CHAPTER 4

PROSPECTS AND CHALLENGES FOR THE GLOBAL AND CHINESE ECONOMIES IN 2022

CHEN Wenling
China Center for International Economic Exchanges, Strategic Research Department, Chief Economist

WANG Peng
China Center for International Economic Exchanges, Strategic Research Department, Associate Research Fellow

Executive Summary

In the baseline scenario of the next decade, the momentum of the global economic recovery is strengthening, but still remains deeply imbalanced as well as unstable. It is anticipated that economic growth in developing countries will be faster than in the developed world and the pace of global growth will accelerate in the latter years. However, developed countries face the challenge of breaking out of economic weakness and averting the double dip. Emerging economies need to deal with imported inflation and the transformation of economic development model. International monetary system is required to be reformed but it will take a while to reach consensus. Aging population is picking up with a fall in the ratio of working population to total population. Global public issues such as food and energy security and climate change should be tackled by joint efforts to build an integrated and comprehensive institutional arrangement.

Facing the above challenges, the best hope to realize economic transformation, structural readjustments and the potential of economic development is changing the traditional mindset and seeking consensus on development. The contribution of emerging economies represented by the 'BRIC' countries to global economic growth is greatly improved, providing strategic space for the economic recovery and prosperity. Moreover, the wisdom of innovation that drives the industrial (post-industrial) society to the knowledge society provides significant potential for promoting future growth. It is also possible that low carbon technologies, circular economy and new energies will be the new engines for driving global economic growth. Finally, setting up global governance mechanisms and rebuilding new international economic orders and the confidence for future growth are important guarantees of sustainable development.

China will play a pivotal role in the global economy in the coming decade. Despite its economic growth rate being lower than that of the past decade, the quality will be considerably enhanced and thus ensure sustainable economic development. China's market will expand faster than others, and domestic consumption will overtake investment and exports to become a new force for economic growth. China has become the largest trading nation, undertaking industrial transfer, elements integration and capital inflows and is one of the most important investors in the world. China will develop into an innovative economy over the coming ten years, aiming to develop a modern educational system and more intellectual support for national development. China will continue to facilitate industrialization and urbanization in order to catch up to the present levels of developed countries and promote industrialization into the mid-to-late stage. China will maintain its focus on improving living standards and satisfy its peoples' expectations of a better life and building a harmonious society. Meanwhile, China is moving to a country with a more marketized and internationalized financial system. RMB will play a larger role in international trade settlement, international capital markets and international currency reserves. However, we need to note that China is facing serious problems and challenges. Transformation of its economic development pattern will be the principle line in the coming decade to maintain China's sustainable development

Prospects and Challenges for the Global and Chinese Economies in 2022

The Baseline Scenario[1] of the Global Economy in the Next Decade

The momentum of the global economic recovery is strengthening, but still remains deeply imbalanced as well as unstable. It is anticipated that economic growth in developing countries will be faster than in the developed world and thus set an upward trajectory.

As the level of household debt in the developed economies falls, consumer spending will return to normal on a gradual basis. In Asian countries export-led growth will rebound to previous levels. Emerging countries are working towards a balance between domestic and external demand and will switch to domestic consumption to drive up economic growth.

As such, the global economy will have a growth rate lower than that of the last 60 years. According to statistics put forward by the World Bank, gross domestic product (GDP) growth from 1973 to 2011 was 3.0% – based on the weighted average exchange rate – and was 2.7% from 2000 to 2011. It is estimated that in the next 10 years the global economy will grow by 2.5%.[2]

Across the globe, economic restructuring is gathering pace. In emerging economies consumption will play a bigger part in driving GDP growth rather than investment and the current account surplus will be reduced. The World Bank[3] projected that consumption will increase from 40% to 47% of GDP between 2010 and 2025 in East Asian economies, and anticipated that a similar trend will occur in India and Latin American countries. The same U.S. ratio over that period will fall from 70% to 63%. Meanwhile, investment will slip from 45% down to 37% of GDP in East Asian economies and a similar decline will occur in other emerging economies. European countries, however, will grow from 16% to 18%.

International trade will continue to increase and become one of the major forces in bolstering the global economy. By 2025 the ratio of trade to world output will increase from 49.9% to 53.6%. A sharp increase in trade of emerging economies is likely to happen thanks to the expansion of domestic demand. Imports will increase from 35% to 45% of total trade volumes and exports from 38% to 50%. The emerging economies' share of global trade will come closer to that of developed countries.[4]

New Economic Challenges in the Next Decade

Developed countries face the challenge of breaking out of economic traps and averting the double dip

In recent years, the global financial crisis has entered into a new phase. Sovereign debt has come out of crisis and the debt crisis in the private sec-

1 This overview is based on the assumption that there will be no large-scale wars or conflicts in the world; an open and liberal trade environment is maintained; the global financial system is relatively stable; there is no major breakthrough in the current global governance mechanism; economic cooperation is deepened although competition is intensified; the U.S. and China's current economic policies are implemented; economic restructuring is well underway; and there are neither breakthroughs nor major conflicts in Sino-U.S. trade relations.

