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Chinese Economy 2010: Post Crisis Development

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The China Policy Institute, part of the School of Contemporary Chinese Studies at The University of Nottingham, was set up to analyse critical policy challenges faced by China in its rapid development. Its goals are to help expand the knowledge and understanding of contemporary China in Britain, Europe and worldwide, to help build a more informed dialogue between China and the UK and Europe, and to contribute to government and business strategies.

Executive Summary

1. In 2010, China's GDP grew by 10.3%, reaching RMB 40 trillion (\$6.1 trillion), making China the second largest economy in the world for the first time.
2. Total trade volume rose 34.7%, reaching \$2.97 trillion, with a trade surplus of \$184 billion, down by 6.4%.
3. Total FDI inflows rose 17.4%, reaching \$105.7 billion. Total FDI stock reached \$1,048 billion.
4. Outward FDI rose by 23.4%, reaching \$59 billion. Total OFDI stock was \$247 billion. By the end of 2010, China had 3,225 non-financial firms in about 120 different countries.
5. Total grain output was 546.4 million tonnes, up by 2.9%. Steel production rose 10.4%, reaching 627 million tonnes. Car production reached 18.26 million units, up by 32.4%.
6. Total investments rose 23.8%, reaching RMB 27.8 trillion. Total retail sales rose 15% in real terms, reaching RMB 15.3 trillion.
7. Becoming the second largest economy can be considered a marker of the success of 30 years of reforms in China. China's nominal GDP will be equal to that of the US by 2020, or even earlier, according to our predictions.
8. China's per capita GDP is still low, equivalent to 8-10% of that in the US or Japan.
9. The income gap between the wealthy and the poor is large and widening.
10. India will be the major competitor of China in the coming decades. The proportion of the population who are at working age in China is declining but the Indian population is much younger. China's current economic development heavily relies on exports but India's economy is based on domestic consumption and service export.

11. During the course of the Eleventh Five-Year Plan (2006-10), the government introduced detailed measures to promote economic growth and fight against the world financial crisis in a timely, flexible and forceful fashion.

12. The year 2011 is the first year of China's 12th Five Year Plan which has the aim of changing the country's economic structure and laying the foundations of an all-round *Xiaokang* Society by 2020.

13. If it is to achieve the goal of an all-round Xiaokang Society, China will face tough challenges concerning its economic transformation.

14. The new objectives are: to increase material/energy efficiency; reduce the country's dependency on exports and investments; boost domestic consumption; reduce environmental damage and carbon emission; reduce poverty and income inequality and build a large number of low-cost houses for the low- and middle-income households, etc.

15. China faces significant challenges in 2011, including rising house prices and inflation, internal and external pressure on RMB appreciation, rising labour costs and labour shortage, persistent rural poverty and high income inequality, etc.

Chinese Economy 2010: Post Crisis Development

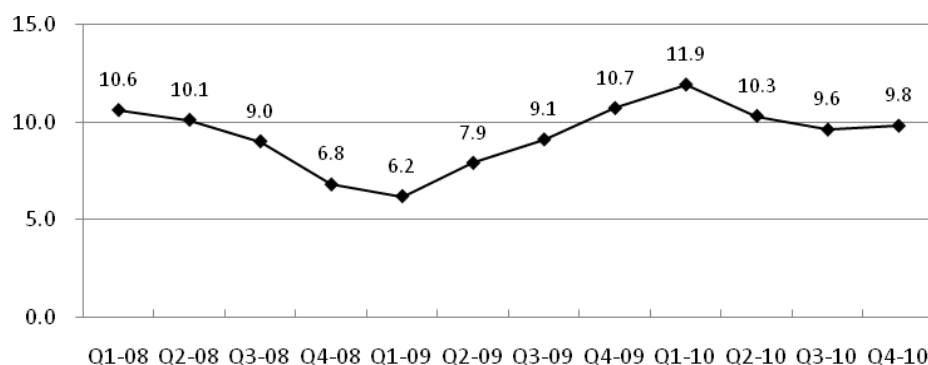
Shujie YAO and Jing ZHANG*

China's Economy in 2010 at a Glance

1.1 The Shanghai Expo 2010 was a great showcase for China's success and its emergence as the second largest economy on Earth. From 1st May to the end of October 2010, the Expo attracted the participation of 200 countries and international organisations and over 72 million visitors, the largest number in history, 20 million more than expected.¹

1.2 In 2010, China's gross domestic product (GDP) grew by 10.3%, totalling RMB 40 trillion, or \$6.1 trillion dollars, overtaking Japan by a large margin.² The actual size of China's economy may be even larger, as the aggregate figure of provincial GDPs is RMB 3.6 trillion larger than this figure produced by the National Bureau of Statistics (NBS). The quarterly growth rates of GDP are shown in Figure 1.

Figure 1: Quarterly GDP growth 2008-2010



Sources: NBS quarterly data.

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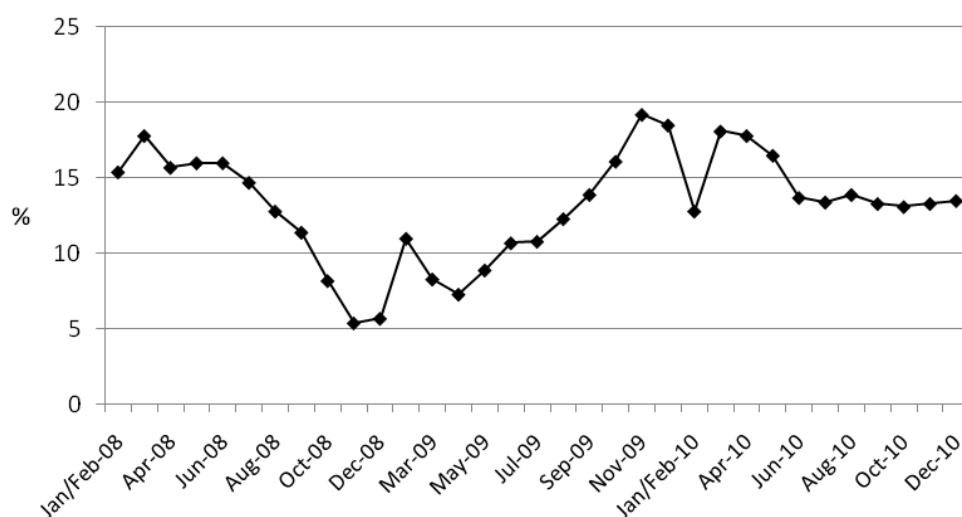
¹ Expo 2010 Shanghai China official website: <http://www.expo2010.cn/>

² Data Source: "National Economy Showed Good Momentum of Development in 2010", *National Bureau of Statistics of China*, http://www.stats.gov.cn/english/newsandcomingevents/t20110120_402699463.htm, 20 January 2011. Same source if not stated in the text.

1.3 The value-added from agriculture, industry and services reached RMB 4.05 trillion, RMB 18.65 trillion and RMB 17.10 trillion respectively, rising by 4.3%, 12.2% and 9.5% over the previous year. The shares of agriculture, industry and services in GDP changed from 10.7%, 46.7% and 42.6% in 2009 to 10.2%, 46.9% and 43.0% in 2010, reflecting a slight deepening of industrialisation and rising importance of services in the national economy. Although agricultural importance in GDP declined, grain output rose for the seventh year, reaching 546.41 million tonnes, up by 2.9%.

1.4 Industrial production increased quickly from the second quarter of 2009 after slowing down for more than one year at the nadir of the world financial crisis. The growth rate of industrial value-added rose to 19.2% and 18.5% in November and December of 2009 (Figure 2). The strong trend of growth continued into 2010. During 2010, the value-added for state-owned enterprises rose by 13.7%, collective owned enterprises by 9.4%, cooperative enterprises by 16.8%, foreign invested enterprises by 14.5%, and private enterprises by 20.0%. Contrary to the popular argument made by 'Guo Jin Min Tui' (state-owned enterprises crowding out private ones), private and foreign-invested firms were of increased importance during this year. Light industry grew by 13.6% and heavy industry by 16.5%, reflecting a continuous shift towards a more technology and capital intensive industrial structure.

