The Dilemmas of China’s Shift in Growth Trajectory and Economic Governance*

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The slowdown in China’s GDP growth in recent years suggests the exhaustion of the driving forces of extensive economic growth and signals a need to switch to an intensive growth trajectory. In order to successfully orchestrate this shift, a reform of the economy’s operation is necessary, including a change in economic policy objectives in order to avoid the middle income trap. This paper analyses the changing role of the sources of economic growth and the main features of the change in the growth trajectory in the post-2010 period, and their relationships with economic governance based on the relevant domestic and international literature and statistical data, without entering into specific details. According to the author’s hypothesis, the Chinese government is prioritising the conflicting objectives of economic rationality and socio-political stability at the expense of the former.

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1. Introduction

This paper discusses the development trends in Chinese economic growth in the post-2010 period. Its starting point is the slowdown in China’s economic growth after 2007, stemming from changes in the global environment and domestic economic conditions, which is attributed to the exhaustion of the factors and driving forces of the extensive economic growth. The importance of the topic is based on the significant impact, both past and future, of the slowdown in Chinese economic growth on the development trends of the global economy.

The objective of this paper is to analyse the process, the sources and the driving forces of the shift to an intensive economic growth trajectory, its economic, economic policy and social factors, and the associated economic policy and political dilemmas. The first hypothesis of the paper is that in order to successfully manage...
the change in the growth trajectory, a radical transformation and even reform of economic governance (the economic policy targets, the ways and means and institutions of achieving such targets, as well as the operational environment of the economy) is needed, which requires great circumspection. *Its second hypothesis* is that the Chinese government will resolve the target conflict between economic rationality and socio-political stability associated with the change in the growth trajectory at the expense of the former. This bottleneck may slow the change in the growth trajectory. According to *the third hypothesis*, by implementing a shift in the growth trajectory building on the reform of economic governance, China may avoid the middle income trap implying that – although it will grow at a slower pace than in the past – the country will continue converging towards advanced economies.

The research *methodology of this paper* combines literature review and the analysis of statistical figures. Accordingly, it was based on a critical discussion of relevant domestic and international literary sources and the analysis of the available statistical data on the Chinese economy. While a large number of literary sources deal with the Chinese economy and Chinese politics, only a limited supply of official statistical data is available, and the reliability of the statistical data is often questionable. In addition to Chinese statistics, this paper uses data published by international organisations (World Bank, IMF, OECD).

2. Challenges facing the Chinese economy and economic policy

The *main challenge* facing the Chinese economy and economic policy has been the systematic slowdown in the growth rate of GDP since 2007 and its consequences. In order to interpret the phenomenon, it is worth looking briefly at economic history antecedents. Regarding the longer-term trends, China’s GDP (gross domestic product) expanded by nearly 10 per cent on average per year between 1978 and 2011, that is over a period of 33 years.1 Only Japan produced a similar performance in global economic history, exhibiting GDP growth of 9.3 per cent on average per year between 1950 and 1973. However, this dynamic growth lasted only 23 years (Angang 2015).

However, China’s GDP growth rate has been slowing continuously over the past 10 years. The 14.2 per cent rate in 2007, the highest in the 2000s, decelerated to 6.6 per cent by 2016, according to preliminary data.2 The European Commission’s short-term forecast expects further slowdown with growth rates of 6.2 per cent in 2017.

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1 Many experts, including *Wildau (2015:8)* and *Holz – Wu (2015:8)* contest the credibility of official Chinese statistical data that overstate the country’s economic performance. The Keqiang index measures national economic performance by electricity consumption, railway cargo volumes and loans disbursed by banks. In this paper, this methodological issue is not dealt with, and the data published by the IMF and the World Bank are considered.

2 If no other source is indicated, the figures in the text are taken from the table included at the end of this paper.
and of 6 per cent in 2018. The figures for 2016 and 2017 coincide with the IMF’s forecast. Within the aforementioned period, the global financial and economic crisis played a pivotal short-term role in the slowdown, resulting in a 4.4-percentage point decline on average between 2008 and 2011, to 9.8 per cent. In China, the impact of the crisis was not a recession as in the majority of advanced economies, but the deceleration of GDP growth coupled with a decline in exports, imports and inflows of foreign direct investments. The risk of economic and political destabilisation also emerged for a brief period.

The negative impacts of the global financial and economic crisis on China were offset by a multi-year economic stimulus scheme introduced in November 2008, amounting to 11 per cent of GDP in 2009, which was completed in 2010 (Wong 2011). Two thirds of the funding within the scheme was directed to infrastructure projects, and financial sources were channelled to other segments of the economy. Funds were increased in 2009, and huge amounts of government loans supported the attainment of the set objectives (Csánádi 2014:116–117). The global financial and economic crisis triggered remarkable changes in the economic system and, in part, in the political system (Csánádi et al. 2009).

As the impacts of the economic stimulus programme petered out and in conjunction with other factors, the economic growth rate has been continuously slowing since 2011. Not even the low world market price of crude oil, which is a positive external factor for China, could curb this trend in 2015 and 2016. In the last three decades, dynamic GDP growth was a key legitimising factor of the socio-political system in China. The slowdown in economic growth has weakened this legitimising factor. At the same time, it cannot be ignored that China’s more subdued GDP growth rates are still remarkable by international standards. Although India has taken the lead in recent years, China is still one of the fastest-growing major countries in the world.

The more than three decades of dynamic growth raised GDP per capita from USD 312 in 1982 to USD 5,582 in 2011 at exchange rate parity and USD 10,384 at purchasing power parity, and to USD 8,140 and USD 14,175, respectively, in 2015 according to preliminary data. Thus, China advanced to the group of middle income countries according to the World Bank’s September 2016 classification.

The slowdown in growth can be considered a temporary phenomenon, arguing that it was triggered by the last global financial and economic crisis, and the rate of GDP growth will automatically return to a (higher) longer-term trend following adjustment to new global conditions after a few years of more modest performance. However, the vast majority of literary resources interpret the deceleration of China’s growth as a lasting phenomenon. The most common explanation is linked to what is referred to as the middle income trap. In simplified terms, this concept describes the phenomenon based on empirical evidence and proven by scientific studies.
in which countries formerly exhibiting dynamic growth stagnate once they reach a middle income level and are incapable of catching up to the group of high-income countries.\(^3\) It is much easier to achieve a medium level of economic development from a lower one than to a high level from a medium level.

The middle income trap stems from the exhaustion of the earlier main sources and driving forces of economic growth. This means that when more industrialised emerging countries reach a certain level of economic development, they find themselves in a unique \textit{competitiveness trap}. Due to relatively high labour costs as a result of dynamic economic growth, under given economic policy priorities, their traditional, mostly labour intensive industries with modest value added content (at the lower end of the global value chain) lose their competitive advantages against low-cost emerging countries, whereas their technology and knowledge intensive industries with high value added content are not competitive with those of advanced industrial countries.

There is no precise, universally accepted definition of the middle income trap (Aiyar et al. 2013; Larson et al. 2016). Without a comprehensive discussion of the topic, it can be mentioned that according to one part of the relevant literary sources, a country's economy is growing in relative terms, but not at a rate sufficient to catch up with advanced economies in terms of GDP per capita. The other part of the literature perceives the middle income trap in absolute terms, defining it as slow GDP growth, even close to stagnation. The question is how to escape the middle income trap. The general response is to increase productivity and total factor productivity.\(^4\)

In China, the rate of economic growth of nearly 10 per cent between 1978 and 2001 encountered internal constraints in and of itself. According to preliminary data, the \textit{volume of China’s GDP} approached USD 11 trillion in 2015. Raising this volume by 10 per cent is much more difficult than lifting GDP valued at USD 5 trillion by the same rate. The increment of a 5 per cent rise in China’s GDP equals to USD 550 billion, and this is approximately the same as that of a 10 per cent rise of USD 5 trillion (also USD 500 billion).