2 "Evaluation and Projections on the US and China's Economic Trend in the Next Decade", Department of Economic Studies, National Information Center, Beijing, forthcoming, 2012.

3 "Global Development Horizons 2011 — Multipolarity: The New Global Economy", World Bank, 2011.

4 *Ibid.*

tor has spread to the public sector. Consequently, core developed economies, such as the U.S., Japan and some European countries, have been mired in debt which has spread to neighboring countries. At present, the amount of the global sovereign debt hit US$95tr , exceeding the global stock market value of US$55tr and global GDP of US$62tr. According to the International Monetary Fund (IMF) predictions[5], the top 10 external debt-issuing countries are developed nations, with overall debt totaling 80% of global debt. In 2014 the total debt of developed countries to GDP will be over 100%, reaching as high as 122% by 2015. Pre-crisis levels won't be restored until 2030.

Analysis of the status quo shows that the crisis is far from over. In the past, the economic cycle of developed countries were shorter, usually lasting six months to a maximum of one year. But the unstable recovery from the recent crisis has already lasted more than two years. Some European countries have even suffered a double-dip recession. The future growth of developed countries, either as a drag or a driver, is crucial to the global economy in the next decade.

Imported inflation and the transformation of economic development in emerging economies

In the aftermath of the 2008 financial crisis, there were wild fluctuations in food and commodity prices. Ballooning food prices have been mainly driven by the Consumer Price Index (CPI) increase in emerging economies. According to the 14 economic cycles tracked by the IMF since 1929, this round of recovery is the most sluggish to date with the fastest credit rebound. The assets held by the global central bank have amounted to US$18tr, accounting for 30% of global GDP, twice that the figure of a decade ago. Against this backdrop, developed economies with large debts opt for loose monetary policies for an indefinite period to sustain the debt cycle. Low long-term interest rates and excessive liquidity on a global scale will be normal. As the output gap is gradually reduced and prices of natural resources are stirred up, the global economy will face an upward pressure resulting in high inflation that may cause turbulence in the financial market.

Although emerging nations such as Brazil, Mexico and Argentina are still growing, their growth rates are slowing, impeded by an unsustainable development pattern, underdeveloped industrial structures, poor infrastructure, low productivity and capital output-input ratios. In this context, global economic growth is likely to stagnate or even head for double dip if the situation is dampened with high imported inflation and strong external shocks over the next decade.

Lack of consensus, joint efforts at international monetary reform and intermittent incurable financial upheaval

Currently, there is widespread consensus that the financial crisis has been caused by the irrationality of the international monetary system. After Lehman Brothers collapsed, the U.S. received more instead of less capital inflows as international investors regarded the U.S. currency as a safehaven. This reflected the fact that international investors were choosing the US$ as the reserve currency and trade settlement currency. Dominance of the US$, in some senses, demonstrates that it is the global investors' currency of choice. Global opinion, including the U.S. itself, advocates reforming the international monetary system while sticking to using the US$ as the global currency.

Major holders of US$s and US$ assets are reluctant to sell because of the fear of further devaluation. Alan Greenspan, former chairman of the U.S. Federal Reserve, acknowledged that the crises are a result of persistent loose monetary policy and low interest rates. However, despite this, such policies continue to be extended. Meanwhile, the 'zero interest-rate' and indefinite quantitative easing policies

5 Global Financial Stability Report, IMF, 2011.

in Japan – adopted more moderately by the U.K., Australia and India – and a tough stance on inflation adopted by some European countries led to an unstable global financial market, which embedded problems of stagnant manufacturing growth and excessive liquidity. The smooth reform of international monetary policies without creating shocks to the global economy is challenging all countries, in particular, the U.S. If substantial reforms are not taken, it will be impossible to contain global excessive liquidity of the US$ and the U.S.' overwhelming deficit. As a result, the US$ will depreciate further and global commodity prices will continue to rise. This will put the global economy, especially emerging economies, at great risk of a double-dip recession.

Aging population and a dwindling labor force

The recent census report[6] published by the United Nations (UN) indicates that the world population reached seven billion in 2011. It only took 12 years for the world population to grow by one billion. It is estimated that it will hit eight billion in 2025 and 10 billion by the end of this century. However, in developed countries such as the U.S., Japan, Italy and Germany, the proportion of the population aged over 60 will make up over 30% coupled with a low or negative birth rate.

The world's aging population has been a major concern of developing countries, some of which may face the problem of "getting old before getting rich" or "getting old while getting rich". By the middle of the 21st century, the aging ratio in developing countries will rise to 14% and the aging population will grow by 400%. The labor participation rate in Northeast Asia is currently high, but is forecast to drop from 64% in 2010 to 57% in 2050.

