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China's Economy: Recent Development and Long-Term Prospects*

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China's economic development in the past three years (1997-99) has been affected by the Asian financial crisis and the rapid changes in the PRC's social and economic institutions. The combined effect has been a sharp decline in exports and foreign direct investment (FDI) and a slowdown of growth in gross domestic product (GDP). Although the implementation of a whole array of monetary and fiscal policies helped to lift the economy in late 1999 and the first half of 2000, the growth rate of GDP still lies below the 1990-96 record.

Despite the recent slowdown, China under the twenty years of reform and opening-up policy has significantly enlarged the industrial base and improved infrastructure and market operations. The long-term outlook on the Chinese economy projected by the World Bank and many Western experts remains optimistic. While some gloomier projections exist, on balance the optimists prevail.

In the journey toward becoming a world-class economic power, the Chinese economy also faces such obstacles as the decay of state-owned-

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enterprises (SOEs), the existence of a huge surplus labor, and the rapid deterioration of the environment. Whether or not solutions to these problems are found will determine China's chance of becoming a major player in the twenty-first century world economy.

KEYWORDS: Asian financial crisis; economic development; economic reform; long-term forecast; economic potential

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After nearly two decades of sweeping institutional reforms and the opening-up policy, the Chinese economy entered a long period of rapid growth. Between 1979 and 1996, the Chinese gross domestic product (GDP) grew at an annual rate of 9.5 percent, ranking the People's Republic of China (PRC) among the fastest growing economies in the world.

This phenomenal growth was disrupted in mid-1997 when the Asian financial crisis erupted in Thailand and then quickly spread into the entire region. The crisis left the regional economy in shambles. Southeast Asian countries and South Korea devaluated their currencies between 20 and 80 percent, while China pledged to safeguard the *renminbi* (*RMB*, Chinese currency). The PRC has therefore lost competitiveness compared to its major trading partners. Moreover, the regional financial turbulence also deterred the inflow of foreign capital. The combined effect has been a sharp decline in merchandise exports and foreign direct investment (FDI). China's GDP growth rate slowed down considerably since 1997, leading to a worsened unemployment situation. Swollen unemployment and the continued layoff from state-owned enterprises (SOEs) prompted a deflationary spiral and a period of economic contraction in 1998 and the first half of 1999. With the implementation of a whole array of monetary and fiscal policies by the government and the gradual recovery of the Asian economy, the Chinese economy showed signs of upturn in late 1999. However, the growth rate of 8.2 percent in the first six months of 2000 is still far below the record attained in the earlier decade.

Despite the slowdown in recent years, the long-term outlook of the Chinese economy remains promising. China's metamorphosis from a backward agrarian economy to a potential world-class powerhouse has triggered a host of projections regarding the future course of the Chinese economy. Divergent methods of currency conversion hinder an accurate international comparison of GDP. Different assumptions of model building adopted by projectors also result in various conclusions.

The purpose of this paper is to review the state of the Chinese economy since the outbreak of the Asian financial crisis, to survey long-term economic projections by various authors, and to highlight the fundamental problems confronting the Chinese economy.

The Impact of the Asian Financial Crisis

The most important effect of the Asian financial crisis on the Chinese economy is the loss of competitiveness in international markets, marked by a steep decline of exports in 1998-99. Prior to the Asian financial implosion, China's export trade rose steadily from US$91.7 billion in 1993 to US$182.7 billion in 1997 with an annual growth rate of 19 percent, making exports the country's most dynamic sector. The growth rate was particularly conspicuous in 1994, 1995, and 1997: each year registered more than 20 percent growth. The Asian financial crisis halted this annual growth trend, however.

In the beginning of 1998, the Chinese administration projected a 12 percent growth of exports, down from the 21 percent growth in the previous year. However, the year-end result showed a minuscule increase of only 0.5 percent. In the first half of 1999, the export trade suffered a 4.6 percent decline, the first negative growth since 1965. The growth rate resumed upward during the second half of 1999, resulting in a 6 percent growth over the previous year.[1] The growth trends of Chinese merchandise exports during the 1978-99 period is summarized in table 1.

The stagnation of exports in 1998 and the outright decline in the first half of 1999 can be attributed to two factors: the competitive devaluation of foreign exchange rates across Asia and the general economic recession in this area. From July 2, 1997 through September 28, 1998, the nominal

[1] *Beijing Review*, January 24, 2000, 16.

Table 1
China's Foreign Trade 1978-99

Unit: US$ Billion

Year	Total Trade	Exports	Imports	Balance
1978	20.6	9.8	10.9	–1.1
1980	38.1	18.1	20.0	–1.9
1985	69.7	27.4	42.3	–14.9
1986	73.9	30.9	42.9	–12.0
1987	82.7	39.4	43.2	–3.8
1988	102.8	47.5	55.3	–7.8
1989	111.6	52.5	59.1	–6.6
1990	115.4	62.1	53.4	8.7
1991	135.6	71.8	63.8	8.0
1992	165.5	84.9	80.6	4.3
1993	195.7	91.7	103.9	–12.2
1994	236.6	121.0	115.6	5.4
1995	280.9	148.8	132.1	16.7
1996	289.9	151.1	138.8	12.3
1997	325.0	182.7	142.3	40.4
1998	323.9	183.8	140.1	43.7
1999	360.7	194.9	165.8	29.1

Sources: PRC State Statistical Bureau, *China Statistical Yearbook 1998*, 620, *Beijing Review*, April 10, 2000, 16.

exchange rate of the Indonesian rupiah depreciated by 78 percent while the Philippine peso fell by 40 percent. Even the Taiwan dollar and Singapore dollar depreciated 20 percent and 15 percent respectively.

Unlike other Asian countries, China has chosen not to follow suit by devaluing the *renminbi*. The PRC government has adopted a staunch political stance against devaluation, committing itself to maintaining *RMB* stability. The policy, which won worldwide acclaim for preventing another round of competitive devaluation across Asia, has incurred substantial costs for China's exports.

The decline of exports to Asian markets, which accounted for 55 percent of China's total exports, is also a result of the deep recessions in this area. The outbreak of the financial storm set stock markets in this region into a precipitous plunge. Over a fifteen-month period, stock indices fell by about 60 percent in Kuala Lumpur (Malaysia), Jakarta (Indonesia), Shanghai (China), and Seoul (South Korea); and about 50 percent in Manila (the Philippines), Singapore, Bangkok (Thailand), and Hong Kong.[2] The slump in the stock markets and the collapse of real-estate markets caused a drop in GDP growth and substantially reduced the purchasing power of this region, which in turn curtailed the growth of Chinese exports.

Affected by the Asian financial crisis, the growth of China's exports slowed quarter by quarter in 1998. Exports rose 13.2 percent in the first quarter, 3.3 percent in the second quarter, 2.1 percent in the third quarter, and fell 17.2 percent in the fourth quarter. Exports continued falling in the first quarter of 1999. Although the decrease rate was narrowed in the second quarter, total exports for the first half of 1999 were 4.6 percent below last year's record, indicating a weaker export sector.[3] Exports showed a moderate recovery in the second half of 1999. Total trade reached US$360 billion, up 11 percent from the previous year.

When China's exports suffered a setback during 1998 and the first half of 1999, FDI also fell sharply. Ever since the debut of the reform and opening-up policy in 1979, FDI has been a significant factor contributing to China's phenomenal growth. Foreign investment increased from virtually zero in 1978 to a cumulative US$307.8 billion by the end of 1999. In the 1993-97 period, China was second only to the United States as a foreign capital recipient. There are now 340,000 approved foreign-invested firms in China. These firms employed 17 million workers in 1997.[4]

Prior to 1990, more than 75 percent of FDI came from overseas Chinese, mostly from Hong Kong and Taiwan. In recent years multinational corporations from South Korea, Japan, Europe, and the United States have begun to set foot in China. Foreign investment reached a new high in 1995 when total contracted investment reached US$90.3 billion. Since then, foreign commitment has begun to subside.

