

**NORTHEAST CHINA AND UNEVEN DEVELOPMENT  
UNDER THE INFLUENCE OF CHINA'S REFORM AND  
OPENING UP**

by

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## **Abstract**

A multi-mechanism framework under a multi-scale method proposed by Wei (1999) is appropriate to analyze the development conditions of Northeast China. In detail, the three mechanisms are decentralization, marketization and globalization, and the three scales are at the interregional, interprovincial and intra-provincial levels.

Decentralization after 1978 in China has led to a weaker central state and stronger local governments, both of which have had important implications for regional development. Challenges from local governments have undermined the control of the central government over regional development. However, powerful local governments have helped Chinese governments to embed in local economies. This has been beneficial to develop and form diversified local economies in the Northeast region. But their over-embeddedness in the economic development target has led to an overlook of local government's responsibilities in maintaining social justice and protecting and assisting the disadvantaged groups, increasing inter-provincial competition and subsequent local protectionism.

Marketization reforms in China have generated a regional biased effect on older declining regions including Northeast China. Privatization or the restructure of State Owned Enterprises (SOEs) has led to losses of skilled labor and valuable intellectual properties, such as product brands and major manufacturing equipment in Northeast China. Moreover, the formation of an integrated domestic market in China after 1978 has created a more advantageous condition for southern provinces, not for northeastern provinces, because of the closer distance with domestic and overseas markets of southern provinces, and market protectionism conducted by some southern local governments through disguised subsidies to

local enterprises or government procurement contracts only for local enterprises.

Foreign investment and trade, two major forms of globalization, also have had influences on regional development in China. In detail, international trade has generated border effects, for example the newly formed economic centers alongside the border with leading western European countries in the central and east European transition countries, and also the prosperous economy in coastal China. Foreign investment's effects on regional development have been influenced by several factors, including the particular selected locations of foreign investors, and also the attitudes or reactions from local players such as governments, labor unions and other actors.

# Preface

This dissertation is original, unpublished, independent work by the author, Tian Xia.

# Table of Contents

<b>Abstract .....</b>	<b>ii</b>
<b>Preface .....</b>	<b>iv</b>
<b>Table of Contents.....</b>	<b>v</b>
<b>List of Figures .....</b>	<b>vii</b>
<b>Acknowledgements .....</b>	<b>viii</b>
<b>1. Introduction .....</b>	<b>1</b>
<b>2. China and Regional Inequality.....</b>	<b>8</b>
2.1 General Theories of Regional Inequality.....	8
2.1.1 Economic Theories.....	8
2.1.2 Political Economy Theories .....	10
2.1.3 Human Capital Theories.....	11
2.1.4 Agglomerations and Clusters .....	12
2.1.5 Major Theories about Regional Inequality in Northeast China .....	14
2.2 China's Regional Inequality .....	17
<b>3. State and Decentralization and Regional Development .....</b>	<b>23</b>
3.1 Strong Centralized States .....	23
3.2 The Decline of A Strong Central Government in China?.....	27
3.3 Decentralized States and Local Entrepreneurism.....	31
3.4 China's Decentralization and Local Governments .....	34
3.5 Summary.....	37
<b>4. Marketization and Regional Inequality.....</b>	<b>39</b>
4.1 Marketization and Inequalities in Transition Economies .....	39

4.2 Marketization and Inequalities in China.....	44
4.3 Summary.....	49
<b>5. Globalization and Regional Inequality .....</b>	<b>51</b>
5.1 The Effect of Globalization on Regional Development .....	51
5.1.1 Trade .....	51
5.1.2 Foreign Investment.....	55
5.2 Globalization and China .....	57
5.3 Summary.....	61
<b>6. Conclusion .....</b>	<b>63</b>
<b>References .....</b>	<b>67</b>

# List of Figures

Figure 1.1 Northeast China and its major cities ..... 4

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# 1. Introduction

Regional inequality has been one of the main topics for economic geography and regional economy (Zubarevich and Safronov, 2011). Regional inequality refers to the differences between regions within a particular state in terms of living standards and work opportunities. Some regions relatively have large shares of well-paid employment opportunities and higher levels of the provision of services, covering from health insurance, education resources to other welfare services, compared to lagging regions usually in peripheral locations (Castree, Kitchin and Rogers, 2013). Another definition, uneven development, has the same meaning with regard to development at varied levels across space and also time, but uneven development also represents the dynamic processes that create unevenness (Castree, Kitchin and Rogers, 2013).

Along with the expansion of the world economy, regional differences in the level of development within large countries have become as significant as differences among countries. This phenomenon has attracted attention in both developed and developing countries. The growing regional inequality in China since 1978 is a representative regional development case, which is important for China because it threatens China's political basis for development and social stability. Indeed, the regional inequality problem is now recognized as a major issue for China's policy makers. Geographers such as Wei (1999) and Fan (1995, 1997) have published amounts of researches on China's uneven development, trying to find out the conditions, root causes and paths. Although a large amount of literature has already focused on China's regional inequality, it mostly measures the empirical gap between regions, provinces or other administrative units. It seldom contributes to understanding the underlying drivers behind its emergence. Furthermore, current research on China's inequality is geographically biased, because it focuses mainly on the changing

situation of the rapidly growing east coastal provinces and seldom expands to the conditions of interior China. In particular, inequality in Northeast China has not received sufficient attention, and the existant literature on Northeast China is mostly too shallow and general to give a grounded clarification of the driving forces behind Northeast China's development status.

A number of disciplines in western research have focused on the issue of uneven development, and provide explanations from relevant economic, social and political economic theories. But China's differences from the western world in terms of history, culture, economic conditions and political regimes result in a failure of the direct application of these western theories to China's particular context. Consequently, it is necessary to come up with more feasible frameworks that are more relevant to China's reality, but developed on the basis of western theories.

Wei (1999) explains the formation of regional inequality in China since 1978 based on an interplay of three dominating factors: state policy, foreign investment and local initiatives, through three mechanisms of decentralization, marketization and globalization. He argues that the various dynamic effects of the three factors and their mechanisms across Chinese regions cause regional inequality and its changes. In general, China's regional development now includes three features: rapid development of the coastal region (typically the Pearl River Delta and the Yangtze Delta); slow development of Northeast China and central China; and under-development of the western region.

Northeast China consists of three provinces, Heilongjiang, Jilin and Liaoning from north to south, located in the most northern region in China (see Figure 1). If China is categorized into the three regions of east, central and west, Northeast China should be further

decomposed, with Liaoning placed in the east coastal region and the other two provinces of Heilongjiang and Jilin grouped to central China. The regional problem for Northeast China is different from that of the coastal region, which faces more intensive inter-county competition, and also of the western region, which is still at an early stage of industrialization. Northeast China, a former industrial and economic center in the Maoist time, suffered a process of gradual economic decline in the period of post-Mao reforms after 1978. A similar decline trend is also reflected in the relative political positions of the three Northeast provinces. For instance, in 1978, the provincial income per capital of Heilongjiang and Liaoning respectively ranked 1st and 2nd among China's provinces, but by 1997, the ranks of these two provinces had dropped to 7th and 5<sup>th</sup> (after omitting the three metropolises of Beijing, Shanghai and Tianjin) (Demurger, Sachs, et al., 2002). The large investments in this region in the Maoist time (such as equipment investments) also decreased in the reform period, when east coastal China was seen as the growth center for the whole China through opening-up and marketization.

Figure 1.1 Northeast China and its major cities



Source: The Guide Book of Dongbei from the Frommers website.

The rapid shifts in the economic and political positions of Northeast China can be a test stone for the feasibility and applicability of western regional development theories in China. However, the use of traditional locational theories or theories about agglomeration

economies, for example, cannot clarify why gaps with the east coast expanded in the reform period, especially considering rich resource endowments, sound infrastructure, ports and transport hubs on coastal and border lines, and aggregated industries in urban areas in Northeast China. Hence, Northeast China needs a multi-factor frame for elucidating its current regional problem. In this paper, the three driving mechanisms mentioned above (decentralization, marketization, and globalization) are adopted to analyze Northeast China's regional problems. Through a comparison of western research and the reality of Northeast China in the three mechanisms of decentralization, marketization and globalization, this paper may give a clearer understanding of Northeast China's development history and current problems.

In the next section, I first discuss selected western theories on regional inequality from the disciplines of economics, political economy and sociology. These theories provide various reasons for how regional and social inequality comes into form, but disagreements always reside in the exact effects (positive or negative) of each factor on inequality. I then focus on China's regional inequality changes since the foundation of the PRC, in both the Maoist and reform periods. Although China's regional development is highly influenced by western economic theories, including growth-pole and inverted-U theories, China's complex regional development at different scales is not a direct result of any single theory, but a result of several forces. Consequently, it is necessary to adopt a multi-factor analysis under a multi-scale frame. Finally in this section, the limited research already conducted on inequality in Northeast China will be briefly summarized.

The following sections three, four and five follow the three-part analysis suggested by Wei (2000) and discuss the effects of government reforms, market reforms and free trade and capital flows on regional development. Through a comparison of theoretical analyses in both

western countries and the reality of conditions in (Northeast) China, it is seen that a number of Chinese regional development issues correspond to the west's problems, but China also has several unique different problems or conditions, which need special research attention.

Section three focuses on the increased decentralization since 1978 and the concurrent result of a weaker central state in China, and their respective influences on regional development in (Northeast) China. In summary, China's central government faces challenges from local governments, in particular relating to its powers over economy and administration. The both kinds of central powers have declined since 1978, which undermines the state's control over regional development. Nevertheless, the central government still maintains certain powers over local governments, especially those in interior regions due to their high dependence on central subsidies as their sole fiscal sources. Another result of decentralization in China has been the escalating roles of local governments in the local economy. This has helped Chinese local governments to further engage in the local economy and overall has been beneficial to development by adopting management and promotion policies more fitted for the needs of local enterprises and other local economic players. But the embeddedness of Chinese governments contains certain defects, such as over-embeddedness in economic development which only focuses on the economic development target but oversees other important responsibilities of governments for the society and the disadvantaged groups, the loss of political autonomy under the influences of other rising powers (such as foreign investors and local entrepreneurs), increasing inter-provincial competition, and subsequent local protectionism and so on.

Section four discusses market reforms from a number of aspects, and point towards their implications for China, including State Owned Enterprise (SOE) reforms, formation of private economy and a domestic market. Although they have been applied nationwide, these

marketization reforms have a regionally biased effect impacting older declining regions such as Northeast China. For example, privatization or the restructure of SOEs leads to valuable losses such as company brands, skilled labor and important manufacturing equipment so on in Northeast China, and the formation of an integrated domestic market has benefited the southern provinces more because of their favorable locations and protections implemented by local governments such as restricted governmental procurement contracts and subsidies only targeting at local enterprises. Furthermore, long-time prejudices and ignorance against private business in Northeast China, together with current harsh local governmental attitudes towards private business has limited the development of Northeast China. All these factors have led to worsening regional development in Northeast China in the post-reform period.

In section five I focus on foreign investment and trade, two major forms of globalization, and their influences on regional development. International trade has border effects by congregating major activities surrounding the border and coastal region. As a result, ports have become important centers in a regional economy. Foreign investment, however, has different impacts on regional development, depending on the locations selected by foreign investors, and also the attitudes or reactions from local players of governments, labor unions and so on. Unfortunately, Northeast China failed to take advantages of China's enhancing globalization due to the failure of local governments and international relations and other factors.

The final conclusion section will discuss to what degree this three-mechanism frame can fully clarify Northeast China's regional economic situation, and propose possible research topics about regional development in Northeast China.

## **2. China and Regional Inequality**

This section gives a brief introduction of chief theories which explore the formation and development of regional inequality. Because regional inequality has been a key problem for governments in both developed and developing countries, and also a chief task to fulfill for world organizations such as the UN, a number of scholars from the fields of Economics, Political Economy, and Sociology have contributed theoretical discussions and explorations to the problem of regional inequality. These theories all provide strong and reasonable explanations to the regional inequality problem from their perspectives. For the regional inequality problem of China, they indicate major factors which resulted in and promoted the exacerbation of the regional inequality problem in China after the reform in 1978. So they can become the theoretical bases and references of an applicable theoretical analysis scheme for China's regional inequality problem, because on one hand each theory only provides a partial explanation from their own perspectives, and on the other hand the Chinese inequality problem was actually formed under a sophisticated environment which involved traditional strong players in the Maoist time, especially the central government and SOEs, and also new players formed in the post-reform era, including private enterprises and foreign powers. A multi-player scheme with a multi-scale analysis method is more appropriate for the China's condition. Literature on China's regional inequality is very abundant, but seldom scholars have ever contributed to explore the conditions of regional development in the Northeast China region, especially adopting the multi-player scheme at multi-scales.

