China's miracle economic growth: its policy implication for socio-economic inclusiveness & beyond

Dr Dilip Dutta
Preface

To use a word like ‘miracle’ about economic growth demands particular justification, but this is the term that Dilip Dutta uses to describe China’s performance from 1978 when it embraced a series of policy levers to shift from a primarily agricultural to a modernising industrial model. The simple fact is that no economy remotely the size of China’s has sustained high growth over such a lengthy period of time. South Korea, Taiwan and Japan did maintain high growth during their development stages and they have supplied China over the last four decades with many useful ideas. But none of them produced the scale and speed of GDP growth of China’s. In this, China is unique.

Where it is less unique is in having to wrestle with the downside of rapid industrialisation. Dr Dutta assembles a range of statistics to show how, in the areas of the environment, rising inequality, resource paucity and energy inefficiency, the China model often uncritically lauded outside the country has plenty of faultlines, and it has left the current leadership under Xi Jinping with a vast array of challenges. Dr Dutta mentions the attempts both in the Third Plenum of 2013 and the Fourth of 2014 to create a framework where the state is able to guide the economy through a tough transition to a more service sector orientated, greener, sustainable model. But there are plenty of dangers lurking ahead, as this paper makes clear.

Perhaps the most striking feature of Dr Dutta’s presentation of China’s development since 1978 is the way in which the state’s role in economic management and policy setting has transformed. Command economy habits lingered in the 1980s, and they have never quite disappeared, though the argument now might be that the state needs to take a larger role than it has in recent years. Health and social welfare spending remain low in China, even as people’s general wage levels and development standards have risen. The state has been building vast amounts of social and physical infrastructure, but it seems to have withdrawn from areas like health provision, where a semi-privatised halfway house currently prevails. Implementation and enforcement of some of the country’s tough environmental legislation is another area where the state had too often turned a blind eye – although with the blight of smogs in Beijing and Shanghai, this may be about to change. In many ways, the state, transformed and changed from its former guise, may need to take up a bigger role in the future and intervene more, even while according, in the words of the Third Plenum 2013 statement, an ‘essential role to the market.’

This paper is rich in detail, yet clear in its framework which outlines China’s development path in the last few decades. It offers a clear-sighted, practical view of where China has got to, but also describes lucidly where it needs to travel on to. Xi Jinping has talked of the great centennial goals in the next decade – reaching the 100th anniversary of the foundation of the Communist Party in 2021, and marking this with finally achieving middle income status for the country. But the road to these great landmarks remains a tough one to travel along. As this paper shows, there is a reason why Chinese leaders and economists are never self-
satisfied or complacent. They have a vast mountain to climb, and need to find answers to some of the huge problems this paper outlines.

Professor Kerry Brown

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1. Introduction

After China’s historic ‘open door’ policy adopted in December 1978 by reformists within the Communist Party of China led by Deng Xiaoping, and then its accession to the World Trade Organization (WTO) in 2001, China has been experiencing a rapid economic growth accompanied by major transformation of its economic structure. This transformation has undoubtedly been facilitated by the Chinese government’s various pragmatic structural and institutional reforms since the early 1980s. China has transformed from a low productive agriculture-based economy to an industrial and service sectors dominated economy. In the 1970s, China was a much closed economy – total value of China's import and export was only $20.6 billion, ranking 32nd in world trade and accounting for less than 1% of the world's total trade. Within three decades, China became the world's largest exporter and second-largest importer. In 2010 the total value of China's import and export reached US$2.974 trillion, 144 times as much as that in 1978, with the total volumes of China's export and import accounting for 10.4% and 9.1% of the world's total, respectively. At the same time, urbanisation has been taking place at an unprecedented rate in its history. Between 1990 and 2011, land urbanisation expanded 3.4 times, while the urban population increased 2.3 times (CSY, 2012). Another noteworthy achievement that China has made is very high reduction in poverty. According to World Bank estimates, Chinese people below the poverty line (i.e. living on the equivalent of US$1.25 or less per day in 2005 purchasing price parity terms) accounted for 13% of the total population in 2008, which is down from about 84% in 1981. Very recently towards the end of 2014, China has reached another milestone in its spectacular economic achievements by becoming the world’s largest economy, as the International Monetary Fund’s (IMF) purchasing-power adjusted gross domestic product (GDP) calculation suggests.

More than three decades of rapid economic growth has, however, transformed China from an egalitarian society into one of high socio-economic inequality. Along with rising income inequality, disparities in social indicators, including health and education outcomes, are also on the rise. Gender equality, one of China’s major pre-reform era achievements, has even reversed. Much of China’s recent increase in income inequality has been a result of various unequal opportunities. For example, providing subsidies and preferential tax treatment for investment in coastal regions over the inland ones has given rise to regional inequality. Similarly, the reduced role of government in the provision of basic services of health care and educational financing in recent years has trapped the disadvantaged groups in low-return economic activities, basically by excluding them from the more skill-based new employment

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1 The author acknowledges that this policy paper is primarily based on four chapters constituting Part-II: Structural and Institutional Analysis of Contemporary China’s Growth and Development in a recently edited book by Dutta (2014). It has also used some additional facts and figures from a few other sources including the Special Issue (2014, Vol. 28, No. 4) of Journal of Economic Surveys; and the section: ‘The state and economic enterprise,’ Asia Forum Quarterly, Vol. 6, No. 4, 2014.
opportunities. Also, more than approximately 200 million rural migrants, without urban hukou and therefore failing to obtain urban registration, are also contributing to China’s rising inequality. The potential threat to political and social stability posed by growing socio-economic inequality has now been widely regarded as the major issue in China. In addition, environmental sustainability, a critical aspect of quality growth, has largely been sidelined until recently in China’s growth-focused policy discourse. This is particularly reflected in the large and growing body of studies that is overwhelmingly devoted to China’s growth miracle and its rising power in the global economy, while omitting the issue of environmental degradation and depletion of natural capital associated with its recent energy intensive pattern of economic growth.