Figure 2 Monthly growth of industrial value added 2008-2010



Source: NBS monthly data

- 1.5 In the first three months of 2010, industrial production went up sharply but it came down to a stable level of around 13%. The growth pattern indicates a trend of industrial structure optimisation and upgrading. The economic efficiency of enterprises increased substantially. The profit/cost ratio increased from 6.31% in 2005 to 6.79% in 2010 and labour productivity from RMB 108,600/worker to RMB 221,000/worker. Many small-scale but energy-inefficient or high-pollution production units were closed down. Production of high-tech manufacturing rose more sharply than national average industrial output, reaching 16.6%, or 8.9 percentage points higher than in the previous year.³ In addition, there was a continuing shift of production gravity from the eastern coast to inland China, showing a catching up process taking place.
- 1.6 The share of industrial value-added as a proportion of the national total accounted for by the inland regions rose from 37.5% in 2007 to 40% in 2010, signifying a regional rebalancing of industrial production activities in favour of the inland areas.⁴ This suggested that there were an increasing number of employment opportunities for local rural migrants, mirroring the 'shortage' of rural migrant workers in the more prosperous coastal regions, especially in Guangdong, Shanghai, Jiangsu, Zhejiang and Fujian. Such a regional shift in industrial production will force firms in the coastal areas to move their production up the technological ladder and engage more in higher level manufacturing to maintain their comparative advantage not only inside China but also in the international market.
- 1.7 China became the world's largest producer of automobiles in 2009 and continued to be so in 2010. The volume of production reached 13.79 million units in 2009 and rose sharply to 18.26 million units in 2010, with a growth rate of 32.44%. Total sales of motor vehicles reached 18.06 million units in 2010, almost 5 million more than that of the US.⁵ For many years, China has been the largest producer of many industrial and agricultural products in the world. By 2010, China's GDP has reached more than 40% of that of the US but it has overtaken the latter as the largest manufacturer on earth. At the height of the world financial crisis in 2009, China produced 567.8 million tonnes

³ "Ma Jiantang's Press Conference on National Economic Performance in 2010", NBS, http://www.stats.gov.cn/tjdt/qjtjtdt/t20110120_402699634.htm, 20 January 2011.

⁴ "Industrial Economy Performance Report in China 2010", *Ministry of Industry and Information Technology of PRC*, <http://finance.people.com.cn/GB/14004435.html>, 25 February 2011.

⁵ *ibid.*

of crude steel, accounting for 46.6% of the world total steel production. Total steel output rose another 10.4% in 2010, reaching 627 million tonnes.⁶

Domestic Investment and Consumption: Driving Growth in 2010

2.1 Investment and consumption were two important drivers of economic growth in 2010. Final consumption contributed 37.3% (3.9 percentage points) to GDP growth and capital formation contributed 54.8% (or 5.6 percentage points). Net exports of goods and services contributed 7.9% to GDP growth.

2.2 Total investment in fixed assets reached RMB 27.8 trillion, growing by 23.8%, which was 6.2 percentage points lower than in 2009. The real growth rate was 19.5% after deflation. Investments in the real estate industry increased by 33.2%, in railways 12.5%, in ore mining 29.2% and in smelting and pressing of non-metallic minerals and non-ferrous metals 31.8%.

2.3 In order to stimulate the economy after the financial crisis and change an economic structure that relies too much on exports, the government promoted a series of policies to stimulate domestic consumption. In 2010, personal consumption, reflected by total retail sales of consumer goods, reached RMB 15.255 trillion, up by 18.4%, or 14.8% in real terms, growing much faster than GDP. The sales of some durables rose sharply. For example, the sales of gold, silver and jewellery jumped by 46.0%, furniture 37.2%, automobiles 34.8%, household appliances and audio-video equipment 27.7%, petroleum and related products 34.3%, building and decoration materials 32.3%. The sharp increases in the sales of such commodities suggest that Chinese people, especially the urban rich and middle class, are entering a consumerism stage.

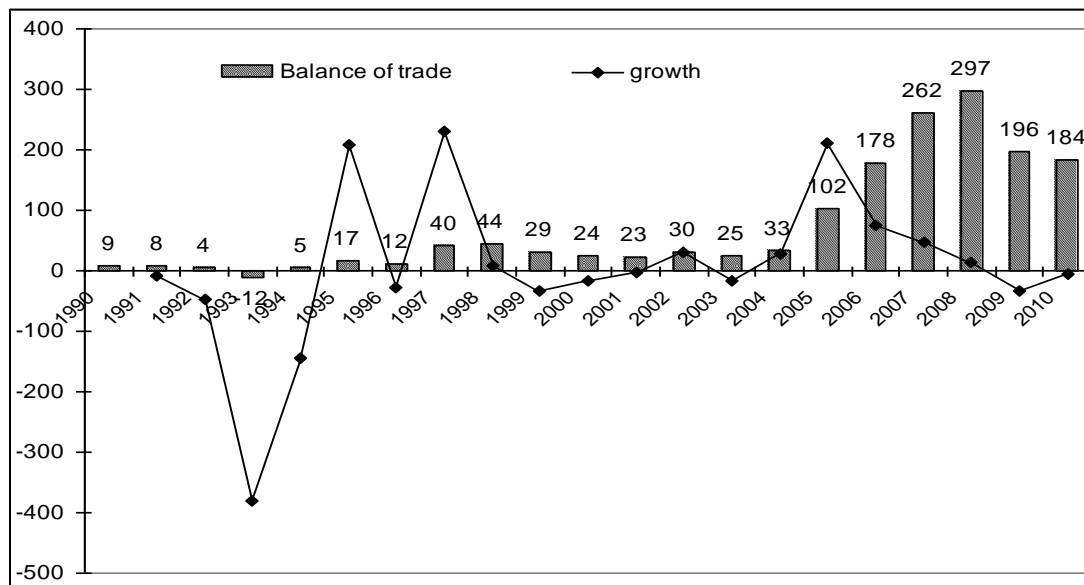
International Trade: Strongly Recovered

3.1 International trade suffered a slight setback in 2009 with a negative growth of 13.9% but it recovered strongly in 2010. The volume of trade rose by 34.7% from \$2.21 trillion in 2009 to \$2.97 trillion in 2010. Total exports were \$1.58 trillion, up by

⁶“Changjiang Securities: Outlook of Steel Sector Annual Report 2010 – Growth in 2010 but looking forward to continuous recovery”, *Hexun Net*, <http://stock.hexun.com/2011-02-25/127567815.html?from=rss>, 25 February 2011.

31.3%, and imports \$1.39 trillion, up by 48.7%. Trade surplus was \$184 billion, a decline of 6.4% compared to \$196 billion in 2009 (Figure 3).

Figure 3 China's trade balance 1991-2010 (\$ billion)



Source: NBS yearly data.

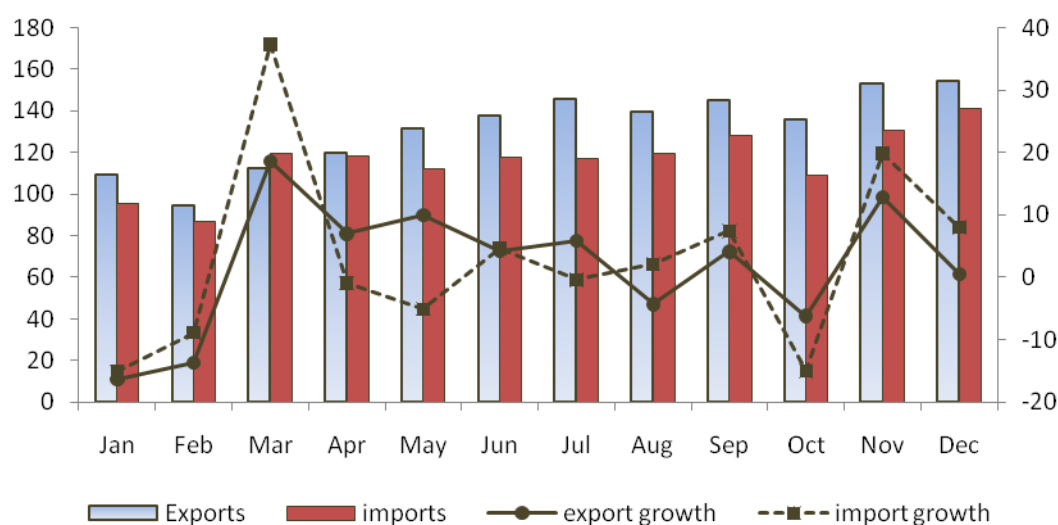
3.2 China's trade surplus reached a peak in 2008 before the world financial crisis (Figure 3). Since then, it has declined due to a number of factors, including appreciation of the RMB, pressure from China's major trading partners, particularly the US, rising labour costs, mounting foreign exchange reserves and China's increasing dependence on imports of oil, ores and other raw materials for its hungry manufacturing industry. For the first time, China's oil consumption dependency ratio surpassed 50%. In 2010, China spent over RMB one trillion on 239 million tonnes of oil imports (Table 1).

