

The choice of China's macro-economic policies for the “new normal”

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The transformation of China's economy from the “old normal” to the “targeted new normal” will be an arduous process and the core of this task is achieving sustainable development of the Chinese economy, i.e., the targeted “new normal,” and realizing the modernization of the state's governance system and capacity through reform. In this transformation period, such aspects as economic growth rate, economic security, the quality and efficiency of economic growth, and fairness and justice are evolving. The development of the “new normal” in this transformation period is jointly determined by China's long-term economic growth and all the reform measures intended for advancing the modernization of the national governance system and capacity. Multiple risks confront the “new normal,” and comprehensive macro-economic policies are needed for the smooth running and further development of the economy.

Keywords: “new normal”, China's economy, macro-economic policy

1. Main characteristics of the “new normal” economy

1.1. Economic growth moving down to a middle-high rate

Currently, China's economy is in a process that is “superposed by three periods,” which are the gear-shifting of economic growth, the throes of structural adjustment, and the digestion of early-stage stimulus packages. As for the gear shift of economic growth, this mainly refers to a process of middle and long term economic growth moving down and seeking a new equilibrium point. This is influenced by factors such as the change of population structure; here, the potential growth rate of China's economy tends to move downward and the future equilibrium point is dependent upon various aspects including economic growth rate, current policies, and the international environment. The second period China is undergoing is “the throes of structural adjustment.” China has gone through a catching-up stage of high economic growth during which the government led resource allocation. Now, the relations between the market and government have yet to be thoroughly straightened out, with distortion still existing in current structures of investment and consumption, between industries and among all kinds of factor markets. As adjustments fix these distortions, the economic growth rate will surely see a decline. The third

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period China is undergoing is “the digestion of early-stage packages.” Since 2008, there has been an overdose of stimulus policies and currently China is attempting to assimilate all these changes. After the appearance of over-capacity, China needs to reduce its capacity, which is typically expressed by the Producer Price Index (PPI) having negative year-on-year growth, leading to a major downturn in this year’s industrial investment growth rate. As for another aspect, the adjustment of the real estate market also caused a big decline in sales areas and investment growth rates of real estate. Lastly, from the perspective of the international environment, the “new normal” post-global financial crisis is believed to entail a slow economic recovery, a downturn of the total volume of the growth rate of the world’s international trade, and an inevitable drop in China’s export growth rate.

Total factor productivity, which propels economic growth, is hard to improve sharply in a short term. For one thing, it is difficult to achieve major breakthroughs and improvements at the technological level in the short term. For another, the effects of labor reallocation have become weakened. For developing countries, the rise of overall productivity, brought about by a labor force being reallocated from agricultural sectors to industrial and service sectors in the process of urbanization, is the main source for the increase of total factor productivity, but the amount of transferable labor in rural areas is decreasing in China. Furthermore, the release of reform benefits needs a more concrete process. The reform of China’s market-oriented economic system can spur new vitality and improve the efficiency of the entire society’s resource allocation. However, with it becoming more difficult to conduct intervening reforms, marketization can gradually perform its role in stimulating economic growth.

Concerning what the current situation of China’s potential economic growth will be, discussion has been conducted for years and consensus has been generally reached of two stances: the first is that the current downturn of the economic growth is not only a result of short-term external shock and internal recycling, but changing fundamental aspects and economic growth potential, so it is almost impossible to return to the high economic growth of double-digit annual rates China experienced in the recent past. The other is that even though China cannot go back to the high growth rates of the recent past, China’s economic growth, given the current stage of China’s economic growth and its advantages, will not fall to the 2%–3% growth range of the frontier countries—meaning there are still possibilities for China to strive for economic growth of a middle-to-high rate. The middle high growth of China’s economy potentially ranges from 6% to 8% with 7% possibly remaining at the median level—which could last another 10 to 15 years (Liu, 2014). China should endeavor to achieve that prospect and what needs to be pointed out particularly is that the potential economic growth rate refers to the average growth potential in a certain period of time, but should not be mechanically interpreted as a growth rate that is to be attained or striven for on a yearly basis. In reality, economic growth will fluctuate because of influences from both inside and outside China and it is very normal. Currently, in the stage which is superposed with the three aforementioned periods, we are not only facing the problem of a falling economic growth rate, but also confronted with the strenuous tasks of adjusting structures, resolving conflicts, and preventing and controlling risks. Some individual years in this stage will probably see lower economic growth rates, or even lower than the potential growth rate—but this should be regarded as normal.

1.2. Improvement of the quality and efficiency of economic growth

With the growing proportion of service industry in GDP, measured as the tertiary industry, standing at 46.1% in 2013, exceeding that of the secondary industry, China is transforming from an industrial power to a service power. As income and capital stock grows, China's economy is transitioning from an investment and export driven mode to a spending driven mode. According to past experiences, all this will significantly promote the demands for the service industry, particularly producer services such as commercial logistics, internet finance, and others. (1) According to the statistics from the Ministry of Human Resources and Social Security, the employment target for 2014 was to create 10 million jobs, and the target was reached in the first three quarters with 10.82 million jobs created, a year-on-year increase of 160,000 jobs. By the end of the third quarter of 2014, the registered urban unemployment rate was kept at 4.07%, lower than the controlled objective of 4.6%. Meanwhile, employment was stable for university and college graduates, transferred rural laborers, and unskilled urban citizens. Supply and demand were generally balanced in the human resource market and the total employment in enterprises remained steady. (2) There is a significant tendency in which the economic development mode has been transforming from the extensive mode of the past, which was over dependent upon resource consumption, to an intensive development pattern. In the first three quarters of 2014, the energy consumption per GDP had a year-on-year fall of 4.6%. (3) The industrial structure is gestating new breakthroughs. The proportion of the tertiary industry in the market continued to rise and the growth rate of value added products in the service sectors was higher than that in the industrial sectors. In 2013, the value added in the service sectors was 26.2 trillion RMB, a proportion of 46.1%. In the first three quarters of this year, the proportion of value added in the service sector continued to rise to 4.7%. (4) The structure of demand had some positive changes as well. Since the beginning of 2014, the growth rate of investments continued to fall, while still remaining at a high level, and the growth rate of exports has shifted gears to a less prevalent role in the overall market. The role of spending in driving economic growth is getting stronger, with a contribution to economic growth standing at 48.5% in the first three quarters, about 7 percentage points higher than that of gross capital formation. The trend of a re-balanced economy is becoming more and more obvious.

1.3. Promoting fairness and justice

The Third Plenary Session of the 18th CPC Central Committee proposed that “we must closely relate our work to better ensuring and improving people's well-being and upholding social fairness and justice, deepening the reform of social systems, carrying out reform of income distribution systems, promoting common prosperity, advancing innovation of systems of social fields, boosting the equality of basic public services, accelerating the formation of a scientific and efficient social government system, all while ensuring that society is harmonious and orderly while remaining full of vitality”. Again, the Fourth Plenary Session of the 18th CPC Central Committee put forward that we must “Rule by Constitution” and “Rule by Law”, and it is the core value of “Rule by Law” to promote social fairness and justice. The new normal of promoting

fairness and justice, in the economic sense, requires China to integrate fairness and efficiency in the development, standardize the relationship of the market and government, and establish fair market distribution structures and social security mechanisms. It is important to ensure fairness and justice in income distribution, citizens' rights for development and development opportunities through primary and secondary distribution. The following aspects need to be addressed to promote fairness and justice for the "new normal" economy: (1) to narrow the income gap; (2) to bridge the significant property distribution gap; (3) to eliminate discriminatory factors in employment and payment of labor; (4) to distribute education resources in a fair manner and create fair opportunities for education; (5) to distribution public health resources in a fair manner; (6) to perfect the social security system; (7) to promote reform of the financial system, to perfect fiscal redistribution functions and bridge the gaps of public goods between urban and rural areas, as well as among regions.

