

ICS Special Lecture

Investigating the legal and Fiscal Aspects of China's Growth

Speakers: Yin Xiangshuo, Professor, Department of World Economy, School of Economics at Fudan University and Ni Shuobin, Professor, Dean of the School of Law of Shanghai University of International Business and Economics

Chair: Aravind Yelery, Associate Fellow, ICS.

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The first speaker was Yin Xingshuo who discussed the fiscal aspect of China's economic growth. Yin began by highlighting the contemporary issues pertaining to China's economy, which according to him has been growing at a rapid pace since the last 30 years or so. There has been a slowdown in recent years, which must be seen as the 'new normal'. The term 'new normal' implies that the Chinese economy is growing at a lower rate owing to a shift from 'extensive development' to 'intensive development'. Thus, there is a shifting of gear from the previous high speed growth to a medium high speed growth. In that sense, the Chinese economic structure is constantly improving and upgrading with the economy being driven by innovation instead of mere input and investment.

The speaker then highlighted the causes for the slowing down of Chinese economy. He pointed out that rapid growth registered by China in the past 35 years has mainly depended on cheap labour, exports and heavy investment. This has led to external imbalance, decrease in capital returns, increase of labour cost, degradation of the environment and heavy depletion of natural resources. He noted that internally there is a major decomposition of China's gross domestic product (GDP). Since the early 1980's, China's consumption ratio has decreased to 50% of total GDP, he also opined that no country in the world consumes at such a low rate. According to the World Bank statistics, China has very low level of consumption and very high level of investment. In this context, although social fixed investment to GDP has increased very quickly in the past decade, in the long run China would need many more investments for a similar output. The speaker stressed that China should make room for more innovation in technological progress. In recent years,

wages have increased more than the GDP growth and this is not going to be a short term phenomenon. The speaker informed that China's population is growing at an alarming rate and will reach its peak by the year 2030. China's labour growth too has reached its peak in the recent years. The speaker believes that this demographic change will lead to various social issues such as increased social burden and high labour cost.

The speaker was concerned that heavy investment together with heavy use of natural resources will cause environmental degradation and depletion of natural resources. According to the World Bank estimates in the year 2008, China and India were the two biggest economies with the largest environmental degradation and natural resource depletion compared to other major economies.

The speaker opined that the Chinese economy could still grow at a reasonable rate by restructuring all the three sectors of industry, namely, primary, secondary and tertiary. The following measures have been introduced in order to facilitate restructuring: reducing government intervention in the economy, reforms in tax and financial system, reforms of state owned enterprises, and development of small enterprises. The above process is ultimately dependent on the development of the service sector which, according to the speaker is going to develop rapidly in the coming years. The tourism sector for instance has grown in an extraordinary manner in the past 10 years. Between 2005 and 2013, the average growth rate of domestic tourism was 12.9 per cent and 16.8 per cent for residents abroad. In 2014, over 100 million Chinese people went abroad. The speaker called it the 'sun rise' industry of China. Another important sector that he believes will grow rapidly is the new phenomenon of online business. He pointed out that online business has laid the foundation for newer industries. In 2013, online consumption in China took over the United States and came up as the largest internet market. Online consumption in 2014 has been estimated at 440 billion US dollars, and is expected to reach 1 trillion within five years. The speaker noted that along with online consumption, online finance such as online payment, online borrowing and third party payments have been growing rapidly.

The speaker also shed light on the One Belt One Road initiative of the Chinese government, which shows that besides structural changes, China has also been trying to promote development by further opening its door and prioritising investment and infrastructure.

In conclusion, the speaker stressed that the development of the service sector and further opening of Chinese economy in the near future would be beneficial for China's economic growth, and aid in better utilizing China's existing facilities and production capabilities. For China to maintain a stable economic growth, the government must gear up its technological innovation and invest in research and development (R&D). The government should not only be market oriented but also create a good market environment by reducing government intervention and putting in place strict anti-corruption law.

As for the future of the Chinese economy, the speaker was of the opinion that China's economic growth rate will decrease by about 7%. As far as discussions about China's potential collapse and the possibility of it falling into a "middle income" trap is concerned, the speaker argued that he does not see such a situation coming up soon. As long as the communist party remains in power and there is political social stability, China will continue to grow.

