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China's increasing policy shift towards more sustainable growth

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Former Premier Deng Xiaoping's famous quotation "crossing the river by feeling the stones," describing the cautious and incremental approach China should take towards development, is still revered as the most basic theory guiding China's development path. How this approach has played out is worth assessing, particularly as many have increasingly questioned if and how Chinese policy has evolved or will evolve to ensure that the country's development is not only focused on immediate economic growth, but also economically, socially and environmentally sustainable. The following Policy Brief addresses this question by tracing key issues in China's past and current path to development. It finds that China is clearly increasingly shifting its policies to foster more sustainable growth, which provides a good indication that its upcoming policies will head in the same positive direction. Admittedly, there are issues to be resolved over certain policies, and China faces significant barriers to actually implementing and enforcing its sustainable development policies and of course has a long way to go in achieving an anywhere near ideal level of sustainable development. Nonetheless, China's continued commitment to better development is nothing short of impressive.

At its most fundamental and macro level, China's overall development path has traditionally been gauged by the authorities in terms of economic growth as measured in annual GDP growth. China's economy grew at an average growth rate of around 10% from 1980-2008. The government's target GDP rates, which are reflected in the different Five-Year Plans it has used

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over the last several decades, represent the rate required to create employment, increase incomes and reduce absolute poverty. China has already met the MDG to halve the proportion of its poor living under the poverty line of \$1/day as of 1990, and in fact the percentage of China's rural population living in poverty was reduced from 46 percent in 1990 to 10.4 percent in 2005.³

Export growth has importantly contributed to China's overall GDP growth, although the relationship has fluctuated over time. Exports have notably contributed to China's GDP growth over the past 30 years, although throughout the 1990s fixed capital investment was the primary driver of growth and private consumption also played a more important role than exports.⁴ However, since becoming a WTO member, exports played a more prevalent role in China's growth, contributing 39.9% to GDP in 2006.⁵ Export-driven policies capitalise on the fact that China has an abundant and relatively cheap labour force (although this is increasingly changing). Numerous subsidy programs and industrial policies have been used to develop products specifically for export. In order to support its export growth, China has in recent years amassed both large amounts of international currency reserves, which are currently in excess of \$2 trillion, as well as foreign debt.

As alluded to, China's overall development path has in part been defined by the amount of foreign direct investment it has attracted. China has transformed itself into one of the world's top destinations for inward FDI. Since 1980 FDI into China has steadily increased, rising from \$57 million in 1980 to \$35.8 billion in 1995, \$44.2 billion in 2001, and \$138.4 billion in 2007.⁶ These investment levels reflect the degree of capital available to contribute to GDP growth, and in turn other facets of development. At the same time, China has been consistently aware that bubbles caused by uncontrolled and improperly regulated investment, e.g. in the form of hot money, can bring risk to development strategies, contributing to inequality and unemployment among other negative outcomes.

China's development strategy has consistently focused on formulating plans for growing specific domestic industries. The domestic industries targeted, often called "pillar" industries, are deemed to be of the utmost economic and strategic importance to China. Some suggest these objectives have translated into economic nationalism and/or protectionism given the types of regulatory and investment frameworks built around the industries. Over time, the Chinese concept of how to grow pillar industries has become more refined, perhaps most clearly exhibited by SOE reform, pushed by the "modern enterprise system" and Company Law in the early 1990s, further developed under the "*Zhua da fan xiao*" ("grasp the big and let the small go") policy of the late 1990s and continuing currently with the operation of SASAC and other initiatives.

Since 1978, China's "one child" policy on population growth has remained in place. While in fact the policy does allow certain families to have more than one child, for example ethnic minorities

³ United Nations and PRC Ministry of Foreign Affairs

⁴ Branstetter & Lardy 2006

⁵ World Bank, World Development Indicators

⁶ Ibid

and farmers in certain circumstances, this policy has effectively curtailed the stress on the country's resources, albeit not without certain moral questions as to its implementation, that would have taken place without such policy.

A policy shift

Although the relatively broad aforementioned policies reflect attention to key economic concerns and certain closely related social issues including inflation, unemployment, population growth, and absolute poverty, China's development in the new millennium has increasingly focused on the quality and balance of its development. The evolution of China's Five-Year Plans over the years reflects this trend. At their outset, China's Five-Year Plans and related policies were clearly indicative of a command economy, detailing which factory should produce which good at what prices, and attempting to micromanage the mechanisms to do so. However, the objectives and implementation of China's Five Year Plans and related policies have changed with its WTO accession and implementation of WTO commitments, with more foreign know-how, acquired business confidence and experience, academic and other sources of policy guidance at home, improvement of education and growing awareness and outspokenness on development challenges among the Chinese population, among other factors.

