

## REDEFINING CHINA'S GROWTH ECONOMIC MODEL IN THE AGE OF GLOBALIZATION

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*Abstract: The period from the beginning of the 21st century until today has brought frequent changes for China's position in the top 10 most powerful economies in the world. Thus, on the 7th position in 2000, this country has surpassed France, Britain, Germany and Japan, and became the second world economic power, after United States of America. China has managed the most spectacular leap of development in the modern history, with an average GDP growth of about 10% per year, which was based on an economic model founded on supporting investment, exports and openness to the world economy. However, in recent years it has become increasingly evident that the Chinese development pattern has generated structural imbalances which make it unsustainable in the long term. In the context of Globalization and of China's growing economic openness to the world economy, increasing competition on the global markets puts pressure towards internal changes. The paper aims to analyze the transition from quantitative growth to the qualitative one, based on increasing domestic demand and consumption. In the first part of the article will be presented the chinese economic system characterized by the phrase "one country, two systems". The second part of the article will include a detailed analysis of the evolution of KOF Globalization Index, the Index of Economic Freedom and Global Competitiveness Index in order to capture the growth of China's economic performance in the globalization context. The third part will comprise the reforms suggested in the latest World Bank Report - China 2030, which shows a new development strategy of chinese economy in the next two decades, and also in the 12th Five-Year Plan Period elaborated by the Chinese government.*

*Keywords: Chinese economy, economic pattern of growth, economic freedom, competitiveness.*

### 1. Introduction

China has adopted an extensive pattern of growth and development, which led to a spectacular development of China's economy over the past 30 years, by going through a process of burning stages in development.

Thus, in this period of three decades, the average annual growth rates have been around 10%, which means that has surpassed the stage of under development countries, reaching one of the major economic powers. Thus, if in 2000 it was ranked 7th in 2010 has surpassed Japan and became the world's second largest economy by GDP, after the USA. China's GDP calculated in current prices increased from about \$ 300 billion in 1980 to \$ 390 billion in 1990, \$ 1.200 billion in 2000, and \$ 9.200 billion in 2013. Also, the GDP at PPP has registered the same trend, from about \$ 250 billion in 1980 to \$ 920 billion in 1990, \$ 3.000 billion in 2000, and \$ 13,400 billion in 2013. Moreover, China's share in global product has increased from about 2% in 1980 to 4% in 1990, 7% in 2000, 10% in 2006, 13% in 2010, and 15% in 2013 (IMF, 2014). If before the reforms the annual growth average was 5.3% (1960-1978), it climbed to 9.8% during 1979-2007, and in the same period, the economy growing in real terms 14 times and the GDP per capita 10 times (Morrison, 2008).

Another interesting evolution is represented by a large increase in the standard of living of the largest populations in the world and removal from the poverty more than 600 millions of Chinese people. Thus, the share of Chinese who living on less than one dollar per day was reduced from 65% in 1981 to 4% in 2007 (World Bank, 2009). Also, the life expectancy of the population has doubled in the same period. The GDP per capita, which is the main indicator of the welfare of a population, increased from about \$ 300 in 1980, to \$ 341 in 1990, \$ 945 in 2000, and \$ 6.747 in 2013 (calculated at the market), or about \$ 250 in 1980 to \$ 800 in 1990, \$ 2.164 in 2000, and \$ 9.844 in 2013 (calculated at PPP) according to

IMF (2014), but due to the numerous population of over 1.3 billion (one-fifth of the world population), China remains an emerging country with large income disparities between regions.

During three decades of development was made the transition from "made in China" to "made by China" and then "payed by China". Since 2010, China is the largest producer of consumer goods (surpassing the U.S. who owned this position about 115 years) and in the post-crisis period has become a major player on the international capital market.

Among the determining factors of economic growth there are:

- the massive flows of foreign direct investment (especially in the Special Economic Zones);
- the transfer of technology and know-how;
- increasing labor productivity;
- massive exports especially after its accession to the WTO (2001); China is the 2nd largest exporter after the EU;
- maintenance of a weak currency to sustain the exports;
- high of domestic savings the rates, due to the low domestic consumption;
- numerous and cheap labor force (798.5 million);
- enormous foreign exchange reserves; China has the largest foreign currency reserve (the \$ 3.341 billion) which is the basis of domestic currency, and providing economic stability, but especially a great financial power.

