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## **China in Transition: Performance and Prospect**

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**Abstract:** China's transition produces both positive and negative social and economic results. Changes of the growth pattern, institutions, and development strategy will drive China's future transition and development.

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**Keywords:** China, transition, performance

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# China in Transition: Performance and Prospect

Yuan Yuan Xing<sup>1</sup>

## I. Introduction

China's transition embraces comprehensive concerns such as its economic system, governance mechanisms, legal system, and cultural factors. The transition not only radically changes China's social stratification, wealth distribution, economic behavior, life styles, and values, it also changes China's position in the world community. Moreover, China's transition has significant impacts on world political and economic patterns and creates both opportunities and challenges to neighboring economies in East Asia, the EU, and the U.S. etc. There are many reasons why China's transition and growth has generated mixed sentiment in the rest of the world.

I present here a qualitative and quantitative evaluation of China's transition and comment on China's future prospects.

## II. Performance in China's Transition: Positive and Negative Effects

China's transition since 1978 follows a unique paradigm. Compared to the Big Bang transition model of the Former Soviet Union, it is a gradual process, led by an established government and centered on economic reform within its established political regimes. In the process of transition, China progressively elaborated its strategy of transforming from a command economy to a market economy. Starting from liberalizing production capacity in the countryside (known as the Household Responsibility System) and then in cities, China aimed at utilizing its national economic strengths to improve standards of living. China adopted a pragmatic transition model which has produced many remarkable achievements and accumulated many conundrums.

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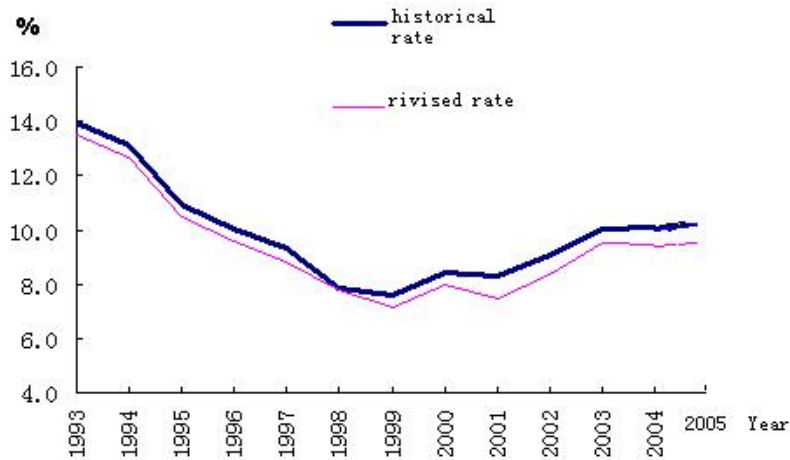
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To better understand the many achievements and difficulties of China's transition we should focus on three features related to growth; economic structures, the market system, and integration into the world economy.

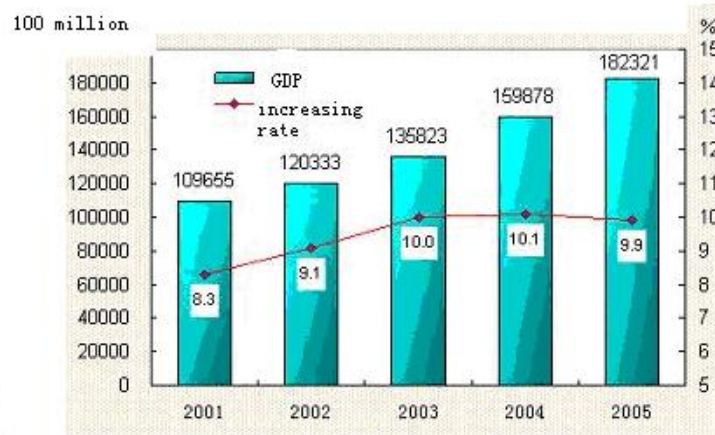
A. Economic growth and economic structure change

