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Analysis of the Economic Development and Policies in China



Summary

After 30 years of sustained growth, China has become a country with a huge economic aggregate, which is undergoing rapid growth in social undertaking and is increasingly incorporated into the world market. However, China is encountering numerous problems in economic development, such as finding new a growth momentum, transforming the economic growth pattern, adjusting the industrial structure, and reforming the financial system.

ECONOMIC HISTORY REVIEW AND ANALYSIS OF THE STATUS QUO

China lies on an area of 9.6 million sq km and has a population of 1.34 billion. Between 1949 and 1978, China's economy was centrally planned. Since the latter date, China has been treading the path of gradual reforms and opening up, repeatedly adjusting to and incorporating the successful experiences. The more than 30 years of transfor-

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mation can be divided into four stages. Between 1978 and 1984, in the initial stage of the reform, the foundations of the planned economy were loosened and people were allowed to start their own businesses. The policy of opening up was first implemented in the coastal areas. The second stage, between 1984 and 1992, was seen as a period experiencing a split in the economy, when the concepts of commodity exchange and free market were gradually accepted by people. The institutions and policies issued by the government to regulate the market were explored and adjusted. The policy of opening was extended to the entire nation. In the third stage, between 1992 and 2012, reforms were deepened, market economy was improved and had a great impact on resource allocation. Macroeconomic control and government policies were polished. China's economy was fully integrated into the process of globalization. In the current fourth stage, market plays a decisive role in resource allocation, and China's policymakers further decrease intervention into and control of the market. Market mechanism will be strengthened.

EXPANSION OF THE ECONOMY

In 1978, China's total GDP was RMB 364.522 billion, accounting for USD 154.97 per capita, while the fiscal revenue of the government was RMB 113.2 billion. In comparison: in 2012, China's total GDP was RMB 51.9322 (USD 8.4 trillion), translating to RMB 38.354 (USD 6100) per capita, and the fiscal revenue was RMB 11.721 trillion (USD 1.95 trillion).

Building social venture

In 2012, the government spent RMB 2.1984 trillion, accounting for 4% of GDP on financial education. In primary education the net enrollment rate was 99%; 85% enrolled in secondary educational institutions, and the gross enrollment rate in higher education was 30%. RMB 2.93 trillion was allocated to healthcare and 95% of the population were covered by health insurance. 0.79 billion people had various kinds of old-age insurance bonds and more than 1.3 billion people were insured for healthcare services. The general revenues, expenditures and sur-

plus of the available five kinds of social insurances (old-age pension, unemployment, healthcare, occupational hazards and maternity insurance) amounted to RMB 2.85 trillion, RMB 2.21 trillion and RMB 3.54 trillion, respectively. The total amount of assets held at social security funds exceeds RMB 1 trillion and local governments manage another RMB 2 trillion as social security funds at various levels.

Change in the economic structure

In 1978, more than 80% of the population lived in rural areas, and agriculture contributed nearly 30% of GDP, while the service sector added a mere 16%. There was huge disequilibrium of economic development and wealth distribution between the regions, industries, urban and rural areas. As a result of a 30-year development, this unreasonable imbalance has been improved greatly. In 2012, the agriculture only contributed 10% to China's national GDP and is still decreasing. The service sector contributed 45% and will rise in the future close to that of the secondary sector of the economy. In 1978, the highest per capita GDP of all provinces, autonomous regions and municipalities of China was recorded in Shanghai, 20.5 times higher than the lowest value recorded in Guizhou province. However, in 2012, the highest per capita GDP (Tianjin) was only 4.7 times the lowest value (Guizhou).

Influence on the world economy

Due to its isolation, prior to 1978 China's economy had a limited impact on the global economy. Even more than 20 years after the start of reforms and opening up, China had a rather insignificant effect on the global economy. Its influence started to rise when the economic crisis hit Southeast Asia in 1997 and strengthened during the global economic crisis that started in 2008. China has become a positive force giving an impetus to the global economic growth and market. China's economy grew at an average of 9.3% per year between 2008 and 2012 and accounted for 29.8% of the net global increase.

