

Creating a reliable financing mechanism for economic development

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Abstract

Purpose – China's economic development in the past 40 years has an array of distinctive features that have attracted the attention of the world. The paper aims to discuss this issue.

Design/methodology/approach – The analysis logic is as follows: with regard to the mechanism, the above factors were met in a timely manner and jointly contributed positive energy to China's economic growth, with the increase in the savings rate as the necessary condition and foundation, and the increase in the savings rate is attributed to the explosive expansion of the financial system at the beginning of reform and the formation of positive incentives for residents, enterprises and governments at all levels, and the expansion of the financial system and the formation of positive incentives are clearly the crystallization of the wisdom of Chinese-style progressive reform.

Findings – Therefore, we have every reason to believe that the growth prospects of the Chinese economy remain bright. The author is nonetheless confident that the new two-step strategy for economic development will be realized, proposed by the 19th CPC National Congress.

Originality/value – Moreover, the growth of China's economy has long been accompanied by the "double surplus" of current accounts and capital and financial accounts in the international balance of payments, which is not completely consistent with the traditional paradigm of development economics. These phenomena are so unique that the international community calls it the "Mystery of China" or "China's Development Path."

Keywords Economic development, Capital provision mechanism, Economic new normal

Paper type Research paper

China's economic development in the past 40 years has an array of distinctive features that have attracted the attention of the world. The most prominent of these features is ascribable to the simultaneous and harmonious manifestations of high savings, high investment and high growth ("three highs") for decades. Moreover, the growth of China's economy has long been accompanied by the "double surplus" of current accounts and capital and financial accounts in the international balance of payments, which is not completely consistent with the traditional paradigm of development economics. These phenomena are so unique that the international community calls it the "Mystery of China" or "China's Development Path."

Starting with the phenomenon of surplus labor transfer, this paper analyzes the key links on which this development path is generated and succeeds and the institutional mechanisms that support them to uncover the theoretical logic behind the Mystery of China. We believe that the continuous transfer of surplus labor force from agriculture to industry, from rural to urban areas and from state-owned to non-state-owned enterprises, namely, the long-term parallel advancement of industrialization, urbanization and marketization, is the key to maintaining the long-term, high-speed growth of China's economy. The long-term coexistence



and mutual support of high savings rate and high investment rate are prerequisites for the continuous transfer of labor and the inevitable result of this development model. They also form the basis for the maintenance of this development model.

The practical experience of China's development path and the theoretical logic it reveals has global significance because it effectively breaks through the long-term economic bottleneck faced by developing countries: the shortage of development funds in a large developing country with "a formidable population economically poor and culturally blank."

The famous "two-gap" theory in development economics holds that developing countries are backward because two bottlenecks restrict their development: internally, a savings gap exists, that is, insufficient domestic savings; externally, a foreign exchange gap exists, that is, attracting foreign investment is difficult. Severe financial constraints have dampened the ambitious investment plans and the growth vision of developing countries. Therefore, solving the two-gap dilemma is the key for developing countries to eliminate poverty and backwardness and ultimately achieve modernization.

For decades, the two-gap theory has been time tested and true. At the beginning of this crisis, the world seemed to see the prospect of eliminating the two-gap spell. In the first few years of the crisis, when developed economies such as the US deteriorated and continued to beef up their "quantitative easing" over time, the economies of vast developing countries were not affected and even experienced a wave of brilliant growth; thus, "two-speed derailment" occurred. However, when the USA began to withdraw from quantitative easing and a large amount of capital returned to the USA, people could not help but immediately see a repeat of the same situations as they occurred in Latin America in the 1970s and 1980s and in Southeast Asian countries such as South Korea and Thailand in the 1990s. Developing countries have successively experienced economic slowdown, augmented inflationary pressures, stock market crash, deterioration of international balance of payments, capital outflows and sharp depreciation of the local currency exchange rate in violent fluctuations. This wave of rollercoaster cycles is a frustrating reminder that the structural distortions in most developing countries have been improved, and the two-gap dilemma remains the same. This situation elucidates that in an international environment where globalization is deeply developed and the USA still plays a leading role, no country can be immune to this dilemma.

It is in this context that, looking around the world after the crisis, people are more deeply aware of the value of China's development path. Since 1994, China has relied on its own strength to basically free itself from the shackles of the two-gap dilemma. Only by relying on domestic savings can the Chinese economy be immune to the spillover impact of the domestic policies of the developed economies led by the USA, keeping "a cool head in a crisis."