Moreover, GDP growth rates of around 10 per cent cannot be sustained in the present external environment and in the prevailing production and expenditure structure as well as with driving forces. Industry and construction are dominant

\(^3\) According to the experts of the World Bank, only 13 countries managed to converge to the group of advanced economies between 1960 and 2008. The calculations of Angus Madison (cited by: Wheatley 2016) pointed out that over the past 100 years, 41 countries have achieved GDP per capita of USD 7,000. After reaching this turning point, 31 of them saw their rate of economic growth fall by 2.8 percentage points relative to the growth rate of the decade preceding the turning point.

\(^4\) Total factor productivity (TFP) measures the efficiency of the utilisation of labour and capital: it is the percentage change in output that is not linked to changes in the volume of capital or labour input. Its significance increases when the quantity of labour available for economic development does not rise.
in the production structure, and the expenditure structure is characterised by the outstandingly high share of investments, exports in general and those of manufacturing in particular as well as net exports by international standards. GDP growth relied heavily on loans provided by state-owned banks. Economic growth was accompanied by significant real economic and financial imbalances. As the extensive economic growth trajectory based on the expansion of investments, construction and mostly manufacturing exports with low value added content lost steam, a shift was set on the agenda to a knowledge, research and technology intensive growth trajectory that is less capital-intensive, characterised by growing domestic consumption, the increase of the service sector, research and development and innovation, and the expansion of manufacturing industries with higher value added content, implying an upward shift in the global value chain. The next part of this paper presents the main features of the shift in the growth trajectory.

3. Slow change in the growth trajectory

The slowdown in the rate of GDP growth recorded after 2010 is closely linked to changes in the sectoral structure of China’s GDP. Although the share of industry decreased from 46 per cent in 2010 to 41 per cent in 2015, China still qualifies as an over-industrialised country not only among advanced, but also among the numerous developing and emerging countries as well. As an illustration of this point: industry (excluding construction) accounted for 19 per cent of GDP in the EU in 2013. By international standards, agriculture also accounts for a high share in the gross domestic product, at 9 per cent. The expansion of the service sector demonstrates some early results of the shift to a new growth trajectory. The sector accounted for 51 per cent of GDP in 2015, compared to 46 per cent in 2010. Substantial development took place in wholesale and retail trade, finances and the real estate sector, whereas more moderate progress characterised IT services, domestic transports, and the entertainment industry.

Despite the changes that occurred after 2010, the breakdown of China’s GDP by main sectors is not consistent with global economic trends that have unfolded in the past two decades. They include on the one hand the “tercialisation” of manufacturing implying that manufacturing uses more and more services as the inputs and service content of its output are also increasing. On the other hand, economic activities are increasingly organised along value chains where production is not the most profitable, rather than in the traditional industrial sectors. An important part of China’s manufacturing sector is concentrated on the last component of the international value chain, i.e., on assembling. For this very reason, its service content is low. All of this points to low profitability by international standards.
For a long time, investments played a key role in the sources of economic growth, and even nowadays this role is significant. The negative impacts of the latest global economic crisis were offset by the increase in the share of investments in GDP. This was considered abnormal by the majority of experts. Although their share relative to GDP fell from 47 per cent in 2010 to 44 per cent in 2016 according to preliminary data, this is still extremely high not only in itself, but by international standards as well, and exceeds the corresponding figures of Asian developing countries by 10 percentage points and was more than double the EU average of 20 per cent in 2015 and much higher than the 25 per cent global average.

The relevant literature labels the consequences of this phenomenon overinvestment, the huge costs of which are borne by the households. Over the past years, the contribution of an additional unit of investment to GDP growth was gradually declining. In other words: rising growth in investments was needed to reach the same GDP growth rate, which is unsustainable in itself in the longer run. From another point of view, this suggests the low efficiency of and unfavourable return on investments. An investment ratio lower by 10 percentage points (of around 35 per cent) of GDP would be in line with the fundamentals of the Chinese economy. This ratio would be a point of return to the “normal” level without jeopardising economic growth and macroeconomic stability (Lee et al. 2012:22). Thus, it is no coincidence that due to overinvestment China’s economic growth was capital intensive, resulting in substantial excess industrial production and export capacities, especially in the heavy industry and construction and in China’s traditional light industry export sectors.

In the increase in investments, the public sector played a key role primarily through the investment activity of local governments. The majority of the investments were implemented from loans granted by state-owned banks. This is highlighted by the fact that the domestic debt of non-financial enterprises relative to GDP increased from 97 per cent in 2010 to 127 per cent in 2015. The increase in the ratio of loans granted by the financial sector relative to GDP from 143 per cent to 170 per cent between 2010 and 2015 also indicated that economic growth was sensitive to external funding. The indebtedness of local governments and overheated investments could be attributed to a great extent to the decision-making mechanisms originating in the general features and the individual Chinese characteristics of the power structure of the one-party state (Csanádi 2012).

Foreign direct investment (FDI) played a key role in the establishment of modern industries including high-tech ones. In 2010 and 2015, the inflow of net direct foreign investments relative to GDP amounted to 4 per cent and 2.3 per cent, respectively. Research, development and innovation is determining the switch-over

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5 For more detail, see: Lee et al. (2012:22).
to a knowledge, research and technology-intensive economic growth trajectory. Between 2010 and 2014, research and development expenditures increased from 2.2 per cent to 2.5 per cent of GDP. Despite this increase, the ratio still lags behind the 3–4 per cent figure of technologically advanced countries. However, the lag is more pronounced on the output side, such as international patents and trademark registrations. The share of high-tech goods in manufactured exports dropped marginally from 28 per cent in 2010 to 25 per cent in 2014. Catching up was fast in higher education; the gross enrolment ratio increased from 24 per cent in 2010 to 39 per cent in 2014. This still lags considerably behind the ratios of around 70–75 per cent average of the advanced economies.

*Domestic savings* provide the main source of investment. Not coincidently, the ratio of gross savings to GDP moved in the same direction as the investment ratio: it shrank from 52 per cent in 2010 to 48 per cent in 2014 and according to preliminary data, it dropped to 46 per cent in 2016. This is still an outstanding figure by international standards: the world average was 26 per cent in 2015, in the US net savings excluding depreciation was around 6 per cent on average over the last three decades of the 20th century. The difference between the savings ratio and the investment ratio financed the general government deficit and was invested abroad rather than in the national economy as indicated by the current account surplus. In other words: the excessive private and public consumption of other countries were funded by the savings of Chinese households. The permanent current account surplus led to an increase in foreign exchange reserves: China has the highest foreign exchange reserves in the world.

The attitude and the mentality of the population, i.e. thrift as social value undoubtedly played a key role in the high savings ratio. However, a coercive force stronger than the motive of prudence was that the welfare state in Western-European terms did not develop in China. This means that there is no universal social insurance, including pension and healthcare and unemployment benefits. Chinese people may typically access to pension payment through private pension funds. Only general practitioner medical care is free of charge, any additional healthcare service must be covered individually.6 Mandatory primary education is free, but higher level education is not (*Bokros 2015*). Over the past years, social insurance changed due to the privatisation of state-owned enterprises and the restructuring of the ones that remained in state ownership. This is because state-owned enterprises previously also fulfilled social insurance functions (in terms of healthcare and pension), which disappeared at the privatised companies, and weakened in the reorganised and rationalised state-owned enterprises. Along with the weakness of the social security system, the unfavourable demographic trends,

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6 Between 2010 and 2014 private healthcare expenses relative to GDP increased from 2.2 per cent to 2.5 per cent, whereas public healthcare spending rose from 2.7 per cent to 3.1 per cent.
such as the decrease and the aging of the population play a key role in the high savings ratio and restrain a decrease in this ratio.