China and the WTO

China's accession to the WTO was the most influential milestone in its modern history in changing the way it established its business and trade regulations. China underwent dramatic changes from 1986, when it first put in a bid to enter the WTO, until December 11, 2001 when it was finally admitted to the WTO. Further, after its formal accession, China continued critical reforms to bring its economic and trading system in line with its WTO commitments, most all of which should have been phased in by December 11, 2006.

China has successfully implemented a host of key initiatives covering its WTO commitments, for example providing national treatment and agreed market access for goods and services, including via reducing NTBs, reducing tariff rates; and continually improving transparency. Since 2001, China has reviewed over 2,000 trade-related laws and regulations, abolishing at least 700 of such measures and amended others to make them fully compliant with its WTO commitments. China has also substantially opened up nine service sectors. China's average tariff for industrial goods was lowered from 14.8 percent prior to its WTO accession to 9.1 percent in 2005, and its tariff for agricultural products was lowered to 15.35 percent from 23.2 percent.⁷

⁷ Speech of Fu Ziyang, Vice Minister of MOFCOM, at the 5th Annual Conference of China's Import and Export Enterprises. April 04, 2007.

More recently, China's Five-Year Plans and related policy statements have reflected more ambitious policy initiatives in terms of quality and balance of growth while still keeping in mind traditional concerns. For example, the "Five Balances," emphasised since the 3rd CPC Plenary Session of the 16th Party Congress in October 2003 call for more focused growth, evenly shared domestic development, and environmentally conscious development. In March 2007, at the National People's Congress (NPC) Press Conference, Premier Wen Jiabao noted "The biggest problem with China's economy is that the growth is unstable, unbalanced, uncoordinated, and unsustainable." Methods to address these concerns, including through a "scientific approach," and building a "harmonious society" and "socialist countryside," are reflected in the 11th Five-Year Plan (2005-2010), and recent related policy statements like the March 2010 Draft 2010 Plan for National Economic and Social Development. This background sets the stage for China's current and future considerations of economic, social and environmental development issues.

"The biggest problem with China's economy is that the growth is unstable, unbalanced, uncoordinated, and unsustainable." *Premier Wen Jiabao, March 2007 at the NPC Press Conference*

Economic issues

China is increasingly considering economic policy issues that have arisen amidst the recent global financial crisis and shifting world economic order. China seeks to maintain target GDP levels while realising the need to transition from an export-heavy economy to one based more on domestic consumption, particularly consumer consumption. It is also crafting policies to better consolidate key pillar industries and foster emerging industries in an attempt to increase economic efficiency and effectiveness and reduce overcapacity and "backward production." Within this context, China is considering, among other inter-related issues, inherent difficulties in transitioning away from an export-heavy growth model, including allowing its currency to appreciate, shifting types of production, shifting educational and training initiatives to support shifts in production, taking measures against overproduction, otherwise improving efficiency of investments and limiting diminishing rates of return, and improving the structure of credit. Amidst these concerns, China seeks to avoid certain risks, for example financial market instability and creating structural unemployment.

On a related note, China is considering numerous strategies to strengthen specific industries in its path to sustainable economic development. One example is building upon a strategy, most fruitful within the last 5-10 years, to increase the level of value-added/global competitiveness of Chinese goods and services, particularly those with technologically innovative and scientific value, and move away from low value-added products. China is building its services industries, recognising services only count for around 40% of its GDP and are essential to accelerate scientific development and support urbanisation. China is renewing support to its agricultural industry which in 2007 employed over 40% of the workforce although contributed to less than 12% of GDP. The government is also focusing on numerous other sectors. It is continually instituting reforms to spur this development, for example by revising certain taxation and investment rules; rules on certifications, specifications, labelling and standards for products; government procurement policies; subsidy measures; export and domestic production restrictions on certain raw materials; licensing requirements; improving IPR enforcement, albeit slowly; among others. More generally, China continues to build its infrastructure and related transportation system to better facilitate business and trade.

Additionally, China is developing and diversifying its economic relations with other nations through increased trade and investment cooperation. For example, it has pursued numerous RTAs and FTAs, particularly given the impasse of the DDA negotiations. Additionally, China is actively pursuing investments and business development abroad, both in developing nations, for example in Africa, and in the developed world.