1.4. Main macro indicators of China's economic "new normal" can still make highlights in world economy

Currently, China's economic growth rate has dropped from the previous average of about 10% to around 7%-7.5%, stepping into the "new normal" and the comprehensive characteristics of the new normal can be observed through the indicators of economic growth, employment, price of commodities, and newly registered enterprises.

First, the "new normal" economic growth is that of efficiency, and the goal of "trimming down" inefficiencies is one of the reasons for the downturn of economic growth. Foreign trade has improved and there has been a sharp drop in investment growth. Since investment is related to over capacity, so the fall of economic growth can be rendered as an opportunity to ease over capacity. The decline of consumption indicators, measured by total retail sales of consumer goods, is part of what has resulted from the central government's adherence to anti-corruption policies and substantial cuts in government spending on overseas visits, official vehicles, and official hospitality. In addition, according to national economic accounting, the role of final consumption in stimulating economic growth was getting stronger and stronger in the first three quarters of 2014. It seems that the new normal constitutes an efficient and trimmed-down style of growth. The downturn in economic growth reflects the combined reaction of potential declines of growth as well as short-term cyclical factors. China's economic growth rate stood at 7.3% in the first three quarters of 2014 and even if the growth rate falls to 7%, it will still rank highest among the top economies in the world (See Table 1).

Second, employment has entered a preferable situation. The labor demand rate and employment rate have both reached healthy levels. The labor demand rate of college and university graduates remains at a low level, which indicates that there are still structural problems in the labor market. The proportion of service industry has risen, so the capacity of per unit GDP to stimulate employment has become stronger. Before 2007, 1% growth of GDP could create 1 million jobs in urban areas; while in recent years, with one percentage point growth of GDP, about 1.5 million jobs are created. In the first three quarters of 2014, altogether 10.82 million new jobs were created in urban areas with the number of migrant workers standing at 175 million.

Table 1

Main economic indicators of some countries and economies in 2014

(unit: %)

	GDP in the third quarter of 2014	CPI in October, 2014	Unemployment rate in September, 2014 (Season Adjusted)
U.S.	3.9	1.7	5.9
Euro Zone	1.3	0.4	10.0
Japan	-1.1	3.3 (September)	3.6
Brazil	-0.8 (2nd Quarter)	6.6	
India	5.85 (2nd Quarter)	5.5	
Mexico	2.1	4.3	
Russia	0.7	8.3	
China	7.3	1.6	

Source: CEIC.

Third, the rise of the consumer price index remains steady and inflationary pressure has been eased. In October, 2014, the consumer price index increased by more than 5.5% in Brazil, India, and Russia. Since 2012, the year-on-year increase of the consumer price index in China has been kept between 1.7% and 3.1%; in October, 2014, the increase was 1.6%, being within the targeted range and lower than the emerging market economies such as Brazil, India, and Russia.

Fourth, the number of newly registered enterprises has increased, which has stimulated the market's vitality. Ever since China's new administration, 632 items of administrative approval procedures have been shortened and streamlined one after another. The reform of the commercial registration system has effectively reduced the start-up costs and requirements for market access and aroused the whole society's enthusiasm for starting and developing businesses. According to the statistics issued by the State Administration of Industry and Commerce, in the first three quarters of 2014, there were 2.648 million newly registered enterprises, a year-on-year growth of 52.44% and the registered capital (funds) totaled 13.42 trillion RMB, a year-on-year increase of 99.76%. Among the newly registered enterprises, enterprises of the tertiary industry accounted for more than 75% of new business and the number of enterprises of industries, including high-tech, cultural, entertainment, and scientific and technological services, maintained high-speed growth. The newly registered self-employed and other private businesses continued to increase rapidly and have become the main channels for meeting employment needs.

1.5. The "targeted new normal" which is compatible with the modernization of national governance system and capacity

The "Decision" issued in the Third Plenary Session of the 18th CPC Central Committee proposes reform strategies that strive to integrate as a whole the Chinese style of socialist economic development, political development, cultural development, social development, and ecological civilization development. The overall objective of comprehensively deepening reforms is to develop and perfect the socialist system with Chinese characteristics and promote the modernization of a national governance system and capacity. The national governance system and

capacity are the concentrated reflection of a country's national system and its system's execution capacity (Xi, 2014). In China, the national governance system refers to the institutional systems in which the nation is administered by the Communist Party of China, including institutions, mechanisms, and legal and regulatory arrangements in fields such as economy, politics, culture, society, ecological civilization, and Party building. National governance capacity refers to the abilities to administer social affairs with the national systems. The final evaluation criteria for the modernization of a national governance system and capacity is the crisis in governance getting resolved and the socialist system with Chinese characteristics that is constantly getting developed and perfected with the leadership of the Communist Party of China. Specifically, we can conduct the evaluation in the following five aspects. The first aspect is the standardization of public power operations. And it requires sound systematic arrangements and standard public order for government governance, market governance, and social governance. The second aspect is democratization. And that means that public governance and systematic arrangements must be based on the principle of popular sovereignty and the people being the ultimate masters—and all the public policies must reflect the will and key positions of the people. The third aspect is governance by law. And that is to say the constitution and law constitute the supreme authority of public governance. All people are equal before the law and no organizations or individuals are allowed the power to go beyond the law. The fourth aspect is efficiency. And that means the national governance systems must effectively maintain social stability and social order and be favorable for improving administrative efficiency and economic benefits. The fifth aspect is integration. The modern national governance system is an organic institutional system and it should be an integrated and inseparable unified whole whether we consider the central level or any level of local governance, from governmental governance to social governance, or any further kind of systematic arrangements (Yu, 2013, 2014).

Putting forth the above-mentioned criteria for the modernization of national governance system and capacity in the economic sense, we can get the “concentrated reflection and requirements that need us to accelerate the development of the socialist market economy, democratic politics, advanced culture, a harmonious society, and an ecological civilization. These advancements will give full play to the vitality of labor, knowledge, technology, management, and capital; all while offering a full flow to the source of the creation of social wealth and make the people share more fruits of development in a fairer manner”. Furthermore, “China also must closely relate our work to deepening the reforms of the economic system through giving the market a determinant role in resource allocation, adhering to and perfecting the basic economic systems, accelerating the perfection of a modern market system, macro-economic regulation and control systems, and open economic systems, advance the transformation of economic development patterns, and the construction of an innovation-oriented country, as well as promote the economic development in a more efficient, fairer and more sustainable fashion.”

2. The reconstruction of economic growth serving as the engine in the “new normal”

Long-term structural factors have pushed China's economy into the “new normal” in its

transformation period. With the original behavioral model of investment entities being restrained by measures of deepened economic system reform, the driving engine of the development of the “new normal” economy has become restructured during this transformational period.