### **2.1 General Theories of Regional Inequality**

#### **2.1.1 Economic Theories**

Within the economic theories of spatial distribution of economic development, there are two dominant schools of thought: the spatial equilibrium school and the spatial disequilibrium school. The major claim of the equilibrium school is that regional inequality is only a



temporary phenomenon deriving from the disparity between national economic growth and the spatial distribution of economic development (Keeble, 1967). Hence inequality between various regions will be finally resolved with the development of national economy. The representative inverted-U theory by Williamson (1965) gives a clear illustration of the relations between regional inequality and economic development. Regional inequality emerges inevitably at the early stages of national economic growth, but after a certain point, the national economic growth will lead to a reduction of regional inequality (Lipshitz, 1992). In addition, from the perspective of labor flows, labor (migration) flows from peripheral regions to core regions due to the enticement of higher incomes will lead to reductions of interregional inequality of income through decreasing differences of interregional marginal output (Borts and Stein, 1964).

With a similar perspective of labor flows, the disequilibrium school, however, asserts that regional inequality is an inevitable and irreversible result of economic development if the market is the only working force. As a result, only the intervention of governments can reduce regional inequality (Lipshitz, 1992). The “backwash effects” and “spread effects” of Myrdal (1957) point out that the draining capital and labor in the declining regions (the periphery) to the growing regions (the core) (i.e. the backwash effects) will exacerbate regional inequality, but the latter compensation flows of labor and capital from the core to the periphery (the spread effects) are negligible under the forces of the market, especially considering the higher returns available in the core regions. Similarly the polarization and trickle-down effects by Hirschman (1958) also argue that market forces alone are unable to remedy regional inequality. Besides the flows of labor and capital, technological innovation is another major explanation in the unequal regional development, which relies on the different innovation capabilities of regions (Friedmann, 1973; Richardson, 1973).

### **2.1.2 Political Economy Theories**

Based on the consideration of Marx's ideas concerning the inherent geographical inequality of capitalism, the Neo-Marxists, including Dunford and Smith (2000) and Harvey (2005), relate patterns of regional development to the periodic crises of capitalism, whereby every period of low growth is likely to be followed by a search for new technologies and new regions for investment. Hence, regional inequality will also demonstrate a cyclical or periodical pattern, which converges during low growth periods but diverges again during capitalism expansion periods. Their arguments are manifested well in the capitalism modernization process of the third world countries, which witness deepening class polarization and geographical inequality, for example in Latin American countries (Timberlake, 1987). Furthermore, the Neo-Marxists believe that a core-periphery demarcation at the international level is necessary for industrial development in the developed core regions, which facilitates the concentration of resources in the continuous development of the core regions (Chakravorty, 2006). Compared with the positive expectations of economists that government investments and other programs in the Keynesian style might be an effective antidote against regional inequality, pessimistic Neo-Marxists take governments as a key driver in the formation of regional inequality. They argue that governments always maintain and take advantages of regional inequality to support the interests of international, first-world and corporate interests in capitalism (Chakravorty, 2006).

State intervention in regional development is inevitable and necessary for political processes to maintain the powers of governments across the nation (Hirschman, 1958; Mills, 1987). But in the policies on regional development, it should be noticed that there is a clear difference and contradiction between state actions specifically geared to the mitigation of regional differences and macroeconomic policies which have no regional dimension but in

reality generate significant spatial implications (Henderson, 1988). For example, policies targeting at balancing regional development are sometimes disturbed by more powerful macroeconomic policies and national objectives, for example the national government's consideration of national security or annual tax revenues. Moreover, these "balancing" policies, for example the supportive or preferable policies specifically planned for some regions or redistributions of fiscal revenue and resources controlled by the national government among different regions, are always de-facto biased towards specific regions like urban areas (Lipton, 1976) and developed countries (Frank, 1967). As a result, the effects of states in rectifying regional inequality need further discussion.

In addition to the function of states in regional development, other political factors, such as the nature of a national political regime, also determine the condition of regional inequality in a country (Nel, 2008). Rueschemeyer et al (1992), and Lane and Ersson (2003) assert that democratic regimes are more efficient and effective in reducing regional inequality, compared to autocratic regimes. But Nel (2008) believes that the consistency of a regime, not the type of a regime, is the crucial and decisive key in regional development. On one hand, consistent and stable regimes generate a favorable political condition for the implementation of redistributive policies; on the other hand, inconsistent regimes are more likely to experience violent civil conflicts and generate deficient public sectors, which both damage the ability and capacity of a state.

### **2.1.3 Human Capital Theories**

With the development of the knowledge economy and a deepening social labor division in the 1990s, investment on human capital began to attract more attention in sociological theories to explain inequalities across regions, genders, classes, ages, occupation, labor groups and so on (Chakravorty, 2006). Apart from sociologists, development economists and

other scholars also believe in interlinked relations between educational attainment, economic growth and progressive income distribution as key factors in explaining regional development. A range of economic models explain the role of human capital in inequality change. Galor and Tsiddon (1997) and Eicher and Garcia-Penalosa (2011) among others argue that unequal distribution of human capital leads to income and regional inequality within developing countries. There are also evidences that higher educational attainment and more equal distribution of education opportunities play a significant role in making income distribution more equal within societies (Gregorio and Lee, 2002). This positive effect of enhancing education conditions on regional development is proved in East Asian countries (Birdsall, Ross and Sabot, 1995). Knight and Sabot (1983) further find a similar relation between income inequality and educational investments as found in the Kuznet curve, which describes the relations between regional inequality and economic development. In the early stages of development, increasing educational investments at the national level will enhance income inequality, but in later periods the expansion of educational investments will decrease income inequality. Furthermore, considering the significant role of governments in development of human capital and education resource distribution across regions, governments again become key research objects in the relations between education and inequality. Bowles and Gintis (1973) among others argue that education controlled by governments is a powerful screening device used to reinforce the existing class structure and income inequalities in a number of developed countries, but in developing countries education creates greater inequalities due to its effects on labor market stratification of formal sectors and informal sectors, which also strengthens the bargaining power of employers in labor markets.

#### **2.1.4 Agglomerations and Clusters**

Another set of theories related to regional inequality concerns the increasing returns of

economic activities in clusters and agglomerations, which is also known as the economies of agglomeration and best reflected in urban and metropolitan areas in reality. Agglomeration and clusters create increasing returns through enhancing the density of economic interaction inside and outside firms in a specific spatial sphere (Chakravorty, 2006). Increasing returns are beyond a specific cause of cluster formation and agglomeration, but also have been an important driving force of clusters and agglomeration in forming and changing regional equalities, through granting more specific benefits, such as availability of common buyers and suppliers, the formation of a skilled labor pool, and increasing informal transfer of knowledge at the local level and so on, to the cluster/agglomeration region (Marshall, 1919; Nadvi and Schmitz, 1999, World Bank 1999). Because of these benefits, the advantages of agglomeration can be sustained even in the face of rapidly rising costs from urban development and concentration due to congestion, pollution, escalating land prices, crime and so on (Scott and Storper, 2003). For less-developed countries, agglomeration is critical to development not only because it is a source of enhanced economic productivity, but also because it is a basic condition of specialization within the global division of labor and an essential foundation of export-oriented growth (Scott and Storper, 2003).

In addition to the influences of increasing returns in clusters and agglomeration on regional development, diseconomies in clusters and agglomerations due to over-dense/congested economic activities will generate strong “centrifugal” forces (Krugman, 1996). The centrifugal forces could lead to a redistribution of economic activities from clusters and agglomeration to other regions with higher returns. As a result, this process is likely to create a new geography of regional equality. So in terms of clusters and agglomeration, it is the balance between centrifugal forces from decreasing returns in diseconomies and centripetal forces from increasing returns in economies of agglomeration that decides the overall geographical conditions of equality.

### **2.1.5 Major Theories about Regional Inequality in Northeast China**

The above four theories all give reasonable explanations from their own perspectives on how regional uneven development forms and develops. But it should be noticed that one thing the four theories have in common in their discussions is their attention on basic function of the market mechanism in regional development. Even in the political economic explanations, the role of the state is also for serving the targets and needs of the capitalists, who will reap their benefits from their main battlefield, the market, with the support they get from the state. The agglomeration theory and the human capital theory, however, focus on the process how uneven regional development realizes and changes through the market force but under the condition of varied regional competitive advantages, which stand for the uneven distribution of human capital in human capital theory and different returns across regions/locations in agglomeration theories. The four theories all provide implications to the originations of China's regional unevenness, but they do not tell the whole story of how the market mechanism functions together with the influences of other important forces, especially when the state is more than a supportive mechanism to the market in Northeast China.

The condition of Northeast China's regional development in fact complies with the prediction of the disequilibrium school that the market mechanism fails to rectify the regional unevenness but became a driving force in the forming process of uneven development. In the past 30 years, Northeast China witnessed its gap with the coastal provinces expanding, and also its internal regional unevenness also enlarging. According to above four theories, these unevenness results can be attributed to the resource and capital concentration in the coastal or some urban regions in Northeast China due to the attraction of higher profit anticipations in these regions, or the advantageous human capital resources or more efficient agglomeration economies in these regions. But it should be noticed that the market mechanism in Northeast

China in fact was disturbed by other forces, mainly the state. In other words, the market mechanism did not realize its real influences in Northeast China because of the intervention of other forces. So it is ungrounded and unreasonable to impute all of these unevenness results to the effects of the market. For example, one basic key term of the market mechanism, the free flows of labor, resources and capital according to the market conditions are not realized in Northeast China. In addition to the limitation of the household registration system (the Hukou system) on the labor flow, low labor flows in Northeast China are also due to its industrial structure set and sustained by the state, which was dominated by large-scale state-owned enterprises (SOEs) or government-controlled firms in basic industries, such as oil, coal mining and telecommunication industries, in the urban regions and large commune farms in the rural region. In the rural region, the larger area of arable land per capita in Northeast China together with its smaller rural population, especially comparing to the rural condition of south China, also limited the rural labor mobility into urban regions after the reform in 1978. But in the urban area, large numbers of SOEs controlled and managed by the state in the 1970s and 1980s became the biggest hurdle of free labor flows inside urban regions. SOEs with guaranteed social security systems, including the provision of pension, health insurance and so on, absorbed the majority of the work force in the cities, and also decreased their mobility to find or change to new jobs. Furthermore, the continuous support to these SOEs from the state until the late 1990s strengthened the preference of local work forces on the SOEs in Northeast China, comparing to other kinds of enterprises. Without free flows of labor, it is impossible to anticipate any similar effects of the market mechanism on regional development in Northeast China to that analyzed in economic theories.

The lack of the human capital resource or agglomeration economies in Northeast China might be responsible for the slow development of Northeast China after the 1990s, when

China began to stress on the shift to a knowledge economy. But the two theories cannot clarify the root cause of the problems in Northeast China, especially when the reform started in the early 1980s. In the 1980s, comparing to other provinces, Northeast China was advantageous in human capital of skilled labor and technicians in heavy industries, due to the former support to the SOEs in Northeast China by the central government. However, the advantageous labor resources in heavy industries on one hand did not meet the demand of foreign investors for cheap labor in simple work, on the other hand the state did not either deregulate their control to the SOEs so that they could not take full advantages of their labor resources for example in research activities or production activities. So the human capital theory might explain one the reasons why Northeast China could not catch up in recent years, but it could not clarify why Northeast China started to crash from the 1980s during the reform time, because the human capital is not the key decision factor. Similarly the reason why the agglomeration economy did not realize its effects in Northeast China is not the lack of agglomeration economy in the 1980s, but is the limitations from other forces on the agglomeration economy. Enterprises in heavy industries in Northeast China congregated in its city regions and formed hub-spoke clusters in Northeast China, which had some important SOEs as the hub, for example the First Automobile Work, and a number of supply enterprises, which were also mainly SOEs, as the spoke serving the hub SOEs. Although the form of clusters was realized in Northeast China, the major advantages of clusters however did not reflect in Northeast China, such as increasing efficiency or increasing research abilities. This is because of the intervention and control of the state over SOEs in the hub and spoke that confined their cooperation and interactions among enterprises. These SOEs did not become a closer union although they were in the cluster form. So the problems of Northeast China could not be owing to the single failure of the market force, but in fact other forces, especially the state, generated larger influences on the development of Northeast China.