The recent economic crisis has affected to a certain extent the Chinese economy, leading to the slowdown in economic growth (for the first time in the past 2 decades), to decline of export volumes to the U.S. and EU, and to a decrease on the FDI flows (it is predicted a run of capital due to an increase of wages and domestic currency appreciation that reduced competitiveness for the field of manufacturing). The crisis was the major event that has shown that the Chinese economic model applied currently has exhausted the advantages and begins to reveal his weaknesses: increasing social tensions resulting from income inequality, disparity in development between regions, over-heating of the economy, lack of democratic rights, lack of social policies, all of these being dangers to future development. Under these circumstances, the government is trying an improvement and adaptation of the chinese pattern of growth and development, to the new social and economic conditions, and the 12th Five-Year Plan (2011-2015) is a starting point.

## **2. The chinese economic model - “One country, two systems”**

China went through a transition from a communist economy to a mixed one, a "socialist market economy" that is becoming more and more perceived as a pattern for emerging countries, and called "The Chinese development model" or "The Beijing Consensus".

Gregory (2012) claimed that China's economic growth occurred despite economic planning, and because of its private sector, large and dynamic. The author also notes the existence of two distinct economies: private economy (which has been on semi-legality until 2007 when Chinese law has recognized the legitimacy of private property) and public economy (represented by large companies in strategic sectors, controlled by the Communist Party). *Yesterday communist and now become "rampant capitalistic"* as appreciate Marinescu (2012, p 258), China's economy is based on a paradox, because has managed to merge the socialism and capitalism, creating a "socialism with Chinese face" or "a market socialism". On the literature, the Chinese development model or "the Beijing Consensus" is used in antithesis to the classic called "Washington Consensus". The last one promotes democracy, liberalization, privatization, human rights, while the Chinese model is based on structural development (infrastructure) and economic (industrial, mining, oil), and the state has a central

role in production (Modoran, 2010). As Jean-Michel Quatrepoint (2011) said, "*the Chinese model of development, called by economic literature melting pot, is a combination of less Leninism, a dose of liberalism, more doses of Confucianism and a drop of european social democracy*".

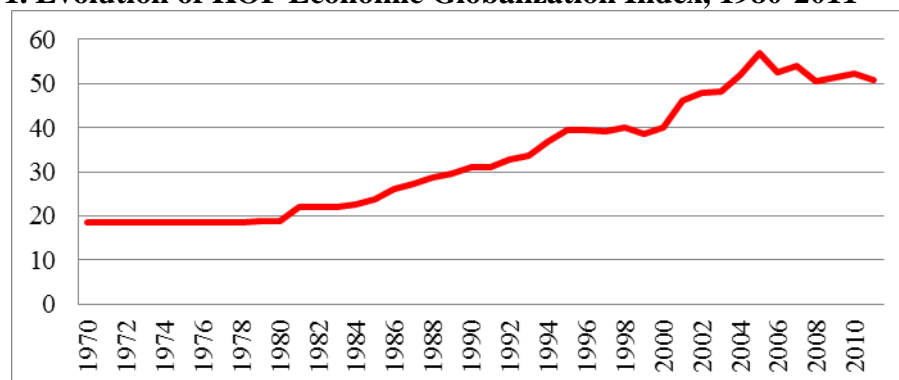
The rise of China has been often compared to the U.S. or Germany in the first half of the 20th century, or to that of Japan in the second half of the 20th century, taking into consideration the massive investments in modern infrastructure and the economic policies that have made the transition from an economy based on agriculture to one based on industry. But the Chinese pattern of growth and development is very different from that of other economic powers because, as Pencea (2012, p.42) appreciate, *the mechanisms of market economy were born inside of a planned economy, and were built by the institutions of a strong interventionist state*. The success of the to those 30 years of economic growth in China is due to some gradual reforms that were designed: to establish private property and a low involvement of the state in the economy, to open economy to international trade, to attract foreign direct investment flows that will bring capital and technologies.

### 3. The impact of reforms on China's economic freedom and global economic competitiveness in the globalization context

#### 3.1. KOF Index of Globalization analysis

*KOF Index of Globalization* is the most important index of globalization and includes 3 of the fundamental dimensions of this phenomenon: economic, social and political. In this study, we analysed just the economic pillar of this index.