The Chinese government has been addressing the issues of socio-economic and environmental degradation by setting targets to expand social protection through improved access to education and healthcare, and to reduce pollution through increased energy efficiency. The Chinese economy has recently shifted towards a relatively slower growth path as a result of the government’s adoption of a relatively sustainable energy consumption policy. Because full privatisation of State-Owned Enterprises (SOEs) is not an option for the Chinese Communist Party, alternative SOE reforms are being intensively discussed by the administration in power for the purpose of policy exploration. Unleashing the services sector equipped with information and communications technology also has the potential to rebalance the Chinese economy. Very recently, Chinese policymakers have begun closely looking at the issue of disinflationary/deflationary trends that have started impacting the economy as the clear symptoms of deeper economic problems of chronic overcapacity, insufficient demand and wasteful investment. These trends are, in fact, the side effects of China’s top-down economic system. In a possible sign of concerns about these ominous trends, the People’s Bank of China cut interest rates in November 2014 for the first time since 2012, although many argue that lower borrowing costs will largely be helping state-backed companies to keep going, even if they are not economically viable.

2. Main sources of China’s economic miracle

Although China has maintained high growth over three decades, the sources of economic growth have changed over time. While its high economic growth rate over the first two decades (1978-2000) was sustained largely through labour productivity growth (measured as output per worker), economic growth in the third decade (2000-2010) and beyond has been largely driven by investment in fixed assets and growth in energy-intensive industries.

The first two decades (1978 to the early 2000s)

Table-1 below summarises sources of growth accounting from 1978 to 2004. During the period of 1978-1993, labour productivity growth rates of all three sectors were growing at a comparable pace, ranging from 4.3% for agriculture, 4.8% for the industrial and 4.7% for services sector. As

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<th>Sector</th>
<th>Growth Rate (1978-1993)</th>
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<tr>
<td>Agriculture</td>
<td>4.3%</td>
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<tr>
<td>Industrial</td>
<td>4.8%</td>
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<td>Services</td>
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structural transformation accelerated, the industrial and service sectors’ contribution to total economic growth accelerated and overtook that of the agricultural sector during 1993-2004, with labour productivity growth in industry and services reaching 9.8% and 5.1% respectively, compared with 4.3% in the agricultural sector.

The third decade (2000-2010) & beyond

Since the early 2000s, the sources of economic growth have changed, and growth has largely been driven by investment in fixed asset (e.g. real estate and infrastructure), capital-intensive industries and export sectors. In 2008, fixed asset investment accounted for about 40% of gross domestic product, higher than all other large economies, including Japan (22%), Germany (19%), US (14%), Brazil (18%) and India (39%) – with the world average being 21% in 2008.

Table 2: China’s recent growth in GDP at factor ost in 1996 prices (per cent)

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<tr>
<td>Agriculture, Forestry, Animal Husbandry &amp; Fishery</td>
<td>11.3</td>
<td>12.7</td>
<td>14.2</td>
<td>9.6</td>
<td>9.2</td>
<td>10.4</td>
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<tr>
<td>Mining</td>
<td>0.8</td>
<td>3.3</td>
<td>10.6</td>
<td>9.2</td>
<td>5.2</td>
<td>7.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>30.2</td>
<td>12.8</td>
<td>3.5</td>
<td>35.3</td>
<td>-14.3</td>
<td>17.4</td>
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<tr>
<td>Production/Supply of utilities (Electricity, Gas &amp; Water)</td>
<td>11.8</td>
<td>14.1</td>
<td>14.1</td>
<td>8.8</td>
<td>8.0</td>
<td>11.0</td>
</tr>
<tr>
<td>Construction</td>
<td>12.1</td>
<td>13.6</td>
<td>11.4</td>
<td>-21.9</td>
<td>4.4</td>
<td>5.7</td>
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<tr>
<td>Source: Various issues of Statistical Yearbook of China over the period of 2005-2012. The author is thankful to Dr. Yibai Yang for computing data used in Table-2.</td>
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*Note: Services include (i) Transport, Storage and Post; (ii) Information Transmission, Computer Services and Software; (iii) Wholesale and Retail Trades; (iv) Hotels and Catering Services; (v) Financial Intermediation; (vi) Real Estate; (vii) Leasing and Business Services; (viii) Scientific Research, Technical Services and Geologic Prospecting; (ix) Management of Water Conservancy, Environment and Public Facilities; (x) Services to Households and Other Services; (xi) Education; (xii) Health, Social Security and Social Welfare; (xiii) Culture, Sports and Entertainment; and (xiv) Public Management and Social Organizations.
As Table 2 above shows, China’s high GDP growth rates have been the result of high growth rates in mining (except in 2008-09), manufacturing, utilities (except in 2007-08), construction, as well as services in recent years, over the past decade or so. The growth pattern during this period was particularly energy intensive. The fast-growing industries were those producing energy intensive products, such as steel, aluminum, and cement, to meet China’s massive domestic demand for housing construction, transportation and infrastructure development, as well as to export to international markets. China accounted for 48% of global cement production, 49% of flat glass production, 35% of steel production, 28% of aluminum production, and 11% of passenger cars production in 2006. The government also aimed to drive economic growth through developing the automobile industry. Between 2002 and 2007, China’s national automobile market grew by an average 21%, or one million new vehicles year-on-year. In 2009, 13.79 million motor vehicles were manufactured in China, surpassing the United States as the world’s largest automobile producer by number. The growth pattern during the decade of 2000s became, as put bluntly by then Chinese Premier Wen Jiabao in 2009, “unstable, unbalanced, uncoordinated and unsustainable.”

