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Global Influence of China's New Reform An Overall Evaluation

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Global Influence of China's New Reform

Main conclusions

- Chinese Economy is expected to grow by 7.5% in 2014. China's economy features a slower growth rate but greater sustainability. In the near and medium term, GDP growth rate will remain around 7%. The ongoing comprehensive deepening reform will continuously resolve the structural challenges facing Chinese economy, which will result in slower growth rate but more sustainable development.

- From 2014 to 2020, China is expected to contribute 7 million new jobs for other countries in the world. By 2020, Chinese economy, as share of the world economy, will increase to 15% with a contribution rate of 27% to global economic growth.

- China's consumption and industrial upgrading will promote import growth. Estimation shows that by 2020, household consumption ratio in China will reach 45% and final consumption ratio is expected to exceed 60%. China will add to \$ 1.7 trillion of import in total from foreign countries during the same period.

- By 2020, China's urbanization rate will reach 60%. New-type urbanization will boost investments in public service facilities and demands for consumer and producer services, offering new opportunities to other countries in the world.

- By 2020, China's outward foreign direct investment (OFDI) stock will surpass USD1.2 trillion. China's industry transfer brings huge opportunity for labor intensive industry and industrialization of neighboring countries.

- Mixed ownership economy will create more room for private capital and foreign capital. An array of projects will be open to private and foreign investors in fields including finance, oil, electronics, railway, telecommunication, resource development, public utilities, etc.

- China's industrial transformation and upgrading will gradually accumulate comparative advantages in medium-end manufacturing and high-end manufacturing with low access threshold, which will drive developed countries to move up their industrial chain. Developed countries will maintain comparative advantages in high-end manufacturing and modern service sector in which they have more complementarity than competition with China.

External influences of China's new reform are now the focus of the international community. China's economic growth will create more jobs for foreign countries, consumption and industrial upgrading in China will drive up exports of other countries, new-type urbanization will render more investment opportunities to foreign investors, China's "going global" strategy will bring capital and industrial transfers to host countries and mixed ownership economy will further facilitate foreign direct investments in China. Industrial upgrading will promote China's competitiveness in medium-end manufacturing, and developed economies still remain advantage in high-end manufacturing and modern service industry. In general, Opportunities by comprehensive deepening reform in China will far outweigh the challenges. Huge dividends generated by China's reform will offer great opportunities and enhanced cooperation for international community. China's reform will also promote other countries to play a positive role in international division of labor and achieving win-win development.

I. Prospects of China's Economic Reform

The core of this round of economic reform is the proper relationship between government and market. China is pushing forward a new round of reform with higher standards, opening up with higher level and development with higher quality. The highlights of the reform include establishing fair, open and transparent market rules; improving market pricing system and reducing improper government intervention; carrying out reforms in productive factors such as land, asset, resource, etc; transforming government functions, improve the macro-control system, and building law-based, service-oriented government. By 2020, China's reform is expected to make decisive achievements in the above important fields and key links. Market will play a decisive role in resource distribution, and government will also take a better role in macro control, risk supervision and information guiding.

China's economy is shifting from high to a new normal growth rate. China's economy will graduate from an export-driven one to an economy fueled by domestic demand and innovation. Soft external demand and structural factors lead to a slower growth rate; economic restructuring facilitates rebalancing and render more sustainable growth. New engines will include consumption, infrastructure investment, industrial upgrading and urbanization, which will ensure the economy a annual growth rate of 7% by the year of 2020.

A new open economic system will be built. Growth model shift will stimulate import demands, open the service sector to foreign capital and keep Outbound Direct Investment (ODI) increasing. "One Belt and One Road" enhances connectivity between China's borderlands and neighboring countries, pushing forward regional economic cooperation. The establishment of Shanghai Free Trade Zone can blaze new ways and gain new experiences for further opening to the outside world and adapting to new international rules.

A new supply-demand dynamic is taking shape. Income increase and changes in demographic structure are underlying causes for transformation of supply-demand dynamic. In decades to come, China will witness a decline in labor supply. It is estimated that the share of working-age population will drop by 4% in 2020 compared with that in 2013. Decreased labor supply leads to higher labor cost, and the supply-demand structure will shift from low-end processing and manufacturing to high added value. Equal emphases on regular higher education and vocational education will offer human capital for industrial upgrading. An ever expanding middle class is becoming the main force to promote consumption and motivate the consumption structure towards mid-and high-grade goods, modern service and intellectual products. Investment priorities will shift to modern agriculture, strategic emerging industries, new-type urbanization and shantytown renovation, urban infrastructure, etc.