China is also slowly starting to re-evaluate its population control policy. It is considering the longer term impacts on the economy of a massive aging population and comparatively limited working population, as well as social issues related to the culture and demographics produced by the policy. As one pilot for this policy shift, in 2009 Shanghai announced a plan to encourage its residents to have a second child.

Social issues

China is increasingly focusing on relative poverty reduction and related issues of absolute and relative inequality. Continued high levels of absolute and relative poverty, best understood in that although China currently has the 2nd highest GDP of any country when considering purchasing power, over 200 million people (by some of the steepest estimates) in China continue to live below the World Bank's poverty line of \$1.25/day.⁸ China's 2009 PPP-adjusted GDP per capita is \$6,546. The country's Gini coefficient is relatively high, at 47. Income inequality is notable in terms of total differences in wages between urban and rural areas, but relative inequality within such areas, for example among members in rural areas or even more so recently among members in urban areas, is also an increasing development problem.⁹ The government seeks to better address income inequality, at least as it lends itself to the concern of social unrest, through a number of often inter-related policies on urbanisation, access to healthcare and education, and social safety nets.

As mentioned, inter-related social issues dealing with urbanisation, access to healthcare and education, and social safety nets are receiving increasing policy focus. The aforementioned rural-urban divide as well as urban-urban inequality is further accentuated by differences in access to education, healthcare, pensions and other social benefits; and even if people from rural areas move into cities, which is increasingly the case and in-line with government efforts to encourage urbanisation, or even if city people move among cities, the *hukou* system often prevents these new residents from enjoying reduced education costs and other social benefits. Further, despite literacy levels of 90% and notable healthcare infrastructure, China's health and education systems need improvement. Policies are being formulated to improve the sustainability of urbanisation and tame related housing prices, improve access to and systems for healthcare and education, as well as more generally strengthen the social safety net.

⁸ Chen, Shaohua and Martin Ravallion. World Bank, 2008. (Note: these statistics are based on 2005 data. Statistics on the estimated percentage of those in China below international poverty lines vary notably, but most deal with data that is at least several years old.)

⁹ Shaohua, Chen and Ravallion, Martin. "Learning from Success: Understanding China's (uneven) progress against poverty." *Finance and Development*, December 2004.

Significant issues related to social identity and political and other rights are also receiving more focus within a general policy to build “socialism with Chinese characteristics,” although, as Chinese academics would agree, there is still a very significant need to improve the implementing policies herein. Dramatic losses of social networks, cultural heritage, and public morals are of growing concern and are closely related with China’s economic growth and specifically with urbanisation. Calls for a check on corruption, and otherwise improved forms of democratic representation are increasingly being recognised – albeit methods to address these concerns are often relegated to questionably effective ‘online democracy’ and overall are still in need of vast improvement. The press remains controlled, and many sources of online information are blocked; nonetheless, key foreign news websites remain unblocked, and while not obviously the result of any enabling policy, not all Chinese politics blogs and other sources of non-party-backed political commentary are prohibited. While China does have an eminent domain/property law, which it revised in 2007, there are still very significant issues over the justifications for many land takings (i.e. what constitutes taking for a “public purpose”), compensation (i.e. what constitutes “fair market value,” and/or if that is value is actually paid) and the method of the takings. Violations of takings laws, or even if not violations simply the frequent use of takings, and infringements upon and lack of other legal rights continue to cause social problems – although government-sponsored efforts to provide free legal advice to the underprivileged to deal with some of these issues have increased.

Environmental issues

In the past, lip service was about the extent of attention paid to environmental issues in China. While a number of pieces of environmental legislation were enacted, including the Environmental Protection Law and its implementing regulations, among others, they often lacked sufficient enforcement mechanisms and government buy-in. As a by-product of China’s past export-heavy development strategy, its exports have been relatively pollution and energy intensive, with about 40 percent of gross consumption directly or indirectly used to produce exports.¹⁰ Seven Chinese cities are among the top ten most polluting in the world.

But China is increasingly moving to a more hands-on approach to improving the environment. This shift in policy is due to an awareness of negative externalities from environmental degradation in terms of costs to the environment itself as well as the public health and welfare systems, increasing public protests resulting from these negative externalities, and, importantly, given that China now feels it can significantly and economically capitalise on developing methods to address environmental issues. It also more generally reflects an increasing obligation to conserve energy and address climate change through the UNFCCC, China’s National Climate Change Programme, and other programs, as China is now the world’s largest greenhouse gas emitter and a top energy consumer. China has encouraged development of environmentally-friendly industries, including green technology in particular, through a combination of attracting foreign investment and technology transfer while also encouraging domestic innovation. This strategy is accomplished through concentrated R&D policies; various

¹⁰ “China’s New Trade Issues in the Post WTO Accession Era.” World Bank, January 2010.

subsidies; local content requirements; export and domestic production restrictions on certain raw materials, like rare earths; green government procurement policies; improving IPR enforcement, albeit slowly; among other policies.

