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**CHINA'S NEW ECONOMIC POLICY INITIATIVES FROM
THE 17TH NATIONAL CONGRESS OF THE CHINESE
COMMUNIST PARTY
– BEGINNING OF THE FINAL PUSH TO MAKE CHINA
THE NEXT SUPERPOWER**

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China's New Economic Policy Initiatives from the 17th National Congress of the Chinese Communist Party

—Beginning of the Final Push to Make China the Next Superpower

Shujie Yao*

Summary

The curtain dropped on the 17th Chinese Communist Party (CCP) Congress on 21 October 2007 after a seven-day long conference. This important event attracted tremendous attention within and outside China.

China has gone through thirty years of economic reform and achieved remarkable results. Living standards have improved beyond the imagination of many, including the planners of the Chinese economic reform.

However, the success of China, or the Chinese economic miracle, has brought about new and emerging issues and challenges, such as party leadership, development and a widening inequality. If China were to become a world superpower, it must address and resolve these fundamental problems while maintaining its high growth momentum.

The successful launch of the Moon-exploration satellite, the Moon-Goddess I, on 24 October 2007 signifies China's ambition to become an innovation-oriented state, which was one of the main development objectives outlined at the Congress. The growth and reform of the Chinese economy are as exciting and complex as the launching of the Moon-Goddess I satellite. Similar to the three-stage launch of the satellite, China may have to pass through three different stages before it achieves success in economic development.

An aim of the Congress was to develop a harmonious society using a scientific approach. China's ultimate economic goal is to build a harmonious society with sustainable prosperity for its people, become a powerful and world-leading innovation-oriented state and a unified country with a socialist democratic system, as well as attain a high level of civilisation with a strong army that is able to safeguard national security and play a peace-keeping role in the world.

China's process to achieve full industrialisation and sustainable prosperity resembles the launching of the Moon-exploration satellite. From 1978 to 2007, China has marched halfway towards its final aim of becoming a world superpower, having a harmonious society at home and a harmonious relationship with the outside world.

After achieving the development goal of *wen bao* in the first stage, China is currently in the second stage of going for an *all-round xiao kang* society. In the following twenty years, China is aiming for high-quality growth and becoming an influential economic leader. The third stage of China's final economic success is to become the world's next superpower by the middle of the 21st century.

Whether China is able to reach its final designated orbit depends critically on the power fired by its new economic policies. Likewise, the success of the satellite launch depends on the satellite's ability to shift smoothly from its orbit of Earth to the orbit of the moon such that it is close enough to take clear photos of the moon.

China's success will largely depend on whether the new policies unveiled at the 17th Party Congress are effectively implemented to fulfil the party's development goals.

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The 17th CCP Congress and its new policies can be seen as the beginning of China's final push to become a world superpower, characterised by harmony at home and with the international community, with an immense influence on political, military and economic matters both internationally and regionally in another thirty years' time.

INTRODUCTION

- 1.1 The 17th CCP Congress was held at a historical time as China has gone through 30 years of economic reform and transformation and it will require another 30 years for the country to overtake the US to become the world's largest economy in absolute size by 2038.¹
- 1.2 Thirty years ago, China was absolutely poor with the vast majority of its population living in poverty, malnutrition and hunger. Today, China has become a world power with a gross domestic product (GDP), measured in nominal dollars, that is the fourth largest in the world, and measured in PPP dollars, the second largest and twice as large as that of Japan, as well as half that of the US. Per capita incomes surpassed \$2,000 in 2006, transforming China from a 'low income' to a 'low middle income' economy defined by the World Bank. The Chinese economy is not only large, but also more open than many OECD countries. In 2006, China was the third largest exporting country in the world, generating over \$188 billion of trade surplus, with a total trade volume of \$1.8 trillion. As of September 2007, China had already generated more trade surplus than in 2006 overall. It is predicted that China will soon overtake Germany to become the second largest exporter, and the US to become the largest by the end of this decade. By the end of 2007, China will also surpass Germany to become the third largest economy measured in nominal dollars. China's integration with the rest of the world is reflected by its thirst for and ability to absorb foreign capital, and in recent years, its rising capability to invest abroad.
- 1.3 People's living standards have improved beyond the imagination of many, including the planners of Chinese economic reforms. Most of the development targets set by China's reform architect, Deng Xiaoping, have been achieved and surpassed by five to ten years in advance. The new target set by the 17th Congress is to quadruple per capita GDP from its 2000 level (\$1,000) to 2020 (\$4,000), compared with a similar target set at the 16th Congress five years ago to quadruple China's total GDP, rather than per capita GDP.
- 1.4 The success of China, or the China economic miracle, has brought about new and emerging problems and challenges. The most difficult challenge is Party leadership, which is characterised by corruption that is deep-rooted and pervasive from Beijing to remote villages. Corruption can be regarded as the number one enemy of the Party, the state and the people, and corruption alone, if not properly contained, could jeopardise the entire China miracle and the country's ambition to become the next superpower. Another challenge is the development trajectory over the last thirty years, which has been characterised by high demand for energy as well as intensive consumption of raw materials, pollution and environmental degradation. One additional challenge is the ever-widening inequality, which has proven to be difficult to contain and multi-dimensional in the forms of an urban-rural divide, unequal regional growth, sectoral divide, class formation, and marginalisation within groups. If China were to become a world superpower, it must address and resolve these fundamental problems while maintaining its high growth momentum. The 'good and fast' growth model proposed by Hu Jintao to replace the 'fast and good' growth model shows how critical it is that China improve its growth quality in the rapid process of industrialisation, urbanisation, internationalisation and becoming a market- and information-based economy.

¹ Yao (2007), Can China really become the next superpower? Professorial inaugural lecture, University of Nottingham, 1 March 2007.

- 1.5 China's reform process resembles that of launching the Moon-Goddess I satellite. Although the satellite was launched on 24 October 2007 into space, it has to go through three main stages before entering its pre-designated orbit around the moon by 7 November 2007. This long process will take 14 days. In the first stage, the satellite will fly 16 hours on an elliptical path with the closest point at 200 km from Earth and furthest point at 51,000 km. In the following seven days, the satellite will accelerate and change its orbital path three times to settle on an orbit 128,000 km above Earth. In the second stage, after gathering its speed to as high as 10.9 km/second and at 380,000 km above Earth, the satellite will fly 116 hours from its last Earth orbit towards the moon. In the third stage, the satellite will break its speed three times within 48 hours until it is 'caught' by the moon's gravity, which will then allow it to settle on a 127 minute- elliptical orbit 200 km above the moon on 7 November 2007. Figure 1 illustrates the movement of the Satellite from Earth to the moon. Only then can the satellite take photos of and around the moon. The photos will be sent to the Chinese National Observatory in Beijing for processing and analysis. The launching of the satellite can be successfully concluded only after the photos are received by the end of November 2007.

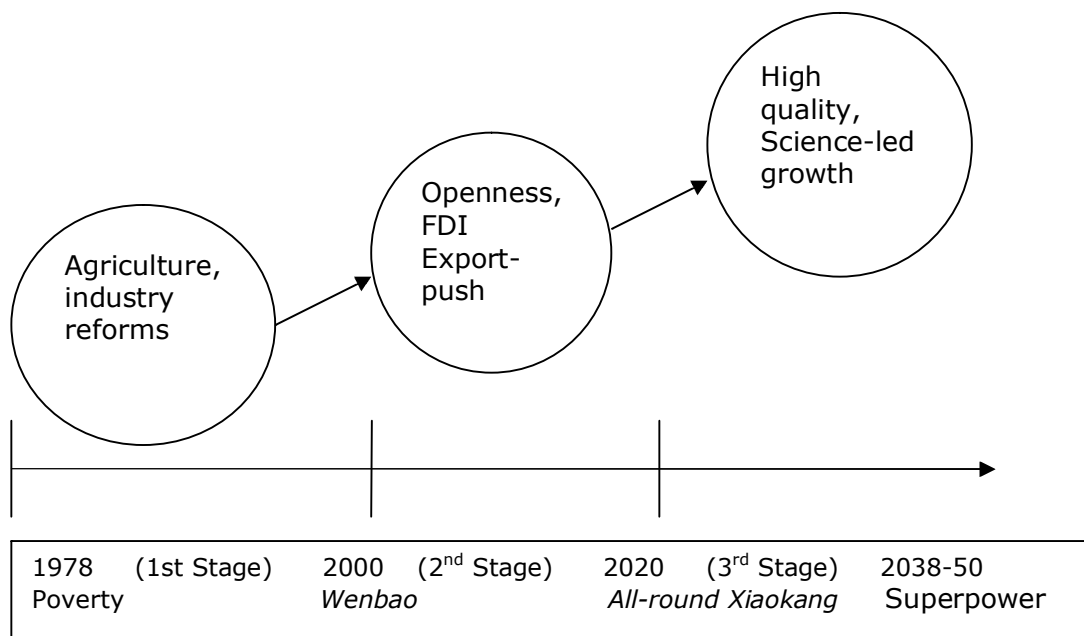
Figure 1 The Moon-Goddess I Satellite and her earth-moon orbits