The decline of foreign investment stemmed from three factors. Fore-

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[2]*Economic Review* (The International Commercial Bank of China, Taipei), November-December 1998, 9.

[3]*Renmin ribao* (People's Daily), August 21, 1999, 8.

[4]Ibid., June 17, 1999, 2.

most was the dwindling of investment from Hong Kong, South Korea, and Japan, a consequence of the recessions in these three economies. For instance, Yaoban, one of Japan's major investments in China and the first major foreign department store with a headquarters in Shanghai, declared bankruptcy in 1996. South Korea, under the Asian economic tempest, has suspended many investment projects in China. The share of Asian capital shrank from 75.6 percent in 1997 to only 68.7 percent in 1998, the lowest level in two decades.[5]

Second, investment from Taiwan, another major source of FDI, also suffered a decline due to the deterioration of the political relationship across the Taiwan Strait. Beijing had reacted violently to ROC President Lee Teng-hui's (李登輝) visit to Cornell University in June of 1995, embarking on a series of missile tests off Taiwan's northern coast in late July 1995. The tension reached its climax when, in March 1996, Beijing conducted another series of large-scale maneuvers including missile tests near Taiwan's two major seaports. In response to Beijing's military threats, the Taiwan authorities in September 1996 banned major investment projects in China. Consequently, Taiwan's contracted investment in China dropped 45 percent in 1997, and has further declined in 1998 and 1999. Recent reports from Taipei reveal that in the first seven months of 1999 Taiwan's investment in China dropped by 36 percent from the same period of 1998.[6]

Third, when the Asian economy was in deep recession, multinational corporations in the United States and Western Europe were in the midst of a large-scale merger and acquisitions movement that required gargantuan amounts of funding. Note that in 1998 the mergers of enterprises in the West involved more than one trillion dollars. As a result, 73.3 percent of world capital flowed into the advanced countries, leaving very little for the emerging Asian economies. Capital supplied to the developing countries in 1998 suffered the first drop since 1985.[7] As the chief recipient of foreign capital in Asia, China's share rapidly dwindled.

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[5]Ibid., August 21, 1999, 8.

[6]*Zhongguo shibao* (China Times) (Taipei), August 21, 1999, 17.

[7]*Renmin ribao*, August 21, 1999, 17.

Table 2
Foreign Direct Investment in China, 1987-99

Year	Number of Contracts	Amount Contracted (US$ million)	Amount Utilized (US$ million)
1987	2,233	3,709	22,647
1988	5,945	5,297	3,740
1989	5,779	5,600	3,774
1990	7,273	6,596	3,410
1991	12,978	11,980	4,366
1992	48,764	58,122	11,008
1993	83,437	111,436	27,515
1994	47,490	81,406	33,787
1995	37,126	90,300	37,700
1996	24,529	73,210	42,350
1997	21,046	51,780	45,280
1998	–	43,495	45,580
1999	–	35,640	37,090

Sources: Data for 1987-98 obtained from the PRC Ministry of Foreign Trade and Economic Cooperation; 1999 figures from *Beijing Review*, February 7, 2000, 23.

Under these unfavorable environments, China's contracted FDI in 1998 was 16 percent below the 1997 level. The decline continued into the first eleven months of 1999. From January to November the amount of contracted foreign investments fell by 18.9 percent, and actually utilized capital declined by 9.7 percent from the same period in the previous year.[8] Many Chinese officials worry that the downward trend may carry forward into the near future (see table 2).

The combined effect of a decline in exports and decrease in foreign investment caused a slowdown in GDP growth. Prior to the Asian financial crisis, China had achieved remarkable growth for six years. Between 1991 and 1995, the annual growth rate of GDP reached 12 percent, 4.1 percentage points above the average rate from 1986 to 1990. The growth rate began to slow down in 1996 and 1997, falling to 9.6 percent and 8.8 percent respectively. The average rate for the 1991-97 period, however, still stood at a double-digit level of 11.2 percent.

[8]Ibid., August 2, 1995, 17.

The healthy growth in the earlier years was due to three factors: expansion of investment, rapid growth of exports, and burgeoning consumer expenditure. The average annual growth rate of fixed assets investment reached 36.9 percent compared with 16.5 percent in the period 1986-90. Total investment as a share of GDP was 44.9 percent, the highest in the world.

During the same period, exports also expanded tremendously. The annual growth of exports in 1991-95 was 19 percent, 7 percentage points higher than the GDP. By 1994, the contribution ratio for exports reached 21.9 percent, becoming one of China's driving forces for economic growth.

When exports became the new pillar of growth, the role of consumption spending entered a period of decline. The share of such spending in GDP fell from 67.5 percent in 1991 to 58.7 percent in 1997, of which resident consumption dropped from 53.1 percent to 47.5 percent. Internationally, these two shares averaged 70 percent and 60 percent respectively.[9] Of the relative shares of GDP in 1997, 51 percent came from consumption, 26 percent from exports, and 23 percent from investments.[10]

The relative shares of these three factors have undergone substantial changes in 1998. Affected by the Asian financial crisis, exports posted only a 0.5 percent growth compared with 21 percent in the previous year. The contribution of exports to economic growth decreased considerably. In the same period, the domestic market also faced an unprecedented situation. The traditional seller's market suddenly changed into a buyer's market. As a result of oversupply in the past few years, conventional consumer goods such as TVs, refrigerators, and the whole range of consumer durables lost much of their glamour. Demand for new products has yet to emerge. The consumer price index fell precipitously from a high of 21.7 percent in 1994 to only 0.8 percent in 1997. By August 1998, the index registered a 3.3 percent decline. Producers have resorted to malicious competition by slashing prices drastically to ensure self-survival. Price wars among department stores and retailers of durable consumer goods

[9] *Beijing Review*, August 9, 1999, 17.
[10] Ibid.

compressed prices further. The economy has fallen into a new stage of deflation.

As the economy fell into recession, China was struck by the catastrophic floods in the Yangtze River in Central China and the Songhuajiang (松花江) and Nenjiang (嫩江) in Northeast China. The floods hit with a severity seldom experienced in modern history and caused severe damage to human life and property. Two hundred and forty million people (one-fifth of the Chinese population) were affected, with 17 million houses destroyed and 21.5 million hectares of farmland affected. Many mines and oil fields suspended operation, including Daqing (大慶), the country's leading oil field. Total economic loss was estimated at over 200 billion *yuan*.[11] The floods reduced 1998 GDP growth by 0.5 percentage points.

To shore up the economy, the government resorted to fiscal expansion. After the National People's Congress (NPC) approved the 1998 budget in March 1998, the State Council issued an additional 100 billion *yuan* of treasury bonds to supply investment to improve the country's infrastructure. The fund was allocated to the fields of water conservancy, roads and railways, telecommunications, urban and rural power transmission, flood control, and environmental protection.

In addition to the 100 billion *yuan* in bonds, the State Council also issued 270 billion *yuan* of special treasury bonds to four major state-owned commercial banks, using the proceeds to increase loans to SOEs. In addition, the central government also provided 18 billion *yuan* for further reform of SOEs and for supporting post-flood rehabilitation.[12]

While helping to stem the decline of aggregate demand (consumption plus investment plus government purchase), the active fiscal policies failed to stimulate consumer spending for four reasons:

1. Reform of SOEs caused large-scale layoffs. At the end of 1997, the number of registered unemployed persons in urban areas was about 5.7 million. Huge layoffs from SOEs reached 11.5 million. In the 1998-2000

[11]Zhu Rongji, "Report for the Work of the Government," ibid., April 5-11, 1999, 10-11.

[12]Ministry of Finance, "China's Current Fiscal Policies and Reform," ibid., February 8-14, 1999, 16-17.

period, 12 million new laid-off workers entered society. Facing job uncertainty, most households selected to curtail spending.

2. Under the old welfare system, workers in the SOEs enjoyed many benefits including housing, education, and medical care, all provided at a minimum cost. With the housing reform, employees of the SOEs are now requested either to buy the house at a preferential rate or are subjected to high rents. Moreover, education and medical care are no longer free. These new financial burdens also dampened each household's propensity to consume.

