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## To where Is China running? Challenges and perceptions after 40 years of Chinese reforms, transformation, and integration into the world economy

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**TO WHERE IS CHINA RUNNING? CHALLENGES  
AND PERCEPTIONS AFTER 40 YEARS OF CHINESE  
REFORMS, TRANSFORMATION, AND  
INTEGRATION INTO THE WORLD ECONOMY**

Bahri Yılmaz

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# **To Where Is China Running? Challenges and Perceptions after 40 Years of Chinese Reforms, Transformation, and Integration into the World Economy**

29.4.2019

Bahri Yilmaz

Sabanci University

*“... Western politicians must understand that the economic, scientific and technological rise of China is unstoppable, and come to terms with this as a fact of life. The only way to race against China is to compete with it.”<sup>1</sup>*

Helmut Schmidt, Former Chancellor of Germany

*“...Without fanfare—indeed, with some misgivings about its new status—China has just overtaken the United States as the world’s largest economy. This is, and should be, a wake-up call—but not the kind most Americans might imagine...”<sup>2</sup>*

Nobel Prize-Winning Economist Joseph E. Stiglitz

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## **1. Introduction**

If we look at the last four decades, without any doubt we can argue that China is the rising economic power of the 21<sup>st</sup> century, which may be called the Chinese Century. It is an economic miracle but not an economic mystery. In 2018, China celebrated the 40<sup>th</sup> anniversary of reform and opening to global trade.

Since 1978, the country has transformed from one of the poorest low-income countries to one of the three leading economies in the world. The country has changed from an agricultural-led economy to an industrial one and from a purely command economy to a world market-oriented economy. The country accounts for one-third of global growth. Over 800 million people have been carried over the poverty line, and many in China have reached upper middle-class status.<sup>3</sup>

This paper has been divided into three parts. In the first part, we will discuss the economic performance of China and its place in the world economy from 1978 until today. In the second part, we will examine the major macroeconomic problems China faces in the beginning of 2019. In the last part, we will draw some conclusions with regard to China's main external and internal challenges and make some recommendations for solutions to China's economic problems.

## **2. An Overview of the Chinese Economy**

China's economic development over the last four decades may be described as impressive and miraculous. At the beginning of 2019, China is one of three largest global economies, including the United States and the EU, the world's largest exporter, and has the largest exchange reserve.

The economic history of China after the Second World War may be divided into three distinct periods since its establishment in 1949:

- (1) 1949–1978, the Mao Zedong Era—during which the People's Republic of China was politically established based on a command economy;
- (2) 1979–2012, the Deng Xiaoping Era—during which radical economic reforms were undertaken and the Chinese economy opened to world markets;
- (3) 2013–present, the Xi Jinping Era—during which China transformed from an underdeveloped to an advanced and modern economy.

We will discuss the latter two eras in this paper.

### ***2.1. Development Strategy<sup>4</sup>***

The fundamental development strategies implemented in China in 1978 were initially based on five main pillars: (1) state-led economic development (state capitalism) under authoritarian rulers; (2) distribution of land owned by the state among peasants (land reforms); (3) educational reforms aiming to contribute to economic construction, progress in science, and social development; (4) world market-oriented (export-led) development strategy; (5) producing for export markets and investing abroad rather than producing and investing for the domestic market.<sup>5</sup>

In order to realize the world market-oriented transformation process, the Chinese government has also put in force the following reform policies that have made a large contribution to the rapid economic development of China under the rule of the Chinese Communist Party since 1978. The World Bank has summed up these long-term reform policies as follows: (i) pragmatic and effective market-oriented re-forms; (ii) balancing growth with social and macroeconomic stability; (iii) interregional competition; (iv) domestic market integration; (v) steady integration with the global economy.<sup>6</sup>

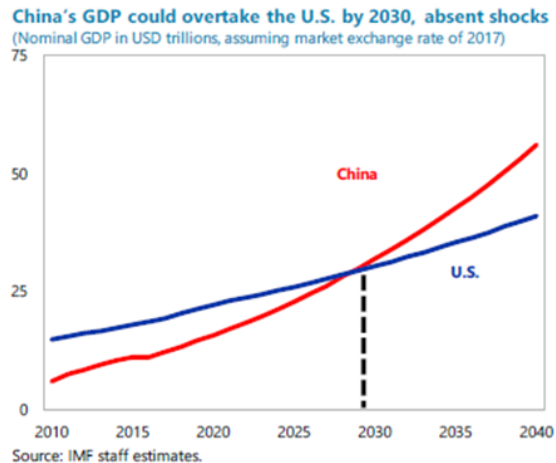
### ***2.2. China's Place in the World Economy<sup>7</sup>***

China has recently made remarkable strides to reroute its economy from a socialist pathway to a modern one with Chinese characteristics. However, in this transformation China does not just see itself as another emerging economy. Rather, China sees its economic resurgence as a return to its status as a major world economic power, harkening back to the 15<sup>th</sup> and 16<sup>th</sup> centuries in which Chinese markets accounted for nearly 30 percent of the world economy.<sup>8</sup>

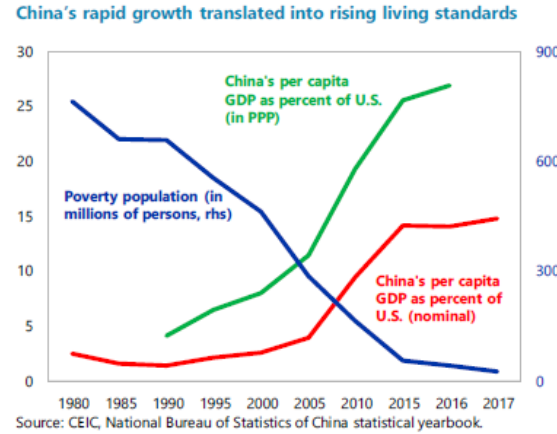
Today, China is the world's third largest economy by nominal GDP (in terms of current USD) and the world's largest economy in terms of purchasing power parity (PPP).<sup>9</sup>

According to the World Bank's estimates for GDP PPP (const. 2011 USD), which compares incomes in various countries in 2017, China has been the world's largest economy for the last three years.<sup>10</sup> It produces USD 21.3 trillion (18.2 %) of world economic output. The European Union is in second place, generating USD 19.066 trillion (16.3%). Together, China and the EU generate 34.5 percent of the world's economic output of USD 116.5 trillion. The United States is in third place, producing USD 17.662 trillion (15.2%).<sup>11</sup>

Estimations from the World Bank in terms of nominal GDP (current USD) in 2017 show that China was the third largest economy with USD 12.237 trillion (15.1%) after the EU with USD 17.227 trillion (21.3%) and the United States with USD 19.390 trillion (24%).<sup>12</sup> The IMF estimates that China will be able to catch up with the United States in 2030 (see Figure 1).



13



14

According to IMF calculations, on a per capita income basis China ranked 72<sup>nd</sup> by GDP (nominal) and 79<sup>th</sup> by GDP (PPP) in 2018. Chinese per capita income was USD 263.2 in 1976, increased to USD 8,643 in 2017, and reached USD 9,630 in 2018 (in terms of current USD). In contrast, per capita income for the EU was USD 33,715 and USD 59,531 in the same year, respectively.<sup>15</sup>

Figure 2 also shows that China was very successful in eliminating poverty, from 95% of China's population under the global poverty line in 1978 (2010 standard of poverty) to 5% today. This means that almost 1.3 billion Chinese people have been pulled out of poverty. In the beginning of the economic reform process, the distribution of income improved until 1990, and then it began to worsen. Inequality in income distribution remains one of the greatest challenges to the Chinese economy today.