China's economy has experienced over two and a half decades of robust growth, at an average rate of 9.6% for 1979-2005 period. Even during 1997's Southeast Asian financial crisis and the more recent world economic slow down, China's economy

**Figure 1 Growth Rate of Chinese GDP: 1993 -2005**



(a)



(b)

Source: China Statistic Yearbook 2006

continued to grow, serving as an engine of regional and world economic resurgence. As a result, China's GDP in 2005 reached US\$2.3 trillion, making it the world's 4th largest economy after the U.S., Japan, and Germany. In 2005 China sold more than 6 million automobiles and had 1.1 billion citizens going on domestic tours, and 30 million taking overseas trips. These are indicators of a prosperous society. However, China's per capita GDP, now at US\$1700, is still around 100th in the world (Wong, 2006). China's economic take off is not an easy venture; its huge population making for a flight with heavily-burdened wings.

Modern economic growth in China has been mainly associated with changes in economic structure. From Table 1 & 2, we can see that the contribution of the primary sector decreased by 15 points from 1978 to 2005; that of the secondary sector held

**Table 1 Evolution of China's Sectoral Proportion (% of GDP)**

Year	Primary	Secondary	Tertiary	Manufacturing
1978	27.9	47.9	24.2	44.1
1985	28.2	42.9	28.9	38.3
1990	26.9	41.3	31.8	36.7
1996	19.5	47.5	33.0	41.4
1997	18.1	47.5	34.4	41.7
2000	14.8	45.9	39.3	40.3
2002	13.5	44.8	41.7	39.4
2004	13.1	46.2	40.7	40.8
2005	12.6	47.5	39.9	42.0

Source: China Statistical Yearbook 2006

**Table 2 Relative Contribution to China's GDP Increase (%)**

Year	Primary	Secondary	Tertiary	Manufacturing
1990	41.9	41.0	17.1	39.7
1996	9.5	62.9	26.7	58.5
2000	4.4	60.8	34.8	57.6
2002	4.5	49.8	45.7	44.4
2004	7.7	52.2	40.1	47.7
2005	6.3	54.7	39.0	47.9

Source: China Statistical Yearbook 2006

fairly constant; and that of the tertiary sector increased by 15 points. The share of the primary sector in GDP growth fell by 35 points from 1990 to 2005; that of secondary industry sector increased by 13 points; and that of tertiary industry sector increased by 22 points (Chen 2005). All of this means that the changes in industrial structure in China have been faster than its relative industrialization level, that is, the proportion of the tertiary sector increased fastest while that of the secondary sector was almost unchanged. The share of the secondary sector to GDP is the largest (over 50%), which means that manufacturing is still the dominant factor in the economic growth of

China. The growth rate of the share of the tertiary sector is the highest, which means that it has been playing a more important role in economic growth. However, compared with other countries, an important characteristic of China's current economic structure is that the contribution of the secondary sector is higher than that of tertiary sector. The contribution of the secondary sector in China is higher than in India and other low- wage countries. This suggests that China remains in the middle stage of industrialization with the secondary sector, manufacturing in particular, dominating economic growth. Even with the rapid development of the tertiary sector, China still has a long way to go compared to many countries.

**Table 3 International Comparison of Economic Structure**

Country	Proportion in GDP 2003 (%)			
	Primary	Secondary	Tertiary	Manufacturing
China	15	52	32	42
U. S	1	22	77	14
Great Britain	1	31	68	14
Japan	1	26	73	21
Korea	3	46	51	23
Brazil	9	40	51	22
India	22	27	51	16
Indonesia	17	43	40	25
Malaysia	10	44	46	31
Russia	5	41	54	25

Source: 2005 UNCTAD Handbook of Statistics

#### B. Is transition to a market economy irreversible?

After more than two decades of transition and dynamic growth, the Chinese economy has been extensively “marketized”, even though the system is still not quite a well functioning market system. Market forces do play a fundamental role in resource allocation. Government’s direct administrative intervention and the scope of mandatory planning in the Chinese economy have been dramatically reduced<sup>2</sup>. Generally speaking, both State enterprises and non-state enterprises now have autonomy to decide the “what”, “how” and “to whom” problems in accordance with the market.