3.3 As China is now the largest consumer of motor vehicles and the demand for oil will continue to rise sharply in the coming decade, China's dependency on oil import will not only be on the rise, but so too will oil prices which were over \$100/barrel in early 2011 for the first time since 2008.

Table 1 Imports of main products in 2010

Items	Million tons	Growth %	\$ billion	Growth %
Soybeans	54.8	28.8	25.1	33.5
Iron ores	618.6	-1.4	79.4	58.4
Coal	164.8	30.9	16.9	60.1
Oil	239.3	17.5	135.2	51.4
Oil products	36.9	-0.1	22.3	31.3
Plastics	23.9	0.4	43.6	25.2
Steel products	16.4	-6.8	20.1	3.3
Copper	4.3	0.0	32.7	44.4

Sources: National Bureau of Statistics (2011), Statistical Report of China's National Economy 2010, <http://www.caijing.com.cn/2011-02-28/110652310.html>.

Figure 4 Monthly exports and imports (\$bil, left axis) and growth rates in 2010 (% , right axis)

Source: General Administration of Customs of PRC.

3.4 The most recent WTO report shows that world trade expanded by 23% in the first three quarters of 2010 and the latest projection of merchandise trade volume growth

is 13.5%.⁷ The recovery of the main economies in the world is conducive to international trade and has also benefited China's exports.

3.5 Imports grew quicker than exports in 2010. The monthly trade data in Figure 4 shows a strong recovery of trade over the previous year. As imports grew more strongly than exports, China's trade surplus declined over the year. In the first three months, there was even a trade deficit for the first time since May 2004.

3.6 China's major trade partners are Hong Kong, the EU, the US, Japan and Korea. China had a trade surplus with Hong Kong, the US and the EU but a deficit against Japan, Korea, ASEAN, Australia and the rest of the world (Table 2).

Table 2 China's major trade partners (\$bil)

Country	Exports to	Imports from	Balance	% of total Exports	% of total Imports
Hong Kong	218.3	12.3	206.1	13.8	0.9
Japan	121.1	176.7	-55.6	7.7	12.7
Korea	68.8	138.4	-69.6	4.4	9.9
US	283.3	102.0	181.3	18.0	7.3
EU	311.2	168.5	142.8	19.7	12.1
ASEAN	138.2	154.6	-16.4	8.8	11.1
Australia	27.2	60.9	-33.6	1.7	4.4
Others	409.8	581.5	-171.7	26.0	41.7
Total	1577.9	1394.8	183.1	100.0	100.0

Source: General Administration of Customs of PRC.

3.7 From January to November 2010, agricultural exports reached \$43.25 billion, an increase of 24.3% compared with the same period in 2009. Agricultural imports were \$63.25 billion, up by 37.1%.⁸

Foreign Direct Investments (FDI)

4.1 Global FDI in 2010 was stagnant with a small growth of 1% and showed diverging trends in its components. Developing and transition economies for the first time

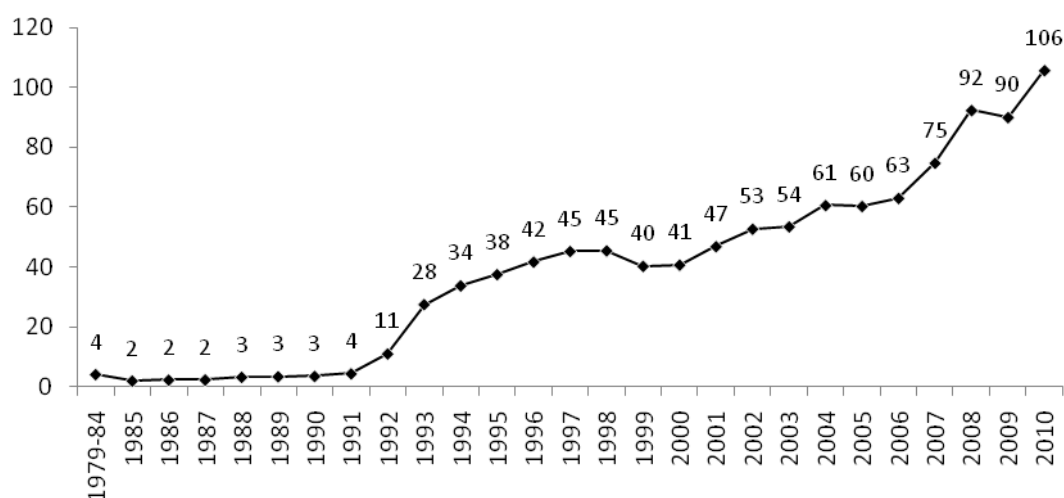
⁷ "Short Term Trade Value Growth Slows in the Third Quarter of 2010", WTO, http://www.wto.org/english/news_e/news10_e/stts_01dec10_e.htm, 01 December 2010.

⁸ Ministry of Commerce of the PRC.

attracted over half of global FDI flows, offsetting a decline in the inflows to developed countries.⁹

4.2 China was still one of the largest hosts of foreign capital. From 1979 to 2010, total FDI stock was \$1048.38 billion. After a slight decline in 2009 during the financial crisis, FDI inflows into China rose 17.4% in 2010, reaching a record high of \$105.7 billion.

Figure 5 Actually utilised FDI 1979-2010 (\$ billion)



Source: NBS (1990-2010), *China Statistical Yearbook* (various issues) and Ministry of Commerce.

4.3 Wholly foreign-owned enterprises and joint ventures were still the most popular forms of FDI, respectively accounting for 76.6% and 21.3% of total inflows. The other two forms of FDI were cooperative enterprises and share holding corporations with the shares of 1.5% and 0.6%, respectively.¹⁰

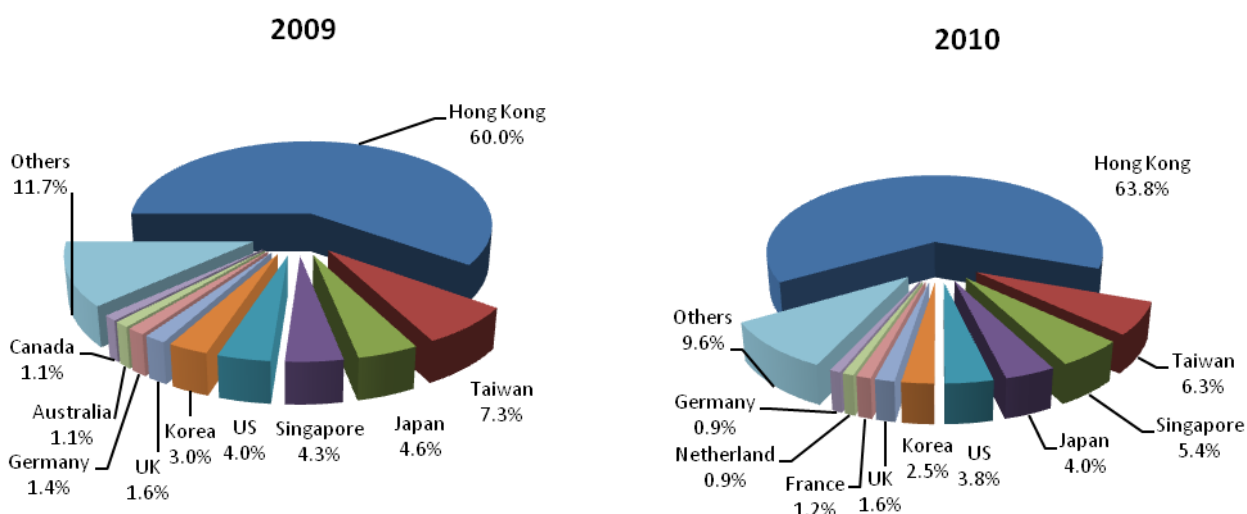
⁹ "Global FDI Stagnant in 2010, Developing and Transition Economies Attracted Over Half of It, for The First Time", UNCTAD, <http://www.unctad.org/Templates/Page.asp?intItemID=5800&lang=1>, 17 January 2011.