The IMF forecasts that the Chinese economy will expand by 42% between 2017 and 2023 (a compound annual rate of 6.1%). The corresponding figures for the United States and the EU are 13% and 2%, respectively. By 2026, the Chinese economy will be the same size as that of the United States, in USD, and its aggregate consumption would reach 74% of U.S. levels by 2027.<sup>16</sup>

The Chinese economy is the largest manufacturing economy.<sup>17</sup> The leading shares of global manufacturing at the end of 2017 were divided between China at 29%, the EU at 14%, and the United States at 11.6%.<sup>18</sup> The Chinese manufacturing industry employed 114.4 million workers, while the U.S. manufacturing industry employed 11.5 million workers—about one-tenth of China.<sup>19</sup>

In 2016 China was the largest exporter of goods in the world, producing 17% of world exports and standing as the third largest importer with a share of 12% of world imports. According to the World Trade Organization (WTO), China was the world's largest exporter of merchandise trade in 2017 (up from the 11<sup>th</sup> in 1995), reaching USD 2,263 billion annually. China was also the world's fifth largest exporter of commercial services in 2017 (up from the 16<sup>th</sup> in 1995), reaching USD 226 billion annually.<sup>20</sup>

China is crucial to world economic activity, accounting for over 10% of foreign direct investment (FDI) and nearly 8% of global lending and services exports. According to UNCTAD World Investment Report, China became the second-

largest recipients of FDI inflows (USD 136 billion) in the world in 2017 (up from the sixth largest in 2007), behind the United States (USD 275 billion).<sup>21</sup> China was the third-largest source of outward FDI flows (USD 124.6 billion) in the world in 2017 (up from the 19<sup>th</sup> in 2007), behind the United States (USD 342.3 billion) and Japan (USD 160.4 billion). According to International Monetary Fund (IMF), China has the largest foreign currency reserves as of December 2017, reaching USD 3,140 billion.

China is a global digital leader. China has around 800 million internet users and 282 million digital natives (internet users less than 25 years old).<sup>22</sup>

### 3. China’s External and Internal Economic Challenges

In the previous part, we have focused on the main macroeconomic achievements of the Chinese economy and its placement in the global economy after 40 years.

Now, we deal with the main challenges the country is facing today. Until 2015, China was the world's fastest-growing major economy, with growth rates averaging 10% over 30 years. Although Chinese growth rates remain high, the growth rate has been slowing down as China becomes less dependent on external demand and the Chinese economy shifts its focus from external-driven growth to consumption and investment -led economic growth<sup>23</sup> (see Figure 4).

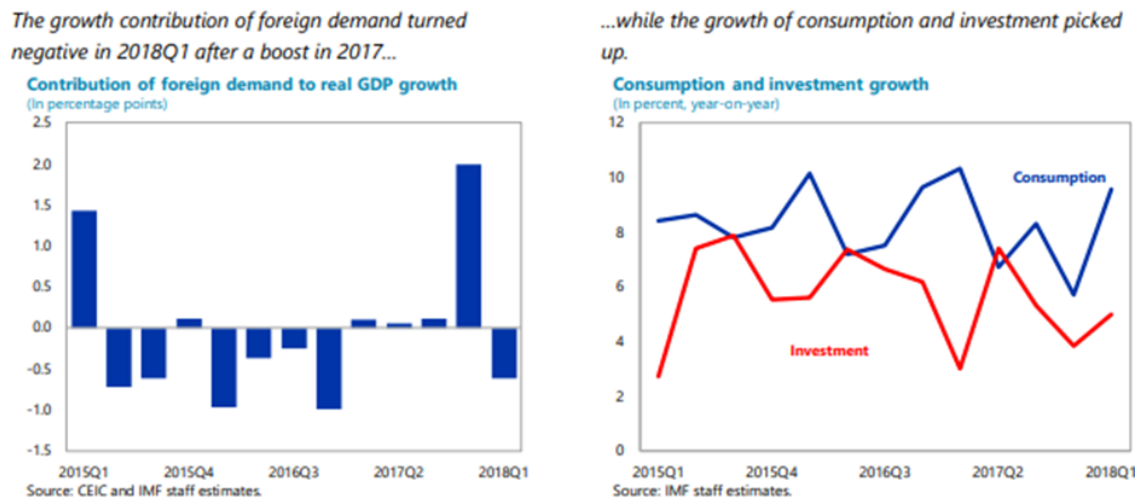


Figure 3

Figure 4



The trade war between the United States and China has seemingly not affected the trade balance. China's trade surplus hit a new record in 2017 and turned negative in 2018 Q1 (see Figure 3).

Decreasing demand, both external and internal, has created an excess capacity of production in industrial sectors due to the massive fiscal expansion program (about 27% of GDP) implemented after 2008.<sup>25</sup> Another reason for decreasing economic growth is that export-led growth has reached its limit. The Chinese growth rate will be mainly determined by private and government consumption spending in the coming years (see Figure 4). A new model of development in the framework of China's 13<sup>th</sup> Five-Year Plan has to build on the rebalancing of internal, external, environmental, and distributional factors within the Chinese economy (see Diagram 1 in the Appendix).

### ***3.1. New Era: Foundation of the Innovation Economy***

Since the 1990s, China has become dominant in manufacturing goods. However, much of this activity is low value-added. China does not create technologies or sell products under its own brands at the end of the process. At the present stage of economic development, it is inevitable that Chinese firms must develop and produce new and sophisticated products for customers inside and outside of the country in order for the Chinese economy to continue to grow.

At this stage of economic development, the Chinese government has understood the importance of moving to an innovation economy based on a "learning society" in order to close the gap in productivity between China and advanced countries.<sup>26</sup> In order to achieve this aim, China needs to move from "low-end manufacturing" of small and medium-size local enterprises (SMEs) to develop an innovation economy with world market-oriented firms. In other words, China needs to develop a more efficient economy through investing in infrastructure, improving the education systems, and promoting research and development in future industries to make China's economy more innovative.

For the time being, China is under heavy pressure to deepen its economic and structural transformation and reform in the domestic market. Obviously, markets and the private sector cannot realize such a giant transformation alone. In order to realize an innovative market-based economy, the government must take the initiative to jumpstart the transformation process. Thus, the Chinese government has been making efforts toward enforcing technical progress and promoting national and international competitiveness with the help of domestic market-oriented reforms and further opening up the economy to global markets.<sup>27</sup>

### ***3.2. Made in China 2025 as a New Start to an Innovation-Based Economy***

In this respect, China has launched a high-tech revaluation and initiated a master plan called “**Made in China 2025**” aimed at changing the country into a center of excellence for high-tech products within the next few decades. The latest MERICS report underlines China’s underlying plans for this project:

China’s ambitious plan to build one of the world’s most advanced and competitive economies with the help of innovative manufacturing technologies (“smart manufacturing”). China’s industrial master plan “Made in China 2025” aims to turn the country into a “manufacturing superpower” over the coming decades. This industrial policy will challenge the economic primacy of the current leading economies and international corporations.<sup>28</sup>

In order to finalize the “Made in China 2025” strategy, create an innovative Chinese economy, achieve high-quality growth performance, and maintain China’s role as a global player, Chinese policy makers should take into consideration all of the improvements in technical progress in order to establish a successful innovation-based economy over the coming decades. In other words, promoting innovation, creating an innovation-based economy, and learning society depends on four main factors that are indispensable for innovation: the inflow of high-tech FDIs; the increasing number of highly qualified human capital; increasing research and development (R&D) spending; and increasing the number of business-minded and profit-oriented entrepreneurs.