This occurrence is a miracle of global significance. Therefore, one of the important tasks in exploring China's development path is to summarize and recapitulate the key links that led to this miracle and the corresponding changes in the corresponding institutional mechanisms.

1. Understand the key position of savings/investment in economic operations

The basic feature of modern social reproduction is the expansion of reproduction. The continuous expansion of the scale requires the generation of new capital. Therefore, investing the generated new capital is among the essential tasks of a country's economic growth and development.

From the perspective of macroeconomic operation, the realistic process of capital formation involves two links. The first link is the process of capital accumulation, that is, the process of saving; the second link is the process of using savings, that is, the process of investment. The core of macroeconomic balance is to maintain a balance between savings

and investment. Here savings is a concept of physical economy, referring to the unconsumed portion of national income. For residents, savings refers to the surplus of disposable income minus consumption. For enterprises, savings refers to the balance of their after-tax profits after deducting profits from their owners. For the government, savings refers to the remaining portion of the government departments' fiscal revenue (tax, fee income, debt income, etc.) after deducting current account expenditures for defense, education, administration and social relief, among others.

In macroeconomic theory, which characterizes the operation of the national economy, savings equal to investment. However, such an "equation" is merely a relationship defined *ex post*. In other words, the so-called *ex post* is in terms of results. The key element of maintaining identity is the particularity of inventory in the economic system: at the supply side of national income, the new output of the enterprise is classified as savings. On the demand (i.e., use) side of national income, it is also defined as inventory investment. This double existence of inventory in national statistics can be said to be what makes "savings" equal to "investment" as a matter of course.

Given that *ex post* exists, then *ex ante* also exists. In economic analysis, *ex ante* refers to economic activities in which economic entities follow their own decision-making functions and decide independently according to their objective environment. In other words, *ex ante* is about the starting point. Undoubtedly, from the perspective of society as a whole, *ex ante* savings and *ex ante* investment are always unequal. Thus, insufficient savings or underinvestment occurs. When savings are insufficient, the economy (*ex post*) has inflationary pressures. When the investment is insufficient, it may lead to an (*ex post*) increase in inventories, which will lead to deflationary pressures and then to economic downturn. In this way, the essential task of macroeconomic regulation and control is to urge savings and investment to be equal *ex ante*. When unequal situations arise, we must try to adjust the two sides and their mutual relations by using various policy instruments.

In the market economy, given that people mostly exist in only one link of the social division of labor and the exchange system, the separation of the savings subject and the investment subject becomes the norm. The usual pattern is as follows: the resident sector, as the major consumption entity with savings that are much higher than the investment of the sector, constitutes the largest fund surplus sector in the whole society. The corporate sector is the main body of investment, and its savings are often insufficient to support the investment thereof. Therefore, it is the largest fund deficit department in the whole society. No set rules exist for the savings and investment dynamics of government departments, but in many cases, government savings are not enough to support government investment. Therefore, government departments are usually bogged down in fund deficits.

Seeing that, in the national economy, savers and investors are often held by different entities with widely varied surplus and deficits, savings need to be converted into investment, and a corresponding mechanism is also necessary.

Savings can be transformed into investment either through fiscal intermediary or through financial intermediary. The former refers to the government's collection of part of private savings through taxation, fees and other means of income, and ultimately the government completes the investment. The latter refers to savers' purchase of deposit certificates, foreign exchange, stocks, bonds, wealth management products and other financial products to transfer their savings (through financial intermediary) to investors, who complete the investment.

Before the reform and opening-up, China was once a country with short savings, like all developing countries. The "Great Leap Forward" in 1958 and the "Great Leap Outward" in 1977 caused catastrophic damage to the national economy because the domestic investment required for the "Leaps" far overstepped the level that domestic savings could support. At the 1981 State Conference, Comrade Chen Yun, the older-generation financial leader of

China, summed up the experience and lessons of China's economic construction since the founding of the People's Republic of China. He summarized the general policy of China's economic work as "one, to eat; and two, to build" (Jin and Chen, 2005). In this plain language, he clarified the interrelationship between several key factors in the operation of the national economy. Here, eating is the first essence; with meals, savings are possible, and only with savings can investment (construction) be supported by noninflationary sources of funds.

Therefore, the number one task for reform and opening-up has become to effectively mobilize savings to support high-level investment, start industrialization and urbanization, and ensure the employment of a growing population of the right age. To put it bluntly, if China's economic miracle benefits from the demographic dividend, industrialization and urbanization simultaneously in complementarity, then the windfall of these factors will obviously start with a steady increase in the savings and investment rates. In this connection, the key to the Chinese miracle is that it created an effective institutional mechanism for mobilizing and allocating savings.