- 1.6 The growth and reform of the Chinese economy are as exciting and sophisticated as the launch of the Moon-Goddess I satellite. Similar to the three-stage launch of the satellite, China may have to pass through three different stages before it attains success in economic development, The official definition of China's ultimate economic success is a harmonious society with sustainable prosperity for all people, a powerful and world-leading scientific and innovative state, a unified country with a socialist democratic system and a high level of civilisation, having a strong army that is able to safeguard national security and play a peace-keeping role in the world. A simple and unofficial definition of China's ultimate success is to become a world superpower.
- 1.7 The three stages of China's development in terms of time path, strategies and goals are illustrated in Figure 2. The first stage was to eradicate hunger, malnutrition and poverty among its population, signified by the target of per

capita GDP of \$800-\$1,000, specified by Deng Xiaoping as *wen bao* (warm and not hungry). This stage started in the late 1970s and ended in 2000. During this stage, China went through two important phases of economic development. The first phase was the implementation of rural reform and the household responsibility system during 1978-84. Rapid growth in agricultural productivity and output during this period laid a solid foundation for China's subsequent reforms and successes in the industrial and urban sectors. The second phase was marked by the policies of openness and export-push after Deng Xiaoping's tour of southern China in 1992. From 1992, China started to attract massive foreign direct investments to accelerate its export-push strategy and to catch up with the advanced economies through the technological spill-over of foreign capital and technologies.

Figure 2 Development time path, strategies and goals of China



1.8 The second stage is to make China a middle-income economy in which the population enjoys a living standard significantly and comfortably above the poverty line, signified by a per capita GDP target of \$4,000, defined by Hu Jingtao as *all-round xiao kang* (comfortable living conditions for all Chinese people). This stage started in 2000 and is expected to be completed by 2020. During this stage, China will become highly integrated with the world economy, starting from its entry into the World Trade Organisation (WTO) in 2001. Between 2001 and 2007, China has rapidly emerged to become a leading exporter of the world. It is expected that by 2010, China will overtake Germany to become the world's largest exporter. China has already accumulated the world's largest foreign exchanges reserves worth more than \$1.4 trillion due to its growing trade surplus and continuing inflows of foreign capital.

1.9 The third stage in the process towards ultimate economic success is to become the world's next superpower by the middle of the 21st century.² The 17th Party Congress was held at a critical time for two reasons. Firstly, after

² David Miliband, UK's foreign secretary suggested that the EU must be a model power but not a superstate, or superpower. He said that the only superpower of the world is the US. Any possible candidate of the next superpower must be China and/or India, but not the EU (16 November 2007, the Independent), <http://news.independent.co.uk/europe/article3166411.ece>.

30 years of rapid growth and transformation in China, many new and challenging problems and constraints have emerged, which could jeopardise the country's long-term ambition and success any time. Secondly, the new economic policies and the ability of the Party to implement these policies successfully are critical to China's efforts to maintain its growth momentum while resolving the aforementioned problems and constraints.

UNDERSTANDING THE NEW POLICIES

- 2.1 In the development literature, each policy objective must come with at least one policy instrument. The key development objectives and their associated policy instruments envisaged by the 17th Party Congress are summarised in Table 1 below.

Table 1 Development objectives and policy instruments of Hu Jiangtao's report

Development objectives	Key policy instruments
Building an innovative state	Medium and long term planning; investments in research and in human capital
Structural change and upgrading of industries	Augmenting domestic consumption; balancing the development of agriculture, industry and services
Comprehensive rural development	Improving farm incomes and rural development
Higher efficiency in use of energy natural resources	Energy- and materials-saving technologies; better economic and industrial structure to reduce pollution and environmental degradation
Balancing regional development	More incentives for backward areas; establishment of clusters of cities as engines of growth, particularly in the poor regions
Building a comprehensive economic system and a modern market system	Ownership diversification, while keeping dominance of state-ownership; improvement of efficiency of state economy
Establishing an effective regulatory system based on financial and tax reforms	Balancing central and local budgets; investing in public services; improving efficiency of the financial sector; preventing financial crisis; compensating uses of ecosystem services
Improving the quality of an open economy	Continuing open policy; nurturing world-class big businesses; improving China's international competitiveness and the quality of foreign investments

Sources: Abstracted from Hu Jingtao (2007), Report to the 17th CCP Congress, 15 October 2007.

Making China an innovative state

- 2.2 Making China a leader in science and technology is considered as the most important objective of the 17th CCP Congress. Rapid growth in the last thirty years is considered by policy makers and researchers to be based on low-level technology, extensive use of energy and raw materials, export processing with low productivity and efficiency. Although China has become a leading exporter in the world, much of its exports have been concentrated on the lower rungs of the value chain. Chinese firms have been relying on big multinational companies (MNCs) for the design and key technologies used in the production of goods for export. A large share of the export value is passed on to foreign MNCs and retailers in the rich importing countries. Chinese workers and exporters receive only a small fraction of the total

export value. Hence, the word 'made in China' does not mean that the goods are made by the Chinese. If China were able to invent all the key technologies, the manufacturing of its exports would not have to depend on foreigners. Consequently, Chinese workers and exporters would be able to get a much larger share of the export value.

- 2.3 If China develops a better capability for science and innovation, it will be able to improve industrial productivity and increase the efficiency of energy and resource consumption. China will then be able to maintain a high growth rate with less pollution, thus slowing down the degradation of its environment, and above all, maintaining a sustainable growth.
- 2.4 This is why building an innovative state is the most important development objective, but it is probably the most demanding objective to fulfill. Specific policies will require massive investments in science and innovative activities. The central point is to accumulate high-quality human capital, such as to educate and nurture numerous high-level scientists, and to establish an effective and efficient research environment.
- 2.5 The development of science and technology in China has been dependent on the principle of 'walking with two legs': one with imports and the other with domestic research and development. Import of foreign technologies take two forms: direct acquisition of foreign technologies and embedded technological transfers through foreign direct investment (FDI). China has been a big buyer of foreign technology. In 2006 alone, China spent about \$17.6 billion on acquisitions of foreign technology. FDI has also been an effective means of absorbing foreign technologies and managerial practices. Yao and Wei prove that up to one-third of China's technological progress during 1979-2005 was due to FDI. In other words, apart from the physical contribution, FDI has indirectly contributed about one percentage point to China's GDP growth per year in the last quarter century.³
- 2.6 Domestic research and innovation in China are mainly conducted within three different systems: the national and regional research network of the Chinese Academy of Sciences, universities, and large- and medium-sized enterprises. Chinese scientists have made tremendous progress over the last few decades in many research areas, especially in space technology exemplified in this paper by the launch of the Moon-Goddess I satellite in October 2007, and by the launch of the manned spacecraft Shenzhou VI in 2006. In the manufacturing sector, China still depends largely on foreign technology for key products and processes. Domestic researchers have made more progress in non-basic innovations such as utility model and design.
- 2.7 Table 2 shows the number of patents applied for with the Chinese government. The patents are divided into three different categories: invention, utility model and design. Invention, being a form of innovation, should be treated as the most important type of patents. Although the total number of patent applications by domestic researchers is much greater than that of foreign researchers, the number of applications for invention patents lodged by the latter is only a little short of that by the former. If we use the number of patents granted, instead of the number of patents applied for, more invention patents have been granted to foreigners than to domestic applicants. About three quarters of domestic patent applications are non-innovative, meaning that the level of research in China is still dominated by low-technology research. In the foreseeable future, China will still have to

³ Yao, Shujie and Kailei, Wei (2007) Economic growth in the presence of FDI from a newly industrializing economy's perspective, *Journal of Comparative Economics*, 35(1), 211-234.

depend on foreign technologies and innovation to sustain its economic growth and the upgrade of its industries and services.

Table 2 Three kinds of patents applied for with the Chinese government

Year	Total 1+2+3 (000)	1. Invention patents		2. Utility models		3. Designs	
		Domestic (000)	Foreign (000)	Domestic (000)	Foreign (000)	Domestic (000)	Foreign (000)
1990	41.47	5.83	4.31	27.49	0.13	3.27	0.45
1995	83.05	10.02	11.62	43.43	0.31	15.43	2.24
1996	102.74	11.47	17.05	49.34	0.26	21.40	3.22
1997	114.21	12.71	20.95	49.90	0.23	27.46	2.96
1998	121.99	13.73	22.23	51.22	0.18	31.29	3.35
1999	134.24	15.60	21.10	57.21	0.29	37.15	2.91
2000	170.68	25.35	26.40	68.46	0.35	46.53	3.59
2001	203.57	30.04	33.17	79.28	0.45	56.46	4.29
2002	252.63	39.81	40.43	92.17	0.97	73.57	5.69
2003	308.49	56.77	48.55	107.84	1.27	86.63	7.43
2004	353.81	65.79	64.35	111.58	1.24	101.58	9.27
2005	476.26	93.49	79.84	138.09	1.48	151.59	11.78

Source: NBS (2004 and 2005), *China Science and Technology Statistical Yearbook*. NBS (2006), *Statistical Yearbook of China*, p831.

