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# THE CHINESE ECONOMY, PAST, PRESENT AND FUTURE

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Since initiating reforms in 1978 China has experienced an unprecedented rate of economic growth and development to become the second largest economy in the world after the United States. Yet there is so much that we do not know about the internal workings and operations of the Chinese economy, in part, because the available English-language literature is but a fraction of the scholarly work on China. English-speaking scholars, business people, analysts and policy makers are typically excluded from Chinese-language scholarship, analysis and commentary, or are often limited to ‘executive summary-type’ articles from ‘business-literature’ outlets. We hope to fill at least part of the gap in the story of *China, past, present and future* with nine up-to-date surveys on some of the critical issues facing China, which have been written by leaders in the relevant fields of scholarship.

China’s rapid economic growth and development was reinforced by industrialization, mainly driven by export-oriented and labor-intensive industries in Eastern China’s coastal cities, and urbanization. Between 1990 and 2011, urban areas expanded 3.4 times and the urban population increased 2.3 times (CSY, 2012).<sup>1</sup> This fast urbanization proceeded despite stringent constraints imposed by a household registration system, the *Hukou* system. A survey by Wang (2009) and PTSPLT (2011) discovered that approximately 220 million people of the urban population are rural migrants living in cities without having obtained the formal status of urban household registration. Migrants without urban registration only have limited access to most welfare entitlements and basic public services, like education for their children, and are excluded from many urban jobs. This differentiation between migrants and native urbanites is creating serious social problems and contributing to China’s rising inequality. Many argue (e.g. Xia and Liu, 2012) that China’s current urbanization exhibits a relatively low quality of life, fails to fully play its role in creating market demand and supply and, due in part to the effects of the *Hukou* system, creates an environment that is not well integrated with national social and economic goals and responsibilities (Ba, 2013). Moreover, industrialization and urbanization have proceeded without agricultural modernization, which is contributing to a

large and growing urban–rural income gap (Wang, 2011). For example, by a comprehensive evaluation based on eight indicators (e.g. labor productivity, land output and mechanization), Yin (2011) finds that China’s agricultural modernization ranks 51st in the world.

China’s industrialization has also occurred in an economy with a relatively low level and growth rate of informatization and the extent to which China is becoming information based lags behind other countries. Since 2003, China’s industrial value added has accounted for over 45% of total gross domestic product (GDP), which by Chenery’s (1979) criterion suggests that China has entered the middle and late industrialization phases. China’s course of industrialization exhibits quantitative expansion with excess productive capacity (Xu and Zheng, 2011), while informatization is still in its growth phase, mainly limited to investment, and its effective integration with industrialization is impeded by technological bottlenecks and interregional barriers (Guo, 2013). Furthermore, according to a survey by Akamai Technologies US, in the fourth quarter of 2011, the world average Internet speed was 2.7 Mbps, while in China it was 1.4 Mbps, leaving China ranked 90th in the world.

The nine papers presented here discuss in detail some key aspects of the Chinese economy, *past, present and future*. They survey the present and future challenges of the Chinese economy, based upon a rich (ancient) past, yet contested (recent) history, and identify some common themes, such as the household registration system, urbanization, demographic transition, inequality and the sustainability of economic growth.

In terms of *China’s past*, the first article by Deng (2014) presents *A Survey of Recent Research in Chinese Economic History*, which argues that differing views on China’s more ancient economic history have started to converge to a consensus view. However, parts of China’s economic history, in particular the more recent history, remain unknown or unresolved to some extent due, in some cases, to taboos. As a consequence, we do not have clear statements to make or analysis to cite relating to the effect that China’s more recent history has had on current outcomes. Knowing more about what conditions were important for China’s modernizations is important, not only for China, but as potential lessons for other countries and Deng appeals for more work on China’s economic history.

