In order to form some educated guess at the future of the Chinese economy, the chapter first summarizes the most salient features of today’s Chinese economy and then the fundamental challenges facing new Chinese leadership as of late 2012. Based on this, I venture to offer a picture of the Chinese economy of the coming decades. It is argued that the Chinese economy is likely to continue growing at a reasonably fast pace for the coming decade. Together with rapid growth, there will be far-reaching structural changes, which are mainly driven by the relative shortage of labor and ensuing higher wage rates. Meanwhile, China’s social–economic institutions will continue evolving. The direction of the institutional evolution is unlikely to be the Anglo-American model of modern market economy. Rather a unique model similar to the German–Singaporean one might be closer to the future of the Chinese economy.

In this chapter, I will discuss the future of the Chinese economy, a very broad topic commanding wide interests. However, it is also a very difficult subject to work on. Of all issues, economists know the least about the future. In order to form some educated guess at the future of the Chinese economy, I will first summarize the most salient features of today’s Chinese economy and then the fundamental challenges facing new Chinese leadership as of late 2012. Based on this, I venture to offer a picture of the Chinese economy of the coming decades. There are three aspects of my picture of the future, including continued and relatively fast growth, structural changes caused by increasing labor cost, and continued institutional changes.

### 1 The landscape of the Chinese economy after 33 years of reform

The landscape of the Chinese economy has changed beyond the expectations most people in the world held thirty-three years ago. This is by no means an overstatement. Three related perspectives will be considered.

#### 1.1 The Chinese economy is now the world’s second largest economy and biggest contributor to world economic growth

As of the end of 2011, the size of China’s mainland GDP was about 50 percent that of the US, accounting for 10 percent of the world GDP, and contributing to 20 percent of the growth of the world GDP. Note that this calculation is based on the nominal exchange rate of the Chinese...
currency RMB. If we use the purchasing power parity (PPP) exchange rate, then the relative size of the Chinese economy as of 2011 will double relative to that of the US. That is, the size of the Chinese economy was almost as big as the US by 2011 and accounted for almost 20 percent of the world economy. (See Figures 19.1 and 19.2.)

Interestingly, GDP-based statistics may very well understate the size and global impact of the Chinese economy. The reason is that the market exchange rate of the RMB (roughly 1/6.2 of US$ as of November 2012) under-reports the actual purchasing power of the RMB in China. In other words, 6.2 RMB can buy (or represents) more economic activities in China than US$1 in the US or other parts of the world. The World Bank in 2007 stated that 2.3 RMB to US$1 would equate the purchasing power of the two currencies in their respective economies.

Rather than disputing the purchasing power equating exchange rate between the RMB and the US$, i.e. the PPP exchange rate, let us look at a few types of products in order to appreciate the real size of the Chinese economy (see Table 19.1.)

It is also worthwhile to keep in mind that the past three decades of Chinese growth have not only been rapid but also relatively smooth. It is a situation comparable to the economic emergence of Japan after the Meiji Restoration and the economic emergence of the US at the beginning of the twentieth century. (See Figures 19.3–19.5.)

Figure 19.1 Chinese GDP relative to US GDP
Source: WDI (2012)

Figure 19.2 Global share of Chinese GDP using RMB market exchange rate
Source: WDI (2012)
Despite the surprisingly rapid pace of growth of the Chinese economy during the past decade, it is important to keep in mind that the Chinese economy as of 2012 is still a “poor” economy. (See Figure 19.6.)

### 1.2 Tremendous economic disparities

Despite the legacy of the centrally planned economy, today’s Chinese economy features one of the world’s highest degrees of disparities both among the population and across regions. (See Figures 19.7 and 19.8.)

What is the reason for the tremendous disparities? The fundamental reason is very simple: the lack of free flow of populations. That is, due to policy restrictions, the population cannot easily migrate from low income regions to high income ones. Population flow in a mature market economy makes sure that population flows from lower per capita income areas to higher per capita income areas, adjusting for climate and other non-economic factors. This is an equalizing force for per capita income. In China, although population flow across regions has increased in

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*Table 19.1 Share of output of Chinese products in the world economy (2011)*