3. The slowdown in economic growth and the increase in unemployed and layoffs pressed down the rise in personal disposable income. The growth rate of income for urban and rural residents declined from 22.5 percent and 29.4 percent respectively in 1995 to only 6.1 percent and 8.5 percent in 1997. In the first quarter of 1998, the growth rate was reduced to 6 percent and 2 percent respectively and in the second quarter, rural income even suffered a 0.7 percent decline. The dismal situation in the rural areas propelled a dwindling momentum in the rural market.[13]

4. Uncertainty about job prospects and unceasing decline of consumer prices created a new consumer psychology. People prefer to hold cash instead of commodities. Even with the seventh reduction of interest rates on savings deposits, people still rush to pile their savings into the state banking system. Total individual deposits have now reached a record high of six trillion *yuan*, up from three trillion *yuan* only three years ago. Because savings far exceed loans, rising deposits became a new burden for the banking system.

Under these adverse conditions, China's economic growth slowed considerably in 1998. Even with a 19 percent rise in public investment, the GDP growth rate scaled down to 7.8 percent, falling short of the target of 8 percent set in the March NPC conference. The downward trend continued into the first half of 1999. By the end of June 1999, GDP growth further decreased to 7.6 percent, substantially below the corresponding period in 1998. In the first six months, exports were down 4.6 percent, FDI down 20

[13] *Zhongguo gongye jingji* (China's Industrial Economy) (Beijing), 1998, no. 11:17-19.

Table 3
China's Economic and financial Indicators 1994-99

	1994	1995	1996	1997	1998	1999
Gross Domestic Product (GDP)	4,675.9	5,847.8	6,788.5	7,477.5	7,955.3	8,205.4
Real GDP Growth (%)	12.6	10.5	9.6	8.8	7.8	7.1
Retail Price Index (%)	21.7	14.8	6.1	0.8	–2.6	–3.2
Consumer Price Index (%)	24.1	17.1	8.3	2.8	–0.8	–1.8
Urban Per Capita Income (*yuan*)	3,496.2	4,283.0	4,838.9	5,160.3	5,350.0	5,854.0
Rural Per Capita Income (*yuan*)	1,221.0	1,577.7	1,926.0	2,090.1	2,160.0	2,210.0
Urban Unemployment Rate* (%)	2.8	2.9	3.0	3.1	3.1	3.5
M2 Supply (billion *yuan*)	4,692.4	5,823.0	7,690.5	9,099.5	10,449.9	11,136.4
M2 Supply Growth (%)	34.5	29.9	30.7	17.1	15.3	14.7
Exchange Rate (*yuan*/US$)	8.6	8.4	8.3	8.0	8.3	8.3
Foreign Exchange Reserves (US$ billion)	51.6	73.6	105.0	139.9	145.0	154.7
Government Revenue (billion *yuan*)	521.8	624.2	740.8	865.1	n.a.	1,137.7
Tax Revenue (billion *yuan*)	5,126.9	6,038.0	6,909.8	8,234.0	8,551.0	n.a.
Domestic Debt (Treasury bond issues, billion *yuan*)	102.9	151.1	184.8	241.2	280.0	n.a.
Foreign Debt (US$ billion)	93.0	106.0	116.0	131.0	146.0	160.0
Government Deficit (billion *yuan*)	57.5	58.2	53.0	57.0	96.0	175.9

Sources: *Almanac of China's Finance and Banking* (1996); *China Statistical Yearbook* (1997 and 1998 editions); *China Monthly Statistics*; Down Jones News Service; Foreign Broadcast Information Service; *Financial Times*; CNN; *China Economic News*.

*According to official statistical figures, which do not include underemployment or the migrant population; 1999 figures: *Beijing Review*, April 10, 2000, 16-23.

percent, the retail price index fell 3.2 percent, and the consumer price index dropped 1.8 percent. The sluggishness of the market showed some improvement in the last quarter. Despite a 4.6 percent decline in the first half of 1999, exports rebounded since July rising 6 percent from a year earlier. The 1999 GDP rose 7.1 percent, slightly higher than that projected by the government.[14] The changes in GDP growth and the consumer price index from 1994 to 1999 are summarized in table 3.

[14]Zhong Yan, "China's Economic Operation: Review and Prospects," *Beijing Review*, January 24, 2000, 11.

The Acceleration of Institutional Reform

Confronted by the depressing condition of the Asian economy, the Chinese leadership acted against the trend by accelerating the pace of institutional reform. The agenda of reform was approved by the Chinese Communist Party's (CCP's) Fifteenth Congress in mid-September 1997 and carried out by the new administration headed by Zhu Rongji (朱鎔基), the new premier, in March 1998.

The Fifteenth Party Congress set the ideological foundation for sweeping reform. The congress classified China's present level of development as only in the "initial stage of socialism," in sharp departure from Maoist conception that China already was at the threshold of communism. The new classification aims to justify the abandonment of Stalinist economic institutions and practices in favor of a full-fledged market economy. The immediate target for the reform program centers at a thorough revamping of the ailing SOEs.

Reform of the SOEs had been planned long before the Fifteenth Party Congress. In 1993, the leadership had already adopted a sweeping "50 points" plan to initiate reform in the banking, taxation, and foreign trade systems in addition to the state-owned sector.[15] Under this plan, the state sought to retain ownership of and strategic control over two to three thousand large enterprises in key industry and infrastructure sectors and make them the mainstay of the national economy. The remaining large and medium-sized enterprises were to undergo "corporatization" through the public sale of shares. Roughly 300,000 small SOEs were to be sold off, merged, or declared bankrupt.

The sweeping reform plan has not been implemented due to several factors. First, the SOEs and government agencies still have not separated, preventing SOEs from becoming an independent economic entity. Second, conservative forces within the party still oppose the shrinking of the state sector. Third, genuine reform will entail massive layoffs among the SOEs'

[15]Data in this section are from H. Lyman Miller, "Preparing for Change with Promises of Continuity," *The China Business Review*, January-February 1998, 9.

120 million workers—a move that could lead to social unrest.

However, by early 1997, reform of the SOEs became imperative. The failing SOEs not only drained the state's declining revenue, but also became an unbearable burden for the banking system. As bad loans accounted for 25 percent of total bank loans, increasing demand to borrow money will soon bring down the whole banking system. Moreover, large-scale subsidies became a barrier to China's entry into the World Trade Organization (WTO).

To remove the hurdle of reform, CCP General Secretary Jiang Zemin (江澤民) in an important speech delivered to the Central Party School on May 9, 1997, redefined Chinese "socialism" in a manner that would permit the continuous shrinkage of the SOE share in the overall economy. Jiang advanced a flexible approach to the term "public ownership" by including township and village enterprises (TVEs) and other "mixed" shareholding forms of ownership with SOEs and collectives. He also declared that "even if the state-owned sector accounts for a smaller proportion of the economy, it will not affect the socialist nature of the economy." Jiang's new approach won the endorsement from the Fifteenth Party Congress and provided the leadership with new political latitude to pursue reform. The difficult task fell on the shoulders of Zhu Rongji who assumed the premiership in March 1998. Zhu spared no time in announcing his determination to carry out a sweeping reform in the forthcoming three years by focusing on the reform in government administration, SOEs, and the banking system.[16]

To facilitate the separation of SOEs and government agencies, the State Council has undergone a radical reshuffle. The number of departments of the State Council was cut from forty to twenty-nine and the number of internal divisions was reduced by one quarter. Over two hundred functions were delegated to enterprises, intermediary organizations, or local authorities. The staff of the State Council has been curtailed by half. The central authorities decided that the army, the armed police, and the procuratorial, judicial, and police security institutions should no longer engage in business activities and that the party and government organiza-

[16]*Beijing Review*, April 5-11, 1999, 10-12.

tions at the central level should cut off all business ties with the economic entities set up by them and the enterprises under their jurisdiction. The separation of business entities from the government agencies represents a major step toward SOE reform.