2.1. Slowly calibrating the cycle of “high savings rates-high investment rates-high growth rates”

In the Chinese economy’s “new normal,” the change of population structure, on one hand, caused the loss of the original population dividends, pushing down the economic growth rate. On the other hand, it also pulled down the saving rate. With the joint action of factors including a rising proportion of the service industry in the market and a slowing down of the pace of urbanization, the growth rate of investment also slowed down. So the cycle of high saving rates, high investment rates, high growth rates, and high savings rates for the “old normal” will be calibrated in the “new normal.” The slowdown of labor supply growth drove the economic growth rate to a slight decline. The population structure in China is undergoing change and some phenomena in some areas have, to some extent, reflected the change of labor supply and demand, such as the “shortage of migrant workers” and “recruitment difficulties.” By the end of 2011, the proportion of people aged 60 or above in the total population increased to 13.7% and that of people aged 65 or above grew to 9.1%. With birth rates kept at a low level and the rapid growth of aging population, the proportion of people aged between 15 and 64—the labor age—has begun to fall year-by-year since 2010. The growth rate of the working-age population has begun to drop year after year since 2011 and in 2013, the absolute working-age population also began to fall (See Figure 1). According to the forecast by the United Nations Population Division, after China’s population of people aged between 15 and 64 reaches its peak value in 2015, the number will gradually fall and by 2060, the proportion of the working-age population in China will fall from 73.5% in 2010 to 57.3% (See Figure 2). The working-age population in China will reach its peak value in 2016 with a total number of 999 million people and then the number will gradually drop to 987 million people by 2020. From 2011 to 2020, the annual average growth of employment is expected to see a drop of 0.9 percentage point from the previous period, leading to a decline of 0.4 percentage point in economic growth. Even through the accelerated advance of urbanization releases surplus rural laborers and improves the overall quality of labor, it still can not make up for the negative influences brought about to economic growth due to the general decline of the labor force. So the change of the labor market means the loss of population dividends and also signifies a decline of labor supply and a slow release of employment pressure, forming suppression to economic growth in the former labor-intensive sectors.

When the changes of the population’s age structure influence the labor supply, it also leads to a decline in savings rates. According to calculations, every one percentage point growth of dependency ratio sees a 0.8 percentage point drop in the savings rate. With the changing population structure, China is becoming an aging society and its dependency ratio continues to climb. From 2011 to 2020, the change of population structure will be driving a 2.8 percentage points annual fall in the savings rate (Cai et al, 2005). As the savings rate goes down, the growth rate of China’s investment demand, if we take into account the effects of foreign capital inflow, will also experience a downturn.

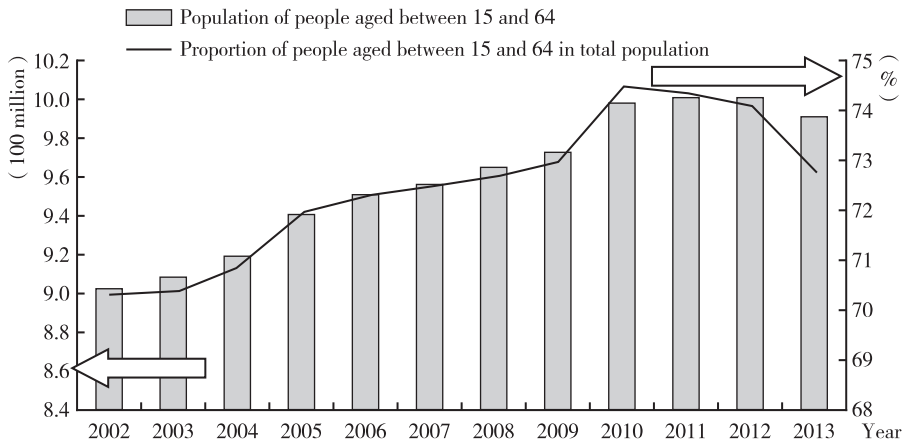


Figure 1. Changes of China's working-age population

Source: State Statistics Bureau of PRC.

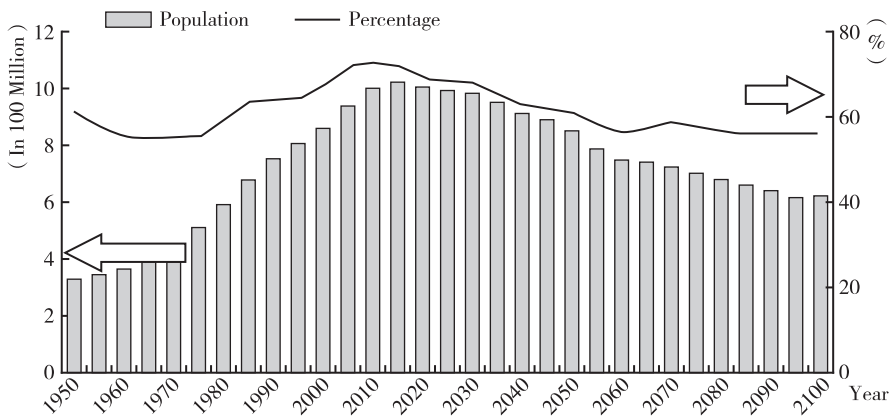


Figure 2. Changing trend of population aged between 15 and 64 in China

Source: United Nations Population Division.

In addition, according to the development tendencies of the service industry, in 2013, the proportion of the service industry in GDP exceeded that of the secondary industry. In the coming years, the service industry's proportion in GDP will continue to rise. The rise of service industry's proportion in total GDP will push down the ratio between capital and labor as well as the investment efficiency of fixed capital. Meanwhile, because the productivity of the service industry is lower than that of the manufacturing industry, the increase of the service industry's proportion in GDP is not advantageous to the improvement of labor productivity, thus ultimately bringing down the economic growth rate. According to the pace of urbanization, the development of China's urbanization follows the laws of the logistics curve. It took 7 years for the urbanization ratio to increase from 30.5% in 1996 to 40.5% in 2003 and 8 years to rise from 40.5% in 2003 to 51.3% in 2011. Based on estimations through simulated results, it was predicted that it would

take 10 years for the ratio to move up from 51.3% in 2011 to 60% in 2021. If calculating the year-on-year index using linear regression, we will find that the increase of urbanization ratio should have begun to fall 10 years ago. In 2013, the urbanization ratio reached 53.7%, and in the future the growth rate of the urbanization ratio will further drop, which means that the economic growth and driving force provided by urbanization-driven real estate investment and infrastructure investment will also be weakened. The constraints from the labor market, land, energy, and environment are getting stronger. Great changes have taken place in the environment of China's contemporary economic development. The previous period of low income, low land costs, low energy costs, and environmental costs are gone and the special advantages formed by distorting land costs, energy costs, and environmental costs will gradually diminish. All these factors have determined the slow reversion of the structure of investment and consumption.

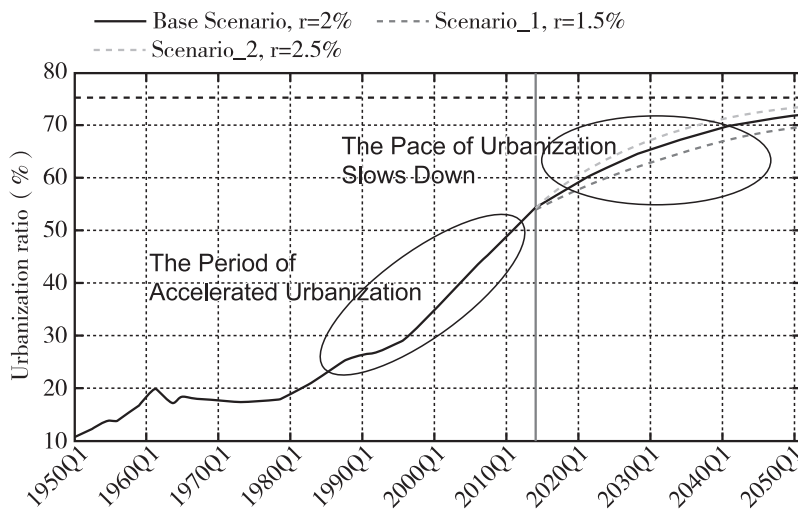


Figure 3. Urbanization ratio

Source: State Statistics Bureau, Author's Calculation.