<table>
<thead>
<tr>
<th>Products</th>
<th>Production capacity</th>
<th>Share in the world (%)</th>
<th>Ranking in the world</th>
</tr>
</thead>
<tbody>
<tr>
<td>Iron and steel</td>
<td>700 million tons</td>
<td>33</td>
<td>1st</td>
</tr>
<tr>
<td>Cement</td>
<td>2.94 billion tons</td>
<td>65</td>
<td>1st</td>
</tr>
<tr>
<td>Machine tools</td>
<td>4 million tons</td>
<td>50</td>
<td>1st</td>
</tr>
<tr>
<td>Automobile</td>
<td>18.40 million</td>
<td>23</td>
<td>1st</td>
</tr>
<tr>
<td>Home appliances</td>
<td>150 million</td>
<td></td>
<td>1st</td>
</tr>
</tbody>
</table>

*Source: Ministry of Commerce of the PRC*

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*Figure 19.3 Chinese and US economic emergence compared*

*Source: Palgrave World Historical Statistics*
the reform era, especially since the 1990s, the government has greatly relaxed policies that forced capital to flow into relatively underdeveloped regions. For example, since the late 1990s, the central bank had basically eliminated policies forcing banks to lend to poor regions. Before then banks had loan quotas independent of the amount of deposits so that banks in rich regions such as Guangdong had surplus funds which had to flow into poor regions.

Another reason for the huge interregional income disparity is the fact that the economy no longer has a powerful social welfare system. Many basic social welfare provisions are lacking. The consequence of the large economic disparity is social anxiety and social discontent. Many in the population are worried about the high cost of health care, living expenses in post-retirement life, etc.
1.3 Unique economic institutions

China still has a system of unique economic institutions. The main feature is strong government intervention in economic decisions, although the intervention is often pro-business and pro-investment, and therefore pro-growth.

The political system can still be characterized as that of a Party State (Kornai, 1992), which means that major political decisions, the most important of which are (government?) personnel decisions, are discussed and decided within the Party before being implemented in the state hierarchies. Therefore, the Party and the state hierarchies, to a large extent, overlap. Thus, one can
conclude that the political system is rather centralized in that local governments are accountable to higher-level government agencies.

But in terms of economic decisions within the government, the Chinese institutions are very much decentralized. Decentralization is the key for economic development in China. Local government officials behave like board members of the holding company of local enterprises, state owned or non-state owned. Local government officials continue to push for more investments and faster economic growth.

2 Challenges facing the Chinese economy and its institutions

Despite the surprising success of China’s economic performance over the past three decades, China is facing a long list of challenges in its efforts to sustain its economic growth. I will discuss three of the most significant ones.

2.1 A new model of development

The first and most imminent challenge facing the new Chinese political leadership is the search for a new model of economic development. This new model should differ from the current one in three very important ways. First, the new growth model must be less dependent upon external demand than the current growth pattern. This is not only because of the anemic state of the world economy, which is unlikely to improve soon and therefore unlikely to support China’s continued rapid growth, but also because surging global protectionism will make it increasingly difficult for China to maintain its high trade surplus with the rest of the world. (See Figures 19.9–19.10.)

The second dimension of the new growth model is that the model has to rely more upon domestic consumption, especially household consumption, and less upon investment. Investment as measured by capital formation has been increasing in its share of GDP. This is unlikely to be sustainable, since this implies that more and more of national savings will be poured into investments and both the commercial and social rate of return of investment will decline, which
implies there will be increased pressure upon the financial and fiscal systems in China. (See Figure 19.11.)

The third dimension of the new growth model is that the model will need to be less dependent upon consumption of resources and energy. As the world’s largest consumer and importer of many types of resources and energy, China is spending an increasing proportion of its international diplomatic capital to secure the supply of these commodities. More importantly, perhaps, is that the huge consumption of such commodities leads to pollution and rapid increase in the emission of global warming gas. In fact, China is already the world’s largest emitter of CO₂, making it the target of international negotiations regarding climate change. (See Figures 19.12 and 19.13.)