An aging society means the end of the demographic dividend and the demand for a new force to sustain economic expansion. It also urgently calls for reforms on the social welfare system, education, employment and provisions for the old. The UN projected that by 2050 the world population will peak at 9.15 billion, 16% of which will be over 65 years old. By then there will be only 3.9 working-aged people to support one 65-year old, while in 2010 the ratio was 8:7.

An aging society reduces both savings and investment. The consumption level will rise, but the real purchasing power is weakened. Countries, especially emerging countries, need to put corresponding polices into place as well as ensure their effectiveness to boost the consumption level and the purchasing power of the aged population. The improvement of financial sectors and social safety nets will also help by slashing precautionary savings that are used for the whole life cycle.

Food and energy security

Threats to food and energy security are exacerbated by the use of biofuels made from corn and grain. The report by the Food and Agriculture Organization of the United Nations[7] indicates that in the next decade international food prices will remain high and unstable. It is likely to be 16% to 40% higher than its average level between 1997 and 2006. According to statistics posed by the UN, one in seven people are currently suffering from hunger. After the recent food crisis another 44 million people will live in chronic hunger. It is predicted that by 2022, the U.S. will use 0.18 billion tons of corn – which could feed 0.58 billion people for one year – to produce biofuel. Plans for producing biofuel from agricultural products are also being implemented in other countries.

The gap between energy supply and demand is growing globally. In 2011 BP plc issued the "BP Energy Outlook 2030"[8]. It points out that global carbon

6 "Population seven billion: UN sets out challenges", United Nations Population Foundation, BBC, 26 October 2011, www.bbc.co.uk/news/world-15459643

7 *OECD-FAO Agricultural Outlook 2010-2019*, Food and Agriculture Organization, 2010.

8 "BP Energy Outlook 2030", London, January 2011, http://www.bp.com/liveassets/bp_internet/globalbp/globalbp_uk_english/reports_and_publications/statistical_energy_review_2008/STAGING/local_assets/2010_downloads/2030_energy_outlook_booklet.pdf

emissions – with a 20% increase compared to 2005 – will peak after 2020. There will be about a 40% increase in primary energy consumption in the next 20 years and non-members of the Organisation for Economic Co-operation and Development (OECD) – with an average annual rate of increase of 2.6% – will see a 68% increase in energy consumption by 2030, contributing to 93% of the world total. The International Energy Agency predicts that global oil production will fall by two thirds over the same period. It can be seen that with the development of the global economy, especially the world population increase and the intensification of emerging economies' industrialization, urbanization, modernization, marketization and internationalization processes, the balance between energy supply and energy demand will become more fragile.

Global challenges and global solutions of public products

• Global warming

A World Bank report[9] predicts that by the end of the century the global temperature will rise by 5°C compared to pre-industrialization levels. The Copenhagen Diagnosis[10] points out that by 2100 global temperatures will go up by 7°C and the sea level will rise by 1 meter compared to current levels.

• Poverty

One quarter of the total population of developing countries are still living in extreme poverty[11]. According to the World Development Indicators 2010 released by the World Bank, the economic meltdown triggered by the international financial crisis has put another 64 million people into extreme poverty.

9 World Development Report 2010: Development and Climate Change, World Bank, 2010.

10 *The Copenhagen Diagnosis 2009: Updating the World on Climate Science*, Bindoff, Allison N. L., Bindschadler R.A., et al, UNSW Climate Change Research Centre, Sydney, 2009.

11 According to the UN's definition, extreme poverty refers to a person receiving an average everyday income of less than US$1.25.

The global economy is threatened by a host of other problems, such as the population explosion, environmental deterioration, natural disasters, and the exploitation of resources, poverty, disease and terrorism, in addition to new rules on bio-technology, immigration, trade and investment. Innovative approaches are required to address these challenges. So far, institutional arrangements set up to tackle these challenges are far from reaching consensus and initiatives have been formulated, some of which have yet to get started. How to overcome these problems is likely to affect the quality of life for generations to come.

Promising Expectations and Opportunities in the Next Decade: Seeking Consensus and Making Constructive Solutions

The most we can hope for is to realize economic transformation, structural readjustments and the potential of economic development: Changing the mindset and seeking consensus

The U.S. put forward strategies for re-industrialization and new energy development. In an effort to return to the real economy, it gives a strategic role to manufacturing and aims to double its exports in five years. It hopes the new energy development strategy can provide an impetus to economic recovery and create more job opportunities.

In June 2010 the European Union (E.U.) 2020 Strategy was approved at the E.U. Summit. It set out to develop a smart, sustainable, inclusive economy and aims to promote employment, research and development (R&D), climate change mitigation, education and poverty reduction in the next decade.