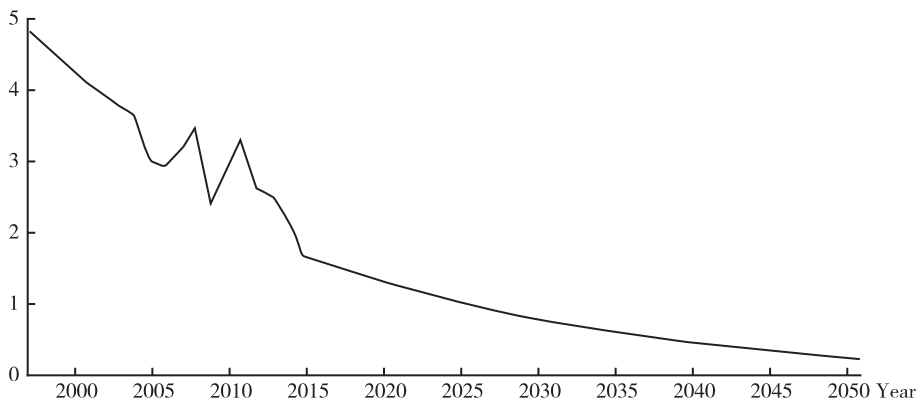


Figure 4. Year-on-year growth of urbanization ratio in China

Source: State Statistics Bureau, Author's Calculation.

2.2. Financial disciplines restrain the behaviors of investment entities

As the reform process advances, investment-driven economic entities in the “old normal” are restrained by stricter financial discipline. The pay cuts of management in the state-owned enterprises brings about the problem of lacking incentives and with the deepened reform of financial system, the behaviors of local governments get dual restraints from indicators of performance assessment and the reform of cleaning up debts. In the process of the current economic downturn, de-capacity and de-leveraging of enterprises and debt management of local governments will inevitably cause a rise in the ratio of the banks’ non-performing assets. For the state-owned enterprises, local governments, and banks as entities, their motivation for pursuing economic growth in the “old normal” has been restrained.

2.2.1. Salary reform in state-owned enterprises may lead to deficiency in incentive mechanism

On August 8th, 2014, the Comprehensive Reform Leading Group of the Central Committee convened at the fourth meeting and deliberated *Salary Reform Scheme for Executives of Enterprises under the Central Government and Opinions on Rational Determination and Strict Specifications of Position Remuneration and Business Expenses for Executive of Enterprises under Central Government*, which kicked off the salary reform of executives in state-owned enterprises, especially the enterprises under the control of the central government. The key and difficult part of carrying out salary reform of state-owned enterprises is to establish a real scientific performance-appraising system. On one hand, the differences of performance requirements between enterprises of different industries should be taken into account, the standards of monopolized industries, public welfare industries, and competitive industries are different. On the other hand, overall planning and all-round consideration should be made for the salary difference between state-owned enterprises and non-state-owned enterprises, managers and staff, and between different state-owned enterprises themselves. Since the process of selecting operating personnel through market mechanisms is lagging, more than 90% of managerial personnel in the enterprises under the control of the central government are hired through administrative appointments. Under this circumstance, salary reform will involve a large number of people, cause widespread influence, and also face great resistance. Once the salary of upper-level executives changes, almost the entire management’s salary will be reduced proportionally. This will affect the vested interest of large groups of people and may also lead to problems of incentive mechanism deficiencies and brain drain (Zhang, 2014).

2.2.2. Cleaning-up of local government debts will move into a substantial operation stage and investment behaviors of local governments will undergo more restraints

On October 2nd, 2014, the central government issued *The State Council’s Opinions on Reinforcing Local Government Debts Management* (Document No.43) and together with the amended *Budget Law* and *The State Council’s Decisions on Deepening the Reform of Budget*

Management System released on October 8th, the three documents sketched the frame of how to deal with the stock of debts and how to finance future payment increments. The Ministry of Finance, on October 23rd, printed and distributed *The Methods for Screening and Cleaning-up the Classification of the Local Government Stock of Debts into Budget Management* (also referred to as the “*Methods*”), which listed the specific details for cleaning-up debt. The purpose of all these measures is to impose hard financial restraints on local government financing platforms and lowering government debt risks, firmly holding onto the bottom line of avoiding regional and systematic risks. The *Methods* requires that local governments of all levels must, through screening and cleaning-up work, carefully identify and pick out the stock items of financing platform companies. For the items that are suitable for developing the Public-Private-Partnership (PPP) mode, they must take efforts to extend the PPP mode.

Besides this, the *Methods* also requires that local governments of all levels must lock the balances of general debts and special debts in strict accordance with the stock of debts approved by the State Council. Local governments of all levels should report situations of the locked stock of debts to the People’s Congress or its Standing Committee of the same level and make it public promptly, according to the related requirements of budget openness. This new round of screening work has paved the way for including government debts categorically into the new, fully-covered budget management system. As for local government debt, it used to be controlled at the terminal of banks or capital supply while now it can be controlled at the terminal of demand. In the future, government debt will only be made through government bonds and how much to issue can be planned and controlled completely. From the perspective of finances and taxes, by reforming the budget system, the transformation of government functions is advanced so that government behavior is transformed and reform is achieved in the real sense. Within a short time, the cleaning-up of local government debts may influence the financing demands of local governments, but in the long run, it may reversely force local governments to change GDP growth driving modes by investment, which will help local governments to set up a standard debt financing system.

2.2.3. An increase of non-performing assets in the banking system restrains credit availability

At the end of 2013, the banking system had about 1% non-performing loans and in 2014 the ratio was 1.04% by the end of the first quarter, 1.08% by the end of the second quarter, and 1.16% by the end of the third quarter. Though the change of that ratio was not significant, the growth rate, given the loan balances and their large base number, began to make banks and supervision organization wary. According to the statistics from China Banking Regulatory Commission, in the first three quarters of 2014, the loan balances of commercial banks increased by 54 billion RMB, 48.3 billion RMB, and 72.5 billion RMB respectively; by the end of September, 2014, the non-performing loan balances of commercial banks in China totaled 766.9 billion RMB, a consecutive rise for 12 quarters. The banking system has been affected by factors such as the downturn of domestic economy, shrinking sales, falling prices in real estate, and a declining rate of returns on investment. The banking loans were subsequently tightened or even frozen, forming a Chinese

style “collateral real estate loss” spiral and intensifying financial and economic fluctuation. Those are the main risk factors causing the increase of non-performing loans (Yan, 2014). As the real estate market is under adjustment, the non-performing assets in the banking system may further increase, suppressing at least within a short term the fast growth of loans as a result.

2.3. Demand constraints to economic growth driving engine

2.3.1. The growth rate of fixed-asset investment slows down and investment structure is adjusted

In 2014, the growth rate of fixed-asset investment slowed down and the investment structure underwent adjustment, which on one hand reflected the demand of de-capacity, and on the other hand, mirrored the requirement of maintaining economic growth above the bottom line. In the first 10 months of 2014, the nationwide fixed-asset investment (not including peasant households) totaled 40.6161 trillion RMB, with a year-on-year nominal growth of 15.9% but 0.2 percentage point down from the first nine months of 2014. In the first 10 months of 2014, the national investment in real estate development amounted to 6.8751 trillion RMB with a year-on-year nominal growth rate of 12.5% (deducting the actual growth of 11.7% due to price factors), while 0.7 percentage point down over the first 8 months of 2014. From the view of investment structure, the year-on-year growth of investment in the primary, secondary, and tertiary industries were 28.9%, 13.4%, and 17.4%, respectively, and the proportions of investment in the three industries were 2.4%, 41.9%, and 55.7%, respectively, with the tertiary industry exceeding the second industry by nearly 13%. The main reason for the slowed growth of fixed-asset investments nationwide is the slowdown of investment growth in the second industry and the internal investment structure of the second industry, which could fully reflect the pressures on some sectors (e.g. mining industry and etc.) in the process of de-capacity. In the first 10 months of 2014, the total investment in real estate development across the country reached 7.722 trillion RMB, a year-on-year nominal growth of 12.4% while 0.1 percentage point down from the first 9 months of 2014. Investment in residential buildings totaled 5.2464 trillion RMB, exhibiting a year-on-year nominal growth rate of 11.1%, but 0.2 percentage point lower than the first 9 months of 2014. The residential building investment accounted for 67.9% of the investment in real estate development. In the “new normal” period, there are still many economic factors restraining investment, such as a lack of local financial resources and too many local government debts. The real estate industry is currently facing a bursting bubble and the rebounding of real estate investment has been elusive, the task of enterprises de-stocking and de-capacitating has been very tough and the lack of new technology and profitable projects in the process of industrial upgrading has been a challenge.