2. Reform stimulates the willingness to save

The first essential step in mobilizing savings is to stimulate the willingness of microeconomic entities to engage in saving. This goal was achieved mainly by promoting progressive decentralization reform and vigorously developing the financial system before the Third Plenary Session of the Fourteenth Central Committee. After 1993, it was comprehensively embedded in the process of building and improving the socialist market economic system.

The economic and financial industries of the first 30 years of the People's Republic of China operated under the traditional planned economic system. The Chinese economic and financial reforms in the four succeeding decades facilitated a transition from a planned economic system to a socialist market economic system and from a closed economy to an open economy. In China, this process initially adopted a gradual decentralization reform model. The difference between a market economy and a planned one is that the latter is determined by the central planners to unify the allocation of resources, whereas the former is determined by a number of dispersed economic parties based on market price signals, and the collection of these decisions guides the allocation of resources. Therefore, the essence of the transition from a planned economy to a market economy is to move from centralization to decentralization in the decision-making process of resource allocation.

This dispersion of resource allocation power (decentralization) consists of two parts. First, the government decentralizes enterprises and households, shifting from a highly centralized and unified planned economy to a mass-employment, enterprise-led market economy. This reform is an "economic decentralization," which represents a shift from a highly centralized and unified planned economy to a market economy characterized by decentralized decision making. It aims to empower microeconomic entities with clear property rights to stimulate their enthusiasm for savings, investment and production. Second is the decentralization of power from the central government to the local governments. This step is a "separation of powers" between governments at all levels. It includes the reallocation of specific authorities and expenditure responsibilities between the central and local governments and aims to encourage, on a large scale, local governments at all levels to develop their economies. Unlike the former Soviet Union and Eastern European countries, China's economic and administrative decentralization reforms are all progressive rather than "explosive." This condition is reflected not only in the incremental deepening of the understanding of the reform objectives, but also in that the reform measures are implemented step by step and as far as possible along the path of Pareto efficiency improvement.

A proven fact now is that the progressive decentralization reforms are undoubtedly more pragmatic, robust and successful as compared with the prevalent beliefs of the former Soviet Union and Eastern European countries that hoped to “leap” from the planned economy to the market economy. The process of decentralization gives property rights to microeconomic parties and creates an incentive-compatible framework for their economic activities, thereby stimulating the incentives for savings and investment and revitalizing the economy. The progressive approach allows all economic parties, including decision makers, to have a process of constantly exploring, trying, summarizing and gradually becoming familiar with new things. The new mechanism is established and improved in this gradual process.

Looking back at the economic and financial system reforms of the past three decades, we found that 1994 was an important watershed. This aspect refers to the “Decision of the Central Committee of the Communist Party of China on Several Issues Concerning the Establishment of a Socialist Market Economic System” made by the Third Plenary Session of the 14th CPC Central Committee in November 1993, which established a clear goal of building a socialist market economic system. Since then, on the one hand, major differences have developed between the reform measures and the previous ones. On the other hand, the most fundamental relationship in macroeconomic operations – the relationship between savings and investment – has been conversed.

After the goal of establishing a socialist market economy is clarified, the unnecessary disputes about “planned” and “market” economy have basically ended. With regard to the focus of the reform, before 1994, the focus was on decentralization and profit-sharing instead of on changing the property rights system. The simple approach of giving benefits without emphasizing the establishment of incentive and restraint mechanisms for microeconomic parties was also corrected. Corporate reforms started to accentuate clear property rights, a perfect governance structure and the establishment of a modern enterprise system. The fiscal system also began a tax-sharing system reform with such far-reaching influence that the international community calls it the “Fiscal Federal System.” Since then, not only have enterprises gradually become the market entities for independent decision making, but also, through the fiscal system reform of the tax-sharing system, local governments have gained a great deal of economic management power, which has been called by domestic and foreign scholars the “secret key” to China’s economic development, ushering in the local government’s initiative to develop the economy and the (primary level) intergovernmental competition based on this.

The continuous deepening of reform has undoubtedly promoted the increase in China’s savings rate and investment rate from the institutional level.