The Japanese government issued its growth strategies. It strives to cultivate a new force for economic growth by releasing the country's domestic potential and opening up to the international market.

For emerging countries like China and Brazil, they are also working on transforming traditional economic development patterns.

In the next 10 years, international organizations, such as the IMF, UN, G20, World Bank, as well as regional organizations, should play more of a role in coordinating the various issues regarding the broader global issues. Further reform, innovation and development will become the common theme of most countries.

More contribution to global economic growth and the potential for future recovery and prosperity: Growth of emerging economies represented by the 'BRIC' countries

Studies by the China Center for International Economic Exchanges (CCIEE) indicate that the proportion of 'BRIC' countries' (high growth developing economies of Brazil, Russia, India and China) GDP to global GDP will rise from 17% in 2011 to 23% in 2015, 31% in 2020, 41% in 2025 and over 50% in 2030. The rise of emerging countries will make a great contribution to global poverty reduction and will become a major force in driving regional as well as international economic development. Furthermore, the emergence of these economies is an irreversible long-term trend of global development.

The most important variable in the next decade: The power of innovation drives the industrial (post-industrial) society to the knowledge society

The new tech-driven industrial revolution has breathed confidence into crisis-stricken countries and brought new hopes to the global economy plummeted by the recession. The U.S. drew up the National Innovation Strategy and the Planning for R&D of Year-Crossing Projects of Smart Grid 2010-2014; the E.U. came up with the Innovation Alliance, the Digital Agenda for Europe; Japan has formulated the largest investment plan ever for innovation and R&D, the draft for the Basic Plan (2011-2015) for the Fourth-Stage Development of Science and Technology; and South Korea put its National Strategy and Five Year Plan for Green Growth into implementation in 2010. BRIC countries have also quickened the pace for technological innovation and development. It can be seen that countries, developed or emerging, aspire to score a breakthrough via technological innovation and revolution in a post-crisis period for industrial overhaul and new industrial development. World Bank[12] estimates that highly productive emerging economies will grow by around 6% per year, while those with lower productivity will grow by only 3% on average.

New powers for future economic growth: low carbon technologies, circular economy and new energies

In retrospect, the circular economy and low carbon technology are directions for future development, and are some of the few fields that saw positive growth amid the crisis. More efforts should be made to build a low carbon economy in the process of economic structural adjustments. According to a study conducted by HSBC[13], by 2020 the annual income of the low carbon industry will exceed US$2tr.

Faced with the challenges brought by climate change, increasingly countries are looking to new energies. Low carbon technologies, clean energies and renewable energies have become new hot spots for scientific and technological innovation. According to the "BP Energy Outlook 2030", between 2010 and 2030 the proportion of solar energy, wind power, geothermal energy, biofuels and other renewable energies to total energy growth will increase from 5% to 18%. New energies, including nuclear power and renewable energies, will gradually replace petroleum, coal and other fossil fuels. The output of biofuels is predicted to increase from 1.80 million barrels per day in 2010 to 6.70 million barrels per day in 2030, which will be 125% of the liquid fuel supplied by non-members of the Organization of Petroleum Exporting Countries.

12 Global Development Horizon 2011- Multipolarity: The New Global Economy, World Bank, 2011.
13 The Climate Equity Opportunity List, HSBC, 2010.

Guarantee of sustainable development: Setting up global governance mechanisms and rebuilding new international economic orders and the confidence for future growth

An effective platform for global governance is required to deal with global economic upheavals. The international financial crisis shattered the old economic orders. In light of the new environment, international organizations, such as the UN, World Bank, IMF and World Trade Organization, have put global governance on the agenda. "The General Survey of Economy and Society of the World 2010" published by the UN calls for reforming the global reserve currency system, reforming the governance structure of the global economy and reforming the global governance mechanism. G20 has extended its discussions to issues other than economics and finance; the BRIC countries' summit has also made an appeal for a more inclusive world economy. The key to global economic governance is to improve risk management systems, enhance the stability of the global financial system and keep inflation in check. It is of equal importance to promote globalization and free trade and narrow the gap between the rich and poor.

Reviews of large international organizations should focus on adopting comprehensive, authentic, impartial and effective principles when tackling global issues. Such organizations, the largest public goods, could bring enormous benefits to the world. They could drive the way to a balance of interests and mutual benefits, and build a fair and inclusive economic order. A global consensus and a universal effort will shape the world in the next decade and the future for mankind.

Two Scenarios of the Global Economy in the Next Decade

The optimistic scenario[14]: Global economy enters into a new growth supercycle

Conference Board[15] forecast that under the optimistic scenario the average global economic growth rate will reach 5.4% in the next 10 years. The growth rate of advanced economies and emerging economies will be 3% and 7.4% respectively. The growth rates of the U.S., Europe, Japan, China and India will be 3.4%, 2.4%, 2.4%, 9.4% and 9.8% respectively. The global output will hit US$105tr, US$15tr more than under the baseline scenario[16].