Income distribution is making adjustments to achieve balance. Income gap is continuously bridged. Gini Coefficient has dropped from 0.491 in 2008 to 0.473 in 2013. If the current trend continues, Gini Coefficient will further be below 0.45 in 2020. With regional efforts to address dualism between rural and urban areas, gap between per capita income of rural and urban residents keeps shrinking. Regional structure is also witnessing new changes. Shanghai has become the growth engine in Yangtze River Delta; development gap between the Pearl River Delta and its surrounding areas has been narrowed with the process of industrial restructuring; and Beijing-Tianjin-Hebei megalopolis sees notably accelerated integration. Industrial transfer from developed regions and the implementation of “One Belt One Road” will significantly promote development and structural adjustment in central and western part of China.

II. Enormous Opportunities Bringing along by China’s Reform

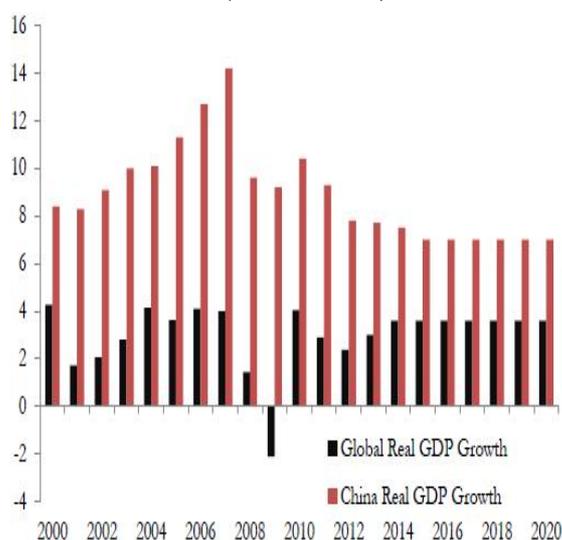
China’s economic growth creating new jobs for foreign countries

Sustainable economic growth in China drives global economic recovery and creates jobs in other countries through more imports and outbound investments. China’s economy grew by 7.7% in 2013, and the rate will slow down to 7.5% in 2014. As estimated, economic growth rate in China will stay around 7% in the medium term. According to OECD, average growth rate of global economy between 2014 and 2020 is estimated to be 3.6% (Figure 1). With the same rate, by 2020, China’s economic aggregate will account for 15% in global economy with an average contribution rate of 27% (Figure 2).

Economic growth improves employment market. According to *World of Work Report 2014* released by International Labor Organization, there will be 40 million more jobs every year in the future. Namely, 280 million jobs will be created from 2014 to 2020. Based on China’s contribution rate to global economic growth, China will create 77 million jobs for global job market during this period. It is estimated that a 1 % of China’s GDP growth will generate 1.5 million urban employments. That is to say, a growth rate of 7% will add 10 million jobs annually in urban areas. **Besides domestic job creation, China will help to contribute 7 million more jobs in total for the other counties**

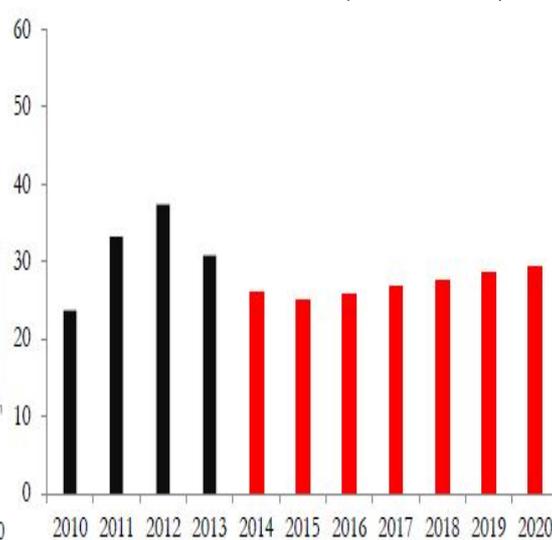
from 2014 to 2020.

Figure1 China & Global GDP Growth Rate
(%, 2000-2020)



Source: WDI, NBS, Authors' Calculation.