In the last few years, China’s rapid export growth has not only been based on the expansion of exports of labor-intensive/low-cost products but also the export basket including more high-tech/sophisticated goods. The increase in the share of sophisticated export products in total exports indicates that China is moving from a labor- and basic capital-intensive producer of goods to a producer of high-tech intensive producers and exporters. Additionally, it shows China’s capability to transfer technologies from advanced countries and the rapid absorption and implementation of the knowledge of high-tech technology in the production process.<sup>29</sup>

### ***3.3. The “Negative List” and Promoting FDI***

One of the main determining factors for improving the efficiency of production processes and developing/applying new technologies is the inflow of inward foreign direct investments (FDIs). The absorption of FDI is part of the policy of opening China to the outside world, aiming at increasing competitiveness in the world market and catching up with economies in advanced countries.<sup>30</sup>

According to the 2018 World Investment Report published by UNCTAD, the Chinese economy was ranked the second most attractive to multinational companies for 2017–2019, after the United States. With steady growth for

several years, FDI inflows continued to increase between 2016 and 2017, from USD 133 billion to USD 136 billion.<sup>31</sup>

FDIs in China from foreign multinationals companies (MNCs) transfer not only foreign capital but also new technologies from other economies. This policy is seen in liberalization plans, the rapid development of the high-tech sector, and the establishment of free trade zones.<sup>32</sup>

In order to catch up with advanced technologies from industrialized economies and develop innovative capabilities of their own, Chinese investors are showing great interest in the acquisition of leading European and American international high-tech companies through direct or portfolio investments abroad. For example, Chinese investments in Europe reached USD 40 billion in 2017.<sup>33</sup>

The Chinese government is aware of the importance and role of FDIs in transferring technology and creating an innovative economy. As a matter of fact, on June 28, 2018, China's Ministry of Commerce (MOFCOM) and the National Development and Reform Commission (NDRC) jointly announced the newest version of the "Negative List." According to the new list, China makes it easier for foreign investors to access the Chinese market by lowering the number of restrictions and prohibitions specified in the list from 63 (2017 version) to 48 items.<sup>34</sup>

One of China's biggest success stories is the fact that the government is heavily involved in large-scale R&D activities and modernization. China's total spending on research and development is estimated to have hit USD 279 billion in 2017—a year-on-year increase of 14%.<sup>35</sup> In 2017 R&D spending amounted to around 2.1% of total gross domestic product; this compares with around 2.8% in the United States, 2.9% in Germany, and 3.3% in Japan, according to World Bank data for 2015. China's annual R&D spending has risen 70.9% from 2012.<sup>36</sup>

### ***3.4. Increasing Educational Opportunities for Young People***

To realize innovation-oriented investments and the application of new technologies, it is absolutely necessary to expand the human capital reservoir of highly qualified graduates in China and build a new generation of entrepreneurs that are capable of producing new high-tech commodities and improving China's international competitiveness.

There are around 250 universities in China. Several of them have an international reputation for being among the best universities worldwide. The total number of students enrolled in higher education institutions in China in 2016 was 37 million, which makes China the country with the largest higher education sector in terms of volume of students. In 2016, approximately 11.93 million students graduated with a degree in higher education, the highest number in the world. In 2016, the number of graduates with bachelor's degrees reached 3.7 million, of which 1.2 million or 32.8% finished with a bachelor's degree in

engineering, a much higher proportion of engineers than high-income countries. The employment rate of university graduates in China is 91.9%. It seems there is a mismatch between the demands for a qualified labor force and the supply of it.<sup>37</sup>

China has become the largest source of international students thanks to its growing pool of potential students. In total, 5.2 million Chinese students have studied abroad over the last 40 years, and 1.5 million students are currently enrolled in higher education institutions overseas. In 2017, developed countries and regions, such as the United States and Western Europe, remained the most popular destinations for Chinese students.<sup>38</sup>

According to the Ministry of Education, the number of Chinese students studying abroad and returning from overseas studies last year continued to increase. Returning students are increasingly equipped with the skills required to support industrial development and government strategies for growth. In 2017, approximately 608,400 Chinese students left the country to pursue advanced studies overseas.<sup>39</sup> At the beginning of the century, only one in ten Chinese students returned to China after studying abroad. In 2017, it was eight in ten.<sup>40</sup>

Schumpeter pointed out that entrepreneurs' success in innovation is dependent on the openness and functioning of the market economy and social climate. An important indicator for the improvement of innovation and the impact of entrepreneurs on innovative products is the number of patents granted each year. The number of US patents granted to Chinese applicants was reached to 8,166 patents in 2015.<sup>41</sup> In addition, the financial sector must provide credits to new enterprises and allow the expansion of old industries, especially SMEs.

#### **4. Policy Recommendations: How to Handle China's Economic Challenges**

After decades of high-speed growth based on demand components such as investment and external demand, China is now focused on high-quality growth and a domestic market-led and innovation-driven economy.

In the 13<sup>th</sup> Five-Year Plan period (2015–2020), China's economy has been facing serious economic challenges. Such challenges include the slowdown of economic growth, a shift away from export-led growth, the structural transformation to service and innovation economies, pollution and urbanization, and growing inequality. International organizations such as the World Bank, IMF, and OECD recommend that the Chinese government undertake tough measures such as deepening economic reforms, further opening markets to global trade, enhancing the quality of growth, increasing energy efficiency, promoting innovation, sharing prosperity, and reducing systematic risks in the financial sector.

The following recommendations for the Chinese economy reflect the concerns voiced by these organizations.

#### ***4.1 Enforcement of the Transformation Process through the Implementation of Economic Reforms***

There is an ongoing discussion on the Chinese real economy related with demand- and supply-side measures that will ensure sustainable growth and resolve the essential problems that China is facing today. In order to achieve sustainable growth and create an innovation economy, the Chinese government ought to follow demand- and supply-side reform policies.<sup>42</sup>

(1) **Supply-side structural reforms** focus on overcoming structural weaknesses and cover three main fields: first, the elimination/rationalism of the so-called “zombie enterprises” and the reduction of old excess production capacities in some industries (steel, cement, plate glass, aluminum, shipbuilding, solar panels, and coal mining).

Second, regulatory measures, as one of the main supply-side measures, promote competition and enable the market to play an important role. Additionally, the central government must intervene in the market through anti-trust laws in order to protect against monopolistic or oligopolistic practices.

Third, as the IMF has recommended as the “Three Critical Fields of Battles”, financial risks should be alleviated by stabilizing the debt/GDP ratio, eliminating absolute poverty/improvement of income distribution, and fighting corruption and pollution.”<sup>43</sup>

(2) **Demand-side measures** concern the increases in private and public spending on healthcare, education, social benefits, and other public services. The key elements of economic reforms are summed up as “...continuing to rein in credit growth, accelerating rebalancing efforts, increasing the role of market forces, fostering openness, modernizing policy frameworks.”<sup>44</sup> The main demand-led policies will be based on the growth in private consumption and public good consumption such as environmental protection, preservation and restoration, healthcare, education and social protection, infrastructure investment, R&D, and innovation. It is important to notice that tax revenues rather than debt finance must finance the increase in public expenditures. Demand-side measures will also increase the productivity of the private sector and can have a positive impact on supply sides of the economy. It seems inevitable that officials will need to reform public finances both at the local and national level.

Another important problem is how new rules, laws, and regulations protect consumers from new types of transactions. An important and expected impact of rising consumption would be an increase in foreign demand for goods and services, especially from advanced countries. In turn, this would increase import spending on goods and services and create a negative impact on foreign trade balance.

## ***4.2 Opening the Economy and Intensifying Close Cooperation with other Countries***

China joined the WTO in 2001 and, henceforth, accepted the rules of the game. It promised to adjust its economy to WTO regulations through liberalizing a certain part of its economy throughout time. While China has initially made progress, some problems remain untouched. These are, according to the EU, "...a lack of transparency, industrial policies and non-tariff measures that discriminate against foreign companies' strong government intervention in the economy, resulting in a dominant position of state-owned firms, unequal access to subsidies and cheap financing poor protection and enforcement of intellectual property rights."<sup>45</sup>

Since the end of World War II, the United States and international institutions such as the World Bank, IMF, WTO, and OECD have promoted the advantages of free trade and principles of the free market for all participant countries. It was a common belief that free trade and the market economy can maximize consumption and production of the world economy through the allocation of each country's resources.

A historical turning point took place with the Trump administration's decision to impose taxes on imported goods from China to the U.S. market. China then reacted with similar protectionist measures against imports from the United States by leveling import tariffs from the United States. These protectionist measures led to the so-called "trade war" between the two countries, and protectionism began to gain further ground in the global economy.

International economics textbooks underline that one of the basic aims of foreign trade policies is to protect inefficient, costly products and uncompetitive domestic industries from international competition, often at the expense of domestic consumers. However, we have to be aware of the fact that China's economic and political challenges cannot be met through protectionist measures. In order to overcome China's challenges, the US and the EU must follow one basic path that will stimulate research and development, intensify competition, promote new technologies, and keep markets open or open them further. Reforms and investments must focus on the fields of education and training, innovation, the tax system, infrastructure, and the business environment.