Figure 19.9  Ratio of export to GDP
Source: National Bureau of Statistics of China

Figure 19.10  China’s trade surplus to GDP
Source: National Bureau of Statistics of China
The future of the Chinese economy

2.2 Mitigating social and political tensions

The second challenge is how to mitigate the mounting social discontent, especially among the young and educated population. Inequality generates anxiety and discontent among young people. A major contributing factor is that Chinese college enrollment has more than quadrupled since 1999 and today’s youth are much more aware of social and political issues. Meanwhile, economic inequality has been expanding, often at the expense of the young; examples include

![Figure 19.11 Capital formation as a share of GDP](source: National Bureau of Statistics of China)

![Figure 19.12 China’s share of iron and other ore imports](source: WDI (2012))
the rapid surge in housing prices favoring members of the older generation who bought housing units before or during the rapid increases of price. To make matters worse, in many cases, children of the rich and powerful receive head starts and advantages over their peers. That is, opportunities are visibly unequal among the younger generation. The internet, with its rapid flow of information around the global and quick interaction of social opinions, only intensifies social sentiments. (See Figure 19.14.)

Even though a major source of the social discontent originates in the economic area and can be mitigated by better economic policies and institutions, social discontent easily migrates to
politics. For example, in recent years, during the annual March sessions of the National People's Congress and the Chinese People's Political Consultative Conference (CPPCC), some young people have gone beyond merely criticizing government policies by challenging the qualifications of the delegates of the NPC and members of the CPPCC.

### 2.3 Easing international anxiety about China's economic emergence

The third challenge emanates from China's external economic and political relations. It is very clear that today's China faces a much trickier international environment than a decade ago. China in 2001 had just been accepted into the WTO; subsequently, China's trade and inflow of investment took off. Today, China has become the largest target of trade disputes. The exchange rate of the Chinese currency has become an issue of dispute. Protectionist policies against Chinese products and Chinese investment are increasing.

Ten years ago, China was able to avoid direct pressures from global warming negotiations, citing the Kyoto Protocol as an international principle. Today, China has become the world's largest emitter of global warming gas. China faces huge pressure to commit to some form of decreasing its global warming gas emission.

Ten years ago, China faced questions from the international community as to whether its economy would collapse, following in the footsteps of other economies during the Asian financial crisis. Today, because of its economy's huge size and rapid growth, China is again facing questions about its geopolitical strategic intentions. Often, China is perceived as a threat to its neighboring countries, and makes economic collaborations much more difficult to come by.

Most people in China who have a reasonable amount of knowledge of the world (including myself) believe that the world is misreading China. Indeed, China is growing extremely quickly in many dimensions. However, the fundamental socio-political institutions of the country are not capable of implementing an expansionist strategy. The mentality of the population is too middle-kingdom-centric to be adventurous in the world. The history of the country is about making peace and achieving unity among the population; this attitude does not create a desire to expand beyond our borders. Certainly, disputes with neighbors over territory and ocean rights will continue to emerge, but these are historical legacy issues and conflicts of old claims and are relatively very small issues if put it in the global context.

In order to ease the world's anxiety over China's economic emergence, Chinese leaders will definitely have to do a better job of explaining China's long-term intentions. Moreover, through pragmatic negotiations, they also have to demonstrate their willingness and ability to resolve thorny issues.

### 3 The future of the Chinese economy

The topic of the future of the Chinese economy is in itself very subjective, since we obviously have no observations of the future and therefore a lot of subjective judgments have to be made in tackling such a topic. Surely, there is a large range of opinions on this. Many analysts in the West are pessimistic about the future of the Chinese economy, arguing that a slowdown is near in sight. Perkins (2012) carefully presents factors behind this view but would not give specific predictions as to when the slowdown will happen. Chow (2012) argues almost the opposite, that is, a growth rate around 8 percent will persist in the coming ten to fifteen years. He is sophisticated in assessing China's political economy institutions, predicting that the institutions will evolve but are unlikely to become similar to those in Western Europe or the US. The picture I will paint in the following tends to be close to that of Chow (2012) but many arguments are different. The readers are of course encouraged to form their own opinions.
3.1 The potential and prospects for economic growth

Despite the rapid growth of the past three decades, China still possesses a large potential for continued growth. The main reason is that China is still very poor; China’s per capita income is still 18 percent that of the US. When a country is still so far behind the technology and institutional frontier and has embarked on the path of rapid growth, the potential for growth will remain huge. Figure 19.5 is a graph of economies that took off while beginning with such a low level of per capita income.

The second reason for China’s potential for rapid growth is that the Chinese economy is a large country economy; that is to say, a large population with a large stretch of land. A large country economy, like that of the US but unlike that of Korea and Japan, has, in principle, the potential to develop a large domestic market rather than rely upon international trade and trade surplus. For example, the inland provinces like Sichuan and coastal provinces like Jiangsu can trade with each other in a manner similar to the international trade between Malaysia and Japan. China is currently a great underachiever in this regard. Once the potential of intra-country trade is unlocked, China’s dependence upon foreign markets can be reduced drastically.