To convert the SOEs into a modern enterprise system, about two thousand pilot firms were selected as an experimental model. Experiences acquired from the pilot firms will then be extended to the whole country. In the meantime, steps were also taken to restructuring basic industries including coal, textile, and petrochemical industries. In the textile industry, the plan called for the discard of some 10 million spindles to reduce overcapacity. In the coal industry, tens of thousands of coal mines that suffered chronic losses were marked for closure.

A bolder step in SOE reform is a plan to swap the debts into equity. Faced with the more than US$200 billion in debts belonging to those moribund SOEs, the Chinese authorities instigated a new plan of debt-for-equity swaps. State enterprises are allowed to list most of their shares in the country's stock markets. Heretofore, state enterprises were only allowed to list 20 to 30 percent of their shares, keeping the control power at the hands of the state. By allowing more than 50 percent of shares to be listed, China will effectively be privatizing the SOEs.

To conduct the debt-for-equity swaps, China has recently established four asset management corporations following the American model. These organizations will be responsible for handling the swaps for each of China's four major state-owned commercial banks—the China Construction Bank, the Agricultural Bank of China, the China Industrial and Commercial Bank, and the Bank of China.[17] Some state media recently reported that nearly US$150 billion debts would be swapped in 2000.[18]

Apart from the reform of SOEs, the banking system will also undergo considerable changes. In November 1998, the People's Bank of China (PBC) abolished its thirty-two provincial branches. In their place, the PBC followed the Federal Reserve system in the United States by setting up nine

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[17] *New York Times*, August 4, 1999, A19.
[18] *Wall Street Journal*, July 27, 1999, A19.

transprovincial branches. The aim of this change is to reaffirm the PBC's authority by cutting the links between PBC branches and local governments, a relationship which had always interfered with the operation of the bank. At the same time, regional offices of the four state-owned commercial banks also will be merged with local banks to simplify the administration and promote efficiency.

In addition to these three major reforms, efforts were also made to reform the housing system, the circulation network of the state grain administration, and the fiscal and taxation systems and medical insurance systems. Of these reform programs, the change in state policy toward urban housing has the greatest bearing on urban society.

For more than four decades, most of China's urban housing units were company-owned and most citizens enjoyed a nominal lease that lasted a lifetime with rents less than US$10 per month for a standard fifty-square-meter house. In the current reform, employers will stop distributing welfare housing to employees. Beginning January 1, 1999, the employees would either purchase the house at a deep discount rate or pay higher and higher rents in the years to come. To promote the marketization of housing, the government will give a cash lump sum to employees helping them to purchase a house. Under a new incentive plan, public servants from section to bureau levels who have worked for twenty-five years will be entitled to receive an amount between 160,000 and 500,000 *yuan* as a housing subsidy. In addition, the state also allows all commercial banks to offer secured loans for individual purchase of various types of commercial houses in all cities. The houses can be resold in the local real-estate market.[19]

Reforms in these fronts have produced mixed results. On the bright side, the elimination of redundant personnel in SOEs and government agencies helped to lift productivity. According to Sheng Silin (盛思林), vice-minister of the State Economic and Trade Commission under the State Council, state-owned companies earned a total of about US$3 billion in the first half of 1999, more than double that in the corresponding period of 1998. At the end of 1997, China had 16,874 large and medium-sized state

[19] *Beijing Review*, December 28, 1998-January 3, 1999, 16-17.

companies, of which 6,599 or 39 percent of them incurred a loss. By the end of 1998, the number of money-losing companies had been reduced to 5,121 either through bankruptcy or improved management.[20] However, the cost of this improvement is the large-scale layoffs which have become the most thorny issue plaguing the national economy.

Reform in the banking system has strengthened financial discipline. The excess prudence of the banking system, however, also caused the decline of lending during a period of deflation.

Reforms in the housing and welfare systems have deprived urban citizens of a security net. Many ordinary consumers fear that the economy will continue to weaken and that they may face unemployment and reduction of welfare benefits. Instead of rushing to acquire property and other goods, people prefer to save when prices are falling.

The combined effect of these reforms has reinforced the deflationary trend caused by the Asian financial crisis. How to get the economy jump-started again has become the government's most formidable task for the years to come.

The New Economic Policies

To prevent the economic downturn from becoming a deep recession, the Chinese government has, since the second half of 1998, adopted a wide array of policies to bolster both exports and consumer spending. The four goals of these policies are: (1) to promote exports and lure new foreign capital; (2) to discourage savings and stimulate consumption; (3) to promote private enterprises; and (4) to stop price wars and control commodity supply. More than a dozen new measures have been put into effect. In addition to those efforts to stimulate consumption, the government also launched a new campaign to advance a large-scale development of the western region of the country.[21]

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[20] *New York Times*, August 4, 1999, C4.
[21] *Beijing Review*, November 29, 1999, 4.

Stimulate Exports and Foreign Investments

Since export expansion has been the driving force of the Chinese economy, the government has advanced policies to inject vitality to this sector. One major step is to raise the size of rebates in order to cut export costs. Export rebates had been established in 1995 but were substantially reduced in the same year. The reduction of the rebate created adverse effects on exporting companies. In 1998, the government decided to raise the rebate rate for textile products from 9 to 11 percent, up two percentage points beginning January 1, 1998. Rebate rates for steel and cement also rose from 9 to 11 percent starting June 1 of that year. Seven categories of machine and electric products also rose two percentage points in different periods.[22] Starting from 1999, most exports received another 2.56 percentage point raise in export rebates in June, with exports for many products enjoying a rebate rate of 17-22 percent (a range equal to the official tax rate).[23] The move helps to reduce export costs and was criticized by the U.S. Chamber of Commerce as a disguised devaluation of the *RMB*.[24] Other major changes included the granting of foreign trade licenses to private enterprises and the delegation of power to enterprises to handle imports and exports independently.

To encourage foreign capital, China has opened several hitherto forbidden areas for foreign investment. Two of the new areas have attracted worldwide attention. One is the permission granted to selected foreign banks to handle RMB business. Beginning from 1997, four foreign banks had been granted such a right, and the government has decided to admit more foreign banks into this field.

The more publicized policy change is the proposed opening of telecommunications services market to foreign participation. Telecommunications has been one of China's most lucrative markets, registering 110 million fixed-line subscribers and 42 million cellular subscribers in 1999. China Telecom, a gigantic combination of state-owned assets, has been a monopoly without competitive opponents. In 1998, the company had

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[22]Ibid., February 15-21, 1999, 15-16.
[23]*Wall Street Journal*, August 4, 1999, A10.
[24]*Beijing Review*, February 15-21, 1999, 15.

assets exceeding 600 billion *yuan* and more than 1 million employees. Lacking competition, the company is poorly managed and provides only high cost and low quality service to subscribers. On February 4, 1999, the government decided to break the company into four independent companies and opened the market to foreign investment. On March 31, the Shanghai Information Investment Company signed a cooperation agreement with AT&T of the United States to set up a joint venture in Pudong, Shanghai to run the area's value-added telecommunications business (including Internet Protocol telephone service), signaling the first step of foreign capital flows into this important sector.[25] When the Sino-American agreement on China's entry into the WTO was signed in November 1999, China promised to further open the telecommunications market by allowing foreign capital to control 49 percent of the market, and up to 50 percent two years after China's accession to the WTO.[26]

Suppress Savings and Spur Consumption

Aware of the limitation of expanding exports in the present international environment, the Chinese government has made great efforts to spur domestic consumption. One major step has been the continued reduction of interest rates for savings deposits which have now reached a record high of 6 trillion *yuan* (US$713 billion). From 1996 to June 1999, the PBC has cut the rate seven times. However, the move failed to dampen resident deposits. In August, the government announced that starting from the year 2000, interest income from bank deposits will be subjected to a tax.

