

# CHANGE OF CHINA'S DEVELOPMENT MODELS AT THE CROSSROADS

Chief Editor: **Chi Fulin**



# CHANGE OF CHINA'S

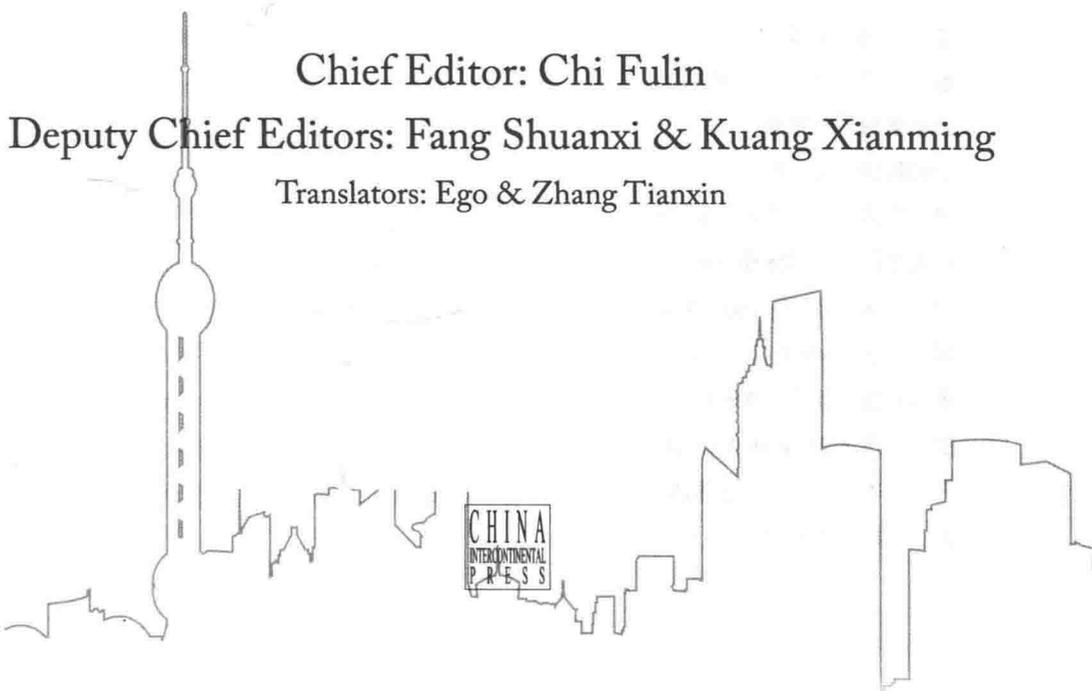
## DEVELOPMENT MODELS AT THE CROSSROADS



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## **Introduction**

# **China's Road to a Consumer Power Is Not an Unknown Number**

In the passed year of 2009, Chinese government took a series of counter measures characterized by “increasing economic growth, structural adjustment, promoting reform and improving people’s livelihood” to grapple with the problems caused by the economic meltdown and successfully fulfilled the growth target of eight-percent protection which has become the success of the first phase. Under such circumstances, people are more concerned about what China will be like in the next five years, ten years or even thirty years than ever. In our opinion, China will be at the critical moment of reform and development in the next few years. Judging by the conclusive changes of the developing periods, justice and sustainable development have become the main themes of China’s development models transformation.

The transformation from a production power into a consumer power is a realistic choice for China’s development models change during the Post-crisis era. During the first change of the development models about 30 years ago, China became a production power all over the world rather than a consumer power. The current anti-crisis moves showcase that the shrinking overseas markets’ demands in European and North American countries will become a long-term or medium-term tendency. The export-oriented model will be difficult to continue as well. Although the overseas markets would be resumed some day, China, a rising power with a population of 1.3 billion, cannot seek economic increase on the basis of overseas market demands in the long run. As a result, given the anti-crisis measures’ achievements in the short run and the realistic requirements for long and medium-term sustainable economic increase, the second transition from a production power to consumer power needs to be launched as soon as possible owing to the objective situations.