Needless to say, one can never write off the danger of China running into the so-called middle-income trap. That is, many economies in the world simply stopped rapid development once they reached the mid-income level with per capita GDP between US$8,000–17,000. Today’s Chinese per capita income is around US$5,000. The often-cited examples include countries such as Argentina, whose per capita income is around US$10,000. For the sake of argument, assume China runs into that trap and becomes another Argentina. The per capita income of such trapped middle income countries is around 35 percent that of the US. Therefore, China still has room to double its per capita income before getting caught in the trap.

More importantly, today’s China is still bursting with reform energy at the grass-roots level, which is very differently from Japan in the late 1990s or many middle-income-trapped countries. Market-oriented economic reforms proved to be the most important engine of efficiency improvement and therefore fast economic growth during the past decades of the Chinese

![Figure 19.15](image_url)  
*China’s economic growth after reaching 18% of US GDP: a forecast*

*Note: Horizontal axis = number of years after 2012; vertical axis = percentage of China’s per capita GDP relative to that of the US*
The future of the Chinese economy

The young and educated Chinese are not content with current economic and political institutions. They are calling for further reforms. No leaders in China are openly supporting inhibiting reform. On the contrary, all the leaders favor reform, although different camps have different visions of what reform actually is. In any case, the appetite for reform is still high in China.

It should be noted that there is also a good possibility that China’s rapid growth may end relatively soon. Perkins (2012) provides a careful analysis of this possibility. He argues that recent world economic history shows that no country was able to have very rapid growth like today’s China longer than thirty years, which China already had. Also, the lack of very fast productivity growth and China’s heavy reliance on capital investment and export are factors pointing at an overall economic slowdown before too long.

### 3.2 Structural change of the economy

Together with economic growth, the structure of the Chinese economy will undergo fundamental changes, and some of the early signs of the structural changes are already in sight.

Blanchard and Giavazzi (2006) raise the rebalancing issues of Chinese economy. In their paper, they presented a so-called “Three-handed approach” as the solution based on China’s economic situation: action on the fiscal and budgetary front, accompanied by currency revaluation. Lardy (2007) suggests that China should promote consumption-driven growth as the engine for the whole economy, and at the same time try to reduce household saving rates. Prasad (2009) enlarges the field of vision to all of Asia, and also recommended that the transformation of the economic development mode should be implemented. In Naughton’s book (2007), he talks about the unsustainability of economic growth driven by investment.

As a matter of fact, China’s economic structure improvement has already begun, and we can see signs of some important changes. The most fundamental change is demographics. The aging of China’s population implies that savings rates will gradually decline. The growth of labor supply will gradually decrease. Most relevant for the coming decade will be the disappearance of surplus labor in rural areas. This is now beginning to cause wage rates for manual labor to increase faster than nominal GDP and in many cases labor productivity (Fang Cai, 2011).

As Figure 19.16 shows, the rural surplus labor is expected to decrease significantly in the coming decade, indicating a structural shift in the economy.

Figure 19.16    Estimates of surplus labor
Source: Li and Xu (2012)
trade surplus has been declining since 2007. By 2012, trade surplus dropped to just above 2 percent of GDP, a number that is significantly below the 4 percent target of the G20 Summit of 2010.

Will the trend of China’s continued wage rate increase reduce China’s international competitiveness so that China will experience a long period of significant trade deficits? I would argue that this is unlikely. Increases in labor productivity will partially or completely compensate for the impact of wage rate increases on trade competitiveness. More importantly, Chinese policymakers are usually very cautious about trade deficits so that when there is a trend of significant trade deficits, policymakers are most likely to implement policy changes or reforms to mitigate the problem, such as more flexible exchange rates, and the lowering or elimination of VAT on exporting firms (a WTO-compatible policy).

Consumption will almost surely increase and increase faster than GDP, having the implication that China will be one of the largest consumption markets in the world. That is, consumption as a share of GDP will increase. This is a consequence of higher wage rates. Indeed there are early signs of this. In a recent study (Li and Xu, 2012), we found that consumption, carefully measured, actually has been increasing as a share of GDP ever since 2007. By 2012, it reached over 41 percent, improving by almost 1 percent a year. Moreover, the increase is found to be driven by the trend of diminishing surplus labor and increasing wage rates.