## 2.2 China's Regional Inequality

China's regional inequality is partly a historical result of the penetration of colonial forces after the 1840s, which produced a clear demarcation of the rich coastal and poorer interior regions (Wei, 1999). After the foundation of the socialist PRC in 1949, however, this regional inequality condition was not rectified. Indeed, China even experienced fiercer and higher regional convergence of economic activities especially after reforms and opening-up in the post-Mao period. But it should be noticed that in the periods of Mao and post-Mao, the conditions of China's regional development were slightly different due to their different dominant ideologies regarding egalitarianism and development. Under the guidance of socialism, Chairman Mao and his colleagues appreciated more on reducing China's historical regional inequality between the coast and the interior. By involving regional equality as a key component of the First Five-Year Plan (1953-1957) and as an important element in the "ten major relationships"<sup>1</sup>, Chairman Mao tried to eliminate China's regional inequality through the implementation of (re-)distributive policies, which favored interregional resource transfers from the rich coast to the interior through centralized fiscal and investment systems (Lardy, 1975; Wu, 1987; Pannell, 1988; Yang, 1990). Although Chairman Mao was ambitious in his dream of an equal China, the results of his centralized policies have been questioned by scholars with the support of statistical data. Lardy (1975) and other scholars argue that Chairman Mao's centralized (re-)distributive policies were effective overall and improved China's regional development. But Donnithorne (1972), Cannon (1990), Tsui (1991) and Wei (1997) among others reject that effective regional development took place during the Maoist time due to the co-influences of several mechanisms, including the path of urban-centered industrialization (which overlooked the rural regions), national defense needs,

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<sup>1</sup> The ten major relationships were summarized by Chairman Mao Tse-tung in 1956 to outline major issues for a socialist construction of an economic, political, scientific and cultural Chinese state. They were relationships between: heavy industry and light industry; industry in the coastal regions and industry in the interior; economic construction and defense construction; the state, the units of production and the producers; the central and the local authorities; the Han nationality and the minority nationalities; Party and non-Party; revolution and counter-revolution right and wrong; China and other countries.

inefficiency of most investments in the interior region (especially those investments in western remote regions during the Third Frontier period) and decentralization to local governments during the Great Leap Forward of the 1950s and the Cultural Revolution time in the 1960s which created important experiences for rural administrations in the southern provinces in later economic development after 1978 (Naughton, 1988; Wei 1995).

From the early 1970s, China gradually shifted from the pursuit of equality to an eager desire for modernization and economic development under the leadership of Deng Xiaoping. In the selection of a development path in the post-Mao period, economic theories, including the inverted-U theory and the trickle-down theory (in Section 2.1.1), became important backbones of China's "ladder-step" theory, which permitted certain regions (the coast) to firstly get rich quick, and demanded the coastal beneficiaries to pay the interior back in a later period through spill-over effects and (re-)distributive policies controlled by the central government (Yang, 1991; Fan, 1997; Wei, 1997). The condition of regional inequality in the reform period is also debated among scholars. Pannell (1988) and Denny (1991) assert that China is more evenly developed now than before 1978 due to the increasing interregional resource transfers, rapid rural industrialization and effective trickle-down effects. However, Lakshmanan and Hua (1987), Kueh (1989), and Chen and Fleisher (1996) among others believe that the biased governmental policies towards the coastal region after 1978 resulted in and widened the uneven regional development of China.

Because of the more complex conditions of China's regional development in the post-1978 era, Wei (1999), and Fan (1995, 1997) proposed a multi-scale research scheme for China's regional development. China's regional development should not be simplified as convergence or divergence, but should relate to scales. Three major geographical scales would be appropriate for China's regional development, including interregional,

inter-provincial and intra-provincial levels, which could improve our understanding of China's regional development (Wei, 1999). Specifically, the intra-provincial level could be further divided into inter-county inequalities and inter-regional inequalities inside a province (Wei, 2000). According to this scheme, China's regional development in the post-Mao period may be seen as comprising of three features: increasing interregional inequality between the coast (east China) and the interior (middle and west China); decreasing interprovincial inequality due to the rise of certain coastal provinces such as Guangdong and Zhejiang; and more complex intra-provincial inequality among China's provinces (Wei, 2000; Fan, 1995).

Although China's post-1978 policies on regional development have been formulated within the frameworks of the ladder-step theory mentioned above, the driver behind China's complex regional development at different scales is not any single theory, but rather the co-influence of several local and global forces. Wei (1999) in his summarization owes the formation of inequality in China to the interplay of three dominating factors: state policy, foreign investment and local initiatives, through the three mechanisms of decentralization, marketization and globalization. Furthermore, the different economic effects of their interactions across China's regions or individual provinces create a complex pattern of quick development in the coastal region (the Pearl River Delta and the Yangtze Delta are representative examples), slow development in Northeast China and under-development in the west region.

The failure of a single theory in explaining China's regional development can be best demonstrated in Northeast China, which experienced a transition from the top economic centers to old-industrial bases and lagging-behind provinces in the post-Mao period. This miserable regional condition of Northeast China is often described as the "Northeast Phenomenon", characterized by factories with obsolete machines and equipment, inefficient

but large numbers of state-owned enterprises (SOEs), over excavations of resources including coal and oil and so on (Li & Li, 1996; Liu and Zhao, 1997). With rich natural resources of coal, petroleum and timber, a favorable geographical position with several sea ports and border ports, strong industrial bases founded during the Japanese invasion time (1931-1945) and also the Maoist time (Chen and Xiu, 1995), as well as abundant skilled labor and talents, Northeast China has considerable geographical and economic advantages. However, Northeast China in the last 30 years or so only achieved a slow decline in its ranking among Chinese provinces, comparing to the continuous rise of the coastal provinces (Demurger, Sachs, et al., 2002). The reality of Northeast China destroys the arguments that free market can realize development on the basis of favorable factor endowments. Governments at the national and local levels have also been important disturbers to market forces in the economic development of Northeast China, whose policies have counterfeited the initial advantages of factor endowments and industrial basis. But governments have not been the only disturbing forces against market mechanisms in Northeast China, global forces, such as international investors, have also ignored this region in the past 35 years. So the three mechanisms proposed by Wei (1999, 2000) (decentralization, marketization and globalization) should be more fitted for the Northeast Phenomenon among existant regional development theories.

Compared with the intense attention on China's uneven development and the coastal provinces, the literature on the regional development of Northeast China has been rather limited. Especially at the interprovincial and intra-provincial levels, research has been far from enough to give any general description or a grounded explanation.

Moreover, at the interprovincial level, the three provinces of Heilongjiang, Liaoning and Jilin are not at the same economic level. Interprovincial inequity among the three provinces exists.

According to income per capita, Hu (2004) categorizes China's provinces into four income groups, with Beijing, Shanghai and Shenzhen with an income per capita at a middle-income country level as the top group; the higher income coastal areas together with a number of large and middle sized cities in the second income group; a group of lower-middle income provinces with over a quarter of population as the third group; and the poor provinces in the west and central China comprising the bottom group. According to this classification, Liaoning belongs to the second income group with its advantageous locations on the coast line, while the other two provinces of Jilin and Heilongjiang are in the third group, with an income per capita gap with Liaoning at 1/3 of their provincial incomes per capital (Geng and Weiss, 2007). But this is only a brief generalization of inter-provincial inequity among the three Northeast provinces; further detailed discussions on the evolution of this interprovincial inequity are not available. But from the annual ranks of China's provincial incomes per capita from 1978 (the Statistical Year Books of China), it should be noticed that the gap between the three provinces was unstable, which was best reflected by the transcendence of Jilin over Heilongjiang in the ranking after 2000. Inter-provincial inequality is also in evolution.

Intra-provincial inequality in Northeast China is even rarely researched, although Northeast China is a good demonstration of China's adoption of the "growth pole" theory and the urban-center development path from the Maoist time, with its cities as the major drivers of its economic development. Furthermore, compared to the rather rapid urbanization of counties and villages faced by cities in the coastal region, the cities in Northeast China have encountered different handicaps, mainly that a number of resource cities accounting for a large proportion in Northeast China are now at the edge of decline or even bankruptcy. The crisis in resource based and traditional industrial cities and the large amount of laid-off workers from SOE restructuring have been the two major tasks for Northeastern

governments to amend (Wang, 2014). These resource-based cities such as Daqing have chiefly depended on resource industries (mainly mining industries) and lacked of other industrial development. Facing the problems of resource depletion, resource cities in Northeast China, however, received various support and subsidies from the central government, which might probably lead to different developmental potentials and future chances. For example, Daqing, the famous oil city in Heilongjiang, China, received investments on its oil industry from its central ministry (Wang, 2014). In comparison, other coal cities in the same province, however, did not get similar strong support from the central government. It is highly possible some resource cities without enough help and government investments will become new “ghost cities”, leading to further worse regional inequality conditions. This unequal treatment among the resource cities in Northeast China needs more consideration.

### **3. State and Decentralization and Regional Development**

As a country with a nearly 30-year history of a closed planning economy, the Chinese central government used to be the only leading power in regulating China's national economic and industrial development. During the planning-economy period, the resources, capital and even human resources were distributed in order to meet the targets and needs of the central government, without considerations of economic efficiency or effectiveness. After 1978, reforms were not only applied in the economic system which gradually shifted the planning economy into a market economy with Chinese characteristics, but also happened in the political and administrative system inside the Chinese governments. One of the most important reforms in the administrative system is the decentralization of some control powers from the central government to governments at the provincial or urban levels. This decentralization created a new strong player in China's economic development, the local governments, who were directly responsible for their local economies and even became important actors in local economies. At the same time, this decentralization is believed to be able to weaken the dictator position over China's regional development and economic development the central government used to own, and consequently leads to a declining central government in the economy. In addition, this decentralization also resulted in a number of conflicts inside the government system in the post-reform era, which never took place before but generated great influences on China's regional economic development. So this section focuses on the effects of decentralization reforms on the central government and local governments, and the subsequent effects of the changing roles of both the central and local governments on China's post-reform uneven regional economic development.

#### **3.1 Strong Centralized States**

Grounded in neoclassical economic theories, the British economist Joan Robinson (1969) denies any positive role for governments in market exchange processes, and she also asserts

that combating regional economic backwardness is an inefficient practice undertaken in the name of equity. She argues that regional poverty is a consequence of deficiencies inherent in the area itself, and that areal dislocations will continue to occur in a period of adjustment and adaptation. But Gramlich (1994) supports the positive effects of governmental intervention and sees it as an important component and a defender of the market economy; moreover, states cannot be completely separated from the market. States possess a monopoly on violence, which generates their power over persons, firms and even market economy, such as taxation, land and property appropriation, punishment according to laws and so on (Chakravorty, 2006). Therefore, having a large power, states have more ability to influence resource distribution, industrial production and even migration flows and other activities, all of which have an impact on regional development. Compared to private ownership, public ownership under a regime of a powerful (autocratic) central government is more likely to generate regional equality, due to its stronger control over resources and industrial distribution (Golley, 2007). The comparative research of Milanovic (1998) on inequality in two periods before and after the transition from centralized socialism to market economy in seven former socialist countries reveals a sharp increase of social and regional inequalities after privatization during the transition. But it should be noticed that although states have the power to create even development, they do not always act in favor of the weaker classes or regions; they often act according to their own interests in economic development and political support (Chakravorty, 2006). In East Asian countries such as Japan and Korea which are believed to have a coexistence of social equality and economic growth, regional inequality still exists (Kim and Jeong, 2003). The industrial location policies developed from the end of the 1960s in the Republic of Korea favored Seoul and cities such as Busan and Ulsan in Gyeongsang Province, at the expense of more peripheral regions such as Gwangju and the Jeolla region (Pike, Rodriguez-Pose and Tomaney, 2006). Japan also had similar results in regional development, with Tokyo and Osaka as the top leading commercial heads



(Fujita and Tabuchi, 1997).