For *China’s present and future*, the central government has proposed a goal of ‘economic and social development’. In October 2010, the 5th Plenum of the 17th Central Committee of the Communist Party of China (CPC) outlined China’s 12th five-year plan and proposed *Three Modernizations Coordination*, targeted at agricultural modernization synchronized with industrialization and urbanization (Xu, Duan and Liu, 2012). Two years later, in November 2012, the Report of the 18th CPC National Congress explicitly announced a new, grand policy orientation of *Four Modernizations Synchronous Development* (FMSD), which is aimed at synchronously developing industrialization, informatization, urbanization and agricultural modernization – all with Chinese characteristics. As previously the CPC indicated the need for a significant transition to achieve the goal of economic and social development (Ren, 2012). Secretary General Xi Jinping stated that, within a century of the establishment of the People’s Republic of China the goal of economic and social development is to build a modernized socialist China that is prosperous, strong, democratic, culturally advanced and harmonious. A central driver to achieve this goal is the *Four Modernizations Synchronous Development*. Secretary General Xi Jinping acknowledges that the FMSD will be a long process with contributions over several generations, a ‘two-century’ timeline, divided into several stages based on the developing speed and complexity of the problems to be resolved.

Some of the critical issues facing modern day China are addressed in the papers presented here. In the second article *Demographic Transition and Labour Market Changes: Implications*

for *Economic Development in China*, Du and Yang (2014) discuss China's demographic transition, which has been influenced by strict population control policy and coincided with rapid economic growth. However, China's changing age structure, i.e. a declining fertility rate and an ageing population, is occurring at a much faster pace than was projected by the government and has led to labor market shortages and rising wages. Population control policy is not the only influence in families' decisions to have children but other factors, such as income growth, increased educational attainment and urbanization, also have been important and the impact of these effects likely has been underestimated in government population projections. A further challenge facing China is that its population has started ageing while China remains a middle-income country without a comprehensive social protection system to support the elderly.

Pension reform, which became a prerequisite for restructuring state-owned enterprises and labor market reform because of the lack of portability of pension benefits, has been on-going since the late 1980s and, as Cai and Cheng (2014) discuss in *Pension Reform in China: Challenges and Opportunities*, a three-part pension system was introduced in 1997. The first part of the pension system is a basic pension plan, which provides employees with a defined benefit. The second part consists of a defined contribution system under which employees and their employers contribute to individual accounts and the third part is voluntary pensions. However, despite three decades of reform China's pension system remains incomplete. Critical issues that need to be addressed are that the current system is only available to urban workers and local government employees in rural areas, its operation is fragmented by decentralized financial and administrative management, it is fiscally unsustainable in part because of low compliance and faster than expected population ageing, and individual accounts earn low rates of return mainly due to investment restrictions and underdeveloped capital markets in China.

Another cornerstone of China's reforms was housing. Housing reform was launched in 1978 and centered on rent reform, the privatization of public housing and the build-up of a housing market. *The Evolution of the Housing Market and its Socio-economic Impacts in the Post-reform People's Republic of China: A Survey of the Literature* is the focus of the fourth article by Chen and Han (2014). As one might expect, the housing sector has been growing rapidly coinciding with sustained high economic growth, internal migration and expanding urban centers. News coming from many local and international sources suggest that the Chinese housing market has entered a bubble-period of price growth, partly as a result of government policies and incentives and/or supply side factors. However, Chen and Han find that empirical evidence on whether or not China has a housing bubble is inconclusive and conclusions largely depend on the definition of what constitutes a bubble that is applied. They suggest that more work is required in this area before a bubble phase can be confirmed – a difficult effect to isolate in any economy and not just China.

Urbanization, which has been a fundamental driving force behind the evolution of China's housing market, is considered in more detail by Lu and Wan (2014) in *Urbanization and Urban System in the People's Republic of China: Research Findings and Policy Recommendations*. The household registration or *Hukou* system has been a major issue in China and as Lu and Wan discuss has led to lagging urbanization as well as efficiency losses arising from too many small cities and larger cities not being large enough. The authors, among other things, propose a quota system under which long-term migrants convert their rural residential land to construction-use land, which is transferred to the city of their employment for urban expansion. Such types of proposal will be important to consider if the known inhibitors to the success of the *Four Modernizations Synchronous Development* are to be removed. The *Hukou* system is

one such impediment to the future, equitable growth of China's economy and society, yet like many other challenges facing China, it is a fundamentally difficult one to resolve.

