

---

**ROLE OF POLICIES IN ECONOMIC GROWTH: A CASE STUDY OF CHINA'S  
ECONOMIC GROWTH**

**Prof. Dr. AbdulGhafoor Awan**

Dean, Faculty of Management & Social Sciences,  
Institute of Southern Punjab, Multan-Pakistan.

**Waqas Ahmad,**

MS Scholar, Department of Business Administration,  
Institute of Southern Punjab, Multan-Pakistan.

---

**ABSTRACT:** *It is historical fact the economic policies play key role in the growth and downfall of different empires whether it was Muslim empires in Spain and India or British Empire, which ruled almost the whole world in 17<sup>th</sup> and 18<sup>th</sup> centuries. The emergence of China's economic growth is the phenomena of 21<sup>st</sup> century. The author has intended to investigate the Chinese policies in different sectors as the drivers of economic growth during the period 1980-2010. The main objective of this research is to investigate different policies introduced by the Chinese government during 1980-2010 to promote economic growth and to measure their effect at micro and macro level of Chinese economy. The author used secondary data collected from different sources such as IMF, World Bank, Barro and Lee, OECD database, US Bureau of Labour Statistics, US Bureau of Economic Analysis, and relevant Journals. Our findings and results are robust because the evidence proves that different policies implemented by Chinese government have brought substantial positive impact on national economy at micro and macro level.*

**KEYWORDS:** FDI, GDP, Poverty alleviation, income inequality, Gini Co-efficient.

---

## INTRODUCTION

Economic growth is a recent phenomenon because the world economy after world war second recorded highest economic growth in the history and the United States was the main contributor. But almost all world major economies such as United States, European Union and Japan faced economic downturn since 1973. Some economic held oil embargo imposed by Arab countries in 1973 and 1979. But this embargo was temporary. The fact is that advanced economies have been producing high-tech products of which prices are unaffordable for the developing countries. Another reason for slowdown is that service sector has major share in the GDP of advanced economies. This sector is itself is slow and its prices have fallen during last two decade. Similarly, the advanced economies particularly, the United States has been continuously involved in wars such as Vietnam War, Iraq and Afghanistan wars. These were costly wars. Americans and their allies paid huge cost of these wars which have brought negative impact on their economies. But China kept itself aloof from war activities and fully focus on restructuring its economy. Now we analyze the policies of the Chinese government that have put china on the path of fast economic growth.

**People Republic of China.**

Morrison (2013) argues that *China's economic growth during last 30 years is not less than a miracle and it is unprecedented in the modern history. During 2000-2012 the GDP of China was increased on average at the rate of 10 percent per annum and around 500 million people have been come out of poverty trap during this period. China has become a major global economic power. China today is the world's largest merchandise exporter, major manufacturer and foreign exchange holder. China has become number two economy of the world, leaving behind all advanced European countries. Some economists predict that China might surpass the United States by 2020. However, it is a reality that China is still less developed as compared to the United States of which per capita income is five times more than China. The economic relations between China and India have substantially improved during first decade of 21<sup>st</sup> century. According to US trade data, 2013, total bilateral trade between two countries were increased from \$5 billion in 1981 to \$536 billion in 2013. At present, China is the second largest business partner of the United States. The United States is the third largest export market of China's product. China also imports goods and services from the United States substantially. A lot of multinational US companies have set up their business operation in China to sell their products in the large Chinese market and to take advantage of low-cost labour for export-oriented industries. Their presence in China has enabled the US companies to be competitive in international market and provide low price products to the US consumers. China invested about \$1.3 trillion by June, 2013 in US treasury bills that has facilitated US government to meet its twin deficits as well as keeping the interest rate low.*

**Size and potential of Chinese Economy**

China's estimated nominal Gross Domestic Product (GDP) in June 2012 was around US\$7.74 trillion while on the basis of purchasing power parity (PPP) it was around US\$12.46 trillion. Its nominal per capital GDP was US\$ 5,184 while on PPP basis it was US\$ 8,394. Its GDP growth in 2011 was 9.5 percent. The composition of Chinese GDP was estimated in 2010 was 46.8% industry, 43.6% services and 9.6% agriculture. During 2000-2010 Chinese industrial sector expanded more rapidly than the services and agriculture sector. Agriculture sector was squeezed because of surplus labour exit from this sector to industrial sector. However, the output of agriculture sector and crops yield was increased due to better farm management. According to 2010 estimate, total Chinese labour force in 2010 was 780 million out of which 39.5% was working in agriculture sector, 27.2% in industry and 33.2% was engaged in services sector. About 15 million new entrants are enter in the Chinese labour market every year for job and it is serious challenge for Chinese policy makers to generate maximum jobs to accommodate them. The unemployment rate in July 2010 was 4.2% while gross monthly salary was US\$457 and average years of schooling was 8.16 years (Baro and Lee-2012).

Chinese main industries are mining and ore processing, iron, steel, aluminum and other metals, coal, machine building, armaments, textiles and apparel, petroleum, cement, chemicals, fertilizers, transportation equipment, automobiles, rail cars and locomotives, ships, aircraft, telecommunications equipment, commercial space launch vehicles, satellites, etc. In 2009 around 8% of the total manufacturing output in the world came from China itself and China ranked third

worldwide in industrial output that year (first was European Union and second U.S.A.). Research by IHS Global Insight states that in 2010 China had contributed to 19.8% of world's manufacturing output and became the largest manufacturer in the world after the US had held that position for about 110 years.

In 2011, Chinese total exports were US\$ 1.897 trillion which was consisted of electrical, iron and steel, medical equipment, data processing equipment, textiles and apparels, etc. Its major exporting partners are: US 20.03%, Hong Kong 12.03%, Japan 8.32%, South Korea 4.55 percent, Germany 4.27%. China is the second big importers of the world and its total imports during 2011 were US\$ 1.664 trillion. Its major imports comprised electrical and other machinery, oil and fuels, optical and medical equipment, metal ores, plastics and organic chemicals. China imports 12.27 % goods from Japan, 10.06 % from Hong Kong, 9.04 percent from South Korea, 7.66% from USA, 6.84 percent from Taiwan and 5.54 percent from Germany. FDI stock in China in 2010 was \$100 billion while its gross external debt was \$406.6 billion. Its public debt in 2011 was 43.5% of GDP. The collection of revenue through taxes was estimated to \$1.149 trillion while total estimated expenditures were \$1.27 trillion in 2010. Its foreign exchange reserves in 2011 were US\$3.20 trillion, which was highest in the world. The state-owned sector still accounts for about 30% of GDP. In recent years, authorities have been giving greater attention to the management of state assets—both in the financial market as well as among state-owned-enterprises. How China has made these miraculous achievements? They are the result of the policies and economic reforms introduced by the Chinese leadership to accelerate economic growth and transform their planned economy to semi-market economy. Chinese economy cannot be termed as a free capitalist economy but it can be regarded as the new experience of “state capitalism.”