- 2.8** Key industrialised nations, including Japan, the US, Germany and other western European countries are the most important sources of foreign invention patents granted in China. This implies that there has been an acceleration in the process of technological diffusion from the world's most advanced industrialised nations to China (Table 3). The three richest economies (the US, Japan and Germany) accounted for almost 80% of the total number of patents for inventions granted in China in 2003 (Table 3).

Table 3 Invention patents granted by country of origin in 2003

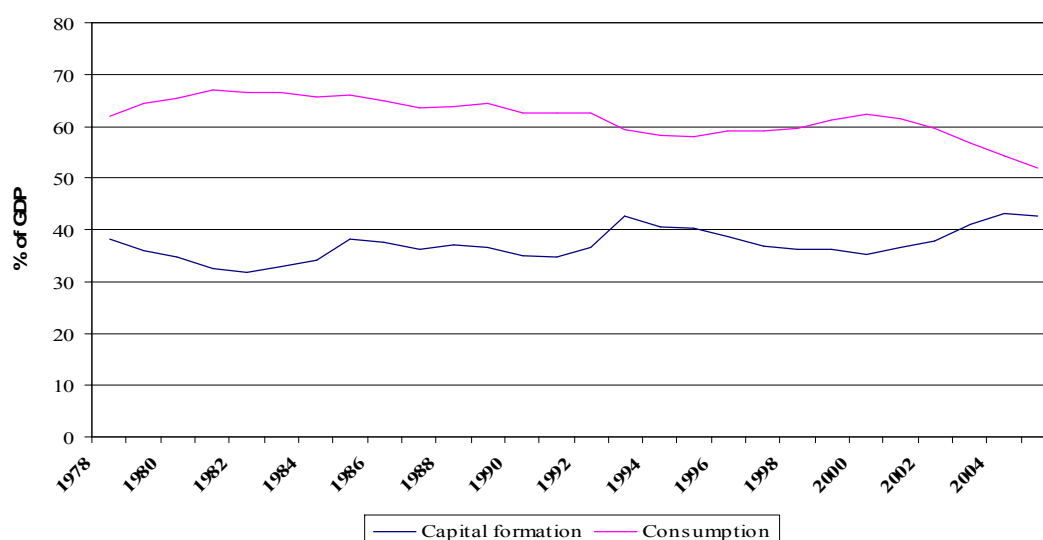
Country	Number	%
Total	25750	100.00
Japan	9369	36.38
USA	5733	22.26
Germany	2615	10.16
Korea	2017	7.83
France	1038	4.03
Sweden	791	3.07
Switzerland	762	2.96
Netherlands	756	2.94
UK	572	2.22
All others	2097	8.14

Source: NBS (2004), *China Science and Technology Statistical Yearbook*.

Shifting economic development mode

- 2.9 Fast growth in China has been driven by extensive investments and exports. The second policy objective of the 17th Party Congress is to change this pattern of growth, implying that China has to make significant structural changes and technological upgrades to its existing industries. The proposed policy instrument is to shift from an over-reliance on investments and exports to a more balanced pattern of consumption, investments and exports.
- 2.10 Figure 3 shows that during the entire reform period, the share of consumption in China's GDP declined from 67% in the early 1980s to just over 50%. In the meantime, the share of capital formation rose by more than 10 percentage points from 33% to 43% (Figure 3). The share of net exports rose from a negative value in 1978 (-0.3%) to about 5.5% in 2005.

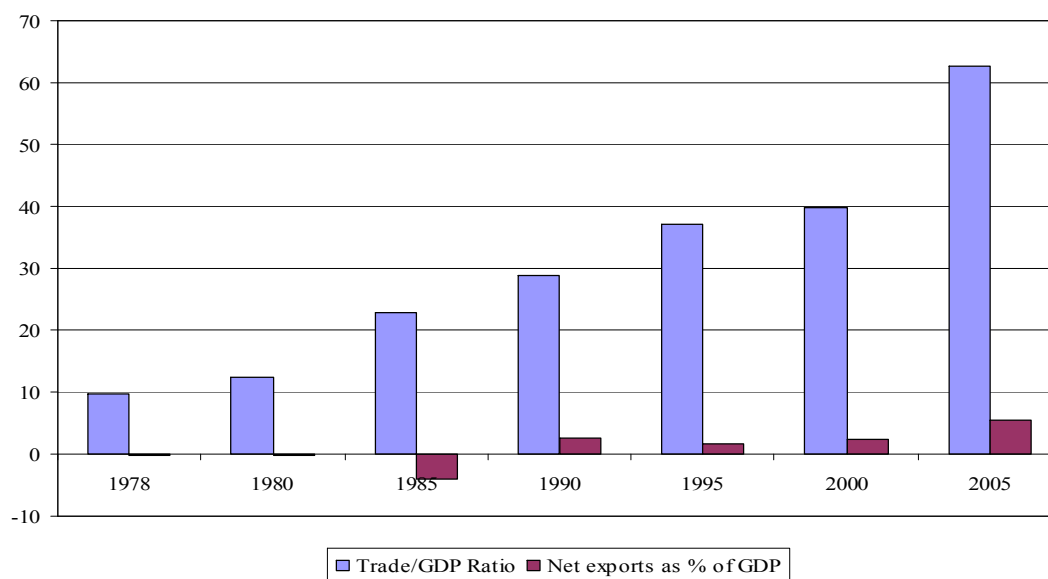
Figure 3 Shares of consumption and capital formation in GDP 1978-05 (%)
(Sources: NBS, *China Statistical Yearbook*, 2006)



- 2.11 The changing structure of the Chinese national economy over the reform period has had the following implications. First, economic growth has become increasingly more dependent on investments and less able to employ labour. China is abundant in labour and there are over 150 million to 250 million unemployed and under-employed people, but the development over the past 25 years has not been driven by labour-intensive technologies and industries. From 1982 to 2005, the capital/GDP efficiency declined by one-third.
- 2.12 Secondly, China's economic growth has become increasingly dependent on international trade. The trade/GDP ratio increased from about 10% in 1978 to 63% by 2005, generating a significant trade surplus that was equivalent to 5.5% of GDP in 2005 (Figure 4). The gradual openness implies that China has become more integrated with the rest of world and been able to benefit from the international division of labour. On the other hand, the rising dependency on trade for economic growth may also have some undesirable consequences for the domestic economy. As trade has been developed unevenly across the regions, it is responsible for widening the regional inequality. Moreover, with more resources being diverted to the trade sector, there has been a lack of development in domestic demand, leading to a

declining share of domestic consumption in GDP. In the long term, this pattern of economic growth may be undesirable for sustainable development.

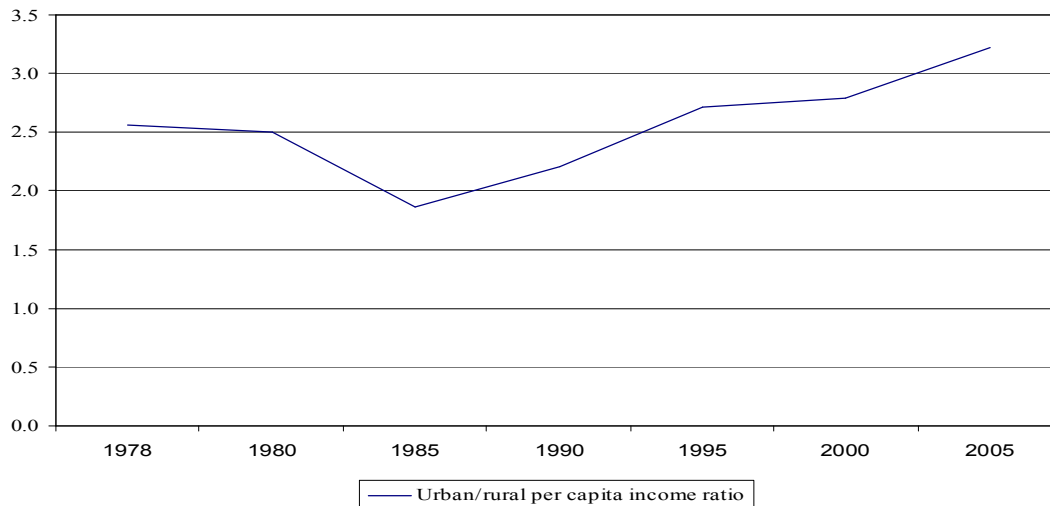
Figure 4 Trade/GDP ratio and contribution of net exports to GDP 1978-05 (%)
(Sources: NBS, China Statistical Yearbook, 2006)



Co-ordinating rural-urban development and constructing socialist new villages

- 2.13 Barring the first stage of economic reforms from 1978 to 1984, Chinese peasants have lagged their urban counterparts in terms of living standards. The urban-rural per capita income inequality declined from 1978 to 1984 due to the success of agricultural reforms, the abolition of communes and implementation of the rural household responsibility system. From 1985 until today, the gap between urban and rural incomes has been increasing. No other country in the world has an urban-rural income inequality similar to China.
- 2.14 Figure 5 shows that the ratio of urban-rural per capita income was only 1.8 in 1985 but rose steadily to 3.2 by 2005 despite the most recent government policies that reduced the tax burden on agricultural production and stimulated farm incomes. From 2004, the government under the Hu-Wen leadership implemented a series of pro-rural, pro-agricultural and pro-peasant policies, which included the complete abolition of agricultural taxes in 2006, free education for rural children up to year 9, healthcare insurance and social security subsidies. All these policies are good for the farmers and for rural development, but the assistance from the state came too late and was too little to arrest the trend of widening urban-rural income inequality as urban incomes continue to grow much faster than rural incomes.