¹⁰ "Statistics about utilization of foreign investment in China from Jan to Dec 2010", *Investment in China*, http://www.fdi.gov.cn/pub/FDI_EN/Statistics/FDIStatistics/StatisticsofForeignInvestment/t20110117_130202.htm, 17 January 2011.

4.4 The investment from East Asia and ASEAN's ten member states increased by 21% to \$88.2 billion; whereas that from the US declined by 31% to \$4.1 billion.¹¹ FDI inflows from the EU27 were \$6.6 billion, up by 11% over the previous year.

4.5 The top ten originating economies of FDI in 2010 were roughly similar to those in the previous year (Figure 6). Hong Kong and Taiwan continued to be two largest investors in Mainland China. Japan, Korea and Singapore were also important. The UK remained the largest European investor in China, accounting for 1.6% of its total FDI inflows in 2009 and 2010. Apart from the UK and Germany, France and the Netherlands increased their investments in China over the year, replacing Canada and Australia as the top ten FDI home countries. Total capital flows from the ten investing economies accounted for 90% of total FDI inflows in 2010.¹²

Figure 6 Source countries/regions of FDI inflows into China in 2009-10.



Source: Ministry of Commerce of PRC

4.6 Foreign invested enterprises (FIEs) continued to be the power engines of China's exports. Data from the Ministry of Commerce showed that total trade value of FIEs was \$1.60 trillion, up by 31.5%, or an increase of 3.23 percentage points over the previous year, taking up 53.8% of the country's total trade volume. More specifically,

¹¹ Ministry of Commerce of China, <http://www.mofcom.gov.cn/aarticle/tongjiziliao/v/201101/20110107370784.html>. East Asian ten economies include Hong Kong, Macao, Taiwan, Japan, The Philippines, Thailand, Malaysia, Singapore, Indonesia, and Korea.

¹² ibid. The flows from these ten economies include their investment via offshore financial centres or free ports, such as British Virgin Islands, Cayman Islands, Samoa, Mauritius, Barbados, etc.

exports of FIEs were \$862.3 billion, up by 28.28%, or 54.7% of the national total, while their imports were \$738 billion, up by 35.4%, or 52.9% of the national total. Processing exports were still more important than general exports in China (Table 3).

Table 3 Export structure and growth rates in 2010 (\$ billion)

Exports	Volume	Growth %
Total exports	15779	31.3
o/w, general exports	7207	36.0
Processing exports	7403	26.2
o/w, SOEs	2344	22.7
FIEs	8623	28.3
Others	4813	42.2

Notes: SOEs = state-owned enterprises, FIEs = foreign invested enterprises, others = other firms.

Sources: National Bureau of Statistics (2011), Statistical Report of China's National Economy 2010, <http://www.caijing.com.cn/2011-02-28/110652310.html>.

Outward Foreign Direct Investments (OFDI)

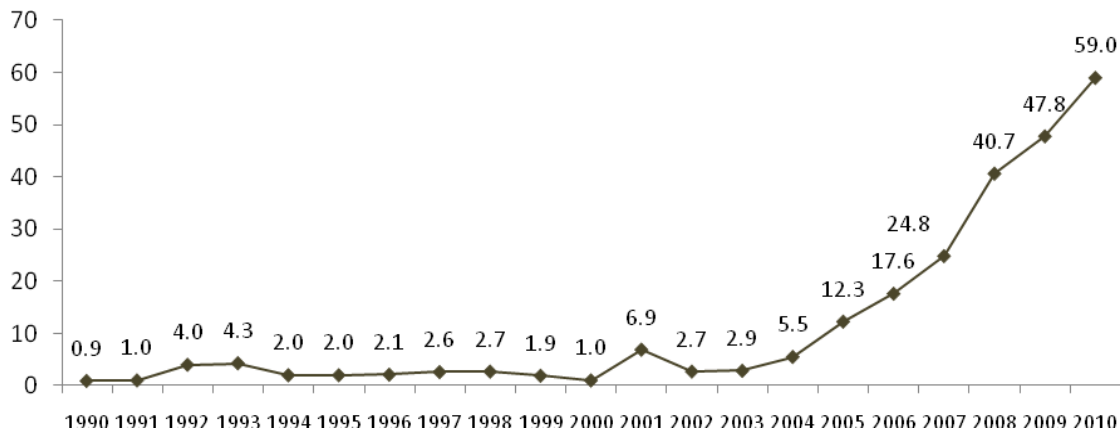
5.1 China's outward FDI was almost unknown before 2003 but increased rapidly since then. In 2009 when global flows of FDI declined sharply, China's OFDI rose almost 20% to reach \$47.8 billion. In 2010, China's OFDI increased even more sharply by 23.4%, amounting to \$59 billion.

5.2 According to the Ministry of Commerce, Chinese OFDI flowed into 120 countries and regions in the world, supporting 3,125 firms in non-financial sectors. By the end of 2010, the cumulative OFDI stock in non-financial sectors was more than \$247 billion (Figure 7).

5.3 Almost three quarters (72.3%) of OFDI was undertaken by Central State Owned Enterprises administered by the State Assets and Resources Commission (SARC). The other 27.7% of OFDI were from local state-owned or private enterprises, mostly

originating from Zhejiang (16.1%), Liaoning (10.9%), Shandong (9.7%), Shanghai (9.5%), Jiangsu (7.4%) and Guangdong (7.3%).¹³

Figure 7 China OFDI in Non-financial Sectors, 1990-2010 (\$ billion)



Source: Ministry of Commerce

China as the Second Biggest Economy in the World

6.1 From the second quarter of 2010, China's GDP surpassed that of Japan to become the second biggest economy in the world.¹⁴ This was confirmed in early February 2011 when the Japanese government announced that its GDP for 2010 was 497.22 trillion yen, equivalent to \$5.47 trillion, which was smaller than China's for the first time.

6.2 Although Japan's GDP grew 3.9% for the first time over the past three years, it lost its number two status which it had enjoyed for 42 years since it overtook Germany in 1967. After the Second World War, Japan rose quickly but its economic miracle ended in 1991 when its real estate bubble imploded. Japan's nominal GDP has not grown since then and shrank in the recent financial crisis. Japan now faces a range of daunting problems such as an aging and shrinking population, weak domestic demand, deflation, strong currency and stagnant exports. The earthquake and

¹³ Ministry of Commerce of China, <http://www.mofcom.gov.cn/tongjiziliao/tongjiziliao.html>.

¹⁴ "China overtakes Japan as world's second-largest economy" *Guardian*, <http://www.guardian.co.uk/business/2010/aug/16/china-overtakes-japan-second-largest-economy>, 16 August 2010, GDP in the second quarter of 2010: China: \$1335 billion; Japan: \$1286 billion, based on average exchange rates for the quarter.

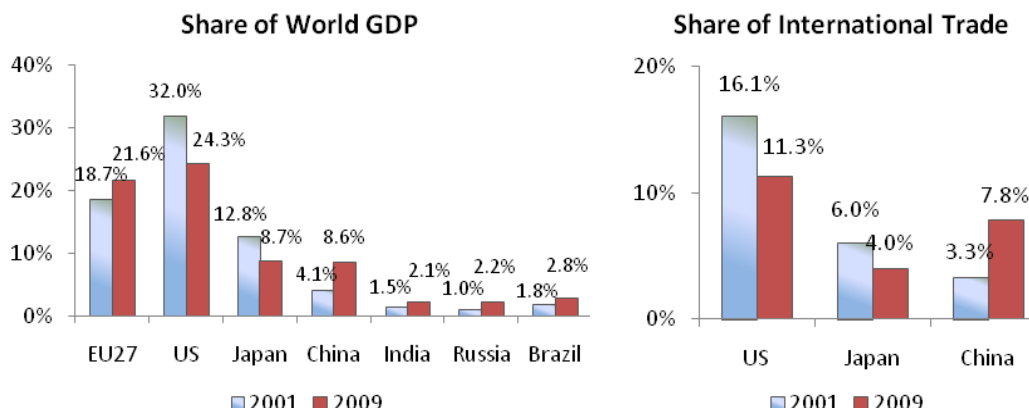
tsunami on 11 March 2011 in northeast Japan will further damage its economy which has been struggling to recover from the world financial crisis.