Another measure to stimulate the market is government encouragement to enter the stock market. Hoping to induce savers to make investments in equity, a succession of policies have been implemented. One such step has been the reduction of the stock transaction tax, allowing brokerage firms to borrow fresh money, and the slashing of the short-term interest rates with the PBC. The government media has also openly endorsed the

[25] John Wang, "Signs of Open in Telecom," *The China Business Review*, May-June 1999, 8-13; and Li Ning, "Opening a Line to More Foreign Investment," *Beijing Review*, June 21, 1999.

[26] *Beijing Review*, November 29, 1999, 19.

investment in the stock market. With the government's blessing and manipulation by big investors, stock indexes in Shanghai and Shenzhen—two major markets in China—have skyrocketed by nearly 50 percent in May and June of 1999. There are now 40 million accounts with market capitalization equal to about 30 percent of the annual economic output. The recent run-up has also created an extra US$65 billion in new wealth.[27]

Despite the sudden boom in the stock market, the "wealth effect" experienced in the United States has not occurred in China. Most people believe that once the big investors decide to withdraw, the market may collapse. Moreover, income for the majority of wage-earners remains too low to increase spending. Many economists strongly recommend that the government raise salaries for public servants by at least 30 to 50 percent and increase pension and financial aid to those unemployed and laid-off. The government has followed this advice. The monthly allowance for laid-off workers and the jobless, along with basic living allowance for urban low-income residents, has increased by 30 percent retroactive to July 1999. Meanwhile, the salaries of civil servants and the pensions of retired state employees also received moderate increases.

Promote Private Sector Growth

As government efforts failed to stimulate exports and consumption, new attention has focused on the growth of the private sector. Long regarded by the authorities as the remnants of a capitalist system destined for termination, the private sector has experienced a rebirth, like a phoenix rising from the ashes of communism. From 1989 to 1997, China's private enterprises increased from 90,581 units to 960,726 units, with an annual growth of 34.2 percent. The number of people working in the private sector has increased from 1.64 million to 13.49 million, and registered capital has grown from 8.4 billion *yuan* to 514 billion *yuan*, with an annual growth of 58.8 percent. Total value of retail sales has increased from 3.4 billion *yuan* to 185.5 billion *yuan*, with an annual increase of 64.9 percent.[28]

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[27] *Wall Street Journal*, July 6, 1999, A10.
[28] *Beijing Review*, March 1-7, 1999, 4-5.

The strength of the private sector convinced the leadership to accept this previously disgraced area as an important component of the national economy. Thus in January 1999, the CCP Central Committee produced six suggestions for constitutional amendment that focused on the state's protection of the legal rights and benefits of the individual in the private economy.[29]

In the past two years, private enterprises in various cities have become the major job providers for millions of laid-off workers, representing one of the bright sides of the Chinese economy. On September 1, 1999, the NPC adopted an Individual Sole-Ownership Law which allows individuals to set up and own a business without a minimum capital requirement. The new law, in effect since January 2000, has won wide applause from many economists who consider this step as a policy breakthrough in the move toward the rebirth of the private sector.

Stop Price Wars and Control Commodity Supply

To stem the free fall of commodity prices, the government has carried out two new policies: setting a price floor for key consumer products in order to prevent or stop a price war and banning new investment for many products in order to control supply.

In 1999, the government ordered manufacturers of twenty-one key consumer products to set minimum prices in an effort to stop ruinous price wars. In June 1999, the country's eight major producers of television tubes agreed to freeze production for several weeks in a bid to push up prices. The action spread to several other fields.

In a drastic move aimed at stopping a steady fall in prices, the government in August 1999 banned new investment for 201 new products that were already in oversupply. No new construction was allowed for a broad range of ordinary consumer items ranging from refrigerators and air conditioners to candy, apple juice, and liquor. The ban also covers construction of luxury hotels, apartments, and office buildings, as well as department stores—all of which have also suffered sharp falls in price as their markets

[29] *China's Foreign Trade* (Monthly), April 1999, 46.

became glutted.

The government's efforts to turn around the flagging economy achieved some positive results. Partly due to the vigorous recovery of the Asian economy, Chinese exports in the first seven months of 2000 registered a 36 percent growth above the same period in 1999. Industrial output rose by 12 percent and GDP advanced 8.2 percent. The consumer price index stopped declining in May. While private savings deposits continued to rise, its growth rate has substantially reduced. Part of the savings has flowed into the stock market. Recent development indicates that the economy has gradually recovered from the recession.[30]

Develop the Western Region

One strategic program initiated in recent months has been the drive to develop the western region of China. China's western region embraces six provinces and one special municipality, covering 56 percent of the country's total land area and 23 percent of the nation's population. Historically having lagged behind the development of the eastern region, this vast area contributes only 15 percent of the country's GDP. Per capita GDP in this area accounts for only 60 percent of the nation's average. To tap the tremendous natural resources and open up a new market in the west, the government at the Central Economic Working Conference held in Beijing from November 15-17, 1999 announced an ambitious plan to develop the western region. Initial projects include intensifying reforestation along the upper and middle reaches of the Yangtze and Yellow rivers, the construction of some 17,000 kilometers of super highway, and the building of several thousand kilometers of natural gas pipeline connecting west and east, as well as large-scale exploration of local mineral resources.[31] While heralding a new era of the hitherto underdeveloped region, the plan's success depends on the ability to overcome numerous hurdles. Among them are adverse natural conditions, the region's inferior industrial base, and a critical shortage of managerial personnel, skilled labor, and local entrepreneurs.

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[30] *Renmin ribao*, August 10, 2000, 1.

[31] *Beijing Review*, February 7, 2000, 11-14.

Several decades may be necessary to achieve this grand goal.

Projections for Long-Term Development

Despite the slowdown in the past two years, the growth records of the eighteen years between 1979 and 1997 provide the foundation for many projections regarding China's future development. Official long-term developmental plans and projections by the Chinese Academy of Social Science (CASS) paint a rosy picture. The sanguine projections have received support from the World Bank and many Western experts. While some gloomier predictions exist, on balance the optimists prevail.

At the fourth session of the Eighth NPC held in March of 1996, a long-term plan toward the year 2010 was adopted along with the Ninth Five-Year Plan. The long-term plan set the following development targets:[32]

1. The gross national product (GNP) growth rate is set at 8 percent annually between 1996 and 2000, and 7.2 percent between 2001 and 2010. With these growth rates, China's GNP will quadruple in the forthcoming fifteen years.
2. The growth pattern will change from extensive to intensive growth. Future growth will depend on the optimum allocation of resources, improvement of product quality and labor productivity, as well as the application of science and technology and the attainment of economies of scale.
3. Future development will focus on agriculture, infrastructure, basic industry, and a group of "pillar industries" which include machine-building, electronic, petrochemical, automobiles, and construction industries.

[32] "People's Republic of China: The Ninth Five-Year Plan (1996-2000) for National Economic and Social Development and Long-Term Target for the Year 2010," *Wenhui Bao* (Shanghai), March 20, 1996, 1-2; English version in *Beijing Review*, November 13-19, 1995, 12-16.

4. In geographical distribution, great emphasis will be placed on the development of the inland regions.
5. The market economy will be further developed and perfected. Related systems in credit, investment, and price will be developed to meet the requirement of a market economy. The reform will focus on the SOEs.

In light of the CCP's proposal, CASS economists presented two long-term projections, one covering the period 1990-2010 and the other covering 1990 to 2050.

The first projection gives an annual growth rate for China's GNP at 9 percent for the decade of the 1990s. Between 2001 and 2010, the growth rate will decline to 7.5 percent. On average, the growth rate between 1991 and 2010 will be 8.25 percent, a very high rate by international standards.

Based on 1990 prices, China's GNP in 1990 was 1,770 billion *yuan*, and was projected to be 4,180 billion *yuan* for 2000 and 8,620 billion *yuan* for 2010. In these three landmark years, the population was 1.14 billion in 1990, and was projected to be 1.28 billion and 1.38 billion in 2000 and 2010 respectively. The GNP per capita was 1,540 *yuan* in 1990, and was projected to be 3,270 *yuan* in 2000 and 6,250 *yuan* in 2010. These are still rather moderate figures. The key problem is how to convert the *RMB* figures into U.S. dollars.