The emerging industries & investment shift towards clean energy

China is now embarking on a new stage of production upgrading. The development of strategic emerging industries (SEIs) is the key focus of the 12th five-year plan (2010-2015), which includes biotechnology, new energy, high-end equipment manufacturing, energy generation and environmental protection, clean energy vehicles, new materials and new generation information technology.

China has started to shift investment towards clean technology. In 2009, overtaking the US, China became the largest investor in clean energy technology; its investment of $34.6 billion accounted for about 21% of global total investment in clean energy. At the same time, it surpassed countries such as Denmark, Germany, Spain and the United States in 2009 to become the world’s largest maker of wind turbines and solar panels.

3. Five major policy factors responsible for China’s economic miracle

China’s economic miracle over the past three decades or so has attracted global attention and spurred a proliferation of studies that attempt to identify factors underlying its unprecedented economic growth. Five factors are broadly considered to be the key determinants of China’s phenomenal growth performance.

(i) Economic reform policies

China’s economic reform policies have been the key impetus behind the country’s sustained growth. Since the early 1980s, China’s highly distorted and inefficient centrally planned economy has been gradually transformed into an economic system that depends, to a great extent, on market forces to allocate resources, enforces private property rights, and operates within a set of relatively developed regulatory institutions.

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2 Recent initiatives include tax incentives through reduced purchase tax on small-engine cars below 1.6 litres and a 5 billion RMB direct-subsidy for farmers purchasing minivans and light trucks. This has had the effect of dramatically stimulating the production and sale of domestic small-engine cars.
The reform process started in the early 1980s in the agricultural sector through the introduction of household responsibility system and development of Town and Village Enterprises (TVEs). It replaced the inefficient rural collective ownership system. The decision of the 14th Party Congress in 1993 to establish a “socialist market economy” paved the way for the next stage of reforms in SOEs and the financial sector. Under the leadership of President Jiang Zemin and then-Premier Zhu Rongji, reform of SOEs during the 1990s involved devolution of management and control from the central government to managers of local enterprises, and privatisation of the majority of SOEs through the transfer of ownership of state assets. As SOEs reform deepened, the private sector had become an increasingly dominant force in the economy, with the private sector share of total industrial output rising from 6% in 1998 to about 52% in 2009 (CSY 2010). Afterwards, under the administration of President Hu Jintao and then Premier Wen Jiabao, the government had, however, thrown its weight behind the SOE champions. Nonetheless, the number of SOEs as a share of the total has continued to fall, dropping to 5% in 2011, although the SOEs have still remained dominant in the commanding heights of the economy.

Another important structural reform involved fiscal and administrative decentralisation from the central government to local tiers of institutions. This decentralisation also created competition among local governments and improved efficiency through better decision-making based on local conditions and better information flows. These reforms unleashed enormous incentives and creativity from individuals, firms and local governments that striving to maximise economic returns through seeking out opportunities, both domestically and globally.

(ii) Government commitment and Chinese style reform

History shows that growth entails much more than just economics. It requires the leadership of governments that are committed, credible and capable. China’s reform experience is a case in point. The Chinese government has evidently demonstrated its strong commitment and leadership to transform China from a poverty-ridden country to a prosperous nation by implementing a wide range of long-term economic reform programs, while recognising the challenges and political risks associated with these reforms.

China’s approach to pursuing these reforms has been unique. Chinese policy-makers understood the enormous uncertainties brought about by economic reforms on such a scale. Following the principle developed by Deng Xiaoping “to cross the river by feeling for the stones,” the Chinese government adopted a gradual, experimental and pragmatic approach to reform, scaling up successful reforms over time and across regions based on the principle of learning-by-doing. The Chinese approach reduced the risks associated with the Big Bang reform approach that was adopted by many Eastern European countries where many reforms were brought to a halt or even made redundant due to political constrains.

(iii) Strong emphasis on public investment in social services and rural development

The third factor lies in China’s long-term commitment to public investment in infrastructure, education and health, and basic services in particular before and during the early period of economic reforms. Although the centrally planned system had severely distorted resource allocation and hindered economic growth, progressive policies in promoting public investment in health, education, and providing access to basic services such as electricity, safe water and sanitation had laid the foundation for China’s economic success.
Public investment prior to China’s economic reform focused on expanding the population’s access to basic health and education services in both urban and rural areas. Promoting gender equality was also one of the development priorities. These development policies resulted in China’s impressive human development outcomes despite its low per capita income. China’s agricultural productivity growth since the early 1980s was largely attributed to the government-led investment in rural infrastructure, including electricity access, rural roads and irrigation. The superior rural infrastructure in China compared with many developing countries made it possible to achieve a faster growth in the agricultural sector when the constraints of the collective farming system were removed.

Essentially, prior to its transition to a relatively open economy, China had built a literate and healthy labour force, and developed an infrastructure base thanks to strong government-led investment in social services. When a productive business climate was created by economic reform, the majority of the Chinese population had the capabilities to participate fully in the expanded economic opportunities brought by the reform policies, raising national income at a rapid pace.

(iv) Integration into the global economy

China’s economic growth was further strengthened by its integration into the rest of the world. The global economy has offered China a nearly unlimited market for its export of goods and services, while allowing it to improve efficiency and productivity by exploring its comparative advantage in low cost labour and economies of scale. Integration into the world economy also provides China with the opportunity to import technology and ideas, the know-how and modern management skills that are embodied in foreign direct investment (FDI) and joint ventures. By opening up its economy through trade and FDI, China’s growth in the export sector also played a key role in stimulating its upgrading of technology.