6.3 In contrast, China in the past 10 years has maintained an average of more than 10% growth rate and the global recession did not change its pace of development. Therefore, the world's previous second largest economy officially transferred the title to China. This can be seen as a marker of the success of China's 30 years of economic reforms. Based on our prediction, China's nominal GDP will equate that of the US by 2020, or even earlier.

6.4 Over the first 10 years of the 21st century, the world economy has suffered from two crises – the bursting of the dot-com bubble in 2001 and the financial crisis which began in 2007 followed by the European sovereign debt crisis in 2010. However, progress in globalisation of the world economy has never stopped. World GDP increased from \$32 trillion in 2001 to \$58 trillion in 2009 at current prices (World Bank), up by 81.6% in nominal terms or by 21.5% in real terms.

6.5 With an annual growth of more than 10%, China's position in the world economy has changed. Figure 8 shows that its shares in World GDP and international trade more than doubled over 2001-2009. The corresponding shares of the US and Japan dropped sharply. These figures underscore China's emergence as an economic power that is changing the global balance. It is already the largest exporter, the biggest car consumer and steel producer, and its global influence is growing. China has also been an important country in leading the world out of recession.

Figure 8 Shares of world GDP and trade of major economies (2001, 2009)



Source: World Bank Indicators, <http://data.worldbank.org/data-catalog/world-development-indicators>.

6.6 Being the second largest economy is a cornerstone for China's building superpower status. However, in terms of per capita GDP, China is still far behind that of Japan and the US. By the end of 2009, China's per capita GDP was about \$3700, which was less than half of the world average, one tenth of that of Japan (9%) and approximately one twelfth of that of the US (8%). Even using the PPP method, China's per capita income was \$6,827, still 40% less than the world average, one fifth of Japan's and one seventh of the US' (World Bank).

6.7 During the past ten years, China's per capita GDP tripled. In the next ten years, if it can double and reach the world average level, its GDP would be equivalent to that of the US or EU27, or more than 20% of the world total. Therefore, China's surpassing Japan and overtaking the US are both expected. It is inevitable because of China's large size and its ability to grow and compete with the rest of the world.

6.8 In China, the wealth gap between the rich and the poor is large and widening. The wealth difference between the top 10% and bottom 10% of the population increased from 7.3 times in 1988 to 23 times in 2007. The Gini coefficient, which measures income inequality, increased to 0.47 in 2007 after reaching the dangerous level of 0.4 ten years earlier. Due to asset bubbles and rising inflation, it may have risen to 0.5 by 2010.¹⁵

¹⁵ "Income Inequalities in China are approach to the red-line of social tolerance", *Xinhua Net*, http://news.xinhuanet.com/fortune/2010-05/10/c_1283123.htm, 10 May 2010.

6.9 Income inequalities exist between rural and urban residents, between households in different regions, between employees in different industries, and between people within the same industry and location. Average income in the urban areas is about 3.3 times as large as that in the rural areas. The largest inter-sector salary difference is 15 times. Wages of senior managers in listed SOEs are 18 times as much as that of an average worker working in the same unit of production. The wages of senior managers in listed SOEs are 128 times that of the national average.¹⁶ Even similar ranked professors in the same university can have huge wage differentials.

6.10 Furthermore, China is still far behind the US, Japan and other developed countries in terms of technology, energy efficiency, environmental quality, education, healthcare and others.

6.11 China is still a developing country in nature, even though it is the world's second largest economy in terms of GDP. Rather than comparing it with Japan and predicting when its GDP may surpass that of the US, it is more important to compare it with India. Both countries have similar population and development potential and can be significant competitors to each other in the coming decades.

6.12 India as another large and powerful emerging power in the world is competing with China in many ways. The gap of GDP growth between China and India is decreasing (Figure 9). Although China seems to be more advanced than India in terms of GDP, per capita GDP, industrial production, trade, FDI, and other macroeconomic indicators, India has its own advantages over China.

6.13 First, the proportion of working age population in China is declining due to family planning, increasing costs of education and behavioural changes of young people. In contrast, the Indian population is much younger with about 50% of its population being under the age of 25.¹⁷ Its economic active population is and will continue to be large, enabling it to derive more demographic dividends than China for a long time to come.

¹⁶ *ibid.*

¹⁷ "India's Demographic Dividend", by Basu Kaushik, *BBC News*, http://news.bbc.co.uk/1/hi/world/south_asia/6911544.stm, 25 July 2007.

6.14 In China, the share of people under 14 declined steadily from 33.6% in 1982 to 18.5% in 2009. The proportion of people over 65 rose from 4.9% to 8.5% over the same period and will continue to rise sharply in the next two decades.¹⁸

6.15 The total number of primary school students in China reached its peak of 140 million in 1996 and declined since then year after year to just 100 million in 2009. The total number of junior high school students reached its peak of 66.2 million in 2003 and declined to 54.3 million by 2009. As over 99% of Chinese children can go to primary and junior high schools, the significant decline in student numbers at both levels signifies the pace of young population contraction which started from as early as 1993.¹⁹

6.16 China's population growth was 1.2% per year in 1978. It peaked at 1.7% in 1987 and then started to decline steadily to just 1% in 1997 and to just 0.48% in 2010. If this trend continues as it did in the past, China's population will reach its peak by as early as 2020 at 1.42 billion people.²⁰

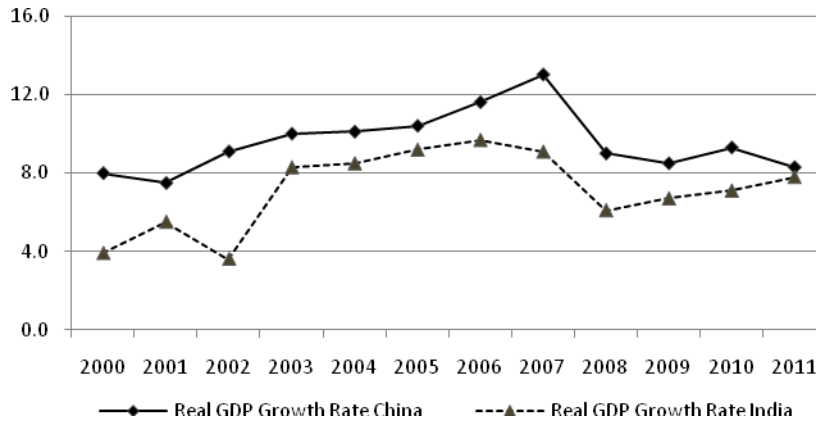
6.17 Second, China's current economic development heavily relies on exports but India is mainly on domestic consumption and exporting of services (Figure 10). This implies that India's growth depends more on its domestic strength and less on the consumption of resources, energy and materials. In Contrast, China's growth is more vulnerable to external shocks, rising costs of oil and other raw materials.

¹⁸ NBS, China Statistical Yearbook, various years.

¹⁹ *ibid.*

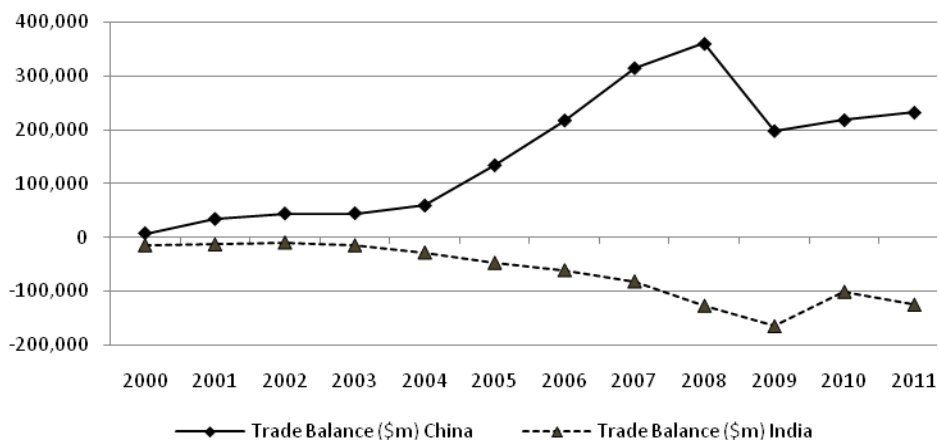
²⁰ Authors' estimate.

