

Market Segmentation and Regional Economic Growth

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Abstract

Market segmentation has the institutional quality. This paper analyses the impact of market segmentation on regional economic growth from the aspect of institutional economic theory. This paper analyses the long and short relationship between market segmentation and regional economic growth from property protection, government efficiency and incentive mechanism. We conclude that, in the short run, market segmentation can promote the regional economic growth; but in the long run, it will decrease the regional economy.

Key words: Market segmentation; Institutional economics; Incentive mechanism

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Market segmentation means that in a united country, it hasn't built up a united market. In China, market segmentation is the result of institutional arrangement. The local governments in China exists administrative monopoly, governments compete with each other under the guidance of economic performance, which bring out market segmentation. The research on the relationship between local economic performance and market segmentation has been abundant. Lu and Chen(2009) thought that market segmentation affects local economic performance with a inverse U shape. At the beginning, market segmentation can promote

the economic growth, but as the time goes, it will hinder the economic growth. Liu and Liu (2010) thought that market segmentation always hinder the economic growth. All of these researches are empirical researches, but the theory of the phenomenon is scarce. This paper is gonging to do the work to make up the deficiency of the theory research.

1. THE INSTITUTION QUALITY OF MARKET SEGMENTATION

The reason why the market segmentation built up is the institution of fiscal decentralization. Under the fiscal decentralization regime, the local government has its own interests, and the local government has the right of discretion. So the local government has more power than it has in theory. In order to get more fiscal income, promote local economic growth, the local government has the enthusiasm to protect local economy, and then it produced market segmentation. But at the same time the central government has the greatest power in administration and personnel appointment. So when the local government's officials' promotion is associated with economic performance, it will certainly make the local government compete with each other under the GDP growth type 'promotion championship'. In competition, the local interest is different and it will do harm to coordination and cooperation. He and Wang (2007) thought that the political championship underlying moral hazard and adverse selection, it can enhance the competition between local governments but it can also prejudice cooperation. Under the guidance of GDP competition, the local government became the main impellor to segment the market. Li, Qiu and Sun used the two stage game theory model to find out that, the inner trade protection is the main reason of domestic market segmentation. Yu (2009) put forward a new concept of regional administrative

monopoly to demonstrate the place protection and market segmentation. He thought that the start point of market segmentation is institution.

We can conclude from the existing literature that market segmentation has the quality of institution, the mechanism of its emergence and lasting are based on the institution.

2. THE EXPLANATION OF MARKET SEGMENTATION BRING ECONOMIC GROWTH

2.1 The Impact of Institution to Economic Growth

North and Thomas (1971), North (1981) 's research provided a new regime to explain the reason of economic growth, and the scholars began to study how the institution impacts economic growth. North thought, the institution depends on the property and ideology. He pointed that some scholars ascribe the growth to labor force, capital and technology, but the key point in economic growth is not whether it can catch enough capital or technology but whether it has the right incentive mechanism so as to use the capital and technology correctly. In the views of the institutional economics, the neoclassical economic school's growth factors are not the reason of growth, but just the performance of growth. One country's judicial system and property protection system is the reason of growth. Hausmann and Rodrik (2002) thought that the economic growth depends on two conditions: good technology and good institution arrangement. And the gap between the developing countries and developed countries is mainly because of the developed countries has more advantages in government efficiency and property protection. A good institution arrangement can assure the contract be carried out, and decrease the transaction cost enhance the transaction efficiency.

2.2 The Incentive Mechanism in Segmentation

In the view of institution arrangement, China has not established perfect judicial system and property right protection system. That is to say, in pure institution quality, China's institution arrangement can not drive economic growth well. But in this relative bad institution arrangement, China has already got amazing GDP growth, and created a miracle. We can find the answer from the institution economy. North always emphasize that the most important factor to drive the economic growth is whether we can provide a good incentive mechanism. And the value of institution is just to provide the right incentive. In China's reform and open policy, although it didn't provide a good institution, it provided a "right" incentive. And the mechanism of this incentive is to give the motivation to

the local government to put more power into the economic growth, and the evaluation of local economic performance will determine the officials' own promotion. In order to get a higher position, the local governments compete with each other in economic growth. In this process, market segmentation is a byproduct of politics championship, and it is with the aspiration of local government. So market segmentation stand for an incentive which drive the economic growth.