China also became a major destination of FDI. According to official statistics, FDI was near zero in the late 1970s and rose to about only US$2.3 billion in 1984-89. Since the early 1990s, China had become the largest FDI recipient among developing countries, with FDI inflow to China reaching $95 billion, accounting for about 19.9% of total FDI in developing countries, and 8.5% of total global FDI in 2009 (UNCADT, 2011).

(v) Knowledge transfer through various exchange programs

Another important channel of knowledge transfer is through various exchange programs. Along with openness of trade and foreign investment, Chinese policy makers paid special attention to foreign education through exchange. The Chinese government invited a stream of foreign experts to help them learn about the functioning and features of a market economic system, while at the same time sending many waves of Chinese students and government officials to be trained in US and European universities. Many prominent Chinese reformers were selected from the pool of western trained technocrats to be placed in key positions in China’s economic reform policy think tanks, playing an important role in reshaping China’s reform policy-making.

4. Rising income inequality, social disparity & gender inequality in contemporary China
However, more than three decades of rapid growth has transformed China from an egalitarian society into one of alarmingly high income inequality and social disparity. About five decades ago, Arthur Lewis – a famous development economist – made a statement which implies that in the early stage “development must be inegalitarian because it does not start in every part of the economy at the same time”. As China was deepening its economic and structural transformation, rising income inequality was, therefore, inevitable.

The relationship between economic growth and income inequality, although remaining controversial, has occupied a central place in economic policy debates for over 50 years since the pioneering work of Simon Kuznets who codified the modern economic growth. The central message of the Kuznets curve is that income inequality dynamics and growth are intimately connected when countries are undergoing a structural transformation, typically from agricultural based economy to one dominated by the industrial sector. The rising income inequality in China should be examined in the context of a wider process of economic development.

The overall inequality in China, as summarized in Figure-1 and Figure-2, is a reflection of both the rural-urban divide and regional disparity. Inequality in China has risen sharply since the beginning of the economic reform in 1978. This rising trend of income inequality is confirmed using various measures and data sources. Figure-1 below shows that the Gini index – a measure of inequality – for national, rural and urban China increased steadily from the early 1980s to 2006.
The regional development gap is most evident between coastal (i.e. Eastern) and inland (i.e. Central and Western) regions. As can be seen from Figure-2 below, all three regions have maintained an increasing trend in their regional per capita GDPs throughout the 15 years from 1996 to 2010, although the Eastern region’s level of GDP has been consistently higher than the Central region, as the Central region has been to the Western region\(^3\). As a result, divergence between the levels of regional GDP has drastically widened during the same period. This demonstrates that China’s “open-door” policy has been successful at least in

\(^3\) The *Eastern* region includes the provinces of Guangdong, Fujian, Jiangsu, Zhejiang, Shanghai, Shandong, Hebei, Beijing, Tianjin, Liaoning and Hainan; the Western region includes the provinces of Shaanxi, Chongqing, Sichuan, Gansu, Qinghai, Xinjiang, Ningxia, Guizhou, Yunnan and Tibet; while the *Central* region includes the provinces of Shanxi, Inner Mongolia, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei, Hunan and Guangxi.
terms of raising average real income per capita in all the three regions during 1996-2010, although underlying divergence between yearly regional GDPs and yearly per capita incomes have persisted. In China, regional inequality has become a concern as it is considered a potential source of ethnic tensions that cause social instability.

In recent years, urban inequality has been a major contributor to the overall inequality in China; the rapidly rising inequality in urban areas has become a major public concern. The rising urban inequality warrants special policy attention for two reasons. First, the significant political stake that the urban population commands in Chinese society means a sharp rising inequality in urban areas can potentially lead to social unrest. Secondly, the continuous massive inflow of rural migrants into urban areas is likely to further aggravate inequalities and urban poverty if policy measures are not put in place to reverse such trends.

Many studies most likely have underestimated urban poverty and inequality because of the exclusion of rural migrants in the sample of urban residents, even though many of them reside in urban areas almost permanently. Evidence based on targeted surveys shows that the average income of migrants is much lower than that of urban residents – the average hourly wage for migrants was about 9.8RMB, compared with 13.5RMB for urban residents in 2010. In addition, income inequality among migrants is much higher, with the Gini coefficient of hourly income at 0.42 for migrants, compared with 0.38 for their urban counterparts. This suggests that urban inequality is likely to be much higher when taking into account migrant populations.

*What are the driving forces behind China’s rising income inequality?*

The rising spatial income disparity, in particular, between the coastal and inland regions, is likely attributable to a combination of differential geographical conditions and government preferential industrial policies. The coastal provinces enjoyed geographical advantages in terms of proximity to ports and the closer trade links with the rest of the world. In addition, the labour force in coastal regions is relatively more educated⁴. The Chinese Government’s industrial policy in terms of providing subsidies and preferential tax treatment for investment in the special economic zones designed to open up coastal regions to international trade and attract FDI, also played a key role in widening regional inequality.

The second source of China’s rising income inequality lies in the significant increase in returns to education. The increasing dominance of the private sector in China’s overall economy, together with the restructuring of SOEs, intensifies competition among firms. In order to maintain competitiveness, firms strive to continuously improve efficiency, upgrade production through new investment and employ more educated and skilled workers.

The economic reform has created a labour market where wage-returns to education have been substantially increased. For example, the wage-return to one additional year of schooling increased from 4% in 1988 to 11% in 2003. Similarly, the salary premium of more skilled occupations has increased substantially, with ‘white-collar’ jobs (e.g. professional/technical personnel, factory managers, and administrators), earning sustainably higher salaries than

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⁴ The average years of formal education of the working age population was 5.9 in coastal rural areas, compared with 5.2 inland in 1989, although disparity in education attainment among the urban population was negligible (Lou and Zou, 2008).
unskilled, ‘blue-collar’ workers. In 1989, the average wage of ‘white-collar’ workers was 10% higher than their blue-collar counterparts, but by 2004, the wage gap increased to 55%.