Household consumption relative to GDP grew marginally from 35 per cent in 2010 to only 36 per cent in 2013 and thus did not keep pace with the surge in the service sector. The Chinese consumption ratio amounts to half the level of the US. The theory of Arthur Lewis provides one possible explanation for this (Lewis 1955). According to this theory, at a low level of economic development a narrow modern sector and a large traditional sector exist simultaneously. The latter sector is characterised by the oversupply of labour force. Because involving additional labour force into the economy is not restricted, the decreasing rate of return does not appear in industrial and construction investments. But the huge labour force surplus keeps the rate of wage increase at a low level even when the economy itself is expanding dynamically. According to Paul Krugman (2013), with the lack of labour force surplus, the Chinese economy reached the so-called Lewis point. This means that as wages increase, employed persons start to enjoy the fruits of economic growth while the Chinese economy still needs to be balanced; that is, due to the decreasing rate of return, household consumption should take over the role of investments in terms of the sources of economic growth. According to international experiences, an economic growth trajectory based on the expansion of consumption enables lower GDP growth rates than the other trajectory relying on the expansion of investments. This is because, in the latter case, the impact of the investment multiplier supporting growth should be taken into account, amongst other things.

Growing employment may contribute, ceteris paribus, to increased consumption at the level of the national economy. As far as labour force supply is concerned, the rate of increase in China’s population has slowed down over the past 10-15 years: the country’s population was 1.34 billion in 2010 and 1.38 billion in 2014 (in 1979, it was only 964 million). According to demographic forecasts, China’s population will reach its peak around 2030 at 1.45 billion, followed by stagnation. The ratio of the working age population (the 16-59 age group) to the total population started to decline in 2012, with a likely fall from 66 per cent in 2015 to 57 per cent in 2030, which may necessitate an increase in retirement age. This suggests the start of the depletion of systemic reserves under the current framework conditions. Consequently, population growth will only moderately contribute to the expansion of labour force potential in the near future, whereas later on, it will not contribute to it at all. Any quality and quantity improvement can only be expected from the movement of rural, mainly agricultural workforce to the cities. Workers can be more efficiently used in the industrial and service sectors of cities where jobs are available than in rural areas where agriculture is characterised by a generally high level of hidden unemployment. The fact that the degree of urbanisation (the ratio
of the urban population relative to the total one) rose from 49 per cent in 2010 to 56 per cent in 2015, and even though many major Chinese cities are becoming unbearably crowded, this ratio still falls short of the 60 per cent average prevailing in emerging countries indicating the opportunities in this field. At the same time, the spread of robotisation and rationalisation in industry may impose demand-side restrictions on the potential for increasing employment (one half of the world’s robots are located in China).

These demographic and labour market trends have also somewhat offset economic growth compulsions. In the past, one of the Chinese government’s postulates was that 6 per cent GDP growth per annum was necessary for the economy to absorb the new labour force appearing in the labour market every year, in other words to avoid a rise in unemployment. This argument is becoming irrelevant in the face of deteriorating demographic trends. Successive Chinese governments have always considered the low unemployment rate (the official figure was 4.1 per cent between 2010 and 2016) as a cornerstone of social stability, and have preferred it to many other economic policy objectives.

A shrinking labour supply in both relative and absolute terms necessarily leads to rising wages, and this may theoretically lay the foundations for an increase in private consumption. In China, there is no general minimum wage, and several levels are defined in the individual regions. The monthly minimum wage in Shanghai rose from CNY 690 in 2006 to CNY 1,120 in 2010 and CNY 2,020 in 2015, representing a threefold increase compared to 2006 and 80 per cent growth relative to 2010, far higher in real terms than the rise in productivity. It can be rightly assumed that as a consequence of the minimum wage hike, wages also grew in higher categories. The 73 per cent total wage growth at the level of the national economy that took place between 2010 and 2015 is consistent with these trends. However, there are significant geographic differences behind this average. In China’s more developed regions and major cities (Shanghai, etc.) wages are far higher than the national average.

The wage developments surveyed above led to the erosion of China’s international wage advantages. This trend can only be outlined in the absence of consistent statistics enabling international comparison, because limited international

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7 In China, the minimum wage is set at around 30 per cent of the average wage despite the fact that it should be between 40 and 60 per cent according to national guidelines. The International Labour Organization benchmark is 40 per cent of the average wage (Wong 2016).

8 More accurate conclusions can be drawn regarding the competitive advantages and disadvantages of various countries from the international comparisons of labour costs containing taxes and contributions rather than from wages alone.
comparisons are available for minimum wages. On this basis, a minimum wage in USD totalling USD 1,927 per annum in China as of 12 November 2016 was higher than that of Pakistan (USD 1,518), Mexico (USD 1,438), Vietnam (USD 1,327), the Philippines (USD 1,240), Indonesia (USD 986), India (USD 778) and Bangladesh (USD 231).

Although the level of wages alone does not express competitiveness, merely looking at productivity and assuming relatively minor differences in productivity between the countries listed above and China, it can be reasonably supposed that cheap labour is no longer a competitive advantage vis-à-vis a great number of emerging countries (and is disappearing vis-à-vis others) in industries with low value added content. Over the past few years, China’s main comparative advantage must have been its relative abundance of capital, rather than its cheap labour.

The new development trends of the global economy also impose significant constraints on the extensive economic growth trajectory. According to the data of the IMF, the 4.2 per cent average growth rate of global aggregate GDP between 1998 and 2007 will decelerate to 3.2 per cent between 2008 and 2017, and the rate of increase of world trade from 6.8 per cent to 2.9 per cent over the same periods (IMF 2016b:228 and 242). With waning external demand, the growth rate of China’s exports of goods and services has been slowing since 2008, highlighting the weakening of the economy’s export-driven nature. To a large extent, this external factor accounts for the decline in the growth rate of Chinese exports of goods and services between 2014 (27 per cent) and 2016 (2 per cent). It should be noted that it is net exports, in other words the difference between exports and imports of goods and services that matters in terms of GDP growth, rather than just exports. Increasing net exports are also held back by external constraints. This is because the majority of the countries in the world economy expected recovery from the last financial and economic crisis and the reduction of external vulnerability by enhancing the foreign trade balance surpluses, and strived to act accordingly.

Without going into details, environmental pollution is both an internal and an external limiting factor of economic growth. It is an internal factor since the rising economic and social costs of environmental pollution eat up an increasingly large share of the increment of GDP every year. It is an external factor as well, since if the earlier growth trajectory is maintained, China cannot fulfil its obligations undertaken

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9 Minimum wages. http://www.wageindicator.org/main/salary/minimum-wage Downloaded: 22 November 2016. The comparison of the various countries is limited for several reasons. First, not every country has a minimum wage, so countries with no such threshold should be left out of the comparison. Second, minimum wages included in the comparisons do not necessarily apply to the same period. Finally, the conversion of the minimum wage to USD may also introduce distortion through the exchange rates applied. However, these limiting factors probably do not have a huge distorting impact on the international comparisons.
in 2014 to reduce emissions. Rising *income inequalities* and *widespread corruption* are also internal constraints to GDP growth.

The shift in China’s growth trajectory as a result of the gradual exhaustion of the traditional factors and driving forces of economic growth took place in part spontaneously, following the least resistance from time to time, and in part under the influence of economic governance. The following section analyses the impact of economic policy in general and economic reforms in particular on the shift in China’s growth trajectory.