In 2012, China's economic growth accounted for 60.9% of global economic growth. China has become one of the pillars of global demand. Between 2008 and 2012, China's share in the global import vol-

ume increased from 6.9% to 9.5%. During the global financial crisis, China posted a 23.3% growth in import volume in contrast to a global shrinkage of 8.4%. It is estimated that China would contribute over USD 1 trillion to global demand annually in the next five years and become the new source of global capital. China's outward foreign direct investment has reached USD 87.8 billion in 2012. Its share in the global volume has increased from less than 0.5% in 2002 to 6.3% in 2012. The share of the Chinese foreign exchange reserve in the total global volume has increased from 8.6% in 2000 to 31% in 2012.

MAJOR PROBLEMS OF CHINESE ECONOMIC DEVELOPMENT

Several problems have emerged as a result of the rapid development of China's economy, the demographic trends and the economic globalization since 1978. These problems are enhanced by the new concerns raised the changes in the global economic and social development, which place China's economic development under considerable pressure and challenge governance in many ways.

Declining economy and realistic demand for stable economic growth

Due to the sluggish world's economic recovery, limited resources and transformation in the development model, in recent years domestic demand continued to slump, and this triggers contraction in short-term demand coupled with decline in medium and long-term growth, and consequently posed the severe pressure on Chinese economic growth. The economic growth rate in China has been declining gradually from the 10% peak recorded in recent years to 7.8% in the fourth quarter of 2012 and then to 7.7% in the first and 7.5% in the second quarter of 2013. As the most populous developing country, development is the key and basis of solving social problems. Especially employment issues would become extremely difficult to handle without high-speed economic growth. A 1% unemployment rate would leave 9 million people unemployed in China. Each% of GDP growth creates 1.3–1.5 million jobs. Thus if China is to ensure that 10 million job vacancies are created and the registered unemployment rate remains at around 4% in urban areas, 7.2% GDP growth should be maintained. Therefore, the focus

on economic growth is actually a focus on employment. The aims to provide the infrastructure to satisfy the needs of 1.3 billion people and improve the care and welfare system are all related to maintaining the speed of economic growth, which is no small challenge for the Chinese government.

Difficulties in adjusting the economic structure and the goal of sustainable development

In order to maintain growth at steady levels, it is essential to solve the problem of providing an impetus for the pattern of economic development to transform into sustainable development when the extensive development pattern is difficult to maintain. Although in the past few decades extensive development triggered rapid growth in the economy, meanwhile it also required high social costs and caused problems in development, primarily the following:

a) Expensive ecological costs. In the past 20 years, environment pollution and ecological degradation cost between 7%–20% of China's GDP.

b) Unreasonable industrial structure. A high ratio of industries is energy-intensive and products are manufactured with low-added value. In China energy consumption per unit of GDP is 2.2 times that of the world average.

c) Serious excess production capacity. Excess production capacity has reached about 0.2 billion tons in steel industry and 0.35 billion tons in cement industry. The same problem is encountered in the electrolytic aluminium, shipbuilding and chemical industries, as well as in some high-end fields such as PV solar cells and polycrystalline silicon manufacturing.

d) Lack of driving force for endogenous investment and consumption growth. In 2009, China's investment in fixed assets contributed 70% of growth in domestic demand, while contribution by consumption was merely 30%. The ratio between investment and consumption is unreasonable.

e) Unbalanced regional development. In 2012, per capital GDP in Tianjin was 4.7 times that of Guizhou province.

f) Lack of independent innovation capacity. In 2012, scientific and

technological development made a 50% contribution to economic growth, 15% to 30% lower than in developed countries.