To combat the over-centralization of economic and industrial activities in specific urban regions, governments of Japan and Korea adopted “counter-pole policies” to achieve industrial development objectives. In detail, this refers to government intervention through a merge of taxation and subsidy programs to distort market incentives in favor of lagging regions (Golley, 2007). But the final regional results of their counter-pole policies were rather pessimistic. In summary, taxation and social security systems, which provide public insurance for the population through provisions of health care and pensions, were major instruments used by both governments. Korea promoted industrial relocation from the Seoul region to the rest of the nation by providing tax exemption and support funds in the 1990s, but both income and employment further concentrated in the Seoul region by 2000 (Kim and Jeong, 2003). Kim and Jeong (2003) found in their empirical research that redistribution of assets and business income could be more effective than industrial relocation policies and other policies targeted at creating more employment and investment in less developed regions. Similar industrial relocation policies were also implemented in Japan to balance its regional development before the 1980s. However facing competitive challenges from Southeast Asia and East Asia countries with lower costs, Japan’s regional policies evolved into a distribution of innovation activities away from Tokyo and Osaka through support from central finance and tax system and public policy corporations (Okimoto, 1989).

Intervention in the market by powerful centralized governments is recognized as a feasible method to achieve a more even regional development in the countries of East Asia. The most often applied regional policies in East Asia include labor wage control through migration policies, welfare provisions, state controlled finances and direct state interference in industrial location and resource distribution processes through their controlled state-owned

enterprises (SOEs) (Douglass, 1994; Huff, 1995). However, centralized governments can also be serious impediments to more equal regional development. In addition to uneven regional results of biased policies mentioned above, there is often a power struggle between central and local governments that jeopardizes regional equality. One important cause leading to the abolition of regional planning in the UK in the 1980s was the conflict between centralization and local governance, which limited the extent that local governments were able to design regional policy due to the intensive insistence on power by senior civil servants and ministers in the central government (Wannop, 1995). As a result, regional coordination between central departments and local areas remained marginal, and the local regions became less vocal advocates of their own interests than they might have been (Self, 1975; Wannop, 1995).

It should be noted that the existence of inequality will in return generate negative effects on centralized governments. Inequality is often systematically linked with the abuse of political power (Nel, 2008). Apart from considerations of economic resources and labor costs, higher inequality among different regions often reflects a deeply skewed power distribution in a society. The elite classes often exercise their larger abilities to manipulate and abuse public policies, and hence damage the autonomy and capacity of states in planning regional and economic development. Furthermore, continuous high inequality will lead to diminishing trust in governments by the major section of a society, because of the decreasing state power resulting from the rising elite class (You and Khagram, 2005). In the worst case, this process will lead to a pessimistic result that bribe-taking, rent-seeking, and state avoidance of appropriate policies become self-fulfilling and self-reinforcing norms. For example, an eroding trust in governments was found in Korea, and its bad distributions of education and job opportunities provided by the governments further deteriorated the public's trust on governments (Chi, Rhee and Kwon, 2013).

### **3.2 The Decline of A Strong Central Government in China?**

From the Maoist time, China's central government consistently has actively planned and managed its national economy. Even in the post-reform period when the market became a major force in China's economy, the role of the state was still not negligible. During China's transition from planning to a freer market economy, there should not be any disagreements on the opinion of a weakening central Chinese government. Taking the fiscal control, one of the key components and measurements of the state centralization, as an example, in the Maoist time, China's governmental-led plan-ideological developmental mode and central control over fiscal resources guaranteed the fulfillment of the goals of the central government, including regional even development. But in the post-reform period, a more decentralized governance in China has led to an diminished role of the central government, because a number of resources and administrative approval rights used to be controlled by the national government were decentralized to be under the control of provincial or local governments in China. Even though in 1992 the central government regained a large part of fiscal control back through fiscal reforms, the dependence of local provinces on the central allocation, especially the coastal provinces, was much lower than that in the Maoist period due to the compulsory fiscal self-reliance of provinces and their stronger fiscal collection abilities from local economic development (Ho and Tsui, 1996). In addition, the central government in the reform process also realized that market should be the leading economic force, and the government should act more at a supportive and supervisory (remedy) position to the market. In spite of a declining role in economy, the central government did not evade from economic and regional development. The poor interior regions are still highly depended on central subsidies and reallocation as their fiscal sources, especially among west provinces (Yu and Yu, 2007).

The biased policies of the state have had a great influence on China's increasing regional inequality. China's preferential policies, such as open economic regions like Special Economic Zones (SEZs) and Export Processing Zones (EPZs), and preferential taxation and remission terms, and regional development policies for example "Going to the west", have always targeted and experimented in some selected specific regions. This has led to a government-selection of champion regions or provinces (for example the adoption of opening up in the coastal region in the 1980s). This differential regional treatment is seen as a main reason for the enlargement of China's interregional inequality between the coast and the interior. Furthermore, when the preferential regional policies are spread across the nation, there rise questions regarding the effectiveness of these policies in "late-comer regions" in economic and industrial development (typically the interior provinces), considering the better formation on infrastructure construction, talent cultivation, and supply industry development and so on in the leading coastal economic regions. There are evidences that taxation exemptions have lost grounds in attracting foreign investment to China's interior regions, which has meant a heavy loss of an useful instrument and an important power to balance and motivate regional development by the central government (Wen, 2005).

Similarly, some national policies have also generated biased effects in different regions, which are always adverse to the interior. A typical example is the new fiscal system after the 1992 fiscal reform. This fiscal reform resulted in a de facto exploitation of the interior region, which was similar to that of the "price scissor" effect experienced in the Maoist and early reform stages. Specifically, the price scissor effect ripped resources and capital from resourceful and rural areas to support urban development and coast development through price controls over agricultural and industrial products and also free migration flows from rural to urban areas. However the new fiscal system after 1992 made regions with a heavier SOE congregation inferior to regions where the private market economy was more active

because of the worse performance of SOEs compared to market biased firms, and a better local taxation base from private economic development. The Northeast China region, as a former ‘winner’ with intense investments in the Maoist period, was a typical ‘loser’ in the new fiscal system, which decreased the fiscal power of local governments in Northeast China and further limited their capabilities and possibilities in powering up local economy by investing in local infrastructure and human resources, and granting support to local enterprises.

In China, competition between the central and local governments over the use of local resources and capitals is not rare. For example, competition and bargain take place between provincial and central governments over their rights and positions in the establishment and implementation of national policies which are favorable for economic development (Shih, 2008). In addition, provincial competition for resources and policies controlled by the central government has also been intense. The political rent-seeking activities from local governments have challenged the remained strong autonomy of the central government (Holbig, 2004). This is also a proof of a weaker central state in today’s China.

In Northeast China, the competition between Northeast governments and the central government over the control of resources and enterprises are major obstacles in regional economic development. In these conflicts, the Northeast governments are in an inferior position to the central government, with key profitable enterprises controlled by the center (ministries), for example the First Automobile Work in Changchun Jilin, and the Daqing petroleum resources in Heilongjiang. As the host of these leading enterprises, the provincial governments have no direct power to influence the operation of these enterprises and also collect few local fiscal benefits, even though these enterprises account for large shares of provincial economies and work as the economic backbones of the three provinces. It is also

difficult for the provincial governments to work with these centrally-commanded SOEs to address local problems of employment, economic development, industrial restructuring and so on, as these enterprises are directly governed by the center, and are not influenced by the provincial governments (Yang, Wang and Nie, 2013). The “*tiao kuai economy*” (*Bar economy*<sup>2</sup> in English) is a very special phenomenon in China and has two meanings. On one hand, the Bar economy represents the separate administrative and economic systems in accordance with the administrative division of Chinese provinces. On the other hand, the Bar economy also stands for the independent management and governances of SOEs in different industries by their parent ministries, not by the SOEs themselves. The two kinds of Bar Economy in China both make it more difficult for SOEs in different ministries and in different provinces to realize cooperation, because the cooperation between SOEs in different provinces should overcome the hurdles of their belonging different administrative divisions, and the cooperation of SOEs in different industries needs to obtain approvals from their different parent ministries (Li and Li, 1996).

Competition between provinces or between provinces and the central government in China involves a number of factors, including economic strength (provincial GDP growth), political strength of the particular province related to the political influences and positions of (former) provincial leaders within the central government (Ho and Tsui, 1996). The attitudes of different provinces over political demands for supports from the central government also influence the bargaining and conflict results. China’s opening-up policy realized its first trials

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<sup>2</sup> The *tiao kuai economy* or the *bar economy* in China is the results of the interference of administrative divisions into China’s economy. Generally, a provincial government is responsible and eligible for the management and recording of the economies inside its boundary. A provincial government, however, does not have rights to interfere into the economies belonging to the administrative boundaries of other provinces. In addition, different ministries are designed to manage their target industries, for example the target of the education ministry is the education industry, the targets of the traffic ministry are the industries of railway, highway and flights. SOEs in different industries are ordained by different ministries according to their industrial types. At the provincial or lower levels, SOEs are managed by the subdivisions of the ministries in the national government. Cross-ministry management of SOEs are not permitted. Consequently, even two SOEs in the same city are not permitted to cooperate before they get the approval from their higher commander ministries.

in the coastal region, which was after a consideration of geographical locations, cultural relations with overseas Chinese and political stability and so on. Besides these factors, it should be noticed that the support from local coastal governments to the opening-up policy when rejections on the opening-up policy inside the communist party were sturdy, also made them the first beneficiaries in the reform process (Hendrischke, 1999). This provides a hint for research on the formation of regional inequality in Northeast China. In essence, the different results of the three provinces, especially the late opening-up of Heilongjiang and Jilin, and Liaoning's role as a member of the first set of opening-up provinces, might be related to their different political attitudes against reforms and opening-up in the early 1980s. This hypothesis needs further exploration. The influence of large numbers of SOEs in Northeast China, together with the relations of northeast provincial leaders with the center concerning their political attitudes should also be considered.

### **3.3 Decentralized States and Local Entrepreneurism**

Decentralization has been prevailing and dominant in a number of countries since the 1980s, although a general rule of decentralization is hard to summarize across countries (Norton, 1994). Decentralization means power redistributed from the central government to local governments, and in many ways it is often associated with a retreat of the central state. Opinions on the relations between inequality and decentralized states vary. Some scholars argue that decentralization decreases the control power of the central government to redistribute to weak regions (Prud, 1995). On the other hand, decentralization might also cause more intense resource concentration in specific locations (Martinez-Vazquez and McNab, 2003). As a result of both trends, regional inequality is likely to rise.

Through decentralization, however, a country can adapt to the changes much better and quicker, and can better relate local policies to local conditions to attract investments and

promote development (Oakes, 2004). In this way, decentralization can effectively prevent the worst effects of government malfunction in the market due to a better understanding of local conditions (Weingast, 1995). Furthermore, the experiences of a number of developed countries certify the emergence of a more efficient and benign intergovernmental competition after appropriate decentralization. Combined with democratic regimes in these countries, decentralization can compel all local governments to offer the best possible public goods (Golley, 2007). Korea's experiences in inequality reduction demonstrate that decentralization can be a feasible solution for existing regionalism/regional inequality through enhancing regional competition and cooperation which are beneficial for local development (Kang, 2003). But Bardhan (2002) argues that this successful logic does not necessarily work in developing countries, partly because of their weak political accountability. The remedy effects of decentralization on inequality are often challenged by their institutional defects such as corruption, poor coordination and so on (Tanzi, 1996).

In the developmental state literature, the embeddedness of governments in local economies is believed to be a key secret in East Asian developmental states' successes (Evans, 1995). Ireland's formation of high-technology industries has also partly depended on the embedded relations of its decentralized bureaus/agencies with foreign investors (Riain, 2004). The Korean case with a successful growing export-oriented economy also demonstrates the importance for governments to accommodate the wills of its private sector (Chibber, 1999). Knowing exactly what the economy demands is crucial and prerequisite for governments to correctly direct and plan its economy.