## **CHINA'S GROWTH POLICIES AND THEIR EFFECTS**

### **Pre-reforms Economic Policies (1950-1979)**

Soon after getting independence, China immediately eradicated feudal system and under land reforms re-distributed agriculture land among the farmers. In 1958, Chinese Communist Party leader, Mao Zedong, introduced “Great Leap Forward” policy under which agro-based scattered economy was re-organized and “communes system” was enforced. Under this system men and women were given specific tasks. Individual family system was dismantled and the farmers were directed to opt new system of community kitchens, mess halls and nurseries. Wage rates were fixed as per need and ability of every person. The focus of Mao's industrial policy was to promote steel industry so that China could come at par with western countries. But this policy was not proved successful because the production of agriculture products particularly grains was substantially declined and a severe famine was occurred in 1960. Similarly, Mao's other initiative was to bring Cultural Revolution by eliminating four old traditions such as old thoughts, old culture, old customs and old habits. For this purpose, Mao used Universities and Schools students as his “Red Guards”. They were assigned the task of destroying old traditions to build Chinese society on Mao's new thoughts. Chinese Central government made large-scale investment in physical and human capital during 1960-1970 to expedite industrialization in the country. State-Owned Enterprises (SEOs) were encouraged to establish big industrial units. The end result was that around three-fourths of industrial output was produced in 1978 by these companies, which used to work under centrally planned system. Private and foreign companies were not allowed to work.

Similarly, foreign direct investment (FDI) was discouraged to keep the economy closed. The main objective of Mao's policies was to make China self-sufficient and independent economically. Whatever Chinese economy produced during Mao's period it was for self-consumption and not for export. Trade relations with other countries was nominal and China imported only those goods which could not be produced locally. The "closed door" policies of Chinese government could not put the country on the path of fast economic growth and there was widespread stagnancy and inefficiency in the economy. As most of the business was run by State-Owned Enterprises there were less incentive for profit earning. Market was uncompetitive and the workers and firms had not incentive to be competitive. Close relations with the Soviet Union kept China away from the western countries and international capital markets. The control on prices and production generated distortions in different sectors of the economy. The living standard of Chinese people was far lower vis-à-vis other developing economy. Chinese living standards were substantially lower than those of many other developing countries. China was the most populous, low-income and one of the poor country of the world at that time. Chinese people faced severe problems due to "Iron Curtain policy of government. However, after Mao's death in 1976, new leadership came into the power and decided to abandon past policies. New Chinese leader, Deng Xiaoping, introduced a new policy framework to bring institutional changes and reforming the economy gradually under free market mechanism. He enhanced trade ties with the western countries and opened up Chinese economy for foreign direct investment. Now we examine his policies and their effects on Chinese economy in 21<sup>st</sup> century.

## **POST-REFORMS ECONOMIC POLICIES**

### **End of Commune System**

When new Chinese leadership came into power after Mao's death in 1978 the commune system under which all farmers were working as production team and sharing output. The crops prices were very low and there was no profit incentives to produce more output. New Chinese leadership replaced old commune system and replaced it with "The Household Responsibility system". Under new system the land was given to the farmers on lease for a fixed period and were allowed them to produce crops as much as possible. Free grain markets were established to facilitate the farmers to sell their surplus crops. The prices of agricultural products were increased to encourage the farmers to produce more. It resulted about 30 percent increase in grain production while the output of tobacco, fruits, cotton, sugarcane and other crops have been doubled during a short span of ten years. The policy of new Chinese government has made agriculture sector more efficient and productive.

Agriculture sector of China is a big sector of economy and about 300 million workers are engaged in it to produce agricultural products. The cultivable land in China is only 75% of U.S.A. but surprisingly the agriculture output of China is 30 percent and livestock than the U.S.A. According to the United Nations World Food Program (2003), China provides food to 20% world's population despite the fact that it had only 7% cultivable area in global term. Only ten to fifteen percent of total soil is suitable for cultivation in China but even though China stood first globally in agricultural products output. Half of agriculture land is unirrigated while the rest of the soil is divided between irrigated and peddy fields. Anyhow, more than fifty percent population lives in the rural areas and this portion of population is fed by local produces. Population migration from

rural to urban areas is on rampant because high earning job availability there. The big farmers are also changing their professions and they are entering into light manufacturing, trade and transportation. This trend has halved the value of rural output. The share of agriculture sector in total GDP was reduced to 9.6 percent in 2013 due to shifting of rural population to other sectors.

### **Restructuring State-owned Enterprises**

Like agriculture, the industrial sector of China was also inefficient and were producing primary goods. The Chinese leaders, Li Xiannian and Deng Xiaoping, introduced rural industrialization program under which the agriculturists were motivated to establish “Town and Village Enterprises” and private investors particularly foreign investors were provided handsome incentive to maximize their participation in this program. As per China’s 1999 industrial survey, there were 7930,000 industrial units where 24 million people were working. Most of these industrial units were state-owned enterprises (SOEs). The ratio of SOEs in 1979 was hundred percent and they were working under centrally planned system but in 2005 their ratio was reduced to 41 percent and their share in total output was only 16 percent. Under new industrial policy 159 state-owned companies were assigned the task of supplying raw material to private sector companies to accelerate and consistent output. This encouraged private sector expansion there were 10 million small business enterprise in China in 2010. The distinguished feature of new industrial policy was that state-owned enterprises were assigned the task of producing heavy machinery and equipment while private sector companies were encouraged to initiate small and medium sized business. This is the reason that SOEs’ share in manufacturing sector is around 35 percent. These companies posted combined net profits of RMB849 billion in 2010 and had total assets of RMB24.3 trillion at the end of 2010. It is the charisma of Chinese leadership that transformed loss-making public sector organizations into profit-making entities. These organizations (SOEs) were suffering huge losses for many years on account of excessive employees, outdated technology and old production process and they were operating as welfare institutions because they were providing housing, education and health facilities to their employees and their family members. Thousands of workers were obtaining financial benefits without performing any productive job. Very few among them were involved in productivity activities. Under law their services were secured because their employment was lifetime as well as financial benefits. Half of SOEs were loss-making organizations but even then they were functioning as continuing concerns on account of having privileges for obtaining loans from Banks on priority basis. By 2001 their outstanding loan amount was \$205 billion. Previously the practice of financing was on grant-basis but after their restructuring it was loans-based. It is interesting to mention that these companies posted a consolidated net profits of RMB 849 billion and their total assets were RMB 24.3 trillion at the close of 2010. There were 58 Chinese companies which were on the list of Fortune Global-500 in 2011. The Chinese government have 50 percent stake in these 54 companies. This is a big achievement of Chinese leadership.

### **One Child Policy**

China was and is the most populous country of the world. In 2013 its population was estimated to be around 1.35 billion. Huge population and fast population growth was consistent problem for China. In order to control fast population growth many family planning programs were launched. But these programs could not achieve desired results and population growth could not be controlled. In 1979, Chinese Government introduced one-child policy and the couples were allowed to have only one child. Both husband and wife were responsible to implement this policy.