The pessimistic scenario17: Sluggish recovery or a 'lost decade'

The possibility of the pessimistic scenario is quite small but it needs to be considered. It is given to urge countries to rise above differences and take immediate action. In the Conference Board's estimation[18], under the pessimistic scenario, the global growth rate will only be 2.6%: 1% in advanced economies and 4% in emerging economies. The growth rates of the U.S., Europe, Japan, China and India will be 1.3%, 0.6%, 0.1%, 5% and 5% respectively. The global output will be just US$80tr, US$10tr smaller than under the baseline scenario.

14 It is based on the assumption that as globalization has deepened, countries have reached consensus on certain issues and begun to take concerted action; they enhanced the cooperation between each other and achieved mutual beneficial outcomes; they complement each other and establish new orders; they are sparing no efforts to promote innovation and deal with slews of challenges; and they make concessions and strive for inclusive development.

15 Global Economic Outlook 2011, the Conference Board, 2011.

16 The estimation is based on global GDP of US$62tr in 2010 and will reach US$90tr in 2020 according to Asian Development Bank's forecast.

17 It is based on the assumption that large countries lack strategic consensus; the global economy is still suffering from the impact made by the financial crisis, debt crisis and the decline of the real economy; the fear of double dip is realized and caused social instability; the global economy remains deeply imbalanced and recovery is sluggish; the market is unstable and the environment further deteriorates; and the international relationship is unraveled.

18 Global Economic Outlook 2011, the Conference Board, 2011.

Outlook for China's economic development in the next decade

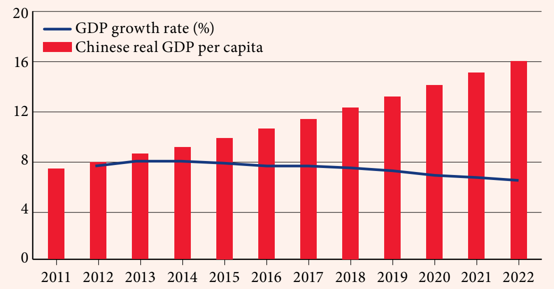
Since China adopted the reform and open policy, it has grown into an integral part of the global economy and later became an engine of global economic growth. It has reaped great benefits from its bilateral trade relations with the U.S. Not only that, China has borrowed experiences from developed countries such as the U.S. and set up the market economy that released its growth potential. Over the past decade, China's GDP grew by nearly 10% and to date its urbanization rate stands at 47.6%. From 2009 to 2011, RMB850bn was spent to establish a medical insurance system that covers 1.267 billion people. What is the vision for the next decade?

China will play a pivotal role in the global economy, despite its economic growth rate being lower than that of the past decade, the quality will be considerably enhanced and thus ensure sustainable economic development

China's 12th Five Year Plan (FYP) set a target of keeping the annual GDP growth in the five year period (2011-2015) at 7% and the goal of enhancing the quality and efficacy of economic development. The 18th Communist Party of China (CPC) National Congress also promised to double China's GDP by 2020 which translates into an annual growth rate of 7.1% during 2010-2020. If the economy grows by 7% on average, China's GDP will reach US$12.5tr[19]. The Chinese State Information Center estimates that China's average annual growth rate will reach 7.4% over the next decade with a total GDP of US$16tr in 2022[20]. The World Bank report[21] projects that China's economic growth rate will slow down in the next 30 years with an annual rate of 8.6% during 2011-2015, 7.0% during 2016-2020 and 5% in 2030. Even with a lower growth rate, China will still surpass the U.S. and become the world's largest economy by 2030.

19 Against an exchange rate of 1:6:38.
20 China's GDP in 2011 was US$7.3tr.
21 China 2030: Building a Modern, Harmonious and Creative High-income Society, World Bank, 2012.

Figure 1: **Outlook for China's GDP and Growth 2011-2022**



Source: Evaluation and Projections on the US and China's Economic Trend in the Next Decade, *Department of Economic Studies, National Information Center, Beijing*

In the next decade China will attach more importance to the well being of its citizens instead of focusing solely on GDP growth. GDP can be used as one of the indicators instead of the only one indicator to gauge a country's economic strength. At present, China's GDP per capita is less than half of the global level and ranks 93 globally. One of the main targets stated in the "18th CPC National Congress Report" is to double people's annual income in 2020 against the 2010 level and with GDP per capita of more than US$10,000[22], getting out of the 'middle income trap'. The State Information Center forecast that China's GDP per capita will reach US$11,517 in 2022[23] (see Figure 1).