Figure 2 China's Contribution on Global
Economic Growth (%, 2010-2020)



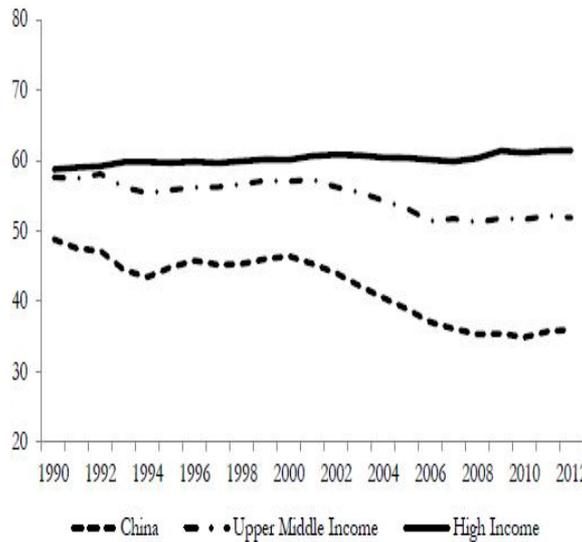
Source: WDI, NBS, Authors' Calculation.

China's consumption and industrial upgrading pushing up exports by other countries

Current household consumption rate stands at 36.1%, lower than that in countries at the same income level as well as developed countries (Figure 3). Factor market distortions and less developed social security system jointly hold back the household consumption. Specifically, government consumption rate among total social consumption is comparatively stable, whereas household consumption rate dropped by a large margin. During the period from 2000 to 2013, government consumption rate maintains around 14%, and household consumption rate dropped from 46.4% in 2000 to 36.1% in 2013. Growing per capita income and labor cost have generated positive changes in household consumption. From the year of 2011, household consumption rate started to pick up. **By 2020, it is expected to reach 45% and final consumption rate is poised to exceed 60%.**

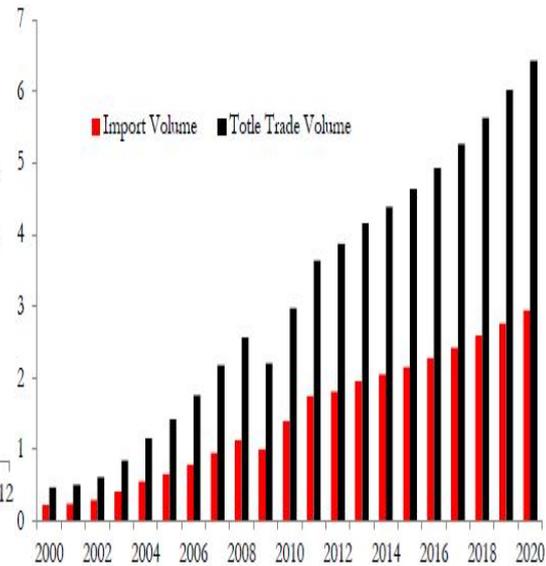
Higher income and improved income distribution upgrade China's consumption structure. As broadcasted by Mckinsey & Co, middle-income population will increase from 230 to 630 million from 2012 to 2022 and become main consumers of mid- and high-end goods, modern services and intellectual products. Going forward, demands for global finance, healthcare and education will keep soaring. Large numbers of students go study abroad for better education. Outbound tourism will also be on a trajectory of steady increase; the next five years will expect over 400 million departures from China. China will also register stronger demands for imports of high-quality, high-tech goods. **As predicted by IMF, growth rate of China's import will average 6.04% with a total of over \$ 10 trillion (\$ 11.5 trillion) of goods between 2014 and 2020. By 2020, a total of \$ 17 trillion of import will be made (Figure 4) .**

Figure3 Household Consumption Ratio
(%, 1990-2012)



Source: WDI, NBS, Authors' Calculation.

Figure4 China's Import and Total Trade Volume
(Trillion USD, 2000-2020)

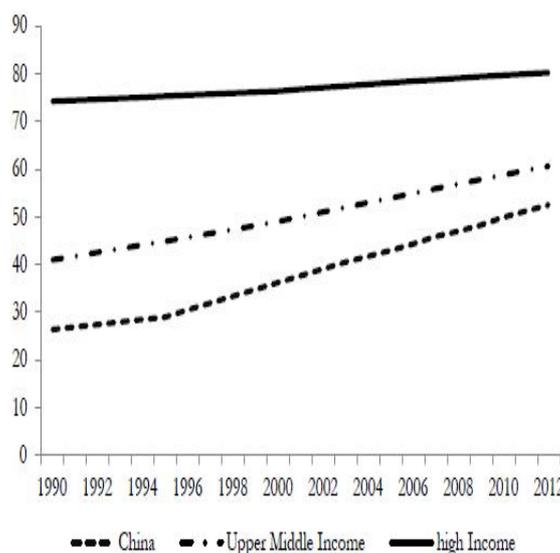


Source: WDI, NBS, Authors' Calculation.