The second speaker Ni Shoubin focused on the legal and financial aspects of doing business in China. He divided the legal system of China roughly into three stages: before 1979, after 1979, and after the entry of China into the World Trade Organisation (WTO). China's entry into the WTO helped in the further opening up of China to the outside world. Establishment of free trade zones such as Shanghai, Fujian province, Guangdong province, and Tianjin province led to the introduction of terms such as liberalization and freedom in China's legal system. Xi Jinping's promotion of the concept of 'rule by law' was a very important step in illustrating the Chinese government's push towards further liberalization.

The speaker then highlighted the legal system framework and how business is to be done in China by foreign investors. In the year 2014 the Chinese government unified the fragment of the foreign investment law in order to attract more foreign investors. The Chinese legal system constitutes four levels of laws, namely, the Constitution, laws promulgated by the standing committee, administrative regulations, local regulations and specific laws. Every province has some freedom to stipulate some regulations to attract foreign investors.

In China, the investment sector is divided into three categories, namely, encouraged, restricted and prohibited. The speaker mentioned that investment in most of the sectors is encouraged.

After Chinese entry into the WTO, the transparency rule has become very important. In recent years the Chinese government's taxation system has been

reformed to attract more foreign investors. who are provided with tax privileges. The speaker further highlighted some compliance related issues in the Chinese legal system such as anti-trust, anti-commercial bribery and anti-unfair competition.

Discussion

An important query pertained to China's increasing domestic saving and lack of domestic consumption. The speaker responded that the Chinese government encourages domestic consumption. However, China has not been successful in encouraging the share of consumption due to inadequate social security system, unequal income distribution and its rapid economic growth, which failed to change the domestic consumption habits.

A related question that came up was about how China could avoid the middle income trap and how it plans to respond to the problem of job cuts? The speaker responded that the Chinese government must give economic freedom by letting the market play a decisive role in the economy. On the question of job cuts, the speaker answered that with increasing labour cost, the labour supply has already reached its peak, and has started to decline. China may soon face the problem of labour shortage. Along with technological innovations, increasing the quality of the labour will also be very important.

On being asked whether there are any legal measures to deal with the fake companies, the speaker stressed that China has a unified jurisdiction system. He mentioned that in cases that may be fraudulent in nature, the foreign companies can move the local court.

Report prepared by Disket Angoma, Research Intern, Institute of Chinese Studies.

About the Speaker:

Professor Yin Xiangshuo is a faculty in the Department of World Economy, School of Economics at Fudan University, Shanghai. International Trade Theory and Policy, Trade Reform and Development, WTO and Multinational Trade System, Regional Economic Integration are his areas of specialisation. He has been a Visiting Scholar at the Massachusetts Institute of Technology, USA, Aston University, UK, the University of Sussex and at the City University of Hong Kong. He is also a member of several trade forums across China.

Professor Ni Shoubin is the Dean of the School of Law of Shanghai University of International Business and Economics, Doctor of Judicial Science and also a Professor of Law. Professor Ni is a member of the Dissertation Guidance Committee of the Institute of Law of the Chinese Academy of Social Sciences, a member of council of the Chinese Commercial Law Society and the Director of the Professional Committee of Trust Law of the Financial Law Research Chamber of the Shanghai Law Society. Professor Ni is not only a professional 27 financial judgment consultant for the Shanghai Court but is also an arbitrator for the Shanghai Arbitration Commission. In 2009, Professor Ni was conferred as the Shu Guang Scholar. Professor Ni's recent academic achievements are as follows: ERISA and Pension Funds Invest (Issue 1, 2014, Legal Science Magazine), Study on Fiduciary Duty of Securities Investment Consultancy Institution (Issue 10, 2014, Social Science), Legal Validity of Banktrust Financial Product (Issue 4, 2010, Legal Science Magazine), Systematic Risk (Issue 4, 2011, The Comparisons) and Study on the legal problems of capital trust operation of the state owned Commercial Banks (Law Press 2008)

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