2.3.2. Big improvements in the consumption growth rate remains elusive

Since 2010, the monthly year-on-year growth of retail sales of consumer goods has maintained a downward trend. For the first 10 months of 2014, the total retail sales of consumer goods reached 21.3118 trillion RMB, a year-on-year growth of 12.0%, and the online retail sales by enterprises above the designated size amounted to 3.307 billion RMB, a growth of 55.6%. In the fourth quarter of 2014, the growth rate of consumption was projected to go slightly higher

than that of the third quarter because of the push of seasonal factors. In the context of the overall economic growth downturn and slowdown of revenue growth in combination with the central government adhering to policies such as anti-corruption, pension reform of public institutions, and standard financial expenditures, consumption will maintain steady growth for a long time and will not, within the short term, become the main driving force to ensure economic growth. The long-term restricting factors for consumption growth are as follows: (1) The situation of the widening income gap is hard to significantly change and the level of residents' disposable income lacks adequate lasting growth. (2) The ratio of housing prices and average income is excessively high, so potential house buyers need a great deal of savings to pay their monthly mortgage, shrinking their consumption in terms of other aspects. (3) Statistically, the service flow generated from real estate consumption is not included in consumption accounting according to the market price. (4) The system of social security and health care is not yet perfect and residents have to depend on savings to prevent and cure diseases and live out their retired life. (5) Property income is not supportive of consumption expansion. Property income of Chinese residents mainly comes from real estate and stocks. The distorted prices of real estate have become a major cause of the current income gap. People who own two or more houses care more about investment income, while people who own one house are not likely to cash in on the housing price rise and increase their consumption. For people without a house, they cannot share the benefits of the appreciation of real estate, so instead they have to increase their savings. The stock market has not yet recovered from the financial crisis in 2008 and the investors' assets have shrunk. This has gone against the fundamentals of economic growth and struck a sharp contrast with the American stock market that has been continuously notching new highs.

2.3.3. A severe situation remains for the middle and long term in regards to exports

Since the global financial crisis, the growth of global trade has been declining. According to the rough statistics from World Trade Organization (WTO), in 2012, the growth rate of global trade stood at 2%, far lower than the 6% growth rate before the crisis (from 1990 to 2008). Normally, the growth rate of global trade should be about two times that of the general global economy. But, in 2012, impacted by the European debt crisis, the growth rate of the global economy fell to 2.1%, making the ratio of global trade growth and global economic growth fall nearly to 1:1. In 2014, China's total import and export volume reached 26.43 trillion RMB, a 2.3% growth over 2013, with export volume at 14.4 trillion RMB, a growth rate of 4.9%, import volume standing at 12.04 trillion RMB, 0.6% down, and a trade surplus of 2.35 trillion RMB, expanding by 45.9%. China's future export situation will be affected by the following factors: (1) The world's economic recovery remains slow and there is a distinct differentiation of economic growth among developed economies. The US is consolidating its economy while recovering and the economy of Europe is experiencing a weak recovery. The economic growth rates of the major emerging market economies are also further slowing down. (2) The comparative advantages of the low labor costs of China's foreign trade exports is being weakened and the decline of developed countries' investments in China's manufacturing industry has curbed the import and export. With the continuous rise of China's labor costs, growing constraints of environmental protection, the competitive advantages of China's traditional industries are blunted. At the same

time, the cooling-down of developed countries' investments in China's manufacturing industry have made the actual foreign capital levels of China's manufacturing industry suffer a significant decline and because around half of China's foreign trade exports are provided by foreign-invested enterprises, the decline of foreign capital in actual use by the manufacturing industry will put a mid-term curb on exports.

2.4. Resilience of the economy's "new normal" and new balanced growth driving engine

As reform deepens and opening-up advances, factors promoting sustainable economic development are increasing and the resilience of China's economic growth has been improved. First, the benefit of reform is amassing momentum for innovation-driven economic growth. Through streamlining administration and delegating power to lower levels, carrying out reform in state-owned enterprises and land reform in rural areas, as well as setting up free trade areas are experiencing favorable conditions for the market to serve its fundamental role in resource allocation. During the third industrial revolution of internet and big data, there have been new opportunities for industrial structural upgrading and enterprise innovation and entrepreneurship. Second, the new open benefits have created a new stage for China's economic development. The developmental strategy of taking building the economic community as its core part has marked a new phase of China's opening-up and reflected common interest demands in China and its neighboring countries for future economic development. Through advancing the "One Belt and One Road" region (referring to the "Silk Road Economic Belt" and the "21st Century Maritime Silk Road") and the building of free trade areas, China will transform from a big trading nation into a capital exporting country. Third, the new type of regional development strategy provides new space for balanced economic development. The integration of the Beijing-Tianjin-Hebei Regions and the building of Yangtze River Economic Zone will be two major growth poles in space and layout optimization, as well as a platform for collaborative development of regional economies in the future. Fourth, the strategy of ruling by law has ensured that economic reform and the systematic benefits of socialism with Chinese characteristics will make contributions to overall economic growth.

3. Major risks in the "new normal" economy

3.1. The pressure of inflation is eased while the risk of deflation rises

As the economy moves into "the new normal of transformation," the pressure of inflation will be eased, while the risk of deflation rises. In 2014, annual CPI growth stood at 2.0%, lower than the inflation target value of around 3.5%. We can see some general trends arising.

(1) The growth of the money supply and social financing scale shrinks and inflation expectations weaken. After the financial crisis, the monetary stimulus policies went through a 4-year adjustment, and in 2013, the annual growth rate of the money supply (M2) and credit was 13.6% and 14.1%, respectively, generally within the range of normal (about 10% to 15%). In 2014, the growth rate of currency and credit continued to move toward normal.

(2) De-capacitation causes the long term negative growth of PPI. The national producer price index had a year-on-year drop of 2.2% and a decline of 0.6% from the previous period. Ever since Producer Price Index (PPI) turned to negative year-on-year growth in March, 2012, to December, 2014, PPI has maintained negative growth for 34 consecutive months. Since the de-capacitation is still in progress, there will be risk of deflation in the long term negative growth of PPI.

(3) The drop of international bulk commodity prices may evolve into imported deflation. The usual transmission route of price levels is “imported commodity price index”—“producer purchase price index”—“producer price index (PPI)” —“retail price index (RPI)—“consumer price index (CPI). The producer price index (PPI) and raw material price index are of the utmost importance for judging the future situation of deflation. Currently, the producer price index and raw material price index have shown negative growth and this will exert big pressure on CPI deflation in the future. In addition, according to the past three rounds of deflation, if the growth of CPI is lower than 1% or the negative growth of PPI is below 4%, then the possibility of CPI deflation will go much higher. In the second half of 2014, the bulk commodity price index went down to a 5-year record low and with US dollars continuing to be strong, the price of bulk commodities priced in US dollars tumbled, including crude oil, iron ore, coal, cotton, and other staple commodities. Given the tendency of US dollar appreciation and decline of international bulk commodity prices brought about by the Federal Reserve retreating from quantitative easing, China’s raw material price index and producer price index will inevitably go down in the future. And if PPI continues to have negative growth and passes it onto CPI, the situation will evolve into imported deflation.