Due to the worldwide application of neoliberalism and globalization, the power of the state at the national level seems to gradually fade, while those at international and subnational (local) levels have become more influential. This has been theorized as an emergent and deeply



contradictory state strategy of glocalization (Jessop, 1990). This regulatory power reorganization then prepares favorable conditions for the formation of local entrepreneurship, which stands for the local governmental policy supporting development and favorable local conditions provision to initiate and develop business activities at the local place. Compared with the belief of a Keynesian welfare national state in an equalized distribution of industry, population and infrastructure in a nation, glocalization stresses on specialization through differentiation and reconcentration of economic capacities into regional growth centers (Golley, 2007). This glocalization process has been throughout west Europe, and involves an adaptation for their major urban and regional economies strategically positioned in the global and deeply united Europe contexts (Martin and Sunley, 1997; Swyngedouw, 1997).

A wide range of development projects have been adopted by local governments in different places, and according to different standards, these instruments can be categorized into different types, such as “soft” and “hard” projects (Flieger, 2009); or financial and nonfinancial instruments (Wolowiec, 2005). But the final economic effects of a particular project on local economic development significantly differ geographically, depending on the capacity and ability of local governments to create and maintain long-term coherent policy support (Wolowiec, 2005; Piecuch, 2010). A major obstacle limiting the enforcement capacity of local governments is the lack of financial resources (Slominska, 2007). Furthermore, in the formation process of local entrepreneurship, a number of activities and policies local governments adopt are enforced under an unconscious condition about their influences. For example, infrastructure development is the most often adopted policy by local governments to promote economic development, although local governments seldom relate infrastructure development to support to local entrepreneurs. Although decentralization increases the connection between governments and local economy, there are still gaps in between. Slominska (2007) found that the expected support of entrepreneurs is not

understood or accomplished by local governments. This gap could highly probably lead to a breakage of the two chief economic players in local entrepreneurship development.

### **3.4 China's Decentralization and Local Governments**

The biggest change decentralization brought to China is the increasing power exercised in the local economy by local governments (Hendrischke, 1999). This has greatly enhanced the embeddedness of local governments in their local economies, which can be reflected in the active participation of local governments in cluster formation (through setting up industrial parks or developmental districts) (Zeng, 2010), foreign investment attraction (Qing, 2005), and local infrastructure construction, all of which have been favorable for local economic development.

Embeddedness in the economy of the central state is relatively weak in China. On one hand, SOEs are still under the supervision and control of Chinese governments even though the Chinese governments have reduced their influence on SOEs by retreating to be merely shareholders rather than direct controllers. The relations between SOEs and governments cannot be classified as “embedded” but more “subordinated”. On the other hand, the domestic private economy was long-time neglected by the central state. So the increasing connection to the economy by local governments could have promotion effects on local economic development. For instance, in certain provinces in South China, some local governments have even readapted their institutions and organizations according to the requirements of foreign investors or private business (Yeung, 2000).

Moreover, the active and powerful intervention of the central governments is not always positively promotional for local economies. Based on the experiences of the western China in its “Go west” programs, the effects of the large-scale top-down projects from the central

government to revitalize local communities were not as expected, and these centrally designed projects, however, even frequently do more harm than good to local economies (Florida, 2010). Consequently, the roles of local governments in promoting local economies should be stressed on in the revitalization process of Northeast China. With similar problems, such as unemployment, economic stagnation and resource depletion, local governments, however, at the provincial and urban levels in Northeast China have developed different models to revitalize their local economies. As a result, it is hard to generalize a single model for the whole northeastern region in the revitalization programs. Even resource based cities in Northeast China have followed different reform paths. For example, Daqing has tried to extend its current oil industrial chain through more investments from the central ministry and also local governments, while Fuxin, a coal city in Liaoning province, has reoriented to modern agro-processing industries in order to replace its coal mining industry (Wang, 2014). The roles of local governments are very crucial for Northeast China's transition and reforms, and hence should be focused on.

Several defects, however, are reflected in China's decentralization process, which also have led to the failure of the central government. Care for economic development of local governments in China is too excessive, which leads to decreasing autonomies of local governments, and also weaker supervision and implementation power of the central government over its policies. This over embeddedness has distracted the attention of local governments from their other chief responsibilities in terms of society and population welfare, which has caused rising disaffection and dissatisfaction with governmental economic activities, for example the land expropriation through violence (Guo, 2001). Secondly, local governments' de facto obviations against state policies inconsistent with local economic interests are popular among local governments. This is well demonstrated by the inappropriate classification of unqualified land in mountainous and other regions as arable

land in Heilongjiang and other provinces (Lin, 2009). In addition, the central government has also lost its supervision power over competition between local governments. Until now, China does not have appropriate coordination mechanisms to discipline local governments' investments in infrastructure, project development and local market development. As a result, repetition construction and development of large projects, for example airports or coastal ports, is very common for local governments, which leads to unreasonable and irrational usage of resources, and drives benign competition between local governments into fierce conflicts and even regional protection. The industrial structures of the three Northeast provinces are very similar, based primarily on raw materials and heavy industries, with only Liaoning having a higher percentage of the tertiary industry. Even the lists of strategic industries contemplated for the "Revitalization of Northeast China"<sup>3</sup> program of the three provinces have had a number of industries in common (Liu and Liu, 2006). Therefore Northeast competition between the three provinces needs a coordination system, which could help form a more effective regional economy in Northeast China to realize complementariness among the three provinces, and also a reasonable labor division between the three provinces.

According to the different relations of local governments with their local economies, China's local governments can be further divided into several types, including developmental, entrepreneurial, regulatory and predatory (Evans, 1989). Among these types, the predatory type is definitely harmful to the local economy, as it drains out limited financial resource through heavy and informal taxations or fees and does not provide further support to the local economy through their collective financial resources. Unfortunately, the Northeast Chinese governments have been more predatory than developmental or entrepreneurial,

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<sup>3</sup> This program was adopted by the PRC in 2003 to rejuvenate industrial bases in Northeast China. It covers the three Northeastern provinces of Heilongjiang, Jilin and Liaoning, as well as the five eastern prefectures of Inner Mongolia: Xilin Gol, Chifeng, Tongliao, Hinggan and Hulunbuir. This program targets at revitalizing the region's traditional industries, at the same time it promotes to speed up regional development in aspects of structural regulation, regional cooperation, economic reform and opening up, environment protection and so on.

especially in their relations with the private economy. According to the interviews with domestic private investors who have invested or planned to invest in Heilongjiang, Northeast China, the interviewees were unsatisfied and angry with governmental activities, which deprived too much from them and made it hard to conduct business in Northeast China (*The Phoenix News*, 2014). Besides the harsh treatment of the private economy during or after attracting investments, powerful local governments with serious problems of corruption have also made investments in this region more complex. Only those investors with strong relations to local governmental officials could benefit in Northeast China; and the worse fact is that the influences of governmental officials have often overtaken the market demands, leading to major investments in service industries instead of manufacturing and agricultural industries, only because the local government officials hope to develop real estate partly for their own interests (Sun, 2005).

### **3.5 Summary**

The decentralization reform inside China's government system resulted in the changing roles of both the central government and local governments. In this decentralization process, the former superior power of the national government over China's economy across every province declined. On one hand, the authorities of local governments were expanded and strengthened; on the other hand, their dependency on the national government also decreased due to the growing revenue sources from prosperous local economies. Although the control power of the central government over economy and activities of the local governments declined, the central government still maintained a part of its powers against the economy and local governments. The fiscal reform in 1992 strengthened the fiscal control power of the central government. However, the allocation of preferable policies together with central fiscal subsidies to specific provinces or regions actually disadvantaged other provinces or regions against those equipped with the central assistance. Furthermore, through this way, the

power of the central government was also enhanced, which could be reflected from the increasing conflicts among local governments for preferable policies and larger-scale support and so on. So in the decentralization process, the role of the central government in China's economies whittled, but it still maintained parts of its control powers over the national economy and also over its subordinate local governments.

In the decentralization process, local governments in China became stronger against the central government and more experienced in local economies. Stronger local governments and their embedded relations in local economies compensated for the loose relations of the central government with economies, and created a number of successful local economies especially in southern provinces such as Zhejiang and Jiangsu. Comparing to the successful southern local governments, Northeastern local governments, however, were disadvantaged in the decentralization process and did not evolve into the strong local governments over local economies in southern China. The effects of decentralization on the economic system and also the administrative system in Northeastern local governments were accomplished slowly, which is partly because of the legacy of the former strict control of the central government over local economies through large numbers of SOEs. The heavy proportion of state-owned capital in local economies and the long-time habit of following the directions from the central government cultivated the inertia of local government leaders for making changes, and also their unfamiliarity and slow adaption to the new market system. In addition, together with reforms of SOEs and the fiscal system, the decentralization actually deprived higher ratio of valuable assets, for example profitable and large-scale SOEs listed as central SOEs which were beyond the regulation of local governments, from northeastern local governments, and left them with heavier burdens and more potential problems, including large numbers of unemployed workers, the natural resources with limited foreseeable mining capacity, and industrial structures heavily relied on SOEs in heavy industries.

## **4. Marketization and Regional Inequality**

This section discusses about another significant change that happened in China after the reform in 1978, the marketization. Marketization in China created a free market which did not legally exist in the Maoist time. But marketization in China meant more than the creation of a new distribution scheme through the market; it also involved drastic changes in the administrative system, the ideology over the relations of economy and governments owned by government officials and also private enterprises, and even social culture over success and wealth. Marketization brought successes to China and a number of provinces or regions especially in South China, exemplified by their active private or collective economy and growing consumption powers. But for Northeast China, marketization reforms resulted in more problems for the local economy and hindered local development, which are even puzzling Northeast China today.

### **4.1 Marketization and Inequalities in Transition Economies**

Historically the socialist formation of the Soviet Union (SU) and other east European socialist countries achieved more egalitarian distributions in the period up to 1990, compared to many market democratic countries such as the United Kingdom during the same time (Bergson, 1984). Regional balance has been taken as a significant feature of socialism (Chakravorty, 2006). But the collapse of socialism in the SU in the late 1980s under a series of pressures from the long-time arms race and rising ethno-nationalism inside the SU finally closed this period of history and unveiled a drastic and unprecedented marketization process in these newly independent countries in central and east Europe (CEE), such as Poland, Hungary, Slovakia and Ukraine and so on. This transition, together with globalization, generated a serious impact on the regional structure of these CEE countries. This was accompanied by a large-scale retreat of the state in public policy, leading to increasing income inequality, widespread industrial recession and deteriorating unemployment and

poverty (Chakravorty, 2006). Geographically, the market transition and the opening up of former socialist state to the European Union (EU) and other western countries only favored the metropolitan and western regions, as well as regions with a strong industrial base in the long run (Petraikos, 1993, 1996; Smith, 1996). Research has found that in a short time perspective the leading regions in the SU period with intense heavy industries degenerated to be the most lagged regions facing the most serious transition problems after the market transition (Petraikos, 2001).

This increasing inequality in the transition economies of the CCE resulted from the interaction of several aspects of governmental reforms, including the formation and growth of private enterprises (EBRD, 2005; Fleisher et al, 2005), increasing unemployment due to large scales of industrial restructuring (Kolosi and Robert, 1993), fiscal adjustment/retrenchment of governments (Forster and Toth, 1997; Keane and Prasad, 2002), price liberalization and inflation (Commander and Lee, 1998), asset transference from SOE reforms (Milanovic, 1998 etc) and also the influences of global economic forces.