There are now two methods for currency conversion. The traditional method employed by the World Bank uses the official foreign exchange rate which significantly understates the Chinese GNP. An alternative method uses purchasing power parity (PPP) which may inflate the Chinese GNP.[33]

Using the exchange rate method by setting US$1 = 5.2 *yuan* (on a three-year average), China's GNP will be US$340 billion for 1990, ranking tenth among world economies; US$800 billion for the year 2000, seventh place in the world; and US$1,650 billion in 2010, still seventh place in the world economy. On a per capita GNP basis, the corresponding figures will

[33]For details of these two methods, see Catherine Gelb, "Anyone's Guess," *The China Business Review*, May-June 1996, 14.

Table 4
Projection of Chinese GNP 1990-2010

	1990	2000	2010
(1) GNP at 1990 *RMB* (in billion *yuan*)	1,770	4,180	8,620
Ten-year average annual growth rate (%)		9.0	7.5
(2) Population (in billion people)	1.14	1.28	1.38
Ten-year average annual growth rate (%)		1.13	0.75
(3) Per Capita GNP (in *yuan*)	1,540	3,270	6,250
(4) GNP Conversion: PPP method: US$1 = 1.2 *yuan* (in billion dollars)	1,470	3,500	7,200
Ranking in world economy	2d	2d	2d
(5) Exchange Method: US$1 = 5.2 *yuan* (in US$ billion)	340	800	1,650
Ranking in world economy	10th	7th	7th
(6) Per Capita GNP Conversion: US$1 = 1.2 *yuan* (in US$)	1,280	2,720	5,200
In world income group	low-middle	low-middle	upper-middle
(7) US$1 = 5.2 *yuan* (in US$)	297	630	1,200
In world income group	low income	low income	low-middle

Source: Li Jingwen, *Zouxiang ershiyi shiji de Zhongguo jingji* (China's economy toward the twenty-first century) (Beijing: Jingji guanli chubanshe, 1995), 47.

be US$297 for 1990, US$630 for 2000, and US$1,200 for 2010, ranking China in the low-income group.

However, if the PPP method applied, the dollar-*RMB* rate would be US$1 = 1.2 *yuan*. Chinese GNP would thus be US$1,470 billion for 1990, ranking third place in the world; US$3,500 billion in 2000; and US$7,200 billion in 2010, advancing to second place in the world. The corresponding per capita figures would then be US$1,280 for 1990, US$2,720 for 2000, and US$5,200 for 2010, placing China in the upper-middle income group. The projections are summarized in table 4.

A longer-term projection by economists at the CASS State Situation Analysis Group foresees three stages of development. In the first stage (2020-30), China's GDP would surpass the United States and advance to first in the world. In the second stage (2030-50), China's per capita GDP would reach the average level of the advanced countries in the year 2000.

Table 5
Projection of Average Annual Growth Rates for Chinese Economy 1990-2050

Period	GDP Average Annual Growth Rate (%)	
	Projected Rate	Range
1990-2000	9.3	9.3—10.2
2000-2010	8.0	8.0—8.7
2010-2020	7.0	7.0—7.8
2020-2030	6.3	6.3—7.0
2030-2040	5.4	5.4—6.2
2040-2050	4.6	4.6—5.4

Source: State Situation Analysis Group of the Chinese Academy of Social Sciences, "A Study on Economic Development Targets and Basic Strategies as China Marches Toward the Twenty-first Century," *Guanli shijie* (Management World) (Beijing), 1995, no. 5:20-30.

In the third stage (toward the end of the twenty-first century), both China's GDP and per capita income would then lead the entire world.[34]

Using an input/output technique and a sustainable growth model, the CASS group estimated the average annual growth rates for the Chinese economy between 1990 and 2050 as shown in table 5. Basing the growth rates in table 5, the CASS economists projected that China's GDP in 2020 would be ten-fold that of 1990 and nineteen-fold in 2030. They forecast that between 2020 and 2030, China's GDP would surpass the United States, Japan, and Germany, with the PRC becoming the world's leading economic power.

Both of the sanguine projections are based on two assumptions: (1) they assume that the Chinese economy will continue its above-average growth for the forthcoming half century; and (2) they use the PPP method to convert the *yuan* into the U.S. dollar. If the exchange rate method is used, both the GDP and per capita income will remain rather moderate.

Along the same lines of CASS, Albert Keidel, a Georgetown University professor, has projected China's future growth in comparison with the United States in the year 2050 under three scenarios. The first scenario

[34]CASS State Situation Analysis Group, "A Study on Economic Development and Basic Strategies as China Marches toward the Twenty-first Century," *Guanli shijie* (Management World) (Beijing), 1995, no. 5:20-30.

assumes that China is able to maintain a stable domestic situation—a low level of corruption and an estimated annual GDP growth rate of 7 percent. Under these assumptions, by 2015, the Chinese GDP would reach US$9.8 trillion, still below that of the United States, which would reach US$11 trillion. Under this scenario, by 2025, China's GDP would exceed US$17 trillion surpassing that of the United States—US$14 trillion in the same year.

In Keidel's second scenario, the condition for China's development is less favorable. Trade wars with the United States and other nations slow China's GDP annual growth to 6.5 percent. By 2025, the Chinese economy would be on par with the United States.

Under a third and more favorable scenario, where the United States and China maintain a smooth relationship, China could achieve an annual average growth rate of 8.5-9.5 percent leading the PRC to overtake the United States in total output by 2015. However, several decades would still be necessary for the average Chinese citizen's income to catch up to the average American's.[35]

In a new comprehensive study Angus Maddison, a renowned economic historian, indicated that at the close of the twentieth century, China was still a relatively poor country. In 1995, the PRC's per capita income was only 11 percent of that in the United States and 13 percent of that in Japan. Countries in this situation have a capacity for fast growth if they mobilize and allocate physical and human capital effectively, adopt foreign technology to their factor proportion, and utilize the opportunities for specialization which come from integration into the world market. China demonstrated a capacity to do this in the 1979-95 period, and there is no good reason to believe that this capacity will evaporate. Maddison predicted that China's GDP growth will slow down from 7.5 percent to 5.5 percent a year between 1996 and 2015, with per capita growth at about 4.5 percent. With such a performance, China would probably reach the U.S. level of total GDP by 2015, account for about 17 percent of world GDP, and have a per capita income equal to the world average. Still being a rela-

[35]Gelb, "Anyone's Guess," 15.

Table 6
Levels of World Performance and Potential, 217 Countries (1995 and 2015)

	1995			2015		
	Per Capita GDP	Population	GDP	Per Capita GDP	Population	GDP
China	2,653	1,204.9	3,196	6,398	1,470.2	9,406
7 Dynamic Asia	6,236	350.1	2,183	12,408	444.4	5,514
India	1,568	916.5	1,437	3,120	1,210.3	3,776
31 Other Asia	1,445	543.7	786	2,147	776.8	1,668
Japan	19,720	125.6	2,476	25,533	130.7	3,337
United States	23,388	263.1	6,150	30,268	308.5	9,338
32 Advanced Capitalist	16,810	436.6	7,339	22,199	463.6	10,291
44 Latin America	5,031	489.0	2,460	6,776	645.7	4,375
15 Former USSR	3,590	290.9	1,044	5,882	296.7	1,745
12 Eastern Europe	5,145	116.8	601	9,292	116.8	1,085
16 Middle East	4,138	211.9	877	5,049	333.8	1,686
56 Africa	1,220	715.2	873	1,489	1,172.0	1,745
217 World	5,194	5,664.0	29,421	7,323	7,369.4	53,966

Units: Population in millions at mid-year; per capita GDP in 1990 international dollars; GDP iin billion 1990 international dollars.