### 4. Shift in the growth trajectory and economic governance

The foundations for the shift in the growth trajectory were laid down by the 12th Five-Year Plan for the 2011-2015 period. The 18th Party Congress also addressed the issue in 2012, and some of its issues had already been added to the agenda earlier. The targets and quantified projections of the 12th Five-Year Plan give reason to assume that the Chinese leadership considered the exhaustion of the driving forces of extensive economic growth and the shift to a different, more balanced growth trajectory (*SCPRC 2011*). The planned 7 per cent average annual GDP growth rate indicated that the Chinese leadership acknowledged the slowdown in economic growth, the gradual depletion of the sources and driving forces of the former growth trajectory and obviously responded in time to the internal and external challenges facing the economy. In Chinese terminology, the slower economic growth rate is labelled the “new normal one”. The government aimed to attain sustainable growth by increasing research and development expenditures,\(^{10}\) by promoting the development of industries necessary to climb higher in international value chains and by extending higher education.\(^{11}\)

The targets include several components that will not only enable the shift in the growth trajectory, but contribute to social stability as well. They include the creation of more than 45 million jobs over five years in urban regions (obviously mainly by the expansion of the service sector), an increase in the urbanisation rate, stabilisation of the registered urban unemployment rate at below 5 per cent, an increase in the number of those involved in the urban basic state pension scheme from 257 million to 357 million, the preservation of price stability (defined as an inflation rate less than 4 per cent), the reduction of social inequalities, and the extension of the average life expectancy by one year. In addition, with a view to bolstering development and moving upward in the global value chain, the plan aimed at developing the following seven priority areas: new (alternative) energy, energy

\(^{10}\) On the input side, research and development expenditures are to be increased to 2.2 per cent of GDP, and on the output side, the objective is to have 3.3 registered patents for every 10,000 inhabitants.

\(^{11}\) One interesting fact is that there were 7 million students enrolled in Chinese universities in 2016.
conservation and environmental protection, biotechnology (pharmaceuticals and medical devices), new materials, new information technologies, the manufacturing of top quality brand-name products, and the production of vehicles using clean energy.

The comprehensive report published by the World Bank and the Development Research Center of the State Council, People’s Republic of China, entitled China 2030 (Building a Modern, Harmonious, and Creative High-Income Society) was a significant contribution to the theoretical and economic policy foundation of the shift in the growth trajectory (World Bank 2013). The paper, which refers to and relies on the 12th Five-Year Plan as its starting point, attempts to answer the question whether China can remain one of the fastest-growing economies in the world, despite the slowdown in its economic growth rate, and whether rapid GDP growth can be maintained without triggering major disruptions in the global economy, in the natural environment and in the domestic social fabric. The 12th Five-Year Plan focused on objectives and paid relatively little attention to the tools necessary for achieving them. In contrast to this, the China 2030 study addressed the tools and methods of implementation. The executive summary of the China 2030 report contained more than 60 recommendations, which – according to the expectations of the authors – will contribute to the realisation of the longer-term objectives.

The 13th Five-Year Plan for the 2016-2020 period partly continues and partly amends the objectives of the previous five-year plan. The economic growth target was modified: the plan projects a 6.5 per cent average annual GDP growth rate. Earlier, a rate of GDP growth of less than 6 per cent was considered recession in China, and this perception may be an explanation for this forecast figure. In the wake of the global financial and economic crisis, the slowdown in growth in 2008-2009 and the resulting rise in unemployment exacerbated social tensions dramatically in terms of mass demonstrations, amongst other things. Some experts think that with the slowdown of GDP growth increasing tensions and more frequent, numerous and radical mass demonstrations are probable in the future (Csanádi et al. 2009:819).

A further objective of the 13th Five-Year Plan is an increase in productivity of 6.5 per cent on average per year, and this is also a key element of the shift in the growth trajectory. A new element compared to the previous five-year plan is that target figures and indicators were set for internet density, environmental protection, education and social issues (UCBC 2015).

12 No English translation can be found on the internet. Among Chinese sources, the following one contains one of the broadest presentations: National People’s Congress of China (2016).
The targets for manufacturing in the 13th Five-Year Plan are included in the “Made in China 2025” document, which was approved in July 2015. This paper can be qualified as a comprehensive industry modernisation strategy governed by the state and implemented under state supervision that constitutes the continuation of the official document entitled “Strategic Emerging Industries” released in 2010. Both studies incorporated relevant international experiences and analogies. Two OECD studies were published to provide inputs for elaborating the 13th Five-Year Plan (OECD 2015a; OECD 2015b). The first study focuses on economic policy, while the other focuses on the priorities of inclusive economic growth. The former contains 19 recommendations, the latter 21.

China’s five-year plans and industry modernisation strategies are not the same as the earlier “classical” centralised Soviet type socialist five-year plans with target figures expressed in quantities (tonnes, etc.) rather than in terms of money: the current five-year plans are strategic plans managed and executed by the government. The similarity to the old plans is the top-down rather than the bottom-up approach. This can be explained by the size of the country, its historical heritage, the idiosyncrasies of its institutional system and the challenges facing economic policy, although there are still too many quantified targets that characterised classical Soviet type socialist central planning. The sophistication of the tools necessary for implementation is not proportionate to the over-dimensioned set of targets. This economic policy may be suitable for addressing a great number of macroeconomic challenges, under given circumstances to promote inventions aimed at achieving new research results embodied in patents, but it is insufficient to stimulate market-based innovations and their diffusion in the economy. The weakness of China’s industrial strategies is that they are short of consistent concepts for streamlining industry in general and manufacturing in particular, and for reducing surplus capacities in production and exports. The promotion of small and medium-sized enterprises receives minor attention.

The plans emphasise economic growth and ignore financial equilibrium or ascribe minor importance to it. There is a conflict between the two objectives; economic growth can easily lead to a deterioration in financial equilibrium, whereas the restoration of financial equilibrium may curb GDP growth. Of course, the plans may implicitly, rather than explicitly, aim at economic growth while maintaining financial equilibrium. The plans include policies with various objectives, but fail to address functional cooperation between the different areas and institutions.

13 China State Council (2015) – The report was inspired by Germany’s Industry 4.0 plan, which was first discussed in 2011 and adopted in 2013. The German concept is centred on the development of intelligent manufacturing through the incorporation of information technology into production. This bolsters the integration of small and medium-sized enterprises into global production and innovation networks.

14 Due to its huge economic weight and the impact of its development trends on the global economy, international organisations continuously monitor China’s economy, and offer various recommendations to orient its economic policy.
Nevertheless, the Chinese leadership has not given up on the implementation of broader market reforms. The World Bank’s 2015 annual update on China identified 27 reform measures approved in 2014 and 2015 (World Bank 2015:20). A specific approach qualified as authoritarian adaptation involving the reform of specific policies is one of the reasons behind the success of China’s economic governance that substituted fundamental institutional changes (Youwei 2015:2). According to this concept, the reform of policies has reached the limits of its opportunities, as there is no more room for authoritarian adaptation in the current framework. The following section argues that this is not necessarily true.

The interest demonstrated by international organisations in China is understandable, because due to its size, the development trends in the Chinese economy have a fundamental impact on the global economy. The rest of the world is interested in China’s smooth shift of growth trajectory. One common feature of the reports published by international organisations is the technocratic approach to economic and social issues based on dominant mainstream economic theories, principles and conclusions that can be applied in mature market economies. The recommendations either completely ignore the social and political implications and consequences, and the limits of implementation, or do not discuss them deeply enough.

The recommendations of international organisations do not take into consideration the limits of economic policy, i.e. the fact that the government is unable to exert influence on certain segments of the economy and has indirect impact on most fields. Although the recommendations are structured according to various criteria such as changing economic policies in a changing world, the creation of better framework conditions for an economy based on a stronger and better functioning market, or the transformation of the state to reform the changing economic model (OECD 2015b:7), but the measures targeting the transformation of individual features of the system i.e. the adjustment of the rules and measures (in terms of quantitates and proportions) are not or not always separated conceptually from the essential and qualitative revision of the individual elements as well as the whole structure of the current system’s logic.15 It is small comfort that the two factors cannot always be distinguished clearly in practice. Finally, the dilemma cannot be ignored that reforms often cause economic downturn or deceleration of GDP growth in the short run, and thereby exacerbate the middle income trap. As a consequence of this, analysts not belonging to international organisations have questioned whether China is capable of avoiding the middle income trap. In the section below some of the main challenges facing the Chinese economy and the responses of economic policy are discussed.