The increasing share of consumption in GDP is not contradictory to traditional theories of consumption that are familiar to well-trained economists in Western countries. One leading theory is Milton Friedman’s permanent income hypothesis, which argues that consumption is proportional to permanent rather than transitory income. In the Chinese context, the rapid pace of change of the economy has been driving up household permanent income, which in turn drives up consumption. However, before 2007, according to Li and Xu (2012), the increase in permanent income has been slower than GDP, and, after 2007, it is faster. This explains the rising share of consumption to GDP after the global financial crisis.

Consistent with the structural change, China’s service sector is increasing disproportionately with respect to GDP. Figure 19.17 illustrates this. The reason is that when consumption rises

![Figure 19.17 Service sector as a share of GDP](source: National Bureau of Statistics of China)
quickly and many consumers upgrade from basic consumption needs, service as a component of the consumption bundle will assume more weight than before. (See Figure 19.17.)

Finally, urbanization almost surely will accelerate. China’s urbanization ratio, defined as the ratio of urban residence relative to the population, is just over 50 percent. In a study (Feng and Li, 2006), we found that the Chinese ratio of urbanization is 11 percent below the level of a country at a comparable degree of development. More importantly, the 50 percent urbanization ratio includes those migrant workers, who work in cities on a long-term basis but do not have resident permits and therefore cannot bring their family with them from rural areas and thus are semi-urban residents at most. These semi-urban residents typically do not identify themselves with the city in which they live and therefore do not consume as much as a normal urban resident. That is, the 50 percent urbanization ratio in China overstates China’s progress in urbanization.

Chinese policy makers have already identified urbanization as the engine of future growth. Many policy initiatives are implemented to facilitate urbanization. Most importantly, economic forces such as the growth of the service sector will lead to faster urbanization in China. (See Figure 19.18.)

In summary, China’s economic structure will undergo fundamental changes, and there are already signs of these changes. Market forces will be the most important factor driving these changes.

### 3.3 Institutional reforms

There should be no doubt that the Chinese economic, social, and political institutions will undergo further changes. A fundamental reason is that Chinese society is currently unstable and energized for change. The grass-roots population is not happy with many aspects of the economy.
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and societal management, ranging from high and ever-increasing prices in housing, medical care, and education. Meanwhile, the elites are asking and pressing for more individual liberty.

Another extremely important but often neglected reason for continued reform is the Communist Party itself. The Chinese Communist Party is an indigenous political party deeply rooted in the Chinese political tradition, very much different from its counterparts in Eastern Europe. Mao Zedong repeatedly reminded his colleagues of this and he himself often drew political ideas from Chinese history books. Moreover, it is a party that had to wage twenty-two years of brutal military fights before assuming national power, in which there was not the luxury of relying upon ideological and strategic dogmas. Both facts imply that the Party is pragmatic and adaptive, and holds a deep belief that the only way to survive is to continue to innovate and reform.

Will Chinese social, political, and economic institutions eventually evolve into ones similar to those in the US, UK, or continental Europe? This is a critically important question that not surprisingly elicits a wide spectrum of answers.

At one end of the spectrum is the view that China will eventually emulate the institutions in present-day US and Europe. For simplicity, we call this the convergence school. Many elites inside China hold this view. Most observers in the West argue that despite China’s economic success, China’s institutions are not duplicable in other developing countries and eventually will converge to the Western practice themselves. See, for example, Williamson (2012). Very interestingly, legal scholars and economists tend to be among the most vocal elites inside China who argue for this point, while the political scientists and sociologists are more diversified in their views. A plausible explanation is that the disciplines of legal studies and economics in China possess many more Western influences than other disciplines.

Two often implicit arguments are behind the belief that China will evolve to Western-style institutions. First, there is a set of universal values that all human society holds to be true, including individual liberty, equal rights for all, etc., and Western institutions are sanctuaries of such values. Second, today’s China is filled with fundamental social, economic, and political tensions, which can only be resolved by embracing the universal values through reforms of establishing Western-style institutions. Thus, those arguing for China’s evolution toward Western institutions are sometimes labeled as believers in universal values. Not surprisingly, many people who hold this view are highly educated social elites. In addition, this camp also includes many government officials who have extensive educational backgrounds and deal with sophisticated and often international affairs. However, the official party ideology apparatus openly denounces these views. Universal values is a topic of discussion that is banned in public forums.