Several penalties were proposed. This policy was proved successful because of its strict implementation and harsh penalties. (Hsu, Liao and Zhao 2011) disclosed:

*“total fertility rate fell from above 6 percent to around 2.9, a 53 percent decline within a decade (1971-1982) and the fraction of working-age population as a percentage of total population increased from 56 percent to 64 percent. It was further declined from 2.9 percent in 1982 to 1.5 percent in 2007. The percentage of working-age population increased to 71 percent in 2007. In 2012, population growth rate has decreased to 0.6 percent, which was the lowest among the developing countries. The survival rate for children increased from 80 percent in 1957 to 98 percent in 2007 while the survival rate for the adults was increased from 87 percent to 96 percent during the same period.”* Greenhalgh (2003) mentioned that Chinese Government has achieved the objective of its one child policy because it has been able to prevent around 400 million of child births during last from 1980 to 2000, bringing a positive impact on its society and economy.

### **Establishment of special Economic Zones**

After lifting “Iron curtain” the Chinese Government established special economic zones in coastal areas in 1978 to attract foreign multinational companies to establish their business units. The government also removed legal barriers, besides providing tax incentives and building infrastructure. These zones were established in 14 coastal cities and they were divided into three regions. The foreign companies were invited to invest in these economic zones and take benefits from booming Chinese economy. Different legal measures regarding patenting, property rights and security of investment were taken. Many latest industries including aerospace, aircraft and automobile manufacturing units were established there. This created unequal industrialization in China. For instance, Shanghai economic zone accounts for about 8 to 10 percent of China’s industrial output. Similarly, the economic zones situated in the Eastern coast accounts for about 60 percent of China’s industrial output. However, pace of industrialization was increased and diversified industries were developed in china. These industries include pharmaceuticals, software, semiconductors, electronics and precision. Foreign companies particularly from the United States, European Union and Japan massively invested in these economic zones and produced goods both for Chinese consumers and for export purpose.

### **Promoting savings**

Chinese government after 1978 took special measures to promote saving in public and private sector companies as well as among its citizens. It generated huge funds for investment. Qian (1988) argues that *sources of Chinese saving were three: households, enterprises and government. in 1978 household saving was only seven percent of GDP while the saving of government was around 15-18 percent of GDP. Between 1978 and 1984, the household saving was increased while government saving was declined. However, the overall saving rate was remained constant. From 1999 to 2007 corporate saving was increased from 14.6 percent to 18.8 percent of GDP, the household saving from 16.7 to 22.2 percent and government saving from 2.6 percent to 10.8 percent. However, China’s saving rate was jumped after its entry into World Trade Organization (WTO) and it reached unprecedented level of 53 percent in 2007. It is highest in the world and China has surpassed Korea, Japan and other East Asian countries in the rate of saving.*

According to Morrison (2013), China maintained high level of saving since 1979 when households

saving was around 32% of GDP has historically maintained a high rate of savings. The high profitability of SOEs was one of the main cause of China's high saving rate. The Central Government of China used these savings for investment to boost manufacturing, which further increased profitability of Chinese companies as well as saving. The end result was the increase of saving rate upto 53 percent of GDP in 2008 as compared to the United States where saving rate was only 9 percent in that year. The exceeding of gross savings from domestic investment levels generated surplus funds and enabled China to invest around the world and lend money to the United States, European Union and other emerging economies. China exported both goods and capital to other countries and in this way it earned interest on loans and money from the goods sale proceeds. It strengthens Chinese economy vis-à-vis its trading partners.

The high and rising aggregate saving and thus the low and declining share of consumption in the GDP constitute a central feature of the Chinese economy. High saving is not only closely related to domestic liquidity, investment, economic growth, and income distributions among firms, households, and the government but also to China's international trade and capital flows. The Figure 6.1 shows the ratio of households, enterprises and government saving as percentage of GDP, which generated huge funds for investment. An interesting picture emerges if we compares Chinese saving with other emerging economies. For example, in 2008 saving rate in China was 54 percent, Russian Federation 36.3 percent, India 32.9 percent and Brazil 19.1 percent. These four economies registered steep rise in saving rate against the advanced economies where saving rate was decline. For example, the saving rate in Japan was highest 34.4 percent in 1991 but it dropped to as low as 25.2 percent in 2006. But saving rates in the United States, United Kingdom and France was seen falling during 1980-2010. A wide gulf in saving rates between China and developed countries was created. In short, in 2008, China's saving rate was about 27.2 % percent higher than that of Japan, 38.6 % higher than that of U.S.A. It reflect the financial soundness of China, which was achieved due to Government solid policies.

### **Investment in fixed assets and infrastructure**

Kotz (et al, 2010) has contended that China's entry to the World Trade Organization in 2001 paved the way its rapid economic growth. The external demand of Chinese goods provided an impetus to pace of investment, which continued to rise since 2001. The fixed investment rate was 40 percent of GDP between 2004 and 2010. According to an estimate, China needs 30 percent per annum investment in order to maintain 10 percent of annual growth in its GDP. Kotz (et al, 2010) calculated the contribution of exports and fixed investment in China's economic growth and concluded that these two factors contributed 69.4 percent of GDP growth. It must be noted that saving and investment rose between 2000-2012 while consumption was sharply dropped from 45.2 percent to 35.6 percent of GDP in China. In contrast, households' consumption in the United States was around 70 percent of GDP in 2010. Similarly, the share of government expenditures was also dropped from 16.2 percent to 13.4 percent of GDP in China, generating surplus funds for investment. During 2001-2007 exports played a vital role in generation of surplus funds. For example, the share of exports rose from 23.8 percent to an impressive 39.2 percent of China's gross domestic products. Exports increased about 21.2 percent per annum while Chinese import was increased around 18.6 percent per annum. The export surplus was 8.1 percent of GDP in 2007. Another feature of Chinese economy is that mostly investment was based on self-generated funds and dependence of banks loans was as low as 21 percent of total investment during 1998-2010.

The ratio of self-generated funds to investment rose from 48 percent in 1999 to 65 percent in 2005. In other words, Chinese public sector companies invested retained earnings. According to China Statistical Yearbook, 2009, the share of state budget in fixed investment was 3.03 percent in 1995 which was increased to 4.35 percent in 2008 while the share of banking loans was 20.46 percent in 1995, which was dropped to 14.46 percent in 2008. The share of FDI was 11.9 percent in 1995 which was sharply dropped to 2.90 percent in 2008 while the share of retained earnings was jumped from 51.88 percent in 1995 to 64.79 percent. According to IMF (2009) estimates, fixed investment related to tradable goods and net exports both accounted for over 60 percent of China's GDP growth from 2000 to 2009 while its was 40 percent during 1989-1999. It is far higher than G-7 countries where it was 17 percent, in European Union 30 percent and Asia 35 percent. China made huge investment in infrastructure to expedite economic activity. According to Deutsche Bank Report (2011) "China invested more than RMB 850 billion in key projects in its Western part. China's recent RMB 4 trillion stimulus package include RMB 1.8 trillion earmarked for transportation infrastructure and power grids and RMB 370 billion for rural livelihoods and infrastructure. Milestones are the east-west pipeline, the Qinghai-Tibet-railway and the new Xianyang Airport in Xi'an in which Germany AG hold 24.5% stake. China invested roughly 9% of its GDP on infrastructure in the 1990s and 2000s while most emerging economies invested only 2% to 5% of their GDP. The advanced countries have no required funds to repair old or build new infrastructure.