Disparity in social indicators and opportunities

Individual entitlements, capabilities, freedom and rights are considered to be central to socio-economic development, and economic growth is the major means to these ends and equity. The notion of equity includes both income and human capabilities, such as health and education outcomes, equality of opportunities and gender equality. However, judging by this notion of socio-economic development, China’s economic growth process in recent years, in many aspects, falls short of what constitutes inclusive development.

China was able to achieve impressive health and education outcomes, with a very low level of income in its pre-reform period. But as its economic status elevates to the rank of the middle-income countries in recent years, its social indicators becoming stagnant, while disparities in health and education, both in terms of access and outcomes, are also widening. The impressive achievements in gender equality before the early 1980s have reversed in recent years as highlighted in the 2008 UNDP Millennium Development Goal Progress Report.

The shrinking role of government

In achieving inclusive development and equity, history shows that public policies, rather than market forces, are the important sources of social insurance. This is particularly true when countries are undergoing major economic transformation and experiencing faster economic growth with rising income inequality as has been the case in China. In contrast to many countries which were burdened with large government budget deficit and slow growth, China’s fiscal capacity increased by more than 22 times between 1980 and 2010. However, the role of government in the provision of social services has been shrinking, and the share of government’s social spending has also been significantly lower than many developed economies.

In China, government social spending as a share of GDP, although increased from 17.7% in 1995 to 20.8% in 2008, is much lower than the OECD average of 44.5%. Public spending on health and education, for example, amounted to the equivalent of 3% of GDP in 2008, which was much lower compared with the OECD level of over 30% in the same year. The government’s contribution to health care financing also declined sharply during this period, from 28% in 1980 to 18% in 2010, while private health spending rose from 16% to 52% (Figure-3). This is in sharp contrast with OECD countries where the share of public spending in total health expenditure accounted for 76% while private sources contributed only 24% in 2010.

Figure-3: Health spending by source: 1980 vs 2010
Moreover, before the mid-1980s, the majority of the Chinese population was able to have access to basic health care at an affordable cost. The Cooperative Medical Scheme covered over 90% of the rural population in China, while the Government Insurance Scheme and Labour Insurance Scheme provided almost free health care to the majority employees in the public sector and SOEs in urban areas. The reform eroded the widespread provision of basic social services that was achieved during the pre-reform era.

The newly-established health insurance scheme has been designed with a strong emphasis on profit-making, partially in response to the declining role of government in health care financing, thus, leading to a rapid escalation in health-care costs in the past decade. Together with the lack of health insurance, hospital care has become unaffordable to a majority of rural residents. The average patient has to pay 60% of the cost of a hospital visit out-of-pocket, compared with 25% in Mexico, 10% in Turkey, and a much lower amount in most developed countries.

China’s highly decentralized fiscal system further aggravates social disparities. With local governments responsible for funding local services, those in poor regions were not able to provide quality social services, and poor households could not afford the high private costs of health and education services. Consequently, rising income inequality reinforces inequality in social indicators.

Gender inequality

The famous phrase that ‘Chinese women were holding half of the sky,’ symbolizes the equal role of women in China as a result of progressive gender-focused development since the early 1970s. However, the impressive achievements in gender equality before the early 1980s have reversed in recent years, as reflected in excess female infant mortality, a widening gender gap in human capital accumulation and employment opportunities. The excess female infant mortality rate was a result of the deeply-rooted preference for son in China which manifests in discrimination against girls at birth and deprives access to preventive and curative health care in early childhood. According to the World Bank’s *World Development Report 2012*,

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5 The health sector reform distorted the incentives of health care providers, encouraging hospitals to recover costs through high fees on drugs and undertaking expensive medical procedures while reducing the supply of preventive care services.
excess female deaths have risen since 1990 from 890,000 to 1.1 million in 2009. Over a quarter of all excess female deaths in China occur at birth.\(^6\)

Gender disparity in human capital\(^7\) is also on the rise in recent years. While the human capital for both females and males increased, the gender disparity widened. According to a recent study, the female per capita human capital was 22% lower than their male counterpart in 2007, but it was only 13% lower in 1985. The increase in gender differential in human capital gap was a consequence of both lower returns to schooling and less working years of females than males. For example, the mandatory retirement regulations now force women to retire at the age of 50 while men can work until the age of 60. Men and women also face differential employment opportunities because the labour market has become more segregated by gender. The 2000 census shows that 95% of females were in low-paid jobs, compared with 90% of males, despite female average schooling (12 years) being higher than that of males (11 years) that year. Not only have women been affected disproportionally by the layoffs of SOEs restructuring, they also have faced more discrimination in gaining subsequent job offers than men have.

5. **The environmental cost of growth**

One important aspect of the quality of growth is environment and resource sustainability. China’s economic growth in the past few decades has come at a heavy environmental cost, resulting in severe environmental and resource degradation, and a surge in greenhouse gas emissions. In 2007, China surpassed the US to become the largest greenhouse gas emitter, although carbon-dioxide (CO\(_2\)) emission per capita remains relatively low – about a quarter of that in the US. According to the Netherland’s Environmental Assessment Agency, the soaring demand for coal to generate electricity and a surge in cement production have caused China's record greenhouse gas emission. The severity of air and water pollution, heavy metal pollution in soil, and an acute water shortage have all reached an alarming level. This is a direct consequence of rapid expansion of energy-intensive heavy industries with predominantly coal-based energy use that has fueled the GDP growth in the past few decades. However, inadequate policy measures to safeguard the environment and weak enforcement of environment regulations, in particular the mindset of ‘grow first and clean afterwards’ at all levels of government in China have also played an important role in the current environmental crisis.

