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Essay Question: Will China avoid falling into the Middle Income Trap under the new generation of leadership?

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Introduction

After the most important and once-in-a-decade political activity, China’s new leadership was generated in 18th National Congress of the Communist Party of China (CPC). It also symbolized a key power transfer in China as current China President Hu Jiaotao will completely retire from his position and is unlikely to retain any power or influence in central government like his predecessor Jiang Zemin. The son of a veteran leader of CPC, Xi Jinping will become the next President of China and be in position in early 2013. One of the members of the CPC Politburo Standing Committee, Li Keqiang will become the next Premier replacing Wen Jiabao. The Xi-Li Administration is a combination of two main coalitions within the Communist Party of China that Xi and Li are from, the so called “Elitist Coalition” and “Populist Coalition” respectively. This unprecedented brand new combination will lead China to step forward in next challenging decade.

Under Deng’s, Jiang’s and Hu’s administrations in past 30 years, China underwent a staggering economic growth as China’s Gross Domestic Product (GDP) grew approximately 9.9 per cent on average per year (Baoliang Zhu, 2011). After two main stages of reform including “Opening Up” and “Going Out” strategies, China has become the largest export country and the second largest economy. After such prolonged rapid growth, multiple problems emerged such as imbalanced economic structure, severe inequality between urban and rural areas, rampant corruption, ageing population, environmental degradation, etc. that threaten the sustainability of China’s development. Worse still, the growth rate has started to slow down in that only a 7.4 per cent growth rate has been measured in last quarter (Global Post, 2012) which is below the government expectation of 8 per cent growth. On the other hand, the World Bank and Asian Development Bank also mentioned that China has just climbed up to the category of upper-middle income country. Historically, it is a critical moment for a developing country as it is losing cost competiveness while facing the grim challenges from advanced countries, known as “middle-income trap”. Under the new generation of leadership, will China be capable to deal with numerous problems and avoid being caught in the middle-income trap in order to accelerate the growth as past few decades? The article is going to examine this topic by following agenda. The next section will briefly understand the concept of “Middle Income Trap” with representative examples and pay attention to analyses of the circumstances of China. The subsequent section will examine whether the new leaders of China are aware of the “trap” and illustrate the direction of
strategies and policies to deal with the problem. And then, the article will analyze the possibility of China to avoid the “trap” by understanding the circumstance of new leadership and the impediments of China’s transformation from middle-income to high-income level. The final section will be recapitulation and conclusion.

**What is “Middle Income Trap”?**

The World Bank (WB) and Asian Development Bank (ADB) classify countries into high-, middle-, and low-income level by Gross national Income (GNI). “Middle Income Trap” is usually describing the developing countries that reached the middle-income level and become trapped in such level or suffer from stagnation for a certain period of time. They lose the competitive advantage of low-cost benefits while incapable to compete with advanced countries with high skills and technologies. Some countries get stuck in this circumstance and their growth experiences a period of slowdown such as Brazil, South Africa. Most of them have enjoyed growth from low-cost production before. When wages gradually rise, they lose the cost benefits. Investors relocate the production to other low-cost and labour intensive countries. The growth stalls and even declines. Moreover, the typical problems occurred in those countries that got stuck in middle-income level are severe inequality, weak domestic demand, low technological level, etc. In contrast, some countries have escaped from the trap and successfully transformed themselves to be high-skill innovated countries including South Korea, Singapore, Hong Kong, Chinese Taipei, etc. These countries encourage investment in Research and Development (R & D) and high level of education. Their policies are emphasis on innovation and technological development. The economic model upgrades to market-oriented and high-end production in order to encourage competition and increase productivity. Different directions of developmental policies lead to different result. To avoid trapping in middle-income level and strike for further growth, it is inevitable to enhance the competitive advantages by transforming and upgrading economy from low-end to high-value.