### **Promoting Foreign Direct Investment (FDI)**

China's trade and investment reforms and incentives led to a surge in FDI beginning in the early 1990s. Such flows have been a major source of China's productivity gains and rapid economic and trade growth. There were reportedly 445,244 foreign-invested enterprises (FIEs) registered in China in 2010, employing 55.2 million workers or 15.9% of the urban work force. FIEs account for a significant share of China's industrial output. That level rose from 2.3% in 1990 to a high of 35.9% in 2003, but fell to 27.1% by 2010. In addition, FIEs are responsible for a significant level of China's foreign trade. In 2011, FIEs in China accounted for 52.4% of China's exports and 49.6% of its imports, although this level was down from its peak in 2006 when FIEs' share of Chinese exports and imports was 58.2% and 59.7%, respectively. These companies mostly involve in high tech products exports. Their share in high tech exports was increased from 79 percent in 2002 to 82 percent in 2010. While the firms totally owned by foreign multinationals' high tech exports was rose from 55 percent to 67 percent. According to official source, annual foreign direct investment was increased from just \$2 billion in 1985 to \$108 billion in 2008. The ratio of inflow has dropped to \$90 billion in 2009 on account of global economic meltdown. But it again rose to \$106 and \$116 billion in 2010 and 2011 respectively. However, this slightly dropped to \$112 billion.

The major sources of foreign direct investment were five countries that include: Hong Kong, United States, Japan, Taiwan and Singapore. After the United States, China was the second largest receiver of foreign direct investment in 2012. Total cumulative foreign capital stock of foreign direct investment by 2013 was \$1.3 trillion. The major beneficiary of foreign direct investment is manufacturing and around 70 percent of total foreign capital was invested in this sector by 2005. However, this ratio was come down to 47 percent. However, investment in real estate was jumped from 9 percent in 2005 to 22 percent in 2010. This brought a boom in the Chinese real estate business as well prices of properties.

### **GDP Expansion**

Chinese government claimed that real annual GDP grew at 6.7 percent per annum. However, some economists questioned this claim on the ground that China's economic data are mostly exaggerated the levels of output on account of a variety of political reasons. Economist Agnus Maddison (2007) estimated that

*“China's average annual real GDP during this period was at 4.4% because .China's economy suffered economic downturns during Mao Zedong's era, which led to a massive famine and reportedly the deaths of tens of millions of people and the Cultural Revolution from 1966 to 1976 (which caused political chaos and greatly disrupted the economy). During the reform period (1979-2011), China's average annual real GDP grew by 9.9%. This essentially has meant that, on average, China has been able to double the size of its economy in real terms every eight years. The global economic slowdown, which began in 2008, impacted the Chinese economy (especially the export sector). China's real GDP growth fell from 14.2% in 2007 to 9.6% in 2008 to 9.2% in 2009. In response, the Chinese government implemented a large economic stimulus package and an expansive monetary policy. These measures boosted domestic investment and consumption and helped prevent a sharp economic growth decline temporarily. In 2010, China's real GDP grew by 10.4%, and in 2011 it rose by 9.2%”. In 2012, China's real GDP growth slowed to 7.8%.*

The International Monetary Fund (IMF) in July 2013 projected that China's real GDP would grow 7.8% in 2013 and 7.7% in 2014. The Chinese GDP growth has been shown in the Table.6.1

### **China's share in world GDP**

China's share of world gross domestic product (GDP) increased during the past two decades, from approximately 5 percent in 1990 to 15 percent in 2010. By 2001, China's GDP had surpassed Japan's. As a percent of total world GDP, the United States, Europe, and Japan each declined slightly over the last two decades, largely because of China's growth. The rest of the world's share of world GDP changed little throughout the 1990s, but Chinese economy grew steadily from 2000 to 2010. We have found that US's share fell from 23% percent to 18 percent, straight drop of 5 percent during 1990-2010. Similarly, the share of European Union was also decreased from 25 percent to 20 percent during the same period. Japan's share in world trade in 1990 was 10 percent which was reduced to just 5 percent. In short, if we sum total fall in the share of the United States, European Union and Japan, it will come to nearly 15 percent out which 10 percent share appears to have been taken by China and the rest of 5 percent by other emerging economies.

### **Expansion of manufacturing base**

As we noted above that China's share in world trade has sharply increased to 15 percent and it was mainly due to the expansion of its manufacturing base. We have also noted that major foreign direct investment was also come in the manufacturing sector because foreign companies have ample opportunity to reap benefit of more than one billion consumers market. It is pertinent to mention here that China overtook Japan as the world number two manufacturer on gross value added basic in 2006 and the United States in 2010. A large number of manufacturing unites in the United States were closed due to high labour cost and these unit were shifted to China. This was resulted high unemployment in the United States and employment in China. In 2011, the value of

China's manufacturing on gross value added base was 23.3 percent higher than that in the United States. The share of China's gross value added manufacturing was increased to 32.3 percent as compared to 12.1 percent in the United States and 18.9 percent in Japan. In dollar terms, the China's gross value added manufacturing was \$500 billion in 2004 which was increased to five time to \$2400 billion in 2011. In contrast, the United States gross value added manufacturing in 2004 was \$1600 billion, which was increased to \$1900 billion in 2011, a just \$300 billion in seven years period while in China's case it was \$1900 billion in corresponding period. According to Global Manufacturing Competitive Index, 2013, China ranked first in manufacturing while the United States ranked third in 2013. It also predicted that the United States rank will further scale down to fifth in 2018. We can assess the productive capacity of China vis-à-vis United States.

**Table 6.1 China 's Annual Real GDP Growth:1979-2012**

<b>Year</b>	<b>Real Growth %</b>	<b>Year</b>	<b>Real Growth%</b>
1979	7.6	1997	9.3
1980	7.9	1998	7.8
1981	5.3	1999	7.6
1982	9	2000	8.4
1983	10.9	2001	8.3
1984	15.2	2002	9.1
1985	13.5	2003	10
1986	8.9	2004	10.3
1987	11.6	2005	11.3
1989	11.3	2006	12.7
1990	4.1	2007	14.2
1991	3.8	2008	9.6
1992	9.2	2009	9.2
1993	14.2	2010	10.4
1994	13.9	2011	9.2
1995	13.1	2012	7.8
1996	10.9		

**Source: Economic Intelligence Unit/IMF July,2013**

#### **4.11 Human Capital Stock and Total Factor Productivity**

When economists began to measure the sources of economic growth, what previously had been considered an unexplained residual - an unexplained factor - became identified as human

capital. From studies of the development of the American economy, and the sources of growth of many countries around the world, it has become evident that human capital—the skill of the population—plays a major role in the productivity of nations. (Schultz, 1981) In 1949 around 70 percent of Chinese population has no formal schooling. In the 1950s, there was a widespread campaign to eradicate illiteracy. The mandatory 9-year education policy-(6 years in primary school and 3 years in junior secondary school) began in 1986. The results of the implementation of the policy were satisfactory in urban areas but lagged in rural areas due to inadequate financial assistance. However, the illiteracy rate among the adult was decreased from 52 percent in 1964 to 17 percent in 1999 (World Bank, 2001). The literacy rate has jumped to 99 percent in 2011, catching up with the advanced countries. Similarly, average years of schooling was reached to 8.6 percent and according to Barro and Lee (2012) China needs 10.5 years to catch up with the United States.