**Water shortages and air pollution**

The World Bank has warned that water scarcity will become an increasingly pressing issue in China. From 2000 to 2009, China's total water reserves fell by 1.5 percent annually, about 35 billion cubic meters of water a year according to the Ministry of Water Resources. According to the 2007 OECD Environmental Performance Reviews of China, among the 600 large cities, 400 suffer from water shortages. The deterioration of water quality from widespread

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\(^6\) These are the numbers of “missing girls” if the normal sex ratio at birth of 105 boys to 100 girls had prevailed in China (the observed sex ratio in China was almost 120 boys born for every 100 girls in 2009). This problem of “missing girls” was exacerbated in recent decades by the practice of sex-specific abortions (Banister, 2004).

\(^7\) The human capital indicator captures all three components: (1) the level of education attainment, (2) return to schooling and work experience, and (3) the total years of working life available that is related to the mandatory retirement age.
pollution further aggravates water shortages in China. According to the OECD report, about 30% of the rivers monitored are classified as worse than grade V (i.e. highly polluted), three quarters of China’s major lakes are considered to be highly polluted (grade V or above) and a quarter of China’s coastal waters are very polluted (grade IV or above). Water pollution in China is caused primarily by chemical fertilisers and pesticides, industrial waste, and raw sewage. China’s first pollution census published in 2010 reveals that fertiliser use is a bigger source of water contamination than factory effluent. The intensive use of both chemical fertilisers and pesticides is three to four times higher than the OECD average. Factor reallocation and poor selection of plant locations have exacerbated water contamination. In 2006, as many as 81% of a total of 7555 chemical and petrochemical construction plants were located in and around environmentally sensitive areas such as densely populated localities, rivers, lakes, etc., while 45% of those were sources of high-risk pollution.

Water scarcity has become a limiting factor in sustaining the scale of China’s agricultural production. In Northern China, water shortages have also forced farmers to use waste-water for the irrigation of about 40,000 square km of agricultural land, resulting in contamination of food by heavy metals. Water scarcity is also constraining the capacity of natural bodies of water to serve their ecological functions. The excessive surface water withdrawals have made it impossible to sustain a minimum level of environmental and ecological flows for major rivers in North China. According to a study by World Bank in 2008, water shortages have also led to overexploitation of groundwater. Consequently, the lowering of water tables, drying up of lakes and wetlands, and land subsidence are frequent occurrences in many cities.

Air pollution in urban area has also become a serious public health threat. According to a World Bank study among the world’s 20 most polluted cities, 16 are in China; and only 1 percent of the China’s 560 million city dwellers breath air considered safe by European Union standards. About a third of 113 cities surveyed in 2009 failed to meet national air quality standards based on Chinese official data, despite the fact that air pollution levels set by China’s national air quality standards are 4-5 times higher than the OECD standards. The main sources of outdoor air pollution in China are coal combustion, motor vehicle exhaust, and the massive scale of urban construction, generating particles of soot, organic hazardous material, heavy metals, acid aerosols and dust, in addition to emissions of sulfur dioxide (SO₂) and nitrogen dioxide (NO₂). Coal, the number one source of air pollution in China, is also the principal source of energy. Figure-4 shows that about 80% of electricity and 70% of total energy in China are produced from coal (much of it of high sulfur coal), compared with only 45% in the US.

Figure-4: Energy source of electricity production: China and USA

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8 About 11.7 million pounds of organic pollutants are emitted into Chinese waters very day, compared to 5.5 in the United States, 3.4 in Japan, 2.3 in Germany, 3.2 in India, and 0.6 in South Africa.
Uncontrolled growth of motorisation

China has by far the highest growth rate of vehicle ownership, 10.6% annually, followed by India (7%) and Indonesia (6.5%). The rapid growth of motorisation in cities has led to rising congestion levels, increased air pollution and a high traffic fatality rate. Unfortunately, this adverse impact has been largely overlooked by all levels of government in the expansion of the automobile industry in the past decade. Emissions from vehicles make up a high and rising proportion of total urban air pollution. Even with stricter emission controls and cleaner fuels, mobile-source pollution is likely to continue rising due to increased use of individual vehicles and longer trip lengths, and, therefore, increasing population’s exposure to vehicle emissions through direct inhalation.

The environmental risk factors, particularly air-, water-, and industrial waste-related pollution, are a major source of morbidity and mortality in China. Despite the frequent references to China’s environmental risks in global policy discussions, comprehensive analyses of environmental indicators and health outcomes through scientific publications and popular media are surprisingly scarce. Studies show that the overall cost of health damage is estimated to be between 1.8–4.8% of GDP, and projected to reach 13% of GDP by 2020. Evidently, the quality of life of the Chinese population, in terms of environment, is at a serious risk when the quality of growth is overlooked by a blind pursuit of the pace of growth.
Energy intensive growth

China’s growth pattern in the 2000s is largely energy intensive. Although China made a rapid improvement in energy efficiency (measured by energy use per unity of GDP) from 1978 to 2000, the total energy consumption increased twofold between 2000 and 2008, while energy import rose from 1% of total energy consumption in 1990 to 13% in 2008. Energy use in industry and households increased by three and two times respectively, between 1990 and 2008 (Table-3). China now ranks with middle-income countries, and energy-intensive consumer goods, like air conditioners and automobiles, are within reach of many Chinese households, as reflected in the rapid increase of private car ownership. Clearly, China is on a development path that features unsustainable production and consumption patterns because of both resource constraints and environmental degradation. The heightened resource scarcity and degradation not only poses a significant health risk to the Chinese population today and in decades to come, but also will act as a constraint on economic growth. The costs of cleaning

\[\text{Energy efficiency is measured by energy use per unity of GDP. On average the energy use of one unit of GDP was estimated to be eight times less in 2000 than in 1980.}\]