China has been heavily criticized not only by the U.S. administration<sup>46</sup> under Trump but also to some extent by the EU, mainly Germany, concerning its investment and trade policies.<sup>47</sup>

The Chinese economy has been taking advantage of the opportunities offered through economic exchange with liberal and market-oriented economies. The foreign enterprises located and operating in China mostly complain of unequal treatment and protectionist measures implemented by Chinese authorities. Restrictions include "...forced technology transfer, lack of implementation of

intellectual property rights, arbitrary administrative treatment, including customs clearance, and unequal access to licenses, financing, subsidies and legal remedies. Frequent and non-transparent regulatory changes make it difficult for foreign firms to do business, especially in industries that have to rely on long-term investments...”<sup>48</sup>

Although China has taken some steps in the last few years to improve the protection of intellectual property rights through special intellectual property rights courts nationwide, the fundamental requirement for the continuation of bilateral economic relations between Western countries and China is still on the table. They insist that China must open its markets for foreign companies and abolish discriminatory and unfair trade regulations.<sup>49</sup> In the near future, China will have one of the biggest advantages in worldwide free trade. Therefore, it is also responsible for reaching a consensus on improving the present trade system in cooperation with other countries. As a first step, China can reform the WTO in cooperation with the G-20, especially with the EU and the United States.

Last and not least, China must accept the rules of the games accepted in the international market, and it must continue opening up its economy to international competition. However, China should not be ignored and isolated by other countries through trade restrictions.<sup>50</sup>

#### ***4.3 Addressing Inequality of Income Distribution***

One of the main economic problems that China is facing is inequality of national income among Chinese citizens. Over the past four decades, China has achieved a sharp reduction in the poverty level; however, this has left China among the most unequal countries in the world (see Figure 6).

The IMF’s “Working Paper on Inequality in China – Trends, Drivers and Policy Remedies” underlines the causes of and solutions to unequal income distribution in China. The paper recommends the following policies: personal income tax reform; labor market policies; the Dibao system (implemented in 2016, this is the minimum income guarantee system); pro-farmer policies; social security; regional development strategy and fiscal transfer policies; poverty alleviation policies and financial inclusion.<sup>51</sup> The Chinese government needs to establish a well-functioning nationwide social system and increase government social spending on health, education, and social benefits (Figure 5).

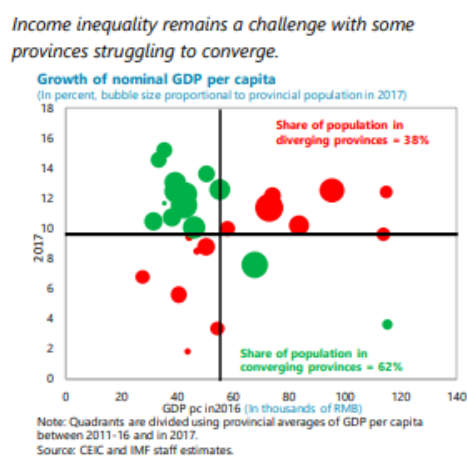


Figure 5

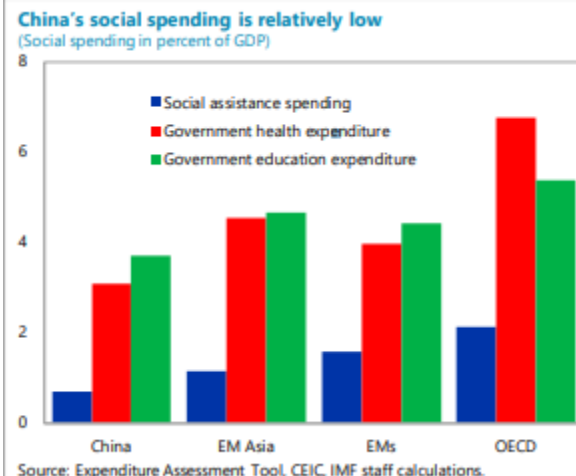


Figure 6

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#### 4.4 Reform in the Financial Sector

One of the main conditions for a successful market economy is a well-performing financial sector. At the end of 2016, the total debt to GDP ratio in China was around 247%. Total debt is estimated to be 260% of GDP at the end of 2018. China has recorded a general government debt equivalent to 47.6% of the country's GDP in 2017 (est. 50.1% in 2018) compared to the United States at almost 105%, Japan at 253%, and the Euro zone at 87.9%.

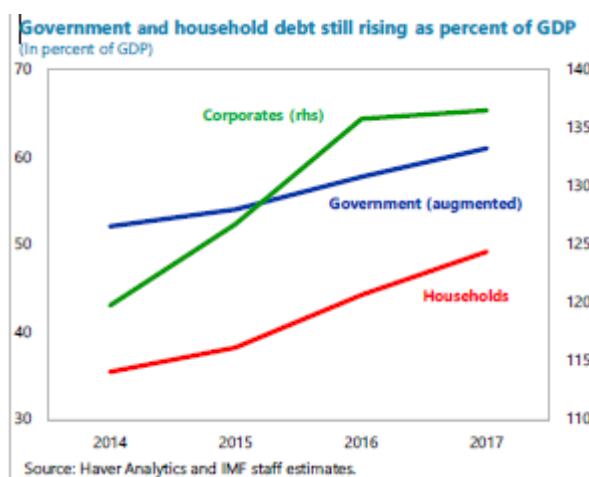


Figure 7

53

The rest of China's debt consists mostly of enterprise debt at 160% of GDP and household debt at around 50% of GDP, of which the government is not responsible for repaying. Nearly all public debt and the great majority of enterprise and household debt are in Renminbi and held by Chinese nationals (see Figure 7).

The OECD recommends that China tighten monetary policy and expand fiscal policies to stabilize economic growth and reduce systemic risk. Two major



policies are essential: to remove guaranties to state-owned enterprises and public entities gradually and to control household debt in the form of credit card and consumer loans. Additionally, shadow banking, financial derivatives, and internet-related financial fraud must be regulated and controlled.<sup>54</sup>

Another important issue is corruption. China is ranked 77<sup>th</sup> (out of 180 countries) with a score of 41 in the Corruption Perceptions Index 2017. In the 2018 Financial Secrecy Index, established by the Tax Justice Network, China ranked 28<sup>th</sup> (out of 112 countries).<sup>55</sup> Over the years, the Chinese Communist Party has vowed to fight against corruption and strengthen internal supervision of party members across all levels. China's President Xi Jinping has vowed to step up the country's fight against corruption until complete victory is achieved. As of last year, his anti-graft campaign, which commenced in 2012, has punished 1.3 million officials.<sup>56</sup>

In short, to conclude this list of China's economic pitfalls, many challenges facing China today require the active participation of the government, at least in the fields of environment, income inequality, and financial stability.

## **5. Conclusion**

Because of the Chinese government's reform and opening policies since 1978, the country has been transformed from one of the poorest low-income countries to the one of the three leading economies in the world. China's share of global gross domestic product was just 2% in 1980; today it is well over 18%. China's share of world trade at the end of the 1970s was just over 1%; today it is 19%. About 800 million Chinese have been lifted out of poverty within the past 40 years.

If we look at the experiences of economic development in Japan, South Korea, Singapore, and Taiwan and compare their development with China's, we can observe that China has been following to a large extent the same development strategy. The development strategies that began in Japan and expanded to South Korea, Singapore, and Taiwan were similarly state-led/state-dominated reforms under authoritarian regimes. Today in China, the Communist Party governs and regulates the present economic system, where the market economy is shaped under the administration of the state.<sup>57</sup>

For a long time Western institutions recommended that the Chinese economy would be gradually reshaped into a market economy and integrated with the liberal, open market economies of the West. However, China is now still between a state-led economic system and a sort of market economy with Chinese characteristics. It is a hybrid economic system.

Throughout the last four decades, the Chinese economy has been moving from a state-dominated economy to an economy focused on private consumption and firms-based market forces. It seems that the Chinese government will continue to play a dominant role as the “party state” in the reshaping of the economy and in the decision-making process in the foreseeable future. As outsiders, the West will have to accept the fact that China’s political and economic structure will continue to change gradually in the next decades.