Figure 5 Urban/rural per capita income ratio 1978-05 (ratio)
(Source: NBS, China Statistical Yearbook, 2006)



- 2.15 The urban-rural divide was one of the three divides that Mao Zedong wished to eliminate when he led the Chinese Communist Party to power. The CCP was established on promises to eliminate the three differences in urban-rural incomes, worker-peasant incomes and intellectual-manual workers incomes. In retrospect, the People's Republic has been founded for 58 years, by no means a short time, but the three differences have not been reduced at all. Instead, they have widened under economic reforms. When Mao was in power, he made many mistakes regarding economic and development policies, but he never gave up building a prosperous and egalitarian society.
- 2.16 Deng Xiaoping corrected Mao's mistakes by introducing a market economy to replace a planned one, opening China's door to the outside world, and using foreign investments and exports to promote economic growth and technological progress. These reform policies have been reinforced by his successors, Jiang Zeming and now, Hu Jintao. Without these reforms, China would never be in its current shape, with a strong growth dynamic and a huge improvement in people's living standards. However, one of the most undesirable consequences of reforms is the ever increasing income inequality, especially the inequality between urban and rural residents. Economists and policy makers may argue that rising inequality is good for economic growth and it should be a short term phenomenon in the early stage of industrialisation, urbanisation and marketisation.
- 2.17 However, the persistence of urban-rural inequality in China may not be as simple as suggested by this argument. Firstly, the ever rising urban-rural inequality goes against the very basic principle of the CCP, which is to bring equality and prosperity to all. Secondly, based on Kuznets's rule, rising inequality is good for economic growth in the early stage of development, but it can hamper economic growth if the inequality is too large as it can make the society less efficient and unstable.⁴ Thirdly, the rising urban-rural inequality has been caused by some poorly-designed policies and corruption in China. As a result, such an inequality could have been reduced if stronger

⁴ See Simon Smith Kuznets, *Economic Growth and Income Inequality* (1955), *AER*, 45(1), 1-28; and *Quantitative Aspects of the Economic Growth of Nations* (1963), *Econ Dev & Cultural Change*, 11(2), 1-80.

policies, biased towards the poor, are adopted in the process of industrialisation and urbanisation. Such a policy shift, however, will impose pains on groups with vested interests, especially party and state officials, managers of state-owned enterprises, private entrepreneurs, employees of monopolistic industries, and some professionals. Without a more radical reform in the economic system and without a strong willingness and ability on the part of the government to challenge the vested interests of the so-called elites, efforts to co-ordinate urban-rural development and to construct new socialist villages will end in vain.

- 2.18 Reducing urban-rural inequality can be done in two different ways: accelerating the pace of urbanisation so that more peasants become urban citizens, and raising rural incomes through comprehensive rural development. China has made significant progress in urbanisation over the last 30 years, the share of urban population in total population rose from 18% in 1978 to 44% in 2006. In the meantime, the share of agricultural employment in total employment declined from 71% to 43% over the same period. However, the share of agricultural production in total GDP declined from 28% to less than 12%. As a result, agricultural productivity and rural incomes have lagged those of the non-agricultural sector and the urban economy. This explains why it has been so difficult to arrest the increasing trend of urban-rural income inequality. It also implies that it will be more difficult to improve peasant incomes through further industrialisation and urbanisation as the rapid growth in urban population is causing alarmingly negative effects on the quality of living in the over-crowded urban areas and the natural environment. As a result, the more effective way to raise rural incomes and the living standards of the peasantry is through comprehensive development of the rural areas, or in Hu Jintao's words, constructing new socialist villages where farmers can get access to non-farming employment and living amenities similar to those of urban citizens without having to leave their homes.
- 2.19 The construction of new socialist villages requires government investments in rural infrastructure, including roads, schools, hospitals and water projects. In addition, the government has to help villagers build a social safety net for looking after the vulnerable, such as the old and sick people who do not have the ability to look after themselves. This is a difficult and long term task as China has failed many times in its economic development history in the last 58 years to promote equality between the urban and rural population. The concepts of comprehensive rural development and constructing new socialist villages are attractive but they may again become another false promise to the peasantry if the pro-rural, pro-agriculture and pro-peasant policies cannot be sustained.

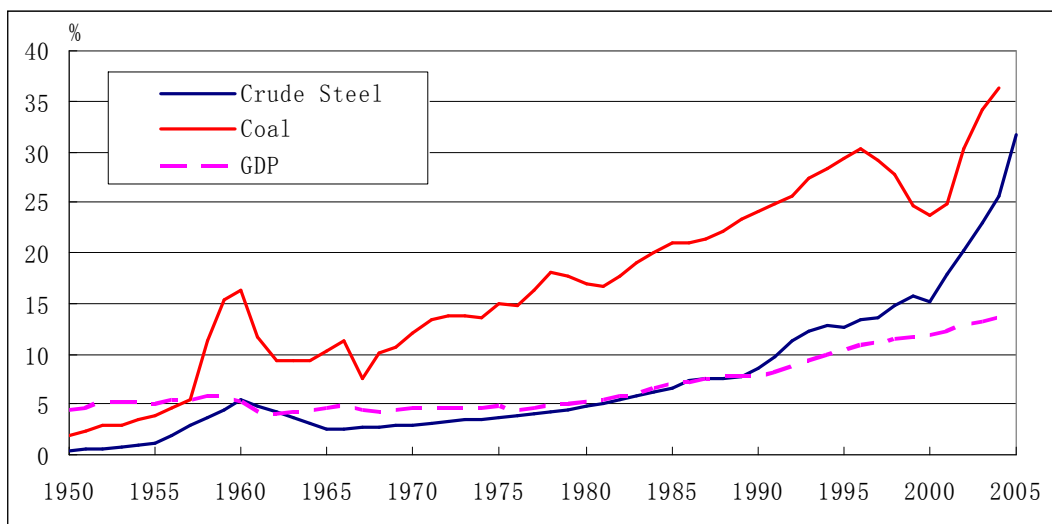
Increasing the capability of sustainable development

- 2.20 Economic growth in China has relied not only on large investments but also on the extensive consumption of energy and non-renewable resources. During Mao's period, China's modernisation and socialist construction were based narrowly on two important economic indicators: output of grain and output of steel. Grain was important because the vast majority of people suffered from chronic malnourishment. Steel was important because the level of development was so low that it was regarded as a symbol of industrialisation. In the late 1970s, China's target for steel production by the end of 2000 as part of its modernisation drive was set at 80 million tons compared with 32 million tons in 1978. The actual steel production in 2000 was 60% greater than the target, totalling 129 million tons. From 2000 to 2006, steel production continued to grow rapidly. By 2006, the total steel output was 420 million tons, more than three times the level achieved in

2000. China's steel output was greater than the combined production of Japan and the US, the world's two largest economies. In the meantime, China has been a large net importer of steel. In 2005, for example, China exported 20 million tons of steel but imported 26 million tons, with a net import of 6 million tons.⁵

2.21 The high and rapidly growing level of steel production in China over the last 30 years has two contradictory implications. On the one hand, it reflects the success of China's economic reforms and its ability to increase industrial production at an unimaginable pace. On the other hand, it implies that China has had to use an excessive amount of steel and related industrial products such as coal and electricity to sustain its fast economic growth. Figure 6 shows that China's share in the world total GDP was only 14% (measured in PPP terms, and about 5% in nominal dollars), but it produces more than one-third of the world's total steel output and almost 40% of the world's total coal output.