### Table-3: China’s Overall Energy Balance Sheet

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<tbody>
<tr>
<td><strong>Energy dependency</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Total Energy Available for Consumption</td>
<td>96138</td>
<td>129535</td>
<td>142605</td>
<td>232225</td>
<td>287011</td>
</tr>
<tr>
<td>Total Energy Consumption</td>
<td>98703</td>
<td>131176</td>
<td>145531</td>
<td>235997</td>
<td>291448</td>
</tr>
<tr>
<td>Imports</td>
<td>1310</td>
<td>5456</td>
<td>14334</td>
<td>26952</td>
<td>36764</td>
</tr>
<tr>
<td>(import as % energy use)</td>
<td>1</td>
<td>4</td>
<td>10</td>
<td>11</td>
<td>13</td>
</tr>
</tbody>
</table>

**Energy use by sector**

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<tbody>
<tr>
<td>Industry</td>
<td>67578</td>
<td>96191</td>
<td>103774</td>
<td>168724</td>
<td>209302</td>
</tr>
<tr>
<td>(as % energy use)</td>
<td>68</td>
<td>73</td>
<td>71</td>
<td>71</td>
<td>72</td>
</tr>
<tr>
<td>Construction</td>
<td>1213</td>
<td>1335</td>
<td>2179</td>
<td>3403</td>
<td>3813</td>
</tr>
<tr>
<td>(as % energy use)</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Transport, Storage and Post</td>
<td>4541</td>
<td>5863</td>
<td>11242</td>
<td>18391</td>
<td>22917</td>
</tr>
<tr>
<td>(as % energy use)</td>
<td>5</td>
<td>4</td>
<td>8</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Household Consumption</td>
<td>15799</td>
<td>15745</td>
<td>15614</td>
<td>25305</td>
<td>31898</td>
</tr>
<tr>
<td>(as % energy use)</td>
<td>16</td>
<td>12</td>
<td>11</td>
<td>11</td>
<td>11</td>
</tr>
</tbody>
</table>

*Source: Wang, Limin (2014)*
up can be significant, and the increasingly fierce competition between energy and water will bring China to a choking point, limiting its future development prospect.

The rising environmental and resource degradation has also become a major social issue, fueling instability and protests. According to the Ministry of Environment website, one environmental accident occurs every two days, and there were 600,000 environment-related complaints in 2006. Perhaps, the voice of ordinary people in China can best convey the key messages of their concerns about environmental problems and discontent with the current pattern of growth in China:

“We are surrounded by black and smelly waterways, breathing the foul air every day and paying the price at the cost of our health. If we can’t breathe clean air or drink clean water, high economic growth is meaningless.”

6. Forward-looking policy options

The decision by the Third Plenum of the Chinese Communist Party’s 18th Central Committee meeting towards the end of 2013 for promoting the ‘decisive role of the market in allocating resources’ by maintaining ‘the dominant position of public ownership’ and ‘the leading role of the state-owned sector’ is noteworthy. After rolling out the large-scale stimulus packages announced in 2008 in order to curb the global financial crisis, the Chinese economy is currently going through a ‘period of pain’ as authorities try to shift it towards a relatively slower and sustainable growth path (i.e. with high speed instead of super high speed). At the recent G20 Leaders Summit in Brisbane, Australia, the Chinese Vice Finance Minister Zhu Guangyao told reporters: “We do have problems that have been accumulating over time.” Mr Zhu simply reiterated President Xi Jinping’s catchphrase of a ‘new normal’ for the Chinese economy. Slowing economic growth and increasing concerns about the misuse of state privilege for private gain have been the two major priorities of the present administration of the central government.

As far as policy options are concerned, both socio-economic inequality and environmental degradation deserve priority consideration for their amelioration. China’s 12th Five-Year Plan (2011-2015) has been addressing these issues by setting targets to expand social protection through improved access to education and healthcare, and to reduce pollution through increased energy efficiency. Its annual growth target of 7% indicates the intended focus on quality of life, rather than pace of economic growth. In a joint study prepared by the World Bank and the Development Research Center, a think-tank affiliated to the State Council, suggestions have been made for ‘strengthening skills development programs, including for migrant workers; enhancing opportunities in rural areas and small towns; and improving transport connectivity for more balanced regional development.’ In order to shift to a relatively sustainable energy path, the options that are open to the Chinese government include ‘enhancing urban environmental services; promoting low-carbon urban transport; promoting sustainable agricultural practices; piloting sustainable natural resource
management approaches; demonstrating pollution management; and strengthening mechanisms for managing climate change.’

Besides, research shows that there is a strong link between inclusive growth as a policy target and China’s institutional environment at local level. It is argued that inclusive growth in China is not achievable by central government intervention alone, because it depends also on local governments and their support for local enterprise development. Small and medium enterprises (SMEs) matter for China’s inclusive growth. A robust SMEs sector promotes broad-based and more equitable growth in several ways. These include the creation of employment opportunities (particularly in less developed regions), a critical mass of market participants and transactions leading to improvement in overall resource allocation efficiency, driving economic growth through fixed asset investment and exports, promoting technology assimilation to enhance industrial specialisation and differentiation, and generating tax revenue which gives governments leverage to finance key socio-economic programs. Because China’s SMEs currently face financial constraints, it is also suggested that policies targeting SME finance should reflect the variation and dynamics within SMEs’ finance structure in China. Specifically, an alternative institutional debt-versus-equity finance framework is a policy option that deserves exploration.