For China, the transformation from a production power into an

important consumer power is a basis road to the justice and sustainable development. According to China's domestic developmental environment, China has finished making a historic leap from the stage of survivability to the new stage of expansibility in the past 30 years by dint of the first transition from the planned economy to the market economy. At the new stage, the social contradictions had their salient features, embodying the human beings' personal development which has become the core objective of the new stage. According to the de facto proceeding of the economic system reform, the people's personal development at the new phase has begun to highlight the second transition although the goals of the first transition have been far from being fulfilled. The human beings' personal development is pressing for removing the tendency to seek the growth of GDP, initiating the second transition with the theme of justice and sustainable development. During the period of the second transition, the economic growth will not be for the sake of increase itself any longer. Instead, it should be on the basis of the widespread increase in the consumption ability, happiness and benefits of the numerous social community members. On the one hand, the widespread increase in the consumption ability will create favorable conditions for people's personal development, especially for giving full play to the majority's opportunities and abilities. In this sense, the so-called "consumption-driven growth" best embodies equitable growth. On the other hand, the consumption-driven growth focuses on neither the expansion of overseas market demands nor the investment propelled by the government. In this sense, the consumption-driven growth can best embody the concept of sustainable growth as well.

China's transition from the survivability stage to the expansibility leaves the country large space for the purpose of building up a large consumer power. The international experience shows that such a transition is in favor of the fast and objective boost of all the development indicators of consumption into a high level. For example, the urbanization will be accelerated and greatly increase people's income. It will present enormous room for the growth of consumption. Currently,

China is seeking to shake off the shackles of the dual economic structure of urban and rural areas. As a result, the process of urbanization will be speeded up. The new structure of integration of urban and rural areas in China will be supposed to turn millions of farmers into urban residents. If their consumption level is almost equivalent to the city dwellers, the consequent increase in consumption demands would upstage any other country in the world.

China badly needs the second transition. And the potential of building up a large consumer power needs to be given full play to by dint of the complete institutional innovation. The second transition launched by China and the complete institutional innovation would create favorable conditions for the cause of building up a large consumer power. On the side of the economic system reform, if the adjustment of national income is able to achieve the breakthrough, the relatively favorable economic environment for the construction of an important consumer power will be established. On the side of the social system reform, if the salient contradictions like the shortage of public goods can be grappled with in an effective way or if the fundamental public service system benefiting a population of 1.3 billion can be set up, the favorable social environment for the construction of an important consumer power will be developed. On the side of the administrative management system reform, if the country can blaze a new trail in transforming the government functions from the economic construction-oriented government to the public service-oriented government, the most pivotal institutional environment for the construction of an important consumer power will be developed.

The second transition leading to the consumer power is China's only road of enriching people and making the country powerful in the next 30 years. It is China's greatest contribution to the world's economy as well. According to a story on British "Financial Times" with the title "Looking Forward to China's Miracle of Import" in recent days, it is almost impossible for China to change from a production power into a consumer power in the short run although Chinese economy planners wish to increase the consumption's share in the economic growth. According to

the United States' *Wall Street Journal*, Chinese authorities are making use of more resources to support the subsidies of consumption expenditure. However, whether China will become a real consumer power is still uncertain. In our opinion, we need to think about China's prospects while setting it against the backdrop of the second transition if we want to get a real understanding of what China will be like in the future. Currently, China has already fulfilled its goal of taking the lead in achieving economic recovery. It will probably enable China to accomplish the historical transformation from a production power to a consumer power if we can take the opportunities based on this while keeping a close eye on the second transition launched by justice and sustainable development in the future 30 years.

The second transition leading to the consumer power is not only an epoch-making event after China's reform and opening but also an epoch-making event in the history of the world economy. If China wants to finish its complete modernization process, the country needs two big transitions at the least. The first transition is the transformation that brings about the market-oriented economic system. The second transition is the transformation that will lead to a consumer power. And it will create necessary institutional conditions for China's probes into its modernization road of "enriching people and making the country powerful." China's second transition is about to present the most supportive factors and most vital factors to the new round of globalization drive, making greater contribution to the sustainable growth of the world's economy.

## Part I >

# CHINA'S NEW SIGNPOST: JUSTICE AND SUSTAINABLE DEVELOPMENT

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China is at the historical turning point leading to the justice and sustainable development. According to the historical tendency of Chinese modernization process, it should contain at least two major transitions and reforms. The first transition and reform is the economic system reform launched by the Third Plenary Session of the 11<sup>th</sup> Central Committee in 1978. Its main theme is to liberate and develop the productive forces and its aim is to construct the socialist market economic system. The Second transition and reform refers to the all-round reforms in the next 30 years or so, including the reforms of the economic, socialist and political systems. Its main theme is to realize justice and sustainable development while its aim is to form the development models with Chinese characteristics.

## Chapter I Crossroads of Chinese Development Models Transition

During the first transition and reform in the past 30 years, China established its market economic system structure and succeeded in fulfilling the goals of economic take-off and fast expansion of economic aggregate. However, the development models transformation has not taken shape. The recent international financial meltdown highlighted all the contradictions related to the previous development models. Currently, China is at the crossroads of its development models transition.