**Table 1. Evolution of KOF Economic Globalization Index, 1980-2011**



Source: own processing with data from <http://globalization.kof.ethz.ch/>

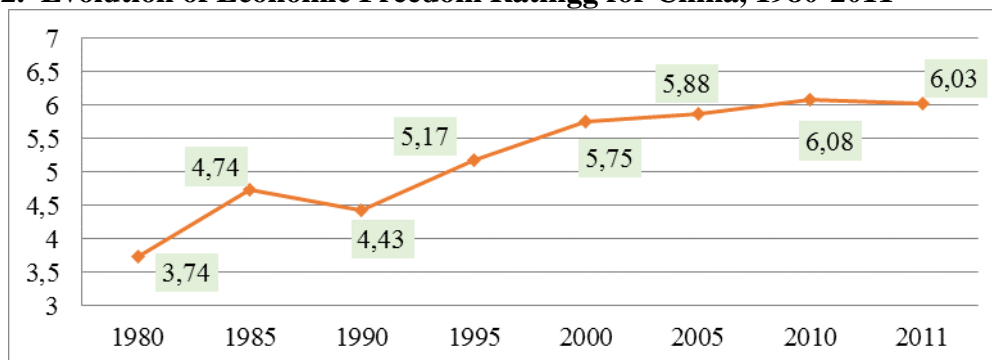
According to the *KOF Index of Economic Globalization*, the period from 1980 to 2011 was characterized by an increasing economic globalization for China and also for the others BRICS countries. 2005 was the top year, when the score was 56.9 (from 100), which climbed gradually to a level of 18.5 in 1970, 18.9 in 1980, 31 in 1990 and 40 in 2000. After 2006, the trend was slightly decreasing, so that in 2011 was registered a score of 50.7. We analyzed the trend of economic globalization for China because between globalization and economic freedom there is a strong correlation, given that economic freedom promotes the globalization. Some factors of the index are essential elements of globalization: business freedom, trade freedom and investment freedom.

#### 3.2. The Economic Freedom analysis

*Economic Freedom of the World* published by Fraser and Cato Institutes is one of the most important indexes which measures how institutions and countries policies encouraging the economic freedom. The estimation is made through points given from 0 to 10 and it is calculated as a weighted average of the scores given to forty two sub-criteria grouped in five

domains (Gwartney, Lawson, Hall, 2013): *Size of Government* (the volume of public expenditures, the level of tax rates and the percentage of the public enterprises in national economy); *Legal System and Property Rights* (judicial independence, impartial courts, integrity on the legal system); *Sound Money* (money growth, standard deviation of inflation, the possibility to use foreign currency); *Freedom to Trade Internationally*; *Regulation* (credit and labor market regulations, business regulations). We used this indicator to identify a country the position of between the two extremes: the minimal state and the totalitarian one.

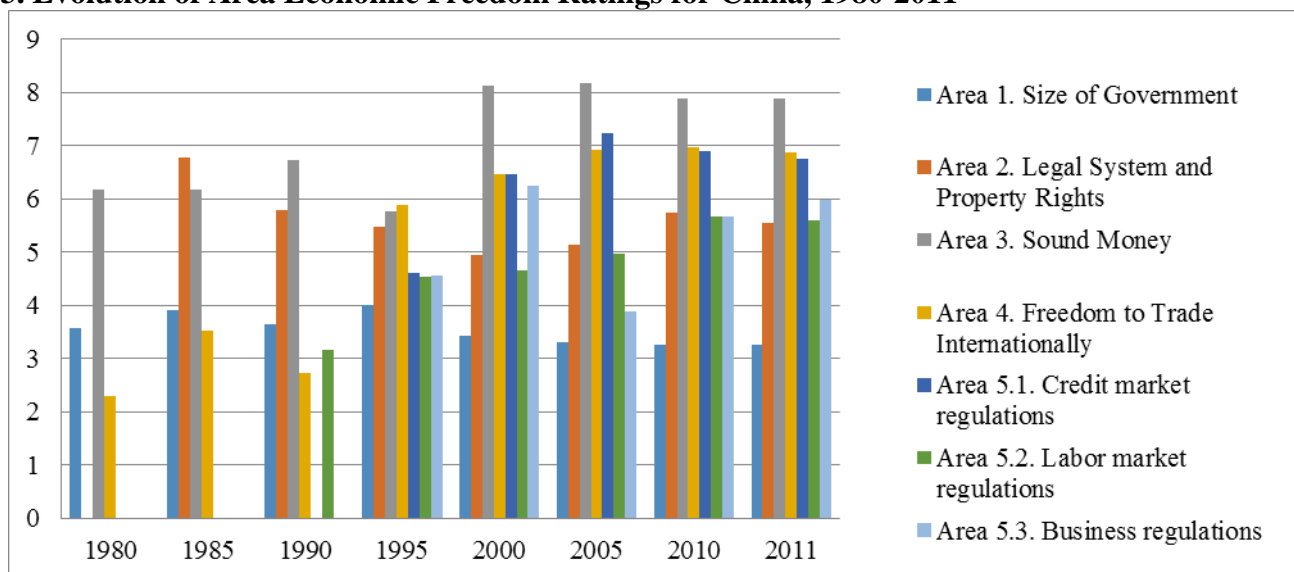
**Table 2. Evolution of Economic Freedom Ratingg for China, 1980-2011**



