Existing contradictions and problems in China's current economic and social development

Wang Tongsan*

Since the 18th National Congress of Communist Party of China (CPC), China has made important achievements and headway in economic and social development. However, now more than ever the focus should be on the conflicts and problems that continue to exist in China's economy. This paper examines six of them: (1) lack of a firm foundation for sustaining steady economic growth; (2) risks and hidden dangers in the financial, banking, and real estate sectors and massive overcapacity in some industries; (3) increasing difficulty in increasing agricultural production and raising rural incomes; (4) severe air, water, and soil pollution in certain regions and the arduous task of energy conservation and emissions reduction; (5) major structural problems constraining employment; and (6) issues of people's livelihood that have been the source of dissatisfaction for many Chinese citizens.

Keywords: economic and social development, contradictions and problems, financial and banking risks, overcapacity, environmental pollution, structural imbalance in employment, people's livelihood

Since the 18th National Congress of CPC, China has adhered to the general working guideline of making progress while maintaining stability. China has worked to maintain stable growth, make structural adjustments and carry out reform in a holistic way. The government has ensured that macroeconomic policies are stable, microeconomic ones are flexible, and social policies meet people's basic needs. China has improved upon the means by which macroeconomic control is exercised and adopted measures with both short-term and long-term benefits in mind. It has striven to break new ground, improve quality, and make progress while ensuring stability. In sum, important achievements have been made in economic and social development.

With regard to the current situation, China should draw upon past achievements and success in a careful, comprehensive, and honest manner. On the one hand, China should adhere to ideas and practices in macroeconomic control that have proven effective in the past and improve upon them. On the other hand, China should be clearly aware that the country will inevitably face many difficulties and problems in its path forward. Six of them are most pronounced.

* Wang Tongsan (email: wangts@cass.org.cn), Academician and Research Fellow, Chinese Academy of Social Sciences, Beijing, China.

1. China still lacks a firm foundation for sustaining steady economic growth and thus needs to strengthen internal growth drivers

China currently faces a complex domestic and international situation. Internationally, the global economy is seeing signs of gradual recovery for the first time since the outbreak of the financial crisis in the United States and sovereign debt crisis in Europe. Thanks to some unconventional bailout measures taken in developed economies in particular, these countries are gradually moving past the worst of the crisis.

However, due to basic contradictions inside the capitalist system, the root cause of the crisis has not been resolved. What's more, Western countries, in order to deal with the crisis, have adopted unconventional measures. While these measures did prevent the crisis from worsening, they increased the burden on these economies after they entered the recovery phase, making for tepid economic recoveries.

In terms of the real economy, developed economies still rely heavily on consumption as a source of growth. At the same time, they have become highly dependent on the service industry, and are facing the distorted structure issue of hollowing-out of manufacturing industry. In terms of banking, developed economies have not completed the deleveraging process. Instead, their leverage ratios are still rising to some extent. The entire banking system still cannot effectively serve the real economy. In conducting bailouts during the crisis, developed economies have seen higher fiscal deficit ratios and debt ratios. The overall debt ratio has reached 106% in the U.S., 95.7% in the Eurozone, and 243.5% in Japan. Last year, the U.S. Congress went to the brink of the so-called "fiscal cliff" to the concerned bemusement of the rest of the world.

Since finance and banking are closely correlated, financial problems can delay solutions to problems in the banking sector. World trade grew by only 2.3% in 2013 and has basically ground to a halt in 2014, with no great change expected. The global economy is estimated to have grown by 3% in 2013, and most organizations expect only a slight rise in 2014.

According to an IMF estimate in January 2014, the global economy grew by 3% in purchasing power parity. According to a January 2014 World Bank estimate using Atlas Methodology, the global economy grew by 2.4%. Both these two international organizations predict that the growth rate of the world economy will at most rise only slightly in 2014. From a global view, China still faces an international economic environment that is severe and complex with many unstable and uncertain factors. Developed countries, such as the U.S., adjusted their macro-control policies, bringing about changes to the world economy. At the same time, emerging economies face new difficulties and challenges. The world economic order is undergoing deep adjustment and the international arena is sure to be increasingly competitive. Coping with such a complex and changeable external economic environment, seizing opportunities, and avoiding a crash is an extremely difficult task.