(4) The rise of structural labor costs will not become the main reason for inflation. According to the statistics released by the National Bureau of Statistics, in the first three quarters of 2014, China’s rural residents’ per capita cash income was 8,527 yuan, displaying a year-on-year nominal growth of 11.8% and an actual growth rate of 9.7% after adjustments for price factors. The per capita disposable income of urban residents in China was 22,044 yuan, a year-on-year growth of 9.3% and an actual growth of 6.9% after adjusting for price factors. According to combined survey of residents in the urban and rural areas, in the first three quarters of 2014, the national residents’ per capita disposable income was 14,986 yuan, a year-on-year nominal growth of 10.5% and an actual growth of 8.2% after adjustments for price factors. The median of the national residents per capita disposable income was 13,120 yuan, a year-on-year nominal growth of 12.1%. By the end of September, 2014, the rural migrant labor force was 175.61 million people with a year-on-year growth of 1.69 million people and a growth of 1.0%. The average monthly income of migrant workers was 2,797 yuan, a growth of 10.0% over the previous period. In the first three quarters of 2014, the growth of national urban residents’ per capita disposable income was 6.9% (with adjustments for price factors), which was lower than the growth of national residents’ per capita disposable income and GDP growth. We believe though various policies that the central government introduced to improve people’s well-being and adjust income distribution patterns form a traction for the rise of labor costs, yet in the picture of increasing pressure of the overall economic downturn, the structural growth of rural and migrant worker income will not be able to promote the overall rise of labor costs. For the long run, labor cost will be expected to experience an upward trend and will offer support for price rises in the short term, but currently it

will not become the main reason for inflation.

(5) The price growth of food, services, and housing has been experiencing a downward tendency. The food price and housing prices have been the two major factors affecting the rise or fall of China's CPI in the most recent 10 years. In October, 2014, the consumer price index fell to 1.6, not yet an outright deflation according to the year-on-year indicators of CPI, because in the CPI basket of goods, there was a maintained moderate positive year-on-year growth of food and housing prices that cancelled out the negative growth of PPI onto CPI. But we note that, since the beginning of 2014, the year-on-year growth of services, food, and housing prices has shown a significant decline. In 2014, the growth rate of service prices fell from 3.7% in January to 2% in October. During the same period of time, food prices' year-on-year growth dropped from 3.7% to 2.5% and housing price growth dropped from 2.8% to 1.6%. If economic growth and PPI decline further in the future, the year-on-year growth of food, services, and housing prices will also continue to fall, thus further driving down the growth of China's CPI. Although the changing trends of CPI and PPI are not exactly the same, our calculations show that between January, 2010, and October, 2014, every 1 percentage point drop in PPI may bring along around a 0.1 percentage point decline of CPI in the concurrent period.

(6) Continuous increase in grain output has laid a foundation for stabilizing food prices. In 2014, the total output of summer grain crops across the country reached 136.60 million tons, an increase of 4.75 million tons over the previous year and exhibiting a growth rate of 3.6%. The total output of early rice harvest was 34.01 million tons, a decrease of 125 thousand tons and a drop of 0.4%. Autumn grain crops are expected to have another good harvest. In the first three quarters of 2014, the output of pork, beef, and mutton reached 59.75 million tons, a year-on-year growth of 2.0% and the production of pork amounted to 39.72 million tons, exhibiting a growth rate of 3.3%. The abundant harvest of grains has reduced the pressure of the price rise of grains and other foods, so the price of grains and other foods will present little pressure on inflation.

(7) In the fourth quarter of 2014, the carryover effect of consumer price index growth ran lower than that in the third quarter and the carryover effect of CPI in 2015 is below that of 2014. The monthly average value of the price rising carryover effect was 0.93% in 2014 and the carryover effect in each of the four quarters of 2014 were 1.1%, 1.5%, 1.0%, and 0.17%, respectively. The carryover effect's impact on pricing was concentrated in the second and fourth quarters, and the influence of the carryover effect was significantly reduced. Suppose that the ring growth of CPI in November, 2014, and December, 2014, are -0.1% and 0, then the monthly average carryover effect of CPI in 2015 will be about 0.29% with 0.45% in the first half of the year and 0.13% in the second half year.

Above all, as the global economy is recovering slowly and China's economic growth has declined to a secondary-level growth rate, while the total demand has been hard to expand. Meanwhile, the continuous increase of grain output across the country, sufficient industrial capacity, and over capacity in some industries will put a curb on rising price. So even though there are some factors driving prices up to consider, such as the rise of costs of domestic factors, substantial advances of price reform, and other causes, importance should be attached to the pressures of economic growth and declining prices.

3.2. The potential risks of debt deflation and the negative output gap

We should take seriously the risks of deflation, debt deflation, and the negative output gap in paying off the debts for excessive investment and the bubble-based economy in the “old normal” period. Over-investment in the old normal period caused excessive idle capacity and the real estate bubble broke away from the prices that the actual income can afford in the future. Since the financial crisis in 2008, unlike many countries in the world which resorted to market clearing to diversify and pad the economy, China has chosen to gradually remove excessive capacity and clean up, step by step, the asset bubbles and local government debts, which is a way to stabilize economic operations in the short term. However, no matter what methods are used, the process of de-capacitation, ridding the economy of bubbles, and de-leveraging will certainly bring about the hidden risks of downturns in economic growth, sluggish prices, deflation, debt deflation, and a negative output gap. Ever since GDP growth reached its peak level of 12.1% in the first quarter of 2010 after the financial crisis, the main center of China’s economic growth has dropped to around 7.5%. As for the adjustment of real estate market processes, if the effect of housing price declines spreads, real estate collateral value will shrink and this will lead to a debt deflation spiral where “banks will be collecting debts and will be forced to sell at a discount causing housing prices to further plunge.” If setting the target growth rate of the consumer price index at around 3.5% is accepted, then the current growth rate of the consumer price index will be about 1 percentage point down from the target. If measuring the price increase rate by GDP deflation, we find that GDP deflation is lower than the current price rise rate. We know through estimation that the increasing margin of GDP deflation was only 0.7% in the first quarter of 2014, 1.6 percentage points lower than the increasing margin of the consumer price index of the corresponding period. No matter what methods are used to estimate potential economic growth rates or how different the estimated results are, judging from the relations between economic growth and price increases, we can tell that currently the economic growth rate is very close to the potential economic growth rate. In this state, the cushion room for resisting unexpected adverse impacts is small. Having an economic growth rate lower than the potential growth rate means that the risk of an output gap is running high, so the difference of economic projection will increase and the risk of misjudgment will also rise.

4. The policy choices in the “new normal”

In conclusion, in the “new normal” of China’s great economic transformation, the potential economic growth rate moves downward in the economic operation and the driving engines for economic growth are undergoing transformation. At the same time, we are also faced with risks of deflation and a negative output gap. So the macro-economic policies should first work to manage a healthy decline of economic growth, prepare effective cushions, prevent catastrophic collapse, and explore new sources of economic growth. In the new normal, macro-control must be carried out in forms of “interval adjustment and control,” “directional adjustment and control” and “structural adjustment and control” with multiple objectives including ensuring employment, stabilizing economic growth, preventing risks, and stabilizing prices, while on the other hand,

adjusting structures, improving people's livelihood, and promoting reforms. We must stick to the general work guideline of making progress while maintaining stability, combining stabilizing growth, promoting reforms, and controlling risks together, continue to implement proactive financial policies and prudent monetary policies, maintain the moderate growth of the social financing scale and money supply, adhere to bottom-line thinking, prevent the amass of financial risks caused by unexpected economic downturns, and ensure non-occurrence of systematic risks in the economy.