The *Hukou* system has also been contributing to rising income inequality as discussed by Wang, Wan and Yang (2014) in *Income Inequality in the People's Republic of China: Trends, Determinants and Proposed Remedies*. A large proportion of China's population still lives in rural areas and the *Hukou* system prevents many potential migrants from sharing the growth dividends in urban or coastal areas. The urban–rural gap is in fact the dominant component of overall inequality in China and while there is consensus that the *Hukou* system must be reformed, as highlighted in the *Decision on Major Issues Concerning Comprehensively Deepening Reforms*, adopted at the 3rd Plenum of the 18th Central Committee of the Communist Party of China, comprehensive reform at the national level remains a daunting task. Moreover, reform of China's fiscal system is considered by Wang, Wan and Yang to be another important driver of positive change.

China's industrialization has largely been led by labor intensive and export-oriented industries in urban and coastal areas. However, industrial production, which is the main source of local and global pollution, has been shifting since the mid 2000s with rising labor and land costs in coastal cities. In *The Evolving Geography of China's Industrial Production: Implications for Pollution Dynamics and Urban Quality of Life* Zheng, Sun, Qi and Kahn (2014) analyze the effects of China's changing industrial geography. In particular, the authors highlight the current trend to shift industrial production from the original coastal preference to inland cities, which, to some extent, has helped reduce regional inequality. It has also lowered the Pigouvian social cost of industrial production in terms of pollution in China, with consequent quality of life effects. More people have benefitted from a reduction in pollution than have suffered from an increase as coastal areas tend to be more densely populated than inland cities. Moreover, the use of cleaner, internationally sourced technology has resulted in some reduction of emissions, however, the overwhelming dependency on coal as a major energy source, especially to produce electricity, remains a concern for the future. Reducing the use of this cheap source of energy, which is fuelling China's industrial production, in order to meet international pressures for lower emissions, will continue to be a source of tension.

China's economic growth over the past decades has been spurred largely by economies of scale in labor-intensive industries rather than through invention and innovation. However, with demographic transition and rising labor costs innovation capability is becoming a more critical factor for sustaining economic growth and it is the topic of discussion by Fan (2014) in *Innovation in China*. Fan demonstrates that although China's innovative capacity is now growing rapidly, the spatial distribution of capabilities remains uneven across China's regions. Moreover, the rapid catching-up of China to be, in some areas, competing directly with established, innovative intensive countries is quite different from other newly industrialized economies. The Chinese approach seems to have initially involved significant in-house research and development (R&D), to be replaced now by a much more globally integrated approach, particularly in the area of telecommunication equipment manufacturing. Like many of the surveys presented in this book, the call from Fan is for further study and research and one particularly interesting and important example, but yet largely neglected issue, relates to the impact of international labor migration and Chinese returnees.

China's industrialization policy, which typically has favored exports of manufactured goods and heavy industries, has started to encourage high-tech manufacture and services and *China's Service Trade* is the topic considered by Chen and Whalley (2014). In this final article,

the authors argue that although the development of China's service trade still lags behind merchandise imports and exports, despite high growth rates recently, service trade already has had large effects on China's economic growth, employment and technology diffusion. Even more major impacts are expected in the future and growing service imports and exports are projected to significantly affect global trade and foreign direct investment. According to Chen and Whalley, liberalization of service trade has the potential to lead to considerable increases in China's and the world's gross domestic product and the international migration of people is becoming an increasingly important aspect of trade in services.

The nine surveys presented here fill some gaps in the story of *China, past, present and future*. However, much more analysis and research on the Chinese economy is needed to help avoid some of the negative consequences of rapid economic growth in particular, growing income and spatial inequality.

### Note

1. Land urbanization and construction have grown faster than the urban population (Ba, 2013) leading to many 'dead cities' nationwide.

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