<sup>2</sup> For example, in manufacture sector, the number of products on which the state still sets mandatory plan targets was reduced from 120 in 1981 to 5 at present. Before 1978, almost all prices of commodities and services were set by the government, while at present, 97% of total retail commodities sales, 94% of total farm products sales and 91% of total capital goods sales are traded at market-determined prices (Yin, 2003).

**Table 4 China's Top 10 Sectors for SOEs: 2005**

Sector	Number	SOEs	Proportion	Total assets	Unit: billion Yuan, %	
					SOEs	Proportion
Total	853	535	62.7	13628	12824.6	94.1
Power and heat production	68	50	73.5	3101.7	2971.9	95.8
Telecommunication & Post	7	6	85.7	1655.3	1651.5	99.8
Petroleum and natural gas extraction	3	3	100.0	1398.5	1398.5	100.0
Ferrous metallurgy	90	45	50.0	1433.5	1235.7	86.2
Transport equipment manufacturing	92	50	54.3	1283.9	1184.7	92.3
Transportation	59	48	81.4	1207.6	1144.7	94.8
Retail trade	257	179	69.6	1026.0	849.4	82.8
Coal mining	66	60	90.9	838.7	829.0	98.8
Construction	189	88	46.6	901.0	8192	90.9
Petroleum processing ,coking & nuclear fuel processing	22	6	27.3	781.8	7400	94.7

Source: Huang 2006, Development Report of Non-State-owned Economy in China

Notable changes have been witnessed in business ownership structure. At the end of 2005, the 1446 SOE groups in China represented 50.8% of the total number of corporations, a reduction of 14.6% compared to 2004 (Ju, 2005). Chinese SOEs have exited competitive industries and mostly concentrate in non-competitive industries and naturally monopolistic industries, such as energy, telecommunications, transportation, and public utilities.

**Table 5 Non-SOEs Sectoral Distribution: 2000 & 2005**

2000		2005
42.8	Whole country	49.7
	agriculture	14.0
	Industry	17.8
	construction	4.8
	The third industry	13.1

Source: National Statistic Bureau.

With their rapid growth, Chinese Non-State Owned Enterprises (non-SOEs) have made a great contribution to China's economy. From 2000 to 2005, the proportion of value added by Non-SOEs to GDP as a whole increased from 42.8% to 49.7% and the proportion of Non-SOE investment increased from 41.9% to 60%. Chinese Non-SOEs are concentrated in competitive sectors, especially in raw material processing, textile, food, and retailing, which are labor intensive with lower capital and technology requirements. Non-SOEs are concentrated in East China.

**Table 6 Non-SOE above-designated-sized Sectoral Distribution:2004**

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Order	Sector	Quantity of Non-SOEs	% of total enterprise
1	Textile & chemical fiber	278	13.12
2	Ferrous & nonferrous metals	199	9.39
3	Retail trade	169	7.98
4	Electric machinery & equipment and wire manufactures	131	6.18
5	Raw chemicals & chemical products	126	5.95
6	Food and beverage	119	5.62
7	Construction	115	5.43
8	Equipment manufactures	113	5.33
9	Real estate trade	104	4.91
10	Metal products	100	4.72

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Source: Huang 2006, Development Report of Non-State-owned Economy in China