4.1. We should adapt to the new normal, respect the laws and make a difference

The long-term structural factors determine the declining tendency of potential economic growth rates and the macro policies must respect the laws of economic development in order to adapt to this new normal. However, China is still in a period characterized by strategic opportunities for economic development, while macro policies are in need of updates. China should prioritize macro-economic policies that give priority to "ensuring full employment," take the output gap as the datum, follow Okun's Law, and implement moderate stimulus policies. Currently, the 7%-8% economic growth rate has been able to ensure employment objectives. In the future, as the labor supply drops and the market proportion of the service industry further grows, the economic growth rate, which is correlated with employment objectives, is likely to experience a further decline. The relation between employment and economic growth rate reflects the dynamics of Okun's Law. If we turn down or violate Okun's Law to accelerate the economic growth rate and increase the output gap through strong stimulus policies, the consequences will be manifested in an excessive rise of nominal wages and price inflation which will trickle down into subsequent economic adjustment and an increase in economic fluctuation. Large scale bailout measures can only be used in the circumstance of market collapse and a great depression. At present, China's economy, with a growth rate of about 7.5%, is certainly not undergoing such extreme conditions. So we should comprehensively deepen the reform to release the economic growth potential and advance the reforms in the areas such as state-owned enterprises, the household registration system, rural land use, and other policies. All these structural reforms will be able to further promote economic growth.

4.2. We should properly handle the relation of consequences brought along by stimulus policies in the early digestion period and stabilizing economic growth

The consequences of excessive stimulus policies between 2008 and 2010 must be gotten rid of through carrying out de-capacitation, eliminating bubble markets, and de-leveraging factors that can contribute to negative growth; however, if the government's power is abused and there is a rush for quick results, it will probably lead to even more dire circumstances. In order to avoid the risks of an economic recession, we must take moderate economic growth stabilizing measures to hedge the negative effects of stimulus policies. Though China's investment rate will see a smooth downward trend in the future, China's savings rate and investment rates are still at a high level and the growth of investments will also be considered a priority. China will see

tremendous demand growth in high-tech industries, ecological civilization construction, new types of urbanization, infrastructure investment in urban areas, integrated regional development, renovation of rundown areas, and upgrading of traditional industries. Stabilizing investment calls for joint efforts from both the market and government. Regarding investments in the market, excessive competition between local governments and enterprises and excessive investment should be avoided by creating a fair-playing environment for market competition, reducing government intervention, and allow market entities to have the independence to make their own choices. To meet that end, we must break monopolies of any form, promote fair competition in real terms, advance reforms in aspects of finance and taxation, and improve the project examination and approval process so that we can provide a sound development environment for the private economy. In regards to investment in public fields, we need to conduct research on why investments cannot or will not go into the field of infrastructure construction; furthermore, we need to explore the model for real, commercialized infrastructure operation.

4.3. We should take measures to weaken the impact of imported deflation

Various effective measures should be researched and employed to weaken the input influences created by price declines in international bulk commodities. First, we should ensure the full play of the futures market's role. Enterprises should be encouraged to resort to hedging to ease the pressures coming from the long-term negative growth of imported goods prices and the PPI, which affects the profits of enterprises. Second, we should strengthen the construction of reserve infrastructure. Expanding the reserve of strategic materials, such as petroleum, which currently stand at a relatively low level, will make such markets less susceptible to interference of international powers. It will also be important to advance the construction of reserve infrastructure which is also in favor of boosting investment growth. Third, we should seize the opportunity of price declines in international bulk commodities and promote reforms of pricing, fiscal subsidies, and tax system in the fields of resource commodities, public services, and other important areas.

4.4. Policy should spread and reduce financial risks through debt restructuring and other measures

There are a number of uncertainties to be addressed in terms of reducing the risk of financial risks. First, following the example of the American house saving agencies' (such Freddie Mac and Fannie Mae and etc.) model, China can set up long-term house finance agencies and encourage some development enterprises and financial enterprises to defuse risks. Second, applying means of reform and methods of marketization, we can establish asset restructuring companies for multiple investments, pointedly strip off the non-performing assets in the banking system and local government debts, conduct corporate restructuring to local financing platforms, and carry out capital market financing in due time to reduce their debt ratios. Third, in the process of advancing asset securities, we can bring in securitized operations for real estate loans in the banking system and local government debts and exchange securitized products through the open market, ultimately spreading and transferring financial risks to a manageable level.

4.5. *China should promote innovation-driven development through reform*

Innovation-driven development is the fundamental momentum for China's economy to transform and upgrade to the "targeted new normal." Fundamentally speaking, innovation requires certain systems and an environment to support it; whether from the perspective of talent, resources, or a research basis, China is equipped with huge innovation potential. However, for a long time there has been malpractice in certain aspects of the education system, talent system, scientific research programs, fund management, and other areas which have seriously restricted the potential of innovation as a driving force for development. China must accelerate reforms in those fields, build systems and a social environment conducive to innovation as soon as possible, and lay a solid foundation for the formation of momentum for new economic growth.

4.6. *China should implement flexible and prudent monetary policy*

In 2015, monetary policy will meet constraints from various aspects. First, the pressure of the overall economic downturn, the risks of deflation, and debt deflation require monetary policy to be moderately relaxed and remove sources of risks in fixed directions and at fixed points. Second, financial innovation causes the moving of deposits in the traditional banking industry, limiting the interest rate's down-regulating space. Third, as the global economy is recovering, the dollar is performing well; the US will slowly raise the interest rates and the trend of international capital's back-flow to US will continue to take its shape. In order to prevent unexpected impacts on China's capital's outflow and ultimately China's economy, constraints should be put on easing policies of price fluctuations such as depreciation of RMB, reduction of interest rates, and other factors playing a role in decreasing China's financial power. Fourth, the total scale of China's foreign exchange reserve has been very large and China should transform these reserves into active capital to be used towards attaining a basic equilibrium of an international balance of payments. The past model of amassing foreign exchange reserves through "double surplus"—increasing funds outstanding for foreign exchange—and enlarging the monetary base will be gradually dropped out and the decline of funds outstanding for foreign exchange will become part of the new normal. Due to this circumstance, the central bank of China must conduct innovation for domestic asset business and develop new channels for the supply of the monetary base. Taking all this into comprehensive consideration, in the economic "new normal," China should further make clear its objectives and frame of monetary policy for the regulation and control of monetary policy in China, integrate the traditional gross control with further structural control, comb the application of quantitative and price control, proactively innovate new tools for monetary policy, and implement monetary policy in a more active and vigorous manner. In 2015, the choices of monetary policy are as follows: First, with the pressure of the economic downturn, monetary policy should be regulated towards a neutral or slightly relaxed direction. And due to the current situation of low level inflation and rising cost of social financing, it is advisable to reduce interest rates and moderately increase money supply. Concrete measures include adjusting loan-to-deposit ratios, and reducing deposit reserve ratios by 1% or 1.5%. Second, monetary base injections and fund flow should be more closely linked though various directional measures such as re-lending

and the directional decline of deposit reserve ratios in order to improve financial support for key points and weak links in economic development. Third, the securitization of assets should be advanced in an orderly manner and channels should be developed for financing so that problems associated with long-term fund procurement can be solved and the means of defusing risks for financial institutions can be increased for the construction of urban infrastructure and public service projects. Fourth, RMB internationalization should be steadily advanced and the adverse impacts of large-scale capital flow should be prevented.