Source: Angus Maddison, *Chinese Economic Performance in the Long Run* (London: Development Centre, Organization for Economic Cooperation and Development, 1998), 97.

tively poor country with one-fifth of the U.S. GDP per capita, China's role in the world economy and its geopolitical leverage would certainly be much greater, however.[36]

According to Maddison, China's per capita GDP will increase from US$2,653 in 1995 (using PPP) to US$6,398 in 2015. China's GDP will rise from US$3,196 billion in 1995 to US$9,406 billion in 2015 compared with US$9,338 billion for the United States (see table 6).

Not all experts make optimistic forecasts. Paul Krugman, a Stanford University professor, in his article "The Myth of Asia's Miracle" contends that the impressive growth rates of the Soviet Union and many Asian countries, including China, could be fully explained by rapid growth of inputs: expansion of employment, increase in education levels, and above all,

[36]Angus Maddison, *Chinese Economic Performance in the Long Run* (London: Development Centre, Organization for Economic Cooperation and Development, 1998), 17.

massive investment in physical capital. He believes that economic growth that is based on expansion of inputs is inevitably subject to diminishing returns. Once the massive investment ceases, the rapid growth will also end. Krugman also doubts the quality of Chinese official statistics and the selection of the baseline year to calculate the growth rates. If 1964, the year before the Cultural Revolution, is used as the base year, he argued, the Chinese growth looks more like the East Asian "tigers": only modest growth in efficiency, with most growth driven by inputs. Even with these qualifications, Krugman admitted that if China can achieve a 7 percent growth by 2010, its GDP will still reach 82 percent of that of the United States. That will still be a substantial shift of the world's economic center of gravity.[37]

More recently, Gerald Segal, director of studies at the International Institute for Strategic Studies in London, in an article "Does China Matter?" in *Foreign Affairs*, discredited all the optimistic projections for China's economic future. Segal pointed out that:

> In 1997 China accounted for 3.5 percent of world GDP, ranked seventh in the world. Its per capita GDP ranking was 81st just ahead of Georgia and behind Papua New Guinea. Taking the most favorable of purchasing power parity calculations, in 1997 China accounted for 11.8 percent of world GDP and its per capita ranking was 65th, ahead of Jamaica and behind Latvia. Using the UN Human Development Index, China is 107th bracketed by Albania and Namibia, not an impressive story.[38]

After downgrading the Chinese role in world economy, Segal also discredited Chinese economic data. He believed that two percentage points should be deducted from the official growth rates of GDP. Segal contended that "in terms of international trade and investment, China is a seriously overrated power. China made up a mere 3 percent of total trade in 1997, accounting for only 11 percent of total Asian trade. Foreign exports to China are tiny. Of China's foreign direct investment some 80 percent came from ethnic Chinese."[39] In sum, Segal argued that "China is best a minor part of

[37]Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73, no. 6 (November-December 1995): 62-78.

[38]Gerald Segal, "Does China Matter?" ibid. 78, no. 5 (September-October 1999): 24-36.

[39]Ibid.

the global economy. It has merely managed to project and sustain an image of far greater importance. The true picture is far more modest."[40]

While most of Segal's criticisms are born out of facts, he has ignored the dynamic change of China's economy during the past two decades and the "catch-up" potential pointed out by Maddison. Two less sanguine but still favorable projections are provided by the World Bank and by Lawrence Lau, an economics professor at Stanford University. Each is examined in turn below.

According to the World Bank study, *China 2020*, China's average annual growth of GDP was 9.4 percent between 1978 and 1995, compared with 4.1 percent for the United States during 1820-1913 and 5.5 percent for Japan during 1960-93. The study attributed China's remarkably rapid growth since 1978 to four factors: (1) a high savings rate which has supported vigorous rates of investment and capital accumulation; (2) structural changes which have been both a cause and an effect of growth; (3) pragmatic reforms, which were well suited to China's unusual circumstances and enjoyed broad support; and (4) economic conditions in 1978 which were especially receptive to reform.[41]

Based on the performances of the past twenty years, the World Bank study presents a scenario in which China's savings rate declines from 40 percent to 35 percent over the next ten years while productivity growth fades slightly to a more moderate 1.5 percent a year. In this scenario, China's GDP growth would be 8.4 percent a year between 1996 and 2000[42] and would average 6.6 percent over the twenty-five years until 2020. By 2020, per capita income in China would be approaching that of Portugal today, but would still be less than half that of the United States. The pace of GDP growth will slow over time from 9-10 percent in recent years to only 5 percent in 2020 (see table 7).

If able to attain this growth rate by 2020, China would be the second

[40]Ibid.

[41]The World Bank, *China 2020* (Washington, D.C.: 1997), 4.

[42]This estimate appears to be quite accurate. According to new statistics in *Renmin ribao* (September 20, 2000, 1), the average annual growth rate of GDP during the Ninth Five-Year Plan (1996-2000) will exceed 8 percent, fulfilling the target set for the plan.

Table 7
China's GDP Growth 1995-2020:
Alternative Scenarios (in annual percentage)

	Total Factor Productivity Growth		
Savings/GDP Ratio	1.0	1.5	2.0
20	4.2	4.5	5.5
25	4.8	5.5	6.4
30	5.4	6.1	7.2
35	5.9	6.6	7.6
40	6.4	7.2	7.9

Source: The World Bank, *China 2020* (Washington, D.C.: 1997), 20-21.

largest trading nation in the world and a major force in grain and energy markets. To fulfill this agenda, the World Bank study suggested that China will need: (1) to encourage the spread of market forces, especially through the reform of state enterprises, the financial system, and labor markets; (2) to deepen integration with the world economy by lowering import barriers, increasing the transparency and predictability of the trade regime, and gradually integrating with international financial markets; and (3) to redirect government toward making markets work better by building the legal, social, physical, and institutional infrastructure of the economy.[43]

Covering the same time span of the World Bank study, Lawrence Lau of Stanford provides a somewhat different picture of the Chinese future development. Like the World Bank study, Lau's long-term projections are based on two assumptions: (1) there will be peace and political stability in China; and (2) economic reform policies will be continued. With these two basic conditions, the projection shows that the Chinese economy will continue to grow on average at a steady pace of 9 percent per annum between 1995 and 2020. Chinese real GDP and real GDP per capita in the year 2020 will approach US$5.5 trillion and US$3,500 (in 1990 prices) respectively. The rate of inflation, which peaked in 1994, will begin a slow but steady decline to reach around 7 percent per annum in 2020.[44] Lau's projection of

[43]The World Bank, *China 2020*, 99-100.
[44]Lawrence J. Lau, "Long-Term Economic Growth in the PRC and Its Sectoral Im-

Table 8
Comparisons of Average Actual and Forecast Annual Rate of Growth of Selected Economic Indicators 1979-2020

	1979-1994	1994-2020 (Forecast)
Real GDP	9.5	9.0
Real GDP/per capita	8.0	7.9
Real Gross Value of Agricultural Production	6.1	5.7
Light Industry	16.5	9.1
Heavy Industry	13.7	11.5
Gross Fixed Investment	14.6	9.6
Employment	3.3	1.7
GDP Deflator	7.2	7.0
Retail Price Index	7.7	7.1
Exports (in current U.S. dollars)	15.6	10.6
Imports (in current U.S. dollars)	14.3	10.8

Source: Lawrence J. Lau, "Long-Term Economic Growth in the PRC and Its Sectoral Implications," in *The Economy of the PRC: Analysis and Forecast*, Studies by the Solomon Brothers Panel of PRC Experts, Report No. 1 (November 1995): 74.

the Chinese economy is shown in table 8.

In Lau's projection, China's real GDP in 2020 still approaches only one-half of U.S. GDP in the same year and ranks the third largest in the world after the United States and Japan. Another fifteen to twenty years (between 2035 and 2040) will be necessary for the per capita real GDP of China to reach US$10,000 in 1990 prices.[45] Compared with the other projections, Lau's forecasts seem more moderate and realistic. Regardless of the differences, except for Segal's prediction, all of these projections foresee that China will be an important player in the twenty-first century world economy.

Problems and Prospects

Based on the development records of the eighteen years between

plications," in *The Economy of the PRC: Analysis and Forecast*, Studies by the Solomon Brothers Panel of PRC Experts, Report No. 1 (November 1995): 72-96.