Beijing is facing serious external pressure, and United States and the European Union will be the main challengers. Without a doubt, China is already a global economic power with a dynamic, growing market, and China will remain one of the most important economic partners and beneficiaries of the global economy.

In order to compete with and develop the Chinese economy, three scenarios are likely in future.

First, the United States, the EU, and international organizations such as the IMF, OECD, WTO, and World Bank must make concerted efforts to negotiate with China and establish common ground for a renewed international economic order. Therefore, these organizations should urgently establish close and targeted coordination between China and other global actors.

Second, China is needed to redesign international institutions and the new rules of the international economic order. On the other hand, China must accept the present rules of the game set up by international agreements.<sup>58</sup>

Third, world markets have to learn how to compete against China’s economic power.

The Federation of German Industries (BDI) underlined the necessities of close cooperation with China in its newest report<sup>59</sup> as follows:

As a dynamically growing market, China remains one of the most important economic partners. German industry has no interest in a conflict-oriented economic, political and technological containment or isolation/decoupling from China. Systemic differences and divergences do not necessarily mean conflict but require the reliable and resilient management of common interests. Cooperation is necessary – despite competition. China is a pillar of the global economy. China, Germany and the EU have a common interest in shaping the future.<sup>60</sup>

## 7. Appendix

TABLE1:

1:

China: Selected Economic Indicators											
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
	Projections										
NATIONAL ACCOUNTS											
Real GDP (base=2015)	7.8	7.3	6.9	6.7	6.9	6.6	6.4	6.3	6.0	5.7	5.5
Total domestic demand	8.1	7.2	7.2	7.6	6.4	6.8	6.6	6.5	6.3	6.0	5.8
Consumption	7.2	7.2	8.3	8.6	7.6	8.0	7.4	7.0	6.8	6.3	6.1
Investment	9.1	7.1	6.1	6.5	4.9	5.3	5.7	5.8	5.8	5.6	5.4
Fixed	9.3	6.8	6.7	6.8	4.3	5.3	5.9	6.0	6.0	5.8	5.6
Inventories (contribution)	0.1	0.2	-0.2	0.0	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Net exports (contribution)	0.1	0.4	-0.1	-0.6	0.6	0.0	0.0	-0.1	-0.2	-0.2	-0.2
Total capital formation (percent of GDP)	47.3	46.8	44.7	44.1	44.4	44.3	43.9	43.3	42.7	42.2	41.6
Gross national saving (percent of GDP) 1/	48.8	49.0	47.5	45.9	45.8	45.2	44.7	44.1	43.4	42.7	42.0
LABOR MARKET											
Unemployment rate (annual average) 2/	5.0	5.1	5.1	5.0	5.1	5.0	5.0	5.0	5.0	5.0	5.0
Employment	0.4	0.4	0.3	0.2	0.0	0.1	0.1	0.1	0.1	0.1	0.1
PRICES											
Consumer prices (average)	2.6	2.0	1.4	2.0	1.6	2.3	2.5	2.7	2.8	2.9	3.0
GDP Deflator	2.4	1.0	1.1	-0.1	1.9	2.0	2.3	2.3	2.2	2.2	2.3
FINANCIAL											
7-day repo rate (percent)	5.4	5.1	2.5	2.6	3.1	---	---	---	---	---	---
10 year government bond rate (percent)	4.6	3.7	2.9	3.1	3.9	---	---	---	---	---	---
Real effective exchange rate (average)	6.3	3.1	10.1	-5.6	-2.6	---	---	---	---	---	---
Nominal effective exchange rate (average)	5.3	3.1	9.5	-6.5	-2.5	---	---	---	---	---	---
MACRO-FINANCIAL											
Total social financing 3/	17.5	14.3	12.4	12.9	12.0	10.5	11.5	10.9	10.1	9.5	9.2
In percent of GDP	180	190	198	209	215	219	224	228	232	235	238
Total nonfinancial sector debt	17.4	17.1	15.4	16.4	14.0	12.2	12.0	11.3	10.5	9.9	9.5
In percent of GDP	192	207	222	242	253	261	269	275	281	286	290
Domestic credit to the private sector	16.6	13.2	15.8	16.5	12.8	10.6	10.6	10.1	9.4	8.8	8.5
In percent of GDP	142	149	159	174	180	183	186	189	191	192	193
House price 4/	7.7	1.4	9.1	11.3	5.7	8.6	8.3	7.9	7.2	6.8	6.0
Household disposable income (percent of GDP)	59.8	60.4	60.5	61.0	60.6	61.0	61.2	61.4	61.5	61.6	61.5
Household savings (percent of disposable income)	38.5	38.0	37.1	35.5	35.5	34.7	34.0	33.3	32.3	31.4	30.5
Household debt (percent of GDP)	33.0	35.4	38.2	44.2	49.2	51.0	52.8	54.9	56.8	59.0	61.3
Non-financial corporate domestic debt (percent of GDP)	109	113	121	130	131	132	133	134	134	133	132
BIS credit-to-GDP gap (percent of GDP) 5/	18.9	21.5	27.2	24.7	12.6	---	---	---	---	---	---
GENERAL GOVERNMENT (Percent of GDP)											
Net lending/borrowing 6/	-0.8	-0.9	-2.8	-3.7	-3.9	-4.1	-4.1	-4.1	-4.1	-4.1	-4.1
Revenue	27.7	28.1	28.5	28.2	28.4	28.8	28.9	28.6	28.3	28.2	28.0
Additional financing from land sales	2.7	2.7	1.9	2.0	2.6	2.3	2.0	1.7	1.4	1.2	1.0
Expenditure	31.2	31.6	33.2	33.9	34.9	35.2	35.0	34.4	33.8	33.5	33.1
Debt 7/	16.0	38.6	36.4	36.7	36.9	38.1	39.3	40.4	41.4	42.4	43.2
Structural balance	-0.5	-0.5	-2.5	-3.6	-4.0	-4.2	-4.2	-4.2	-4.2	-4.2	-4.1
BALANCE OF PAYMENTS (Percent of GDP)											
Current account balance	1.5	2.2	2.7	1.8	1.4	0.9	0.8	0.8	0.7	0.5	0.4
Trade balance	3.7	4.1	5.1	4.4	4.0	3.3	3.1	2.9	2.7	2.5	2.3
Services balance	-1.3	-2.0	-1.9	-2.1	-2.2	-2.1	-2.0	-2.0	-2.0	-1.9	-1.9
Net international investment position	20.7	15.2	14.9	17.4	15.1	13.9	13.6	13.2	12.9	12.4	11.9
Gross official reserves (bn US\$)	3,880	3,899	3,406	3,098	3,236	3,198	3,144	3,088	3,024	2,935	2,809
MEMORANDUM ITEMS											
Nominal GDP (bn RMB) 8/	59,696	64,718	69,911	74,563	81,204	88,282	96,107	104,434	113,132	122,194	131,915
Augmented debt (percent of GDP) 9/	48.1	52.3	56.6	62.0	67.5	72.4	77.1	81.3	85.0	88.5	91.6
Augmented net lending/borrowing (percent of GDP) 9/	-7.6	-7.2	-8.4	-10.4	-10.8	-10.7	-10.9	-10.8	-10.7	-10.4	-10.3
Sources: Bloomberg, CEIC, IMF International Financial Statistics database, and IMF staff estimates and projections.											
1/ IMF staff estimates for 2016 and 2017.											
2/ Surveyed unemployment rate.											
3/ Not adjusted for local government debt swap.											
4/ Average selling prices estimated by IMF staff based on housing price data (Commodity Building Residential Price) of 70 large and mid-sized cities published by National Bureau of Statistics (NBS).											
5/ Latest observation is for Q3 2017.											
6/ Adjustments are made to the authorities' fiscal budgetary balances to reflect consolidated general budgetary government balance, including government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.											
7/ Official government debt. Estimates of debt levels before 2015 include central government debt and explicit local government debt (identified by MoF and NPC in Sep 2015). The large increase in general government debt in 2014 reflects the authorities' recognition of the off-budget local government debt borrowed previously. The estimation of debt levels after 2015 assumes zero off-budget borrowing from 2015 to 2021.											
8/ Expenditure side nominal GDP.											
9/ Augmented fiscal data expand the perimeter of government to include local government financing vehicles and other off-budget activity.											