Figure 9 GDP growth rates in China and India



Source: Yao (2011), 'China's Rocky Road to Becoming a Superpower', unpublished paper, University of Nottingham.

Figure 10 Trade Balances in China and India (\$million)



Source: Yao (2011), 'China's rocky road to becoming a superpower', unpublished paper, University of Nottingham.

Twelfth Five-Year Plan (2011-15): Structural Transformation

7.1 Over the course of the Eleventh Five-Year Plan (2006-10), the government introduced measures to promote economic growth and fight against the world financial crisis.²¹

²¹ "China in Past Five Years" , *Xinhua Net*, http://news.xinhuanet.com/english2010/china/2011-01/03/c_13675183.htm

Such measures were flexible, timely and forcefully implemented. The focus on economic control shifted from preventing economic overheating and inflation to ensuring economic growth, better living standards and social stability.

7.2 Policy measures aimed to expand demand, boost consumption, promote innovation and develop strategic industries. Efforts were made to better coordinate urban and rural development and promote development of cultural industry. The government also enhanced policies which help create employment, reduce income inequality and improve public services. Free compulsory education was offered in western rural areas in 2006 and expanded to the whole country in 2008.

7.3 Over the past five years, more than 57 million jobs were created in the urban areas, including 45 million rural workers who were transferred to the cities. Medical insurance was promoted in the cities, and an old-age insurance system was introduced in the rural areas. A three-year national healthcare reform was unveiled in 2009. Over 5.9 million low-cost housing units were built in 2010. The government also promoted low carbon technologies to build a resource-saving and environmentally-friendly society.

7.4 China held three major international events, the 2008 Beijing Olympics, the 2010 Shanghai Expo and the 2010 Guangzhou Asian Games. It has been actively involved in addressing the global financial crisis and other challenges such as climate change, food security, national security, terrorism, public health, poverty-alleviation, etc.

7.5 The Wenchuan Earthquake in 2008 was the most devastating disaster in China after the 1976 Tanshan Earthquake. The government and people from all over the country reacted quickly and decisively to rescue and help millions of victims affected by the earthquake. A large rebuilding programme worth over one trillion RMB was launched to build new cities and towns to house and provide a new livelihood for the victims.

7.6 Despite China's great economic success and its demonstrated ability to host large international events and fight natural calamities, many problems and challenges exist for China's move towards a more developed stage of its economy.

7.7 The 12th Five-Year Plan (2011-15) is designed to address these challenging issues. The blueprint was laid out in October 2010 by the Fourth Plenum of the 17th Chinese Communist Party Central Committee (CCPCC). The ***Proposal for Formulating the 12th Five-Year Plan for China's Economic and Social Development (2011-2015)*** has been approved at the annual session of the National People's Congress in March 2011. The 12th Five Year Plan seeks to boost the quality of development, focusing on scientific development.

7.8 The proposal sets five major targets for economic and social development in the next five years: maintaining stable and relatively fast economic growth; promoting economic restructuring; raising people's income; enhancing social construction; deepening reform and opening up; and further consolidating the foundation for the making of a better-off society in an all-round way, to be achieved by 2020.

7.9 Premier WEN Jiabao has suggested that China's GDP growth rate for the next five years will be adjusted down from its previous 10% to 7%.²² The reduction in growth target is intended to improve growth quality. It implies that the economy will become less dependent on environmental pollution and energy/material consumption, and income distribution will be improved to benefit the poor more than the rich. The concept of 'inclusive growth' is important and will guide China's next stage of development. Inclusive growth means that future growth will benefit all people more equally than before, be less environmentally damaging, and increase people's income/happiness faster relative to GDP growth than before.

7.10 The key policy instrument to achieve this growth target involves transforming China's current economic model which has been heavily depending on energy and material consumption, investments and exports, rising inequality and environmental pollution. In the following five years, efforts will be made to increase energy/material efficiency, reduce carbon emission and pollution intensity, improve income equality and care more for the poor and most vulnerable groups, improve investment efficiency and export/import structure and promote technological progress and scientific innovations.²³

²² "Wen Jiabao: Expected GDP Growth Target in The Next Five-Year is An Annual Average Rate at 7%", *Xinhua Net*, http://news.xinhuanet.com/politics/2011lh/2011-03/05/c_121151739.htm, 05 March 2011.

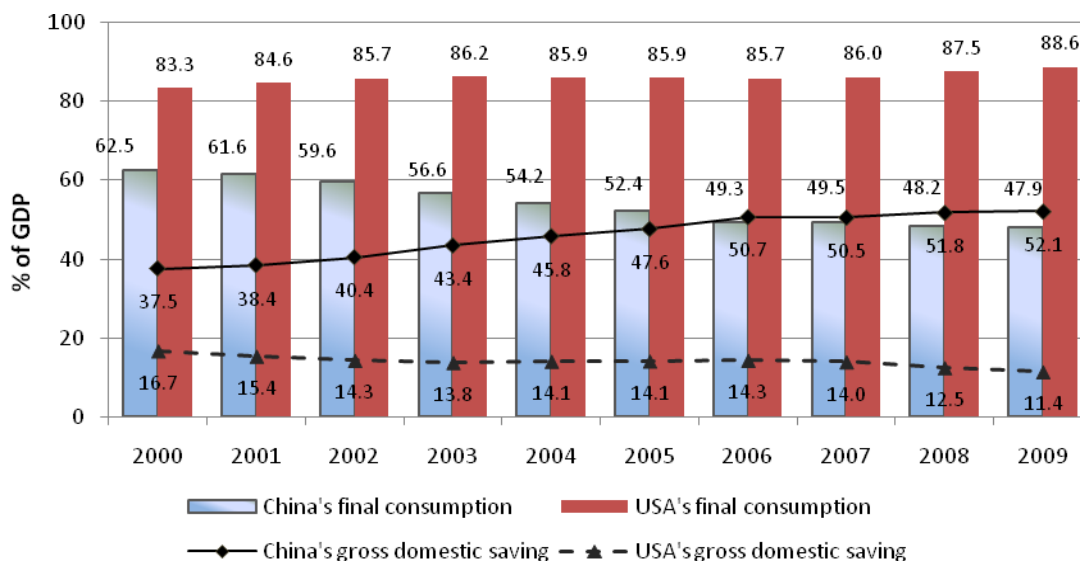
²³ "CPC Sets Targets for 12th Five-Year Program", *China.org.cn*, http://www.china.org.cn/china/2010-10/27/content_21214648.htm, 27 October 2010.

7.11 China can no longer rely on the traditional growth model. The government has declared a change to the structure of the economy by boosting domestic consumption while reducing the dependency on investment and exports.

7.12 China's domestic savings were 52.1% of GDP in 2009, compared to US' 11.4% (Figure 11). The high savings/GDP ratio resulted in low consumption expenditure, which accounted for only 47.9% of GDP, compared to 88.6% in the US (World Bank). There is a long way for China to go in boosting domestic consumption, particularly private consumption. Therefore more aggressive action is needed to realise this goal through raising wage incomes and public expenditure in social services, including healthcare, education, pensions, housing and other social benefits for the less well-off in society. More spending in public services will also enable private consumers to raise their consumption expectation and reduce the level of private savings to stimulate further economic growth.

7.13 Furthermore, more efforts should be made to eradicate absolute poverty and alleviate relative poverty throughout the country. Through reducing income inequality, rapid economic growth will enable China to move from a low-middle income economy towards to a middle-high income country in the next 10 to 20 years. By 2020, it is expected that China's per capita GDP will equal to the world average from its current level of less than 50%.

Figure 11 Final consumption and domestic savings in China and US



Source: World Bank Indicators.