New-type urbanization bringing along new investment opportunities for other countries

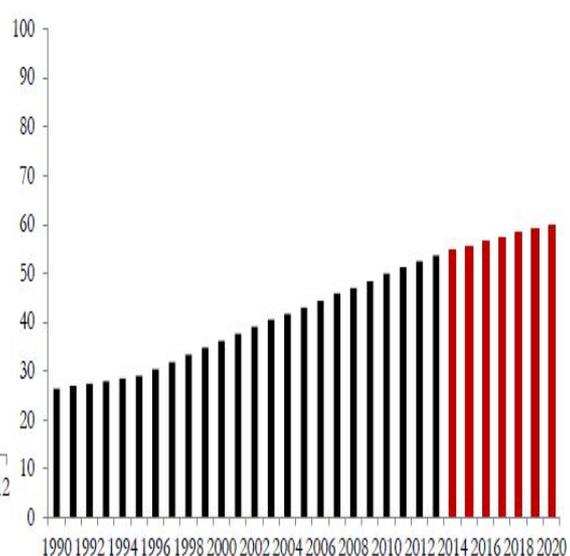
In 2013, urbanization rate in terms of permanent urban residents in China stood at 53.7%, and that of registered population was only 36%. Both were far lower than the average 60% in developing countries with similar income as well as the average 80% in developed countries (Figure 5). China's urbanization will generate enormous demands for investment, boost the service sector and contribute to economic growth in China and the world. **By 2020, urbanization rate in China is expected to reach 60%** (Figure 6).

Figure 5 Urbanization (%) 1990-2012)



Source: WDI, Authors' Calculation.

Figure 6 Urbanization in China (1990-2020)



Source: NBS, Authors' Calculation

Urbanization means demands for more investment in urban infrastructure, affordable housing, real state development, public service like education, healthcare and environmental conservation, etc, which boosts investment in and development of correlative industries such as food, home appliances, textile and clothing, automobile, energy, chemical industry, iron and steel. Investment in China then will enter a new growth cycle, making contributions to economic growth in the world as well as in China.

Urbanization also promotes service sectors: population concentration, change of lifestyles and improvement of living standards serve to boost demands for **consumer services like education, culture, tourism, healthcare, childcare, provisions for the aged**; optimized allocation of production factors, interaction between three sectors, more detailed division of labor will also engender stronger demands for **producer services like finance, logistics, law, science and technology, accounting, auditing**, etc. Concentration of innovation elements and knowledge dissemination derived from urbanization attract global capital, technologies and talents and form new R&D, fiscal and management centers. In this way, innovation gets momentum, traditional industries tend to be upgraded and emerging industries gains steam. As China opens trade in services to the world, China's service sector delivers favorable opportunities to foreign capital to engage in the urbanization process.

China's "going global" strategy providing host countries with capital and industry transfers

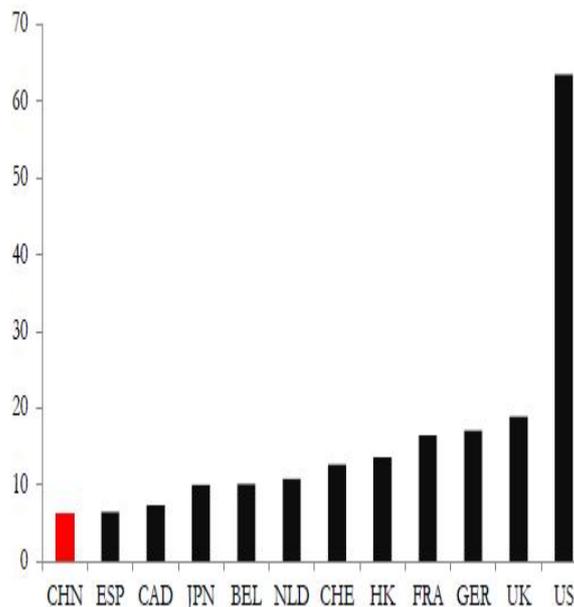
In 2013, China became the world's third largest investor with a net ODI of \$ 101 billion, of which \$ 90.17 billion is non-financial ODI. By the end of 2013, China's ODI stock reached \$ 613.5 billion, ranking the 12th globally. It was only as much as 9.7% of that of the U.S., 32.5% of the UK, 35.9% of Germany and 61.8% of Japan (Figure 7), showing a yawning gap. As China establishes a new system of opening up, **its ODI is bound to increase steadily. It is estimated to surpass \$ 500 billion in the next five years, and by 2020, the ODI stock will go above \$ 1.2 trillion** (Figure 8). **Hong Kong, ASEAN, EU, US and Russia will become main destinations of Chinese investment** that primarily goes to fields like **leasing and commercial service, finance, mining, wholesale and retail, transportation/warehousing and postal service, construction**, etc.

