



## REPORT ON WILTON PARK CONFERENCE 881

### CHINA'S RAPID ECONOMIC GROWTH: INTERNAL IMPACT, EXTERNAL IMPLICATIONS

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#### Summary

Since the initiation of the current economic reform programme in 1978, China has achieved tremendous sustained economic growth, fuelled mainly by low-cost manufacturing exports and huge consumption of resources and energy. While improving living standards for a large swathe of the Chinese population, this economic leap has also been accompanied by widening income disparities, rising social conflict, environmental degradation, a huge surplus in international trade and high upward pressure on the exchange rate. Moreover, political reforms have lagged behind economic progress. Although a major force in the world economy, China maintains a low profile in many international issues. The country is still on a learning curve with regard to its role in the international community, and cooperation with other countries in the World Trade Organisation (WTO) and on environmental issues. The Wilton Park conference reviewed recent economic growth in China, together with its impacts, risks, challenges and trade-offs as well as examining policy options for China's future development in a global environment.

#### Background

1. The People's Republic of China, established in 1949, was a poor agricultural country which developed a command economy closed to the rest of the world. Since 1978, China has been in transition from the planned economy to a market one, from a closed economy to an open one. Drastic changes have occurred. In particular, extraordinary economic growth, at an average annual 9.7% GDP increase between 1978 and 2006, has lifted millions of Chinese out of poverty. China is set to overtake Germany as the world's third largest economy. Cheap labour, a vast growing domestic market, and large foreign direct investment (FDI) inflows have contributed to the country's global competitiveness.

2. China is experiencing both rapid industrialisation and urbanisation. Industrial output has increased at a double-digit rate in recent years; industrial gross value added (GVA) accounted for 43.1% of the country's overall GVA. There are now over 150 million internal migrants, constituting the largest migration wave in human history. Most of these migrants moved from rural to urban areas.

3. Significant income disparities exist between the relatively affluent east coast and the less-developed interior regions, and between urban and rural areas. East China accommodates 35% of the country's 1.3 billion population, but produces over 57% of the country's GDP. Per capita income in urban areas is three times that in the countryside.

### **The 17<sup>th</sup> Party Congress**

4. The 17<sup>th</sup> Party Congress in October 2007 continued to uphold the banner of 'socialism with Chinese characteristics'. The policy of 'reform and opening-up' was reaffirmed. The theory of 'scientific development' was written into the Communist Party of China (CPC) constitution, advocating sustainable economic growth. The CPC also committed itself to improving people's livelihoods and ensuring economic rewards were shared by all. The Congress called for the construction of 'a harmonious society', balancing rural and urban development, human and natural resources, domestic and international issues, and resources for current and future generations.

5. Economic growth has spread from the east coast to the interior regions. For example, Inner Mongolia has experienced the highest GDP growth rate in recent years. However, the Party recognised that economic growth had been driven by investment and exports rather than consumption; by the industrial sector rather than the service sector, and by massive use of resources and energy. Such a development strategy was not sustainable.

6. The Congress called for an increase in domestic consumption that could be achieved through reforms of the public financial system and establishing a social security system. A move from a manufacturing and construction base towards a more service-oriented one in the next five years would be encouraged. This would emphasise strengthening skills and

education. In addition, greater emphasis would be placed on innovation and technology aimed at more efficient use of natural resources.

### **Economic perspective**

7. China has not developed a fully-fledged market economy, although market forces play a growing role. The product market has been developed to a great extent, whilst capital and labour markets are not completely liberalised. For example, money flows are influenced by both interest rates and state policies.

8. More Chinese companies have been listed in global financial markets. The four big state banks welcome international investment in their stocks. There is a financial boom in the Chinese capital market although some signs of slowing are apparent. High liquidity in the market gives rise to concerns of price and asset inflation.

9. There are close trade relationships between China and Africa, Middle East, the EU and USA. China imported more from the EU than from the USA in 2006, although it runs trade surpluses with both. In order to balance its surplus trade, China is keen to import advanced technologies from western countries, but protectionist tendencies in the West are growing. The trade surplus has resulted in an enormous foreign exchange reserve equivalent to US\$1.3 trillion, and a concomitant huge pressure for the Chinese currency renminbi (RMB) to appreciate. Such imbalance could be reduced by the cooling-down of the world economy in the short run and further reforms to China's financial system in the long run. The recent credit crunch in the USA may slow Chinese export growth and accordingly the more open Chinese financial sector needs to adjust.