At the other end of the spectrum is what one may call the divergence school. This group believes that China will gradually adopt a social, economic, and political system that is very different from the West and possibly similar to contemporary Singapore. The reason behind this is the belief in Chinese values instead of universal values. The fundamental argument of the divergence school is based on Chinese history and the population’s preference for current-day China. The main theme of China’s history is basically one of a unified empire. By far the dominant political philosophy is Confucianism, which assigns tremendous weight to social order relative to individual liberty and is almost the opposite of US political ideology. To the divergence school, one can never underestimate the power of history, especially for a country like China. Education is the medium of continuity. As a result, the political tradition as embodied in history gives rise to the Chinese population’s preference, which differs from that of the West.

Therefore, according to the divergence school, the future of Chinese social, political, and economic institutions will most likely not only be different from those of the US, but a polar opposite. The Chinese institutional landscape may well be similar to that of today’s Singapore.
The future of the Chinese economy

In the following, I will delineate the vision of the future of Chinese institutions according to the divergence school, excluding the perceptions of the convergence school. The reason is obvious: our readers are already very familiar with the institutions in the West, which, according to the convergence school, represents the future China.

The Party

The official ideology of the Party has gone through tremendous evolution: from achieving communist revolution, to representing the interests of most of the population, to scientific development. The evolution will continue as every generation of the Party’s leadership tends to create a new version of the ideology as their most important legacy.

Democracy within the Party has been widely discussed and gradually incorporated. The consensus in this regard is to push democracy from top down. Starting at the level of the Standing Committee of the Politburo, instead of mostly following the views of the General Secretary, the committee now acts collectively in decision making. The meetings of the Politburo and the Central Committee are also widely covered and members are conscious of following formal procedures. It is very likely that in the coming decade, there will be more changes, including open voting and open questioning of the work of the Politburo by members of the Central Committee.

According to the divergence school, the nature of the party state will definitely change. The key change will be that more non-communist party members will increasingly occupy key positions in the government. More non-party individuals will be in the People’s Congress (PC) and the CPPCC. The Party will be less dominant in the decision making of the government, a trend Deng Xiaoping pressed for in the mid-1980s but later slowed down. The delegates of the PC and members of the CPPCC have become more and more vocal, opinionated, and critical of the government.

The rule of law

Pressures are mounting for the country to follow the spirit and practice of the rule of law. The pressure is not only to encourage better functioning of the market economy, including proper functioning of the financial system and technological innovation, but also to encourage proper ruling and better disciplining of the Party itself. There are almost daily reports of misbehavior among party members and government agencies that is detrimental to the overall political regime.

Therefore, the independence and sanctity of the legal system will gradually be enhanced. In the past decade, this has not been the case. Court and legal affairs were put under stricter control of the party committees, which caused tremendous social discontent among the elites and the even party members. The case of Bo Xilai highlighted the damage that can occur when the Party dominates law, and will serve as a reminder that even in regard to the Party’s own interests, the rule of law is important.

According to the divergence school, the future legal system in China is unlikely to be a copy of the US or UK institutions. It is unlikely that the Chinese legal system will be as independent as that of the US. On critical issues, the courts will closely coordinate with the government, protecting fundamental interests of the government and the Party. The government and the Party will still have an important say in some of the most critical decisions of the courts, similar to the situation in Singapore. Instead of arguing that this system is superior or inferior in supporting economic prosperity and social welfare, I would only like to say that it is a big stride toward improving the current state of affairs.
Democracy

Democracy is the trend. This is very obvious, since the population is increasingly better educated, more open, more diversified, and the economy is ever more complicated with increasing intensity of conflicts concerning economic interests and rights. According to the divergence school it is unlikely that the future evolution toward democracy will lead China to a US or even European-style system. Rather, a Singaporean-style system may be a better reference. Specifically, there will be (higher-level) government or party-nominated candidates for election to the People’s Congress. There might be seats reserved for professional society, e.g. accountants, professional managers, etc.

In the view of the divergence school, the elites will have more voice and influence. It is possible that some seats in the legislative council will be voted on by the elites. CPPCC will very likely remain a political institution similar to the House of Lords in the UK but without lifetime tenure. But the procedure to choose its membership will evolve to become more transparent and the function of the CPPCC will surely become even more active than it is today.