Challenges in 2011

In the short term, China is facing a few important challenges in the aftermath of the world financial crisis.

Housing market

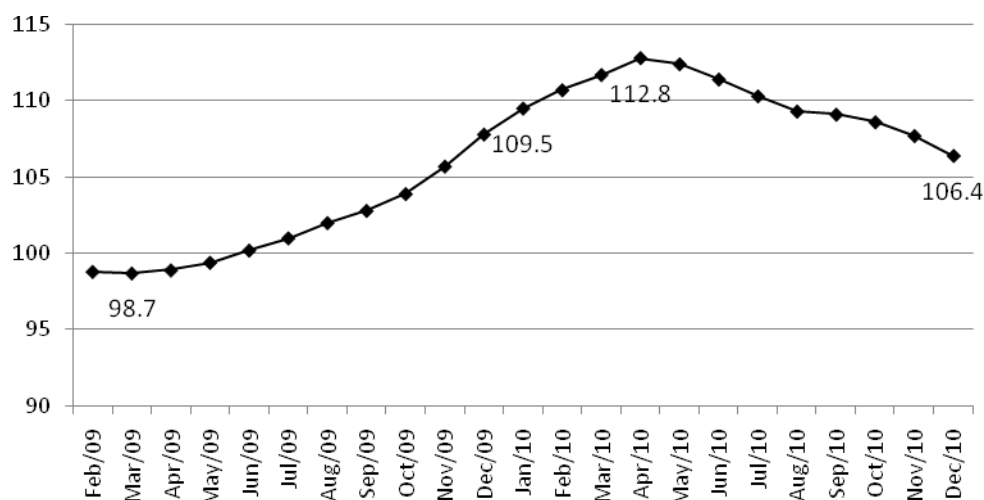
8.1 Average new house prices of China's first-tier cities, Beijing, Shanghai, Shenzhen and Guangzhou rose by more than 50% in 2009. In 2010, the State Council and most regional governments pronounced a series of policies designed to control house prices. The impact of such policies, however, has appeared ineffective. By the end of 2010, the average new house prices in these cities rose from 24% (Guangzhou) to 42% (Beijing). Average prices of newly built houses in Beijing, Shanghai and Shenzhen were 22-24 thousand RMB per square metre, and that of Guangzhou nearly 14 thousand RMB per square metre.²⁴

²⁴ "Housing Price in Beijing Up by 42% in 2010, The Highest among The First-Tier Cities", *Caijing.com.cn*, <http://www.caijing.com.cn/2011-01-05/110610989.html>, 05 January 2011.

- 8.2 In 2010, investments in the real estate sector reached RMB4.827 trillion, up by 33.2%, among which investments in residential housing was RMB3.404 trillion, up by 32.9%. The highest growth rates were found in Beijing and Hainan. The total area of commercial residential building was 1043.5 million square metres, up by 10.1% over 2009. Total sales revenue reached RMB5.248 trillion, up by 18.3%.²⁵
- 8.3 Apart from the first three months of 2009, average house prices of 70 large and medium sized cities increased significantly every month. There was a strong rising trend from March 2009 up to May 2010 before the growth rate came down to 6.4% at the end of the year (Figure 12). To control speculative demand and maintain house prices at a reasonable level, the government has successively introduced a range of policy measures, including land use restrictions, banning loans for third-home purchase, raising the required down-payment to 60% and mortgage rates to a factor of 1.1 times the normal lending rate for a second home, and imposing value-added taxes when houses are sold, etc. By February 2011, Beijing, Shanghai and other 30 cities and towns introduced the toughest restrictions on house purchases. In Beijing, for example, people are not allowed to buy any houses if they do not have residency and have not paid taxes for five years. Even Beijing residents are not allowed to buy a second home.

²⁵ "Investment in Real Estate Increased by 33.2% in 2010 Compared with Previous Year", *Caijing.com.cn*, <http://www.caijing.com.cn/2011-01-17/110620923.html>, 17 January 2011.

Figure 12 House Price Index of 70 Large- and Medium-sized Cities (year-on-year)



Source: NBS monthly data.

8.4 Aside from controlling the demands of rich households, the central and regional governments have promised to build 10 million low-cost housing units in 2010 after 5.6 million units were built in 2009. The total construction cost of 10 million low-cost houses will be RMB 1.4 trillion. It is planned that 36 million low-cost housing units will be built during the 12th Five Year Plan. In addition, there will be more control placed over the construction of large houses and priority will be given to the building of smaller houses in the commercial housing sector. It is suggested that at least 70% of newly sold land will be used for low-cost housing and small-sized commercial housing.²⁶

8.5 The fundamental problems of the Chinese housing market include (1) rising inequality, (2) market imperfection where minority-advantaged groups are able to acquire land/houses at lower than market costs and collusion/monopoly of property developers, banks and local government officials, (3) corruption, (4) rapid urbanisation without reforming the household registration system, etc.

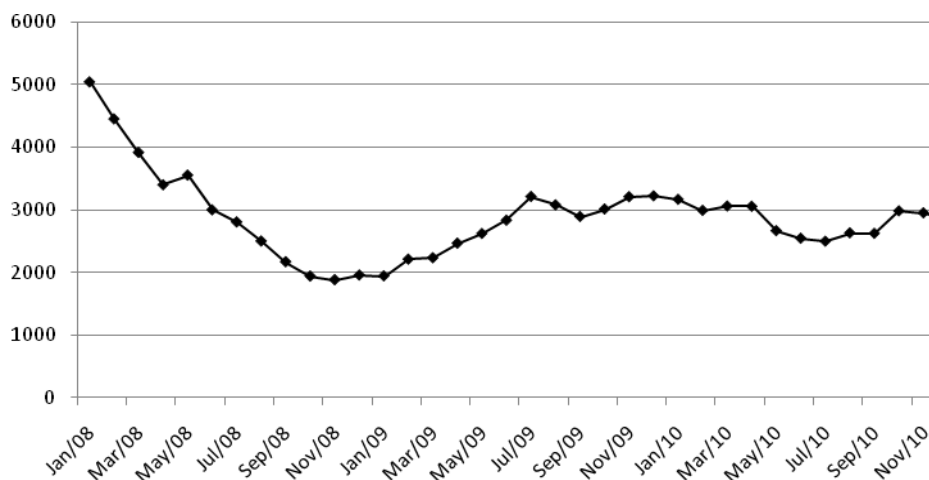
²⁶ "Low-cost Housing Units To Cover More Than 20% in Urban Areas in China by The End of The 12th Five-Year Plan", *Xinhuan Net*, http://news.xinhuanet.com/politics/2011-02/28/c_121131498.htm, 28 February 2011.

8.6 Due to these fundamental problems, all the policies so far drawn up have had little impact on house prices. Although house prices in large cities have become relatively stable, those in the medium and small sized cities have been rising more rapidly than before. It is likely that house prices in China will continue to rise until the end of 2011 before they become stable or start to fall.

Stock Markets

8.7 The Chinese stock markets reached their peak at the end of 2007 but the bubbles burst spectacularly in 2008. At the peak, the Shanghai Stock Exchange Composite Index was 6,135 but it touched its lowest point at 1,608 towards the end of 2008. It has recovered somewhat, but has been struggling to fluctuate around 3,000 after more than three years from the bubble bursting. At the end of 2010, it was less than 2,900 (Figure 13).

Figure 13 Stock Market Index in China



Source: Trading Economies: monthly average of Shanghai Composite Index.

8.8 In 2010, China became the world's largest IPO (initial public offering) market, raising RMB 349 billion. However, China's A shares was the second worst-performing stock market in the world during the year, losing 14%, or RMB 1.8 trillion (Table 4)²⁷.

²⁷ "Chinese Stock Market in 2010: Milking Money from Chinese Investors", by Yi Michelle, *The Epoch Times*, <http://www.theepochtimes.com/n2/china/chinese-stock-market-in-2010-milking-money-from-chinese-investors-51097.html>, 11 February 2011.

8.9 The reasons for such a poor performance against China's fast economic expansion may be summarized as follows. Firstly, most investors spent all their money in the housing market, inflating the housing bubble. Secondly, the implementation of stock index futures-trading, margin-trading, and securities lending allowed short selling of stocks. Thirdly, there was a strong dilution effect caused by IPOs and additional issuance of new shares by listed companies. Fourthly, there was a crackdown on stock market insider trading. Fifthly, listed companies have failed to pay dividends despite making huge profits, reflecting their lack of corporate social responsibility and lack of trust in them by private investors.