From a domestic point of view, China's economic growth is slowing. Although GDP growth has remained at a high level of 7.7% over the most recent two years, compared with the 9%-10% growth in previous years, the drop is significant, and this impacts many aspects of the economy and society. It does take time to solidify stable economic growth. In 2013, the added value of industrial enterprises above designated size, which reflect the growth of the real economy, had a real growth rate of 9.7%, 0.3 percentage point lower than that of 2012 and the lowest since the financial crisis in 2009.

The real growth rate of the added value of industrial enterprises above designated size continues to decline, which indicates that China has not built a solid foundation for sustained, steady economic growth. In 2013, China's fixed asset investments (not including farmer households) grew by 19.6%, down by 1 percentage point from 2012. Manufacturing investment, a mirror of the performance of the real economy, grew by 18.5%, 2.8 percentage points lower than that of 2012 and the lowest since 2000. In addition, although it grew faster than state-owned and state-held enterprises (15.6%), the growth rate of non-state-owned enterprise investment (22.4%) was still 2.4 percentage points lower than that of the previous year.

Despite a flat GDP growth rate compared with the previous year, in 2013, urban per capita disposable income and rural per capita net income were 2.6 percentage points and 1.4 percentage points lower compared with 2012. In 2013, retail sales of consumer goods had real growth of 11.5%, 0.6 percentage point lower than in 2012. In terms of the contributions of the top three demand drivers for GDP growth, the contribution rate of final consumption expenditures was 50%, 5 percentage points lower than that of the previous year. The contribution rate of net exports continued to decline, dropping to - 4.4%, while the contribution rate of gross capital formation increased to 54.4%, 7.3 percentage points up from the previous year.

Creating domestic demand, especially consumer demand, a main driver of economic growth, remains an arduous task. Another problem requiring attention is the expansion of the "price scissors" between the consumer price index (CPI) and producer price index (PPI). While the CPI has leveled out, the PPI continues to drop, showing a continuing negative trend. The continued divergence of the consumer price index and the market price index is indicative of the degree of difficulty in real economic terms and the severity of overcapacity in the industrial sector.

China must take a serious look at the difficulties caused by disadvantageous factors arising from both the internal and external environment, and work hard to mitigate and transform negative factors. At the same time, China should seize opportunities in the domestic and international environment, strive to further consolidate steady economic growth, and maintain steady growth of the macro economy in the coming year.

2. Risks and hidden dangers still exist in sectors including public finance, banking, and real estate; some industries are heavily burdened by excess production capacity; and macroeconomic controls have become more difficult

In terms of fiscal income, the Chinese government worked through a period of slow economic growth in 2013, with full-year national public fiscal income growing 10.1% and the 2013 GDP growth rate equaling that of the previous year. Nevertheless, fiscal revenue growth rate was 2.7 percentage points slower than the previous year. Currently, the biggest financial risks and dangers within local financial administrations lie in local government debts.

According to debt statistics issued by the National Audit Office on December 30, 2013, at the end of June 2013, Chinese governments at all levels had a combined debt of 20.7 trillion yuan (direct debts), of which the debts of governments at the provincial, municipal, county, and township levels amounted to 10.89 trillion yuan (307 billion yuan of which was village and town government debt). If we include contingent debts in the calculation, general local debts amounted to 17.8 trillion yuan. From an overall perspective, the proportion of government direct debts to GDP was around 37.7%; if "contingent debts" are counted, China's government debts totaled approximately 30.27 trillion yuan, with a generalized debt ratio of 55.2%.

Overall, China's government debt ratio is within a controllable range. But some local government debts are close to maturity and debt ratios will be high this year and next, so there will be hidden liquidity risks due to the high pressure exerted by debts maturing at nearly the same time. In addition, the growth in debt of some local governments is higher than that of revenue.