Rising labor cost and industrial upgrading will promote labor intensive manufacturing industry transferring from eastern coast area to central and western China and neighboring countries. With the development of China-ASEAN free trade zone and the implementation of "One Belt and One Road", neighboring labor abundant countries will bring lower labor cost advantage into play, which in turn, will provide important opportunities for these countries to receive industrial transfer and build up modern manufacturing industrial system with China's capital, appropriate technology, management experience and development concepts.

With the cluster development between China and the neighboring countries and the integrated industrial chain, recipient countries will see obvious increase in resident income and consumption capability, and form the complementary strength with Chinese

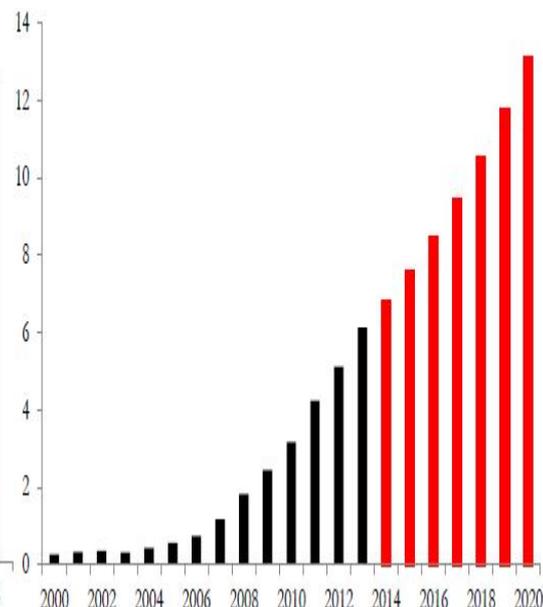
economy. Besides, most developing countries must improve their infrastructure in order to receive industrial transfer. When China participates in local infrastructure building and consumes domestic production, it also creates opportunities for financial service providers in developed economies.

Figure 7 Outward FDI Stock in 2013
(100 Billion USD)



Source: UNCTAD, Authors' Calculation.

Figure 8 China's Outward FDI, 2000-2020
(100 Billion USD)



Source: UNCTAD, Authors' Calculation.

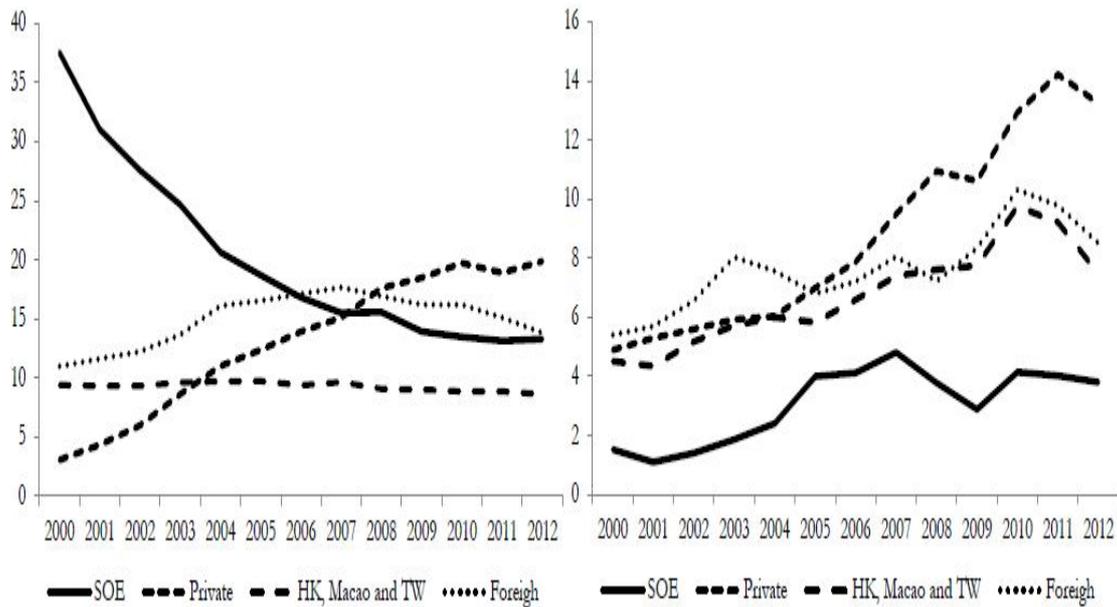
Mixed ownership opening up more space for foreign investment

