

Proposals for the Chinese Development Path to Modernization

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Foreword

In recent years, reverse globalization has been on the rise, along with heightened geopolitical tension and the onset of a new round of scientific & technological revolution. Since the COVID-19 pandemic outbreak, rising global debt and high inflation have forced developed countries to implement monetary policy tightening, resulting in highly uncertain and volatile economic outlook. The 20th CPC National Congress ushered China into a new era of development. In response to the complex, volatile and uncertain international situation, China is set to advance modernization with Chinese characteristics and strive to build a great modern socialist country.

The current economic slowdown in the developed countries has significantly exerted downward pressure on global trade. Under the strained relations between China and the United States and the influence of “China plus one” strategy of multinational corporations, some Chinese companies order book has been hit by sluggish export growth in the spring of 2023. In response, China is expected to strengthen its domestic circulation system, invigorate the potential of household consumption, and vigorously boost domestic demand to maintain stable economic development. Moreover, China has to enhance the innovation capacity and management capability of its enterprises, upgrade its international competitiveness, in its quest to build a prosperous, democratic, civilized, and harmonious socialist country.

To address China’s economic development challenges and bottlenecks, this paper offers five suggestions related to the pursuit of Chinese style modernization and high-

quality development:

1. To strengthen domestic demand through higher consumer spending

China is known for its huge consumption space, with a population of more than 1.5 times that of the developed countries combined. A large population will bring huge consumer market potential, rich human resources and strong momentum for economic development. China maintained its position as the world's second largest consumer market in 2021, with total retail sales of consumer goods reaching USD 6.83 trillion, about 92 percent of those in the United States (USD 7.4 trillion). This consumption space, if further stimulated, will have huge potential. In purchasing power parity terms, for example, the number of middle- and high-income Chinese households earning more than USD 22,000 a year is now slightly lower than in Europe, but could rise to about 400 million in a decade's time, which would be close to the size of Europe and the US combined.

Consumer spending is a key driver of domestic demand and economic recovery in China. According to the pattern of economic development, China's demand structure will gradually transition from investment and exports to consumption as the level of economic development rises. A consumption-led economy tends to be more stable and less prone to sharp fluctuations.

China's consumption structure has a lot of room for improvement. China's consumer spending as a share of GDP averaged 53.3 percent between 2011 and 2020, which is still a far cry from the World Bank's figure of 80 percent for developed countries and more than 70 percent for developing countries. The low consumption share of the economy is partly due to low income levels. The ratio of household income to GDP in China is only about 45 percent, compared with 83.4 percent in the US, 76.9 percent in India and 60.7 percent in Germany. In the future, higher pace of income growth can be achieved through adjusting means of distribution and policies to promote common prosperity.

Chinese residents “fear to spend” stems from inadequate social security which is a constraint to consumption. China is expected to improve its medical care, education, pension and other social security levels, further extend the coverage, and enhance equal access to basic public services. In recent years, spending on medical care, education, social security and employment has increased from 32.5 percent in 2015 to 36.8 percent in 2021, up 4.3 percentage points, but still well below the 60-70 percent seen in advanced economies. Medical personnel resources is a case in point. The number of nurses per 1,000 people worldwide in 2018 was 3.7, while the figure was 8.3 in the Americas and 7.9 in Europe, according to the World Health Organization (WHO). The number of registered nurses per 1,000 people in China increased from 2.9 in 2018 to 3.5 in 2021, still falling short of the global average in 2018. In Shanghai, the proportion of urban education spending in the national economy is only 4.69%, lower than 7.88% in the United States, 7.13% in Japan, 6.10% in the United Kingdom and 6.36% in South Korea.

In addition, most of China’s major cities face housing affordability challenges, with high housing prices limiting consumers’ spending power. The price-to-income ratio in the top 30 cities is 11.5, higher than the national average of 8.4. In first-tier cities, the ratio is even higher, at 21. The high share of household budgets devoted to housing limits other types of consumption. The central and local governments have launched various policies, such as land reform, ownership restriction, and loan ceilings in major cities, in an effort to control the rapid rise in housing prices. Meanwhile, the government is accelerating the development of affordable rental housing, providing financial support and tax incentives to encourage its development.