Hsu, Liao and Zhao (2011) in their empirical study revealed that the fraction of skilled workers was about 3.12 percent in 1957, which was increased to 11 percent in 1982. The ratio of skilled workers was further increased to 18.8 percent in 2007. Wang and Yao (2002) mentioned that with human capital being incorporated, the growth of total factor productivity (TFP) contributed positively to output growth in the reform period, accounting for 25.4 percent of growth during 1978-1999. The contribution of TFP growth was consistently negative for pre-reform period-1949-1977. Whaley and Zhao (2010) argue that human capital stock was increased rapidly in China after 1999. The human capital stock was 1095 billion yuan in 1978, and reached 9826 billion yuan in 2008, increasing 7.6 percent annually. The increase of human capital from tertiary education is even larger, from 27 billion yuan in 1978 to 1712 billion yuan in 2008, an increase of 14 percent annually. There is an increased rate of human capital formation for tertiary education after 2002 which is consistent with China's higher education expansion after 1999 (See Li et al, 2008). Becker et al (1990) describe two steady-states: one with large families and small investment in human capital and one with small families and rising investment in human capital. They state that a country can switch its steady-state given certain policies and adequate living standard.

Subsidizing and supporting public education system can be used to advance higher investment in human capital (Fanti and Gori (2011), Zhang,(1997). Since private returns to education at the moment are possibly below its marginal value, as Holz (2008) states, China has to invest in the education system to further promote the investment in human capital. To give education more weight may help maintain economic growth. As Holz (2008) has said:

*“If talent is randomly distributed among the world population and if China's education system is able to identify the brightest students, the China has a larger pool of talent to draw from than any other country in the world.”*

The use of these resources more efficiently means more innovation are possible and therefore a higher level of productivity and economic growth occur. China has achieved high rates of total factor productivity (TFP) growth relative to the United States. TFP represents an estimate of the part of economic output growth not accounted for by the growth in inputs (such as labor and capital), and is often attributed to the effects of technological change and efficiency gains. China experiences faster TFP growth than most developed countries such as the United States because of

its ability to access and use existing foreign technology and know-how. High TFP growth rates have been a major factor behind China's rapid economic growth rate. However, as China's technological development begins to approach that of major developed countries, its level of productivity gains, and thus, real GDP growth, could slow significantly from its historic 10% average, unless China becomes a major center for new technology and innovation and/or implements new comprehensive economic reforms. A report by UBS in 2009 concluded that China has experienced total factor productivity growth of 4 per cent per year since 1990, one of the fastest improvements in world economic history. If we compare China and the United States productivity we find that in 2000 US productivity was only 1 percent while China's productivity was four percent. In 2008 US productivity was become negative while China's productivity was jumped to 8 percent. However, US productivity was increased to around 3 percent in 2010 but China's productivity was dropped to 6 percent in the same period. In 2012 US productivity was again dropped to one percent while China's productivity was also declined to 5 percent, showing worldwide recessionary condition.

### **Entry into World Trade Organization (WTO)**

China joined World Trade Organization in 2001 after developing necessary infrastructure, manufacturing base and preparing to compete in international market. Well-prepared to meet open market challenges was the one of the main causes of China's success. China's foreign trade was increased around 30 percent annually during 2002-2005 (NSBC,2006). Chinese trade policy encouraged the workers in relevant sectors to produce more and reap benefits from high prices of their goods in world market. The domestic prices particularly agricultural products were also increased handsomely, increasing the income of farmers and motivating them to produce more. (Huang et. al., 2003 and 2006). China's entry into WTO and liberalization of trade have brought positive impact both on agriculture and industrial sector. The employment in both major sector of economy was increased and consequently the level of poverty and income inequality in China has reduced. The income of those households who were working in exporting industries was substantially increased.

### **Low Wages: China's Real Competitive Advantage**

Low wages is assumed to the real competitive advantage of China as compared to developed and other emerging economies. It enabled China to produce cheap goods and export in international market. Other countries particularly the advanced countries where wages were far high to China could not compete it. This was the reason that most of labour-intensive industries were closed in the advanced countries due to in competitiveness. The labour cost particularly in the United States, European Union and Japan was high more than hundred times. However, the competitive advantage of China in this field is gradually reducing because prices in the Chinese domestic markets are increasing. For example, China's average real wages were increased at an average rate of 11.8 percent per annum. The comparison with other countries further clear the picture. The average monthly wages in China were \$94 in 2000 while in Mexico it were \$311 in the same period. However, in 2012 Chinese average monthly wages were shot up to \$625, which were 32.6 percent higher than Mexico (\$459). It means real wages in China were increased more sharply than Mexico. Similarly, Chinese average monthly wages were 92 percent higher than Vietnam in 2000 but in 2012 they were 434 percent higher. The data shows that China's competitive advantage in labour wage is rapidly eroding. US Chamber of Commerce got conducted a survey of the US

companies operating in China to measure the rising labour cost. The survey reveals that 39 percent respondents feared that labour costs are the biggest business risk facing the US firms and it has increased from 23 percent in 2011 to 82 percent in 2013. The survey mentioned that rising labour costs are affecting the profitability of foreign companies. Similarly, 89 percent respondents pleaded that China was losing its competitive advantage to some extent. In order to control labour costs the Chinese government has embarked upon to transform its economy into innovative economy and concentrating on increasing the level of productivity. In spite of all these facts regarding the rising wages, China labour costs and wages are still far lower than those of the United States, European Union and Japan.

### **China's international trade**

In 1979 China's economy was closed and there was very low international trade. It was restricted to certain items of imports which could not be produced locally. So the volume of international trade was on \$14 billion. But after opening Chinese economy the volume of international trade was multiplied to many hundred times and it was reached to \$2.1 trillion in 2012. China was emerged as a major world trading power. China's annual growth in exports and imports from 1990 to 2012 were around 18.1 percent and 17.1 percent respectively. China's trade surplus was sharply increased from \$32 billion in 2004 to \$297 billion in 2008. In 2012 it has been projected to \$397 billion. China's share in world trade was only 1.80 percent in 1999 while it was multiplied to 11.5 percent in 2012. In 2009, China overtook Germany to become both the world's largest merchandise exporter and the second-largest merchandise importer (after the United States). In 2012, China overtook the United States as the world's largest trading economy. China's share of global exports nearly tripled from 2000 to 2012, rising from 3.9% to 11.5%; the World Bank projects this figure could increase to 20% by 2030. Merchandise trade surpluses, large-scale foreign investment, and large purchases of foreign currencies to maintain its exchange rate with the dollar and other currencies have enabled China to become by far the world's largest holder of foreign exchange reserves at \$3.31 trillion at the end of 2012.