China's market to expand faster than others, domestic consumption to overtake investment and exports to become a new force for economic growth

With the upgrade of consumption structures and further released domestic demand, China will be one of the world's largest consumer markets. In 2012, consumption contributed 51.8% of economic growth, replacing investment for the first time in six years. The World Bank report[24] forecast that by 2020 the ratio of investment to GDP will decline from 42% to 38%

22 China's per capita GDP in 2011 is US$5,414.
23 Evaluation and Projections on the US and China's Economic Trend in the Next Decade, Department of Economic Studies, National Information Center, Beijing, forthcoming, 2012.
24 China 2030: Building a Modern, Harmonious and Creative High-income Society, World Bank, 2012.

and the ratio of consumption will climb from 56% to 60%. Morgan Stanley's report "Chinese Economy Through 2020"[25], points out that in the next decade China will embrace a golden period of consumption. By then China's consumption will be two thirds that of the U.S. and 12% of the world total. Its newly cultivated consumer market has already outstripped that of the U.S. in 2008 and it is expected to double, accounting for 20% of global market by 2020.

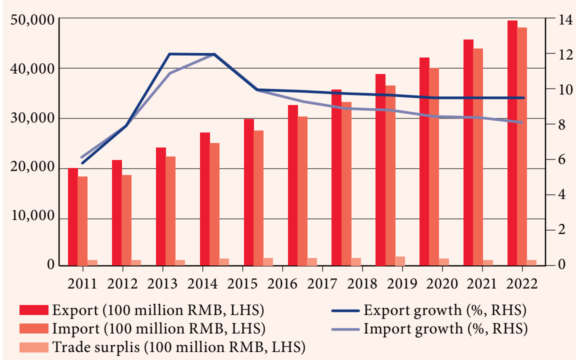
In addition, China's social security system has picked up steam in recent years. It has established the social safety net for its citizens in a country with the worlds' largest population, covering nearly all of Chinese urban and rural households. This will encourage spending and foster consumption-driven growth.

China to become the largest trading nation and one of the most important investors in the world while maintaining its focus on industrial transfer, elements integration and capital inflows

China is an important founder, participant and contributor of international economic systems. It is a member of more than 100 governmental organizations and has been actively involved in over 300 international conventions. China is also a strong supporter and practitioner of trade liberalization and investment facilitation. To date, it has set up bilateral mechanisms for economic and trade cooperation with 163 countries and regions, finalized 15 free trade agreements, and negotiated investment protection agreements with 129 countries, agreements on double taxation exemptions with 96 countries and 10 free trade agreements. In the coming decade, China will continue to establish more free trade areas, set up cross-border economic cooperation areas and actively facilitate the Doha Round of World Trade Talks.

According to China's State Information Center, considering the change in the global economic growth pattern, the decline of global imports, the shift of China's export structures, and the RMB annual appreciation of 2% vis-à-vis the US$, China's exports and imports are still likely to grow by 9.4% and 10% and its trade surplus to steady at around US$250bn during 2013-2022 (see Figure 2).

Figure 2: Outlook for China's Foreign Trade, 2011-2022



Source: Evaluation and Projections on the US and China's Economic Trend in the Next Decade, Department of Economic Studies, National Information Center, Beijing

China is bound to be a major investment destination as well. In recent years, the total stock of China's outbound investment has increased by an average rate of 44.6% per year. It has amounted to US$400bn in 2011, ranking 13th among major investment countries. The Asian Studies Center and Kissinger Institute on China and the United States[26] estimated that China's outbound investment will be US$1tr-2tr in the next 10 years. However, Chinese investors have been often discouraged by cultural differences, various rules and regulations, discriminatory policies and political pressures. It should thus be made clear that under current special circumstances, the inflow of Chinese investment is not only for the benefit of the investor but also for that of investees entrenched in high debt levels and lack of capital. In the future, stimulated by guidance and encouragement by the Chinese government and

25 Chinese Economy Through 2020, Morgan Stanley, 2010.

26 Daniel H. Rosen and Thilo Hanemann (2011), *An American Open Door? Maximizing the Benefits of Chinese Foreign Direct Investment*, Asia Society and Kissinger Institute on China and the United States

Figure 3: Status Quo of China's Science and Technology Talent and Development Targets

Year	R&D personnel (10,000/year)	R&D personnel (10,000/year)	R&D personnel per 10,000 members of labor force (persons/year/10,000 members of labor force)	R&D personnel per 10,000 members of labor force (persons/year/10,000 members of labor force)	Fund for R&D personnel per 10,000 members of labor force (RMB 10,000)	Fund for R&D personnel per 10,000 members of labor force (RMB 10,000)
2008	196.5	105.0	24.82	13.3	23..5	44.0
2015	280	150	33	18	38	71
2020	380	200	43	23	50	100

Source: Evaluation and Projections on the US and China's Economic Trend in the Next Decade, Department of Economic Studies, National Information Center, Beijing

through experience, China will be better equipped to invest abroad.