### SECTION I THE FIRST TRANSITION: TERMINATION OF EXPORT-ORIENTED MODEL

During the past 30 years, China succeeded in taking the historical opportunities offered by the third globalization wave. The country adopted the active strategy of opening to the outside world, forming its own export-oriented model characterized by large-volume import and export. When the post-crisis period is approaching, the changes of the overseas market have pushed such an export-oriented model at the critical moment of historical transformation.

#### **1. The decline of overseas market demands would be a medium and long-term tendency**

The major export partners of China are those developed countries in Europe and North America. However, these developed countries are the hard-hit area of the international financial crisis this time. Although the most scary period of the crisis is already over and the tendency of economic slow-down has been under control, the crisis' impact on these developed countries has not ended. Both the globalization situation during the post-crisis era and the country's medium and long-term development requirements show that such a model should be terminated.

(1) Developed countries' de-leveraging is a medium and long-term tendency. Take the United States as example, the de-leveraging of personal property in the United States has already begun to affect Americans' personal consumption modes. According to the recent statistics, American people's personal savings rate had risen from the record low of 0.8% in August 2008 to the record high of 6.9% in May 2009. It is the record high in the past 15 years. There are similarities between the financial crisis and the Great Depression. During the resurgence of the Great Depression, the savings level got a growth of 7.5 percentage points from 1933 through 1936 under the circumstances of a large-scale decrease of disposable personal income. The major cause is the increase in the precautionary savings.<sup>1</sup> It can be predicted that the restoration of American households' balance sheet during the financial crisis and the growth of precautionary savings would change the US consumption structure in the three to five years.

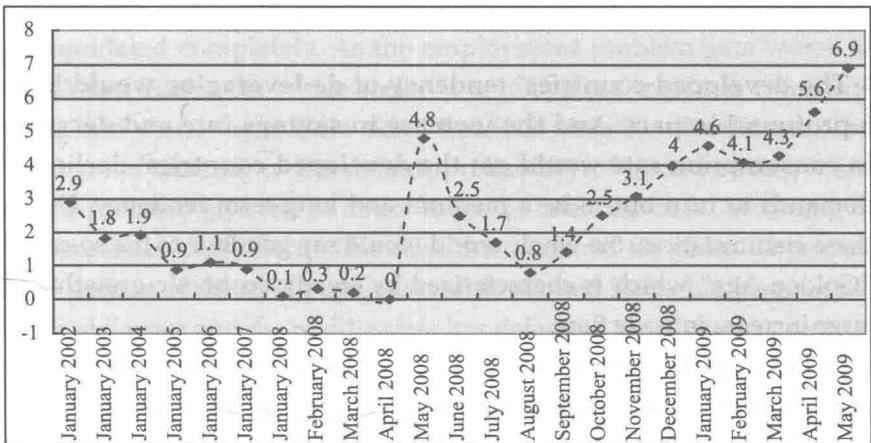


Figure 1.1 2002–2009 American people's personal savings rate (unit: %)

Source: the United States Department of Commerce, <http://research.stlouisfed.org/index.html>.

1. Increasing Growth of US Personal Savings Rate, Export to US Is Hard to Remain on the Increase (N), *Financial Times*, 2009-7-24.

In addition, the personal consumption in Euro Zone and Japan is of the tendency of obvious decrease as well. What was going on in Japan seemed to be relatively serious. (Figure 1.2)

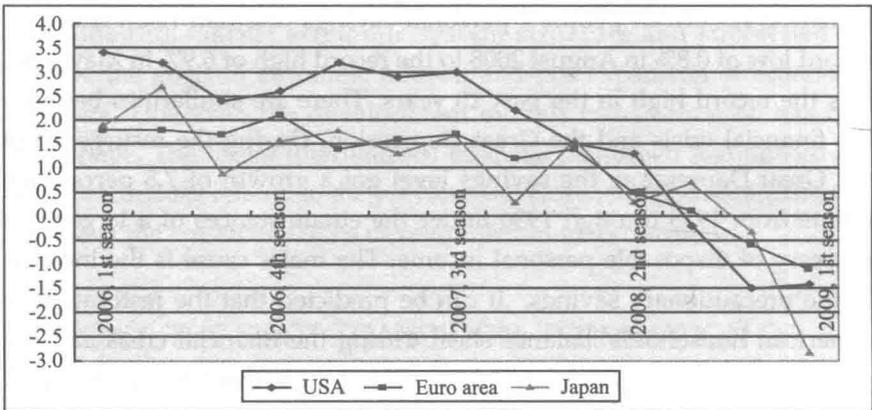


Figure 1.2 Change of the personal consumption year-on-year growth rate in developed countries since 2006 (unit: %)

Source: China Monthly Economic Indicators.