Transition towards market economies in the CEE countries meant a concurrent process of both destruction and reconstruction of the industrial structure, with more competitive industries in the market economy arising as winners, and those not compatible with the market being eliminated. Moreover, this industrial structure transition cost was not evenly distributed over space. Regions with a more diversified economic structure would only undertake a relatively small share, while monostructure regions such as old industrial areas in decline and without changes suffered the most (Petraikos, 2001). Furthermore, prospects for recovery and revitalization also differed, with old regions in decline at an advantage in the long run. With existent basic infrastructure, idle capital from obsolete industries and a large skilled labor pool, the declining industrial regions could highly have the potential of a quick and powerful



recovery, at least compared with other undeveloped regions (Peschel, 1992). But it should be noticed that a precondition of serious investments and efforts on both environment and technology in the declining regions was necessary for their resurgence. In addition, considering the growing importance of tertiary industries and increasing returns from agglomeration and clusters in modern economy, the chief regional beneficiaries of high-level service industries, such as banking, insurance, and financial services, was likely to be in urban areas, especially large metropolitan centers (Coffey and Polese, 1987; Fournier and Axelsson, 1993; Coffery and Bailly, 1996).

SOE reform is a key aspect of marketization in the CCE countries. The effectiveness and performance of privatized SOEs was believed to be one of the chief forces driving the development of transitional economies in Central and Eastern Europe (Frydman, Gray, Hessel and Rapaczynski, 1999). In these CEE countries, a common privatization mode had been the merger of SOEs with private businesses by either foreign investors or insiders (such as workers) (Estrin, 1994; Kogut, 1996). During the privatization process, strategic fit, which means the anticipated benefits of a merger to the strategy of the acquirer basing on the assets and operations of the merging firms, and organizational fit, standing for the compatibility of organizational attributes of the mergers and acquirers, were the two main problems affecting the privatization results (Uhlenbruck and Castro, 2000). Whether or not privatization could improve economic performances of SOEs depended on post-privatization activities and adjustments. In other words, privatization of SOEs did not mean definite economic escalation and success. Furthermore, economic gain of a single company or a limited group of firms was not equal to the gain of workers or more generally the society, as it might mean a greater loss of the society. Witness of stagnation, decapitalization, bankruptcy and unemployment in transitional countries after the large-scale privatization revolution is not a surprise (Nellis, 1999). In this way, privatization realized a dispossession from the majority to the minority in

disguise through reallocation of limited resource and powers (Harvey, 2005). Hence Nellis (1999) called for a slower, more cautious, and more governmental-led path to ownership transfer in the CEE countries.

The rapid entry and formation of the new private businesses in the CEE countries were known as “privatization from below”, which covered a number of former SOEs (Naughton, 1994). Brunetti, Kisunko and Weder (1998) found that political credibility of governments on implementing rules was highly related to performances of economic growth and investment. This meant in an early transition stage the marketization would face bigger obstacles from the economic and political systems. Besides, the formation of private business in transitional economies faced challenges from society. For instance, social awareness and acceptance of private business is the prerequisite for the formation of private business and also the market economy. Hence improving the social attitude and the institutional environment for private business were the chief work for governments in transitional economies at an early stage. Furthermore, the effects of marketization across regions in CEE countries also suffered from path-dependency and historical effects. For example, the informal/illegal business and the SOEs during the SU period provided seedbeds for the formation of a private economy in transitional economies, and they also generated a “nomenclatura” economy in these countries, which stands for the businesses operated by SOE managers and former governmental officials through privatizing SOEs (Smallbone and Welter, 2001). According to the experiences of the CEE transitional economies, private entrepreneurship was easier to appear in countries where reforms proceeded smoothly and quickly and where a strong pre-socialist industrial tradition existed (Mugler, 2000; Smallbone and Welter, 2001).

Globalization has been another influential force in regional development during the transition process. In the post-transition period, CEE countries eliminated barriers against west-east

capital and merchandize flows. In detail, foreign direct investment (FDI) was expected in the early stages of transition to generate a polarized pattern of development. For instance, with better provision of a minimum of infrastructure necessary for international business activities, central places in CEE countries, for example metropolitan cities such as Warsaw were expected to attract more FDI (Cohen, 1981; Rosenblat and Pumain, 1993), while small cities and rural peripheries was likely more disadvantaged.

Furthermore, the distance from the EU leading economies in the west also had an additional spatial implication on regional development. Geographic proximity generated a west “coast” and east “interior” division in CEE countries, because investments, subcontracting, cooperation were more active in the border areas with western European economies such as Germany. The closer to the European gravity center a CEE country or an area inside a CEE country was, the greater was the possibility of concentrating economic functions and developing multiple strategic location cities or regions that would be placed in the upper part of the European hierarchy (Petraikos, 2000).

The collapse of former trade barriers with west European countries reoriented trade relations of CEE countries away from the former SU members and other Eastern European countries to the European Economic Community (EEC), and away from a reliance on central planning and military contracts to market demands. This trade enhancement terminated any former protection over local economies under the central planning system and even linked local economies in CEE countries to international competition. Under these contexts, it was not a surprise to witness a large transformation of regional development in these countries. Facing challenges from home and abroad, old heavy industrial cities highly dependent on SU central planning, and the regions without diversified industrial structure were the primary cost takers.

Finally, the geographical influences of globalization on CEE countries in the transition period followed a path-dependency way. Metropolitan areas, western regions and places with a diversified production base and a short distance to the EU market experienced positive effects and tighter relations with the EU, while other lagged regions encountered further unfavorable impacts from globalization, which in return exacerbated their development possibilities.

## **4.2 Marketization and Inequalities in China**

In the marketization reform process, Northeast China has had both the advantage of leading industrial basis and also the disadvantage of late and slow reforms of its political and economic systems at the same time in the creation of an active private economy in China and the country's participation in international business and trade. But the truth of Northeast China is that the region's disadvantages have overridden its advantages.

China's SOE reforms have been very similar to those reforms took place in the CEECs; yet they have been more cautious. A joint venture with foreign investors has been the most popular way of reforming existing industrial enterprises in China, as SOE leaders and local governmental officials have had a fetish for high-technologies and advanced equipment from abroad, which have been seen to be representative for productivity and competitiveness, together with the forbidden acquisition by domestic private business before the late 1990s (Gabriel, 2006). In this joint venture transition process, the government's influences cannot be ignored, and the relations between Chinese governments and SOEs also changed in this process. In summary, the role of Chinese governments in SOEs shifted from a mixture of buyers, suppliers and the only managers who decided the inputs, outputs, investments and expansions in the Maoist time to a major shareholder in the reform period. Furthermore, the

power balance between SOEs and foreign investors has been controlled by the Chinese governments if they had the motivation to intervene, for example with the desire of control over key industries or for leading technologies. Central SOEs have traditionally been always more powerful than their competitors and also foreign investors, and the SOEs in important industries including telecommunication and automotive have attracted more attention from governments due to their importance to China's national economy (Kennedy, 2007). But at the local scale, conditions are opposite, as local governments have always given up their control and management rights over newly formed joint ventures and have retreated to a more passive role as shareholders or dividend recipients. Without direct control and influential power at the hands of local governments and knowledge of enterprise management, local governments have hardly interfered in the operation of these joint ventures to protect local interests. Furthermore, these ventures always end in full taking-over by the foreign investors or unexpected negative economic performances like losses or decreasing market shares (Gabriel, 2006). It could be contemplated that several factors might contribute to the decreasing power of local governments, such as over-competition among local governments for foreign investments, limited resources and support from the central government, or inactive attitudes of local governments against these joint ventures (Huang, 2003).

Privatization of SOEs in China has jeopardized the interests of SOE workers and the local society, especially in the SOE congregated regions such as Northeast China. Although privatization has been a cure to "sick" SOEs, it has also meant a loss of state-owned capitals which are said to be owned and shared by the whole population in China. The new joint ventures have tended to take away the most valuable and crucial assets of SOEs, and left the "sick" SOEs only empty frames without any valuable assets (Nolan, 2004). Among the valuable assets, the losses of former leading brands or factories to foreign investors were the

most troublesome problems because this drained out limited economic resources in Northeast China and other under-developed regions (Chu, 2004).

In addition to the losses of leading factories and brands, SOE reforms in Northeast China also led to a large number of laid-off workers. According to relative statistical data, the three provinces were members of the only five provinces in China with laid-off workers of more than one million in 2004. Although there have been policies encouraging the employment or entrepreneurship of these people, the majority are still under unemployment. Without new jobs creating by privatized SOEs and no outstanding economic achievements in Northeast China, the final result of SOE privatization has been a miserable failure, which has only deteriorated local economic conditions.

Although the private business has become an indispensable and important part of China's market economy, especially in the coastal region, Northeast China has been left far behind in the development of private business (Gao and Qian, 2007). The successful private business in the coastal region, for example Jiangsu and Zhejiang, accounted for more than 70% of industrial output after 2000, at the same time it also absorbed more than half of local employment. But the same ratios of private business in Northeast China have been far lower, especially the share of private business in industrial output. The productivity of private business in Northeast China has also been inferior to its counterparts in the coastal region. Theoretically the private economy could be a feasible solution to the legacy problems of SOE reforms, as they could increase competition and also relieve the unemployment stress. The chief factor limiting the development of private economy in Northeast China is believed to be the slow and imperfect market reform, coupled with the domination of SOEs in this region. But the root causes of the relatively weak private economy in Northeast China have been the rigid Northeast governments who are too harsh and exploitative of their (possible)

private economies. The attitudes of local governments with SOEs, the private economy and foreign investors, have been in a triple-track system, among which the private economy has been at the bottom. In the Maoist era, the private economy was described as an “ulcer” in the socialist regime, and a signal of capitalism which should be eradicated (Saich, 2004). This discriminatory attitude persisted to the early reform stage, and even led to social panic over private business for fears of punishment from the central government. When the market gradually took the lead in China’s economy, environments for private business in Northeast China rarely changed. The private economy was in an inferior position to SOEs and even township and village enterprises (TVEs), the successors of former collective owned enterprises (COEs), on the radar of Chinese governments. Private business was always the first to blame when economic reforms confronted difficulties. For instance, there was a ban on local private business immediately after the turmoil in late 1980s (the Tiananmen Square incident) but there were no harsh restricts on foreign investment (Gabriel, 2006). When coastal provinces, especially Zhejiang, strived in the development of a private economy, Northeast governments continued to orient more resources and preferences to their SOEs. In Northeast China, governments were not supporters or protectors or promoters of private entrepreneurship; they were more inhibitors and despoilers to private entrepreneurship.

In addition to reforms of SOEs and private economy, China also created a new domestic market free from heavy governmental planning intervention. Although the Chinese domestic market provided opportunities for all provinces and locations to take advantages of its huge scale and potentials to develop particular industries, the actual effects of marketization on different regions need further discussion. Liu (2006) in his research on the relations between market location and rural income demonstrates that the distance to the main market still matters. Provinces close to the three national market centers of Beijing-Tianjin, Shanghai-Nanjing-Hangzhou and Guangzhou-Shenzhen-Zhuhai witnessed higher rural

incomes, while remote provinces experienced both the lowest level and the slowest increase of rural incomes. This has been due to the concentration of industrial development in the market regions, which provided extra-agricultural incomes for rural districts close by. Similar effects can be extended to the provincial level, with provincial market centers as the economic hubs, and to regional industrial development.

Furthermore, far from being an integrated national market, the Chinese domestic market has consisted of multiple segmented regional markets, which differ in economic development and local culture (Swanson, 1998). The Chinese domestic market can be divided into seven parts comprising the South, East, North, Central, Southwest, Northwest and Northeast regions<sup>4</sup>, grouped according to their overall individual income levels. Compared with other regions, Northeast China and Northwest China are classified into the “untapped market” group, which are the most undeveloped markets, while the main consumer group congregates in South and East China, and the North, Central, and Southwest markets are in growth (Cui, and Liu, 2000). The poor regional market condition in Northeast China has limited the development of its SOEs and private businesses, as operating in this small-scale regional market is not easy for some industries, especially the low-value-added labor-intensive products, to realize economic scale effects. Besides economic and geographical factors, local governments also contribute to the formation of segmented markets in China, especially the factor market at intra-provincial and inter-provincial levels through limits on factor flows. The decentralization to China’s local governments mentioned above is a key reason why they are able to create segmented markets. But the similar industrial structures of provinces in the same region, which originated from Maoist policies, are the basis for the segmented markets

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<sup>4</sup> South China includes Guangdong, Fujian and Hainan Provinces; East China includes Shanghai and the provinces of Zhejiang and Jiangsu; North China is consisted of Beijing, Tianjin and the provinces of Hebei and Shandong; Central China includes Henan, Hubei, Hunan, Jiangxi and Anhui provinces; Southwest China includes Yunnan, Guizhou, Guangxi and Sichuan; Northeast China include the three provinces of Heilongjiang, Jilin and Liaoning; Northwest China includes Shanxi, Shaanxi, Inner Mongolia, Gansu, Ningxia, Xinjiang, Qianghai and Tibet.



to form (Yin and Cai, 2001). In Northeast China, the three provinces all have petroleum and chemical industries, and traffic equipment and agricultural production and so on, leading to intense competition among them for both local markets and outside (Liu and Liu, 2006) As a result, from 1987-1997, the regional input-output tables of Jilin and Liaoning provinces showed that the inter-provincial trade barriers remained stable or became even stronger (Geng and Weiss, 2007). So for better development of Northeast China, a critical problem is not the further development of markets to expand its capacity or to deepen marketization, but the necessity for the governments to figure out an appropriate solution to coordinate their industrial developments and try to form a complementary and supplementary Northeast market.