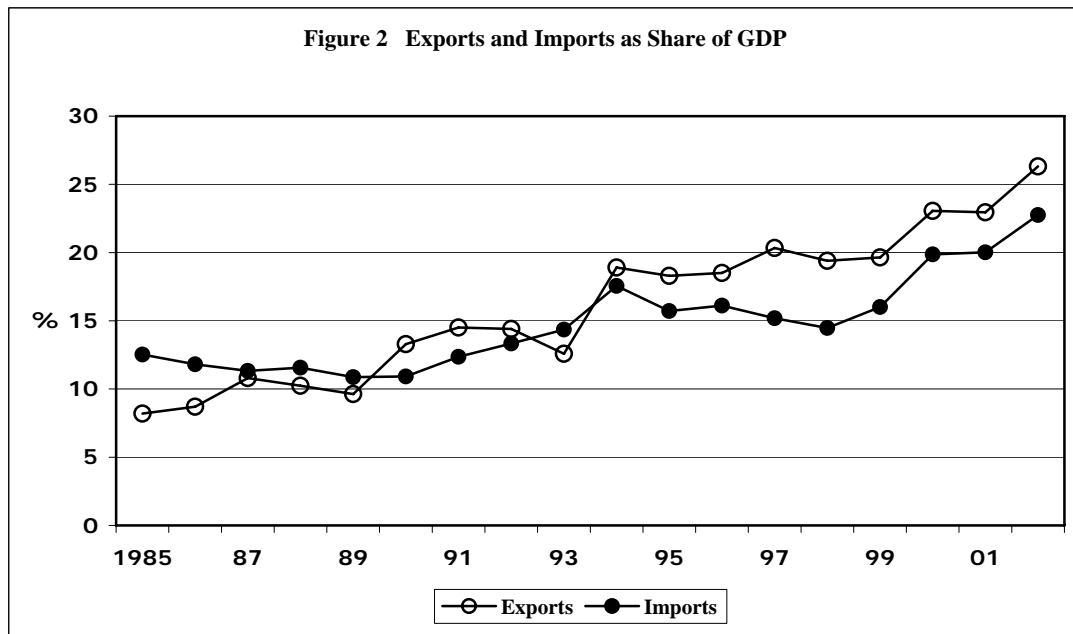
**Table 7 Provincial Distribution of Non-SOEs above-designated-sized (top 14):2004**

province	quantity	percentage	province	quantity	%
National	2119	100	Hubei	42	1.98
Zhejiang	666	31.43	Henan	38	1.79
Shanghai	495	23.36	Neimenggu	35	1.65
Jiangshu	167	7.88	Liaoning	35	1.65
Shandong	164	7.74	Hebei	29	1.37
Anhui	65	3.07	Jiangxi	29	1.37
Sichuan	57	7.69	Guangdong	29	1.37
Shanxi	52	2.43			

Source: Huang 2006, Development Report of Non-State-owned Economy in China

### C. Integrating with the world economy

In 2005, China became the world's 3rd largest exporter after the U.S and Germany. In recent years, China has also witnessed a stable increase in imports. China's trade liberalization was part of a wider strategy of achieving stability and efficient resource allocation over the past decade. The pursuit of a policy of industrialization took place with a gradual liberalization in tariffs and quotas as a means of integrating into the world economy.



Source: Asian Development Bank, Key Indicators 2003.

**Table 8 Sectoral Distribution for FDI: China & Liaoning Province**

Sector	China		Liaoning	
	Value(bn Yuan)	%	Value(bn Yuan)	%
Primary	10.01	1.87	1.42	2.69
Secondary	391.97	73.26	38.02	68.09
Manufacturing	369.36	69.03	34.36	61.55
Construction	6.12	1.14	1.16	2.08
Tertiary	133.07	24.87	16.31	29.22
Transportation	8.67	1.62	0.91	1.63
Insurance	2.32	0.43	0.02	0.04
Retail	11.16	2.09	1.87	3.35
Real estate	52.36	9.79	9.36	16.77
Social service	31.61	5.91	3.27	5.87
Total	535.05	100	55.83	100

Source: Huang 2006, Development Report of Non-State-owned Economy in China

In 2005, China also continued to be a leading destination for FDI, with a total FDI inflow near the 2004 peak of US \$60 billion. Most FDI has been concentrated in manufacturing and real estate. China's recent move towards a more flexible exchange rate regime, which is one example of institutional change, is in line with the progress of FDI development. China's huge "double surpluses" in both capital and current accounts, along with high domestic savings (45% percent of GDP) and low fiscal deficits, will induce Chinese enterprises' internationalization. In July 2005, the RMB appreciated by 2.1%, following the People's Bank of China's decision to abandon its fixed US-dollar peg in favor of a more flexible exchange rate system. This institutional change will cause gradual RMB appreciation. In coming years, we should see more outward FDI from China into Southeast Asia and other regions, including the U.S.