China to develop into an innovative economy: Aims to develop a modern educational system and more intellectual support to national development over the coming ten years

China has drawn up a host of long-term plans for talent development, educational reform and technological development. According to the plan, by 2020 the number of skilled people will rise by 58% from 114 million to 180 million. Human capital will account for 33% of overall economic growth and its large pool of talent will contribute 35%. Furthermore, investment into R&D will exceed 2.5% of GDP. It is expected that 60% of GDP growth will benefit from technological advancement. The protection of intellectual property rights has been and will continue to be improved to encourage innovation.

Improving the education system is essential to foster talent. By 2020, China's gross enrollment ratio will climb to 90% and the gross enrollment ratio of higher education will reach 40%. The average education years of China's working-age population will increase from 9.5 to 11.2 and the proportion of population that has received tertiary education will reach 20%, double that of 2009.

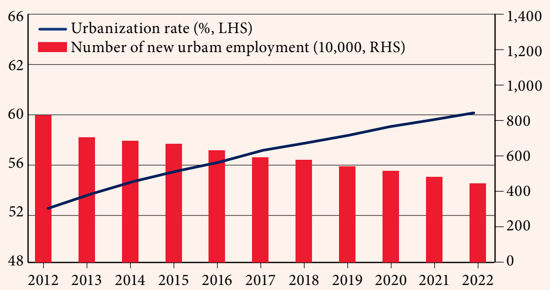
China to continue to facilitate industrialization and urbanization: Aims to match the urbanization level of developed countries' current level and industrialization to have entered into a new phase by 2022

Thirty years ago, 80% of China's population lived in rural areas. Now nearly half of the rural population has moved into cities. In 2011 the urbanization rate in China was 51.2%, realizing the target of the 12th FYP ahead of schedule. It will be 60% by 2022 if this momentum is maintained (see Figure 4). According to the World Bank report[27], in less than 20 years two thirds of China's population will be living in cities. Urban residents in China will pass the total urban population of the U.S., Japan and the E.U.. Such an urbanization process is unprecedented in scale and offers a tremendous impetus for China's economic growth.

The new industrial process will continue to accelerate supporting the country's move to industrialization. The pace of development is set to increase in such key areas as energy-saving and environmental-protection technologies, new information technologies, bio-technology, high-end equipment manufacturing, new energy, new materials and new energy fueled autos. It is stipulated in the 12th Five Year Plan that by 2015 the added value of strategic new industry to GDP will reach about 8%. By 2020 the ratio of non-fossil fuels will be 15% of total energy consumption. CO_2 emissions per GDP will be reduced by 40% to 45% than that of 2005.

27 China 2030: Building a Modern, Harmonious and Creative High-income Society, the World Bank, 2012

Figure 4: **China's Urbanization Process, 2012-2022**



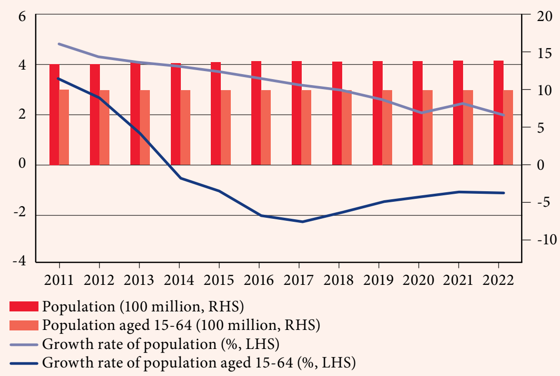
Source: Evaluation and Projections on the US and China's Economic Trend in the Next Decade, Department of Economic Studies, National Information Center, Beijing

China to continue to maintain its focus on improving living standards, satisfy expectations of a better life and building a harmonious society

In 2022 GDP per capita in China will surpass US$10,000. In the next decade, the population growth rate will start to decline. By 2022, the total population will stay within 1.4 billion. There will be negative growth in the growth rate of the labor force aged between 15 and 64 (see Figure 5). Average life expectancy will increase by one year to 70.5 years old. Social security will be further enhanced. There will be a gradual improvement in basic medical insurance of urban households and increased subsidies for rural medical care, financed by the government.

A significant part of Chinese government policy will be to raise living standards of low-income and impoverished people and narrow the gap between the rich and poor. From 2011 to 2015 there will be an annual increase of over 30% of the lowest wage standard. In most areas the lowest wage standard will be over 40% of the average wages of urban workers. The minimum subsistence level for urban and rural residents will increase by over 10% annually. Thirty six million public housing facilities in urban areas will guarantee 20% of the housing needs of the impoverished. World Bank[28] projects

Figure 5: **Forecast of China's Population Growth, 2011-2022**



Source: Evaluation and Projections on the US and China's Economic Trend in the Next Decade, Department of Economic Studies, National Information Center, Beijing, 2012

that by 2030 the gap between the rich and poor will be reduced to 2.4:1 from 3.2:1 in 2010.