Figure 6 China's shares of steel, coal and GDP in world's total (1950-2005)



Sources: National Bureau of Statistics, *Comprehensive Statistical Data and Material on 50 Years of New China*, Beijing: China Statistics Press, 1999. Angus Maddison, *The World Economy: Historical Statistics*, Paris: OECD, 2003. International Iron & Steel Institute, *World Steel in figures 2005*, <http://www.iisi.org>. Gao and Hu (2007) Development of China's steel industry, paper presented to the 18th Annual Conference of CEA (UK), April 2007, University of Nottingham.

2.22 Apart from steel and coal, China is also the largest producer and consumer of cement and chemical fertilisers in the world. The output of cement increased almost 20-fold from 65 million tons in 1978 to 1.24 billion tons in 2006, representing an annual growth rate of 12%. The output of chemical fertilisers increased more than six-fold from 8.7 million tons to 53.5 million tons over the same period. As grain production increased by only 62%, the grain/fertiliser output ratio declined from 35 to 9.3. In other words, for every ton of grain production, the input of fertilisers increased 3.7 times between 1978 and 2006 (Table 4).⁶

⁵ Gao and Hu (2007) Development of China's steel industry, paper presented to the 18th Annual Conference of CEA (UK), April 2007, University of Nottingham. NBS, *China Statistical Yearbook*, 2006.

⁶ Some fertilisers are used for non-grain production. Assuming that the same proportion of fertilisers was used for non-grain production in 1978 and in 2006, then the same output of grain would still require 3.7 times the amount of fertilisers used in 2006 compared with 1978.

Table 4 Key agricultural and industrial products (1952-2006)

Products	Unit	1952	1978	2006
grain	million tons	164.0	305.0	497
meat products	million tons	3.4	8.6	80.5
fish	million tons	1.7	4.7	52.9
coal	million tons	66.0	620.0	2373.0
electricity	billion KWH	7.3	256.6	2865.7
steel	million tons	1.4	31.8	419.2
cement	million tons	2.9	65.2	1236.8
fertiliser	million tons	0.0	8.7	53.5
vehicles	1000 units	0.0	149.1	7278.9

Sources: NBS, *China Statistical Yearbook* (various years, 1980-2007).

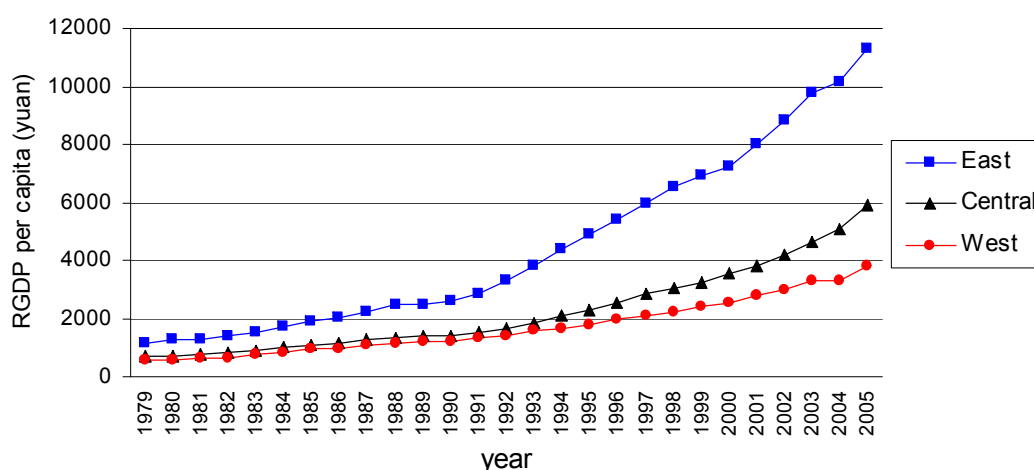
- 2.23 Apart from steel, coal, cement and chemical fertiliser, the production of electricity and vehicles also experienced an enormous growth during the reform period. The rapid increase in these products reflects China's ability to sustain its extraordinary level of growth but they also have serious implications for its long term ability to maintain such a growth momentum as there is obvious evidence that the economy has been driven by excessive consumption of products, which is extremely hostile to the natural environment, and is over-dependent on non-renewable energy and natural resources. For example, the increase in China's energy demand between 2002 and 2005 is equivalent to Japan's current annual energy consumption. By the end of 2007, China will become the world's largest CO₂ emitter, and by 2010, the world's largest energy consumer.⁷ If China could achieve the same level of energy- and material -intensity of GDP as in the US and Japan, it would not have to produce more coal, cement, steel and electricity in order to double or even quadruple its current level of GDP. Or if China were to follow the same pattern of dependency on the aforementioned industrial products, by 2020, China would have to produce an amount equal to or more than the world's total current output of steel, coal and cement, in order to achieve its growth objective.
- 2.24 In any case, it appears that it is impossible for China to continue to grow so rapidly by following the same growth pattern of the past without causing irreversible harm to the natural environment and depleting the reserves of certain non-renewable resources in the foreseeable future. Hence, it is imperative that China changes its mode of development. Firstly, China has to change its over-dependency on the manufacturing sector to sustain its two- digit or high single-digit economic growth rate. A more balanced industrial structure should be developed so that the services sector, which is less dependent on energy and raw materials, should be encouraged to grow faster. Secondly, China should employ more science and technology in improving the industrial efficiency in the use of energy and materials. Thirdly, China should focus more on the development of labour-intensive, capital- and material-efficient, as well as environmentally-friendly industries, while moving away from those capital- and material-intensive and environmentally-harmful industries.

⁷ Martin Wolf (2007), Welcome to the new world of runaway energy demand, Financial Times, 14/11/07, <http://www.ft.com/cms/s/0/ba8b0d6a-9254-11dc-8981-0000779fd2ac.html>.

Balanced regional development

- 2.25 One major problem of China's economic growth over the last 30 years is the widening of income inequality in different dimensions, of which regional inequality accounts for as much as one-third of total inequality. Suppose China is divided into three large geo-economic regions: East, Central and West, the richest region is the East, the poorest is the West and in the middle lies the Central region.
- 2.26 Figure 7 shows that per capita real GDP in the East was higher than that of the other two regions at the beginning of economic reforms but the gaps in per capita incomes were relatively small. The classical economic theory suggests that regional incomes can converge over time due to the law of diminishing returns on capital, which implies that capital will gradually move from the rich to the poor regions such that the originally poorer regions are able to catch up with originally richer ones in terms of per capita incomes. In China, unfortunately, the logic of the classical economic theory does not apply to economic reforms. On the contrary, the gaps of per capita incomes between the three regions widened rapidly and continuously. The ratio of East-Central-West per capita real GDP was 1.71:1.23:1 in 1979, 2.03:1.15:1 in 1992, rising to 2.98:1.56:1 in 2005.

Figure 7 Real per capita GDP in comparison, 1979-2005 (yuan)



Note: Per capita GDP is measured in 1990s prices.

Sources: China Statistical Data for 50 Years 1949-98 (NBS, 1999) and *Statistical Yearbook of China* (NBS, 1998-2006, various issues).

- 2.27 The increasing regional inequality has two important consequences and policy implications for the Chinese economy. Firstly, regional inequality has led to massive inter-regional migration, putting serious economic, social and environmental pressure on the coastal areas. These regions have become exceedingly densely populated and the large cities are struggling to provide adequate and decent public services to migrants and their families, resulting in a significant increase in urban poverty, crimes and prostitution. On the other hand, the poor regions have suffered from a shortage of educated, able and young people to develop the local economies, further worsening the coastal-inland income inequality. Some researchers and policy makers argue that migration leads to a reduction in inter-regional inequality as migrants are able to remit their incomes back home. It may be true that remittances help local residents to improve their living standards, but the effect of emigration on the development of local economies may significantly outweigh the benefits of remittances. In addition, migrants working in the cities and the coastal areas often end up in low-paid and arduous jobs that

are unwanted by urban residents or their coastal fellow peasants. Some workers may also end up unemployed and their children have to live in poverty without proper access to education.