Mixed ownership economy is a key way to improve the economic vitality. Since 1990s, China has started to build a liberal environment for non-public-owned economy by allowing Chinese private and foreign firms to take part in the ownership reform and reorganization of state-owned enterprises (SOEs). As shown in Figure 9, from 2000 to 2012, the ratios of the total assets of private and foreign enterprises to total assets of industrial enterprises grew by 16.7% and 2.8% to 19.8% and 13.8% respectively, whereas at the same time, the share of SOEs dropped to 13.3% from 37.5%. Common development of different types of enterprises generates a sound competition environment and spillover effect and invigorates the Chinese economy.

Mixed ownership economy and more efficient capital allocation expand profit margins for all enterprises. Cross share-holding by state-owned, collective and non-public capital are conducive to complementarity, mutual promotion and common development among them. Though SOEs register decreasing share in the economy, introduction of competition, sound modern enterprise systems and corporate governance structure have boost their profit margin by 22.3 percentage points on the basis of 1.5% at the beginning of this century. Private and foreign enterprises also record higher profit margins thanks to the reform. Currently, profit margin of private enterprises is 9.4 percentage points higher than that of SOEs. The margins of enterprises from Hong Kong, Macao and Taiwan and foreign enterprises are respectively 3.7 and 4.7 percentage points higher

(Figure 10). Differences of profit margins among SOEs, private and foreign enterprises are the internal impetus behind further development of mixed ownership economy in China.

Figure 9 Ratios of Different Types of Enterprises (% , 2000-2012) Figure 10 Profit Margins of Different Types of Enterprises (% , 2000-2012)



Source: WDI, Authors' Calculation.

Source: NBS, Authors' Calculation

Mixed ownership economy opens up more space for private and foreign investment. Capitals with different ownerships **Market attributes of capital with different ownerships will be strengthened and the role of enterprises as market players will be reinforced. More investment projects will be gradually rolled out to private and foreign capital in fields like finance, oil, electronics, railway, telecommunication, resource development, public utilities, etc.** Both state-held and non-state-held mixed ownership economies should be encouraged. In consequence, mixed ownership does not advance one kind of ownership at the cost of the other. Instead, the nature is joint development.

III. Influence of China's Industrial Transformation and Upgrading on Developed Economies

Economic growth has been driving up costs of labor, land and natural resources. Factors such as technologies, capital and high-caliber human resource are growing into new comparative advantages of China. **Medium- and high-end manufacturing, new strategic industries and modern service industry** with those factors as main inputs are taking increasingly significant roles in the industrial structure. Traditional labor-intensive industries are losing advantages and starting to transfer to neighboring developing countries. Traditional manufacturing in China will be pressured to carry out technological innovation, transformation and upgrading. They must move towards the mid or high end in the value chain to identify new core competitiveness.

As domestic market expands and enterprises increase R&D input, medium-end manufacturing and high-end manufacturing with low access threshold find China suitable for standardized production. China in turn, will gather comparative advantages in **medium end manufacturing industries including telecommunication equipments, electronic products, high-speed rail equipments, home appliance, automobile, chemical industry, electrical engineering, passenger aircraft, solar energy, wind power installations among others.**

Though China's investment and industrial structure are edging up to higher ends, it still lags behind developed economies in terms of high-end manufacturing and modern service industry. China and developed economies share more complementarity than competition in new energy, bio-pharmacy, industrial service and financial innovations, which brings opportunities for developed countries to expand exports of advanced technologies and equipments, key parts and components and intensify investment in advanced manufacturing and modern services. Brics countries including China's industrial upgrading will speed up scientific and technological progress and R&D capacity building in developed economies, motivate the concentration of preponderant resources on higher links of the industrial chain and push forward the production frontier of the developed economies.