### **4.3 Summary**

As a region whose local economies were dominated by large numbers of SOEs, reforms on SOEs in this region was a chief and difficult mission for both the central government and local governments. On one hand, without reforms of SOEs in Northeast China, the economic burdens for the central and local governments would be too heavy which jeopardized the legitimacy and powers of governments, and a market system could not be thoroughly established in China which was on the contrary of the central government's reform intention. So it was necessary to reform some specific SOEs to relieve the heavy burden on governments and promote the formation of market. On the other hand, reforms in SOEs, however, were accompanied with high risks of losing former control powers over the SOEs and hence led to threats to national economic and defense security. So governments had to be prudent and cautious with reforms in SOEs. Both concerns of the governments were clearly reflected in the SOE reform process in Northeast China. A number of SOEs were privatized or reorganized into a new joint venture without serious contemplation of risks and the condition of SOEs by Northeast local governments, which led to a heavy loss of valuable

assets in Northeast China, including skilled labor, product or company brands. However, for the important SOEs which were held by the central or local governments, governments always manipulated their directions and processes of reforms, in case of losing control over the key SOEs or for considerations of the importance of their products to China's economy. So the reforms in these SOEs were rather imperfect and actually did not change the management modes already formed in these SOEs.

Another problem accompanying with SOE reforms was a large number of laid-off workers, which has not been solved until today. The incompletely reformed SOEs in Northeast China could not provide jobs for these workers. However, the private economy also did not perfectly form and develop, due to the slow changes in the ideology against private economy in local governments. The discriminatory attitude against private economy and the persistent preference for the SOEs contributed to a unfavorable environment for the development of private economy in Northeast China.

In addition, the limited local regional market (consumption power) in Northeast China, and its long distance from the major markets in China, including the three markets in Beijing-Tianjin, Shanghai-Nanjing-Hangzhou and Guangzhou-Shenzhen-Zhuhai, further inhibited the development of both SOEs and private enterprises in Northeast China, which limited the possibility to achieve scale economies and competitive advantages over their competitors. In summary, marketization brought more problems for Northeast China.

## **5. Globalization and Regional Inequality**

### **5.1 The Effect of Globalization on Regional Development**

The global economy changed greatly from the 1950s, towards an increasing interconnectedness between different parts of the world. Trade and foreign direct investment (FDI), two major forms of globalization, have grown at astounding speeds and have contributed directly to this increasing interconnectedness (Dicken, 2011). The success of China's economy was related to its export-oriented growth mode and the large-scale capital inflow through the form of foreign direct investments. After the reform in 1978, China became opener to foreign markets and enterprises, but at the same time, China's development was also under strong influences of these foreign powers, through the locational selections of foreign investors for their investments or the changing world markets of chief export products in a province or a specific region. So this section focuses on the relation between the two chief forms of globalization with the regional development of Northeast China.

#### **5.1.1 Trade**

The economic theory of Heckscher-Ohlin (the H-O theory) clarifies that specialization in the production of goods that most intensively use factors of production the countries are best endowed with in order to realize maximum welfare for a specific country in international trade (Chakravorty, 2006). This approval also provides an explanation for regional inequality reduction following a growth in international trade. Through trade relations of product and factor flows, factor prices among trade partners between countries will be finally equalized (Burtless, 1995). However it should be noticed that the equalization effects only take place at the inter-national level. At the intra-national level, the intergroup inequality among labor will expand (Chakravorty, 2006). In detail, in developed countries, the wage of low-skilled labor will decrease to the level of low-skilled labor; in developing countries, the wage of skilled

labor will rise to the level in developed countries. As a result, inter-group inequality and also inter-regional inequality based on labor distributions inside a country will expand. The H-O theory does not consider possible relative changes of factor prices and subsequent effects on regional development. With technology and knowledge becoming more valued for economic development than natural resources and labor, their prices also relatively rise over time. The relative price changes of technology and human capital against other traditional factors such as natural resources and unskilled labor between the countries with different factor endowments privilege those abundant in human capital and technology. There is a “resource curse” in a number of resource abundant countries; essentially advantageous resource endowments do not necessarily realize improved economies and improving equality. Moreover, the reluctance for quick changes and reforms, and concentration of control and benefits over resources only in few elites in these resource abundant countries also contribute to the tragedy of the resource curse in these countries (Nel, 2008).

Economic theories on trade and inequality are not enough by themselves to elucidate increasing inequality across and inside countries. Other economic, social and political conditions in a specific country have also to be considered when the effects of trade on inequality are discussed. For example, industrial structure modification inside a country or regions, together with trade, can upgrade interregional comparative advantages, and generate new patterns of interregional inequality (Rodriguez-Pose and Gill, 2006). Geographically, trade brings about a border effect on regional development, which mainly benefits the “coastal” regions and “border” regions. This can be exemplified by concentration of investments and business nearby borders with the EU mentioned above and similar Mexican border economic aggregation in NAFTA.

Other than the great business and economic chances for border regions in a specific country

from the development of international trade, the old industrial regions in the specific country, however, always face challenges from opening-up and globalization. The relocation of capital and manufacturing facilities to other domestic regions or overseas countries for cheap labor, harsher international competitions from liberalization of existing foreign trade policies, together with the rise of automation technologies in production processes, have brought nightmares of declines for a number of resource-based and tradition industrial regions in Western countries, such as the USA, Western European countries and Japan (Wang, 2014). For example, the downfall of Muroran, a former important steel town in Japan, after the 1980s was a result of the synergy of oil shocks during the 1970s and lower export competitiveness since the yen appreciation of 1985-1986 (Edgington, 2012).

In addition to the impacts on traditional industrial regions in a specific country from globalization, globalization can also become a transition and rising opportunity for these regions. The global hunch for knowledge and technologies and the growing significance of localization in business and management have compelled multinational enterprises in the USA and Japan to locate and expand their research and business investments in Europe and other countries. For example, a number of Japanese enterprises, including Sony, Sharp and Honda, set up their R&D facilities in European from the mid-1980s to mid-1990s. During the same period, US enterprises also increased their overseas R&D expenditure and investments, which made up for the weak and expansive R&D activities inside the USA (Cooke, 1995). But these investments have been always geographically focused on regions with intense resources, especially the cluster regions such as Cambridge in the UK and the Baden-Wurttemberg mechanical and electronics clusters in Germany. For these traditional regions, it is still possible for them to take advantages of the globalization trend, if they have had or tried to construct their local clusters with specific technological and cost advantages, which might or might not be based on their existing industrial structure with or without the

help from foreign enterprises and investors according to plans and selections of local governments and enterprises. When local clusters are formed, foreign investments and economic development may possibly realize. For example, through training programs on workers, development programs for local suppliers, innovation initiatives programs to strengthen local technological abilities, as well as the technological supplement from foreign inward investors such as Robert Bosch, Wales successfully transited from a mining and steel making region into a new manufacturing center, and attracted a substantial amount of foreign investments from overseas, such as Japan and Germany, during the late 1980s and early 1990s (Cooke, 1995). Similar stories of cluster construction and upgrade also took place in the revitalization process of auto industries in Pennsylvania and Ontario during the 1980s and 1990s (Cooke, 1995).

Another important geographical effect from the trade development process is the growing roles of logistics and transportation hubs as the cores of trade. Although telecommunication and bulk-transportation technologies have successfully reduced time and transportation costs, location, especially the coastal ports, still matters (Gallup, Sachs and Mellinger, 1999). Besides transportation cost effects, geographical proximity to international markets also relates to better trade policies of a country. With closer distance to overseas markets, a country always chooses more open trade policies comparing to the countries far from markets (Gallup, Sachs and Mellinger, 1999). In addition, good policies and good geography always tend to go together. Better geographical locations have more beneficial policies regarding taxation and regulation, which are supportive to trade and local economy.

Furthermore, it should be noticed that current international trade environments become much harsher for developing countries, especially those at their early industrialization stage of unskilled labor-intensive industries. The ability and possibility to increase large-scale exports

of labor-intensive products, such as textiles, clothing and agricultural products, have become rather limited compared to the 1960s when Japan and other East Asian countries rose, mainly due to low supply-side elasticity and restricted access to major foreign markets (Sharma and Morrissey, 2006). The escalation of these developing countries to knowledge and skill intensive industries is disturbed by their pre-existing low levels of human capital and infrastructure, and also their incapacity to improve the conditions.

### **5.1.2 Foreign Investment**

Foreign investors contribute to regional inequality inside a country through their selections of specific cities or clusters to invest. Dunning's OLI paradigm indirectly describes how transnational corporations select their foreign investment locations, mainly through consideration of the ownership advantage of the company, the local advantage of the host country, and the internalization advantage of direct foreign investment in terms of overseas production and sales from the perspective of corporations. Iammarino and McCann (2013) criticized that the original version of Dunning's OLI theory was out of date, as it framed the locational advantage only at the national level. In a knowledge economy era, multinational enterprises (MNEs) have evolved and focused on locations of innovative hubs at the subnational level. Through tapping into a variety of agglomerations containing research activities and core manufacturing located mainly in the urban area or industrial clusters, MNEs can possibly gain new innovation capacity.

Increased FDI penetration during the past era played a key role in worsening inequality in host developing countries (Nel, 2008). But the effect of FDI is more complex than it is often assumed. FDI is seen as a selected means adopted by MNEs to incorporate far-flung parts of the world into their global production system (Bornschieer and Chase-Dunn, 1985). In this process, MNEs realize a redivision of labor across and inside the countries they take root in.

Inside developing countries, FDI exacerbates the “dualism” by creating well-paid jobs in the modern international high-skill sector and specific invested locations, but leaving large segments of traditional low-skilled or unskilled workers marginalized (Nel, 2008). The bargaining power of TNCs over local host governments could even undermine the fiscal power of local governments and local welfare (Rudra, 2002). Consequently, larger degrees of FDI penetration are believed to correlate with higher levels of inequality, despite the neoliberal faith in its positive influences on regional and social inequality (Nel, 2008). At the international level, large-scale outsourcing activities and production relocation to developing countries, such as Indonesia and Vietnam, have been drivers of these national economies and also their important vehicles to achieve industrialization. But the effects on inequality in these developing countries have varied according to the technological levels of the relocated industries in host countries (Feenstra and Hanson, 1996). Considering that MNEs often transfer the relatively low-value parts in production chains to developing countries, it should be questioned about the real promotion effect on technology and skills in the host countries. Unskilled production does not provide many learning spaces for developing countries, and might even confine their further improvements in future (Hayter and Edgington, 2004).

The OLI theory and other MNC theories only consider the MNE influences on regional development in the FDI process, but a multi-player perspective is necessary to understand the de facto effects of FDI on regional development, especially involving the local factors like governments, labor unions, supply firms, and target firms for joint venture transformation. The concept of “strategic coupling” in the Global Production Network (GPN) by Dicken (2008) provides an applicable approach. Strategic coupling is well used to explain the reasons why foreign investments in the form of joint ventures have often failed (Yeung, 2000; Coe, 2012). One of the chief reasons has been the distinctive targets of cooperative partners of foreign investors, including the governments and the joint venture partners. Indeed, these



factors exert influences from the design of FDI. Attitudes and reactions of local players against FDI could disturb FDI decisions of MNEs, and in different countries the influences of these local factors differ according to the local political economies. For instance, in the Russian SOE reforms, it was found that the workers agreed on the necessity for SOEs to improve their equipment and technologies, but they were hesitated with introducing foreign investors. Their unfavorable attitudes impeded the success of SOE reforms (Bevan, Estrin and Meyer, 2004).