- 2.28 Secondly, regional inequality could result in social instability and low efficiency of the national economy, leading to unsustainable development. As there is a large floating population at any one time throughout the country and a significant proportion of these people do not have stable homes and regular incomes, they have to endure harsh living conditions, isolation, and loneliness. For some poor young men without jobs or incomes, they may resort to crimes to make a living. For the young women without jobs and incomes, they are vulnerable to becoming prostitutes and sex-related workers in bath parlours in cities and towns throughout China. Increasing income inequality means that some urbanites are so rich that they can afford to consume services such as 'massages' and 'baths' while the poor women have no choice but to serve these rich people in order to support themselves and their poor families living in the remote and poor countryside. The twisted consumption pattern has an important implication on economic efficiency as rich people spend their money on low-linkage services, while investments in education, healthcare and infrastructure in the poor regions are neglected. Furthermore, the rapid expansion of the commercial sex industry in China, primarily driven by rising income inequality and massive rural-urban migration, has resulted in an alarming public health problem, as HIV/AIDs and other sexual transmitted diseases have become a deadly threat to the lives of the millions of sex workers and the rich urbanites.⁸
- 2.29 To reduce regional inequality, the best approach is to adopt a more balanced regional development strategy, focusing more on the development of the western and central regions, revitalising the northeastern region while maintaining the dynamism and prosperity in the eastern region. With development in the less advantaged regions, people will be able to stay at home and work in nearby cities to reduce the pressure from long-distance movement of labour, thus reducing the level of crimes and prostitution, and improving the overall level of economic efficiency for the whole country.
- 2.30 Regional development also requires specific strategies. Development can be evenly spread out to cover every corner of a region (carpet-style development), or it can be focused on a few centres of growth to lead the development of their surrounding areas (growth centres-led development). Development experiences in the East have proven that the growth centres-led development model does work successfully and effectively.⁹ The same strategy should also be adopted in the development of inland and the northeastern regions. The government should try to facilitate the development of city clusters (growth centres) in these areas and enable these city clusters to lead the growth in peripheral townships and countryside. For example, the West may focus its efforts on developing a few large (and medium size) cities, such as Chongqing, Chengdu, Xi'an, Lanzhou, Urumqi, Kunming, and Nanning, to be growth centres in the West in the next 10 to 15 years and then make use of these cities to help the entire region develop in the next phase of growth and prosperity. .

⁸ Dylan Sutherland (2006), Applying the scientific concept of development to HIV/AIDS in China. *In*: Chen Qilin (ed.), *Scientific development concept and China's new industrialisation: theory, problem and policy (Chinese)*, Xiamen University Publishing House.

⁹ Yao, Shujie and Zongyi, Zhang (2001) On regional inequality and diverging clubs: a case study of contemporary China, *Journal of Comparative Economics*, 29 (3):466-84.

Modern market economy

2.31 One of the most important policy objectives is to build a comprehensive economic system and a modern market economy. According to the report by Hu Jingtao, the CCP will continue to uphold its policy of building a market economy but the Chinese market economy will differ from those of the advanced western countries in the sense that state-ownership will continue to be a key feature. State-ownership or state economy means that the central and regional governments will continue to maintain control and majority ownership of many large commercial corporations and enterprises.

2.32 As state-owned enterprises are renowned for being low in efficiency, reforms should be focused on how to make them more efficient and profitable without having to give up state control. In other words, China will not use total privatisation to improve the efficiency and profitability of large state-owned enterprises. Instead, private and other forms of ownerships are encouraged to compete with the state economy. After almost 30 years of reforms and trials, it is believed that joint-stock ownership can help to reform the state economy such that large state-owned companies, including the state commercial banks, insurance companies, and other enterprises in the energy, transportation, communication, media, metallurgic, and other monopolistic industries, have been and will be publicly-listed to attract private investors. It is also hoped that after the stock listings, these state-owned companies will be able to improve corporate governance, efficiency and competitiveness. China also aims to develop scores of large businesses to compete in the international market. By 5 November 2007, China had already produced five of the world's 10 largest companies in terms of market value (Table 5). The profitability and labour productivity of these giant companies are, however, well below those of their counterparts in the advanced industrialised countries.

Table 5 World's 10 largest companies in market values on 5 November 2007

Company	Market capital on 5/11/07	Revenue in 2006	Profit In 2006	Labour in 2006
	\$billion	\$billion	\$billion	(1000)
PetroChina	1,079.40	110,520	13,265	1,086,966
EXXON	484.69	347,254	39,500	106,400
GE	412.92	168,307	20,829	319,000
China Mobile	378.79	35,914	6,260	130,637
ICBC	371.49	36,832	6,179	351,448
MICROSOFT	344.84	12,542	8,922	79,000
Gazprom	307.79	81,115	20,321	432,230
Sinopec	301.97	131,636	3,703	681,900
SHELL	268.30	318,845	25,442	108,000
CLI	257.78	33,712	174	77,660
China 5	2,389.42	348,613	29,581	2,328,611
China 5/EXXON	4.93	1.00	0.75	21.89

Notes: Market capital is calculated based on share values on 5/11/07. Revenue, profits and labour are for 2006. 1\$=7.4538 RMB. ICBC = Industrial and Commercial Bank of China, GE = General Electric, CLI = China Life Insurance. China 5 = PetroChina, China Mobile, ICBC, Sinopec and CLI.

Sources: Yahoo Finance (date: 05/11/2007); cnnmoney (31/12/2006).

- 2.33 The top five Chinese giants include PetroChina, China Mobile, ICBC (Industrial and Commercial Bank of China), Sinopec, and China Life. PetroChina moved its listing from the Hong Kong Stock Exchange to the Shanghai Stock Exchange on 5 November 2007 and its stock value rocketed by 161% on the same day to reach 43.6 RMB per share. Its share price was only HK\$1.80 when it listed in 2000. Although PetroChina was over twice as large as EXXON in market value and the only company in the world to break the \$1 trillion record, its revenue or profit was only one-third as large as that of EXXON, and its labour force ten times as large as that of EXXON. This means that labour productivity of PetroChina, measured by profit or revenue, is only one-thirtieth of its US counterpart. Putting all the top five Chinese companies together, the total market value was \$2.4 trillion, or equivalent to 4.9 times the market value of EXXON. However, in terms of profits, the combined profit of the five Chinese companies in 2006 was only three quarters of that of EXXON, and their total labour force was 22 times that of EXXON. Measured by labour productivity, the Chinese companies are over-valued by 30 times compared to EXXON. Measured by the price/earning ratio, the Chinese companies are over-valued by six to seven times. In other words, although China is able to produce some super-large companies in terms of market value, the quality of these companies is overwhelmingly overshadowed by their US counterparts. If the Chinese stock markets were to crash, the market values of these Chinese giant companies would be reduced many times, leading to an unforeseeable suffering by shareholders.¹⁰ High volatility in share prices implies there is a great degree of speculation in the Chinese stock markets, reflecting potential bubbles and risks in the financial system.

Establishing an effective and efficient regulatory system

- 2.34 The role of the state in economic development is not just to control the large corporations and enterprises. As a market economic system becomes more matured and complex, the state has to establish an effective regulatory system based on the deepening of financial and tax reforms. Financial reform in the past few years has been characterised by reform of the state-owned commercial banks, state-owned insurance companies, the Shanghai and Shenzhen Stock Exchanges, etc. Since 2005, nine commercial banks and one insurance company have been listed on the stock markets. ICBC, CCB and BOC have emerged to be among the world's largest publicly-traded banks in terms of market value, and ICBC has surpassed Citigroup to become the world's largest commercial bank.
- 2.35 As financial reform deepens, it is important that the central government develops an effective regulatory mechanism to provide a conducive environment for market competition and to guard against market failure, especially large-scale financial crises.
- 2.36 China has 31 provinces and each province has its own interests in local economic development. To protect those regional interests and to ensure that national economic and social policies are implemented to maximize people's welfare, it is important to establish a fair tax system, a fair and efficient central-regional budgetary allocation model and a fair and effective compensation system for the use of ecosystem services. A fair tax system is necessary for establishing a level playing field for competition and for enhancing the state's ability to improve income equality through the 'second round' distribution of national production. A fair central-regional budgetary allocation model is important for enhancing regional development incentives

¹⁰ On 19 November 2007, the share prices of the top five Chinese giants had plummeted by 28% from their peak reached two weeks earlier and China Life was forced out of the world top ten list.

as well as helping the less developed regions. A fair compensation system is necessary for the state to build a harmonious society and to protect the most vulnerable groups of the population from exploitation by the advanced regions and elite groups.

Improving the quality of an open economy

- 2.37 China's latest stage of economic growth has been driven by massive inflows of foreign capital and international trade. Most people believe that China has been producing low-quality and cheap products to serve the world markets. The word 'made in China' does not mean 'made by China' and is often regarded as the synonym of 'cheap and low-technology'. To change this image, besides implementing the strategy to transform China into a leading nation of science and technology, China needs to change its open policies as follows:
- 2.38 Firstly, exports have to depend on more high-value and high-technology products, instead of high volume, low value products. Secondly, 'made in China' has to depend more on domestic technology and innovations and less on foreign design and key technologies so that Chinese exporters and labourers can get a larger share of the value chain of exported goods and services. Thirdly, China should encourage more domestic consumption so that economic growth will not have to depend overly on exports and investments, which would expand the space to upgrade quality and international competitiveness, and reduce risks caused by the ups and downs of international business cycles. Finally, foreign investments have to be directed towards the less advantaged regions and into more high-technology sectors in advanced locations.

