

China's Long-Term Economic Reform: Perspectives and Implications

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1. Background and Purpose of Study

Since the "*Gaige Kaifang*" (Reform and Opening up), China has been implementing various policies for market reforms and opening the market. Starting with a primitive level of economic reform measures and opening the market of coastal cities during the initial stages of the *Gaige Kaifang*, the country promoted foreign capital inducement, liberalization of current transactions, and reforms of state-owned enterprises in the 1990s. Since the early 2000s, it accelerated opening the market, took the opportunity of accession as a WTO member, and implemented structural reforms to establish market economy. Consequently, China has achieved rapid economic de-

velopment during the last 30 years. Its importance and standing in the global economy has greatly increased to become the world's second largest economy in terms of GDP.

However, during the process of the rapid economic development, energy shortage, environmental destruction, unbalanced growth dependent on investment and export, inter-regional and inter-class imbalance, weakened supply of labor force factors, all of which can threaten the country's sustainable economic growth, have also been exposed. Therefore, since the 11th 5-year plan, China has recognized sustainable economic growth and harmonious social development as long-term national development strategies and has concentrated economic pol-

icies on changing the ways of economic development, economic restructuring, improvement of people's lives, and reinforcement of the *Gaige Kaifang*. In particular, at the 3rd plenary session of the 18th-term Central Committee of the Communist Party of China (CCCPC), held last November 2013, China's new leadership expressed that they would carry out extensive economic reforms in the future.

Owing to such implementation of economic reforms in China, substantial changes may appear in its economic policies and environment for Korea's penetration into China. It is expected that such situation will afflict direct/indirect impacts on Korea. Therefore, it is necessary to look into the directions of China's economic reforms, Korea's largest trading partner, and to prepare countermeasures.

This study analyzes the content and forecasts of the directions of China's economic reform implementation in the eight categories of money market, marketization, public finance, tax system, prices, state-owned enterprises, labor, hukou system (household registration system), and international economy; presentation of implications for Korea and countermeasures that should be taken.

2. Directions of China's Economic Reform Implementation by Category

A. Financial Reforms

Having selected liberalization, globalization, and privatization as financial reforms directions, China is planning to implement the following measures to realize them: (a) normalization of the money market function of efficient resources allocation, (b) improvement of

loan environment for SMBs, (c) phased implementation of interest rate liberalization, (d) liberalization of foreign exchange rate and loosening of foreign exchange regulations, and (e) advancement of measures against financial risks and financial supervision system.

B. Fiscal Reforms

The current fiscal system of China is rooted in the Tax Distribution System, which was enacted in 1994. While its enforcement has concentrated fiscal authority on the central government, it caused difficulties for local governments in maintaining stable fiscal revenue, and rapidly increased fiscal deficit of local governments. Accordingly, to solve this problem, China needs to reinforce fiscal self-reliance capability of local governments through public finance reforms, such as tax distribution ratio modification, between the central and local governments as well as real estate tax levy. As such fiscal deficit or debts of China's local governments is likely to have considerable impact on Korean enterprises, we need to closely monitor this.

C. Tax Reforms

As it is expected that China will put the emphasis of tax reforms on income inequality, tax burden inequality, global imbalance (expansion of domestic consumption), and optimal allocation of resources, we can forecast that the major directions of China's tax reforms will be as follows: (a) active implementation of tax reduction measures, (b) reform on consumption tax and business tax (completely abolishing business tax and integrating it into value-added tax), (c) reform on personal income tax and corporate income tax and (d) reform on taxes on foreigners and resources tax.

D. State-Owned Enterprise Reforms

Even though China's new leadership emphasized redefinition of market roles and mixed ownership system regarding reform on state-owned enterprises in the 3rd plenary session of the 18th-term CCCPC, detailed plans and actions have not been observed. Accordingly, it is expected that huge changes will not occur in China's reform on state-owned enterprises for the time being. Rather, gradual implementation of reforms is forecasted. In the future, even though the portion of state-owned enterprises in the Chinese economy will steadily shrink, it is projected that China's unique public or mixed ownership system will still account for a dominant portion of its entire economy. In particular, it is foreseen that China's major state-owned enterprises will continue to play critical roles in cultivating representative enterprises of global competitiveness, in running strategic projects for creating innovations, and in strategic business categories and areas.

E. Market and Price Reforms

One of the reform measures for fair market competition is the enactment of the antitrust law. It is forecasted that China's mid- to long-term antitrust regulatory reforms will be implemented in the following directions: (a) implementation of unified legal enforcement of the antitrust law through a single enforcement agency, (b) establishment of a clear basis for judging market dominance of enterprises, and (c) possibility that the antitrust law will include criminal punishment clauses in the mid or long term and will stipulate inclusion of state-owned enterprises in cartel investigations.