Other issues in policy formulation, implementation and enforcement

Cross-cutting the policy formulation discussed is the desire to avoid discriminatory trade practices while also creating policies that foster sustainable development. A number of the policies mentioned throughout this brief clearly foster sustainable development; however, some may have and/or continue to discriminate against certain enterprises, for example in favour of SOEs and/or in favour of domestic enterprises over foreign enterprises. China is continually working within the WTO framework and in various other multilateral as well as bilateral dialogues with its trading partners to improve transparency and limit concerns over its trade regime, with the view to creating win-win situations for all parties.

Also cross-cutting the aforementioned policy shifts is a central-government objective to better extrapolate such policies across provincial and local governments. This has been historically difficult given China's more central-level, macro approach to development, but it also is due to the long-standing difficulty in actually communicating and cooperating with these provinces to design and develop comprehensive policies, transferring know-how and best practice to implement these policies, and extending monitoring and enforcement in these regions. It is also related to overlapping bureaucracy, infighting, and corruption among government bodies. Additionally, it relates to the reluctance of local and township level governments to relinquish control of SOEs or other generators of economic growth, which might in turn jeopardise local economic growth for more 'qualitative' objectives. Herein, incentive structures sometimes conflict.

Some provinces and regions around China have effectively designed, adopted and/or implemented development programs reflecting more balanced sustainable development. A notable degree of these successes may be a direct result of past initiatives drawn-up at the central level, although this is not always the case. Significant central-level initiatives targeted eastern coastal regions as part of Special Economic Zones or other 'zone' or development 'area' programs. The 'Go West' initiative originating in the 1990s attempted to better develop western China, although with less success in meeting its objectives than the aforementioned policies. More recently, central-level support has resulted in successful infrastructure and social programs in western regions; development of services, agriculture, and equipment manufacturing as well as improving policies for resource-dependent cities in the Northeast; building three different types of production bases and transportation hubs in the central region, and fostering innovation in eastern China.

Another issue, cross-cutting the formulation, implementation and oversight of China's development policy shifts, is the growth of civil society. The government has continually relied on itself and economic output from for-profits to implement its development policy. Less attention has been given to developing civil society *per se*. For example, it is still very difficult to register an NGO in China and individual donations to NGOs are still not tax deductible. Nonetheless, there are some key NGOs openly operating in China. Some good initiatives have been undertaken to strengthen civil society in China, for example through university partnerships with the government, although as Chinese academics will also suggest, there is still significant room for growth in this area.

Conclusion

The story of China's path to recent development is one of both increasingly balancing the three pillars of sustainability, i.e. social, environmental, and economic issues, and doing so in a way that increasingly focuses on the quality of development within these pillars. This marks a change from China's previous focus on broader and less holistic development issues. This evolution has been the result of an understanding of the negative impacts of unchecked economic development as well as the benefits of sustainable development – an evolution fostered by a variety of factors within China and also facilitated by foreign support. By understanding the driving factors and strategies which have allowed China to reach its current state of development, one can at least broadly assess China's motives and strategies in future development. As such, the brief analysis herein suggests there is a good indication that China's future development policies will increasingly foster more sustainable development.

This said, China of course has a long way to go in achieving an anywhere near ideal level of sustainable development. While China's development policy is heading in the right direction, some economic, social and environmental policies could benefit from improvement. There is still progress to be made in improving regulatory transparency. Some progress is needed to limit certain discriminatory trade policies, although this, frankly, applies to many other WTO members and should not be blown out of proportion. More significantly, while China's development policy is heading in the right direction, effectively implementing and enforcing this policy is a precondition for actually ensuring sustainable development. And there are numerous daunting barriers to this task. One of these barriers is simply the incredible magnitude of the issues that the policies are intended to address, let alone the barriers mentioned at the provincial level in particular. Also, civil society has a relatively limited role in assisting with these tasks whereas it could lend greater assistance.

Then again, the Chinese government has indeed shown a strong willingness to tackle a wide range of development barriers on its own; with academics, business and some civil society at home; and also increasingly so in partnership with the rest of the world. China's continued commitment to better development is nothing short of impressive. This understanding sets the context for China's most significant development policy guidance next year, the 12th Five Year Plan to be officially promulgated in March 2011, as well as its future approaches to policy implementation and enforcement.

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