Source: own processing with data from *Economic Freedom of the World Reports*

According to Table 2, China had an increasing trend in terms of economic freedom. Thus, there is a rising trend from 3.74 in 1980 to 4.74 in 1985, as a result of liberalization reforms started in 1978. Upward trend was maintained until now, but with a lower rate of growth especially after 2000. Only in the 90's there was a deviation of the uptrend, since the score has dropped from 4.74 in 1985 to 4.45 in 1990.

**Table 3. Evolution of Area Economic Freedom Ratings for China, 1980-2011**



Source: own processing with data from *Economic Freedom of the World Reports*

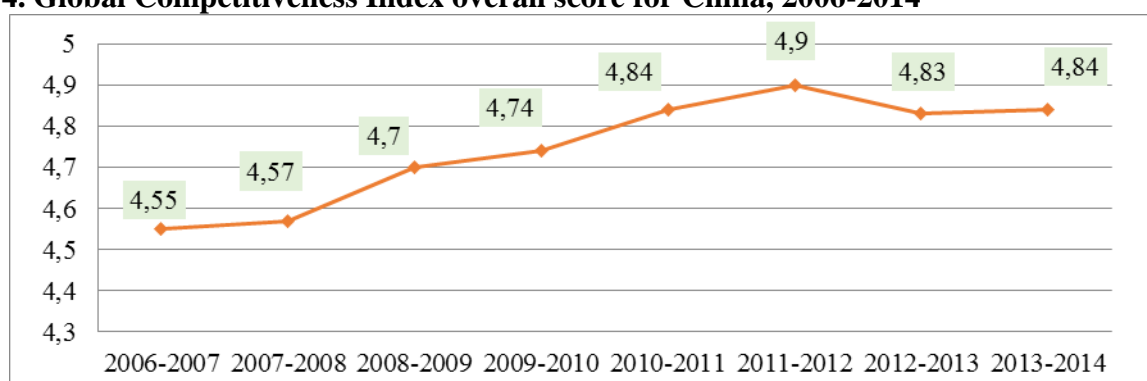
According to Table 3, the scores for the size of the public sector have improved rapidly in during 1980-1995, and since 2000 have maintained a relatively constant trend. This is because the state still holds a large part of the companies from strategic sectors like energy, machine building, banks, telecommunications, home appliances, food. However, the public sector has declined from 78% of the overall result of industrial production in 1978, to 30% in 2009 (OECD, 2009). Regarding the evolution of the scores for area 2, is maintained a lack of transparency, enforcement mechanisms, failure of private property, which makes the legal system to remain weak. Visible progress is found for area 3, monetary stability, as a result of the control over inflation growth. A rising trend is observed for area 4, because the freedom of

international trade has increased as a result of liberalization of trade flows and FDI. The same rising trend is found for the area 5, due to the reforms in all three sub-areas. As regards China, the empirical analysis evidence show that, as the role of the state in the economy began to decline as a result of liberalization reforms started in 1978, the level of economic freedom started to grow. But economic liberalization not led to political liberalization.