Financial system and local finance hindering the economic potential

Despite the fact that reform in the taxation system with the implementation of tax sharing in 1994 assigned more power for local governments to manage their revenues and expenditures, high concentration in tax legislation resulted in the lack of decision-making power for local governments in tax matters. Financial administration practice and the low level of institutionalization in power adjustment instead of reliance on political negotiations increased instability in local governments' fiscal revenues. The lack of main tax resulted in an unreasonable structure in the local tax system. Other problems included the low efficiency of financial expenditures, weak supervision, the high costs of tax administration and collection, and irregular special tax transfer payment under various and complex pretexts, etc. As the tax base is weak and there is increasing demand for public services, reliance on revenues from land and rising local government debts pose serious problems. Huge local government debts and complicated debtor–creditor relationships result in high potential economic risks. According to the National Audit Office's report of 30 December 2013, by the end of June in 2013, state debt increased to RMB 30.27 trillion, or 50% of GDP, of which fully covered central government debt amounted to RMB 12.38 trillion, and fully covered local government debt to RMB 17.89 trillion. 37.49% of the debts lawfully repaid by local governments is used to fund municipal constructions. 51.45% of the debts lawfully guaranteed by local governments is used to fund public transport. 36.45% of the debts saved by local governments is used to fund municipal constructions, debts and transport. At the end of 2012, the ratio of debts outstanding and lawfully repaid by the state was 36.74% of GDP. Although this ratio is kept under control, it has approached the international warning line.

Lag in the Market Economy Reform to affect economic development

During the earlier stages of the reform, some important areas were not transformed to ensure success in the economic reform. But after

the establishment and improvement of market economy, in these important industries issues grew serious and led to a split in the social interest structure. They increased the barriers to the reform and risks to economic development and social stability. Currently, reforms are becoming pressing in two fields. One of them includes reform in the public sector. Although since the economic reform of 1978, the %age of the state-owned businesses in the economy has declined substantially, it still has a highly significant influence on economy and control over resources. In 2012, state-owned enterprises have pocketed RMB 42.38 trillion revenues (RMB 51.93 trillion GDP in that year), made RMB 2.20 trillion profits, and collected RMB 3.35 trillion taxes (in 2012 the financial revenue was RMB 11.73 trillion). In the same year, 73 companies were listed on the 2012 Fortune Global 500 from Mainland China, 63 of which were state-owned. More than 70% of China's top 500 companies and the very first 30 are state-owned. Control over important industries by State-Owned Enterprises is determined by the social institutions of China and is essential for Chinese economic security and national stability. However, SOEs have monopolistic interests and use their control over natural resources and preferential policies, which result in low efficiency and generous welfare for themselves, triggering serious discontent of other interest groups. Reforming and improving the management of SOEs will remain an important long-term task.

The second vital reform concerns public institutions. They were established during the planned economy system with the aim to provide various kinds of public services. A large number of them are supported from public funds and are in monopoly positions, nevertheless they directly or indirectly compete in the market. This means fair market competition is seriously injured. Although in 2012 the central government issued a guide to the reform of classifying public institutions, its implementation is slow.

Increasing financial risks and inflation caused by the financial reform

In 2012, China's M2 monetary supply exceeded RMB 100 trillion. Due to oversupply in monetary credit, inflation expectations began to form and tended to increase, which in turn caused rise in consumer prices in

the manner of “keeping up with the Joneses” compensation and prevention. Besides the threat posed by money supply, the following financial and credit problems are also encountered:

a) Structural imbalance in lending. State-owned enterprises and local governments have considerably easier access to credit than small and micro-enterprises or the emerging industries. Therefore, a large amount of credit flows into the government-dominated infrastructure.

b) Non-performing loans and potential risks threatening the operation of financial institutions. At the end of March 2013, the balance of non-performing loans in commercial banks reached RMB 524.3 billion and rebounded in six consecutive quarters.

c) Impact of international hot money flows. In 2012, hot money outflows from China amounted to about USD 320 billion. However, the large-scale inflow of international hot money rose in 2013. In March the amount of new foreign exchange was RMB 236.3 billion.

d) Impact of interest rate liberalization and RMB internationalization in banking. China pushed for the full convertibility of RMB, which resulted in internal and external pressure on bank system transformation.

Social security and welfare

Despite rapid economic development, China’s social security and welfare remained low-standard. Due to the disparity between development in urban and rural areas, there was a huge gap in basic public services, such as education, healthcare, social security and employment provided by the government.

a) Lack of financial support. Although financial investment in social security, employment and health care has been improved substantially, as a ratio of the total fiscal expenditure it is still below the average of developed countries.

b) Low level social security. The only kind of insurance that has been extended to the entire society is health insurance. China needs to improve the level, sustainability, efficiency and fairness of social security institutions to converge to developed countries in this respect.

c) Cumulative risks in value maintenance and the appreciation of the social security fund. Between 2005 and 2011, the annual average

benefit of the fund was only 1.5%, which is 1.52% lower than the inflation rate in the same period. Over the term of 7 years, the benefit exceeded the CPI only in a single year, and thus the cumulative shrinkage exceeded 10%.