#### D. Negative effects

China's transition process has stimulated a number of negative socio-economic side-effects. Many of these tough problems are caused by the inherent nature of China's transition model and its unique transition trajectory. Those negative by-products highlighted by the international media include corruption, income disparities, environment deterioration, and public health risks.

##### 1. Corruption

China's transition has both occurred under and been targeted at, sustaining the established political system. A "political imperative of high economic growth" has been firmly built into China's

transition process. In the Chinese government hierarchy, from the central government in Beijing to every province, city, county, and even town and village, all ranks of government are growth-oriented. GDP growth is one of the most important criteria for the evaluation of government leadership performance. Government agencies control import and export quotas and control approvals of large infrastructure and public shared projects for local development, This control leads to more rent-seeking opportunities for local officials.

## 2. Income disparities

Income disparity has widened significantly. The degree of income inequality in China, as measured by the Gini coefficient, is now above 0.4 (World Bank, 2005), which is higher than that of U.S.. Income disparity is a symptom of China's regionally unbalanced development, urban-rural biased development pattern, and unbalanced distribution among different interest groups during the process of privatization. Even worse, all of these disparities root in opportunity inequality. Equity in opportunity is more important than equality in income. Corruption, especially in monopolized sectors such as telecommunications are key sources of opportunity inequality. Increasing university tuition, which is a direct result of Chinese higher education marketization, limits access to higher education by young people from poor families. This will create more opportunity inequality in China. During the transition process, the Chinese government did not put in place an effective institutional framework to regulate or guide the operation of the market, nor well-connected social security and safeguard networks. The biased interest distribution and income gap induced by aggressive implementation of privatization schemes for SOEs caused labor discontent in many Chinese factories.

## 3. Environmental deterioration and public health risks

Some undesirable by-products of China's transition are environmental degradation and increased public health risks. Profit-seeking by businesses and performance-oriented government officials, combined with a disregard for the environment and for human life lead to many environment problems and public safety risks. Coal mining accidents and river contamination (e.g, Song Huajiang River chemical spill) are examples.

These emerging problems were either caused by or worsened by transition. Solving them will also depend on efficient and effective transition and sustainable growth. To fulfill these goals, China

should change its growth pattern, restructure its development strategy, and integrate more completely with the world economy.

### **III. Prospect for China's Transition: Changing Growth Patterns, Institutions, and Development Strategy**

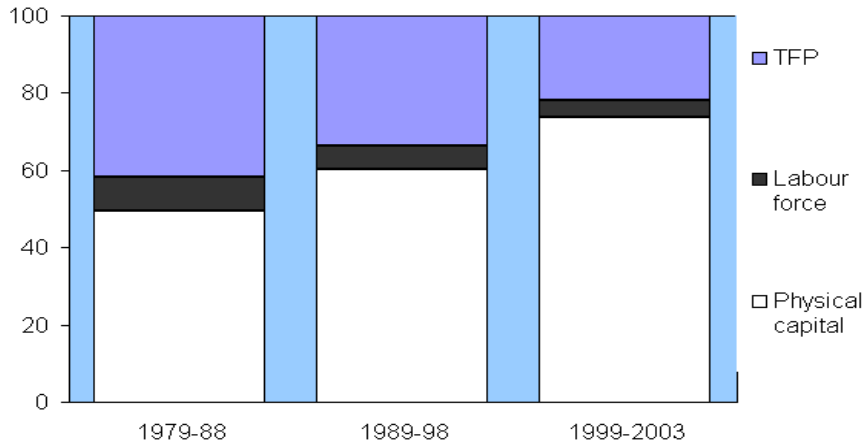
#### **A. Restructuring growth and export patterns through technology innovation and institutional change**

Economic growth will still be high on the agenda of China's transition. We can observe from Figure 3 that China's current growth is investment-driven and resource intensive. However, facing the challenge of a myriad of constraints, including energy, raw materials, environment, and even labor force, there is need to adjust the growth pattern. In the future, we will witness economic growth fueled primarily by technological innovation and institutional change.