Regulations

In the eyes of the divergence school, while direct government intervention in economic decisions such as investment project approval will likely be greatly reduced, regulations of those critical areas of economic transactions will likely be greatly enhanced. Examples include safety standards for food and other products, environmental protection standards, financial market transactions, and health care products and services. In this dimension, the Chinese government will be more powerful than it is today and perhaps more so than in the US and other Western governments.

The state ownership of assets

The divergence school argues that, unlike the US and most European economies, the Chinese governments, central and local, will most likely continue to hold large amounts of production assets. However, the production assets may not be in the form of majority shares of SOEs. Instead, the Chinese governments may divest their current holdings of SOEs and use the proceeds to establish a sequence of investments funds, which in turn will invest in a large cross-section of enterprise shares. This is the Temask model of Singapore. The reason is that it is unlikely that Chinese governments will completely retreat from involvement in the economy. Meanwhile, it is very attractive to follow the Temask model since it not only provides a solid foundation for public finance but also enables the government to intervene in the economy without causing too much distortion.

Social welfare

Almost surely, there will be systemically more provisions for social welfare in the Chinese economy. The Chinese economy needs to reestablish a system of social welfare. The current situation of limited state provisions for social welfare is not socially sustainable. Again, according to the divergence school, the Chinese social welfare system will most likely be very different from the US and European model. Given the strong aversion to excessive social welfare as an aftermath to the pre-reform era, the future system in China will not be comprehensive. Second, given the desire of the government to intervene in the economy, the system is likely to be based on benefits in kind, rather than monetary transfers.
The future of the Chinese economy

Which vision is more likely to be the future of Chinese institutions, the convergence school or the divergence school? As is often the case, the reality lies between the two extremes. Future Chinese institutions are unlikely to be exact copies of the US or other Western countries. Neither will they be completely different from those of the West. Many fundamental principles underlying the configurations of the institutions, such as separation of powers and checks and balances, will be the same.

Corruption

Corruption has become a major social and political issue rather than an economic concern in China. It is not a drag on economic growth, since corruption in China, unlike that in other developing countries, mostly happen when business deals are facilitated. However, corruption has caused mounting social discontent.

There are two views on the future of corruption in China. One view is that corruption in China cannot be eradicated since this is incompatible with one-party control. The implicit logic is that senior party officials benefit from corruption and therefore it is unrealistic to expect them to eliminate corruption. In other words, it takes credible and external forces to get rid of corruption, which are lacking. The other view is that corruption is a passing phenomenon. The ruling party has the political will to clean it up since the Party is fully aware of the fatal consequences of continued corruption and rapid economic growth provides the Party with good economic means to do so. For example, the Party can pay explicitly high monetary amounts to government officials in order to set up a system of meritocracy. The example is Singapore, where a cabinet minister’s compensation is set to be comparable to that of the CEO of a multinational corporation. The Chinese Communist Party has not been able to do it. Part of the reason is that doing so contradicts its traditional ideology, which states that party officials should be diligent servants of the people, while average income of the people is still very low and the average income of the elite is much higher. Arguably, it takes time to change the officials’ ideology.

Which view is more relevant to the future of corruption in China? It is hard to judge. The reality again may lie in between. After the 18th Party Congress in November of 2012, the new leadership of the Communist Party has repeatedly pushed for reforms to control corruption arguing that this is the life and death issue of the ruling party. The second view seems to be gaining currency.

4 Concluding remarks

Nothing excites analysts more than predicting the future but predicting the future is the most challenging task. The past three and half decades of the Chinese economy have consistently proved many predictions wrong. Indeed, China is not only fundamentally different from the US and Western Europe but also far apart from those former Western colonies such as India and Latin America. In my effort to predict the future of the Chinese economy, I base my analysis upon the fact that it is still a poor economy with a fundamental drive for continued institutional change under the control of an indigenous, nationalistic, and dominant political party. Therefore, I argue that most likely the Chinese economy will continue growing at a reasonably fast pace with far-reaching structure changes, which are mainly driven by the relative shortage of labor and ensuing ever-higher wage rates. More importantly, China’s social–economic institutions will continue evolving. The direction of the institutional evolution is unlikely to be the Anglo-American model of modern market economy. Rather a model similar to the German–Singaporean one might be closer to the future of the Chinese economy.
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Note

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