## **5.2 Globalization and China**

Compared to other interior provinces, the three provinces of Northeast China have better geographical conditions, with a coastline in Liaoning and borders in Heilongjiang and Jilin. Hence, in principle it could be easier for Northeast China to develop successful export-oriented economies similar to those in South China and other East Asian developmental states. But in Northeast China, Liaoning has been the only province to realize an active export-oriented economy since 1978, while the other two provinces only achieve lower than the national average in indexes such as the share of export products in industrial products (Pang, 2004). The coastal location of Liaoning, especially the port city Dalian, makes Liaoning the backbone force in the export trade of Northeast China. Dalian has been the main accessible sea port to foreign markets in Northeast China, and more than 60% of the trade in Northeast China is accomplished through Dalian (Pang, 2004).

In addition to the sea-based export transportation advantage, Northeast China, mainly Heilongjiang and Jilin, is also adjacent to several countries, including Russia, the Republic of Korea and Mongolia (Pang, 2004). But compared to sea-based export activities, border exports have been much more limited in both quantity and forms. Thus the most typical border trade in Northeast China is between Russia and Heilongjiang in several border port

cities including Heihe, Suifenhe and so on (Wang and Yu, 1997). But the main form of Russia-Heilongjiang trade has been barter trade in a small scale compared to Liaoning's sea-based exports. Furthermore, the cross-border barter trade has also been unstable as it faces a number of problems such as inconsistent pricing systems and weak transportation infrastructure construction on both sides (Marton, McGee and Paterson, 1995). Port cities, including sea-port cities and border-port cities in Northeast China, have been the first beneficiaries from international trade activities. Besides their strategic locations which could save traffic costs, port cities also have chances to develop high value-added supportive service industries for their large-volume transportation functions, which help diversify their economies. It is highly possible that the Northeast port cities might also diversify to evolve into locomotives for regional economies. Moreover, it is believed that the significance of port cities is not their export activities, but rather than their capability to provide spill-over effects on its surrounding interior regions (Wang and Yu, 1997). Unfortunately, at present the port cities, including sea-port cities and border-port cities in Northeast China, are not powerful economic engines for their interior regions. Their influential scopes are constrained to their nearby towns and counties, and do not even expand to other big cities in the same province (Wang and Yu, 1997).

The strategic location of Northeast China as the traffic hub of Northeast Asia gives Northeast China chances for economic development, due to its connections with Russia, South Korea, and Japan. These Northeast Asian countries are also complementary to each other in industrial structure and also resources, with Russia prevailing in resources and heavy industries, Japan and South Korea specializing in high-technology industries, and China in low value-added manufacturing industries. A "flying-geese" industrial pattern exists in Northeast Asia (Marton, McGee and Paterson, 1995). As a result, theoretically, Northeast China has chances to both link the growing trade flows in Northeast Asia (for example

channeling resource flows of oil, gas or timber from Russia to Korea and Japan and reversal transportation of high-technology products in the way back) and also developing export-oriented economies on the basis of neighboring countries' needs. However, the industrial structure of Northeast China is representing by heavy industries and dominated by SOEs. This impaired its development opportunities, as current Chinese products with comparative advantages have been mainly in light products. Moreover, foreign investors are also more inclined to cooperate with private firms rather than large SOEs.

Local governments in Heilongjiang and Jilin also realize the possibilities to achieve economic development through exports by taking advantages of the translocation or relocation of industries from the coastal regions and also from overseas. Although they have made some efforts, the results regarding attracting both foreign and domestic capital have not been as positive as they wish. Several factors lead to the terrible results. Besides the historical factors of war experiences among these countries and also current political conflicts and disputes on territories, one important factor is the different attitudes of the Northeast Asian governments on the economic interconnections. Russia, for example, has been much stricter and cautious towards its economic opening to China along its borders. In Russia, there is also a fear that imported Chinese products would destroy their market economy by “dumping” of many low-price products. In addition, Russian governments, including urban governments near the border, also have stricter controls on trade and also migration flows (Kerr, 1996; Ryzhnova and Ioffe, 2009). This partly hinders the trade development between the two countries. Before a wider achievement of cooperation and interconnections among countries in Northeast Asia, a number of problems have to be solved.

A related problem of globalization is the competitive pressure on the SOEs in Northeast

China. For example, joint ventures may possibly damage the original supply chains of the SOEs because the foreign investors are always more dependent on their own suppliers and may cut off the existing supply chains. Many Chinese scholars have warned that local supply economies (competitive suppliers) would be destroyed in the joint venture reform process (Chu, 2004). Furthermore, SOEs cannot freely engage in reform activities and foreign cooperation. They have to follow the directions of Chinese governments, which are always from the considerations and interests of the governments, not from the target enterprises (For example the FAW had to acquire several bankruptcy auto manufacturers inside and outside Jilin due to the command from the central ministry for the consideration of control over key industries and also the leading manufacturers in these industries) (Huang, 2003).

With greater decentralization from the central government, local governments now have got more power to approve local FDI projects. Northeast provincial governments have further decentralized this power to lower governments at the city or county levels (Zhang, 1993). The Northeast governments have also simplified the FDI approval procedure in order to better serve foreign investors. There are even preferential treatments towards foreign investors and domestic private enterprises by Chinese governments, which granted the foreign (joint) ventures super-national preferential policies for a relative long time. But it should be noticed that the preferential policies towards FDI are mostly targeted at specific industries, not all industries, in order to meet industrial development targets of central and also provincial governments. The different attitudes towards different industries of Northeast governments might be demonstrated in the final realized FDI types and amounts. Compared with the coastal regions, even after the implementation of the “Revitalization of Northeast China” in 2001, the major concern of Northeast China still lies with its existing economic foundation, the heavy industries and their SOEs, especially the equipment manufacturing industries (Li & Yu, 2006). Among the three provinces, Liaoning has had a more welcoming

and beneficial investment environment for FDI with more preferential policies in addition to taxation preferential policies (Sun, 2005). Furthermore, different cities have also exhibited different attitudes toward FDI, including the provision of information and the efficiency of approvals. For example, in Heilongjiang, Harbin and its surrounding area have had better investment service for overseas investors (Li & Yu, 2006).

### **5.3 Summary**

Although China has deeply integrated with the world economy through strong export activities and a leading receiver of foreign investments, the openness of Northeast China is rather limited. As a result, the promotion effects of global forces on economic development of Northeast China are not as significant as the effects on the economy of South China. Trade development of Northeast China was not successful, only with Liaoning possessing an active export-oriented economy. The cross-border trade activities of the other two provinces of Heilongjiang and Jilin were confined by the unstable trade relations with their partners and weak transportation infrastructure. The successful port city Dalian and other border port cities did not generate spill-out effects and support to the development of their surrounding cities, which limited the effects of trade activities on regional development in Northeast China. The single heavy industrial structure in Northeast China together with different attitudes of other Northeast Asian governments on the economic interconnections with China furthermore constrained the development of trade effects and its propelling effects on regional development.

Foreign investments in southern provinces such as Guangdong and Jiangsu were believed to be a key for the economic success in southern provinces. In order to rectify the economic problem in Northeast China, Northeastern governments also devoted to attract foreign investments to promote local economic development. But comparing with the better

environment in infrastructure construction, services provided by local governments and so on formed in the past 30 years in South China, the investment environment in Northeast China was disadvantaged. Furthermore, the welcome attitude to foreign investments varied according to the category of the proposed invested industries and also varied among different cities or regions. Northeastern governments still paid more attention to their traditional heavy industries, with the hope to revitalize these backbone industries through the assistance or cooperation with foreign investors.

In summary, the positive effects of global forces on regional economic development were limited, which was partly due to the constraints of competitive advantages owned by Northeast China limited by its industrial structure and relations with neighbor countries. But the intervention of Northeastern governments was also flawed, especially in their biased attention on possible investors in different industries.

## 6. Conclusion

The chief theories of Economics, Political economics, Human capital and Agglomeration all provide important explanations on regional development. But they could not clarify all the major forces behind the problem of Northeast China. These theories all stress on the crucial role of the market force in regional development, and do not give hints on the effects of the market system on regional development under influences and even limitations of other forces, which is the fact of China's economy, especially when the reform started in the 1980s. So the regional development of Northeast China could not be completely due to the influence of the market force, but it should consider functions of other forces, especially the state. So these theories could not fit in the reality of Northeast China. The analysis scheme proposed by Wei (1999) which involves three forces of globalization, marketization and decentralization from the central government, however, is more fitted to Northeast China's reality. But Northeast China's condition was slightly different from the conditions of Wei's objectives in South China, where the foreign/global forces were more active and attractive. In Northeast China, the influences of the government comparing to the foreign/global force should not be neglected. This is because of the different industrial structures and strategic positions of Northeast China and South China in the plans of the Chinese state. So Wei's analysis scheme needs some adaptation to the condition of Northeast China.

The three mechanisms of decentralization, marketization and globalization in Northeast China have drawn attention to the challenges of promoting regional development in the post-1978 period. In the decentralization process, the local governments in Northeast China have become weaker in their tax base and political power. For example, fiscal power controlled by Northeast governments became very limited because of the termination of former large amounts central reallocation and subsidies that were available in the Maoist

period, and little economic shares of local governments in key properties and enterprises controlled by the central government. Marketization and globalization, however, have not achieved any presumed economic successes in Northeast China. SOE reforms after 1978 deeply damaged the Northeast economy by shutting down or transferring a number of former leading SOEs. The potential private economy in Northeast China however faced development difficulties from restricted support of local governments and relative harsh business environments. In addition, the supposed potential globalization forces of FDI and trade did not give too much attention to Northeast China after the opening-up of the three provinces. Foreign investors seemed to neglect the majority locations in Northeast China other than the coastal region in Liaoning. So during the past thirty years Northeast China witnessed a problematic combination of weak local governments and weak market economies.

Although the three mechanisms provide an useful and feasible method for inequality research in Northeast China, they still have some drawbacks. Factors outside this framework which are significant to analyzing Northeast China's development opportunities are not mentioned. For example, a key problem for Northeast China is the outflows of talents and skilled labor from Northeast China to other regions. This possibly relates to the culture of Northeast China, which embraces the adventure spirit originating from the first Northeast migrants from other Chinese provinces when the three provinces did not have anything yet. Furthermore, the historical background of Northeast China also has had strong influences on its past and current development. At least the history can provide a good explanation on the leading position of Northeast China during the Maoist time, due to the firm industrial basis from the colonial period. In the post-1978 reform period, we can assume that this historical basis continued to influence the low levels of foreign investment and the region's late opening up because of its high heavy industrial composition. Further research is needed.



Considering further research on the relationship between FDI and regional development of Northeast China, several points can be generalized from the above analyses.

The first potential research issue concerns the role of local governments in Northeast China in both the post-1978 reforms and their involvement in addressing global forces such as trade operators and foreign investors. It would be interesting to observe the requirement of FDI proposed by local governments through preferential policies and other declarations (which may have changed during different periods under different political economic conditions in China), and the competition between local governments in attracting foreign markets and FDIs which possibly leads to the decreasing bargaining power of local players.

A second issue relates to the relationship between the region's SOEs with global forces, especially in the process of SOE reforms. SOEs used to be the backbone of Northeast China's economy. Consequently how they have changed and interacted with foreign investors will heavily influence the economic development of Northeast China. Hence this will be an important research topic.

A third issue concerns the considerations of foreign investors. Besides traditional requirements of resources, markets, labor forces and so on, foreign investors in Northeast China should also consider the function of the local supply networks and local technology innovation capacity. The other way round, it is also necessary to notice the FDI's effects on existing (mature and powerful) suppliers in Northeast China, which might encounter survival crisis from the entry of foreign investors.

Fourth, the influence of the formation of private economy in Northeast China on foreign

investors and the roles of local governments in this process, the transformation of its resource cities and the different treatments they get from Chinese governments at different levels under the context of globalization and localization are also important topics.

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