On top of the various reform currently under way, further urbanization will help raise income and consumption. By the end of 2021, the urbanization rate of permanent residents reached 64.72 percent, while the urbanization rate of residents with household registration rose to 46.7 percent, up 0.83 and 1.3 percentage points respectively over the previous year. The gap between the two urbanization rates has narrowed for the first time since the 13th Five-Year Plan. As the urbanization rate

of residents with household registration increases, more and more rural residents are able to improve their incomes and quality of life, thus further promoting their willingness and level of consumption. Considering the above factors, the development of China's consumer market is driven by efforts to further improve the structure of national income distribution and to raise the proportion of middle- and low-income groups through improving the tax system, increased transfer payment, and promoting market-oriented circulation of rural land. There is a need to accelerate the reform of the household registration system, expedite the urbanization of migrant workers, stabilize the expectations of migrant workers, thereby raising the marginal propensity to consume.

2. Scientific and technological innovation to drive high-quality development

Scientific and technological innovation is the primary driving force for high-quality development. By 2030, China will become a leading innovator and achieve a fundamental shift in the drivers of development, significantly improve its level of economic and social development and international competitiveness, laying a solid foundation for building an economic power and a society of common prosperity, according to the strategic objectives of the *Outlines on National Strategy for Innovation Driven Development*. At present, China is entering a crucial period of innovation-driven development.

On January 27, the United States agreed with Japan and the Netherlands to restrict exports of advanced chip-manufacturing equipment to China, following the introduction of semiconductor regulatory measures in October 2022. In addition, the EU argued that China must be denied access to the most advanced chip technology and must limit its progress in quantum computing, artificial intelligence and microchips, where it is already "choked". At present, China can only make 14nm microchips (SMIC), and only SMEE 28nm lithography is fully homemade, while TSMC is now making 3nm. In terms of technology, China's chip

manufacturing should speed up to catch up with the international frontier level. Technically “bottlenecked” by Western countries, China must improve the innovation system and enhance the capacity for scientific and technological innovation to break the current deadlock.

Science and technology is an important driving momentum for the fourth Industrial Revolution. China must change its role as a “follower” in technological development and truly become a “pacesetter” that leads the trend and occupies core advantages. In May 2021, Chinese President Xi Jinping pointed out that “we will support qualified local areas in building comprehensive national science centers or regional science and technology innovation centers, so that they will become the gathering place of the world’s scientific frontier fields, technological innovation in emerging industries, and the elements of global science and technology innovation”. China must be technically self-reliant, build itself into a great power in science and technology for national strategic strength, and increase investment in scientific research to build platforms for innovation. Regional science and technology innovation centers are an important part and critical node in the construction of the national innovation system in the new era. Based on the three international science and technology innovation centers in Beijing, Shanghai and the Guangdong-Hong Kong-Macao Greater Bay Area, a multi-level national system of scientific and technological innovation has been formed, creating a complementary innovation development network linked to international science and technology innovation centers.

Based on the country’s hierarchical layout of international and regional science and technology innovation centers, it is advised to replicate the innovation ecosystem in Shanghai to a number of selected cities having the potential for scientific and technological innovation development. Such efforts can foster seamless integration and linkages among the government, enterprises and industrial parks. In this way preferential policies can be provided to attract clustering of innovative talents and enterprises, venture capital funds, international legal, accounting and other professional services, and foster an inclusive atmosphere for innovation, creating

an attractive office space and livable environment.

3. Enhance the quality of professional services to meet international standards

Since China's reform and opening up, "Made in China" has quickly risen in the global scene. The bulk of the success has been in low-end manufacturing, covering the middle and low end of the "smile curve", while R&D and design of products with higher added value and brand marketing are still underdeveloped. With rising labor and business costs and increasing foreign trade barriers, "Made in China" is increasingly hitting the bottleneck, thus industry transformation and upgrading to the high ends of the "smile curve" is inevitable.

China's service sector suffers from the problem of low labor productivity, with a high proportion of activities still in the low efficiency traditional services. Significant differences are seen in labor productivity between market-oriented services (ie.wholesale and retail, computer and information technology, finance, transportation and storage, culture and entertainment) and non-market-oriented services (ie.education, medical care, and public administration). The former reaches the level of developed countries, while the latter is significantly lower than the current level of developed countries.

Low efficiency traditional services render the economy within the realm of high costs and low output. The key to solving this problem is to increase labor productivity in the service sector. There is a need to build a system of high-quality and efficient services through promoting further integration of modern services with advanced manufacturing and modern agriculture.