An 1% increase in China's GDP will provide jobs for about 1.3 million people in the cities. In the next decade, due to improved employment levels in the service industry and the upgrading of the manufacturing structure, job elasticity will be gradually reduced. The shrinking labor force and easing unemployment pressure will ensure the urban employment rate will remain stable.

China to become a country with a more marketized and internationalized financial system: RMB to play a larger role in international trade settlement, international capital market and international currency reserves

China is on course to the internationalization of the RMB. It started the reform on the exchange rate regime on 21 July 2005. Since then, the RMB has appreciated by over 30% vis-à-vis the US$ until May 2012. The RMB has become a convertible currency on current account and its convertibility ratio in capital account has exceeded 40%. At present, the share of China's trade settlement in RMB has over 10% of the total China has signed for currency swaps with over 10 countries and regions. The total currency exchange amount has reached RMB29.2bn. Hong Kong has become first RMB

28 Evaluation and Projections on the US and China's Economic Trend in the Next Decade, Department of Economic Studies, State Information Center, Beijing, 2012.

offshore trading center. Shanghai will follow Hong Kong and become another international financial center. There is no doubt that in 10 years China will continue to accelerate its financial reform to make it more market based. Currency exchange scale will be further expanded and Shanghai will play a predominant role in Asian financial transactions. International financial centers such as Singapore, London and New York will also become RMB offshore trading centers sooner or later.

Apart from facilitating the ongoing financial reform, China will also advance reforms of large state-owned financial institutions by establishing a modern corporation system and corporate governance structures. China will also raise the share of direct financing, deepen its reform on the initial public offering system and put in place a delisting system. To prevent financial risks, China is preparing the establishment of a counter-cyclical dynamic capital buffer and precautionary provisions, tightening the supervision and management of liquidity and leverage ratios so as to maintain the stability of the financial system.

China's continued problems and challenges: To maintain sustainable development, China will have to focus on the transformation of its economic development pattern in the coming decade

China has a large population and its resources are quite limited. It provides for nearly 20% of the world population with 7.9% of arable land and 6.5% of fresh water. There is a great disparity in the development between the urban and rural areas. Its economic growth relies excessively on the consumption of tangible resources. China is relatively weak in innovation and at the lower end of the global industrial chain. The living standards of Chinese people are relatively low and the social security system has yet to be improved.

China's economic growth will face a lot of pressure, such as inflation, resource shortages, environmental deterioration, an aging population and poverty. According to the UN's standard, China still has 150 million of its population below the poverty line. In accordance with international standards, China became an aging society in 1999[29]. In 20 years, it will come to an important turning point when population dividends might end. The contribution of labor quantity to economic growth will diminish.

At present, the shrinking of external demand exacerbates the over-capacity problem of the Chinese economy. The loss of comparative advantage has come into being. Against this background, massive export-oriented industries are in a state of over-capacity, including traditional industries such as textiles and new industries such as wind power equipment, silicon and solar panels. The higher labor cost deprives the comparative advantages of the labor-intensive manufacturing industry, while comparative advantages in technology and capital-intensive industries have yet to be set up.

Challenges in resources and environment are even more grave. Two thirds of cities have serious water supply problems. Almost one quarter of surface water is contaminated. Three hundred million rural people do not have access to safe water. According to the Morgan Stanley report[30], if China cannot solve its own problems successfully, it will inevitably encounter slow economic growth and persistent high inflation rate. Under these circumstances, China's average annual growth rate will only be 6.5% in the next 10 years. The report by the Carnegie Endowment for International Peace[31] also points out under the pessimistic scenario, in the first next five years China's average economic growth rate will be 7.1% and in the five years after that will only be 5.8%.

The risks of China's economic slowdown arises partly from the changes in the macroeconomic en-

29 Wang, Dewen, The Demand and Supply of Labor Force against the Backdrop of Low Birth Rate and China's Economic Growth, Chinese Journal of Population Science, vol 1, pp. 46-54, 2007.
30 Chinese Economy Through 2020, Morgan Stanley, 2010.
31 China's Economic Prospects 2006-2020, Carnegie Endowment for International Peace, 2007.

vironment, such as the fall in real estate prices, the contraction of domestic investment and the decline of exports induced by the global economic meltdown, and partly from economic structural problems of its own. The latter problems are more difficult to solve, requiring the government to further facilitate economic and structural reform, otherwise it is possible for China to fall into the 'middle-income trap'[32].

However, as the progress of China's urbanization, industrialization and agricultural modernization continues, China's huge domestic demand will be further released and propel the country's sustainable economic development. China is bound to make bigger strides in the next decade and will be better prepared to face up to every hurdle it comes across. It will shoulder more responsibility in dealing with global affairs and provide more public goods. A rising China will make its due contribution to the common progress of mankind.

32 Chinese Economy Through 2020, Morgan Stanley, 2010.