

# BONUS FROM REFORMS

## FIVE TRENDS OF TRANSFORMATION AND REFORMS AFTER THE CPC'S 18TH NATIONAL CONGRESS

  
Chief Editor: Chi Fulin

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Bonus from Reforms:

Five Trends of Transformation and Reforms after the CPC'S 18th National Congress

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主 编 / 迟福林

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## Preface >

In 2013, and the years to follow, China's reform is expected to undergo substantial changes even more dramatic than in the past:

First, transformation will go hand in hand with reform, with important breakthroughs in terms of economic, social and government operational transformation.

Second, problems resulting in an imbalance in interests will become even more outstanding during deep-going reforms, and overcoming these will be vital in determining the success of the reforms.

Third, with "crisis" looming larger, China has to firmly grasp the initiative in conducting reforms.

When we say reform is the most lucrative bonus in China, we are really saying that the crux lies in whether China can make the most of the "opportunities, the potential and the ultimate bonus". Efforts have to be made to make the most of the strategic opportunity offered in meeting the growing needs at home, especially in tapping the potential of population urbanization.

By 2020, China's consumption demand is expected to reach 45,000-50,000 billion Yuan. This should allow China's economy to grow at an annual rate of 7-8 percent for the 10 years to come.

China is promoting urbanization, and this is a boon for releasing pent-up consumption. Population urbanization is a definite benefit in all future reforms.

China should therefore work hard to release the potential through structural reform and innovation. Whether it can succeed depends on whether it can do a better job of reforms and releasing the anticipated bonus.

Transformation calls for reform. China needs to work out a general scheme with regard to the course of action for reform as soon as possible, along with deployment and identifiable areas of focus for the whole of society amid deepening reform. If a major breakthrough can be achieved, China can usher in a golden 10 years in Chinese history.

We choose to study the topic of reform bonus as our 2013 project with a view to assisting the government in devising its reform policies. Our study is concentrated in the five areas: leading role of consumption, population urbanization, multiplying the size of the middle-income group, market-oriented reform, and government function transformation and reform.

In writing the book, I received generous support from my colleagues and friends: Fang Shuanxi, Kuang Xianming, Xia Feng, Zhang Fei, Mei Donghai, Ma Zhentao, postdoctoral Song Min and Dr. Wu Panlong, who took part in drafting some of the chapters; Yin Zhongyi and Miao Shubin, who helped with revising the book; and Chen Suohua, Fang Yunyun and He Ying, who did the editing work. I owe them many thanks in this regard.

Chi Fulin  
January 20, 2013

## Introduction >

# TRANSFORMATION AND REFORM AFTER THE CPC 18TH NATIONAL CONGRESS

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China's reform will undergo profound and complex changes in the next few years within the context created by both the internal and external environment. Firstly, reform will be conducted in parallel with economic and social transformation and transformation of government functions. Whether the latter could be successful depends upon the former. Secondly, greater conflicts will emerge in the distribution of benefits and the efforts to solve this problem are crucial to ensuring overall national stability. Thirdly, given the risks that will inevitably exist during the reform, it is vital to work out the reform plan, road map and timetable as soon as possible in order to obtain substantial breakthroughs<sup>1</sup>.

"Reform is China's biggest Bonus". The ongoing urbanization program has the potential to promote greater domestic demand, and efforts should be made to make the most of the opportunity.

## I. REFORM IS THE BIGGEST BONUS

In the past 30-odd years, China has enjoyed fast economic growth through population growth and globalization.

With the change in the external environment, the traditional Bonus has declined raising several important questions such as: what are China's strategic opportunities for further development and what will become the main engine for transformation and reform? All the evidence suggests the new Bonus will come from reform and transformation.

### 1. Domestic Demand Bonus and Reform

**(1) China's domestic demand offers the greatest strategic opportunity for further development.** With social and economic change, public consumption will rise in the next five to eight years. By 2020, nominal consumption in the urban and rural areas combined will reach 45,000 billion Yuan. Combined with the potential need for investment will create total domestic demand of 100,000 billion Yuan.

**(2) Domestic demand alone will be great enough to support economic development in the next five to ten years.** Preliminary calculation indicates that with every one percentage point increase in consumption, the economy will grow by 0.76 percentage points. In the period 2012-2020, if public consumption can register an average annual real growth rate of 7.66 to 8.92 percent, the overall yearly economic growth rate will be 7.07 to 7.96 percent. This suggests that, if the domestic demand potential can be fully tapped the benefits for China's transformation in the next five to ten years will be enormous.

**(3) Greater domestic demand calls for major breakthroughs in consumption-led transformation and reform.** Therefore, efforts should be made to establish an organized system for promoting public demand in the remainder of this decade.

- Experience dictates that it is not possible for economic growth to continue for a long time through dependence on long-term investment as this tends to create more structural problems for long- and medium-term growth if unsupported by consumption and carefully guided investment.

- The reform of State-owned enterprises and the adjustment of State-owned capital are increasingly important levers for socio-economic development.