In terms of banking, by the end of 2013, China's general money balances (M2) was 110.65 trillion yuan and the ratio between M2 and GDP has remained at over 190%, which indicates high-level pressure on inflation. At the same time, the financing scale of the entire economy is up to a total of 17.29 trillion yuan, up by 9.7% from the previous year. However, in terms of the real economy, the private economy—SMEs in particular—still faces difficulties in financing, as well as pressures from continuously rising financing costs. In the middle of 2013, the weighted average interest rate of inter-bank lending surged to 6.58%, an all-time high. On one hand, such a situation shows that China desperately needs to improve its capital usage efficiency; on the other hand, it indicates that banking has not adequately served the real economy, and consequently, transformation of economic development model should be carried out with urgency.

Additionally, in terms of financial regulations, close attention should be paid to the impact of the constantly expanding shadow banking system on financial stability. Shadow banking does have the potential benefit of improving allocation efficiency of deposited money and breaking arbitrary separation and barriers in the monetary market through a variety of financially innovative means, thus allowing for interest rate liberalization and efficiency improvements in the financial system. However, the shadow banking system has also revealed a series of problems —particularly liquidity risks resulting from the term mismatch of its products (i.e., the asset term structure is too long, while the debt term structure is too short)—which create systematic risks that threaten the stability of the financial system. The issues with the shadow banking system can lead to the excessive expansion of credit, which in turn can lead to failure of regulation policies intended for bank credit expansion and the weakening of the effectiveness of conventional monetary policies. Addressing the problems of the shadow banking system is currently a major issue for financial regulators.

In terms of real estate, although price growth has slowed nationwide, they have not stopped. Until January 2014, housing prices had risen for 13 consecutive months. According to data released by the National Bureau of Statistics, in January 2014, 69 out of 70 large and medium-sized cities saw housing prices rise compared to the corresponding period in the previous year.

First-tier cities, i.e., Beijing, Shanghai, Shenzhen and Guangzhou, saw a significant increase in housing prices in January. This was due to a lack of balance between supply and demand in the market, with demand severely exceeding supply. On the other hand, in third- and fourth-tier cities, there is oversupply in the real estate market due to excessive real estate development. Real estate investment and market regulation should maintain continuity and stability. Emphasis should be put on "issuing differential guidance by category." However, it is a difficult task to coordinate all aspects in the real estate industry.

Another serious problem that China is facing is excessive overcapacity in some industries. As a result of the profound impact of the global financial crisis, the downturn in the international market has impacted China's domestic market, slowing down the growth of domestic demand. The problem of supply exceeding demand has become increasingly prominent in some industries. There is widespread overcapacity in traditional manufacturing industries, and challenges facing high-consumption and high-emissions industries, including steel, cement, and electrolytic aluminum are especially acute.

Statistics show that in China, the capacity utilization rate in the steel, cement, electrolytic aluminum, plate glass and shipping industries are only 72%, 73.7%, 71.9%, 73.1% and 75% respectively, which are significantly lower than the global average. Profits have dropped sharply in the steel, electrolytic aluminum and shipping industries and many companies are experiencing operational difficulties. In spite of this, many overcapacity-loaded industries still have a group of projects currently being built or about to be built, which will further exacerbate the situaion. If China does not promptly take measures to resolve the issue of overcapacity, already cut-throat competition in the market will intensify, causing an expanded scale of losses in the industry, which will lead to large lay-offs, increased non-performing assets in the banking sector, aggravated energy and resource shortages, a deteriorating ecological environment, and other problems. All this will directly threaten the sound development of manufacturing industries and even impact progress in improving personal wellbeing and social stability.

In a market economy, mild excess in supply over demand allows the competitive mechanism to play its role in the market. Moderate excess in supply is also favorable to regulating supply and demand and promoting technological advances and management innovation. However, when production capacity is significantly greater than effective demand, it can lead to enormous waste in social resources, reduction of resource allocation efficiency and impediments to the upgrading of the industrial structure. To resolve the issue of overcapacity effectively, China must adamantly curb unwise expansion of production facilities, rectify illegally built production facilities, remove outdated production facilities, and establish a long-term mechanism to strengthen macro-control with the goal of resolving overcapacity problems.