15 Lajos Bokros refers to the former as parametric reforms and to the latter as paradigmatic reforms.
In an effort to *slacken or stop the ageing of the population*, the Chinese government has eased its one-child family model introduced in 1979. Nevertheless, this measure will lead to an increase in labour supply over the long run, in a period when China’s GDP is likely to grow at a slower rate than in the previous years. The further easing of the *hukou registration system*\(^\text{16}\) or even its abolition as a more radical move, which would constitute an essential reform measure, would improve the lives of 270 million people (migrant workers) and is essential for promoting urbanisation. The hukou system impedes the flow of labour force from villages to cities by prohibiting access to public services in cities for migrants, and providing free education for their children and free medical care in their villages. According to plans, easing of the hukou system would result in the improvement of the status of 45 per cent of migrant workers by the year 2020. This would also have a positive impact on entrepreneurial and, in the broader sense, innovation activity. It is an empirical fact that in the 1980s, most innovative market experiments were initiated in provincial areas rather than in coastal cities. With the gradual easing of the hukou system, a large number of people open to enterprise, business start-ups and innovation in the broad sense would flow from agriculture into less crowded, medium or smaller-sized cities by Chinese standards that offer better chances of making a living compared to large metropolises such as Beijing or Shanghai (Ma 2016). The example of South Korea can be cited as an analogy, where agricultural reform accomplished in the 1960s produced similar positive results. The reform of the hukou system is necessary that its stakeholders of uncertain status (referred to as internal migrants) are sources of permanent social tensions due in part to the system’s features and in part due to the temporary or long-term unemployment they face.

However, the transformation of the system and allowing access to social security services irrespective of geographic location assumes radical structural reforms, including that of the state pension system, and the extension of the public education and healthcare system that is free of charge or at least financially accessible to citizens. Besides reinforcing social stability, this would alleviate households’ saving compulsion, thereby indirectly encouraging private consumption (also supported by rising wages), and in a broader sense, the shift in growth trajectory.

There is also an *external constraint* to the reduction in savings, *independent of Chinese economic policy*: the differences in the current account balances of the various regions and countries of the world, in other words the fact that the current account balances of certain regions or countries exhibit significant surpluses, whereas others run huge deficits. The Chinese surplus, which corresponds to the investment of domestic savings abroad can be reduced without any negative domestic economic consequences (such as a recession) if the rest of the world decreases its deficit. Although global imbalances have eased in recent years, they

\(^{16}\) For a more in-depth analysis, see: Székely-Doby (2014) and Jordán (1998).
have not declined to an extent that would allow a substantial decrease in China’s current account surplus and thus its saving rate.

The question is how quickly will the social norms of consumption change in China, how much influence does the government have over this and whether the shift to the new growth trajectory could take place without a major economic downturn. The share of household debt in GDP has risen in recent years. If a part of the debt increment ended up in consumption loans, it may imply that households partially financed their consumption or its growth increment by credit.

Cutting agricultural subsidies in an effort to abandon the concept of agricultural self-sufficiency and the *liberalisation* of agricultural prices, possibly supplemented with a reduction in the barriers to imports would bolster the flow of labour force from agriculture to cities and into the service sector. Simultaneously, the streamlining of industry is also rendering a large quantity of labour unnecessary, and a solution must be found to employ this labour.\(^\text{17}\)

Chinese economic policy tends to restrain the reduction of excess capacities in construction, industry in general and the production of construction materials in particular as well as in exports by *external economic policy measures*. The “One Belt, One Road” international infrastructure development programme aims not only at decreasing the sales costs of Chinese goods (mainly manufactured ones) in international markets, thereby improving their international competitiveness: an additional objective is to generate business for surplus capacities in construction and the building material industry and to promote the exports of traditional Chinese light industry goods. The cost calculations forming the basis of the project are not known. It can be assumed that external expansion is less costly than capacity reduction if externalities are also taken into account, and it does not create social tension such as mass redundancies. Several elements of China’s external economic policy have been applied to enable the utilisation of excess construction and industrial capacities and the exports of manufactured goods. They include the official foreign lending policy, which reflects rational economic priorities compared to the earlier political preferences. The creation of the Asian Infrastructure Investment Bank has made it possible to raise external financial sources to fund international infrastructure projects carried out with the participation of Chinese companies.

*Progress in urbanisation* also means that urban housing and transport infrastructure must be created for 20 million people every year. This may hold back the streamlining of construction that has been inflated in the period of dynamic GDP growth. Transformation of the sector’s structure is also necessary, with greater

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17 Industry executives plan to lay off 1.8 million people in the steel industry and coal mining (Wong 2016).
emphasis on home construction. Progress in urbanisation thus creates tensions in other areas and restrains the transformation of the macroeconomic structure. It is also unclear whether the labour force flowing into urbanised districts can be employed, and if so, how efficiently in areas particularly essential for the shift in growth trajectory. Moreover, it is uncertain whether this labour force has the necessary qualifications to be employed in the new environment.

The funding needed for the structural reforms promoting the shift in growth trajectory (state pension and healthcare, education, etc.) also lays burden on general government expenditures. Although there is some room for increase of the redistribution ratio (general government expenditures officially accounted for 25 per cent of GDP in 2010 and 28 per cent in 2016), the question is to what extent the government is able and willing to lift revenues, and which level of deficit and gross government debt increase it is willing to tolerate (the former was officially 3 per cent of GDP in 2016). China’s general government statistics differ from international standards, and there are many items that do not appear in the budget, particularly those belonging to local governments. According to the IMF, if extra-budgetary items were included, the general government deficit would amount to 10 per cent of GDP since 2009, and government debt to 60 per cent (IMF 2016a:22–23). In light of these figures, the fiscal room of manoeuvre is far tighter.

In principle, the financial sources necessary to fund the shift in growth trajectory can be generated by transforming the structure of general government expenditures. In the competition for budgetary funding, large infrastructure projects are likely to be held back; in addition, some of them served prestige purposes in the past, rather than purely economic ones. The return on several infrastructure projects over their entire lifespan is questionable. Reducing the indebtedness of local governments may also create additional funding potential.

As far as extra-budgetary funding is concerned, the Chinese government intends to involve more private capital in the form of public-private partnership (PPP) schemes to implement economically well-founded infrastructure projects. The social security fund may be allowed and encouraged to purchase municipal government bonds. The sovereign wealth fund of the government managing assets valued at USD 600 billion, is also a potential source of financing. Greater reliance on FDI in relation to the streamlining, overhaul and technological and structural modernisation of manufacturing is also an option, but has been largely ignored or neglected in official documents.

Increasing military expenditures, which currently total 2 per cent of GDP, may decelerate the reduction of industry and – to a smaller extent – construction, particularly if the lion’s share of these expenditures are used for the procurement of technology-intensive weapons and other military equipment from domestic sources,
and may stimulate technological development, if modern weapons and weapon systems are developed. It can be assumed that such economic considerations may also be among the motives for increasing China’s military capabilities in addition to international political ambitions.

In the unique model of the Chinese market economy, market mechanisms do not always fully prevail. This is indicated by the fact that there are many state-owned banks and state-owned enterprises with great national economic significance by international standards. Over the past three decades, with the rise of the private sector, privatisation, bankruptcies and streamlining of state-owned enterprises, the weight of fully or partly state-owned companies has decreased and at present they account for just 5 per cent of all firms, but 17 per cent of employees in cities, 22 per cent of industry revenues, 38 per cent of industry assets, as well as an elevated share of equity market capitalisation. Excess capacities are mainly concentrated in heavy industry (coal mining, steel, shipbuilding, heavy machinery) where most state-owned enterprises are making losses.