Unleashing the services sector equipped with information and communications technology has the potential to rebalance the Chinese economy. It is often argued that “(w)ithout competition in the services sector, the supply of services by the SOEs is insufficient, quality is low, prices are high, and domestic demand is thus depressed.” Therefore, breaking down the SOE monopoly is one major way forward. This has also high potential for creating job opportunities, mainly because the SOEs are predominantly capital intensive. It is further argued: “Encouraging more private investment will help to boost domestic consumption, reap the reform dividend’ and sustain robust economic growth in the long run.”

Because full privatisation of the SOEs is not an option of the Chinese Communist Party in the very near future, alternative SOE reforms have been discussed last year at the third plenary session of the Chinese Communist Party’s 18th Central Committee meeting. In the Third Plenum Report, a blueprint for reform, the buzzword is ‘mixed ownership economy’ with the basic idea of encouraging private capital to be involved in SOE reform. But, many private entrepreneurs seem to be unenthusiastic about the invitation. It is yet to be seen if the main theme – ‘rule of law’– of the just concluded Fourth Plenum of the Chinese Communist Party’s 18th Central Committee will have any strong effect in motivating private capital.

Meanwhile, another fear of a disinflationary/deflationary spiral has been haunting the Chinese policymakers. As China’s official statistics shows, producer prices have already been in outright deflation with negative inflation rate for nearly three years, while consumer price index having dropped to a near five-year low of 1.6 per cent on an annual basis in October 2014 indicates a disinflationary trend with a positive inflation rate that has been steadily declining over the past three years (2012-14). These disinflationary/deflationary trends are the clear symptoms of deeper economic maladies of chronic overcapacity
particularly in manufacturing sector; insufficient demand both in China and abroad; and wasteful investment in needless steel mills, ghost cities and empty stadiums as a part of the 2009 stimulus in response to the global financial crisis. In a possible sign of concerns about disinflation/deflation, the People’s Bank of China has cut interest rates in November 2014 for the first time since 2012. Many argue that the trend of the current disinflationary/deflationary spiral is the side effect of a top-down economic system where ‘cosseted state enterprises are reluctant to retrench and local governments are engorged with easy credit.’ In fact, the rapid accumulation of debt as a percent of GDP in China has, according to Standard Chartered calculation, significantly increased from 150 to 250 in just the past five years. In the current economic environment with the disinflationary/deflationary trend, currency devaluation may be an option, if the trend worsens. But the devalued renminbi could boost exports which in turn will use up excess capacity to some extent, but, at the same time, it would increase import prices of inputs. So, the net effect of currency devaluation is an uncertain business, more so if the other countries follow suit.

7. Conclusion

The Chinese growth experience as presented above evidently shows that economic growth can be a powerful force to reduce poverty when it is combined with targeted public investment that emphasises equal access to health and education services, and rural development. But growth itself does not guarantee achieving desirable development outcomes as measured by improvement in health and education, equity and equality of opportunities. Nor does it ensure environmental and resource sustainability. The role of government is critical in key areas, such as human capital accumulation, natural capital conservation, and mitigating negative production externalities.

China’s first two decades of growth is marked by its first stage transformation from an agriculture-based economy to one dominated by industry and services sectors and elevation to becoming a middle-income country. Economic growth was largely driven by productivity growth, through improvement in resource allocation efficiency as the centrally planned system was gradually replaced by market forces. The steady growth rate of labour productivity in the agricultural sector has made it possible to achieve the expansion of industrial and service sectors through the release of surplus rural labour for migration to urban area. During the third decade of 2001-2010 and afterwards, China’s economic growth has, however, been driven largely by excessive capital accumulation, and growth in energy intensive industries. Although China has become the largest economy in the world, it lags behind in its development of knowledge-intensity in high-technology industries and services, compared with the OECD and major Asian economies. During this current period China has also been experiencing fast rising inequality and disparities in socio-economic and spatial indicators as well as reduced social mobility. Another important aspect of quality growth – environment and resource sustainability –has largely been overlooked by China until very recently.

After Deng Xiaoping famously popularised a “getting rich first” (xianfu lun) development philosophy, which encouraged a section of people and some regions to get rich first, and after more than two decades of high rates of economic growth, China’s leaders are now promoting via the slogan “common prosperity” (gongtong fuyu) the idea that more people and more regions should share the
fruits of economic development. Since the beginning of the new millennium, a number of major policy strategies have been introduced by the Chinese government. These include the introduction in 2000 of ‘the great western development strategy’ to tackle the regional divide, and in 2005 of the ‘socialist new countryside development’ movement aimed at reducing the rural-urban gaps. Also, in 2006, the government has adopted the goal of ‘building a harmonious society’ in its 11th Five Year Plan (2006-2010). Afterwards, in 2011, the 12th Five Year Plan (2011-2015) started addressing the issues of socio-economic inequalities and spatial disparities by setting various targets for quality of life, rather than pace of economic growth. In November 2013, the Third Plenum of the 18th Central Committee of the Chinese Communist Party outlined a systematic approach to tackling the inequalities and disparities through reforms in a number of areas including social protection, access to public services (particularly education and health care) and the hukou system.

Outlining reform agenda is certainly the first step, however even after the adoption of reforms, there still remains the question of effective implementation. Because of the one party political system, China has both the means and the ability for successful implementation of policy reforms related to say, socio-economic inequalities and spatial disparities, whose impacts are confined predominantly within the country. There are another set of policy reforms (such as drastic reforms of the SOEs, including full privatisation) which certainly need strong political will. There are another set of policy reforms (such as currency depreciation, in case it needs to be adopted) which require careful cost-benefit analysis especially because it directly affects other countries as well, and therefore could trigger similar policies elsewhere. So far, China has chosen to experiment mainly with piecemeal economic policy measures so to maintain the political status quo.

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