### 3.3. The Global Competitiveness analysis

*Global Competitiveness Index (GCI)* published by *World Economic Forum* is the most commonly used index of competitiveness and includes 12 pillars aggregated into a single index: 1st pillar: *Institutions*; 2nd pillar: *Infrastructure*; 3rd pillar: *Macroeconomic environment*; 4th pillar: *Health and primary education*; 5th pillar: *Higher education and training*; 6th pillar: *Goods market efficiency*; 7th pillar: *Labor market efficiency*; 8th pillar: *Financial market development*; 9th pillar: *Technological readiness*; 10th pillar: *Market size*; 11th pillar: *Business sophistication* and 12th pillar: *Innovation*. The score ranges from 1 to 7, representing the highest level of competitiveness of a country.

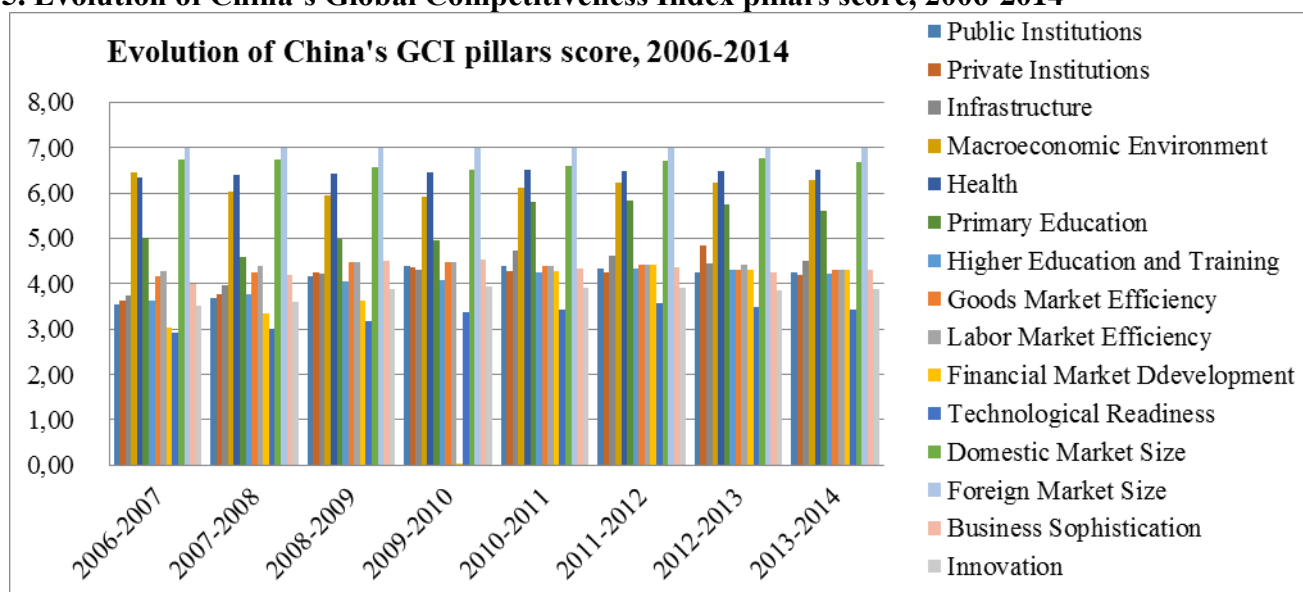
**Table 4. Global Competitiveness Index overall score for China, 2006-2014**



Source: own processing with data from *Global Competitiveness Index Reports*

In Table 4 we can see an increasing trend in terms of global competitiveness for chinese economy. Thus, if before the global economic crisis China had a score of 4.55, in 2013 it got to 4.84, placing the country on the 29th rank. In competitive analysis, China has the highest score and the best position on hierarchy of the BRICS countries - Africa (53rd), Brazil (56th), India (60th) and Russia (64th).

**Table 5. Evolution of China’s Global Competitiveness Index pillars score, 2006-2014**



Source: own processing with data from *Global Competitiveness Index Reports*



Table 5 shows the evolution of the 12 pillars of competitiveness, and we can observe that China records the highest scores for Foreign market size (7.0), Domestic market size (6.7), and Macro environment (6.3). Low scores registered in the the field of Public Institutions, Private Institution, Health, Higher Education and training, Technological Readiness and Innovation.