### **Growing Energy Demand**

The economic boom in the Chinese economy has also enhanced the demand for energy. As the China has a vast base of energy consumer it also affect international oil prices. According to International Energy Agency (IEA) Report, 2010, *China left behind the United States in 2009 as the world's largest energy user*. According to the US Energy Information Administration (EIA), the level of oil consumption in China was estimated to half of the world's oil consumption level in 2011. It predicted that Chinese demand will likely to increase 30 percent of global energy demand in 2035. It is projected that China will consume 70 percent more energy than the United States in total term not in per capita energy consumption, which will be less than half of the level of the United States. China consumed 9.8 million barrels oil per day in 2011 as compared to 3.9 million barrel per day in 1997. It is projected that the level of oil consumption will likely to increase 16.9 million barrel per day by 2035. China's net oil imports in 1997 was 632,000 barrel per day which was increased to 5.7 million BDP in 2012. It means China was the number two net oil importer after the United States. It is projected that quantity of China's import will likely to exceed 13 million barrels per day. China has constructed three big dams to exploit hydel power resources to generate electricity. These dams were completed in 2012 and their total capacity is 22,500 megawatt. Total power generation capacity from hydel source has increased to 25,615 megawatt.

It was a big achievement in power sector. In 12<sup>th</sup> five year plan, China has set the target of clean energy and many financial incentives and tax concessions have been given to attract investment in this sector. Presently, China is producing 90 percent of its energy from coal and furnace oil. It is plan to reduce 15 percent dependence on this costly energy source by 2020. China is encouraging renewable energy and has planned to invest RMB 11.1 trillion in energy sector in next 10 years. According to the Bank of China's prediction, the power to be produced through renewable energy will likely be double by 2020.

### **China's Investment in other Countries**

During 1980s and 1990s Chinese strategy was to attract maximum foreign investment and technology to boost economy and to generate employment. Local companies were encouraged to expand business, manufacturing base and opt latest technology to increase their competitiveness. At that time, China was facing scarcity of financial resources and technology. Handsome incentives were given foreign investors to enter Chinese market and exploit idle Chinese labour. But after accumulating capital and building foreign exchange reserves in trillions of US dollars, China changed its global posture and follows a new "Go Global" strategy. Under this strategy, Chinese State-Owned Enterprises were motivated to invest in promising markets to enhance returns, to secure raw material for Chinese economy and to exploit new opportunities. China Investment Corporation (CIC) was formed in 2007 for investing in foreign business ventures. The funds initially allocated to CIC was \$200 billion and it was just like a largest sovereign wealth fund. Chinese government itself invested more than one trillion US dollars in US Treasury bills and now China is number in holding US official assets. Japan is number two because it also holds more than one trillion US Treasury securities. But this excessive exposure of China in the US securities can create problem for it in case of meltdown in US economy and drop in the value of US dollar. China has determined to make its companies to be competitive and innovative in the global economy. It has been encouraging them to hunt skilled professional, secure latest technology and management skills and introduce internationally recognized brands. Under the government policy, Chinese companies are gradually leaving the production of primary goods and maximizing value-addition. For this purpose, Chinese companies are active international market to seek acquisition and mergers. A Chinese compute company, Lenovo Group Limited, acquired personal computer division of US IBM Corporation for \$1.75 billion. China's investment in abroad has increased from just \$2.75 billion in 2002 to \$84.2 billion in 2012. Chinese multinational companies are investing in joint venture of Research and Development, manufacturing units and technology-related business. Sectorwise, China has made 51 percent of its investment in oil and minerals, 22 percent in chemicals, 14 percent in services, 12 percent in industry and one percent in automobile industry in 2011. Public sector companies (SOEs) has 70 percent share in total Chinese investment made in acquisitions and mergers in 2011. Chinese major investment went to four regions such as the United States (\$1.8 billion), European Union (\$7.6 billion), Russian Federation (\$716 million) and ASEAN economies (\$5.9 billion) in 2011.

### **High Corporate Profit**

The profitability of enterprises has generally improved since the early 1990s. While the nominal firm profits increased more than 15 folds from 1992 to 2007, the ratio of profits to industrial value added also improved remarkably from about 21 percent in the late 1990s to close to 30 percent in 2007. The share of enterprise income in the GDP rose from 13 percent in the late 1990s to above

18 percent in 2007. The rise in corporate profitability is the result of a series of socioeconomic and institutional changes implemented in China throughout the reform period. For instance, the privatization of state-owned enterprises (SOEs) and the growth of private enterprises are found to have induced more innovative efforts and raised the labor and total factor productivity of the corporate sector (Jefferson and Su, 2006; Bai et al).

Labor market reforms involving the use of labor-incentive schemes, the relaxation of worker mobility restrictions, and especially the massive rural-urban migration have all contributed to the efficient functioning of firms. In particular, the large flow of rural labor to cities, which was estimated at around 135 million in 2007 (Meng et al., 2010), has helped maintain low labor costs for business, a major factor behind China's emergence as the workshop of the world (Yang et al., 2010). Moreover, China began implementing a large-scale privatization of SOEs in 1998 with the objectives of improving corporate governance and maintaining the competitiveness of the state sector in the national economy. From 1997 to 2003, the share of SOE workers in urban employment dropped from 54.6 to -26.8 percent as the result of enterprise restructuring (NBS, 1998, 2004). The productivity of the state sector rose, and the competitive pressure also spread to raise the productivity of the non-state sector.

The rise in corporate saving from 14.6 in 199 to -18.8 percent of the GDP in 2007, was also attributable to China's remarkable expansion in export associated with its accession to the WTO. Beginning in the late 1990s, with the anticipation of joining the WTO, China's export growth accelerated. The momentum of trade expansion continued after China's accession to the WTO in 2001 as trade barriers and tariffs continued to fall. Between 1999 and 2007, the export growth reached an unprecedented 26 percent per annum (NBS, 2008). This expansion in demand handed China an opportunity to realize its potential comparative advantage in trade. When exports were combined with equally remarkable FDI inflows as well as the imports of sophisticated intermediate inputs, these factors jointly created a powerful force to increase firm productivity and profits.

Trade expansion, and thus increases in corporate revenue, was facilitated by trade policies in China. Since 1998, after the Asian financial crisis, China has initiated a trade-promoting policy of Rewarding Tax Rebates for exports (TRE). Since then, TRE has become an important macroeconomic management policy. Total volume of TRE increased from 115 billion Yuan in 2002 to 586.6 billion in 2008. The size of these tax rebates was highly significant: in 2006, the total TRE received by exporting firms was equivalent to 10 percent of aggregate corporate saving and about 14 percent of government tax revenue in the same year. The TRE remained at high levels throughout 2004–2008.

### **Capital Market Development**

China's stock exchanges in Hong Kong and Shanghai are among the largest in the world, ranking six and seven respectively by market capitalization (in H1 2010). The New York Stock Exchange in the US is the world's largest stock market by a wide margin, with a market capitalization of around US\$12 trillion; by comparison, the stock markets in Hong Kong and Shanghai have market capitalizations of US\$2.2 trillion and US\$2.05 trillion respectively. The number of domestically listed companies has been increasing steadily over the last decade and stood at 2,229 as of June 2011. In addition to domestic listings, many Chinese companies have pursued IPOs in the United States. In the aftermath of these issues, Chinese companies may increasingly turn to domestic stock

markets to raise capital in the future. China introduced the Qualified Foreign Institutional Investor (QFII) system in 2002 to permit institutional investors to buy into Chinese equity and debt markets. The QFII system has already allowed more than 100 foreign investors access to China's markets; these investors include banks, trust companies, securities firms, sovereign wealth funds and pension funds. Institutions that receive approval under the QFII system are allowed to invest in China's stock and bond markets up to a quota which is set for each institution.