CONSTRAINTS AND CHALLENGES ON CHINESE NEW ECONOMIC POLICIES

- 3.1 In the previous section, we discuss the six key economic policies outlined in Hu Jingtao's report to the 17th CCP Congress. It is obvious that the Party and its leaders are fully aware of what needs to be done and how things can be done better in order to achieve China's development goals and objectives.
- 3.2 If these policies are implemented effectively and successfully, China will be able to achieve its medium term objective of quadrupling per capita GDP from 2000 to 2020. By 2020, per capita GDP is expected to reach \$4,000 with China becoming an innovation-oriented state and possessing a much stronger capability in research. In addition, China will lay a strong foundation for further economic growth and prosperity beyond 2020, and become a world superpower in another 20 to 30 years. By 2038, China's total GDP measured in nominal dollars will be as large as that of the US and significantly larger in PPP terms.
- 3.3 This is an achievable target given the present growth momentum and the country's achievements in the last 30 years. However, China may also fail for various reasons because of significant constraints and challenges that may have emerged or arise as China's economy moves up the ladder of industrialisation, urbanisation and internationalisation.
- 3.4 The most important challenge is the ability of the Party to lead the country in maintaining another thirty years of high economic growth and development and achieving common prosperity for its people. The 17th CCP Congress has appointed many new people to the most powerful policy-making bodies: the Politburo of the CCP and its Standing Committee. All these people are younger and more educated than their predecessors. They

represent the hope of continuity in the Party's leadership. A stable and good Party leadership is a necessary condition for China's social and political stability, which is important for economic growth and prosperity.

- 3.5 However, a strong and stable Party leadership is not a sufficient condition for China's ultimate success. It has to depend on the leadership's ability to come up with good policies and make these policies work in the country's best interests. In other words, strong leadership is different from good policies while good policies are different from their successful implementation. The Chinese leadership has been saying that the Party and the government are able to do an excellent job, yet more often than not, they have failed to deliver on their promises.
- 3.6 For instance, Mao Zedong wanted to reduce the differences in rural-urban, worker-peasant and mental-manual incomes, yet these three gaps have become a real headache for China today. In the early 1980s, and in the last three years since 2004, the government had emphasised year after year that farming incomes should increase and peasants should have better lives, but the reality is that urban-rural income gaps continued to widen. In the newspapers and in other forms of Chinese media, anti-corruption is mentioned daily in all official speeches given on both central and regional levels. Hu's report to the 17th CCP Congress even suggests that the Party and corruption are staunch enemies. The truth is that corruption has not been eliminated. Mr Lai Chanxin fled to Canada after he was found guilty to have made as much as 70 billion RMB of illegal money and bribed hundreds of high government and party officials. The Chinese government has been saying that he should be deported back to China but he has remained at large in Canada for many years. The reason why he has not been deported is that the Party may have to arrest some high-level politicians sitting in the centre of the most powerful decision-making bodies of the Party and the state.
- 3.7 It is reported that many high-level officials are subjected to the death penalty and imprisonment every year. However, the death penalty has not deterred government officials from corruption. On the contrary, the scale of corruption has been growing much faster than China's GDP and it appears that the Party is helpless in turning around this situation. People are unhappy and feel let down. Open demonstrations have been strictly prohibited to avoid violence and the threat to social and political stability. Nonetheless, tens of thousands of small scale anti-government protests take place every year, triggered by grassroots' anger over the misdeeds of local government officials, property developers and the like.
- 3.8 Academics may argue that corruption is inevitable in the early stage of economic development. Some people suggest that with a one-party system, it is impossible to contain corruption. Regardless of the correct theory or argument, the fact is that the CCP has not found an effective way to fight corruption despite the existence of many legal bodies, including the courts of law, interrogation courts, security bureaus, anti-corruption bureaus, auditing bureaus, party political and law commissions, etc. These law-setting and enforcing organs are ultimately found to have incurred more corruption cases than any other party or governmental organisations.
- 3.9 In the last 15 years, as reforms in the financial, real estate, education and healthcare sectors deepen, the opportunities for party and state corruption exploded. In the industrial sectors, large state-owned companies with monopolistic power are controlled by party and state officials and/or their relatives. Private firms are also linked to party and state officials. There is no doubt that in China there are some emergent classes which represent

power, or a combination of money and business. It is the ordinary workers, rural migrants and peasants who have been heavily exploited for their hard work and created millions of rich and super rich within a very short span of time. For instance, many of the richest Chinese in recent years are property developers. It is true that these developers are clever and hard-working and thus succeeded in their businesses. It is equally true that many of these rich people have worked closely with politicians, village heads, bankers and other powerful people who have the ability to lend money, sell land and help them evade taxes. The profits from these property developers are shared among these powerful groups, while ordinary people lose their land with little compensation in return, or have to buy houses at prices which are many times their wages and exceed their ability to pay within their life-time.

- 3.10 The banking sector is largely controlled by four large state-owned banks, whose revenues are guaranteed by interest charges. The government fixes deposit and lending rates to allow a high interest spread (at least 3 percentage points) to make sure that state-owned commercial banks have secure and high-interest incomes. In addition, 2.7 trillion RMB of non-performing loans were stripped off the balance sheets of the four large state-owned commercial banks before three of them were listed on the stock exchange. This effectively means that tax payers and depositors have been forced to subsidize these banks, which, in turn, have been supporting a small proportion of the population to become extremely rich and to evade their social responsibility.
- 3.11 Malpractices in business, abuses of political and administrative power and collusion between power and capital are fundamental causes responsible for many of the social, economic and political problems, constraints and challenges faced by China today. For example, the ever rising inequality in China has been caused by people in power and in business who are able to become very rich quickly because of their easy access to capital and land and tax evasion, while peasants are confined to working in cities with extremely low wages and long hours. While workers of state-owned enterprises lose their jobs, their managers get to buy the companies with little money and turn them into their own. Owners of companies can become very rich overnight when their firms are listed on the stock exchanges. However, many listed companies are formerly state-owned. Workers are excluded from the profits they have helped create for those listed companies that turn managers and government officials-turned-businessmen into overnight billionaires. This process of class formation and social polarisation has taken place with the backdrop of a Party who has all along promised that workers and peasants are masters of the country.
- 3.12 The “three large mountains” that Mao Zedong aimed to destroy were imperialism, semi-feudalism and semi-colonialism, and bureaucratic capitalism. In theory, the first two ‘mountains’ were destroyed when the Japanese were driven out of China in 1945 and when the People’s Republic was established in 1949. The bureaucratic capitalists, rural landlords and rich peasants were ruthlessly suppressed and more or less eliminated before the Great Leap Forward Movement. The suppression of pre-1949 industrial and commercial entrepreneurs, rural-rich classes and intellectuals had a detrimental effect on China’s economic growth under Mao’s leadership. Under Deng Xiaoping and his successors, free markets were encouraged and capitalism fully developed under the slogan of “socialism with a Chinese characteristic”, or “the early stage of socialist construction.”
- 3.13 Corruption and poor governance are to some extent responsible for China’s present industrial structure and environmental degradation. For example, 31 Chinese provinces resemble 31 states among which there is limited

cooperation in industrial development. If one city, or one province, sets up a steel factory or a vehicle-making plant, other cities and provinces will follow suit. This is because such plants or factories contribute to the GDP and profits of local governments whose performance is judged by criteria such as output and revenues derived within their territory. As a result, China has been able to expand production of many industrial products, such as steel and vehicles within a short time period, while ending up with too many factories producing an identical product. As many factories are producing the same goods, their efficiency and impact on the natural environment are highly problematic. Much of the pollution of China's water, soil and air has been caused by the desire of local governments to compete against other authorities and regions for natural resources and meet production targets. Corruption has also produced a flood of illegal, or semi-illegal, small-scale but highly-polluting plants being set up throughout the country.

- 3.14 In short, the policies of reform and free market have worked great wonders. Without these reforms, China would not have grown as prosperous. However, the "mountain" of bureaucratic capitalism has revived and developed on such a massive scale that it has become the "evil" behind many undesirable social, economic and political problems in China today. The newly-rich class in China is dominated by bureaucratic capitalism which contains the following groups of people: party and state officials, especially those highly corrupt officials; former party or state officials assigned by the government to run state-owned enterprises; property developers and bankers; owners of large- and medium-sized private enterprises; stockbrokers and fund managers; and a small proportion of intellectuals and professionals in the universities, research institutes, schools, hospitals and law firms. Some of these newly-rich have made a fortune by their own efforts and creative activities, but many of them have become rich through illegal or semi-illegal measures, including the use or creation of legal loopholes, market imperfections, tax evasion, abuses of power, or collusion of power and capital.
- 3.15 As the newly-rich are either in power or have the loudest voice in Chinese politics and the most marginalised groups are isolated, it is almost impossible to create a fair society in China. Hu Jingtao is right to set an ambitious target of harmony and common prosperity, yet existing interests and the class structure could render the government incapable of achieving its goal. Consequently, if the government is really determined to make a fundamental change to Chinese society, radical political reforms and painful approaches have to be adopted. For example, corruption must be dealt with brutally and the Party should set a significantly lower tolerance level for power abuses and collusion between power and capital. Tax reforms must be implemented so that the state is able to tax the rich far more aggressively and transparently. Tax incomes should be used to support development of the poor regions and to create better employment opportunities for the poor. The job market should become fairer and more competitive so that the "lower classes" and "rural people" are not subject to excessive marginalisation and exploitation.
- 3.16 The second most critical challenge to China's new economic policies is the low efficiency of growth. China's GDP growth rate could be as high as 10% per year for many consecutive years, but people's living standards have not risen as much because of the low quality of growth. Excessive inputs of energy and raw materials, high levels of pollution and environmental damage, wasteful investments, slow rates of technological progress and efficiency improvements suggest that high growth cannot be maintained without bearable social and environmental consequences. The threat to

political stability can also jeopardise the long term plan of economic growth and development.

