

The Relationship between Coastal Preferential Policies after 1980s and Inequality of Regional Development in China

Linhan He

Beijing International Bilingual Academy, Beijing, 101300, China

Corresponding author: linnhann0603@gmail.com

Abstract

Preferential policies implemented in the coastal regions in China after 1980 have enhanced the economic development of eastern coastal provinces, while inland provinces are left with less development opportunities, leading to increased regional economic inequality. Although abundant research has been conducted in 1960s and 1970s to evaluate the macroeconomic impact of coastal preferential policies, less focus on revealing the pathway in which these policies enlarge regional inequality and how different regions could effectively respond. This paper takes Pearl River Delta and Guizhou Province as cases to discuss the impact of preferential policies implemented in coastal regions on regional inequality and its mechanisms. By comparing economic data and other indexes, there is a stark regional gradient difference between Pearl River Delta and Guizhou in terms of GDP, economic structure, human capital net flow. This essay confirms that such economic inequality is largely due to preferential policies toward coastal regions. Moreover, these preferential policies are self-reinforcing, and the initial effect of policies is amplified through capital and human capital agglomeration and financial mechanisms, resulting in continuous enlargement of coastal advantages.

Key words

Preferential policy; Regional development inequality; Factor agglomeration; Financial mechanism

1. Introduction

In the 1960s and 1970s, China had long focused on Third-Line construction project in the western part

of China, particularly Sichuan, Guizhou, and Yunnan. In this period, more than 200 billion have been invested and more than 1000 construction projects have been

built, ameliorating the unreasonable layout of weak industrial foundation and transportation inconvenience. However, after 1978's economic reform in China, the central government has shifted the strategy from pursuing 'balance' to prioritizing 'efficiency', focusing economic development and resource allocation for coastal provinces, especially Pearl River Delta. SEZs (special economic zones) and preferential policies have been set and introduced in order to boost economic growth. In 1995, Eastern coastal areas have already account for 50% of the GDP, and the three SEZs of Pearl River Delta have a total agricultural and industrial output of 28.2 billion Yuan [1]. However, such targeted policy has enlarged domestic regional differences. Inland provinces were economically less developed, and before 2000, the policy of the Development of the Western Region in China has not been implemented. The result of this economic imbalance is that the economic development between coastal regions and inland regions widens.

This essay chooses Pearl River Delta and Guizhou Province as case study, because their economic structures are considered as disparate, one is prioritized while the other is late developing. This essay collects data from 1980 to 2000 to compare economic index to show unequal and unbalanced economic development of Pearl River Delta and Guizhou Province and examines the role of preferential policies, including taxation, foreign investment, and infrastructures, implemented in Pearl River Delta. Finally, the essay would propose implications for government policies and regions with different level of economic development.

2. Preferential Policies of Coastal Regions

2.1 Tax

In 1994, after the tax reform in China, the corporate tax for foreign enterprises is fixed at 33%. However, in three SEZs in Guangdong, the tax system was set up differently mainly in four ways.

First, the tax rate for foreign firms is only 15%. Second, enterprises that planned to stay and operate for more than 10 years could be exempt from taxes for

the first two profitable years, and in the following three years, they can enjoy a tax reduction of 50% of the SEZs tax, which is only 7.5%. Third, firms that invest in large scale infrastructural projects and technology, they could enjoy even longer exemption. Lastly, there are no tariffs on equipment, raw materials, and other production imports, which reduces the cost of factors of production [2].

Such differential tax policy easily creates space for institutional rent [3]. Firms in Pearl River Delta enjoy the exclusive tax benefit that is not implemented in inland, so they could obtain profit that is higher than in a competitive market. The unbalance of distribution of institutional rent between coastal regions and inland provinces could contribute to transfer of resources and factors, with more and more capital flows from Guizhou, which has high tax and low efficiency, to Pearl River Delta, which has low tax and high efficiency.