First, a direct result of market-oriented reforms is that investment entities have shifted from state-owned economic units to diversified entities. The transformation of investment entities means that market economic mechanisms will gradually play a role. This condition not only greatly stimulated the rise of investment, but also improved the efficiency of investment and greatly stimulated the enthusiasm of the majority of microeconomic entities. Therefore, it can be said that the “enterprization” corporate reform and the diversification of investment subjects are among the basic institutional factors that are supporting China’s high savings and high investment, and thus supporting China’s industrialization and urbanization.

Looking further, the deepening of market-oriented reforms has gradually reduced or even eliminated the various welfare benefits enjoyed by the employed population under the traditional planned economic system. On the demand side, these reforms have caused demand to shift to the market, thereby inevitably requiring residents to increase their savings in advance to accumulate their ability to pay. Furthermore, compared with the integrated system of employment, welfare and pension under the planned economic system,

market-oriented reforms may also cause increased uncertainty of future expectations by the labor population, thus additionally increasing residents' "preventive savings." At the supply end, the transformation of the supply entities and the gradual replacement of the planning mechanism by the market mechanism have greatly stimulated the investment of the whole society. The surge in manufacturing investment is self-evident. Housing, old-age care, medical care and education, which have long been blocked from the government's investment list, have begun to attract increasing input. Then, after the economic infrastructure and society infrastructure entered our field of vision, China's investment entered a period of long-term high growth.

3. The financial "explosion"

Consistent with the shift of resource allocation power in the reform of the economic system from government plan to market orientation, since the reform and opening-up, the financial system that "grandly unified" in the People's Bank of China has been gradually split into an increasingly complex financial organization system, including the Central Bank, commercial banks and non-banking financial institutions. Meanwhile, a large number of other financial institutions that are compatible with the market economy, such as credit unions, financial companies and various financial institutions, including capital markets, money markets and fund markets, have also sprung up in China. The allocation of financial resources is increasingly determined by the decentralized decisions of various types of financial institutions, financial markets and non-financial sectors.

This reform process, which domestic and foreign researchers called "eliminating financial repression," first touched on the price of funds. The long-term distortion of the interest rate suppressed at low levels gradually rose with the deepening of financial reforms and became an important factor that stimulated the rise of China's savings rate. However, unlike the simple conclusions of general textbooks, the factors that affect Chinese residents' saving behavior are broad, including the following at least: the prioritization of the pattern of national income distribution for residents; the upswing in Chinese residents' monetary income levels as China's economic monetization continues to deepen; the increasingly rapid and uncertain institutional changes that increased residents' willingness to have precautionary savings; and China's adoption of policies to curb consumer credit, resulting in low debt ratios among residents.

However, in the process of increasing China's savings rate, the rapid development of the financial system is also indispensable. The continuous enrichment of financial institutions, financial markets, financial products and financial services has provided an increasingly broad savings channel for the majority of microeconomic entities.

In 1978, China had only one financial institution: the People's Bank of China, which monopolizes all functions of the central bank and commercial banks. It is also a ministerial administrative agency of the government.

From 1978 to 1984, in line with the diversification of economic entities and the marketization process of economic operations, China's financial system began a diversified process. The most notable events were the successive recovery and establishment of the People's Insurance Company of China, the People's Construction Bank of China (later renamed China Construction Bank) and the Agricultural Bank of China.

With the loosening of financial controls, various non-bank financial institutions and credit unions also began to develop. In October 1979, China's first trust and investment company, China International Trust and Investment Corporation, was established. In 1980, to meet the capital needs of the rapidly developing urban collective and individual enterprises, the first urban credit cooperative was listed in Hebei Province and soon triggered the climax of the establishment of urban credit cooperatives throughout China. At the same time, corresponding to the rapid development of township and village

enterprises, the number of rural credit cooperatives in rural China has also soared since 1953. In April 1981, China Oriental Leasing Co., Ltd was established, marking the beginning of the financial leasing industry into China's financial system.

In 1985, as the People's Bank of China began to independently exercise the functions of the central bank, a new state-owned bank, the Industrial and Commercial Bank of China, which took over the function of the commercial banks that were separated, was founded. In this way, the state-owned commercial banking system that plays a leading role in China's banking system forms its basic framework.

Taking the establishment of the Central Bank System as an opportunity, China has further launched a large-scale financial institution innovation boom.

In terms of commercial banks, the first commercial bank in China organized by the shareholding system, the Bank of Communications, was reopened in 1986. The first bank initiated by a corporate group, CITIC Industrial Bank, was established in 1987. The first regional commercial bank, Shenzhen Development Bank, which was jointly funded by local financial institutions and enterprises, also started operations afterwards. Since then, more than ten joint-stock commercial banks, such as Minsheng Bank and Hainan Development Banks, as well as dozens of city commercial banks such as Beijing, Shenzhen and Shanghai Banks, have become new members of the Chinese commercial banking system.