**Middle Income Trap in China**

China is facing the challenge of the middle-income trap. According to latest statistic from World Bank, China has just classified as upper-middle-income country with per capital GNI of $4,930 in 2011 (The World Bank, 2012). China has made use of her labour-intensive and low cost benefits to boost the economic growth and thus made an unprecedented high level of
progress. Similar to other middle-income countries, after such astonishing economic growth, China started to slow down a little bit this year. Inflation and ageing population, rising wages and drop in labour supply are eroding the competitive advantage of China economy. The current industrial and economic model may be unable to sustain the growth of China but cause stagnation. It is because China will no longer be able to enjoy the benefits of low-cost as other low-income countries and possess the advantages from the high-value production skills and technologies as high-income countries. Without any structural changes and innovations, China probably will repeat the fate of those Latin American countries that got trapped in the middle-income level.

Besides, several problems mushroomed after high-speed economic growth in China that may also hinder China’s growth and therefore trap her in middle-income level. China is developing with an imbalanced economic structure. Her rapid growth of economy is mainly driven by export and investment and China’s economy heavily relies on these two factors. With her cheap labour, land and energy, China attracted plenty of foreign direct investment. For instance, many foreign investors build factories or companies in China. They process the production there and send back to home countries for selling in order to gain the cost benefits. China becomes “world factory” and thus the rate of her exports surges. What is more, the low-cost benefits generate large margins for people. People reinvest their money with an attempt to gain profits. One of China’s largest investment markets is real estate, which also impelled China’s economic growth. During the past 30 years of development, China’s economy has been excessively dependent on her export and investment. On the other hand, the domestic consumption rate remains low thanks to severe inequality and large disparity between rich and poor. Certain portions of people did not benefit from the rapid growth and are still suffering from poverty. Domestic market demand is too weak to power the economic growth of China. China, with reaching the level of middle-income, is losing her low-cost advantages and thus this kind of imbalanced economy will no longer sustain her growth and may lead her to get stuck in current level.

Serious environment degradation after surging rate of manufacturing activities makes the problem in China worse. Under-pricing benefits attracted plenty of foreign investment flow into China. Most of them process the manufacturing and production there. Not only did these activities stimulate China’s economic development, but also left much environmental damage in China as their production predominantly used coal-based energy, which can cause serious
pollution. Damage to the ecological system can cause climatic change, which affects agriculture and has a ripple effect on the entire economy. In contrast, an environmentally friendly economy and renewable energy are crucial for sustainability and long-term growth. Particularly for the coming era in which the natural resources become scarce, developing green technology is vital for national growth in coming decades.

Under a range of challenges, including gradually losing low-cost advantage and still immature high-tech skills, coupled with imbalanced economy, inequality, weak demand of domestic consumption market, and environmental degradation, etc., it is no doubt that there is no easy task for China to overcome these obstacles and thus escape from the middle-income trap. The next generation of leadership of CPC, the Xi-Li administration, will be responsible for this tough task and take the lead to sustain China’s growth. The very first step of tackling the problem is to be aware of the problem before launching any policies. The following sections will illustrate the awareness of China’s new leaders toward the challenge of Middle Income Trap and their direction of the policies as well as the strategies dealing with the issues.

**New leadership of Communist Party of China**

Although the new leaders are not officially in position yet, it is still clear to see that they have been aware of the challenge of the Middle Income Trap and are planning to tackle this problem as one of the key policies of their administration. In the 18th National Congress held last month, Premier-in-waiting Li Keqiang, who acts as the main beacon of China’s economic development, gave a speech that in depth analyzed China’s economy current circumstance and the future plan of economic development. He stated three major challenges. One of them is the challenge of Middle Income Trap. Li admitted, “China’s per capita GNI has reached the middle-income level and is facing the similar challenge like other middle-income countries.” Moreover, he emphasized that in order to overcome the Middle Income Trap, changing the economic model was a must and the concept of scientific development must become the core value of future economic development. In his blueprint of China’s future economy, apart from keeping on insisting Chinese style of Socialism, the objective is to deepen the current reform and upgrade the economic model by promoting technology and innovation, enhancing domestic demand to boost private consumption, cultivating green
culture in development, etc. Several changes and reforms have been planned to pull China out of the trap.