2.2 Foreign Investment

Pearl River Delta was endowed for looser administrative approval and regulation. Foreign firms face less red tape, and the registration procedure is simplified and streamlined, thus, the set-up cycle for businesses is quick and flowing. At the same time, Pearl River Delta region is given more freedom and discretion to utilize capital to attract foreign investment and approve projects. According to the *Supplementary Provisions of the State Council on Developing Export-Oriented Economy in Coastal Areas* published in 1988, Guangdong and Fujian province are allowed to have self-approval for total investment of projects lower than 30 million dollars.

At the same time, in Pearl River Delta, multiple SEZs implemented the "Three-plus-one" trading mix, which aims to raise the foreign exchange level. This policy not only provides foreign firms to have access to cheap labors and factories, but also accumulate domestic capital for future purchase of capital goods such as machines and technology.

These preferential policies allow Pearl River Delta to attract more foreign direct investment—in 1996, the number of foreign firms in Guangdong has reached 60,000.

2.3 Infrastructure

After the reform, the central government announced to invest in infrastructure in coastal regions especially Guangdong, and many of the projects are directly funded by the central government. Ports, airports such as Shenzhen Bao'an international airport, and expressway such as Guangzhou-Shenzhen expressway are built to improve transportation and efficiency. Also, these infrastructures are mostly served for export-oriented manufacturers such as container ports, which largely shortens the cycle from manufacturing to export. Such upgrade in infrastructure would better support export and accumulate foreign exchange reserve.

In Guizhou, although there are some major infrastructures such as the Naning-Kunming Railway, most of them are energy-dominant and are served as a medium to transfer advantageous resources to Guangdong, as resources such as electricity and other raw material are low-cost in Guizhou. Under the policy of West-East electricity transmission project, which intends to mitigate the dire need of electricity in Pearl River Delta. After economic reform, multiple large-scale hydropower stations have built in Guizhou, including Dongfeng and Puding Hydropower Stations [4]. Nevertheless, these construction are not primarily fulfilling local industrial consumption and upgrading its industries, but to transport ores and electricity to Guangdong.

3. Comparison of Economic Development between Pearl River Delta and Guizhou

3.1 Aggregate Economic Index

The difference in policies and government priority result in a disparate economic development. In 1990, the GDP level of Pearl River Delta is about 150 billion Yuan, and the per capita GDP is about 3200 Yuan. In 2000, After rapid economic reform and implementation of preferential policies mentioned above, GDP rises to about 740 billion Yuan, roughly five times than 1990, and the per capita GDP has reached 22,000 Yuan, six times more than 10 years ago [5].

By contrast, although the GDP growth rate difference is nuanced, Guizhou province has only 100 billion Yuan in 2000, 14% of Pearl River Delta's. The GDP per capita increases from 810 Yuan to 2500 Yuan, also much less than coastal areas.

3.2 Economic Structure Index

Industrialization is a key objective of economic reform in 1980s. Different level of industrialization industrial shift result in different economic structures.

In 1980, primary sector accounts for about 26% of the economy while only secondary sector holds 42%. In this stage, agriculture still account for a large percentage, and manufacturing and service industry are just fledging. However, in 2000, primary sector's level drops to only 8% and secondary and tertiary sectors account approximately 50% respectively [6]. At this stage, Pearl River Delta has shifted to a manufacturing-dominant economy and export-oriented, global economic zone.

In Guizhou, the situation is quite different. Without the support of central government and proper policy guidance, primary-sector acts as the mainstay—about 41% in 1980 and 28% in 2000—and secondary and tertiary are underdeveloped. This leads to a reduction of capital accumulation and widened economic gap.

There is also difference in the inner structure of manufacturing. Pearl River Delta are replete with high value-added industries including earlier clothes and toys making and later electronics and telecommunication innovation. Such innovation is galvanized by advanced technologies and intense competitions. However, Guizhou is located on the lower stream of supply chain, so the amount of valuable resources are deflected.

3.3 Human Capital

In Guizhou province, from 1980 to 2000, there is an incredible outflow of human capital about 44 million people, and most of them ended up in Pearl River Delta for employment. Thus, Guizhou and other inland provinces are labor exported regions and cannot retain talents. This would result in a severe predicament: continuous brain drains.

One serious consequence of brain drains on economy is a lower level of total factor productivity (TFP).