[45]Ibid.

1979 and 1998 and the new factors emerging from the development, there are reasons to support the guardedly optimistic projections.

First, the size of the Chinese economy has enlarged considerably. A comparison of major industrial output between 1978 and 1996 shows substantial growth for most items. In the key industrial products, electricity grew by four-fold; steel, three-fold; cement, 7.5-fold; automobiles, 12.6-fold; chemical fibers, 12.4-fold; and machine-made paper, 6.4-fold. The Chinese industrial base has significantly expanded. Since 1996, output of steel, coal, cement, chemical fertilizer, and television sets ranked first in the world.[46]

Corresponding to the expansions of the industrial base, facilities in transportation and communications have also shown various degree of progress. The completion of the 2,370 km Beijing-Kowloon Railway in 1997 and the construction of a new 898 km line connecting Nanning in Guangxi (廣西南寧) and Kunming in Yunnan (雲南昆明) are two pivotal projects in the railway network. Regarding the highway system, more than 10,000 km of super highways with international standards have been added: Shenyang-Beijing (瀋陽—北京), Tianjin-Tanggu (天津—塘沽), Shanghai-Nanjing (上海—南京), Chengdu-Chongqing (成都—重慶), Guangzhou-Shenzhen (廣州—深圳), Qingdao-Jinan (青島—濟南), and the trans-island super highway of Hainan Island (海南島). The addition of these new roads has significantly improved the transportation conditions in the affected areas.

Great strides have been made in civil aviation. Extremely backward before 1978, China's civil aviation has taken off over the past decade. By 1998, the number of international and domestic aviation routes increased from 167 to 1,122 and the mileage from 148,900 km to 1,500,000 km. By the end of 1995, the number of civil aircraft used for commercial purposes reached 720, and the number of airports reached 139—81 of which serve Boeing 737 or larger aircraft. A civil aviation network has quickly formed.[47] The most impressive progress, however, has been in the postal system and

[46]Tong Ji and Bei Qing, "Changes in 50 Years," *Beijing Review*, September 27, 1999, 12-14.
[47]PRC State Statistical Bureau, *China Statistical Yearbook 1996*, 521.

telecommunications. By the end of 1995, China had 61,898 post offices, a fourteen-fold increase over the 1950s. The increase in telephones is particularly conspicuous. The number of telephones in 1995 was six times of that installed during the thirty-six years prior to 1978. By the end of 1995, there were 54.56 million city switchboards and 17.47 million rural switchboards. Total telephones in 1996 reached 100 million units, giving China the second largest number of telephones in the world.[48] The improvement in the infrastructure has helped to attract foreign capital.

China's financial condition is relatively sound compared with other major developing countries. During the past twenty years, China received a total of US$406.9 billion in foreign capital.[49] The PRC's foreign exchange reserves exceeded US$145 billion and domestic savings reached a record high of 6,859.6 billion *yuan* (US$836 billion) in 1998. The high rate of savings has become a very favorable condition for future growth.

Several major hurdles for China's long-term development are discernible. Foremost is the existence of a huge number of SOEs. Although the share of state enterprises in GDP has dropped continuously, their role in the Chinese economy remains crucial. SOEs still hold 65 percent of the country's fixed assets and contribute 70 percent of the state's tax revenue. In many key industries—such as petroleum, natural gas, electric power, steel, chemical fiber, coal, and pharmaceuticals—state enterprises remain the mainstay enterprises.

State enterprises employed 110 million people in 1998, the second largest employer in the national economy. Due to the ambiguity of property rights, the burden of surplus labor and social welfare, as well as the existence of government control and bureaucratic management, a large portion of the SOEs suffered heavy losses for a long period of time. In 1994, 49.6 percent of state enterprises incurred a loss. Total losses in that year reached 100 billion *yuan*, accounting for 29.6 percent of the state budget deficit.[50] The debts owed by the state enterprises to the banking system now exceed

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[48]Ibid., 529.

[49]Including direct investment and loans. See *Renmin ribao*, August 20, 1997, 1.

[50]Chu-yuan Cheng, *China's Economic Reform: Program, Progress, and Effects* (Taipei: Chinese Association for Eurasian Studies, 1997), 205.

three trillion *yuan*. Attempts to revamp this system failed to make real progress because the government still upholds the ideology of state ownership. Without the separation of state and enterprises and without clear-cut property rights, state enterprises will continue to drain and impede the progress of the national economy.

The existence of a huge surplus of labor in urban and rural areas poses another stumbling block for future development. During the twenty-seven years prior to the reform, China adopted a full-employment, low-pay policy providing jobs for almost all urban labor force. As a result, there are huge superfluous personnel in all state enterprises. Surplus workers in state enterprises throughout the country were estimated at 30 million.[51] The existence of this huge disguised unemployment in the state economic orbit hinders any improvement in labor productivity. In recent years, government attempts to promote efficiency by laying off some superfluous workers immediately created social unrest. No immediate solution exists for this difficult problem.

In rural areas the total labor force is estimated at 450 million, 90 million of which are required for farming, 120 million are employed by TVEs, and 50 million are needed for other agricultural activities, resulting in surplus labor of 190-200 million. In recent years, 70-80 million rural laborers flowed into the cities as contract laborers. There are still 120 million surplus laborers in the countryside. As the Chinese population is expected to reach 1.3 billion in 2000 and 1.6 billion in 2030, how to create employment for this labor force will become another formidable task for Chinese leaders.

Last, the rapid industrialization, particularly the sprawling development of the TVEs, has resulted in serious degradation of ecosystems. China relies on coal as the chief source of energy. Until 1995, coal still comprised 75 percent of the country's energy consumption,[52] compared with 30 percent for the rest of the world. Most of the coal has not been washed and thus is the main source of air pollution. Chemical analysis of

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[51] *Jingji ribao* (Economic Daily) (Beijing), September 7, 1988, 1.
[52] *China Statistical Yearbook 1996*, 203.

particulate in several northern Chinese cities showed the highest reading in the world for concentration of suspended particulate matter (SPM) and sulfur dioxide which in turn produces acid rain. Environmental experts believe that acidifying emissions are likely to rise in the future if coal remains the chief fuel. The increase in motorized transport also has the potential to raise nitrogen oxide emissions.

Water pollution in China is even worse. Western experts report that around 30 percent of urban river water is polluted by excessive oxygen demand. Statistics in the mid-1980s indicated that 90 percent of urban ground water resources were already contaminated by industrial wastes.[53]

Other ecological problems include the denudation of vegetation. As a result of large-scale destruction of forests and the blind conversion of vast stretches of grassland into farmland, huge mountain areas in northwest and southwest China have been stripped away of topsoil and thus dump millions of tons of silt into the Yellow and Yangtze rivers. Many geologists are warning that before long the Yangtze River will become silt-laden like the Yellow River.[54] There are other problems such as widespread corruption, a widening income distribution gap, and the growing disparities between the costal and interior regions. All of these problems are detrimental to a sustainable economic development.

In conclusion, China's large population and relative abundance of natural resources give China the potential for further growth. Development in the past twenty years has significantly enlarged the industrial base. Improvement in infrastructure has also provided a better environment for domestic and foreign investments. Gradual improvement of the market operations has laid the foundation for developing a large internal market. In the journey toward becoming a world-class economic power, the Chinese economy also faces the problems of the decay of the state enterprises, the existence of a huge surplus labor, and the deterioration of the ecological system. While the Chinese authorities are aware of all of these thorny issues and have prescribed remedy policies in the Ninth Five-Year Plan and

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[53]Richard Lat Speich and Aimin Chen, "Environmental Protection in the PRC," *Journal of Contemporary China* 6, no. 14 (1997): 33-59.

[54]*Renmin ribao*, September 4, 1979, 2.

the long-term plan, the key is whether these policies can be fully implemented. A thorough reform of the state enterprises, the continuous expansion of the non-state sector, and a strict environmental protection policy will bolster China's chance to become a major player in the twenty-first century world economy.