3. It has become increasingly difficult to raise agricultural production output and rural incomes

In 2013, agricultural and rural development showed steady improvement. Food production grew for the tenth consecutive year, and food production output reached an all-time high; the growth rate of per capita rural income exceeded that of GDP; the income gap between rural and urban residents shrank; rural reforms have been carried out widely and deeply; peasants' life level has got continuously improved; and rural society has maintained harmony and stability. However, agricultural production still remains a weak link in China's economic development. It will become increasingly difficult for China's agricultural production output to grow and for rural incomes to rise.

In agricultural production, China faces the challenge of declining agricultural competitiveness. In recent years, there has been a rising trend in China's net import of agricultural products. Not only does China import large quantities of soybeans, a land-intensive product, the import volumes of corn have also been growing. Furthermore, import volumes of labor-intensive agricultural products such as rice and cotton have been increasing, too. The main reason for China's declining agricultural competitiveness is the increasing cost of agricultural labor.

Research shows that in 2004, the labor costs of rice, wheat, and corn were 171.44 yuan per *mu* (equivalent to 666 square meters), 111.84 yuan per *mu* and 140.49 yuan per *mu*, respectively. In 2010, the labor costs for these products rose to 266.58 yuan per *mu*, 178.83 yuan per *mu* and 235.10 yuan per *mu*, respectively. Moreover, those figures have continued to rise in the past few years. The second reason for China's declining agricultural competitiveness is the constant increase in land costs. With the expanding scale of land transfers and excess demand over supply for land, the subcontracting price for farmland has increased dramatically to 9,000-12,000 yuan per hectare. The rising costs of labor and land constitute a major challenge in maintaining China's competitiveness in agricultural production.

In order to continue growth in agricultural production output, China must accelerate agricultural modernization with Chinese characteristics. With reform based on China's situation as the fundamental driver, China should work to: maintain household operations as the basis for agricultural development while developing agricultural businesses of various types, integrate the tradition of intensive farming with modern materials and technological equipment, and coordinate a healthy balance between high-yield and high-efficiency agricultural needs and sustainable utilization of resources and ecology. Government support and protection should complement the decisive role of the market in resource allocation and seek to pioneer agricultural modernization with Chinese characteristics, characterized by advanced technology, moderate operating scales, strong market competitiveness, and ecological and environmental sustainability.

One important approach to increasing the incomes of rural residents is to grant farmers' additional property rights and raise farmers' property incomes. Currently, a Chinese farmer's most important property is the rural land he possesses as a member of an economic collective. A recent policy document entitled *The Decision of CPC Central Committee on Major Issues Concerning Comprehensively Deepening Reforms* proposed the establishment of a unified market for land for non-agricultural uses and the creation of a land value-added income distribution mechanism that takes into account state-owned, collectively-owned and individually-owned land, in order to increase individual income in a reasonable manner. The *Decision* also proposes granting farmers rights of possession, earnings, quitting compensation, mortgage guarantees, and inheritance to the collective asset stock. However, the implementation of those policies requires joint efforts by all sides. Care also needs to be taken to address various difficulties and problems that may arise from the implementation process of these policies.

China's economic and social development is still undergoing a period of transformation, and rural reform and development are taking place in a complex environment with increasing difficulties and challenges. The rapid development of industrialization, automation, and urbanization more desperately calls for the synchronized acceleration of agricultural modernization.

The conflicts between guaranteeing the supply of food and other important agricultural products and ensuring resource capacity and environmental sustainability is becoming increasingly acute. Profound changes to China's economic and social structures also pose a challenge requiring innovative rural social management. In such circumstances, it is important to implement comprehensively the spirit of the 18th CPC National Congress and the Third Plenary Session of 18th CPC Central Committee, which calls for improving stability, strengthening reform and innovation, removing shortcomings in systems and institutions, maintaining the fundamental position of agriculture, and accelerating agricultural modernization.

