

# ECONOMICS

## Yr12 Economics Assignment – China's Economy

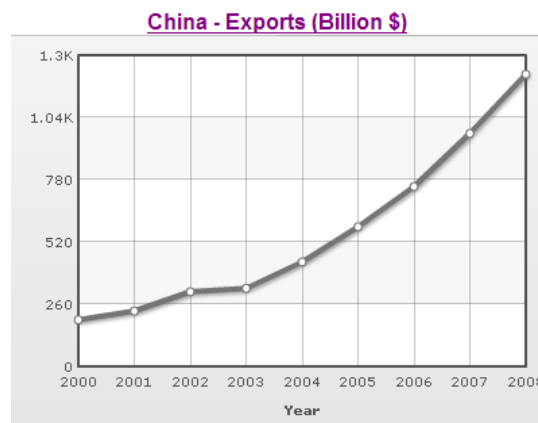
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The Chinese economy is now the 2nd largest economy in the world (2007), with a GDP of over US\$6.9Trillion and averaging over 8% growth in GDP per annum. It was once a planned economy, with 80% of enterprises being state owned, working on principles of socialism under a communist government. Since 1978, the Chinese economy has been transformed into a market economy, based on the westernised model, with state ownership of enterprises falling to about 25%. The private sector grew significantly and the market now determines over 95% of prices. The national Government has a much smaller role as the country integrates itself into the world economy and reaps the benefits of globalisation.

In China, globalisation has been a major source of economic growth and development, significantly transforming the economy. Globalisation is the growing integration and interdependence of nations in the world, increasing links of trade, investment, finance, labour and technology.

### Effects of Globalisation

Reduced protection, as a result of globalisation, has made trade between China and the rest of the world much easier and much more common. It has enabled China, and other nations, to specialise and enjoy economies of scale. Trading barriers and restrictions have been removed, including tariffs, increasing market access and rapidly increasing China's levels of trade (see figure 1).



<http://www.indexmundi.com/g/g.aspx?v=85&c=ch&l=en>

In the past 25 years, China's levels of foreign trade have increased faster than its GDP. In 2006, China's trade exceeded US\$1.76 trillion, making it the third largest trading nation after the USA and Germany. Commodities such as energy, oil, steel and aluminium are among some of the most commonly traded goods of China, making it an important and powerful nation in the global economy. This has increased economic growth resulting from increased consumer demand, increased incomes and a greater standard of living.

Increased foreign direct investment and foreign portfolio investment between China and the rest of the world has dramatically increased since globalisation, increasing to over US\$13 Billion since 1999, allowing greater economic growth rates and higher standards of living. Foreign portfolio investment has increased through the development of stock markets. During the 1990's, China allowed foreign investors to purchase "B" shares in the stock exchange. These were special share issues for overseas investors.

Also since the 1990's, foreign direct investment increased when the Chinese Government allowed overseas investors to manufacture and sell goods and services on the Chinese domestic market. Foreign investment is now a strong element in China's rapid growth and economic expansion, with the government offering incentives to attract more foreign capital for investment.

As a result of increased links with overseas nations, China's influence from the global business cycle has also increased. China can affect and is affected by the global business cycle in the now very interdependent global market.

An example of this global interdependence and influence from other nations is the "Asian Financial Crisis" around 1997. Thailand's economy was failing due to large foreign debts and a collapse in their currency. This created uncertainty in the region and soon the crisis spread with many nations in the region experiencing collapses in their currency, stock markets and asset values. While China was not originally the nation in trouble, the interdependence and increased links with overseas nations meant it too was affected.

International treaties and agreements formally showed the links between nations as a result of globalisation.

China signed numerous bilateral and unilateral agreements with its neighbours and other major global nations to promote international cooperation and healthy relationships. For example, in 2001, China became a member of the World Trade Organisation (WTO), which promotes international trade cooperation in the global economy.

### **Strategies to Promote Economic Growth and Development**

Strategies are implemented by the Chinese Government to promote further economic growth, measured as an increase in real GDP, and further economic development which involves improvements in quality of life and higher growth rates in the future.

Every five years, the Chinese Government develops a "5 year plan" that establishes a range of economic objectives for China. These plans are used as the main strategy for promoting growth and development with the latest one being developed in 2005 for the period 2006-2010. In the latest plan for example, an increase in GDP of 7.5% annually for 5 years was one objective, with an increase in GDP per capita of 6.6% annually being another. The plans cover a range of economic issues, including economic growth, economic structure, population, resources and the environment, public service and people's lives.

The primary objective of the current 5 year plan is rural and agricultural development, aiming to balance disparities in social and economic development between rural and urban areas. Two specific objectives in this category are to increase the coverage of the rural medical care system from 23.5% in 2005 to over 80% in 2010 and to increase per capita disposable income of urban and rural residents by 5% annually for 5 years. To achieve this there has been, and will continue to be, funding on modern production, and construction of infrastructure. Almost 700 medium to large industrial projects are being concentrated on to help achieve industrialisation. Agricultural cooperatives will also be developed to aid in the transformation of the agricultural industry, towards other sectors of the economy. The Government has already spent over US\$44.9 billion on development of rural areas and transformation of agricultural industries.