### **Changes in Demographic Structure**

According to 2010 Census (National Bureau of Statistics of China), the fertility rate in China in 1965 was 5.99, which was fallen to 1.76 in 1995 and 1.4 in 2010. According to data in the Penn World Table (2011), China's population grew from 960 million people in 1978 to 1.3 billion in 2009. In the same time, the Gross Domestic Product Per capita (GDP capita) purchasing power parity (PPP) converted, in international dollar at 2005 constant prices) grew from \$550 to \$700 in the same period. In their Report of 2004, the United Nations Population Divisions predicts the demographic window for China opened in 1990 and lasts until 2025. Mankiw et.al (1992) showed the general significant negative correlation between population size and output of a country in their article. Concerning China, Li and Zhang (2007) show in their paper that a decline of the birth rate by 1/1000 increases the economic growth rate by an estimated 0.9 percent per year. Yu (2011) gives very interesting explaining of the positive impact of one child policy (OCP) on economic growth and argues that China on average averted 13 million births a year to the dependency ratio and calculate China's GDP per capita growth rate with the different numbers, comparing it afterwards with actual growth rates, He says, for example, in 1995, the real GDP per capita would have been 13 percent lower without the one child policy. He calculated that the high ratio of working to non-working population led to higher savings, higher savings led to higher level of investment and the large capital stock led to threshold externalities as shown as existing in developing countries. This all together ended in an economic take off effect. The estimated threshold value of the ratio of working population and non-working population is 1.8. Chen and Hao (2010) argue that due to the OCP more women were released to the labour market which added to the working age population. This is also supported by research conducted by Blook et al (2009) who argues that decreasing fertility rates enhance female labour participation. Cai and Wang (2006) and Yu (2011), Family structures in urban China experienced substantial changes in during 1990s and 2000s. The average size of the household dropped from 3.5 in 1988 to 2.9 in 2007, whereas the average age of the household head increased from 43.2 to 47.3, suggesting the advent of an aging society. The most striking pattern is the sharp decline in child dependency, which is defined as the percentage of households with children below 16, from 68 percent in 1988 to 37 percent in 2007. The decline in child dependency is an outcome of the strict population control policy.

Wang and Mason (2008) have concluded that the demographic transitions during the last decades are responsible for one-sixth to two-six of China's GDP per capita growth since 1978. The costs of children have risen rapidly in recent years. Therefore, for households with middle-aged heads, the increase in their expenditures on raising children appears to have more than offset their higher earnings, thus dragging down their household saving relative to those of other households. According to projections made by the United Nations Population Council, China's dependency ratio, which is defined as the sum of the young aged 14 or below and the old aged 65

or above divided by the working population aged between 15 and 64, has reached the lowest level at 38.5 percent in 2010. However, this ratio will rise dramatically to 64.7 percent in 2050, a level comparable to the US figure of 67.7 percent in that year. What drives this rising trend is age dependency: the percentage of population aged 65 or above will increase from the current 11.5 percent to an astounding 38.9 percent in 2050, a level higher than that of Japan (37.8 percent) and the US (21.6 percent) projected for that year. Rising dependency ratio, especially for the old, will likely reduce aggregate household saving through not only the more mouths to feed effects but also the fact that old dependency is generally associated with lower personal saving in high-income economies. This demographic trend has already set in to influence saving, labor markets, and other aspects of the Chinese economy.

### **Alleviation of Poverty**

China was a poor country and facing absolute poverty in 1970s. But the policy of Chinese government to improve the income of people living in urban and rural areas through industrialization and increasing the prices of agriculture crops in 1980s and 1990s brought a dramatic effect on the level of poverty. According to China National Bureau of Statistics, the level of poverty in 1981 was 53 percent and 150 million people were spending their lives on less than \$1.25 dollars per day. But as a result of policy initiative the poverty level was reduced to 2.5 percent in 2005, which was an admirable achievement. No country has reduced the poverty level in such a way as China has brought it down substantially. Similarly, other social indicators were also improved substantially. For example, child death rate was decreased by 39 percent during 1990-2005 maternal mortality rate was decreased around 41.1 percent. This was occurred due to better health services. According to World Bank Report, 2006, the poverty level in the rural areas of China was 74.2 percent in 1990. It was reduced to 26 percent in 2005. While the ratio of population living below poverty line in the urban areas was 34.4 percent in 1990 but it was come down to 1.7 percent in 2005. If we compare poverty alleviation policies of China, India and Indonesia, we will find that China's performance is far better than India and Indonesia.

The success of China's effort in poverty reduction is more impressive when compared with those of other developing countries. While the global poverty headcount (using the one dollar per day poverty line) fell during the 1990s by around 200 million, if China were excluded, the headcount of the poor in all the rest of the world's developing countries actually rose by 100 million (ESCAP, 2003). It is a fact that there has been a sharp fall in the rate of poverty in China during the 1980s and 1990s, there is less agreement about the causes. In particular, little is known about the linkage between the nation's rapid economic growth and the rate of poverty reduction.

In fact, broad trends suggest that it is possible that macro-economic forces and general economic policy efforts may have been instrumental in the reduction of poverty in China. There have been many reform policies that have been implemented. Trade liberalization has changed China from a hermitic country to one of the more open economies in the world. The patterns of growth have changed significantly during this time. The share of agriculture in GDP declined from 31 percent in 1979 to less than 13 percent in 2005. The output of rural enterprises rose from a negligible level in the early 1980s to a level at which they were contributing more than one third of the national GDP, although the role of state-owned enterprises in the economy declined substantially. Before 1986, special grants funds and initiatives to spur growth were pushed in poor areas (Park et al.,

1996). After 1986 the government aimed a major set of investments on increasing growth of incomes in poor areas (Rozelle et al., 1996). The earliest empirical efforts concluded that most of the rise in productivity in the early reform years was a result of institutional innovations, particularly HRS (McMillan et. al. 1989; Fan, 1991; Lin, 1992). Since the mid-1980s, technological change has been the primary engine of agricultural growth (Huang and Rozelle, (1996). Fan and Pardey, (1997). Periods of higher growth rates in agriculture are closely associated with the periods of poverty reduction. According to NBSC (2003-2006) the poverty rate in rural China in 1978 was 30.7 percent which was sharply declined to 2.5 percent in 2005. It is not less than miracle.

### **Income inequality**

As in case of other advanced countries the increase in economic growth has created income inequality particularly in urban areas. Some economists have segmented this inequality into three sources: inequality between the people living in rural and urban areas, among the people living in urban areas and among rural population. The inequality among urban and rural residents have brought negative effect on poverty level. On account of this reason the income gap between urban and rural people have widen during last two decades. The percentage of rural-urban income has increased from 2.49 in 1990 to 3.34 in 2005, highest since inception of China in 1949. He, Ya, (2008) mentions that Gini coefficient was 0.30 in 1979 which was increased to 0.45 in 2006. It shows widening income inequality in the Chinese society, which is not a good omen. The income inequality has been increased due to three reasons.

