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Why is interregional inequality in Russia and China not falling?

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ABSTRACT

In large and heterogenous countries, cross-regional inequality often fuels political conflict over redistributive demands. Standard economic theory holds that initial inequality in incomes across subnational regions of a country should eventually give way to convergence. However, economic liberalization in Russia and China has not produced cross-regional convergence. The paper demonstrates that interregional inequality remains high in both countries and grounds explanation for this finding in their communist institutional legacies. Their common institutional history complements country-specific explanations for the observed trends in cross-regional inequality.

1. Introduction: the problem of interregional inequality

Although the global rise in interpersonal inequality has been the subject of a great deal of public and scholarly debate in the last decade, inequality across the subnational regions of countries is of no less political importance (Piketty, 2014; Milanovic, 2005, 2010; Atkinson and Piketty, 2010; Atkinson et al., 2011; Beramendi, 2012). Like interpersonal inequality, interregional inequality can generate redistributive conflict. Indeed, interregional inequality can often trigger political conflict more readily than can interpersonal inequality. Given the collective action problem inherent in mobilizing diffuse social constituencies across a national society, it is often less costly for elites to mobilize regional demands for redistribution of rights and resources based on a state's existing territorial-administrative divisions.

Cross-regional tension over the distribution of resources and obligations can originate both in richer and poorer regions. Groups in worse-off regions may demand that the center distribute a greater share of the national pie to them, while richer regions resent their poorer neighbors' claims on the national purse. Moreover, ethnic divisions and price controls can exacerbate regional conflict. If prices are subject to administrative regulation (for example, if oil or cash crops are procured by the central government at state-set prices in some regions and sold at below-market prices in others), it is easy to rouse public ire over an unfavorable system of exchange. This was a common perception throughout the Soviet Union, Yugoslavia, and Czechoslovakia in the 1980s. Publics in both richer and poorer republics were convinced that the federal government's control of the economy put their own republic at a net disadvantage. In the USSR, Russians complained that the natural resources extracted from their republic were subsidizing the rest of the union while Uzbeks complained that the center had forced them into a quasi-colonial mono-cultural cotton economy (Roeder, 1991; Remington, 1985; Remington, 1989).

Similarly, if regional boundaries coincide with ethnic group attachments, then regional conflict can take on a primordial character (Horowitz, 1985). The congruence of ethnic-national and territorial-administrative boundaries meant that cross-regional inequality undermined the unity of all three of the communist ethno-federations, the USSR, Yugoslavia and Czechoslovakia (Bunce, 1999; Roeder, 1991). Similar tensions are common in many developed and developing states. The recent

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tendency in the literature to emphasize the redistributive implications of democratization applies equally to the problem of cross-regional inequality (Acemoglu and Robinson, 2006; Boix, 2003). Therefore differential long-term rates of growth across different regions have major political implications.

As Pablo Beramendi has argued, large, heterogenous states often face a trade-off between policies that centralize fiscal and social policy in order to carry out redistribution at the individual level and policies that give different regions autonomy to devise their own fiscal and social strategies. If richer regions in such a state fear the destabilizing implications of cross-regional migration from poorer to richer regions, they frequently endorse inter-regional redistributive policies in order to preserve their own autonomy. This expedient is likely to be endorsed by the leaders of poorer regions if it allows them to maintain control over their own labor markets and use the interregional transfers to maintain their own power. The more that the country's economic geography is uneven and its institutions of political representation push toward decentralization, the likelier it is that fiscal transfers across regions will substitute for, rather than complement, more centralized fiscal and social policy that aims at interpersonal redistribution (Beramendi, 2012). Although Beramendi's analysis pertains to democratic states, the political-economic logic he outlines also applies to large authoritarian post-communist states as well.

This paper compares trends in interregional inequality for two such post-communist states, Russia and China.[1] Both have very diverse economic geographies and both are undergoing a market transition including integration into global product and capital markets, spread of private property relations, and use of market-clearing prices. These cases therefore lend themselves to evaluating theories about the dynamics of cross-regional differences in economic growth following a market transition. Standard economic theory holds that, following the end of central planning, an initial rise in cross-regional divergence would give way to a long-term convergence of growth rates. However, as the paper will show, we do not observe such convergence in Russia and China when we examine trends in mean incomes, output per capita, and wages at the level of the first-tier subnational administrative units in Russia (the 83 subjects of the federation) and in China (the 31 province-level units). The paper seeks to offer an explanation for this finding based on the shared legacy of the communist economic and political system. That is, while factors specific to the development of Russia and China are important, similar institutional features of the two states that are inherited from their state socialist past help explain barriers to interregional convergence.

What is the basis for the expectation that over time, interregional inequality will fall? The neo-classical assumption is that, given a reasonably well-integrated national market for capital and labor, mobile productive factors will tend to flow to regions where they can command a higher marginal return. Therefore following some initial technological or institutional shock, regional income inequality might rise initially, but would then fall. After the initial shock, inherited cross-regional differences in the distribution of transportation infrastructure, proximity to ports, natural resources, human capital, and administrative status would be expected to generate increasing returns to initial comparative advantages. Regions more richly endowed in such advantages would grow at a faster rate than poorer regions, widening cross-regional differences in incomes, wages, wealth, and output. However, both economic forces–the incentive on the part of the owners of capital and labor to seek a higher return as well as political pressures for redistribution through the central government would eventually tend to act to redress inter-regional differences.

For example, Jeffrey Williamson argues that the process of industrialization may affect different parts of a country differently, initially increasing interregional differences as capital and labor flow to the higher-growth regions. Over time, however, the gap tends to close as factor prices equalize and political pressures mount for redistribution of public investment (Williamson, 1965). He posits an inverted-U shaped curve in cross-regional inequality over time, as regional differences initially widen and subsequently diminish in the course of national development. He found considerable evidence for such a pattern over a number of cases. In the case of the United States, Gavin Wright has shown that changes in federal labor laws, such as the minimum wage, that undermined the regional isolation of the Southern labor market, reinforced by the effects of World War II, brought about a rapid increase in Southern growth rates after the 1940s as labor and capital gravitated to the South (Wright, 1987). These institutional changes resulted from a shift in the relative power of local political coalitions that sought to maintain traditional rural and racial hierarchies (Olson, 1983).

The long-run tendency for regional growth differentials across and within national economies to fall has been termed “the iron law of convergence” (Barro, 1996a, 1996b; Barro and Sala-i-Martin, 1992; Barro et al., 1991). The theory recognizes that convergence works only over long time spans and can be disrupted by exogenous shocks. If national political institutions are weak, the central government will be unable to enforce laws uniformly, redistribute across regions, or invest in infrastructure, civil and judicial administrative capacity, and human capital. As a result, rates of development would diverge. Institutional restrictions on the mobility of capital or labor would reinforce cross-regional inequality. Therefore the real question is under what conditions institutional obstacles to national integration can be overcome by the pull of market forces. Douglass North's theory of institutional equilibria suggests that low-level equilibrium traps can persist over long periods of time (North, 1990).

The paper proceeds as follows. In the next section, I describe the different trajectories of economic liberalization in Russia and China since they began market reforms. Part 3 analyzes the data on regional-level growth, incomes and wages and graph and table form. To test standard economic theories of convergence, the paper first presents trends in the inter-quartile spread of the wage, income, and output series across regions over time. It then shows the results of OLS regressions of regional

[1] I refer to China as post-communist in its economic institutions, while recognizing that many policy-making powers remain in the hands of its ruling communist party. Both Russia and China have turned decisively away from the state socialist model of a planned economy with state ownership of the major means of production.