Income disparities between rural and urban areas are another related issue. In some areas, GDP per capita is as low as 1744 Yuan while in other areas it is approximately 3203 Yuan. The average is about 2476 Yuan.

A social security system is another strategy used to try and redress this issue. Increased social security payments and a re-evaluation of the taxation system will be used to make the distribution more equal across China. The Government aims to increase the coverage of the basic old-age

pension from 147million people in 2005 to 223 million people in 2010.

If this income was redistributed evenly, spending would most likely increase, stimulating the economy and leading to increased economic growth and then increased levels of economic development. Spending will also be increased on education and training programs to build skill levels, research and development over a range of areas and industries and on improving sanitation to raise living standards. Along with increased spending; tax incentives, marketing campaigns (especially in the case of environmental issues) and training programs may be used as strategies to further promote economic growth and development and balance out disparities between rural and urban areas. “Pump Priming” is a popular strategy used by the Chinese Government to promote economic growth and development. “Pump priming” of the economy involves government spending in commercial enterprises to stimulate the economy. It may also include tax cuts or reduction in interest rates that increases the flow of money in the economy. While this does effectively stimulate economic growth and can lead to increased economic development, it has also led to a build up of public debt and interest liabilities.

Developing a system of free trade is another strategy used to promote economic growth and development in China. A system of free trade is where there are little or no restrictions on trade across the globe; it makes trade easier, cheaper and more convenient for most nations. China aimed to maximise exports and remove some of its trade regulations, hoping other nations will follow the trend.

To aid in this process, China became a member of the WTO (World Trade Organisation) in 2001 and joined APEC earlier in 1991. This opened up the Chinese market to other markets and enabled a diversification of the export base, attraction of more foreign investment and more domestic innovation and use of technologies in order to remain competitive. This strategy stimulates economic growth in that production increases to cope with extra foreign demand, there is increased flow of capital from exports, employment in some industries will rise and transnationals may move their production to the area, bringing new technologies with them. All these will raise GDP and also lead to a rise in standards of living, increasing both economic growth and development.

Environmental protection strategies used in China include pollution targets and environmental policies. Strategies such as reducing the release of major pollutants by 10% in a 5 year period, and reducing energy consumption per unit of GDP by 20% in 5 years aim to increase economic development. Pollution targets have been set and a policy has been introduced to move away from fire-powered energy generation and instead use hydroelectricity and/or nuclear power. The establishment of tradeable emission permits is another part of the environmental strategy. The tradeable emission permits act as an incentive for firms to reduce their omissions and then trade in their permits to make a profit. The reduction in pollution leads to a healthier environment and therefore a greater standard of living for the Chinese population.

#### Success of Strategies

The Government strategies used in China to promote economic growth and development have had varying levels of success. Some have been more successful than others, and some are still progressing towards achieving their objectives and still face some challenges.

The strategies used to increase free trade have been very successful. They included a deregulation of the global market with fewer tariffs and other trading restrictions.

In 1996 the average tariff level in China was approx. 32%, while in 2007 the average import tariff was approx. 9.9%. This reduction in tariffs resulted from China’s involvement in the WTO, an organisation responsible for promoting increased free and fair trade globally. Lower tariffs greatly increased the levels of foreign trade with trade levels growing faster than GDP in the last 25 years. China became the third largest trading nation in the world and the increased levels of free trade encouraged more domestic efficiency to remain competitive. The success of these strategies improved not only economic growth but also economic development. As a result though, the gap

between incomes and standards of living in coastal and inland regions has widened. The incentives to promote foreign trade and foreign investment have created GDP per capita inequalities between the two regions. In 2002, GDP per capita in the North-West was only about  $\frac{1}{2}$  of what it was in the East and North-East.

“Pump Priming” the economy is also effective as an economic strategy. By having the government increase spending in the commercial sector, multiplier theory effects begin and the economy is stimulated. Business profits increase, real incomes increase, consumer spending and demand increases and employment rises. This leads to higher levels of economic growth, measured by annual GDP. Negatively, the temporary stimulation of the economy creates high levels of public debt and interest liabilities. While economic conditions were favourable, consumer spending and borrowing increases, resulting in these problems when the economic boom started to level out again. This problem needs to be monitored and balanced in order to achieve successful economic growth and development.

A “Millennium Development Goals” plan was developed as a strategy to reduce the poverty levels in 1990 by half by the year 2015. This goal was reached in 2001, 15 years ahead of schedule when the number of people living in extreme poverty was reduced by approx. 400 million people. The social security system, another part of the strategy used to increase human development, is not yet functioning as well as it could.

While it has helped some of the population to escape poverty, there is still insufficient funding and coverage of beneficiaries of the system.

As the global economy continually changes, China will need to continue developing new strategies to promote economic growth and development, and reap further benefits of globalisation and a more integrated global market. The current uncertainty of the global economy, with the current credit crisis spreading internationally, highlights a danger of globalisation. With nations linked in so many ways, it is hard to escape the effects of a crisis that began in the US.

China’s economic situation may change considerably as a result of the current global credit crisis and the Government will need to constantly monitor and evaluate levels of economic growth and development to remain a powerful economy in the global market. There are many benefits of globalisation but some argue that it leads to a loss of cultures and traditions, and a loss of national independence. Governments need to find ways to balance out the effects of increased global integration to achieve the most suitable outcome for their nation.

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