10. Efforts by the Chinese government to reduce its trade surplus include reducing tax returns for exports, increasing wages and prices of land, and limiting steel exports. The RMB has appreciated, but not at the required higher rate which some believe to be around 20%. Experts in western countries urge further RMB appreciation. The conference favoured a gradual approach to avoid uncertainty associated with a sudden rise of the RMB, to lower Chinese foreign exchange reserves, to lessen damages to export-oriented investments and to keep inflation low in western countries. At the same time China needs to balance its internal and external economic commitments carefully in order to cope with inflation within

the country. The central bank had to increase reserves for savings rather than raising interest rates. International negotiation was called for in order to agree a level of RMB appreciation acceptable both to China and to the rest of the world.

11. Although some concerns were expressed, China's high savings rate is conducive to economic growth. Many people save for old age and children's education due to the lack of a well-functioning social safety net. The provision of better social benefits and services would encourage greater balance between savings and consumption.

### **Inequality and rural-urban divide**

12. Alarm was expressed at the scale of income inequality in China, which has become one of the most unequal societies in the world. The trickling down policy spreading wealth from east to west has not worked efficiently, and has resulted in widening regional income disparities in China. Such disparity might result in social disorder and hinder further economic growth.

13. Bridging the urban-rural divide is a key issue in China's modernisation efforts. The rural-urban income gap accounts for about 70% of overall inequalities. Administrative and legal distinctions exist between urban and rural areas, including governance, land management, residence registration (*hukou*) and provision of social benefits and care. Rural areas lag behind in terms of per capita income, social service provision and human capital indicators.

14. Education, particularly primary education, was thought to be vital for poverty reduction. In addition to free tuition and textbooks, free lunches can encourage parents to send their children to school. Despite measures such as the introduction of a rural healthcare cooperative insurance scheme, healthcare remained a challenge that would take a long time to address comprehensively. Additionally, the development of non-agricultural industries was crucial for improving peasants' incomes.

15. Labour flows from poor to rich regions should be promoted to improve efficiency. Municipal and other city authorities should be encouraged to provide social housing for migrants moving from the country; rather than staying in the villages migrants' children

should be educated in cities where the education system was almost universally better than in the country.

16. Other suggestions were made. For example, private banks should be allowed to provide capital for rural development in order to break the monopoly of state banks, and infrastructure should be developed to improve communication and transportation. Agricultural research centres located in villages would help to modernise working practices and improve productivity. A safety net should be provided to peasants in the countryside, which could start at a low level to cover pension and medical insurance. These benefits need to become sustainable. However, rural areas in China differed greatly, and should thus have the freedom to formulate appropriate policies at local level.

17. Some suggest the *hukou* system be abolished outright on the grounds that it prevented labour mobility, while others advocated reform of the system on a gradual basis. Many believe the *hukou* system *per se* would not be a problem, so long as public services and benefits in rural and urban areas were brought up to similar standards. Land management reform was much more complicated, and needed further consideration to ensure the protection of property rights as well as the more efficient use of land. There was a need for improved channels to allow political participation by rural residents.

18. There are positive signs that the government is taking measures to address the problems of urban-rural divide. But, even at best, inequalities will take a long time to resolve given the current target is only to stabilise the growth of the gap.

## **Governance**

19. The ruling party in China, the Chinese Communist Party (CCP), is the largest communist party in the world with 73.3 million members and 3.6 million grass root organisations. The party shares power with the state. The Party has grown to 'involve all social groups', incorporating workers, peasants, soldiers, government officials, professionals, and private entrepreneurs. There are signs of *de facto* political pluralism within its structures; intra-party democracy has been developed; and the party has adapted to the international environment. The people's congress system has been strengthened to some extent to develop people's democracy. What is lacking is the formalisation of political

pluralism. Currently, the multiple-party approach of western countries remains unacceptable to both the CCP and the state.

20. There has been progress in terms of institutionalising the promotion of 'outsider' leadership. Two non-party members were promoted to key positions in the central government. But the political system is not transparent, and the process of selecting top leaders, subject to both formal and informal rules, remains hidden from the outside world. The new generation of leadership nominated during the 17<sup>th</sup> Party Congress will mainly learn how to govern the country in the next five years and continue the policies of the older generation of leaders. The main concern of political leaders remains stability in China, together with the continued need for economic growth. Radical changes, if any, might only be seen after the next five years.