4. There is severe air, water and soil pollution in certain regions, and the task of conserving energy and reducing emissions remains arduous

Currently, China has a serious problem with environmental pollution, including a diversity of pollution sources, constant expansion of polluted areas and persistent pollution effects. The increasing area and duration of smog days have drawn increasing attention from all sides. In addition to traditional air pollution from coal combustion, compound pollution from fine particle matter and ozone is adding to the already hazardous pollution situation in China.

According to China's new air quality standard, which sets a PM 2.5 concentration limit and an 8-hour average ozone concentration limit, the air quality in around 60% of cities nationwide is below standard. Water pollution is also a serious problem in China. In key watersheds, chemical oxygen demand, total phosphorus content and total nitrogen content remain at high levels, posing a threat to water resource security. In some areas, water and soil pollution are at critical levels: according to monitoring by relevant government units, most rivers and lakes in China suffer from eutrophication at different levels, and of the 62 state-controlled key lakes and rivers, 61.3% are at Class I to III pollution levels, 27.4% at Class IV to V levels, and 11.3% are worse than Class V.

Among the seven water systems in China, the Huaihe River, Haihe River, and Liaohe River have relatively seriously pollution. Across the country, most cities have different degrees of polluted groundwater. Soil pollution is also becoming more significant in China. Nearly 20 million hectares of farmland —one-fifth of total farmland in China—have been polluted by heavy metals such as cadmium, arsenic, chromium, and lead. Over 16% of polluted cultivated land suffers from heavy metal pollution.

Industrial development has had a significant, accumulated impact on soil pollution. Some farmland areas are in critical condition, with pollution far exceeding the standard limit. Economic growth, increased population, expansion of cities, and rising energy and resource consumption all have intensified pressures on the ecological environment.

The current task of energy conservation and emissions reduction is extremely difficult for China. To date, the primary objectives, key tasks and major projects proposed in the *Outline of "Twelfth Five-Year Plan"* have been progressing successfully. A majority of the 24 primary objectives are on schedule, and a small number have even been fulfilled ahead of the deadline. In stark contrast, however, efforts to meet the four obligatory targets with regard to energy conservation and environmental protection, including energy intensity, carbon dioxide emission intensity, structure of energy consumption and NO_x emissions are falling short and the targets will likely be missed. Faster-than-anticipated economic growth, slow optimization and upgrading of the industrial structure, slow optimization and adjustment of the energy structure, and insufficient emissions reduction in some enterprises have led to a situation in which environmental targets are trumped by economic targets.

Taking NO_x emissions as an example, the *Outline* proposed reducing total NO_x emissions by 10% across the country within the Twelfth Five-Year Plan period. However, instead of falling, NO_x emissions rose in 2011, up by 5.74% from the previous year. Though that measure dropped by 2.77% in 2012, the indicator is still 2.82% higher than the average level of the previous two years.

According to these measurements, to achieve the objectives proposed in the *Outline*, China needs to reduce emissions by an average of 4.3% in the final three years of the Twelfth Five-Year Plan period. In terms of the other three unmet targets, energy intensity (energy consumption per unit of GDP) dropped by 5.5% in the first two years of the period. To accomplish the target of a 16% drop, China needs to reduce energy intensity by an yearly average of 3.84% in the final three years. The *Outline's* target for carbon dioxide emission intensity (carbon dioxide emission per unit of GDP) is a 17% reduction. In the first two years, it decreased cumulatively by only 6.6%. In terms of the energy consumption structure (the share of non-fossil fuel in primary energy consumption) the *Outline's* goal was to achieve an increase of 11.4%. However, it only increased by 0.8% in the first two years, requiring a cumulative rise of 2% in the last three years to meet the goal.

5. Major structural problems constraining employment

At present and in years to come, the employment situation in China will remain a challenge. The difficulties related to employment are mainly the result of aggregate employment pressures and structural problems in employment, namely the imbalance between the labor supply and labor demand structure. The lack of laborers with medium and senior professional technical skills is a significant manifestation of this problem. The foundation for vocational training in China is weak and changes need to be made in the public employment service system to improve the capacity of urban and rural grass-root employment services to satisfy diverse laborer demands. Current labor security efforts such as supervision, law enforcement and arbitration are inadequate, and significant problems in labor relations have yet to be effectively resolved.