IV. Comprehensive Deepening of Reform Will Overcome Challenges to China's Economy

Over the past three decades, China is the only emerging power devoid of severe systemic financial crisis. Since the 2008 global financial crisis, China's economic growth has slowed down, structural problems originated from high growth rate started to surface. Real estate and risks of local-government debt stand out as common concerns of Chinese and foreign scholars.

According to international experience and China's data, however, risks facing China's economy are within a controllable range. All China's credits are domestic debts, similar to local-government debts of Japan and the US. It is foreign debt that is more easily to evolve into systematic financial crisis, such as the European debt crisis, 1997 Asian financial crisis, and Latin American debt crisis. In China, local government debts are mainly invested in infrastructure and pro bono projects. Municipal construction, land purchase and storage, transportation, public housing, education, science, culture, public hygiene, agriculture, forestry, water conservation and ecological preservation take up about 87% of all spending, forming enormous high-quality assets that pay back the debts with revenues. In the next few years, China will intensify efforts on building public housing and renovating shaggy towns. Speculative demand will be contained, and the real estate market will be gradually led back to normal with fewer drastic ups and downs.

Leverage ratio in China has risen to 210%, but it is still much lower than the global high-risk window (250%-280%). Considering its high saving rate, there are no systemic risks. Though the scale of shadow banking has expanded, it only accounts for 62% of GDP, much lower than the 110% in G20 countries. Meanwhile, shadow banking in China

is dominated by banks, and the vast majority has been put under supervision. By the end of 2013, the debt-to-GDP ratio of central government was 22.4%, much lower than the average of 106.3% in developed economies and 34.5% in emerging and developing countries. So the central government is able to cope with potential risks caused by local-government debts.

The market-based reform of financial system is a key part of China's comprehensive deepening reform. It is also an important measure to handle risks in financial sector. China has for long adopted repressive financial policies and caused undersupply of effective financing. That is why shadow banking and middle- and small-sized enterprises suffer financing difficulties. Going forward, China will promote interest rate liberalization so that interest rate reflects supply-demand dynamic and that capital flows from state-owned sectors with low efficiency to private sectors with higher efficiency, thus a higher efficiency of fund use. China will also forge ahead with reform of foreign exchange regime to make monetary policies more independent, create a favorable environment for the opening of capital account and facilitate free flow of capital. China's financial sector will undergo major changes and the government will encourage direct financial market. The opening up of banking sector will provide foreign-funded banks with opportunities to do business in China as well as will fuel the development of medium- and small-sized financial institutions.

V. Policy Implications of Dividends from China's Reform

International cooperation on sustainable development. Countries in the world shall make concerted efforts to cope with climate change, cut emissions and protect environment. A universal carbon trading market shall be set up in accordance with different development phases and establish "common but differentiated responsibilities" in an objective manner. Cooperation and research concerning reduction of carbon emission, such as renewable resources, nuclear energy, clean coal technology, CO₂ sequestration and storage shall be enhanced with engagement of private sectors.

Recognition of China's economic development. Peaceful development and sustainable economic growth in China bring opportunities rather than challenges or threats to others. Developed countries should conduct fiscal consolidation and enhance macro-policy coordination with developing countries so as to curb fluctuations in the global financial market. Developing countries should adjust industrial structures, reinforce IPR protection, encourage innovation and build an open, transparent and level playing field.

Investment facilitation with a more open mentality. Potentials of bilateral investment should be further released to create more jobs and business opportunities. The maturing Chinese market has offered more profit margins to foreign capital. China's ODI helps improve infrastructure and employment in host countries as well as discharges social responsibilities. Host countries should adopt effective measures to enhance investment facilitation and provide favorable policy environment and opinion support for foreign direct investment, including that from China.

Advocacy of free international trade with more rationality. Developed countries should follow global trade rules and invite emerging and developing countries including China to trade negotiations, rather than raise trading standards making use of TTP and TTIP and exclude emerging and developing countries. At the same time, they should also lift restrictions on high-tech exports and new energy development. Emerging and developing countries should conduct FTA negotiations with China and sign FTA agreements so that disparities and complementarity of economies are strengthened.