21. Chinese economic growth has been accompanied by notable abuses of political power. Different government departments use funding for their own benefit, such as building better offices and offering higher incomes to their staff. Corruption is rooted in the absence of law and the rule of law, and prevalence of ill-disciplined civil servants. Monitoring the governments' performance is difficult given the absence of a free judiciary and free press. The party needs to be subject to the law and to public scrutiny. Independent institutions were proposed to monitor the governments' performance, and citizens should be encouraged to comment on government policies and actions.

22. Some Chinese delegates argued that corruption was bound to the economic transition and caused by the governments' active role in economic activities. This was reflected by the governments' close relationship with enterprises in the market economy. Further economic reform would push the government to retreat from direct involvement in economic activities to service provision, such as managing the social welfare system. Corruption might be reduced at that stage.

23. Most local governments aim to maximise local economic growth. The current evaluation criterion of government officials' performance, relating it to GDP growth, meant that the more GDP generated, the better local officials' chances of promotion. Hence, preferential policies, such as free land and tax reduction, were adopted to attract capital. Authorities

reliance on capital for economic growth created a down side of increased scope for corruption and worker exploitation.

24. The GDP-first criterion also results in economic growth at the cost of environmental degradation. 'Green GDP' was suggested as an alternative measure of officials' performance. It was, however, difficult to measure.

25. Authorities reclaim land from residents at low costs to sell on to developers at a higher price. This leads to involuntary relocation and social unrest. It was more efficient to empower people so that they can have capacity to help themselves, instead of empowering the government to help people. People should participate in the decision-making process so that their ideas could be heard.

26. Economic development has led to a mixed economic structure with a booming private sector and this, in turn, generates growing demand for public participation. One manifestation of this is people's active participation in decision-making on local and national issues through the internet. Moreover, compared to the more old-fashioned rural election system in the country, 'owners' community' (*yezhu weiyuanhui*) plays a growing role in making people's voices heard in cities. Owners' communities fight for house owners' rights and seek participation in deciding local issues. This is a good model to develop.

### **Risks and uncertainty**

27. The economic boom since 1978 has been accompanied by a steep rise in social disorder. People with higher incomes know more about the world and the governance of other countries. Hence, they know what can be improved in China. The administrative failure to meet rising social expectations may lead to social unrest.

28. There is evidence of more active independent social groups, but so far no pluralism in the political system. The government has demonstrated little tolerance of civil society and NGOs. Disadvantaged groups have little means of participation in decision-making. The government and the party agree to be ruled by law in principle, whilst little progress has been made in practice. There is inconsistency between regulations and their

implementation. This dearth of institutional structures and pluralism could have serious political consequences.

29. Other risks include widening income disparities, corruption, an inadequate social welfare system, unemployment, moral deterioration, heavy costs of pollution, little improvement in efficient energy use, the impact of global credit crunch, and the Taiwan issue. The Chinese government has found it difficult to address challenges such as the safety net, environment, resources, production strategy, sustained economic growth and the political stability.

### **The Chinese model**

30. There is no Chinese model of development. China's development strategy is described as 'crossing the river by feeling the stones', which means that the government learns and adapts its strategy to changing circumstances. The Chinese government has adopted a pragmatic approach, doing what is feasible based on trial and error. If an experiment succeeds, the government justifies it. Otherwise, the government keeps quiet and turns over the page. It is not a suitable model for any other country because countries need to find their own development paths to suit individual needs.

31. Chinese leaders set a clear goal to achieve a modestly well-off society (*xiaokang shehui*) by 2020, to be followed roughly by almost every policy-maker in China. Stability is the priority of government policies, which promotes economic success but hinders political reforms. The government detects various problems arising during the development process and seeks to find solutions to the problems.

32. China's large population provides an abundant labour supply as well as pressure for poverty reduction. Its population has been controlled through the one child policy since 1978. It is estimated that 400 million births have not taken place as a result but Chinese birth control policies raise serious qualms in the West. However, the challenge of poverty reduction would be huge without such population control.

33. There are different development trajectories in different regions. The Pearl River Delta benefits from large investment from Hong Kong and Taiwan; FDI from a wide range of

sources fuel the Yangtze River Delta; the Bohai Gulf attracts investment and is developing logistics along the coast. Township and Village Enterprises (TVE) have fostered an economic boom in South Jiangsu, and the private sector contributes to rapid in Weizhou County. Yet China's development remains uneven across the country.