4.7. China should implement fiscal policies in a more proactive and effective manner

With the increasing pressure of the economic downturn, we should implement fiscal policies in a more proactive and effective manner. First, efficient use of funds should be a priority. In 2014, as more effort was attached to anti-corruption campaigns and financial discipline is more strictly reinforced, the size of government fund precipitation further expanded, causing deflation. “Revitalizing financial funds” has been a lingering problem for China. The long-run solution should be to streamline administration and delegate power to lower levels, reducing the size of government, shrinking fiscal revenue, “returning taxes to people” through tax reduction, fundamentally curing the “puffiness” of fiscal expenditures, and removing the deflated cycle of pooling funds by fiscal taxation and treasury bonds. For the short term, China needs to clean up, classify, and rationally arrange its budget spending. Second, fiscal deficit capacity should be expanded. In the process of economic growth slowing down, fiscal policy, on one hand, is subject to the impact of fundamental economic factors and the growth rate of fiscal revenue will fall while, on the other hand, fiscal policy needs to bear the responsibility of counter-cyclical regulation and control as well as expanded spending, so it will certainly bring about moderate expansion of the size of the national deficit and debt. Third, in the process of advancing economic transformation to the “targeted new normal,” the optimized revenue and expenditure structure should be ensured. In the aspect of revenue, we should (1) abolish fees and replace them with taxes, expanding the regularity of government revenues, and (2) adjust the structure of the taxation system, increasing the proportion of direct taxes. In terms of the aspect of fiscal expenditures, we should attach equal importance to fiscal planning, stabilizing scales, and structural adjustments specifically including (1) planning budgets and establishing a unified distribution model for public resources, (2) stabilizing the tax burden, targeted tax cuts, and adjusting the expenditure structure to move towards improved technological innovation and the people’s general well-being. We should also comprehensively implement inclusive measures such as deductions for enterprise research and development funds and other innovation driving factors. China should also prioritize perfecting policy including accelerated depreciation of equipment, accelerating technological transformation in enterprises, further reducing tax burdens of small and macro enterprises, and extending the policies of stock owner incentives. It is also important that scientific and technological achievements applied in National Independent Innovation Demonstration Zones should be expanded to science and technology parks, and educational institutions. Policies should give play to the government’s leading role in investment, encouraging social capital to be brought into infrastructure investment, clean energy, and other fields through a

PPP cooperation model between government and social sectors. Policies should aim to accelerate the pace of building railways, affordable housing, and other infrastructure, as well as advance the construction of projects including UHV power transmission, nuclear power, urban underground pipe systems, and general rural infrastructure.

4.8. China should optimize trade structure and improve trade quality

The slowdown of China's foreign trade growth will be a long-term tendency and the trade policies should adapt to this "new normal." Currently, China should focus on promoting upgrades to trade processing, expanding intra-industrial trade and service trade, advancing trade re-balancing, and promoting import substitution strategies in some industries to cope with the rapid fall of trade export growth both within the short term and for the long run. China should establish a new trade system of an optimized structure and balanced revenue and expenditures. First, we must promote the transformation and upgrading of processing trade and avoid the adverse impacts of the rapid depression of trade processing on economic stabilization and full employment. Second, China must encourage the development of intra-industrial trade and constantly improve the quality of intra-industrial trade. China must also extend service trade, attach more importance to service trade exports, and avoid the continued expansion of trade deficit. It will also be important to promote trade re-balancing strategy and create a broader space for enlarging exports by expanding imports. China must also implement import substitution strategies in some key and strategic industries and gradually improve their level of international competitiveness and export capacity.

4.9. China should adjust the foreign economic strategy and develop inside and outside linked and mutually benefited open economy

China is a huge economy with constantly expanding openness; China's economy is striving towards comprehensively building up a new open economic system, which will be one of the important characteristics of China's "new normal." As China's economy moves into the new normal, we should also make adjustments to the foreign economic strategy accordingly; the key points include four aspects: First, China should promote a "new pattern of relations with great powers" between China and the US and avoid decoupling from the American economy. Second, China should optimize its export structure, encourage outward foreign direct investment, ensure the transformation from a large international trader to a strong international trader and a large capital exporter, as well as advance development strategies for building the 21st Century Maritime Silk Road and the Silk Road Economic Belt. Third, China should take part in the international government in a proactive manner, organizing and coordinating with other countries to solve problems in the international sphere by means of the IMF, World Bank, APEC, G20, WTO, and other organizations. China should seek common ground while reserving differences, promote international infrastructure construction and development, and play a more active role in regional economic development by shifting from passive involvement to active participation.

Fourth, China should reinforce international coordination in terms of macro regulation and control and promote RMB internationalization. For some time in the future, China's foreign economic strategy should follow the theme of "win-win cooperation" and handle the relations between "two markets" and "two resources." China should promote the orderly and free flow of domestic and international factors, ensure high-efficiency allocation of resources and a deepened integration of markets, and speed up the cultivation of new advantages for participating in and leading international economic cooperation and competition. This will all be in the name of progressively developing a linked and mutually beneficial open economy in both foreign and domestic markets.

4.10. China should strengthen environmental management, advance ecological civilization construction and ensure harmonious co-existence of economic development and environment friendly society

To adapt to the economic new normal, we must abandon the excessive pursuit of extensive growth and advance economic development to transform from mainly being dependent upon factor inputs to a sustainable mode that more relies on innovation as the growth driving engine. First, we should perfect comprehensive decision-making mechanisms and consummate an environmental management system that entails the government's responsibilities, united monitoring mechanisms, and effective management of environmental protection divisions. Coordination and cooperation between related departments and full participation of the entire society will be extremely important. Second, we should strengthen the construction of the legal system and thoroughly implement environment management laws. Third, we should perfect environmental economic policies including price discrimination, emission trading, advancing the reform of environmental taxes, and the establishment of credit evaluation systems regarding environmental impact, as well as exploring setting up a special national fund system of regional ecological compensation. Fourth, China should strengthen scientific and technological support and improve basic research and application capabilities in environmental science and technology. China should also develop an effective environmental protection industry. Because environmental management calls for industrial upgrades, it will bring along new investment opportunities and will open up a vast space for future economic development.

4.11. China should advance coordinated development of internal regional economy from the view of national strategy

China should perfect spatial distribution of urbanization and transfer payment systems, bridge regional gaps, progressively eradicate dual economy structures, and open up space for permanent economic growth. China has vast territory and large population and there are large differences in the levels of its regional development. The depth of development of industrialization and urbanization needs to undergo a progressively more distributed process, and the decline of population dividends must also be a gradual process. This will provide a large space for China's

economy to maintain a rapid growth rate for a period of time in the future. In 2013, the per capita GDP in China reached roughly seven thousand US dollars; however, there was still a big gap between urban and rural areas, as well as between cities. The per capita GDP has exceeded ten thousand US dollars in cities like Tianjin, Shanghai, and Beijing, but there are still some cities in which the per capita GDP is no more than six thousand US dollars. Urban negatives, such as traffic congestion and pollution, have been occurring in developed cities that are subject to limited geographic space. China must advance regional coordinated development in order to improve the overall economic development level, open up effective methods of ecological civilization construction, and promote the coordinated allocation of population, economy, resources and environment. The development of regional economies, such as the Beijing-Tianjin-Hebei Economic Zone, Yangtze River Economic Belt, and super city agglomeration, provides tangible development space for China's potential economic upgrade.

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