Xi’s recent “southern tour” showed his strong interest in change and reform of China. China’s President-in-waiting Xi Jinping put strenuous effort into differentiating the new leadership from predecessor Hu Jiaotao which symbolized there will be changes in China. Behavior, language, and working style are giving a fresh image to people. He specially chose Guangdong, the leading place under previous Deng’s reform, as his first official visiting place after being elected to be the president. This indicates the future direction of Xi’s leadership would continue and deepen the reforms that Deng Xiaoping advocated. During the tour, Xi emphasized China will continuously open up to the world and have further internal reforms particularly in the aspects of enhancing technology and innovation, better people’s living environment, developing green society, etc. These show the next top leader’s willingness to lead China to solve the typical problems of middle-income countries as mentioned above through a series of changes and deepening reforms.

The Central Economic Work Conference, which is the most important economic policy meeting and just held in December this year, gives a further indication that China prioritized market reform as her key economic strategy in coming years. To avoid the Middle Income Trap, it is essential to change the economic structure from low-end to high-value, from heavily reliance on the external market to developing domestic market in order to enhance competitiveness and sustain the growth. In the conference, the discussions embodied what Xi and Li have said during the 18th National Congress and the southern tour. It mapped the road of reforms and transformations aiming at speeding up urbanization, expanding domestic demand, maintaining healthy economic growth, etc.

It is obvious that China’s next leaders have been planning to overcome the so-called Middle Income Trap by promoting an array of reforms and advocating transformation and upgrade of current economic model as well as technological capacity. Although it seems that the leadership got the right direction, there are some factors affecting the effectiveness of implementing the future reforms that determine the ability of China avoiding the trap. The next section examines the possibility by focusing on analyzing the circumstance of new generation of CPC leadership and illustrating the major impediment of China’s transformation.
Will changes happen under the governance of the fifth generation?

In Chinese Politics, the chairman of the Communist Party would be the President of country which is the highest position, followed by Premier who is the leader of State Council, the chief administrative authority. Apart from these, there is a Politburo Standing Committee (PBSC), which is the national decision-making body. All of them represent the top political positions in China. In this fifth generation of leadership, besides the a brand new combination of top leaders, the Xi-Li administration, one or two of the youngest members of the PBSC (under 60) possess the highest educational level compared with previous generations of leaders. The new image of paramount political body is likely telling people that there will be changes in China.

The changing role of Chinese leaders entails a different working style in the Xi-Li era. Xi and Li have different educational background from previous generations of leadership. With international experiences, learning foreign language and high educational level as doctoral degree holder, both Xi and Li act like comparable open-minded and western style leaders. Through their behavior, language and speeches, it is obvious that Chinese leaders act like a manager rather than strong dictator as former presidents. For instance, Xi abandoned traditionally extravagant style but organized a down-to-earth and friendly visit to Guangdong; he gave up conventional bureaucratic and rhetorical speech and emphasized pragmatic works and an easy tone. Furthermore, Li used English for his speech while former Chinese leaders have never used languages other than Mandarin to give speeches. What is more, both Xi and Li give high profile support to reforms in China. These are portraying a picture that China will undergo a brand new era under the fifth generation of leadership.

However, there is not the same case if we have an in-depth view of the next layer in the new structure. The newly elected members of the PBSC indicating the transformation in China may not be guaranteed. Although it has its youngest member, Li Keqiang, only aged 57, most of the others are old and conservative. They tend not to have much desire to promote any changes in China. On the other hand, some younger reform activists such as Wang Yang, former Guangdong party chief and Li Yuanchao, minister of party’s organization, were blocked to join the policymaking committee. These are contradictions to the Chinese leader’s advocating of change. The PBSC serves as the major decision-making body, it has certain
level of influence on policy making. It is not easy for Xi and Li to roll out reform-related policies without the support of PBSC. Moreover, the government needs innovative ideas, particularly if launching the reforms China needs to develop a high-tech economy. If the government constitutes of group of conservative people, it is hard to see any transformation taking place.