According to the official view, state-owned enterprises are exposed to internal and external competition as a result of the reforms accomplished in the past decades, and operate under strict market conditions. By contrast, independent analysts and the executives of foreign-owned companies believe that Chinese state-owned enterprises receive various preferences and privileges (monopoly positions, direct subsidies, preferential financing, exemption from competition rules, preferential treatment in public procurement, exclusive market access, etc.). The preferential treatment of state-owned enterprises creates competitive disadvantages for private companies, distorts competition in the market and stifles innovation.

The debt of the corporate sector relative to GDP was 97 per cent in 2011 and 170 per cent in 2015. The bulk of this was accumulated by state-owned enterprises with a high proportion of non-performing, i.e. bad debt. Extensive government lending aimed at alleviating the impact of the latest global financial and economic crisis played a pivotal role in the accumulation of debt and continued after the crisis. The possibility of bailouts by the government fuels free-rider behaviour and moral hazards, representing substantial obstacles to the shift in growth trajectory.

 Radical reform in terms of enforcing state-owned enterprises to operate under market conditions and on a market basis is impeded by the fear of mass bankruptcies and the consequences thereof (reduced output, layoffs); consequently such reform is unlikely to occur. However, maintaining the current status quo

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18 Csanádi et al. (2009) discuss the transformation dilemma in detail.
19 Capitalisation: the number of shares multiplied by their market price.
20 In the context of market reforms, some 40 million people were laid off from state-owned enterprises in the 1990s (Pelkmans et al. 2016:46).
carries the risk of further indebtedness and is unsustainable over the long run. With the recent consolidation of large state-owned enterprises, justified by the savings generated by economies-of-scale effects and the elimination of competition between state-owned enterprise groups, the situation has worsened, rather than improved. Privatisation is not on the agenda, mainly for ideological reasons, and mixed ownership, i.e. minority private ownership does not resolve efficiency or other problems. Corruption permeates the sector. Reform initiatives would soon come up against the resistance of stakeholders of the state-owned enterprise sector.

One of the major challenges to Chinese economic policy in the shift in growth trajectory is how to increase the significance of research, development and innovation, which is essential for moving up in the global value chain. The Chinese innovation system is geographically concentrated in a few metropolises resulting in large gaps among regions. One unique contradiction is that – although research in general and invention in particular aiming at achieving new scientific results can be stimulated significantly by the tools and institutions of strategic planning (by ensuring adequate financial, human and other resources, etc.) – the Chinese economy performs better in the field of development. In its own right, the increase in R&D expenditures does not necessarily contribute to GDP growth. Successful innovations require an economic environment where economic participants can operate and assume risks building from bottom to top, independently of administrative constraints, flexibly and with free mutual communication in terms of exchanging and developing ideas. An essential element of this environment is the institutionalisation of the protection of intellectual property from competitors, which is an important precondition for achieving returns on research and development. Both the institutionalisation of the protection of intellectual property and the enforcement of the relevant legal rules remains highly underdeveloped in China. Other impeding factors are the preference of excessive data protection, which limits communication both within and between organisations (Pencea – Bâlgăr 2016:45–46).

There may be significant reserves in the field of promoting entrepreneurship based on a bottom-up approach, which is a broader area than R&D&I. The time required to set up a business increased from 20.9 days in 2010 to 34.1 days in 2013, and 28.9 days in 2016, according to the Doing Business database of the World Bank, and these are extremely high levels relative to advanced economies.

The shift in growth trajectory is also hindered by high indebtedness, which is a legacy of the fiscal and credit expansion to offset the recession in 2008. China’s total outstanding debt (corporate sector, households and public sector) has quadrupled since 2007 and is currently estimated at 280 per cent of GDP, exceeding the corresponding figures of both Germany and the US. Total outstanding debt is unsustainable, but there is no apparent solution on how to reduce it without
severe negative side effects. The issue is exacerbated by what is referred to as the shadow banking system. This consists of non-bank financial intermediaries that sell financial products directly to market participants. Due to the lack of competencies, supervisory authorities do not reach them although this would be necessary, since they sell many risky products and are closely intertwined with the official banking system. The shadow banking system is estimated to amount to 80 per cent of GDP, significantly inflating the credit market bubble that may be the leading risk factor for the Chinese economy (Moody’s 2016).

In the decades that followed 1978, the development of the financial sector failed to keep pace with the buoyant growth of the real economy either in horizontal or in vertical terms, and the financial intermediation system still reflects the realities and requirements of the investment-oriented growth model. In the absence of other possibilities, households were allowed to and could invest their savings in financial instruments with low yields. For a long time, bank deposits were the only investment opportunity. Interest rate were kept artificially low by administrative measures as well. This scheme also contributed significantly to channelling economic and social resources into investments.

The Chinese system of financial intermediation is still underdeveloped compared to the needs of the real economic sector and households. For lack of more sophisticated domestic investment opportunities (e.g. the market for government securities issued by the central government is barely larger than the UK market, despite the substantial difference in the size of the two countries’ GDP), and limited possibilities of purchasing foreign financial instruments, the lion’s share of household savings was invested in riskier instruments such as real estate and shares, resulting in the overvaluation of both sectors. This applies less to the housing market than to shares, because this market also involves actual physical demand in addition to speculative demand, in part due to demographic reasons. The macroeconomic significance of the housing market is associated with the fact that a large portion of loans are backed by real estate collateral, and therefore it plays a more significant role in economic growth. The size of the Chinese stock market (a large part of which consists of state-owned enterprises or companies with state involvement) is equal to that of Switzerland. The stock market rally was propelled by speculation. Contrary to the concerns of many Western experts, the low capitalisation by international standards (amounting to one third of GDP compared to 100 per cent in advanced market economies) and the burst of the stock market bubble will probably not jeopardise financial stability and the real economy. Nevertheless, Chinese authorities rushed to mitigate the impact of the bursting stock market bubble in July and August 2015 (for fear of potential negative political consequences) by applying non-market conform administrative measures.
(banning the short-selling of securities, massive stock purchases in large part from public funds in order to curb price falls, etc.).

With the help of the exchange rate regime, the Chinese government has kept the yuan undervalued vis-à-vis the US dollar and in certain periods, against a currency basket for a long time. Although in 2015 measures were taken to reinforce market elements in the Chinese exchange rate regime, including those recommended by the IMF, and to upgrade the international role of the Chinese currency, liberalisation of the exchange rate regime has yet to be accomplished. Appreciation of the yuan would be consistent with the requirements of the new growth trajectory, which could also contribute to the more effective allocation of resources in line with the reform of the Chinese financial intermediation system and would promote upward movement on the technological pyramid and in the global value chains. Nevertheless, under the current circumstances and for reasons that cannot be discussed in depth here, liberalisation of the exchange rate regime would lead to a depreciation of the yuan; and this is not in the interest of any other country and could lead to an extreme scenario of competitive devaluations.

According to relevant forecasts, despite the slowdown in GDP growth, China appears to be able to avoid the middle income trap successfully in both absolute and relative terms. Obviously, a recession cannot be ruled out with full certainty, but the likelihood of this is currently negligible, and relevant medium-term forecasts do not expect this scenario. Instead, the main risk factor is that the slowdown in economic growth will be stronger than expected, not least due to the bursting of the credit market bubble. According to the baseline scenario presented in the medium-term forecast of the World Bank, China’s average annual GDP growth rate is likely to amount to 7 per cent between 2015 and 2020, 6 per cent between 2020 and 2025 and 4.9 per cent between 2025 and 2030 (World Bank 2015:22). Although not the highest, these figures will most likely exceed the projected growth rate of the global economy and will be far higher than the growth rates of the developed countries. As a result, China will continue catching up to the advanced economies, albeit at a slower rate than between 1978 and 2011, and reaching the volume of US GDP seems to be a realistic possibility after 2030.

