened and measures must be undertaken to fight corruption.

The Government should take measures to ensure that small and medium enterprises (SMEs), which are often particularly vulnerable to bureaucratic harassment and the buying of privilege by the well connected, can participate effectively in markets. Such measures include ensuring access to credit by promoting financial deepening and reducing the sources of market failure; and lowering the transaction costs of reaching export markets by expanding access to IT infrastructure, providing training in modern business practices; and building feeder roads to reduce physical barriers. Creating a sound business environment for the private sector may also involve deregulation and complementary institutional reform, for example, reducing restrictions on the informal sector, especially those

affecting small business, and tackling land tenure or registry inadequacies that discourage small investments. The 2002 Law in Promoting Small and Medium Enterprises is a positive step in addressing some of the problems faced by these businesses.

Private investment will have to be complemented with public investment to enhance competitiveness and create new market opportunities. Particularly important is complementary public investment in expanding infrastructure and communications and in upgrading the skills of the labor force.

International best practice shows that this public-private mixture will be most efficient if there is a clear understanding of the costs and benefits of various property rights and contractual arrangements (Table 1-20).

Table 1-20 Cost-Benefit Analysis of Public-Private Mixed Policies

Policy	Degree of Government Involvement	Property Rights	Instruments That Could Be Implemented in the Western Region	Major Costs and Benefits
Public finance	Highest	Public ownership	Public investment in: <ul style="list-style-type: none"> • Infrastructure • Environmental protection • Education 	Tight macro control Ease of project initiation Higher monitoring cost Lower incentives and efficiency
Private sector participation	High	Public-private mixture	Service contracts Management contracts Lease Concessions, BOT, BOOT, ROT, divestiture	Efficiency gains Management improvements Reduction in risks, revenues, benefits Private sector responsible for investment and operations
Fiscal incentives	Medium	Regional/Industry-specific policy Plus:	Tax exemptions/credits Tax holiday	Higher incentives and efficiency than public investment More flexible implementation
Monetary incentives	Medium	Bounded private ownership	Direct credit Subsidized credit Interest-rate rebates	May generate distortions Rent-seeking activities
Regulation	Lower	Private ownership	Capital mobility Market access Competition policy	Correction of market failure Less distortion than fiscal/monetary incentives May generate rent-seeking activities Regulatory authority may have incorrect information
Legal framework	Lowest	Private ownership	Private land usage Property rights Intellectual property rights Regional competition	No distortion and a level playing field Potentially high incentive and efficiency Loose macro control Sometimes hard to initiate a project

Source: Compiled by consultants.

Notes

- 1 There has been discussion of adding the Xiangxi prefecture of Hunan province and the Enshi prefecture of Hubei province to the definition of the Western Region. This would make the Western Region consist of 12 second-level governments (seven provinces, one municipality, and five autonomous regions) and two prefectures. In this report, the “Western Region” is taken to mean the area under the 13 second-level governments; “northwest,” the area under the six northernmost governments of the 13; and “southwest,” the area under the seven southernmost ones.
- 2 The following is an extract from the Premier’s speech:

“Carrying out the strategy for Western Region development to accelerate the development of the Central and Western regions is a major step taken to achieve the strategic goals of the third stage of the country’s modernization drive. During the Tenth Five-Year Plan period, we need to place emphasis on key projects for a good beginning of the program. Construction of infrastructure and protection of the ecological environment should take priority, and we should strive for major breakthroughs within five to ten years.”
- 3 See Dong and Ye (2001).
- 4 Officially called government budgetary capital construction investment, the government investment in infrastructure that has received formal approval from the National People’s Congress.
- 5 See Dong and Ye (2001).
- 6 See Dong and Ye (2001).
- 7 In a processing industry, foreign companies provide raw materials, parts, components, and equipment and a domestic entity processes or assembles them. For a more precise definition, see Lin (2000).
- 8 FIEs comprise four categories:
 - Sino-foreign equity joint ventures
 - Sino-foreign cooperative joint ventures. These are formed jointly by at least one PRC investor and at least one foreign investor, on PRC territory, in accordance with PRC laws and regulations.
 - Wholly foreign owned enterprises (WFOEs)
 - Foreign investment companies limited by shares. These are enterprises established under the *Tentative Provisions of MoFTEC on Several Issues Regarding the Establishment of Foreign Investment Companies Limited by Shares*.
- 9 See Dong and Ye (2001).
- 10 World Bank (1996) and (1997).
- 11 As was reported in the *People’s Daily* on 19 December 2000, the Ziyuan Group (in Yunnan) invested 400 million yuan to rebuild the old Xuanwei municipality; Pacific Construction Group (in Jiangsu) invested 1,000 million yuan to build a Wensha first-class road in Xinjiang; a private firm in Shenzhen invested 406 million yuan to build a highway in Guizhou; and Xiangying Company (in Harbin) invested 30 million yuan for desert abatement in Inner Mongolia.