CHINA'S ECONOMIC POLICIES AND FUTURE TRANSFORMATION

Challenged by a delicate domestic and international economic situation, the Chinese government takes the following measures to promote economic restructuring and maintain stable economic growth:

MAINTAINING STEADY ECONOMIC GROWTH

To solve the problem of declining economic growth, the following direct measures are taken:

a) Increasing investment in livelihood and releasing domestic demand

Currently, functional problems are encountered in three areas of economic growth: sluggish domestic demand, deteriorating foreign trade environment and diminishing marginal investment efficiency. In the developed countries domestic demand is the main driving force of economic growth. In the three largest economies, i.e. the United States, Japan and the European Union, domestic demand contributes 75-85% of GDP, citizens' general needs amounting for 65-70%. For a long time, China's economic growth has been driven primarily by investment with a high investment rate against low consumption rate. In 2010, China's consumption rate was 47.4%, considerably lower than the 87.7% ratio in the United States, 80.7% in European Union, 78.6% in Japan, and significantly lower than the 67% ratio in other medium-income countries. The Chinese government regards investment in livelihood to increase domestic demand as a solution for the widespread economic worries. Firstly, the ratio of expenditure on education, employment, housing, healthcare and cultural aspects is constantly increasing, and distribution has also been obviously improved. In the fiscal year of 2011, the central government's expenditure on education, healthcare, social security, employment, affordable hous-

ing and culture, which are directly related to people's lives, added up to RMB 1.165931 trillion, representing an increase of 30.7%. Expenditure on agriculture and irrigation, public transport, energy, environmental protection and urban and rural community affairs, which are closely related to livelihood, total RMB 1.394432 trillion. Most local tax refunds and general transfer payments by the central government are used to upkeep and improve people's living standards. In 2011, the central government spent altogether RMB 1.04977 trillion on these three major areas in rural China, up by 22.4%.

b) Promoting technological innovation to reduce the use of resources and the environmental costs of economic development

Whether it is to maintain a stable and rapid pace, or to accelerate the transformation of economic development, we need to enhance scientific and technological innovation, and exploit the potential of an enterprise innovative development. In joint effort with enterprises, universities and research institutions, in the next five years, China will accelerate the establishment of a system of technological innovations with focus on enterprises and the market. A national intellectual property strategy will be implemented with focus on breakthrough points in key technologies that subdue industrial transformation and upgrading, and the increased consumption of material resources will be replaced by scientific and technological progress, the improvement of the quality of labour, and innovation in management as the main driving forces of economic growth.

Improving the market economic system

The main measures include two aspects:

a) Continued streamlining in the administration and the delegation of power to lower levels, rethinking government functions, and the further clarification of the relationship between government and the market

As China is a country shifting from a planned to a market economy, in order to assign a genuinely decisive role in resource allocation to market mechanisms, the most important task is to clarify inter-relationships between government and the market, and to solve the problem caused by too extensive and too direct government inter-

vention in the economy due to the inertia caused by planned economy. The Chinese government will therefore continue to streamline and decentralise its administration, redefine government functions, and create the conditions of market mechanisms to play a more pronounced role, based on the requirements of the development and the

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adjustment of government functions. In July 2013, China's State Council decided to cancel or delegate administrative approval for 50 different issues. So far, China's central government has cancelled and adjusted 2497 projects requiring approval fol-

lowing 6 large-scale decentralization programmes. In the meantime, the Chinese government also had a clear change of direction in functions, to create an appropriate environment for market operations, to provide high-quality public services, and to safeguard social fairness and justice.

b) Improving the basic system of market operation

In recent years, China has accelerated the legislative process related to market-based entities, market behaviour, macroeconomic management, and intellectual property protection, such as the Antitrust, the Competition and the Consumer Protection Acts. By strengthening legislation and enforcement, China has removed market barriers, reinforced market competition order, guaranteed the free flow of resources and information in markets, and established special agencies to supervise and manage all kinds of behaviour that interfere the order of market running. The Act on Macroeconomic Control is under preparation for publishing. It will set the objectives, principles and procedures of macroeconomic control and remove the economic barriers between provinces. At the same time, the establishment of a series of markets, such as China's capital market, human resources market, technology market, information market, land market, and property replacement markets will also be conducted. Standards are being set for product quality and service quality assessment. All these measures will guarantee the sound development and stable operation of the market.