At present, the root cause of the problems in employment structure relates to low quality and poor skills among laborers that leave them unable to meet the demands of a transforming economy. Among the employed in China, 70.3% have only a middle school education or less. Only 12.94% have a university education or above. There is a lack of skilled workers in the labor market, with a critical shortage of workers with advanced skills and talents.

Moreover, employment stability in China is low. The average employee turnover rate is 15.9%, one of the highest in the world. The industries with the highest turnover rate of grassroots employees are labor-intensive enterprises. Related research shows that there is a "short-term work" trend—in which many staying at each job very briefly—among migrant workers in China. Of all migrant workers, 65.9% have changed jobs. Among this group, 25% changed their job within the past 7 months, and 50% changed their job within the past two years. With respect to this situation, China should implement a strategy of employment priority, strengthen the role of economic development in stimulating employment, carry out more effective employment policies, and promote employment and entrepreneurship among focus groups.

6. Issues affecting people's quality of livelihood remain

Since China began reform and opening up and thanks to sustained economic growth, the housing conditions and living standards of urban and rural residents in China have significantly improved, but there are still low-income groups who have difficulty in finding housing. Building affordable housing is the key approach to helping low-income groups with housing, and is also a key to solving other practical problems related to people's wellbeing. Nevertheless, challenges exist in building affordable housing, such as funding gaps, insufficient land supply, worrisome construction quality, and so forth.

Food and drug safety is another extremely important issue that directly concerns health and safety. As a result of multi-faceted, collaborative efforts, food and drug safety has steadily improved in China in recent years. The overall situation remains stable and there have been no regional or systematic food safety issues. This is a remarkable achievement for China, a developing country with a large population, and one that is at historical stage of accelerated industrialization and urbanization with numerous small companies and an overall low industrial level.

Despite these achievements, China should not underestimate the problems and potential risks in the field of food and drug safety, where incidents happen from time to time. Some past cases seriously breached both criminal and moral codes and had a profoundly negative impact on society.

With respect to healthcare, progress still falls short of what people expect. The problems related to the healthcare system, especially local, grassroots health service systems, and the lack of medical resources has becoming increasingly acute. Healthcare supply is still stubbornly financed by pharmaceutical sales, and the inaccessibility of healthcare and the high cost of medicine have yet to be adequately addressed. Additionally, China needs to improve its capacity to prevent and control major diseases and cope with public heath emergencies.

Overall, fairness in the provision of medical and health services is still far from satisfactory; the public's attitude toward the healthcare system is negative in many respects, and physician-patient relations are increasingly tense. China has a long way to go before it reaches its targets for healthcare reform.

Problems related to an aging population are also becoming more severe in China. At the end of 2013, people aged 60 and above accounted for 14.9% of the country's total population; people aged 65 and above stood at 9.7%. China's old-age support resources are generally insufficient, and it is often difficult to secure a spot in the few high-quality government-run senior care institutions. By the end of 2012, there were approximately 40,000 senior care facilities in China, with a total of 3.9 million beds. On average, there are only 20.5 beds for every 1,000 elderly people. At the same time, there is an uneven distribution of senior care resources in China, further exacerbating the problem of care for the elderly population.

There are many other sources of dissatisfaction for the public, including education, income distribution, land requisition and demolition, social security, etc. There are also occasional incidents of serious and major workplace safety violations. In the social sector, corruption remains common, and some public employees do not fulfill their duty with diligence.

These problems discussed above are rooted in the process of development, or caused by malpractice. However, regardless of the source of the problems, the government must explore and find effective solutions to them, and shape government policies to meet the expectations and hopes of the public. China must keep in mind its responsibilities and missions, be more mindful of potential dangers, and work tirelessly to solve these problems for the benefit of Chinese society and the Chinese people.