Young human capital, such as engineers, scientists, networkers, and researchers, are the key for innovation, as they have better access to advanced education and get in touch with edge-cutting concepts and skills. A loss in human capital would lead to less innovative entrepreneurship and thus less economic activities.

In contrast, in Pearl River Delta, there is a significant level of inflow of human capital from nearly all parts of China. Long-term residents in the region increases 22 million in 20 years, and most of them are working in textile, electronics, and toys-exported industries [7]. A large level of young human capital could promote knowledge spillover due to potential increase of communication and exchange of innovative ideas, creating positive externality in the market.

4. Mechanisms of Impact of Coastal Preferential Policies on Inequality of Regional Development

4.1 Factor Agglomeration

Factor agglomeration refers to the concentration and combination of various factors of production in a specific region, and thus the region could exert a centripetal force and continues to attract outside factors.

There are mainly two ways of factor agglomeration in the context of China's economic reform. The first way is capital agglomeration. The preferential policies such as half tax rate and flexible right of land usage increase the marginal capital returns, because more profits are retained in the businesses. As a result, more foreign firms and investment are concentrated in coastal regions and away from inland. In 1990s, foreign investment in Pearl River Delta is ubiquitous while negligent in Guizhou. Moreover, nationalized banks at the time would distribute credit and loans for each region, but in inland provinces, the marginal rate of investment is relatively low and saving rate remains high. Thus, capital would be circulated within the system and eventually flow to regions with higher investment returns such as Pearl River Delta through inter-bank lending, which could then supply resources for housing, infrastructures, and manufacturing.

In this process, inland provinces such as Guizhou are the one who acts as blood donor.

The second way is labor agglomeration. Guangdong and other coastal provinces implement market economy, and the vitality policy has brought strongly attract teachers, technicians, and managers in Guizhou, who are restrained by the state-owned enterprises [8]. As a result, this saps the scarce entrepreneurship and talents in inland provinces, and millions of young labors moved to coastal regions to work in the factory [9]. Problems ensued. Local industry and manufacturing are stagnant, and aging starts to grow which lead to heavier burden of pension and medical care for local government.

Thus, capital and labor are more intensive in coastal regions, and higher demand is created. As a result, firms and factories could benefit from economies of scale, process of decrease of average total cost as output raises, which further drives factors to the region, leading to exacerbated inequality in economic development.

4.3 Financial Mechanism

In the 1990s, inland state-owned enterprises face fierce competition and struggled to get the order. However, rigid redemption guarantee means that financial institutions have to act as backstops for enterprises' credit and for staffs. Thus, banks would still give out loans. On the contrary, it is extremely hard for coastal private enterprises to get loans through formal channels, and they would have to face a much higher interest rate.

A key mechanism is the dual-track interest rate system. Under this system, the planned track, in which the interest rate is fixed and set by the central bank. Most of loans on this track goes to state-owned enterprises. In contrast, the other track, the market track, is usually for private enterprises [10]. They have to borrow money from underground banks or trust companies, facing a higher interest rate. As a result, space for arbitrage is created. If inland banks give loans to local state-owned enterprises, they could only receive a maximum interest rate of 10%, but the interest rate would be at least doubled if lending money through the market track. Such large return on capital encourages inland banks to transfer capital toward coast. They could achieve this by mainly two ways.

One way is through bill discounting. Inland state-

owned enterprises would request a banker's acceptance from large local state-owned banks based on a spurious trade with coastal enterprises, and coastal private enterprises would take the bill to coastal commercial banks to apply for discount [11]. This mechanism works because the credit rating was shifted from coastal private enterprises to state-owned banks, and thus coastal banks would reckon such bill as nearly zero risk. As a result, capital is shifted from inland provinces to coastal regions.

Another way is through cross-regional lending. Inland commercial banks would use interbank lending as smokescreen to transfer capital to coastal non-bank financial institutions, such as urban credit cooperative and financial companies [12]. Then, these coastal institutions would directly transfer the capital to designated private enterprises.

5. Policy Implications

5.1 Implications for Pioneer Regions

For pioneer regions such as Pearl River Delta, it already enjoys the dividend of preferential policies. Thus, it should take more responsibility to reduce the economic inequality and attempt to spread its prosperity to inland provinces.