The Chinese institutional framework has improved slightly, but weaknesses remain: corruption, security issues, low levels of accountability and ethical standards among businesses. The most important problems are in the areas that have become critical for China's global competitiveness and for the remodelling of the economic model based on cheap labor to one based on consumption. These areas includes financial market development which is undermined by the relative fragility of the banking sector; the technological adoption by firms and by the population at large remains very low; and the efficiency of its goods market which is seriously undermined by various barriers to entry and investment rules, which greatly limit competition (Gwartney, Lawson, Hall, 2013, p. 34). China's macroeconomic situation is favorable because inflation is kept at a low level, after a prolonged period of high inflation, the budget deficit is moderate, and the gross savings rate has increased to 50% of GDP, which shows the need to switch China's growth from investment to domestic consumption and higher education and training. The higher education represents a weakness because of China's low tertiary education enrollment, the average quality of teaching, and an apparent disconnect between educational content and business needs. Regarding China's innovation capacity, but there is a long way to go until becoming an innovative economy. From 1980 until now, private economy had a growth rate much higher than the public sector, being the one who has contributed on large part to China's impressive growth rates. In the recent years however, an increasing trend is observed in terms of state involvement in the economy and private sector discrimination through higher taxes, stricter regulations, bureaucracy.

#### **4. Towards a new economic development model**

World Bank (2013) together with Chinese experts have developed a report called "China 2030. Building a modern, harmonious and creative" in order to analyze the challenges of long-term development of China, building on current success and proposing reforms to assist the transition to a market economy. China has reached a turning point in the way of development and needs a new structure of economic growth. The current model based on exports and foreign investment which has been successful for over 30 years, will not be applicable in the following decades. China has already a upper middle-middle income status according to the World Bank classifications, with a GDP per capita of about \$ 9000. If in 2030 the income per capita will increase to \$ 16,000, the country would have an economy equivalent 15 times of the S Korea current economy at market prices, which is not a sustainable model according to Robert Zoellick (2012). Also, in the coming decades China will reach the limits of growth generated by the current technologies, and if does not modify the strategy of development, risk falling into the trap of "average income" and to face competition from both low-income countries with low wages, and from those with high income that dominate through innovation and technological change.

Indeed, China needs a new development strategy to make the transition from quantitative growth to qualitative one. To achieve this goal and to complete the transition to a market economy, the government must redefine its role, to not have so much weight in the economy, to abolish monopolies, the property being diversified, the barriers to entry of private firms to reduced to facilitate the access to finance for SMEs, the progressive liberalization of interest rates in accordance with market principles. It is also necessary innovation through openness to international sources of innovation that would improve the quality of tertiary education and research, and in addition would make the connection with

capital markets and the economy, supported by strengthening the rule of law and enforcement of intellectual property.

The 12<sup>th</sup> Five Year Plan (2011-2015) would like to make the transition from an economy based on extensive growth, toward an intensive one, by shifting social and economic pattern toward economic performance on the post-crisis. This plan is considered "*essential in order creating a moderately prosperous society in all its aspects, to deepen reforms and opening outwards and to accelerate the transformation of economic development pattern*" (Jiabao,2011).

The main objectives included on this plan aims improvements in 12 areas (Mobius, 2011): increase the share of services in GDP; increase the value added in industry; encouraging local innovation; reducing dependence on exports and global policies; reducing trade differences through increased imports; reducing the share of government investment in fixed assets; transition to a greener economy; improve energy efficiency; to ensure a better distribution of wealth in future growth; to prevent problems in the labor market by addressing workers' rights and better union representation; ensuring that citizens' complaints about housing, healthcare, education and other areas are considered and to reduce regional disparities.

### 5. Conclusions

This new stage would like to make the transition from growth to economic development because the Chinese economy broadly completes its effort to catching up the advanced economies, reaching a stage of maturity, where the quantitative targets remain in the background and the quality aspects of growth are becoming priorities. The transition to a sustainable economic pattern adapted increasing global competitiveness aims transition from exports as the basis of economic growth towards domestic consumption boosted by economic policies more flexible; technological progress by increasing investment in research & development; stimulation of domestic investment by increasing the share of private sector in the economy; facilitation of a social and health services for all citizens. To achieve this transition, the government will have to rely more on private capital and market forces, to reduce state control over enterprises in strategic sectors, to gradually liberalize interest rates, and to weak the control over exchange rates. The success of reforms needed restructuring the entire economy is subject, however, by fight against powerful interest groups and corrupt officials who use their political power to enrich themselves by accepting bribes and shares in various companies.

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