There are many descriptions of the evolution of Chinese economic planning. My favorite is found in Daniel Yergin's *Commanding Heights*. Osgood Program Associate, Zhu Xuan, does not revisit that topic in this paper. Instead he provides a short guide to an underappreciated subtle turn in the current economic intentions of the Chinese leaders as revealed in the latest version of the Five Year Plan. Neither the Plan nor this paper can answer all the questions about China's economic future, but at least we should know what course the Party hopes to chart.

Shelton L. Williams, President, The Osgood Center for International Studies

The Twelfth Five-Year Guideline and China's Development Priority: Expect a New China

What is the "Five-year Guideline"?

The Five-year Guideline of the People's Republic of China, also known as the Five-Year Plan, is a series of social and economic growth targets and strategies for economic development.

The concept of a Five-Year Plan is in accordance with communist economic theory, which believes in Economic Planning. Following the Soviet economic model, China introduced the First Five-Year Plan for 1953 to 1957 and kept the tradition except for the years 1963 to 1965, during which the economy had to take time to recover from the damage of the Great Leap Forward. From the 11th Five-Year Program forward, the name was changed to "Guideline" instead of "Plan" to reflect China's transition to a socialist market economy ("socialism with Chinese characteristics") rather than a Soviet-style planned economy.

The Twelfth Five-year Guideline includes the years 2011 to 2015. Provincial governments completed discussion and evaluation of their own "guidelines" for 2011 to 2015 and then sent them to the State Council. Based on these provincial "guidelines," the State Council devised a national one and presented it to the fifth plenary session of the 17th Communist Party Congress for debate. The National People's Congress (NPC) then approved the Plenum's Plan and released a full proposal on March 14, 2011.

What is special about the Twelfth Five-year Guideline?

China has maintained a high growth rate since 1991. In 2010, China became the world's second largest economy with its GDP surpassing that of Japan. Moreover, the OECD predicts that China will eventually replace America as the largest economy by 2020. It seems that China is on its way to a bright future.

However, it is too soon to conclude this trend will always continue. China's economic growth is very difficult to sustain without some serious reform. In spite of all the economic growth, China is now facing demographic aging problems, serious pollution, inequality and a shabby financial system.

In order to deal with these problems, the Twelfth Five-Year Guideline shows some features quite unlike the past Plans. After decades of growth based on foreign direct investment and exports in an extensive economy mode, two of the main priorities in this Guideline are industrial upgrading and promotion of domestic consumption. It also embraces the goals of addressing rising inequality and creating an environment for more sustainable growth by prioritizing more equitable wealth distribution and improved social infrastructure and social safety nets.

Analyzing the priorities of the Twelfth Five-year Guideline

Industrial upgrading

According to reports by Carnegie Europe, today roughly 72 percent of Chinese are of working age. Yet China today has few children much due to the one-child policy. According to National Bureau of Statistics of China (NBSC), the birth rate of 2011 is only 1.19% compared with the perk 2.87% in 1987. With fewer potential laborers and the baby boomers of the 1950s and 1960s set to retire this decade, serious aging problems are now looming in China. An aging population indicates a heavily burdened social welfare system, which would inevitably stall economic growth. In addition, an aging society often indicates a shortage of labor. However, a very interesting unemployment situation is also bothering China. Even though factories in China desperately need technical workers, college students find it very difficult to find jobs in the current environment. The reason is closely related to China's past economic pattern. Known as the "world factory," China is full of low-end industries while high-end industry is yet to become the dominant driver for the economy. This is part of the reason the Twelfth Five-Year Guideline establishes industrial upgrading as a priority.

Another compelling reason for industrial upgrading is to enhance competitiveness of Chinese companies. China has gradually lost its advantage of cheap labor due to increasing domestic living costs. Even though China's Ministry of Commerce has denied a vast flight of multinational corporations, it is reasonable for factories to start searching for places with cheaper labors such as Vietnam and Indonesia. Shifting from low-end industries to high-end ones, increasing productivity, and guaranteeing quality of goods and services are the keys for China to compete in the world market in the future.

Promotion of domestic consumption

Many commentators including the *Economist* argue that China's economy is now unbalanced, with an investment-driven model that has generated vast trade surpluses, growing inequality and a dramatic decline in household income as a share of GDP. Even former Premier Wen has admitted in his governmental report to the NPC in 2011 that "unbalanced, uncoordinated and unsustainable development remains a prominent problem."

However, the Twelfth Five-Year Guideline that does not show that China agrees with this assessment or that it is deciding to change direction. When interviewed by *China Securities Journal* in May, 2012, Justin Yifu Lin, Senior Vice President of the World Bank, noted that China's economic growth still needs to be driven by investments, as consumption is the result of economic growth rather than a method to make an economy develop.

Even though China admits its economy is unbalanced, China is not yet considering overturning its economic model to make it a consumption-driven one. The reason the Twelfth Five-Year Guideline puts consumption as a top priority is mainly to encourage domestic demand. Since exports would shrink due to decline of low-end industries while high-end industries are yet to be competitive, domestic demand needs to be encouraged to digest the fruits of investment and avoid excess production capacity. With the historically high saving rate in China, there is s lot of room for the domestic market to develop.

Moreover, the promotion of domestic consumption can be also seen as determination to handle the problem of inequality. In January 2013, the NBSC, for the first time in 12 years, released the GINI Coefficient* of the past ten years. Chinese Coefficients vary from 0.474 to 0.491, though skeptics claim the real number should be much larger: just a month earlier on December 9, Chinese Family Financial Investigation and Research Center affiliated to Southwestern University of Finance and Economics released a report indicating the GINI coefficient to be 6.1 in 2010. Credibility of these numbers aside, this shows two things: a) China is now suffering a severe inequality problem and b) China's authorities are now paying attention to it. A society with large concentrations of wealth held among a few people is unlikely to have enough domestic demand to spur growth Methods to stimulate domestic demand can only be successful if based on better distribution of wealth and a sound social welfare system.

Conclusion

The two priorities of the Twelfth Five-Year Guideline are both about the sustainability of economic growth. A double-digit growth rate is no longer a Chinese priority, thus leaving much space for structural reforms. Though the aspiration is well articulated in the Guideline, the problem is how to implement these goals. The Plan is already halfway through its duration. So far China has lowered its GDP growth target to 7.5%, which shows its will for sound economic reform. July's credit shortage in China was another sign to show its determination to implement its reform policies. We are all looking forward to seeing China's next move on structural reforms and expect to see a new China with a healthier economy.

*GINI is a statistical method for assessing societal economic inequality. A number closer to zero marks less inequality while a figure closer to 1 marks great disparities of wealth.