Reforms of distribution system are focusing on breaking of inter-regional distribution barriers, reform on state-owned distribution firms,

expand market participation by private enterprises, and improve logistics networks to activate chain businesses.

Meantime, China's new leadership is emphasizing market roles in resources allocation in changing the way of development for sustainable growth and also reforming pricing mechanism for the marketization of prices of resources/energy and agricultural products.

F. Labor and Hukou System Reforms

China is reforming labor and family registration system for the improvement of people's lives and of allocation system. It is expected that the labor supply shortage in the eastern region will be further aggravated. Such shortage is not a transient phenomenon but is related to the change in China's decreasing labor population structure. Because its labor market has already reached the "Lewisian turning point", and because the Chinese government is going to increase the minimum wage, a steep rise of real wages will be inevitable. In addition, along with the improvement of the bargaining power of workers, it is expected that labor movement will appear in China's industries. On reforms of family registration system, as interests are entangled complexly among residents of urban and rural areas and government agencies, it is anticipated that further development of reform measures will not be attained until such institution and mechanism are established as can modulate the interests.

As the core purpose of the policies to improve people's lives is to protect living conditions and rights of the minority, willingness of the government to improve people's lives is critical to achieve such purpose. Therefore, expansion of fiscal spending, proliferation of public opinions, and establishment of institution for the protection of the minority will be

visualized.

G. International Economic Policies

The directions of the external economic policies of China's new leadership can be broadly subdivided into change in the way of external trade development, voluntary opening strategy, and active local cooperation strategy. To seek change in the way of external trade development in accordance with the changes in the ways of domestic economy development, China is pursuing the enhancement of export industries and balanced development of export and import. China is focusing on inducing reforms of domestic economy by opening it; the Shanghai Pilot Free Trade Zone is regarded as a representative example of its pursuit of voluntary opening strategy. It is expected that China will pursue active trade and FTA strategies in response to the trend of regionalism and neo-protectionism of the global economy.

As the core tasks of China in realizing such strategies, we suppose changes in policies on FDI, ODI, free convertibility of capital items, and reform on foreign exchange system for the globalization of RMB, and China's pursuit of FTAs.

3. Future Outlook and Implications

At the 3rd plenary session of the 18th-term CCCPC, held last November 2013, China's new leadership presented mid- to long-term reform directions targeted at the overall intensification of reforms. Based on the outcome presented at the session, we can forecast that China's economic reform directions will be as follows.

First, in the reform on state-owned enterpris-

es and state-owned assets, its basic direction will be developing various ownership systems. Second, in the reform on money market, it will mainly include loosening of entry barriers, marketization of interest rates, reform on capital market, and reform on related institution for the globalization of RMB. Third, in the areas of public finance and tax systems, reforms will be implemented in accordance with a new change in the way of economic development. Fourth, prices will be reformed to reduce government's interference with pricing control and to establish market-led pricing system. Fifth, various experiments will be carried out to pursue reforms on family registration system and to stimulate domestic reforms by opening the market. In addition, it is forecasted that China will reinforce allocation for laborers, try to solve income inequality through reallocation, and pursue reforms to improve people's lives and social safety.

Such extensive implementation of China's economic reforms presents critical implications not only for the advancement of Korean enterprises into China but also for Korea-China trade. First of all, China's extensive economic reform policies will slow down the growth rate of the Chinese economy as well as Korea's exports to China. In addition, China's economic reforms may pose both opportunities and risks in Korea's export to and investment into China. In other words, if China's economic reforms improve institution and increase level of opening the market, it will facilitate Korea's penetration into the Chinese market and will increase the possibility of penetration into new areas. On the contrary, increase of factor prices because of China's reform policies will act as the largest risk factor.

In response to the policies of China's new leadership for implementing extensive eco-

economic reforms, we need to exert efforts to establish an institutional basis to improve the environment for Korea-China economic cooperation. As the most important mechanism for such endeavors can be the Korea-China FTA, we need to sufficiently utilize China's mid- to long-term directions of economic reforms and its changes in international economic policies. However, to maximize the Korea-China FTA mutual economic cooperation and practical benefits, we have to deal with the following during the FTA negotiation process. First, FTA should be implemented in consideration of not only mutually

sensitive areas but also of trade characteristics for both countries. Second, we need to respond to major competitors, such as Taiwan and Japan, in China's import market. Third, in the investment area, we should utilize the changes of China's policies related with foreign investments. Fourth, as the negotiation of the Korea-China FTA on the service industry has a very important meaning that Korea can basically take an offensive posture, we need to further expand the level of opening the market of China's service market during the FTA negotiation process. 