- The 600 million middle-income earners in the nation form a vital target for distribution reform. By 2020, China expects to see urban and rural residents double their income. This is especially true for the middle class, whose income growth is expected to average two percentage points a year up to 2020.

## **2. Urbanization and Reform**

### **(1) Urbanization leads to expanding domestic demand.**

- Urbanization is bound to boost consumption. In 2011, the per-capita consumption gap between urban and rural residents was 3.34:1. Every time the urbanization rate goes up by one percentage point, at least 13 million rural people become urban residents, which can be converted into 174 billion Yuan in new consumption. If the urbanization rate increases by 10-15 percentage points in 10 years, it will generate between 700 and 2,600 billion Yuan of new consumption.

- Urbanization creates more opportunities for investment. In the coming 10 years, based on the urbanization rate increasing by 1.2 percentage points annually, a further 200 million farmers will move live in cities and towns. This, plus the existing 1.6 million migrant workers in urban areas, will mean a new urban population of some 400 million. If around 100,000 Yuan worth of investment is needed for one migrant worker to become urban resident, there will a demand for approximately 40,000 billion Yuan in total investment.

### **(2) Orientation of urbanization.**

The pressing task is to avoid past mistakes that produced some blind investment for urbanization; there is the need to work out a national program for urbanization to allow migrant workers to become urban residents.

### **(3) Innovation needed for population urbanization.**

Major breakthroughs have to be made in aspects: turn migrant workers into urban residents; reform the household registration system; reform the (rural) land ownership system; reform fiscal and taxation systems to

adapt to the urbanization of the population; reform the rural communities management system; reform the regional administration system dominating urbanization; and promote further administrative reform.

### 3. Reform Bonus vs Breakthroughs

(1) **The success of the reform over the past three decades or more involves three aspects:** the first is the “Smithian growth” which refers to the expansion of markets; the second is the “Schumpeterian growth” which refers to innovation; and the third is the “North growth” which refers to system reform. In fact, “Smithian growth” and “Schumpeterian growth” are closely rooted in “North growth”.

In the early 1980s, the household contract responsibility system was introduced as the core of rural reform, bringing a substantial increase in the efficiency of agricultural production from 8.7 percent in 1980 to 9.8 percent in 1986, or an annual average increase rate of 9.4 percent in that period.

After Deng Xiaoping made an inspection tour of south China in the early 1990s, the nation set “establishment of a socialist market economic system” as the goal of the reforms. As a result, China’s potential economic growth rate increased from 9.8 percent to 10.3 percent in the first half of that decade (annual average 10.1 percent).

With China’s accession to the WTO, the potential growth rate rose from 9.8 percent in 2001 to 10.7 percent in 2006 (annual average 10.4 percent).

The three periods of successful economic growth were the result of system reform<sup>2</sup>. In the next ten years, Bonus with regards to greater domestic demand and urbanization await further stimulus in this regard.

(2) **Outstanding contradictions in the socio-economic situation are rooted in the fact that proper reforms have not been put in place.**

- Problems in economic development are rooted in the slow transformation of the mode of economic growth. The consumption rate declined from 62.3 percent in 2000 to 48.2 percent in 2010, with the contribution rate to the overall economy dropping to 43.1 percent. It rebounded to 49.08 percent in 2011, but remained unstable. It means that the imbalance between investment and consumption pattern remains fundamentally unchanged.



- Structural imbalance stems from the reform process lagging behind. There was lackluster progress in structural adjustment, for example, producing a continued high proportion of secondary industry and a low proportion of tertiary industry. The latter has long been hovering around 40 percent, far lower than other parts of the world at the same development level. In terms of industrial structure, the proportion of heavy and chemical industries with high energy consumption remains excessive. In the period 2000-2011, the proportion of heavy industry increased from 60.2 percent to 71.9 percent, and the ratio of light to heavy industries was 3:7<sup>3</sup>.

**(3) A breakthrough in this regard can bring about a huge bonus for reform.** Given the fact that the present institutional mechanisms have to be improved, much could be done in terms of institutional innovation.

- Market-oriented reform focused on rationalizing the relationship between the government and the market will ensure proper allocation of resources. In 2010, the income margins and return on assets of sample State-owned enterprises were 5.67 percent and 1.75 percent respectively, while the relevant figures for private enterprises were 6.05 percent and 3.63 percent, showing that the economic benefits and efficiency of the former were inferior to private enterprise<sup>4</sup>. If efforts could be made to break the monopoly and introduce the competition mechanism, more resources will be allocated to the private sector, and efficiency will be significantly optimized. This means that, even if no new investment is made, with improved efficiency of resource allocation, there will still be satisfactory economic growth.

## II. NOTABLE FEATURES OF THE REFORM AFTER THE 18TH NATIONAL PARTY CONGRESS

### 1. Integration of Transformation and Reform

**(1) Without making a breakthrough in reform, it would be hard for the economic growth mode to change from one driven mainly by investment to one led by consumption.** At present, the efficiency of the former is declining rapidly; the investment-output ratio dropped to 1.44