In the reform scenario of the World Bank, China’s average annual GDP growth rate in the aforementioned periods is projected to be 0.1-0.2 percentage points higher compared to the baseline one (World Bank 2015:22). Over a longer horizon, this is a significant improvement. The impact of reforms is pointed out in the improvement of total factor productivity, the annual average rate of growth of which is forecast to be 0.3-0.4 percentage points higher than in the baseline scenario and will more than offset the decline in the contribution of capital to economic growth (labour as a source of growth is the same in both scenarios, i.e. the factors feeding the increase and decrease in labour supply will probably extinguish each other in the forecasting
horizon). Therefore, according to the forecasts, the contribution of market reforms – often a fetish in the Western literature on China – to the acceleration of GDP growth is expected to be rather modest. The real significance of the reforms is that they support the shift in growth trajectory and the transition to a more effective growth path of better quality by improving total factor productivity.

The shift in China’s growth trajectory is a highly complex process with contradictions whose quantification by economic models is difficult. First, in most cases, economic policy decisions affecting certain fields also have an impact on other ones in terms of unintended side effects. Second, economic policy measures may also influence each other and could be closely correlated, resulting in what is referred to as multicollinearity. As a result, certain measures may not only accelerate, but also weaken the pace of the shift in growth trajectory. Finally, subsequent economic policy decisions that are not currently known may alter not only the pace but also the direction of the shift in growth trajectory. Forecasters treat this issue by incorporating into their projection only known and planned measures which are likely to be implemented. Using the concepts of technical sciences, China’s shift in growth trajectory forms a nonlinear system that cannot be quantified by economic concepts and tools, or can only be done so with great uncertainty. This is one of the reasons for the qualitative nature of this analysis.

5. Summary and conclusions

In the four years after 2007, which more or less coincided with the global financial and economic crisis, *inter alia* under the influence of the changed global economic environment, the traditional sources and driving forces of the extensive economic growth trajectory based on the expansion of investments, industry and construction output and manufactured exports were exhausted in China. This manifested itself in the deceleration of the rate of GDP growth. The period between 2010 and 2016 saw a shift to a *knowledge, research and technology-intensive growth trajectory* based on the increase of private domestic consumption and services, research and development and innovation, and the development and spread of higher value added industries in manufacturing and the upward move in global value chains. The process is still at the beginning and will last over a longer period, and its end-results are not guaranteed.

The shift in growth trajectory started *partly spontaneously*, relying on the autonomous development of the economy, sometimes following the path of least resistance, *and partly under the impact of economic policy and socio-economic reform measures*. The conceptual basis of the economic policy and economic reforms were based on the 12th and the 13th Five-Year Plan and the related strategic documents as well as the analyses published by the World Bank, the IMF.
and the OECD. The reports of the international organisations are associated with the concerns of the leaders of advanced economies, the risks and uncertainties regarding the global consequences of a shift in China’s growth trajectory. The overhaul and restructuring of economic policy objectives and the identification of new ones consistent with the requirements of the shift in growth trajectory are included in the Chinese strategic planning documents prepared in a top-to-bottom approach. The requirements and the recommendations for their implementation elaborated in a bottom-up approach were presented in the reports of international organisations. Despite the experiences accumulated in a small number of successful countries, there is no recipe for implementing a shift in growth trajectory. Due to the specific features of the Chinese economy, international experiences can only be applied carefully and with reservations. Top-to-bottom economic governance includes the risk of excessive centralisation and may hold back the bottom-up growth energies and initiatives of economic participants.

In promoting the shift in growth trajectory, economic policy faces conflicting objectives, contradictions and internal and external limiting factors. It needs to meet a great number of contradicting requirements and find a satisfactory balance among them. They include the most essential conflicting objective of choosing between economic rationality and socio-political stability, in other words, economic rationality can be enforced at the expense of socio-political stability and vice versa. Reducing the share of industry in GDP through rationalisation, improving productivity, restraining investments, abolishing the prohibitions imposed on village populations concerning the choice of residence, the liberalisation of agricultural prices and the stimulation of urbanisation in an effort to shore up the service sector, curbing the ageing of the population, and exposing state-owned enterprises to genuine external and internal competition certainly lead to mass bankruptcies of firms and the rise of excessive labour supply and unemployment in the short run, with the result of weakening social and political stability. Fears of these factors and the mitigation of the associated risks by softening reforms is likely to decelerate the pace of the shift in China’s growth trajectory.

The major constraint to promoting research, development and innovation is the economic policy based on top-to-bottom planning and strong direct interventions by the government. There is presumably room for decentralised, bottom-up incentives, but only to a limited extent. Without this, it is improbable that a greater liberalisation of the economy would automatically stimulate innovation. The situation is different in the promotion of entrepreneurship, where cutting red tape and introducing positive incentives could release substantial social energies.

The shift to a growth trajectory based on rising consumption is conditional on the reduction of household savings. Attempts to establish a welfare state (health, unemployment and pension insurance, free education) similar to the Western
European model based on public funding serve this objective. However, the reduction of private savings is restricted on the one hand by global factors, i.e. the huge differences between the current account balances of various countries and regions. Moreover, the saving and consumption habits of households also change at a slow pace, and government intervention does not promise rapid change in the realm of consumption growth.

China’s economic policy also attempted to mitigate the conflicting objectives associated with the shift in growth trajectory by shifting certain emphases. It has used external economic policy to ease the shift in growth trajectory. With huge investments in infrastructure in a great number of beneficiary countries, the “One Belt, One Road” international project enables the utilisation of excess capacities in Chinese construction, reduces the sales costs of Chinese exports and thereby promotes the exports of both traditional and new Chinese manufactured goods. Similar functions are attached to China’s official aid policy. The development of the military industry may also decelerate the contraction of industry and under certain circumstances contribute to its technological and structural modernisation.

Another challenge is how to raise the financial resources necessary for the shift in growth trajectory. Regarding the actual size and the balance of the general government, the financial room for manoeuvre is limited, particularly compared to the tasks at hand. Financing constraints could be alleviated by restricting the excessive borrowing of local governments, the more wide-spread use of PPP schemes, stronger reliance on the sovereign wealth fund and FDI.

Since the opening to the global economy that started in 1978, the reform of economic governance has been permanent in China. However, the reform process has not been linear or free of readjustments of smaller or greater size. It has been characterised by gradualism, rather than quick and radical changes. This has received relatively little attention in the relevant international literature because mainstream economic experts appreciate only the economic policy and other measures that bring China closer to the Western type model through reforms, whereas the shift in growth trajectory may also be stimulated by other types of tools, other ways and means. Although fundamental institutional changes are needed, there are still reserves in the realm of policy reforms.

According to medium and long-term forecasts, China may be able to avoid the middle income trap in both absolute and relative terms, in other words, it may continue its catching up with developed economies, albeit at a slower pace than between 1978 and 2011. The process will involve significant negative risks and uncertainties. The main instrument of the transition to a new, higher-quality growth trajectory includes the more efficient utilisation of the available resources, which will stem from the improvement of total factor productivity. Market reforms will
play a minor role in economic governance compared to other measures such as the overhaul and the restructuring of economic policy objectives and the tools and institutions.

The greatest challenge facing Chinese economic governance is that the shift to the new growth trajectory should be managed in a specific way. Since economic growth is a key legitimising factor of the political system, the shift to the new growth trajectory should lead to the smallest possible deceleration in the rate of GDP growth in order to avoid the disruption of social equilibria. This depends on global trends as well. Due to China’s position in the global economy and its impact on global economic trends, every country open to the global economy is interested in China’s relatively smooth transition to the new growth trajectory, and supporting the process — with criticism, if necessary — is a global interest.