The developed countries' tendency of de-leveraging would have a profound impact. And the increase in savings rate and decrease in consumption rate would get the developed countries' decline of demands to turn out to be a medium and long-term tendency. Under these circumstances, the whole world would say goodbye to the so-called "Golden Age" which is characterized by steady economic growth and large increase in trade flow.

(2) Developed Countries' Long Process of Liquidating Toxic Assets. One of the causes of the international financial crisis is the large-scale toxic assets. As a result, the process of getting rid of the crisis is the process of liquidating toxic assets. In March 2009, the United States launched the plan of "recycling toxic assets." Such a plan can be classified into two categories. The first category aims to expand the "periodical loaning system for asset-backed securities" established by the US Federal Reserve Board, supporting the investors who buy the "toxic assets" from the

banks. On the other hand, the authorities set up a public-private fund through the aid funds, which is devoted to supporting private investors who buy "toxic assets."

The materials show that the nominal value of the financial derivatives in the United States financial system is supposed to surpass 1,000,000,000,000,000 US dollars. The value of the financial derivatives held by America's commercial banks only is estimated to reach a staggering 202 trillion US dollars. Of them, the five largest commercial banks held 96%. The financial derivatives of the Goldman Sachs Group climbed to 39 trillion US dollars, which is more than 3 times as much as US GDP. Even if only one per cent of the financial derivatives worth 1,000,000,000,000,000 US dollars faced risks, its amount would rise to more than 10 trillion US dollars.<sup>2</sup> Although the US government has spent trillions of dollars in this sphere, handling of tens of trillions of dollars worth of toxic assets is still a long procedure.

Another new phenomenon is that some problems have already happened to some previous prime loans before all the toxic assets can be liquidated completely. As the employment problem gets worse in the United States, the whole society's employment crisis has come into being and made the middle class' financial situation deteriorate. The continuous increase of the default probability of good housing loans would probably give rise to a new round of financial crisis. According to the recent analyses, the middle class that accounts for about 65 percent to 85 percent of the total population of the United States has been on the brink of danger and the middle class has defaulted greatly in its previous good lending with less risk with the rise of the unemployment.<sup>3</sup> In recent years, the United States has fired a total of 7.2 million people, setting the highest record after the Great Depression in the 20<sup>th</sup> century. As the highest record after the first unemployment rate investigation in 1948, the United States' annual unemployment rate in 2009 was more than 10% on

2. Graham Sommers, Five Major Reasons of American Stock Market Crash This Fall, <http://finance.sina.com.cn/stock/usstock/comment/20090807/03586583678.shtml>. (2009-8-7)

3. The Second Wave of Housing Loan Default Tide Invades USA: Middle Class Becomes Chief Culprit.

the average. According to the latest statistics issued by the US Currency Supervision Administration and the US Thrift Institutions Supervision Administration, the number of households that ask for the 60-day overdue payment for the good housing loans in the third quarter of 2009 has risen to 839,000 compared to the same period of the previous year. The number of foreclosure cases has increased drastically in recent three quarters and the rate of increase is much higher than the newly increased foreclosure numbers of the sub-prime housing loans. It can be expected that handling the toxic assets and preventing the deterioration of good loans would bring the uncertainty to the recovery of American economy.

(3) China's overseas market demands cannot be restored to its original level easily in the short run. According to the initial estimation of the Customs House, the gross value of China's foreign trade's import and export was 2.20727 trillion US dollars. It decreased by 13.9% compared with the previous year.

China's export also showed a downward trend in the country's bilateral trade with its major trade partners. In the first half of 2009, China's export to European Union, the United States and Japan has dropped by 24.5%, 16.9% and 20.2% respectively. In addition, the export of China's all major foreign trade-oriented provinces and cities dropped in various degrees in the first half of 2009. During that period, the import and export value of Guangdong, Jiangsu, Shanghai, Beijing (Central government's Beijing-based units are included), Zhejiang, Shandong and Fujian added up to 83.6% of the whole country's total value of import and export. These regions' export volume dropped by 18.4%, 24.8%, 22.2%, 17.8%, 19.7%, 17.6% and 14.1% respectively.

By the end of 2009, the whole world had stepped into the post-crisis era. However, the influence of international financial meltdown still lingered on and the country's foreign trade was still characterized by the mingled hope and fear. From January to November, China's export to European Union was about 211.83 billion US dollars, a decrease of 21.8%. The export to the United States was 198.61 billion US dollars, a decrease of 14.8%. The export to Japan was 87.44 billion US dollars, a decrease of 17.6%.