With the development of the urban non-state-owned economy, urban credit cooperatives have rapidly spread in Chinese cities. In the most prosperous period, the total number reached more than 3,000. Rural credit cooperatives have adapted to the rapid development of township and village enterprises and once peaked at more than 40,000.

Non-bank financial institutions have also mushroomed. Trust and investment companies have sprung up. Financial companies based on corporate groups began to appear in 1987 and soon reached a scale of dozens. Investment funds also broke ground with the development of the securities market. After 1991, with the rise of the stock market, securities companies have developed rapidly throughout China, with as many as 200 at most.

On the basis of the above developments, since 1994, as per the principle of separating policy-related operations and commercial operations, as well as the principle of separated operation and administration of the banking, trust and securities industry, monetary authorities have also launched a large-scale restructuring of the financial institutional system of China. The policy loan business, which had been contained in state-owned commercial banks for a long time, was separated and handed over to three newly established development banks, namely, the National Development Bank, the Export-Import Bank and the Rural Development Bank. At the same time, the state-owned banks also followed the practice of commercial banks and began another round of commercialization reform.

Financial markets such as currency markets and capital markets, which have long been a taboo for people, have also emerged since the early 1980s. Beginning in 1981, in the most developed economies of the Jiangsu and Zhejiang areas, some "underground" fund borrowing and lending activities had been occurring, with the aim of regulating the surplus and deficiency of funds. In January 1986, the lending market was officially incorporated into China's financial system. In 1982, the People's Bank of China advocated the implementation of bills of exchange, promissory notes, cashier's checks and letters of credit, which can be described as the inception of the Chinese bill market. In 1982, China resumed the issuance of national debt, and the development of the capital market began. In 1991, on the basis of a fairly developed national debt market, the government bond repurchase business began to be piloted. A major event that should be particularly noted is that in the early 1990s, on the basis of the pilot reform of the national corporate shareholding system in China, the stock exchanges in Shanghai and Shenzhen opened in late 1990 and early 1991, respectively, marking the point where the stock market formally became an integral part of China's socialist market economy system.

In summary, in the short period of 15 years from 1978 to 1994, China's financial institutions grew from the "one piece" of the People's Bank of China into many central banks, (national and regional) commercial banks, insurance companies, finance companies, urban and rural credit cooperatives, non-bank financial institutions (securities, trusts, leasing, funds, etc.) and policy-related banks, which all constitute a full range of modern financial institutions. Stock markets, currency markets and bond markets have also become outlets for investments with which investors are acquainted. This unprecedented and explosive development has laid a solid systematic and institutional foundation for the improvement of China's savings rate.

Statistics show that China's savings rate and investment rate have both improved steadily since 1994.

Before 1978, as the classic theory of development economics stated, China's fixed asset investment and economic growth were always constrained by the savings gap (saving rate lower than investment rate). Over 16 years, specifically from when the reform began in 1978–1993 when the reform entered the new stage of building a socialist market economic system, eight years exist in which the Chinese savings rate was higher and lower, respectively, than the investment rate.

After 1994, the situation changed radically. The savings rate outpacing the investment rate is a normal situation in the Chinese economy. This situation is manifested in the domestic market given the continuous long-term, high-speed growth of bank deposits and new financial assets; in external economic relations as the long-term, continuous surplus of the current account; and the resulting rapid boom of foreign exchange reserves.

In 1978, China's savings rate was only 37.9 percent. In 1994, it rose to 42.6 percent, which exceeded the investment rate of the year (41.25 percent). Since then, China's savings rate has climbed, rising to around 51 percent in 2008 and around 49 percent in 2017. Correspondingly, China's investment rate (capital formation) has also steadily escalated from 38.22 percent in 1978 to 41.25 percent in 1994, 44 percent in 2008 and around 46 percent in 2017. On average, China's savings rate and investment rate have reached 38 and 36 percent, respectively, in the past 40 years, being much higher than those of other developing countries in the corresponding period and developed countries in their historical periods of high growth. The savings rate and investment rate, which are high, last for a long period, and mutually supportive, have laid a solid foundation for China's miracle of an average annual growth rate of 9.5 percent in the past 40 years.

4. Population: from "burden" to "dividend"

In the short term, investment rate and savings rate are primarily a function of capital profit rate and interest rate. In the long run, the investment rate and the savings rate are mainly determined by the population structure.