1. In the rural areas the income of those workers has increased who earned from both sources of farm and non-farm income.
2. In the urban areas the income of skilled workers and particularly those who are working in the manufacturing sector and other export industries has increased more than those of unskilled workers or those who are working in non-export industries.
3. The growing wage gap is another reason of income inequality between rural and urban workers. This gap is also creating multi-dimensional problem both for workers as well as for manufacturing. The rising wages have increased the production cost of goods and services. In industrial and services sector the wages are rapidly increasing. According to US Bureau of Labour Statistics, 2010, average compensation of the Chinese workers was increased from US\$ 0.60 to US\$1.74, about 114 percent during 2002-2009. The urban worker's hourly compensation was increased from US\$0.95 to US\$2.85, about 195% during 2002-2009 while the hourly compensation of rural worker was increased from US\$0.41 to US\$1.15, an increase of around 180%. In 2002 the gap between compensation of urban and rural worker was 131%, while it was 1.47 %. It means the gap was increased about 16%. The high wages in urban areas and lower in rural areas is one of main cause of income inequality in China.

### **Reforms in Financial sector**

Like other sectors Chinese Government has tight control over country's banking system and all major banks are state-owned. Chinese government's share in banking assets are 98 percent which shows the concentration of ownership of public sector. The State Council is the main body which controls the whole financial system. It operates through Ministry of Finance and the People's Bank of China which are two authorities responsible for regulating banking sector. The People's Bank of China was constituted in 1950 and it took over all private banks. It mostly performs the same

functions as other central banks perform in different countries. It controls the issuance of currency, circulation of currency, distribution of credit as per budgetary plan and also manage import and export business.

China's financial sector is dominated by four state-owned banks: the Agricultural Bank of China (ABC), Industrial and Commercial Bank of China (ICBC), the Bank of China (BOC) and China Construction Bank (CCB). China's state-owned banks account for over half of all banking assets, with the remainder shared between city commercial banks, privately owned banks and credit cooperatives. Foreign banks first incorporated in China in December 2006, and by the end of July 2010, 37 foreign banks had a presence in the country. Some regulations are making the operating environment more challenging for foreign banks, for example the 2011 deadline to reduce the loan to deposit ratio to 75 percent. In spite of hurdles, the assets of foreign-funded banks in China still increased from RMB 800 billion in 2006 to RMB1.9 trillion in 2010, representing a compound annual growth rate of 23.4 percent.

China has also introduced reforms in financial sector. The Chinese government has relax rules for foreign investment in banking sector by allowing to hold 30 percent equity in the Chinese listed companies. China Securities Regulatory Commission on July 28, 2012 has unveiled the rules under which the foreign investors have been allowed to invest in the China's inter-bank money market and bond market. The objective is to secure long-term investment in China's capital market. However, only those investor can invest in the Chinese capital market who hold license issued by the Regulatory Authorities. In 2011 China issued 25 license to foreign institutional investors while 37 new license were issued between January and June 2012. In this way China has gradually eased the rules for foreign investment. But it has not totally opened its financial sector to foreign investors. It has set certain rules under which the foreign investors can neither invest in any sector nor withdraw their investment forthwith without the permission of Chinese government.

## CONCLUSIONS

We summarized our conclusions in the following:-

China kept the momentum of economic growth through effectively implementing reforms in different sectors and eradicate corruption from the society. China has also paid attention on the distribution of growth benefits to all sections of society.

China has taken initiative to bring all areas at par through development projects in order to reduce poverty. Initially it focus rural population which was provided handsome incentives to grow more and sell more and in that way this segment of the society come out of poverty and its per capita income was increased. One child policy kept the population growth in check and to use the stock of human capital more effectively. Chinese literacy rate has gone up to 99 percent.

Another characteristics of China's policy was to boost industry through fiscal incentive and by establishing special economic zone particularly for foreign companies and inviting them to invest. Now the China, after U.S.A., is the leading country where foreign companies have been investing capital and transferring technology. This has transformed Chinese economy from an imitation economy to an efficient and to some extend a knowledge economy. All this was the result of good economic policies

**REFERENCES**

- Barro,Robert J. &Lee,Jong-Wha (2012) “A New Data Set of Educational Attainment in the World, 1950–2010” UNESCO Institute for Statistics. (<http://www.barrolee.com/>).
- Cai , Fang Du Yang Wang Meiyang (2006) “ Employment and Inequality outcomes in China”, Institute of Population and Labour Economics, Chinese Academy of Social Sciences.
- Fan,ShenggenPardy, Philip G (1997) Research, productivity and Output growth in Chinese Agriculture”, *Journal of Development Economics*.
- HOLZ,Carsten A. (2008) "China's Economic Growth 1978-2025: What We Know Today about China's Economic Growth Tomorrow." *World Development* 36, no. 10 (Oct. 2008): 1665-1691.
- Huang,Jikun,YangJun,ZihigangXu,ScottRozelle and Ninghui Li (2007) “Agricultrual Trade Liberalization and Poverty in China”, *China Economic Review*, Vol 18,pp 244-265.
- Huang, Jikun, &Rozelle, S. (1996). “Technological change: rediscovering the engine of productivity growth in China's agricultural economy”. *Journal of Development Economics*, 49: 337-369.-
- IMF (2010) “Financial Stability Report-2010” Washington,D.C.U.S.A.
- IMF (2010) “World Economic Outlook”April,2010,Washigton,D.C.,U.S.A.
- Jin,Hehui and YingyiQian (1998) “ Public Vs Private Ownership of Firms:Evidence from Rural China”, *Quarterly Journal of Economics*,113,pp 733-808.
- Lin,Yifu Justin (1992) “Rural Reforms and Agricultural Growth in China” , *The American Economic*
- Morrison,Wayne.M (2013) “China’s Economic Rise,History,Trends,Challenges and implications for the United States”, *Congressional Research Services*,7-57000,U.S.A.
- O’Neil,Jim (2008) “BRICs could point the way out of the Economic Mire”, *Financial Times*, September 23,2008 pp28 London,UK.
- Rozelle,Scott,Linxu Zhang &Jikun Huang (1997) “Poverty, population and environmental degradation in China”, *Food Policy*, Vol. 22, No. 3, pp. 229-251, Elsevier Science Ltd, UK.
- Shultz,T.Paul (1994) “Human Capital, Family Planning, and Their Effect on Population Growth”. *American Economic Review*, Vol 84, No.2,pp 255-260.
- Yu,Q (2011) “Capital investment,international trade and economic growth in China: Evidence in 1980-2010”, *China Economic Review*,Volume 9,pp 73-84.
- Wang,Feng;Mason,Andrew (2008) “The Demographic factor in China’s transition”, *Cambridge University Press,Cambridge*,pp 136-166.
- Zhang,Linxu, JikunHuang and Scott Rozelle (2003) “China’s war on poverty: Assessing targeting and the Growth impact of poverty program”, *Journal of Chinese Economic and Business Studies*, Vol 1 No.3,pp 299-315.