One thing that government could do is horizontal fiscal transfer between Guangdong government and Guizhou government. Such provincial capital transfer could potentially reduce the burden of central government and establish long-term linkage between coastal regions and inland provinces. Specifically, Guangdong government could use net population inflow and tax revenue difference as reference to transfer a certain proportion of its fiscal revenue to Guizhou for support of basic education, vocational training, and medical care [13].

Moreover, Guangdong and Guizhou could establish interconnected partnership relationship. Guizhou is located in the upstream of Pearl River, with high forest coverage rate, playing an important role in achieving sustainability. In contrast, economically developed Pearl River Delta is industrial-intensive and highly urbanized, with high carbon emission and carbon footprint. Thus, Guizhou could utilize its high carbon sequestration and

clean energy as carbon assets to sell to high-consumption firms in Pearl River Delta through domestic carbon emission trading market. Through this system, Guangdong could offset a proportion of its carbon quota, turning it into economic gains. In return, Guangdong government could transfer payment to Guizhou and other upstream regions for flood management.

The government could also consider industrial transfer. The land rent and cost in Pearl River Delta is relatively higher than in Guizhou, so the government could shift some of the manufacturing businesses and part of industry to Guizhou, so that it elicits catfish effect which acts as a stimulant to local market and galvanize competition and innovation, resulting in a greater efficiency and a more active economy. However, the viability is constrained, as it only works when the whole industrial chain and base is complete and sufficient; otherwise, it would face logistical pressure and long turn-over cycle.

5.2 Implications for Late-developing Regions

For regions that are late developing, especially inland provinces such as Guizhou and Sichuan, they should not just try to copy the economic model and industries such as toy making and textiles in Pearl River Delta. Instead, they should develop their own unique industry and avoid direct competition to coastal regions. In this way, they could utilize their own resources such as geographic factors to build up their own economic advantage.

In 1960s and 1970s, in Guizhou, especially Guiyang, Zunyi, and Anshun, there are remnants of Third Front construction ranging from aviation, aerospace, electronics to precision military and numerous research institutes such as base 011 and base 063 [14]. Guizhou could shift these technological resources from military-based to civilian-based, developing into high value-added products such as precision sensors and optical lenses. In this way, Guizhou and other western and inland provinces could avoid fierce competition with coastal regions and develop their own advantages.

In addition, Guizhou has cool summers, so it is suitable to develop computationally intensive industries

including data processing and storage. Guizhou could also utilize its natural endowment to serve as a test base for development of advanced machineries, providing trial services for firms for their products.

6. Conclusion

This essay uses Pearl River Delta and Guizhou as case studies for comparison, examining the role of preferential policies after economic reform given to coastal regions on impacting regional economic inequality in China. Through factor agglomeration and financial mechanism, economic inequality between two regions is reinforced.

The shift of strategic balance from focusing domestic equality to efficiency is intended to elicit positive feedback of ‘the better-off lead the less well-off.’ However, preferential policies would keep attracting human capital and resources. As a result, late-developing regions would sink into negative feedback of ‘low-income, factor outflow, lack of vitality, and even lower income.’ Without proper policy guidance and intervention, economic inequality would be greater.

Although preferential policies in coastal areas have promoted domestic economic growth and integrated China into the global economic system, they come with opportunity cost. Any preferential policies would result in a certain level of inequality, which is verified by the stagnant growth of inland regions. While the policy of Western Development has generated positive impact, the absolute difference still present and would take a long time to resolve.

By analyzing the characteristics and natural endowment of Guizhou and Guangdong, the structural imbalance resulted could be mitigated by multiple ways. For pioneer regions, they could provide capital support and value return to late-developing regions through horizontal fiscal transfer and carbon trade; for Guizhou and other late-developing regions, they could utilize their legacy from Third-Line construction and geography to develop their uniqueness and thus be an integral part of domestic economic chain.

This essay uses comparison and economic mechanism to present findings, but lack quantified measurement, limiting showing the effectiveness of preferential

policies on two regions. The essay would consider using quantified research and data models to reflect the accurate net influence of policies in the future and would extend its focus to incorporate more regions and factors contributing to regional inequality.

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