



## An Analysis on China's Economic Transformation towards Quality Development

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The 19<sup>th</sup> National People's Congress stated China's economic transformation from rapid growth to quality development. The two sessions have prioritized quality development, working on improving imbalance, modernizing the economy, and optimizing economic structure. This article aims to answer the questions of what is quality development, how to achieve quality developments, and what is the objective of quality development.

As early as the mid-nineties, the ninth five-year plan actively promoted changes in the economic growth model. The eleventh five-year plan considered changing the growth model an important task in the new era. The twelfth five-year plan formulated a series of policy frameworks to promote supply-side reform and economic restructuring. The latest push for quality development further clarifies this theme.

### Main ideas

Quality development encompasses the following four ideas.

The first one is enhancing quality and efficiency. The quality of goods, services, and management is still lagging behind demand and needs a profound revolution. To make Chinese goods and services a benchmark of quality, the focus should be on enhancing supply-side quality management in advanced manufacturing, agriculture, and high-end services. Meanwhile, economic efficiency must be improved by minimizing the labor, capital, land, and resources required for maximum output in terms of labor income, corporate profit, tax income, and jobs.

The second one is innovation. Countries all over the world are increasingly attempting to improve competitiveness by innovation in technology, culture, theories, and systems. Innovation contributes to both quality development and economic growth. A new global phase of technological innovation and industrial reform will create both pressure on and opportunities for China. China's old growth model may not be sustained, as the labor force has begun to decline and resource input ran into bottlenecks. Technological innovation must become a main engine of economic growth.

The third one is green development and low carbon emission. Green development is not only a global trend but also a requirement for China's economic sustainability and people's desire for a better life. China is still being plagued with severe pollution and ecological degradation. However, green development and low carbon emission technologies are advancing rapidly, helping alleviate pollution and restore the ecological system. Green development and low carbon emission will become a hallmark of quality development.

The fourth one is coordinated development and inclusive growth. Rural and urban development should be coordinated to integrate cities and countryside, reducing their gap by lifting the living standards of farmers. Regional coordination consists of optimization in the East, rise of the Middle, and development in the West. Meanwhile, three world-class city clusters will be built in Beijing-Tianjin-Hebei, the Yangtze River Delta, and the Pearl River Delta. More importantly, growth should be inclusive, benefiting the general public fairly to achieve common prosperity.

Of the four main ideas listed above, enhancing quality and efficiency, innovation, and green development and low carbon emission are basic features of quality development. These goals are shared by both advanced economies and China. In comparison, coordinated development and inclusive growth are the basic requirement and feature of socialism with Chinese characteristics in the new era.

### **Operational keys**

The key to quality development is building a modern economic system, which requires focusing on the real economy and limiting the virtual economy. Focuses on the real economy entail building modern industries in the upper echelon of the value chain, while limiting the virtual economy entails preventing bubbles in real estate and financial markets. The emphasis on the real economy, innovation, agriculture, and coordination touches on a number of policy areas including direction of development, growth engine, agricultural issues, and regional development. These are the operational keys to and hardware for quality development. Meanwhile, to promote comprehensive opening, reforms should be deepened, and the market economic system should be improved. An optimal market economy and comprehensive opening are the main software for quality development.

This year is the inception of quality development. Premier Li Keqiang's work report emphasized deepening supply-side structural reform and limiting the virtual economy. Moreover, to strengthen innovation and improve competitiveness, development strategies should be driven by innovation, leveraging a new phase of global technological revolution and industrial reform. There are four operational keys.

The first one is improving supply-side quality. The focus is on developing new growth momentum and strengthening manufacturing. The main areas are industrial clusters, artificial intelligence, “internet plus”, integrated circuit, 5G telecommunication, airplane engines, and new-energy automobiles. In the meantime, modern services should be developed to improve quality, benchmarking international advanced standards.