2.3 Property Rights Protection Under Market Segmentation

North has been always praising the fully market-oriented institution arrangement, emphasizing the value of private property rights for economic growth. But in fact, from the developing process of China, Japan and South Korea, we can see that the government oriented market economy has a lot to do with the common property rights. Especially in China, the local government is a big force not allowed to ignore. So North once said, although the initial political-economic structure is different, the followed changing improved the function of the government. Lu and Chen (2005) thought that the local government affected the economic growth in two ways, one is the force consistent with the market which leads to market integration and industrial cluster; while the other is the force inversed to the market which lead to market segmentation. These two forces built the economic condition of China nowadays.

Property rights protection and government efficiency are important foundation for economic growth. The traditional views of economic growth tell us that without formal property rights protection, economic growth will definitely be blocked. But China is an obvious exception. Although there is no formal property rights protection system, under the situation of market segmentation, local governments play the role of informal property rights protector. Zhou (2007) thought that political championship provided the property rights protection and made the policy environment good. The political championship is a special incentive mechanism for property rights protection, and it is the substitute of formal property rights protection. That is to say, in the situation of market segmentation, the local governments have the enthusiasm to provide a special property rights protection. And the protection provided by the governments is better and more efficient than the formal institution in a sense.

In one word, market segmentation provided an institution arrangement, which can be more efficient than that provided by the market. Although it is an informal institution, it played an important role fully. And it also brings about China economic growth and creates the miracles of China.

3. THE BOUNDARY OF GROWTH BROUGHT OUT BY MARKET SEGMENTATION

The problem is whether market segmentation can make the growth sustainable. The growth of this kind is just a temporary phenomenon or a sustainable situation is deserved to think about.

3.1 Market Segmentation and “North Paradox”

The North paradox of institutional economy thought that the state is the key element of economic growth, but meanwhile, it is also the source of decline. Market segmentation is one form of local protections, it stands for the degree of governments intervening in the economy in the essence. A powerful government can improve the growing speed of economy in particular time, but it can not solve the problems of coordination and it can not build a creative modern society either. At the beginning of China’s reform and opening period, economic development level is low, and the elements of economic growth are in the state of silent. So the government oriented economic growth type was in the state of efficiency increasing stage, and the government had no conflict of benefit with the people. The government has more benefit in common than in contradiction. That was because at that time, there was little interest in our society and the problems of producing was the focus for both the government and the people. The government played a good role of economic growth in that time. But as the economy developing, the efficiency of government began to decrease, the negative influence of government’s interfering to the economy became clear. When distribution problems became the focus, the effect of the government became inversed. When the incentives drive people to grab not to create, the governments have transferred themselves from the “helping hand” to “grabbing hand”. And the society would definitely fall to the bottom. At this time, the market segmentation will obviously hinder the economic growth, not as it has promoted the economic growth before. At the other side, market segmentation stands for the style of government manipulating economy, but from the views of history, the rulers always have the motivation to abuse of power, so as to grab more interest from defining property rights. The market segmentation brings conflict with local government and people and gives bad effect to economy and society development. The economy cannot realize a long term steady growth.

3.2 Market Segmentation and Market Scale

Edward Shils thought that constitute and sustain a unified social need three elements, that is, unified market, unified culture and unified political authority. Has any hands of these three elements been impaired, the unity of the society weakened. Market segmentation is a factor that

can block the unity of market, which will do harm to the economic of scale. The relationship between market scale and economic growth is deep. North once ascribed the industrial revolution to the enlargement of market scale. The enlargement of market scale caused the emergence of customary law, which leads to organization changes. Meanwhile, market scale pushed forward the division of labor, and decreased the cost of technological transformation, which could improve the technological efficiency, and put the technology forward. Technology is the most important side of economic growth. If the market segmentation blocked the technology progress by blocking the market scale, it would produce negative influence to long term economic performances.

From the analysis above, we can conclude that market segmentation can bring about economic growth, but the growth has a boundary. Due to the incentive mechanism and market scale, market segmentation cannot drive the economy into the process of continuous growth, but just lead it growth to a certain position, and then it will block the economic growth.

CONCLUSION

Although market segmentation has the mechanism to promote the economic growth, it also has the mechanism to block the long-term steady growth. And these mechanisms have significant time effect, that is it can drive the economy grow well at the beginning, but has obvious negative influence latter. The relationship between market segmentation and economic growth is an inverted “U” shape.

So, for countries like China, as the economy grows, the barriers between regions should be erased gradually, eliminate market segmentation ,build unified commodity market and factor market so as to make resources across the country get reasonable and effective configuration. At the same time perfect property rights protection institution should be built to substitute the local governments’ protection hands, and the right incentive mechanism should also be established to diminish the negative influence of local protection and market segmentation.

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