

TALES *from the*
**DEVELOPMENT
FRONTIER**

*How China and Other Countries Harness Light
Manufacturing to Create Jobs and Prosperity*



Hinh T. Dinh
Thomas G. Rawski
Ali Zafar
Lihong Wang
Eleonora Mavroidi

Local Industrial Policy in China: The Role of Provinces And Municipalities

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Hinh T. Dinh

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I. Background

- Light Manufacturing in Africa Project
- Uses analytical reviews, case studies (including both successes and failures), and testimony of individual entrepreneurs



INDUSTRIES STUDIED



APPAREL



LEATHER PRODUCTS



WOOD PRODUCTS



METAL PRODUCTS



AGRIBUSINESS

Role of Government

- Critical to structural transformation
- In the past, development economists tended to shift from one extreme view of this role to another
- In practice, the Chinese has fostered the growth of enterprises through an extensive support network that includes elements of both the “big push” and the “laissez faire”

II. The Nature of Government Support in China

- In China, government support for enterprises in manufacturing covers a wide range of policy measures, from fiscal incentives to providing hard and soft infrastructure
- These policies vary by subnational level, by region, and by locality and do not always involve government spending.

Varied Nature of Support

- In general, this support increases with the agglomeration of economic activities, that is, the bigger the cluster of activities, the greater the support.
- National policies usually establish the general direction and pace of reforms
- Most of the direct support for enterprises and clusters is provided by provincial and municipal governments.
- Government support varies according to phases of the business life cycle.

III. Role of Central and Local Governments

- The central government played a key role in reassuring the first generation of private firms about the market direction of the reforms
- The 1994 fiscal reforms allocate 60 percent of enterprise income tax to the central government and 40 percent to local governments. Local governments could thus benefit directly from the development of nearby industrial clusters
- The central government gradually implemented a new performance evaluation system for local government officials. Besides political loyalty, local GDP is a decisive component of the system. Promotions among local government officials depend on whether regional economic growth can catch up to or outpace the economic development of other areas in China => ferocious competition among local governments in nurturing entrepreneurship and attracting investment
- By the early 1990s, local governments behaved as if they were “professional corporations”
- The negative side of this is impact on the environment.

Local Governments

- Compared with the central government, provincial governments play a more active and specific role in regional cluster development. They affect the formation and upgrading of clusters in two main ways: land allocation and cluster development planning. They use their market information and networks to identify exemplary clusters and design and implement cluster upgrading and development plans to support them
- Municipal governments are directly connected to clusters, which generally account for most of the economic activity in a village or town.
- While all levels of government now benefit from the growth of clusters, no single level of government totally controls cluster development. The Chinese style of federalism has created a political basis for the success of cluster-based economic development (Montinola, Qian, and Weingast 1995).

Measures Taken by Local Governments

Local governments can take several measures to foster cluster development:

Nurturing clusters from an existing industrial base

Building industrial parks

Creating special platforms for specific industries:

Why Local Governments?

- In some countries, the central government plans and develops strategic industries by mobilizing and allocating resources. These efforts to pick winners often fail.
- Local governments have fewer options. They cannot change the macroeconomic environment or build national monopolies, and they lack many of the resources for building industries that are available to the central administration. As a result, local governments have generally supported profitable firms that are already in business in local communities.
- Hence China's experience at the local governments level illustrates the case of "backing the winners" rather than "picking the winners"

IV. Tailoring Government Support to the Business Life Cycle

The intimate knowledge of enterprise conditions by the provincial and municipal governments allows them to tailor their support according to phases of the business life cycle.

- In the start-up phase, government support for domestic start-ups is typically small and may amount to little more than providing infrastructure in the same way other countries have done.
- In the growth phase and the maturity phase, the government support in China is substantial and provides clear evidence that the government's industrial strategy is designed not so much to pick winners as to back winners. This is a crucial difference with the strategy typically adopted in other countries.

Support During the Growth Phase

Support in this phase can be broadly grouped into three types:

- Policies to facilitate production factors including subsidies on land, credit, training programs to develop worker skills
- Policies to create externalities through industrial parks or cluster development
- Policies to help set up the upstream and downstream activities to complete the value chain for enterprises.