3.17 During 1978-85, China's GDP and people's incomes grew simultaneously. Within seven years, the real per capita GDP increased by 67%, real per capita urban income by 52% and real per capita rural income by 169% (Figure 8). Economic growth brought about a significant improvement in people's living standards, especially the living standards of the rural population. Meanwhile, the long-term urban-rural income inequality was greatly reduced and over 75% of the rural poor were lifted out of poverty.¹¹ The per capita urban-rural income ratio declined from 2.6 to 1.8 over the period (Figure 5). This period is the best example of high-quality rapid growth in the 58 years of modern economic history in China as the benefits of GDP growth was immediately passed on to improve people's living conditions, reduce income inequality and poverty, and increase employment.

Figure 8 Real per capita GDP, urban & rural incomes 1978-85 (1978=100)
(Sources: NBS, *China Statistical Yearbook*, 2006)

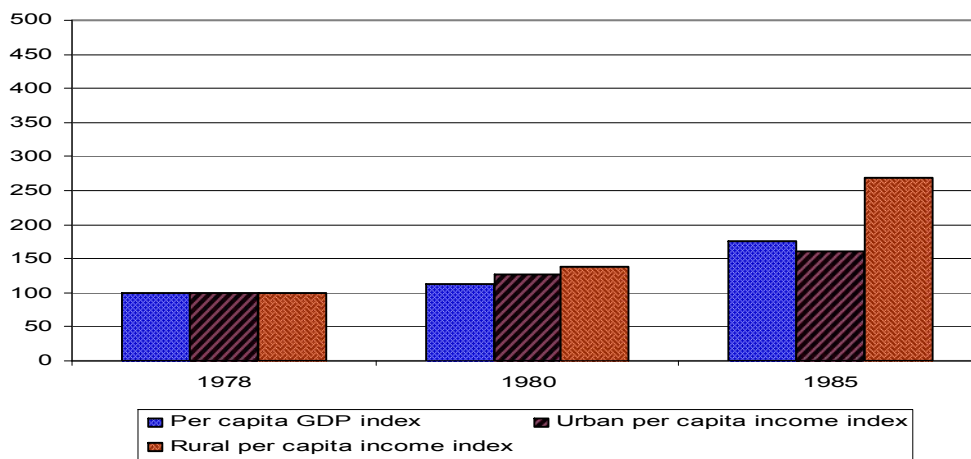
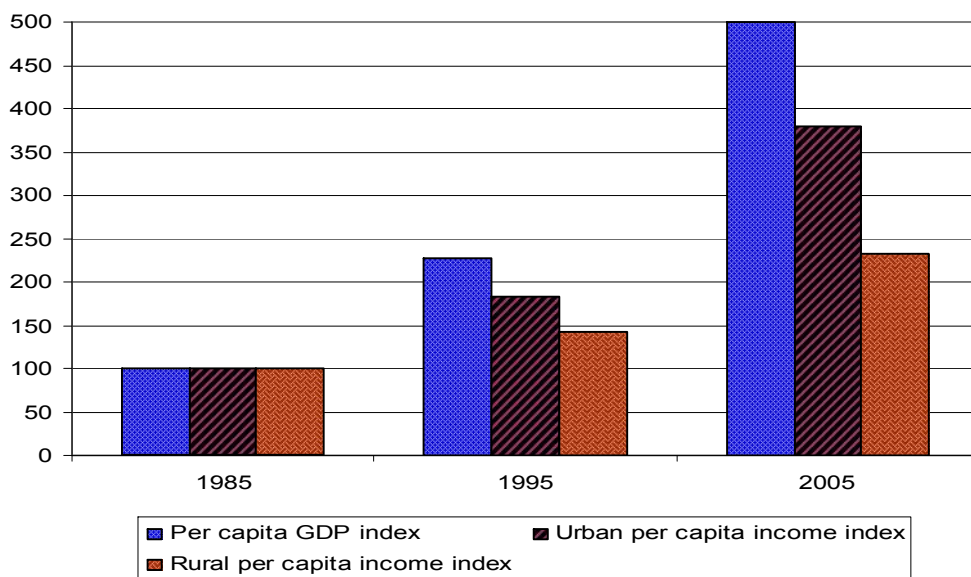


Figure 8a Real per capita GDP, urban & rural incomes 1985-05 (1985=100)



3.18 The quality of economic growth deteriorated after 1985 as the focus of reforms shifted away from agriculture and the rural economy to industry

¹¹ Yao, Shujie (2000) Economic development and poverty alleviation in China under economic reforms, *Economic Development and Cultural Change* 48(3):447-474.

and the urban sector. The pro-agriculture and pro-rural development strategy implemented during 1978-85 was overtaken by heavy investments, foreign capital, exports and above-all, intensive consumption of energy and materials. As a result, GDP grew faster than before but the growth of personal incomes, especially rural incomes, did not match the growth in GDP. Over the 20 years from 1985 to 2005, real per capita GDP increased by 400% and real urban per capita income by 270%, but real rural per capita income by a mere 132% (Figure 8a). The increase in rural income over 20 years was significantly less than that achieved over seven years during the period of reforms. In addition, excessive investments and consumption of energy and resources have led to massive losses in economic efficiency, environmental degradation, and rising income inequality. Without improving the quality of growth, China will not be able to build a harmonious society with sustainable prosperity.

CONCLUSIONS

- 4.1 The six key economic policies of the 17th CCP Congress discussed in this paper are detailed approaches taken by the CCP to resolve problems and reduce the constraints on China's future growth and prosperity. These policies can be summarised into two phrases mentioned in Hu Jingtao's report: "building a harmonious society" with a "scientific approach".
- 4.2 Building a harmonious society is a long term goal and objective. Harmony means that everyone gets a fair share of economic growth and prosperity. In other words, income inequality has to be reduced, regional development has to become more balanced, party and state officials have to become less indulgent in rent-seeking and other corrupt activities. If the Party manages to build a harmonious society, it will be able to maintain its power and control of the country along with popular support. If the Party fails to do so, it may not deliver on its promise to the people and eventually lose its power and control of the country. As a result, building a harmonious society is a pre-condition for the CCP to be able to lead and better serve the Chinese people in the future.
- 4.3 But how can China build a harmonious society? Hu Jingtao suggests a scientific approach which can be interpreted as follows: China has to rely on science and innovation to improve production efficiency, reduce its over-dependency on non-renewable energy and resources, create a better economic and market system so that China will become more competitive internationally, improve the current industrial structure and reduce its over-dependency on manufacturing in order to sustain high economic growth, increase the process and quality of industrialisation and urbanisation, reduce pollution and environmental degradation, find alternative sources of energy and materials, improve the quality of living for everybody in terms of education, healthcare and other public services, and make China a superpower with considerable influence on politics, military affairs, culture, education, science and technology globally.
- 4.4 China has moved to the second stage of its development towards becoming a world superpower. It has done well in the first stage and in the first seven years of the second stage. The next 13 years from 2007 to 2020 is a critical period. If China is able to achieve its objective of quadrupling per capita GDP to \$4,000 by 2020, and it is able to arrest the rising trend of income inequality and divergence of the coastal region from the rest of the country, China will be able to lay a solid foundation for its last stage of development from the middle of the 21st century. At the time of writing this paper, the

Moon-Goddess I satellite is still flying from its last earth orbit towards its first moon orbit and will continue to fly for about 4 days before it is "caught" by the moon's gravity, enabling it to settle on its final designated orbit. Although it is almost certain that the Moon-Goddess I satellite will be successful, it is less certain that China will be able to reach its ultimate objective by the middle of this century. China's success, however, will largely depend on whether the new policies of the 17th Party Congress are effectively implemented to fulfil the party's development goals. Hence, the new policies discussed in Hu Jintao's report can be seen as the beginning of the final push for China to move onto its orbit of sustainable growth, common prosperity, and to become a world superpower characterised by harmony domestically and internationally, having an immense influence on political, military and economic matters both regionally and internationally.