Sources: Bloomberg, CEIC, IMF International Financial Statistics database, and IMF staff estimates and projections.

1/ IMF staff estimates for 2016 and 2017.

2/ Surveyed unemployment rate.

3/ Not adjusted for local government debt swap.

4/ Average selling prices estimated by IMF staff based on housing price data (Commodity Building Residential Price) of 70 large and mid-sized cities published by National Bureau of Statistics (NBS).

5/ Latest observation is for Q3 2017.

6/ Adjustments are made to the authorities' fiscal budgetary balances to reflect consolidated general budgetary government balance, including government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.

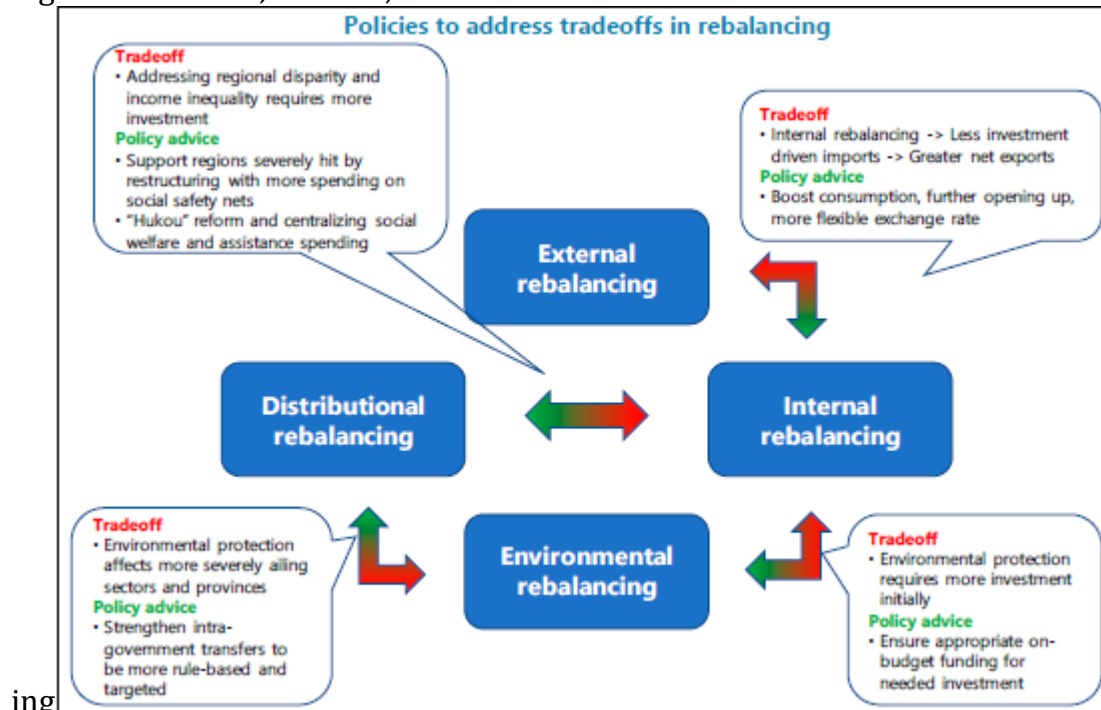
7/ Official government debt. Estimates of debt levels before 2015 include central government debt and explicit local government debt (identified by MoF and NPC in Sep 2015). The large increase in general government debt in 2014 reflects the authorities' recognition of the off-budget local government debt borrowed previously. The estimation of debt levels after 2015 assumes zero off-budget borrowing from 2015 to 2021.

8/ Expenditure side nominal GDP.

9/ Augmented fiscal data expand the perimeter of government to include local government financing vehicles and other off-budget activity.

Source: People's Republic of China : 2018 Article IV Consultation-Press Release; Staff Report; Staff Statement and Statement by the Executive Director for the People's Republic of China, International Monetary Fund. Asia and Pacific Dept Publication Date: July 26, 2018, pp.3.

Figure 1. External, Internal, Environmental and Distributional Rebalanc-



ing

Source: People's Republic of China : 2018 Article IV Consultation-Press Release; Staff Report; Staff Statement and Statement by the Executive Director for the People's Republic of China, International Monetary Fund. Asia and Pacific Dept Publication Date: July 26, 2018, p.18.

## End Notes

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<sup>1</sup> Helmut Schmidt, *Vertiefungen* (Deepening) (Berlin: SiedlerVerlag, 2010), 303–305; Bahri Yilmaz, “Why has China Succeeded?” IPC Working Paper (Istanbul: Istanbul Policy Center, June 2018), 19.

<sup>2</sup> Joseph Stiglitz, “The Chinese Century,” *Global Thought*, January 2015, <https://cgt.columbia.edu/news/stiglitz-chinese-century>.

<sup>3</sup> “People’s Republic of China: 2018 Article IV Consultation Press Release; Staff Report; Staff Statement and Statement by The Executive Director for The People’s Republic of China,” IMF Country Report No. 18/240 (Washington, DC: IMF, July 2018), <https://www.imf.org/en/Publications/CR/Issues/2018/07/25/Peoples-Republic-of-China-2018-Article-IV-Consultation-Press-Release-Staff-Report-Staff-46121>, 4.

<sup>4</sup> See more detailed analysis on Chinese development Strategy, Bahri Yilmaz, “Why has China Succeeded?” IPC Working Paper (Istanbul: Istanbul Policy Center, June 2018).

<sup>5</sup> *Ibid.*, 4.

<sup>6</sup> *Ibid.*; World Bank, *China 2030: Building a Modern, Harmonious, and Creative Society* (Washington, DC: World Bank, 2013), 3; 4–11. <http://documents.worldbank.org/curated/en/781101468239669951/China-2030-building-a-modern-harmonious-and-creative-society>.

<sup>7</sup> For a more in-depth study, see: Anna Saarela, “A new era in EU-China relations: More wide-ranging strategic cooperation?” European Parliament, Policy Department for External Relations, [http://www.europarl.europa.eu/RegData/etudes/STUD/2018/570493/EXPO\\_STU\(2018\)570493\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2018/570493/EXPO_STU(2018)570493_EN.pdf).

<sup>8</sup> Seung-Youn Oh, “China’s Reform and Opening: 40 Years and Counting,” *The Diplomat*, June 1, 2018, <https://thediplomat.com/2018/06/chinas-reform-and-opening-40-years-and-counting>.

<sup>9</sup> Purchasing power parity (PPP) is an economic theory that compares different countries’ currencies through a “basket of goods” approach. According to this concept, two currencies are in equilibrium or at par when a basket of goods (taking into account the exchange rate) is priced the same in both countries. See <https://www.investopedia.com/updates/purchasing-power-parity-ppp/>.

<sup>10</sup> The World Bank, “GDP (current USD),” accessed April 1, 2019, <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD>.

<sup>11</sup> *Ibid.*

<sup>12</sup> *Ibid.*

<sup>13</sup> Figure 1: China’s Economic Development between 2010 and 2040; Source: International Monetary Fund: Asia and Pacific Dept, “People’s Republic of China: 2018 Article IV Consultation-Press Release; Staff Report; Staff Statement and Statement by the Executive Director for the People’s Republic of China,” Country Report No. 18/240, July 26, 2018, accessed January 29, 2019, <https://www.imf.org/en/Publications/CR/Issues/2018/07/25/Peoples-Republic-of-China-2018-Article-IV-Consultation-Press-Release-Staff-Report-Staff-46121>, 1, pp. 4.

<sup>14</sup> Figure 2: The Development of Per Capita Income and Poverty; *ibid.*, pp. 4.

<sup>15</sup> World Bank, “GDP (current US\$).”

<sup>16</sup> Martin Wolf, “Consumption to replace investment as key to China growth,” *Financial Times*, May 29, 2018, accessed April 1, 2019, <https://www.ft.com/content/627ab75c-4256-11e8-97ce-ea0c2bf34a0b>.