Deepening reforms in the fiscal, taxation and financial sector

Currently, the focus of China's financial reforms is to improve budget management and taxation, and to establish the system of powers and competences in line with the responsibilities for expenditures. Instead of the government it is the Congress that has the power to decide on the budget, and this improves the budget process, and standardizes the system of fiscal payment transfers. The current reform of including business taxes into VAT will be a key breakthrough, primarily supported by the government, as it serves to promote structural change, the transformation and upgrading of enterprises, and ultimately, economic development.

In the financial sector, the Chinese government has insisted that finance should serve the real economy, requiring that the financial innovative reform should be launched on the basis of demand by the real economy, and therefore made eight specific requirements for reforms and innovations in the financial sector. They focus on guiding credit funds to support the real economy, increasingly favour credit in three dimensional rural issues, small and micro-enterprises and other weak links, supporting enterprises to “go global”, boosting consumer upgrades, accelerating the development of multi-tier capital markets, promoting private capital to flow into the financial sector, and strictly preventing financial risks. In addition, the Chinese government has also promoted interest rate liberalization. In 2012, the floating range of the RMB exchange rate was increased from 0.5% to 1%; in 2013, private deposit and loan interest rates remained unchanged, while other deposit and loan projects were limited in respect of interest rates by the government. The Chinese government has also encouraged financial institutions to explore the overseas financial markets.

In the currency sector, the Chinese government will continue to adhere to prudent monetary policy, maintain moderate liquidity, achieve a reasonable growth in money, credit and social financing scales, and maintain the basic stability of general price levels. The Chinese government is also actively promoting the internationalization of RMB, firstly allowing importers and exporters to settle accounts in RMBs, secondly establishing offshore RMB deposits markets in Hong Kong and London, and then proceeding to pilot RMB bonds in some overseas mar-

kets. The central bank of China and the central banks of many other countries have signed currency swap agreements to speed up the process of RMB internationalization.

Adjusting income distribution

Although the balance of China's economic development has improved as a whole since the start of the reform and opening up, inequities in income distribution between different regions, groups, industries are still salient. According to the National Bureau of Statistics, China's Gini coefficient was 0.474 in 2012, with a peak of 0.491 in 2008. China's Gini coefficient has been higher than the level of the international warning line of 0.4 for more than ten consecutive years since 2000. Currently, incomes are about three times higher in urban areas than in rural areas. According to urban wage statistics, the income gap between high- and low-income industries is about fourfold. In addition to seriously affecting sound economic development, this unfair distribution of income also has become a reason for social conflicts and undermines social stability. To solve the problem, the Chinese government takes measures to promote the reform of income distribution, with the basic principle being the "the adjustment of taxes levied on high-income earners, the continued expansion of medium-income groups, and significant increase in the incomes of low-income groups". In the initial allocation process, it is emphasized that factors such as labour, capital, technology and management are weighed according to their contribution in the primary distribution mechanism. During redistribution, the Chinese government insists on the focus on fair value, takes efficiency into account, endeavours to narrow the income gap through redistribution adjustment mechanisms in taxation, social security, and payment transfers as the main vehicles, and gradually puts forward a series of policies and measures to promote the development in regional co-ordination and to break the duality between urban versus rural areas.

CONCLUSION

Douglass C. North, 1993 Nobel Laureate in economics proposed that the existence of a state is the key to economic growth, while the nation

is the rootstock of contrived depression in economy. In the process of improving economic and social development, for the countries of the world, it is a universal problem that deals with the interrelationships between government and market. As China is a country with a vast economy and a huge population, in a period of social transformation, drastic economic fluctuation will not only trigger a series of serious social problems, but also affect the global economy. Thus the adoption of positive and steady measures to promote reform in the economic system will be the basic principal of the government's economic administration in the future.