Table 4 Performance of main stock markets in the World 2010

Country/Region	Index	Change	Country/Region	Index	Change
London	FTSE 100	+11%	South Korea	Kospi	+22%
US	Dow Jones	+11%	China	SSEC	-14%
Germany	Dax	+18%	Hong Kong	Hang Seng	+5.3%
France	CAC 40	-1%	Russia	Micex	+22%
Australia	ASX	-2%	India	Sensex	+15%
Japan	Nikkei	-3%	Brazil	Bovesp	-1%

Source: "World Stock Markets Review of 2010" by White Garry, *The Telegraph*, <http://www.telegraph.co.uk/finance/markets/8226932/World-stock-markets-review-of-2010.html>, 28 Dec2010.

8.10 In 2011, Chinese stock markets may be affected by the following issues: (1) currency appreciation which may have reduced corporate profitability; (2) devaluation of US dollar caused by quantitative easing; (3) new fiscal and monetary policies to tackle inflation; (4) government's support to a few strategic sectors in new energy, new materials, bioscience, and medicine; (5) restructuring of industrial sectors as the main objective in the 12th Five-Year Plan; and (6) changes in the international environment.

Inflation

8.11 Inflation has increasingly become a major concern since the third quarter of 2010 (Figure 14). The consumer price index (CPI), a main measure of inflation, grew

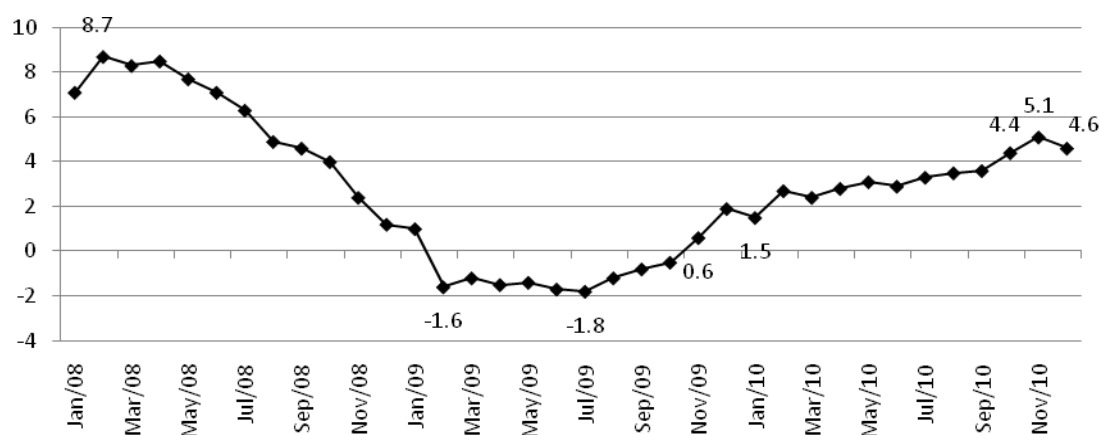
steadily after it moved back into positive territory in late 2009. CPI increased by 3.3% over the whole year, among which food prices went up by 7.2%, hitting the low- and middle-income households particularly hard.

8.12 The quarterly CPI growth rates in 2010 were respectively 2.2%, 2.9%, 3.5% and 4.7% compared with the same quarters in 2009. CPI went up by 4.4% in October, 5.1% in November and 4.6% in December, all exceeding government's target of 4%. In November, CPI grew by 4.9% in cities and 5.6% in rural areas, with food prices increasing by 11.7%, vegetables 24.9% and fruits 16.4%.

8.13 The prices for investment in fixed assets increased by 3.6%. The producer price index for farm products rose by 0.9%, manufactured goods 5.5%, raw materials, fuels and power 9.6%.

8.14 To curb inflation, the government introduced a range of aggressive measures, such as raising bank reserve requirements and interest rates. The bank reserve ratio was raised 8 times to 19.5% by February 2011, and bank deposit and lending interest rates were raised 3 times to 3% and 6.06% respectively.

Figure 14 Monthly consumer price index growth (% , against the same month in the previous year)

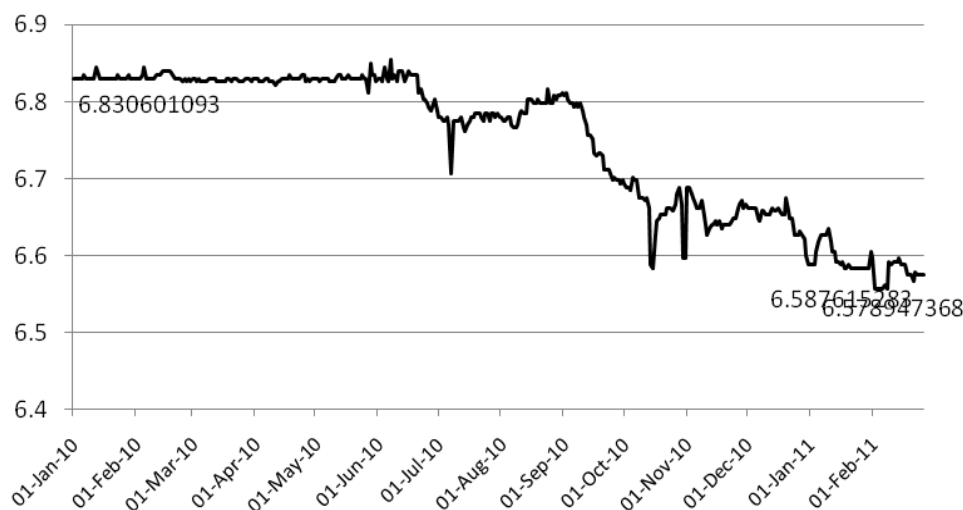


Source: NBS

RMB Appreciation

8.15 The Chinese currency appreciated by 3.8% against the US dollar in 2010. The exchange rate (RMB/US\$) remained relatively stable at 6.83 in the first half of the year but dropped to 6.59 at the end of 2010 (Figure 15). In 2011, China will face increasing pressure, from the US and other countries, to appreciate its currency. The government will push forward exchange rate reform, creating a market-based and managed floating regime. But the progress will be independent, gradual and controlled.²⁸

Figure 15 Exchange rate (RMB/US\$)



Source: Bank of China

Conclusions

9.1 Although many industrialized countries are still suffering from the world financial crisis, China has recovered strongly to lead the world out of recession. It has been the first time that China has overtaken Japan to become the second largest economy in the world. It is anticipated that China will be able to become the world's largest economy by 2020 if the current trends of growth in China and the US continue.

9.2 Agricultural and industrial production increased significantly in 2010. Grain output reached a historical high of 546.4 million tonnes, rising for the seventh consecutive

²⁸ "China to Push Forward Exchange Rate Reform Prudently", *China Daily*, http://www.chinadaily.com.cn/bizchina/2011-02/28/content_12088084.htm, 28 February 2011.

year. China was the largest producer in the world for more than 220 industrial products, including cements, coal, steel, motor vehicles, cloth, computers, telephones, TV sets, etc.

9.3 In 2010, China produced 60%, 44% and 50% of the world total outputs of cement, steel and coal, respectively, although its GDP was less than 10% of the world's total. This implies that China's GDP is much more material and energy intensive than the rest of the world. As a result, changing the economic model is an important task for China's sustainable growth and development in the next 10 to 20 years.

9.4 Although China has become the second largest economy in the world, its per capita GDP is still low, equivalent to 8-10% of those in US or Japan. To become a middle-high income economy, China will face tough challenges on its economic transformation. In addition, the country is facing many internal and external changes, including rising inflation and house prices, rising inequality and environmental pollution, pressure for the RMB to appreciate, over-dependency on exports and investments for economic growth, etc.

9.5 The 12th Five Year Plan aims to address all these issues. The new objectives are to increase material/energy efficiency, to reduce the country's dependency on exports and investments, to reduce environmental damage and carbon emission, to reduce poverty and income inequality, to build a large number of low-cost houses for the low- and middle-income households, etc.