<sup>17</sup> Over the past decade, the ten largest industrial industries in China have not changed (i.e., metals production; electrical and electronic production; food and beverage production;

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chemical and pharmaceutical production; automotive production; textile production; aggregates production; semiconductors and electronics components; equipment and goods production; rubber and plastics production). See <https://www.interactanalysis.com/chinas-manufacturing-industry-in-2018/>.

<sup>18</sup> The World Bank, "Manufacturing, value added (% of GDP)," accessed April 1, 2019, <https://data.worldbank.org/indicator/NV.IND.MANFZS>.

<sup>19</sup> INS Consulting, "Analysis of Trends in the Chinese Manufacturing Industry in 2017, Global Expansion Simplified," accessed April 1, 2019, <https://ins-globakconsulting.com/analysis-of-trends-in-the-chinese-manufacturing-industry-in-2017/>.

<sup>20</sup> World Trade Organization, "World Trade Statistical Review 2018," accessed April 1, 2019, [https://www.wto.org/english/res\\_e/statis\\_e/wts2018\\_e/wts2018\\_e.pdf](https://www.wto.org/english/res_e/statis_e/wts2018_e/wts2018_e.pdf), 125.

<sup>21</sup> "Economic and Trade Information on China," HKTD, November 14, 2018, accessed April 1, 2019, <https://beltandroad.hktdc.com/index.php/en/country-profiles/china>.

<sup>22</sup> China is followed by India's 391 million, the EU's 413 million, and the United States' 246 million internet users. See IMF, "China's Economic Outlook in Six Charts," July 26, 2018, accessed April 1, 2019, <https://www.imf.org/en/News/Articles/2018/07/25/na072618-chinas-economic-outlook-in-six-charts>.

<sup>23</sup> According to the MERICS Indicators, the consumption expenditure growth (5.2%) made up the largest share of economic growth; investments remained stable (2.1%). However, a decline in net exports (-0.66%) led to a slight reduction of overall growth. The deteriorating trade balance is seemingly not affected by the trade war between the United States and China, as China's trade surplus with the United States hit a new record high in 2018. Mercator Institute for China Studies, "MERICS Economic Indicators Q3/2018," October 24, 2018, accessed April 1, 2019, <https://www.merics.org/en/merics-trackers/economic-indicators-q3-2018>.

<sup>24</sup> Source: International Monetary Fund: Asia and Pacific Dept, "People's Republic of China: 2018 Article IV Consultation-Press Release; Staff Report; Staff Statement and Statement by the Executive Director for the People's Republic of China," Country Report No. 18/240, July 26, 2018, accessed January 29, 2019, <https://www.imf.org/en/Publications/CR/Issues/2018/07/25/Peoples-Republic-of-China-2018-Article-IV-Consultation-Press-Release-Staff-Report-Staff-46121>, 34.

<sup>25</sup> Wan-hsin Liu and Rolf J. Langhammer, "China's Growth Challenges," Kiel Policy Brief No: 101, September 2016, 4.

<sup>26</sup> Joseph E. Stiglitz, "Reflections on China's 13th Five Year Plan," <https://www8.gsb.columbia.edu/faculty/jstiglitz/sites/jstiglitz/files/Reflections%20on%20China%E2%80%99s%2013th%20Five%20Year%20Plan.pdf>, 9; J. E. Stiglitz and B. Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress* (New York: Columbia University Press, May 2014).

<sup>27</sup> IMF, People's Republic Of China Staff Report for the 2018 Article IV Consultation, June 28, 2018, 4.

<sup>28</sup> MERICS, "China's Industrial Modernisation: A Challenge to Advanced Economies," [www.merics.org/sites/default/files/2018-/MPOC\\_No.2\\_MadeinChina2025\\_web.pdf](http://www.merics.org/sites/default/files/2018-/MPOC_No.2_MadeinChina2025_web.pdf), 6; Recently, *The Economist* described the policy as "China's designs on Europe," which drew the attention of European policy and economic institutions. See *The Economist*, October 6, 2018, 11; 17–19.

<sup>29</sup> Kunwang Li and Wei Jiang, "China's foreign trade: Reform, performance and contribution to economic growth," in *China's 40 Years of Reform and Development: 1978–2018*, edited by Ross Garnaut, Ligang Song, and Cai Fang, 575–593 (Acton: Australian National University Press, 2018), available at <http://press-files.anu.edu.au/downloads/press/n4267/pdf/book.pdf?referer=4267>, 583.

<sup>30</sup> According to a statement released in early 2018 by the Chinese Ministry of Commerce, 35,652 foreign-funded companies were set up in China in 2017, up 27.8% from 2016. FDI

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in the 11 free trade zones hit almost USD 16 billion in 2017, up 18.1% year on year, much higher than the national average. In contrast, the MOC's data showed non-financial out-bound direct investment (ODI) declined in 2017 amid government curbs on investment overseas. FDI stocks were up 10% between 2016 and 2017 and reached USD 1,491 billion. See, "China: Foreign Investment," <https://en.portalsantandertrade.com/establish-overseas/china/foreign-investment>.

<sup>31</sup> In 2017, Hong Kong is the largest investor in China. Singapore, Taiwan, South Korea, Japan, the United States, the Netherlands, Germany, the United Kingdom and Denmark are other major investors. Investments were mainly oriented towards business services, manufacturing, trade, new technologies, real estate, and financial intermediation. Ibid.

<sup>32</sup> According to the research results, firms with foreign capital participation or those with good access to domestic bank loans innovate more than others. Inward FDI at the sectoral level is positively associated with domestic innovative activity only if firms engage in own R&D activities and absorptive capacities. See Sourafel Girma, Yundan Gong, and Holger Görg, "FDI, access to finance and innovation activity in Chinese enterprises," Kiel Working Papers, No: 1400/2008, 19-20; Furthermore, Stiglitz argues that even in the United States, the most important innovations have come from government-funded research, not from the private sector—from the advances that led to the computer to the internet. See Stiglitz, Reflections on China's 13th Five Year Plan p.9 and "Foreign direct investment (FDI) in China", <https://www.nordeatrade.com/dk/explore-new-market/china/investment>

<sup>33</sup> The EU-China 2020 Strategic Agenda for Cooperation puts an EU-China Investment Agreement as central to the EU's long-term bilateral relations with China. Negotiations for the Investment Agreement began in 2013. The negotiations aim to improve investment for European and Chinese investors by creating investment rights and guaranteeing non-discrimination. Improving transparency, licensing, and authorization procedures providing investments rules on environmental and labour-related aspects of foreign investment. See European Commission, "Countries and Regions: China," last updated April 16, 2018, <http://ec.europa.eu/trade/policy/countries-and-regions/countries/china/>; "Chinese investment in Europe," *The Economist*.

<sup>34</sup> Rolf J. Langhammer and Wan-Hsin Liu, "China between External Pressure and Domestic Policy Reforms," Kiel Policy Brief, Institut für Weltwirtschaft, No:117, August 2018, 4-5, <https://www.ifw-kiel.de/de/publikationen/kiel-policy-briefs/2018/china-between-external-pressure-and-domestic-policy-reforms-in-search-of-a-balance-11523/>.

<sup>35</sup> "China spent \$279b on research in 2017," *The Sun*, February 27, 2018, accessed April 2, 2019, <https://www.sunnewsonline.com/china-spent-279b-on-research-in-2017-minister/>.

<sup>36</sup> "China spent an estimated \$279 billion on R&D last year," CNBC, February 28, 2018, accessed April 2, 2019, <https://www.cnbc.com/2018/02/26/china-spent-an-estimated-279-billion-on-rd-last-year.html>. China has established dozens of new high-tech industrial parks and incubators aimed at promoting technologies such as artificial intelligence, robotics, and big data. The country is also investing heavily to dominate industries such as nuclear and renewable energy, high-speed trains, and electric vehicles.

<sup>37</sup> Ministry of Education of the People's Republic of China, "China striding ahead to become global force in higher education-- Overview of China's progress in reforming and developing higher education since the 18th CPC National Congress," June 9, 2018, accessed April 2, 2019, [http://en.moe.gov.cn/Specials/Specials\\_Conference/conference\\_Achievements/201810/t20181009\\_350929.html](http://en.moe.gov.cn/Specials/Specials_Conference/conference_Achievements/201810/t20181009_350929.html).