Annex

<table>
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<tr>
<th>Table 1</th>
<th>Figures on China’s economy</th>
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<tbody>
<tr>
<td>GDP volume at constant prices (USD trillion)</td>
<td>6.06</td>
</tr>
<tr>
<td>Population (billion persons)</td>
<td>1.34</td>
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<tr>
<td>Urban population as a per cent of total population</td>
<td>49.2</td>
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<tr>
<td>GDP per capita at constant prices (USD)</td>
<td>4,523</td>
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<tr>
<td>Percentage change of GDP at constant prices over the previous year</td>
<td>10.6</td>
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<tr>
<td>Sectoral breakdown of GDP (total = 100%)</td>
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<tr>
<td>Agriculture (%)</td>
<td>9.6</td>
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<tr>
<td>Industry (%)</td>
<td>46.2</td>
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<tr>
<td>Services (%)</td>
<td>44.2</td>
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<tr>
<td>Volume of exports of goods and services (% of GDP)</td>
<td>26.5</td>
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<tr>
<td>Volume of imports of goods and services (% of GDP)</td>
<td>22.9</td>
</tr>
<tr>
<td>Balance of exports and imports (% of GDP)</td>
<td>3.6</td>
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<tr>
<td>Foreign trade balance (% of GDP)</td>
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<td>Investments (% of GDP)</td>
<td>47.3</td>
</tr>
<tr>
<td>Gross savings (% of GDP)</td>
<td>51.8</td>
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<tr>
<td>Difference between gross savings and investments (% of GDP)</td>
<td>4.5</td>
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<tr>
<td>Percentage change in the volume of exports of goods and services (annual)</td>
<td>26.6</td>
</tr>
<tr>
<td>High-tech goods in per cent of manufacturing exports</td>
<td>27.5</td>
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### Table 1: Figures on China’s economy

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<tr>
<td>Percentage change in the volume of imports of goods and services (annual)</td>
<td>19.9</td>
<td>17.7</td>
<td>6.6</td>
<td>10.6</td>
<td>8.7</td>
<td>0.6</td>
<td>3.9</td>
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<tr>
<td>R&amp;D expenditures (% of GDP)</td>
<td>1.7</td>
<td>1.8</td>
<td>1.9</td>
<td>2.0</td>
<td>2.0</td>
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<tr>
<td>Gross enrolment rate in higher education (%)</td>
<td>23.9</td>
<td>24.9</td>
<td>27.2</td>
<td>30.2</td>
<td>39.4</td>
<td>16.7</td>
<td>14.0</td>
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<td>Percentage change in nominal wages over the preceding year</td>
<td>16.7</td>
<td>14.0</td>
<td>12.9</td>
<td>10.0</td>
<td>9.9</td>
<td>9.0</td>
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<tr>
<td>Monthly minimum wage (CNY)</td>
<td>1,120</td>
<td>1,280</td>
<td>1,450</td>
<td>1,620</td>
<td>1,820</td>
<td>2,020</td>
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<tr>
<td>Household disposable income (% of GDP)</td>
<td>58.3</td>
<td>59.4</td>
<td>60.0</td>
<td>60.7</td>
<td>62.2</td>
<td>63.2</td>
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<td>Household savings in per cent of disposable income</td>
<td>41.0</td>
<td>40.8</td>
<td>38.5</td>
<td>37.9</td>
<td>37.4</td>
<td>36.9</td>
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<tr>
<td>Household debt (% of GDP)</td>
<td>27.8</td>
<td>29.6</td>
<td>33.0</td>
<td>35.3</td>
<td>38.4</td>
<td>41.8</td>
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<tr>
<td>Domestic debt of non-financial enterprises (% of GDP)</td>
<td>97.0</td>
<td>104.7</td>
<td>108.9</td>
<td>112.8</td>
<td>120.0</td>
<td>127.4</td>
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<td>Time requirement for starting a business (days)</td>
<td>20.9</td>
<td>20.9</td>
<td>20.9</td>
<td>18.2</td>
<td>34.4</td>
<td>31.1</td>
<td>28.9</td>
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<td>Total domestic loans of the financial sector (% of GDP)</td>
<td>143.6</td>
<td>142.1</td>
<td>150.8</td>
<td>157.6</td>
<td>169.4</td>
<td>169.6</td>
<td></td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>4.1</td>
<td>4.1</td>
<td>4.1</td>
<td>4.1</td>
<td>4.1</td>
<td>4.1</td>
<td>4.1</td>
</tr>
<tr>
<td>Percentage change of the consumer price index (annual)</td>
<td>3.3</td>
<td>5.4</td>
<td>2.6</td>
<td>2.6</td>
<td>2.0</td>
<td>1.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Percentage change in housing prices over the preceding year (nominal)</td>
<td>5.7</td>
<td>8.7</td>
<td>7.7</td>
<td>1.4</td>
<td>9.1</td>
<td>8.9</td>
<td></td>
</tr>
<tr>
<td>General government (% of GDP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenues</td>
<td>24.6</td>
<td>26.9</td>
<td>27.7</td>
<td>27.7</td>
<td>28.0</td>
<td>28.6</td>
<td>27.7</td>
</tr>
<tr>
<td>Expenditures</td>
<td>24.0</td>
<td>27.0</td>
<td>28.4</td>
<td>28.5</td>
<td>28.9</td>
<td>31.3</td>
<td>30.7</td>
</tr>
<tr>
<td>Balance</td>
<td>0.6</td>
<td>−0.1</td>
<td>−0.7</td>
<td>−0.8</td>
<td>−0.9</td>
<td>−2.7</td>
<td>−3.0</td>
</tr>
<tr>
<td>Gross government debt (% of GDP)</td>
<td>33.1</td>
<td>33.1</td>
<td>34.0</td>
<td>36.9</td>
<td>39.8</td>
<td>42.9</td>
<td>46.3</td>
</tr>
<tr>
<td>Private healthcare expenditures (% of GDP)</td>
<td>2.2</td>
<td>2.2</td>
<td>2.3</td>
<td>2.4</td>
<td>2.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public healthcare expenditures (% of GDP)</td>
<td>2.7</td>
<td>2.8</td>
<td>2.9</td>
<td>3.0</td>
<td>3.1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current account balance (USD billion)</td>
<td>237.8</td>
<td>136.1</td>
<td>215.3</td>
<td>148.2</td>
<td>277.4</td>
<td>330.6</td>
<td>270.8</td>
</tr>
<tr>
<td>Current account deficit (% of GDP)</td>
<td>3.9</td>
<td>1.8</td>
<td>2.5</td>
<td>1.5</td>
<td>2.6</td>
<td>3.0</td>
<td>2.4</td>
</tr>
<tr>
<td>Military expenditures (% of GDP)</td>
<td>1.9</td>
<td>1.8</td>
<td>1.9</td>
<td>1.9</td>
<td>1.9</td>
<td>2.0</td>
<td></td>
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<tr>
<td>Net FDI inflow (USD billion)</td>
<td>243.7</td>
<td>280.1</td>
<td>241.2</td>
<td>291.0</td>
<td>268.1</td>
<td>249.9</td>
<td></td>
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<tr>
<td>Net FDI inflow (% of GDP)</td>
<td>4.0</td>
<td>3.7</td>
<td>2.9</td>
<td>3.1</td>
<td>2.6</td>
<td>2.3</td>
<td></td>
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<tr>
<td>Net official development grant and aid (USD billion)</td>
<td>645</td>
<td>−608</td>
<td>−193</td>
<td>−672</td>
<td>−960</td>
<td></td>
<td></td>
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<tr>
<td>Gross official foreign currency reserve (USD billion)</td>
<td>3,256</td>
<td>3,388</td>
<td>3,880</td>
<td>3,899</td>
<td>3,406</td>
<td>3,181</td>
<td></td>
</tr>
</tbody>
</table>

*The figures for 2016 are the preliminary data of the IMF.
http://www.tradingeconomics.com/china/minimum-wages
Downloaded: 20 November 2016
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Wildau, G. (2015): Scepticism about the accuracy of the country’s official data has intensified as investors worry that economic slowdown is worse than Beijing admits. But what if the underlying figures are reliable? Financial Times, September 29: p. 8.


