

Commentary by Mr. Stanley Fischer

China Development Forum

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I would like first to thank the organizers of the China Development Forum for inviting me to participate in this conference. It is one of the prime conferences of the year. And it takes place in China, which is undergoing one of the most extraordinary development experiences in all recorded history. So it is a special pleasure to be able to take part in this event.

The topic of the presentation by Mr. Lou Jiwei, vice minister of finance, was entitled “Inter-Governmental Fiscal Relations and Regionally Balanced Growth.” And it fit very nicely with the previous presentation by Minister Wang on “Development of Regional Imbalances and Migration.” For these two topics are very closely related.

They are also of great interest and importance. President Hu Jintao has set as a priority the development of rural areas and the improvement of living standards in agricultural areas. And that is a significant priority. For the differences in living standards between regions within China, and between China’s urban and rural areas, are very great.

I agree with the presentation of Vice Minister Lou Jiwei. He emphasized two central facts. First, regional imbalances within countries will continue in many parts of the world. He mentioned the difference in development between southern and northern Italy. One could also cite as an example Germany, where huge efforts have been made to produce regional equalization between the comparatively undeveloped eastern part – what used to be known as East Germany – and the more developed western portion of Germany. So far these efforts have not had much success. Vice Minister Lou Jiwei mentioned that while a great deal needs to be done to reduce such intra-national regional disparities, we should expect that possibly large differences will persist for a long time.

The second point he emphasized is that we must allow market forces to play a primary role in resolving existing regional imbalances. That is a crucial point. There are obvious equilibrating forces in a market economy that will help reduce differences in regional levels of income. Most obviously, there is the migration of people, which was the subject of the first session this morning. That migration will be from the low income areas – i.e. rural areas -- toward the high-income urban areas. On a regional basis in China, we're talking about movement from the west to the east.

But there could also be positive forces that would tend to raise incomes in the poorer regions, including the allocation of capital. If it were indeed true that there are higher returns to capital to the lower-income regions, and if there were a national market for capital, and if capital were allowed to move freely around the country, that would tend to offset the trend of migration. But if the returns on capital are higher in the coastal and more developed industrial areas, then we would expect capital to move into industry and land development in the areas of higher income. The possible development of a national market in land, and the ability of private developers to develop part of the urban infrastructure needed to support migration, are important components of the equilibrating forces that would operate in a market economy.

It is an interesting point that while these market forces may not eliminate the differences among average regional incomes, they will tend to equalize the distribution of income *across individuals*. The reason is that the individuals who migrate to the richer parts of the country will become richer, and closer in income to the national average.

In this regard, President Hu Jintao is considering how to reduce disparities of income between the agricultural and industrial sectors. The primary answer must lie in reducing the agricultural labor force. For, as was pointed out in an earlier session, the income levels for agriculture workers cannot rise to anywhere near the level of those working in industry. They never will. The present discrepancy will not change by enough as long as the ratio between the portions of the labor force engaged in agriculture and industry remains what it is now.

There are also a number of mechanisms through which government policy can seek to reinforce the equilibrating forces of a market economy -- namely the migration of people, and the allocation of capital -- that will create more equality in income levels across individuals. Fundamentally, and firstly, there are fiscal transfers. In that regard, Vice Minister Lou Jiwei did mention briefly what has happened to fiscal transfers. Mr. Xu, the Chairman of our session, told me separately yesterday that while 70 percent of China's fiscal revenue is collected centrally, only 30 percent is spent centrally. So there can be very large fiscal transfers between the central government and provincial and municipal governments -- provided they are done in a reasonable way. And they can be one of the mitigating mechanisms that deal with the inequalities of income across individuals.

Incidentally, on this topic, China has avoided a major problem that confronted the country just over a decade ago, when the central government was losing control over the finances it was disbursing, and the sources of financing were being gathered at the state, provincial, and municipal levels. This reestablishment of central fiscal control is an important reason why macroeconomic stability has been maintained.

It is extremely important if migration is not to create social problems that the receiving parts of the country-- i.e. the urban areas in the east -- be able to provide the health, education, and residential infrastructure to those migrating from the rural areas. Vice Minister Lou Jiwei emphasized also the legal infrastructure. That is certainly another important requirement, especially in the case of land. It is crucial for those who come into urban areas to be able to acquire land, and to acquire title to the properties that they build. This is one way such migrants can begin to establish themselves in these areas. In many countries where rapid development is taking place one sees ugly pictures of shanty-towns. They are not very appealing. But look at what happens over the course of time. Once it becomes possible for those who have migrated to cities to acquire ownership of the properties on which they live, they begin to improve them. With the provision of urban infrastructure, water and electricity in particular, people invest in their homes. And if you visit the same areas a few years apart, you see places that looked terrible a few years earlier beginning to look better and to become more established. The legal system is a crucial element among the mechanisms that make the economic system work better.

There are also several forces that can offset the desire for migration. These were emphasized by Vice Minister Lou Jiwei, and they include the provision of water in the North and the provision of energy through the gas pipeline network. These developments, along with the provision of transportation, will make it more attractive to live in the areas from which people would otherwise be emigrating.

In summary, there are enormous regional discrepancies within China – and within other countries. They need to be mitigated, and there are two ways of doing so. One is to improve the conditions in the regions in which people in the agricultural workforce live, in urban centers in the west, and in the smaller urban centers in the rural areas. Improving conditions there is one part of the equilibrating mechanism. At the same time, people should be afforded the right to migrate out of those regions into other, more developed areas. To manage this migration, it is important to have in place facilities relating to land use, and education and health services. Those who have the courage to undertake migration should be able to find the mechanisms that will improve their own standard of living.

It was interesting and encouraging that the process described by Vice Minister Lou Jiwei seems pretty broadly to fit that description.

Thank you very much.