### **International role**

34. China's influence on international affairs is not yet commensurate with its rapid economic growth. China does not seek a high profile role in international issues, such as WTO and environment co-operation. China is learning how to cooperate with other countries and make its voice heard. Peace and development are regarded as its two main policy goals. Stability is crucial for the country's peaceful rise. China's development can only be achieved in a peaceful world, and in turn it is believed this will contribute to world peace.

35. As an economic power, China is expected by other countries to be a more responsible international stakeholder. But this ran counter to Chinese foreign policy based on the principle of non-interference in other countries' domestic issues. Nevertheless, China was accused of being too assertive in the WTO and its growing role in Africa.

### **China in Africa**

36. China is relatively poor in resources such as copper and iron ore. This gives rise to growing global imports of energy and resources from Africa, Middle East and Australia. China's demand for resources has increased dramatically in recent years as a result of a development strategy based on heavy industrialisation. The consumption of copper, aluminium and steel has grown at an annual rate of 20% over the past five years, constituting the world's largest source of demand for minerals. For example, China accounts for more than 20% of the world's consumption of aluminium and copper, and over 40% of the total traded iron ore. Some consumption is due to the relocation of manufacturing from developed countries to China, but domestic demand is also significant. About 30% of steel is used in residential housing; 20% for business construction and 10% for other infrastructure.

37. Africa is likened to 'a football field of competing political ideologies'. China went to Africa not only to obtain resources to fuel its rapid economic growth, but also to exert 'soft power' influence and promote a 'socialist market economy'. China has invested in infrastructure, education and health in Africa. Chinese delegates emphasised that Chinese aid in Africa did not have pre-conditions because China respected other countries' modes of governance and routes to development. China recognises African countries had the right to choose their own ways of development based on their own circumstances. This differed from the western approach in Africa, which is regarded as prescriptive and imposes its own model as a pre-condition for aid and investment.

38. Some liken China's involvement in Africa to 'colonisation'. But Chinese delegates rejected this, arguing that China's investment in Africa was based on market rules. China purchased energy and resources through transparent commercial bidding in the same way as imports, for example, from Africa and Australia. China has no intention to colonise either Africa or Australia. If China invests in Africa through contacts with governments and elites, China needs to foster more dialogue with African people. Overall, it was accepted that African countries had more choice in terms of selling products and accepting aid and investment, as a result of growing Chinese engagement with the continent.

### **Balancing environment, resource, and energy needs**

39. The Chinese economy relies on high consumption of resources, which results in environment degradation. This scale of development is unsustainable. China needs to advance its technology to use resources more efficiently and adopt measures to protect the environment. Energy taxes and water fees can help reduce consumption of resources. But these may encounter implementation problems due to popular opposition.

40. The country's overall carbon emissions are high, but per capita emissions are lower compared with western countries. Although total country emissions would be higher it is argued the Chinese people have the right to improve their living conditions, for example installing new central heating systems for the winter.

41. China exports various products to western countries, generating pollution during the production process. As the ultimate users of these products, western consumers need to

take some responsibility for tackling the environmental problem in China. It is estimated that 23% of emissions in China were caused by exports to meet external demand. If the UK, for example, did not import from China, emissions in the UK would increase by at least a third.

42. It was agreed environmental issues are not a Chinese problem, but a global one, which requires global cooperation. Efficient use of finite resources through technological innovation is crucial. China's central leadership pledges to rebalance its economy, making it more sustainable both economically and environmentally. Rebalancing includes a proposed shift of its development strategy making the economy less intensive in its use of energy and raw materials. Achieving this goal will be challenging.

43. The UK will support China's development; encourage Chinese capital to invest in the UK; promote education and student exchanges; and cooperate with China to clean cities and establish eco-cities.

## **Summary**

China's rapid growth will continue in the foreseeable future. The country has reached a new stage of development, which promotes not only economic growth, but sustained growth in terms of economic, social, political and environmental development. The current development strategy, which relies heavily on export-led industrial production and high consumption of resources, needs to shift to one with a growing emphasis on domestic consumption, service sector development, efficient use of energy, and environmental protection. A well-functioning social welfare system needs to be established to encourage consumption and to address the widening rural-urban divide. The political system needs to be reformed to ensure the rule of law and improve public participation in decision-making. Further cooperation with other countries on a range of international issues is needed to help China develop into a responsible global player.

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