A "Smiling curve" describes a development phenomenon that profitability at various stages of production has come to follow a U-shaped curve - high at the upstream and downstream processes and low at the midstream processes (Figure 4). In the labor division of the world's production, the segment accessible to China is largely limited to the part around the tip of the chin, i.e., fields where value added is the lowest. The smiling curve is getting steeper and steeper. To transfer its growth and export pattern, China must focus on the two ends of the smiling curve. For this, improving independent innovation capacity is vital, and China has a long way to go.

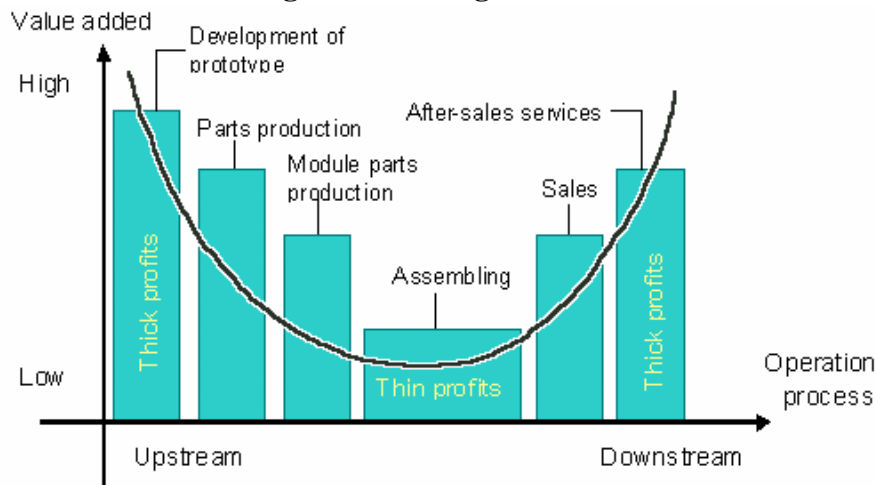
Although science and technical progress might free China from the smiling curve trap, the ultimate solution will lie in continued institutional change and innovation, for example, a new tax system to motivate venture capital investment, banking and financial system reform, regional innovation system, and university-research institute-industry collaboration, etc. However, institutional reforms in these areas may be the most difficult.

**Figure3 Growth Source of China's GDP**



Source: World Development Indicators 2004

**Figure 4 Smiling Curve**



2002, China's Immiserizing Growth

Source: Kwan

**B. Building a harmonious society by balanced development and scientific development**

China's new paradigm of transition was embraced by the 11th Five-Year Program (2006-2010) approved by the 5th Party Plenum on 11 October 2005. New development strategies can be concentrated in President Hu Jintao's concept of the "Harmonious Society", which is a turning point in China's transition. Building a harmonious society covers both domestic and international strategy of China's leadership. It shows China's decision to pay equal attention to efficiency and equity at home. Two pillars for the "Harmonious Society" are "balanced growth"

and “scientific development”. Balanced growth will rectify the income gaps, and scientific development will lead to “greener GDP” and a better quality of life in China. From an international perspective, with its deeper involvement in the world economy, China will learn how to respond to the world’s critiques such as its intellectual property rights protection and human rights situation, to deal more effectively with emerging trade and political conflicts, and to harmonize with other world powers.

#### **IV. Conclusion**

China’s unique transition path provides lessons for other developing countries and transition economies. The future of the world economy will depend, in large measure, on how China plays its role and on how the rest of the world, particularly the developed countries, respond to China. How Sino-US economic and political relations evolve, in particular, will be pivotal for the world community.

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