Take artificial intelligence. The government is determined to develop artificial intelligence and has formulated high-level strategies. Artificial intelligence is now being dominated by China and the U.S., with China gaining a leading position in computer visualization technologies. In 2016, China filed 30,000 patents in AI, 10 times than that in 2010. The size of this industry has exceeded RMB 10 billion and is expected to rise to RMB 34.4 billion in 2019.

Second, mass entrepreneurship and innovation will be upgraded. The government’s work report identified China’s massive human resources as a driving force of innovation. Pooling the wisdom and energy of these talents will give China a competitive edge. Innovation and entrepreneurship will require comprehensive services in the form of financing and tax incentives. Also, the talent development system should be reformed by improving labor mobility, improving incentive schemes for talents, and attracting overseas Chinese students. The number of entities in innovation and entrepreneurship is rising rapidly. On March 16, the 100 millionth business license in China was granted in Beijing. In 2017, almost 1,000 enterprises were established daily in Shenzhen. These burgeoning entities are a testament to the enthusiasm in innovation and entrepreneurship and will fuel quality development.

Third, wasteful supply will be minimized. This year, ineffective supply will be eliminated, overcapacity will be curtailed, and inefficient production will be made obsolete. In the past 5 years, steel capacity was reduced by 170 million tons and coal capacity by 800 million tons. On top of that, steel capacity will be trimmed by a further 30 million tons and coal capacity by 150 million tons. Although the reduction in overcapacity is almost completed, the government remains determined to reduce wasteful supply and eliminate zombie companies.

Fourth, corporate taxes and fees will be cut. This year, value-added taxes will be improved, vastly increasing the number of micro and small enterprises eligible for tax cuts amounting to over RMB 800 billion. Furthermore, a number of administrative fees, government levies, and social security contributions will also be reduced, saving corporate entities over RMB 300 billion. These measures combined will reduce the burden on corporates by over RMB 1.1 trillion, almost double the RMB570 billion in 2016 and RMB 550 billion in 2017. As a result, companies will become more flexible and contribute to restructuring and upgrading the real economy.

## Long-term objectives

Now, the question is how to define the long-term objectives of quality development. One of the objectives of quality development is substantial improvement in labor productivity, or greater output for less input. By this metric, China still lags far behind advanced economies. In 2016, labor productivity of the U.S. was 8.4 times that of China and Japan 7.6 times that of China. To improve labor productivity, the quality of labor must be enhanced by increasing the contribution of knowledge, technique, and management to economic growth. China has made huge progress. Last year, the number of Chinese citizens with higher education exceeded 170 million, or 12.5% of the population, 30 times greater than 0.4% in 1982. In 2030, this share is expected to rise to 20%, or 35% of the workforce. China will experience a historic transition from demographic dividend to knowledge dividend.

Another objective of quality development is improving total factor productivity. In 2015, total factor productivity was mentioned in the government's work report for the first time. The 19<sup>th</sup> National People's Congress again mentioned total factor productivity. In recent years, supply-side structural reform has optimized resource allocation, while innovation has raised total factor productivity. Last year, technological improvements accounted for 57.5% of economic growth, 5.3 percentage points greater than five years ago. Thanks to the strategy of quality development and technological breakthroughs, the contribution of technological improvements to growth will continue to rise, reaching about 80% in 2035 and approaching the levels in advanced economies.

The third objective of quality development is for strategic emerging industries to become a main engine of economic growth. During the twelfth five-year plan period, China's strategic emerging industries rose rapidly, with their share as a percentage of GDP doubling from 4% to 8% and likely reaching 15% in 2020 and 30% in 2030, truly becoming a main driving force of economic growth. Therefore, the pace of economic growth will not be held back notably by quality development, the potential and prospects of which are positive.

The economic growth target of this year in the government's work report was the same as last year at around 6.5%. Development is the foundation and key to solving China's problems. Economic growth will be maintained within a reasonable range, achieving synergies between steady growth and quality improvement. This year, China's economy is likely to enter a phase of quality development, with improving quality and efficiency driving steady economic growth above 6.5%.