Other areas of intervention during the growth phase include : (1) creating knowledge spillovers through the establishment of enterprise associations and chambers of commerce to strengthen local communication among enterprises and identify shortcomings in zone administration, (2) improving managerial and worker skills, (3) reducing the bureaucratic burden, (4) expediting payments, (5) reinforcing market signals, and (5) providing services such as quality control, brand building.

Support During the Maturity Phase

Maturity phase: Government support during the maturity phase tends to gear toward research and development (R&D), networking, marketing, assistance through trading companies, and completing the value chain through investment in upstream and downstream activities. Chinese officials, acting as matchmakers, connect firms with research agencies and consultants, reducing the costs of access to information.

V Examples

The support in China includes policies across all levels of government, and policies may vary from region to region and from locality to locality.

- Provincial policies provide preferential tax treatment to key and high-technology firms. They identify, design, and implement cluster upgrading strategies. The Guangdong Province initiated a special project shown in the next slide.

Selected Upgrading Strategies by Clusters in Guangdong

<i>Cluster</i>	<i>Stage in cluster life cycle</i>	<i>Upgrading strategies</i>
Hardware industry in Xiao Lan	In transition from a development to a mature stage	Regional rebranding; shift from exports to the domestic market
Lighting industry in Gu Zhen	In transition from original design manufacturer to original brand manufacturer	Develop light-emitting diode and photovoltaic lighting technology; build national marketing channels
Wool textile industry in Da Lang	In transition from original design manufacturer to original brand manufacturer	Help leading firms build international brands; strengthen design capabilities
Ceramic industry in Nan Zhuang	In deindustrialization stage	Build a ceramic service cluster and a low-carbon economy after manufacturing activities move out
Shoe industry in Huang Bu	In transition from OEM to original design manufacturer	Increase the mechanization of shoemaking; build design capabilities

Example of Municipal Support

- Yiwu Huatong Meat Products Company Ltd
- Wuhou industrial park in downtown Chengdu, Sichuan Province

Example of Cluster Support

- In 2005, to optimize resources and expand market share, Wuhou District launched the construction of the Brand Enterprises Base (BEB) of the Western Shoe Center of China Industrial Park to establish an industrial platform for shoe materials selection, shoe buying and trade, R&D, and international logistics for women's shoes.

Cluster Support (cont.)

- To expand business further, the Wuhou government sent delegations to the leading footwear-producing areas of Guangzhou, Quanzhou, and Wenzhou to learn from their experience.
- In 2004, it promulgated guidelines to encourage private firms to engage in R&D, brand-name production, and export. It set up a competition for the title of “Famous Brands” at the municipal, provincial, and national levels, with respective rewards of Y 30,000 (\$3,625), Y 50,000 (\$6,041), and Y 600,000 (\$72,492).

Financing

In Wuhou, the municipal government financed these and other extensive interventions through land deals. Through the intervention of the municipal government, state enterprises located in the city's central district sold their downtown land parcels and moved their operations to suburban industrial parks. The municipal government then resold these valuable plots to commercial developers. The relocated companies used the proceeds from the land sales to repay debt and upgrade technology.

VI. China's Exceptionalism

- Large domestic size, which allows for huge economies of scale and fierce competition and facilitates the swift completion of supply chains.
- Financing of local governments is done through coercive large-scale land sales and leases. Few other countries can pursue such policies.
- Competition of local governments for growth led to environment degradation.
- Moreover, China began with a labor force that was not only large, but also literate and increasingly well educated.
- China's large diaspora was an indispensable source of knowledge about commerce, technology, and trade. The strong ties and allegiance demonstrated by overseas Chinese promoted rapid transfers of expertise and financial resources, benefits not available on such a scale to most other countries.
- China has also benefited from the unusual depth of entrepreneurial resources among the domestic citizenry and overseas migrants.

VII. Concluding Remarks

- Much of China's recent industrial success is attributable to the facilitating role of local and provincial governments. China's successful industrial policy combines elements of dirigisme and laissez faire.
- There has not been a singular prescriptive policy applied in all districts and provinces. Instead, various policy approaches have been adopted depending on the local context and the particular stage of development.
- The goal is to guide the firm and the industry to become nationally competitive. The government has thus played a critical role in facilitating the creation of input and output markets around which industrial value chains and clusters have evolved.

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