<sup>38</sup> Ibid.

<sup>39</sup> Ministry of Education of the People's Republic of China, "2017 sees increase in number of Chinese students studying abroad and returning after overseas studies," April 4, 2018, accessed April 2, 2019, [http://en.moe.gov.cn/News/Top\\_News/201804/t20180404\\_332354.html](http://en.moe.gov.cn/News/Top_News/201804/t20180404_332354.html).

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<sup>40</sup> Youyou Zhou, "Chinese students increasingly return home after studying abroad," July 29, 2018, <https://qz.com/1342525/chinese-students-increasingly-return-home-after-studying-abroad/>.

<sup>41</sup> The China-U.S. Trade War and Future Economic Relations, By Lawrence J. Lau, The Chinese University Press, Dec 14, 2018 - Political Science, p.134.

<sup>42</sup> Joseph E. Stiglitz, "Reflections on China's 13th Five Year Plan," paper prepared for the China Development Forum, Beijing, March 2016.

<sup>43</sup> IMF, "People's Republic Of China Staff Report for the 2018 Article IV Consultation," June 28, 2018, Country Report No. 18/240, 4.

<sup>44</sup> The International Monetary Fund underlined that the government should put policies into force as follows: "... staff sees tensions in the authorities' strategy between, on the one hand, the stated goals of stabilizing leverage, allowing market forces a decisive role, and greater innovation and opening-up, and, on the other, still-unsustainable debt growth, the pervasive role of the state in the economy, and the relatively restrictive trade and investment regime in some areas. To achieve the desired higher-quality development will require addressing these policy tensions by building on the existing reform agenda and taking advantage of the current growth momentum to "fix the roof while the sun is shining." IMF, "People's Republic Of China Staff Report for the 2018 Article IV Consultation," June 28, 2018, Country Report No. 18/240, 1.

<sup>45</sup> European Commission, "Countries and regions: China."

<sup>46</sup> "How China's Economic Aggression Threatens the Technologies and Intellectual Property of the United States and the World," White House Office of Trade and Manufacturing Policy, June 18, 2018, <https://www.whitehouse.gov/wp-content/uploads/2018/06/FINAL-China-Technology-Report-6.18.18-PDF.pdf>.

<sup>47</sup> The complaints can be summed up as follows: "the alleged violation of private intellectual property rights, the forced technology transfer from foreign to Chinese enterprises through its joint venture requirements, massive subsidies suspecting the legitimacy of anti-dumping procedures, unfair import tariffs and complaint of manipulation of keeping national currency Renminbi against US\$ undervalued." See Langhammer and Liu, "China between external pressure," 4,

<sup>48</sup> "Partner and System Competitor—How Do We Deal with China's State-Controlled Economy?" in "The restriction of competition to the detriment of non-Chinese companies through market closure and unequal treatment," BDI Policy Paper, January 2019, 3.

<sup>49</sup> By July 1, 2018, China started to reduce import tariffs on a Most-Favoured Nation base (MFN) against all trading partners. For almost 1,500 items, mostly consumer goods, tariffs were cut by almost 60%, from an average level of 15.5% to 6.9%. Even if today Chinese tariffs are still significantly higher than those in the EU, Japan, and the United States, Chinese tariff policy must be reshaped and adjusted to the trade war between partner countries. See Langhammer and Liu, "China between external pressure," 9–10.

<sup>50</sup> The IMF has recommended that China, as one of the main beneficiaries of the global trading system, has a strategic interest in playing a leading role in defending it. Doing so also means accelerating China's opening, maintaining progress in reducing the current account surplus, and continuing to seek to resolve trade disputes through established mechanisms (e.g., WTO dispute settlement) or negotiation.

<sup>51</sup> Sonali Jain-Chandra, Niny Khor, Rui Mano, Johanna Schauer, Philippe Wingender, and Juzhong Zhuang, "Inequality in China – Trends, Drivers and Policy Remedies," IMF Working Paper WP/18/127, July 2018.

According to the research results: "(i) China has moved from being a moderately unequal country in 1990 to being one of the most unequal countries. (ii) The official estimate by the National Bureau of Statistics (NBS) assessed it slightly lower at 47.3 Gini points. (iii) Despite the large increase in income inequality, much of China's population has experienced rising real incomes. (iv) Differences in education and the skill premium are significant



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drivers of the increase and the subsequent modest decline in income inequality. (v) The rural-urban gap explains a large share of inequality and its trends, but the contribution of regional disparities has been declining. The researcher found out that those structural factors have played a major role in China's rising inequality, and will keep inequality elevated in the foreseeable future, absent policy changes. Fiscal policy can be a powerful tool and a more pro-active scenario has the potential to quell the rise in inequality."

<sup>52</sup> International Monetary Fund: Asia and Pacific Dept, "People's Republic of China: 2018 Article IV Consultation-Press Release; Staff Report; Staff Statement and Statement by the Executive Director for the People's Republic of China," Country Report No. 18/240, July 26, 2018, accessed January 29, 2019,

<https://www.imf.org/en/Publications/CR/Issues/2018/07/25/Peoples-Republic-of-China-2018-Article-IV-Consultation-Press-Release-Staff-Report-Staff-46121>, 17, 35.

<sup>53</sup> Ibid, 10.

<sup>54</sup> "...Strong Chinese output growth after the Global Financial Crisis was supported by booming credit. This credit boom carries risks. International experience suggests that China's credit growth is on a dangerous trajectory, with increasing risks of a disruptive adjustment and/or a marked growth slowdown. Several China-specific factors—high savings, current account surplus, small external debt, and various policy buffers—can help mitigate near-term risks of a disruptive adjustment and buy time to address risks. But, if the risks are left unaddressed, these mitigating factors will likely not eliminate the eventual adjustment, but make the boom larger and last longer. Hence, decisive policy action is needed to deflate the credit boom safely...." See Sally Chen, JoongShik Kang, "Credit Booms—Is China Different?", IMF Working Paper, January 5, 2018, <https://www.imf.org/en/Publications/WP/Issues/2018/01/05/Credit-Booms-Is-China-Different-45537>.

<sup>55</sup> Ibid, 55; Saarela, "Key economic and social indicators."

<sup>56</sup> Complete Manufacturing and Distribution, "Understanding the 2018 China Manufacturing Landscape, Corruption," accessed April 2, 2019, <https://www.completemad.com/china-manufacturing-landscape>. The anti-graft campaign may also have negative effects. Public servants do not dare to initiate any administrative measures on their own out of fear to be punished. Therefore, reform and improvements on the ground are stalling.

<sup>57</sup> Yilmaz, "Why has China Succeeded?" 4.

<sup>58</sup> "EU-China relations are increasingly affected by growing Sino-United States strategic competition. The Trump Administration considers China a strategic competitor to confront, rather than a country with which to engage. The EU, on the contrary, refers to China as a strategic partner and, despite persistent and considerable differences in position in some areas, continues to engage. The United States' current preferences for bi and unilateralism, and withdrawal from multilateral arrangements, which the EU considers vital elements of a rules-based international order, create openings for China to fill the gap. For the EU, this implies the need to seek issue-based alliances and to strengthen strategic cooperation with China on issues of common interest to reach and uphold multilateral solutions to global and regional challenges." See European Parliament, "Briefing - State of play of EU-China relations," January, 21, 2019,

[http://www.europarleuropa.eu/RegData/etudes/BRIE/2019/633149/EPRS\\_BRI\(2019\)633149\\_EN.pdf](http://www.europarleuropa.eu/RegData/etudes/BRIE/2019/633149/EPRS_BRI(2019)633149_EN.pdf).

<sup>59</sup> The President of the Federation of German Industries (BDI), Dieter Kempf, has called on the German Federal Government and the European Commission to strengthen the European Union (EU) in the face of competition with China. The BDI has outlined 54 demands addressed to Berlin and Brussels for the New Year in order to better meet the growing challenges posed by the state-dominated Chinese economy.

<sup>60</sup> "Partner and Systemic Competitor," BDI, 6.