As such, although Xi and Li have a strong interest in launching reforms and transformation, it is not a given that China will undergo changes and successfully upgrade the economy that avoids the Middle Income Trap as the key political body is still conservative and tends to not support changes. Worse still, there is still a rooted problem that may retard China to have any progress or even breakthrough in term of political reforms.

**Major impediments to China’s transformation**

Rampant corruption penetrating different levels of Chinese society as well as central government may jeopardize China’s development. Corruption may undermine a country’s rule of law or justice and also cause distortion of policymaking as people can manipulate money to achieve their goals no matter they are illegal. In China, even in government, it is common to see corruption. The typical example is Bo Xilai’s case. Bo, who is the former Chongqing party secretary, was accused of receiving RMB100 millions bribe from bidders of lucrative rail project and making use of his political power to cover up his wife’s crime. Corruption is also common in society. People “purchase” some favorable job positions or school’s places with “official prices”. BBC News reveals a case in Beijing that the parents need to pay RMB10 thousands to obtain the place of a state school for their son (BBC News, 2012). This means poor people do not have chances to change their destiny by having better education or job opportunities. As such, inequality will not be solved but get worse. China’s next leader Xi Jinping also admitted that serious corruption may “doom the party and the state” in the 18th National Congress. With China in a critical moment that needs a structural reform to avoid being trapped in middle-income level, corruption may discourage vested interest groups to embrace any political changes in China that may affect their benefits. Worse still, they may use money or bribes to affect the delivery of policies. If so, the reform will not be successfully rolled out owing to absence of consistency between top leaders and operational levels.
In other words, it is essential to deal with the problem of corruption to increase the efficiency of government and thus to effectively launch reforms to help sustaining China’s development. China is stepping up efforts on anti-corruption. The next leadership announced a new anti-corruption campaign in the first Politburo meeting (CCTV, 2012). Xi Jinping highlighted the problem and showed the interest in combating it by saying that, “especially problems such as corruption and bribe-taking by some party members and cadres, being out of touch with the people, placing undue emphasis on formality and bureaucracy must be addressed with great effort.” The Central Commission of Discipline Inspection (CCDI) serving as CPC discipline watchdog was appointed to be the main responsible department to investigate the cases of corruption and clean the government. After the warning from the leadership, numerous officials even in senior position who involved in corruption have been dismissed. For instance, the party secretary of Sichuan province Li Chuncheng has been swiftly removed from duty as he was suspected of making use of his political influence in real estate deals (SCMP, 2012). As the problem has been taking root in China for decades, it is not an easy and short-term task but a tough and prolonged commitment of combating endemic corruption for China’s leadership. It still need certain period of time to prove the effectiveness of the anti-corruption campaign.

Conclusion

After the dramatic growth in the past few decades, China successfully reached the level of middle-income country according to the judgment of World Bank. In the coming era, China will face a range of challenges in terms of political, economy, society and environment that generated from her rapid economic development. Also it will be critical for China to avoid getting stuck in the so-called “Middle Income Trap” in order to have further growth. According to empirical experiences of some countries that successfully avoid the trap, it is essential to have an array of reforms or transformation in order to upgrade the economic model and developing domestic market to enhance competitiveness and sustainability. In the year of key power transition in China, the fifth generation of leadership, which is the Xi-Li administration, takes the helm of development in the next decade. Even though the next leaders are aware of the challenges that China is facing and making efforts on them, there are still impediments that hinder China’s reform or transformation such as conservative policymaking body, powerful vested interest groups and severe corruption. It is too early to
make judgment that will China successfully have any reforms and finally avoid the Middle Income Trap. Nevertheless, China has been made her first step toward it.

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