Shanghai's service-oriented industrial structure has made headways and advancing towards the top tier. In 2022, the value added of China's service sector accounted for 52.8% of GDP, while the value added of Shanghai's service sector accounted for 74.1% of the city's GDP, higher than the world's average of 71.8%, but still far

behind Tokyo's 88%. Under the strategy for integrated development of the Yangtze River Delta, Shanghai should take advantage of its well established professional services to further enhance its global city function, speeding up its catch-up with Tokyo, New York and other global cities. Shanghai should strengthen its regional role as the spearhead to expedite the development of professional services in Nanjing, Hangzhou and other Yangtze River Delta cities.

4. Greater efforts to strengthen the rule of law in building a great modern socialist country

To build China into a great modern socialist country, it is important to provide a market-oriented, law-based and international business environment. Over the past three years, the economic downturn has rattled the expectations of households and businesses, evidenced by depressed confidence among households, private enterprises and foreign investors. It is pressing to strengthen the rule of law, reduce excessive regulation over market players, and improve the business environment so as to stabilize market expectations and restore their confidence.

In 2021, the State Council promulgated the *Outline for Building a Law-Based Government (2021-2025)*, charting a blueprint for building a law-based government from the aspects of legislation and law enforcement. The legalization will be implemented step by step in the future. We believe that the *Outline* will enable the government to better play its role, improve the system of administrative decision-making, and enhance the credibility and enforcement of administrative decision-making to provide institutional guarantee for the smooth realization of modernization with Chinese characteristics.

The rule of law is one of the necessary guarantees to attract and retain domestic and foreign investors, and such a society will instil investors' confidence. Currently there is still room for improvement. The Shui On Group has encountered difficulties in law enforcement for one of its investment projects in Beijing. The case involves

a RMB 120 million owed to Shui On by a company. The judgement for this case was rendered by the court in 2011, deciding that the debtor shall repay the loan principal and pay related interests, and the enforcement proceedings has been initiated since 2012. The core asset of the person subject to enforcement was an office building located on the East Second Ring Road in Beijing, which was seized by the Beijing court in 2012. However, the appraisal and auction procedures of this asset has not started so far, and the debtor has refused to use the property rent to pay off part of the debt to the creditor. Therefore, there has been no substantial progress in this case. It is believed that not only Shui On has encountered difficulties in enforcement, and other investors in China may have encountered similar challenges. To strengthen the legal system, it is necessary to attend to the enforcement of court judgments, implement efficient solutions to commercial disputes in accordance with the law, and establish a sound legal system, thus enhancing investors' confidence.

The legal system in China differs from the common law system in Europe and the United States. In the process of promoting opening-up at a higher level, it is suggested to review the features of Hong Kong's common law system, and its developed professional services and financial systems. Since the reform and opening up, Hong Kong has played an important role in China's economy. It can continue to serve as a bridge and link for the higher-level opening-up of the Chinese economy.

5. To maintain and encourage the development of the non-public sector

The Report to the 20th CPC National Congress points out that the government must function as the strategic guidance of national development plans yet minimize direct involvement in management and micro-level intervention. With a view to building a high-standard socialist market economy, we must unswervingly encourage, support, and guide the development of the non-public sector. It is important to see

that the market plays a decisive role in resource allocation and provide an enabling environment for private enterprises, protect their property rights and the rights and interests of entrepreneurs in accordance with the law, and facilitate the growth of the private sector. There is room to improve the modern corporate system with distinctive Chinese features, encourage entrepreneurship, and move faster to help Chinese companies become world-class outfits. The key underpinnings of the market economy, such as property rights protection, market access, fair competition, and social credit, should be enhanced in order to improve the business environment.

In the aftermath of the three-year pandemic, great changes have taken place in the business environment for private enterprises: The drop in revenue has worsened enterprise financial situation, resulting in financing difficulties and capital chain disruption. There is a need to create a more inviting environment for investment and development of the private sector, improve the financing situation for private enterprises, and amend some of the subsidies to state-owned enterprises and state-owned financing vehicles, ensuring the financial resource allocation adheres to the principles of capital efficiency.

To improve the system for scientific and technological innovation, it is necessary to improve the efficiency of national research institutions, and stimulate the enthusiasm of private enterprises and research institutions for innovation, allotting financial support for the innovation inputs of private enterprises in line with the national strategic direction. In the current economic downturn, the financial system has turned cautious and refrained from credit support to some private enterprises. Financial institutions can be encouraged to provide financing to sound private enterprises to alleviate this dilemma and helping to restore entrepreneurs' confidence.