High investment rates and high savings rates have coexisted for a long time, leading to the emergence of demographic dividends, which derives from changes in the age structure of the population. In the decades following a wave of the "baby boom," the usual phenomenon is that the proportion of the working-age population in the economy increases, while the proportion of children (children's dependency ratio) and the elderly (old-age dependency ratio) declines. In the process of this structural change in the population, if the working-age population is able to obtain employment, then the labor participation rate of the total population increases, thereby promoting the increase of the savings rate in at least two aspects: first, the increase in the proportion of the working population leads to an increase in the total income of the entire population, which will inevitably increase the level of savings; second, the relative increase in young working population leads to a decline in the propensity of the total population to consume and an increase in the propensity to save, which in turn creates an additional savings rate

increase effect. Looking further, in the context of high savings rates, if the investment rate can be increased accordingly, then the economy will maintain a high growth rate. This phenomenon of high demographic rate, high investment rate and high economic growth rate caused by changes in demographic structure simultaneously and in parallel and support each other is a “demographic dividend.” However, a detail that is particularly important to point out is that demographic changes constitute only one of the necessary conditions for generating a demographic dividend. The sufficient condition is to provide continuous and large-scale employment opportunities, which can only be engendered from the process of large-scale industrialization and urbanization.

Studies have shown that demographic dividends are a common economic phenomenon that, however, occurs in different countries and regions in diversified time periods with varied degrees of influence on economic development.

Since 1949, China’s population growth has experienced two waves of baby boomers. One wave occurred in the 1960s, when the natural population growth rate was maintained at around 20–30 percent. The other wave took place in the 1980s after the reform and opening-up, when the rate remained at around 15 percent. Simple calculations indicate that the population born during the 1960s baby boom is currently between 50 and 60 years old. The population of this age group is not only a major component of the labor force after the reform and opening-up, but also major savers, with the gradual stabilization of work, the growing up of children, the relative increase in income and the relative decline in consumption. Similarly, the population born during the baby boom of the 1980s has now become major producers and savers. Undoubtedly, the two waves of baby boomers, especially that of the 1960s, have strongly driven the changes in China’s demographic structure and have had a substantial impact on economic growth.

Like other countries, the change in the age structure of the population has also produced a phenomenon of demographic dividend with high savings rate, high investment rate and high economic growth rate in parallel. As the proportion of the working-age population increases, the employment rate of the working-age population in China has remained at around 98 percent, which has led to an increase in the labor participation rate of the total population as the age structure of the population changes. In 1979, at the beginning of reform and opening-up, China’s total population participation rate was only 42 percent. By 2004, it had reached nearly 58 percent, and in 2010, it was as high as 74.2 percent. Since then, China’s population participation rate has begun to decline. In 2014, it fell to 67.0 percent[1]; however, although it has declined, it is still significantly higher than that of middle-income countries by 63.6 percent and Taiwan by 60.4 percent. With regard to the trends, changes in the total population participation rate are highly consistent with changes in the savings rate and investment rate.

In recent years, as the Chinese economy entered a new normal with the characteristics of medium- and high-speed growth, the demographic dividend has become one of the hot topics among the government and the public. What most people mean is that China’s economic growth over the past few decades has relied on the harvest of several dividends, of which the demographic dividend is the most significant and long-lasting. But now, from about 2010, the demographic dividend will fade away. Thus, we urgently need to plan new support for China’s economic growth in the future.

This idea is normal and reasonable. However, a particularly noteworthy detail is that if the fading-away demographic dividend is only regarded as a population issue and planning for the future focuses is mainly around the population, then it may be a misunderstanding. This detail is enough to draw attention to one fact: the total population growth and the rising population participation rate, which are considered by everyone nowadays as necessary for the demographic dividend, are considered a burden to be removed before the reform and opening-up and for a long time afterwards. At that time, when it comes to

population, from domestic to foreign, from theory to policy, it is said to be the “cancer” and “death load” of China’s development. A large population and the high degree of rejuvenation in the population structure means that China cannot solve its own employment and subsistence problems. Therefore, the population needs to be controlled; this issue eventually generated the controversial “family planning” policy. If we discuss this matter in depth, then the well-known Ma Yinchu’s debate, which occurred before the reform and opening-up, is worth mentioning. Professor Ma Yinchu, then the president of Beijing University, insisted that people are “mouths.” Given the reality of less land, less food and more people, he advocated family planning and population control. Opponents insisted that people are “hands” and stated that “when everybody adds fuelwood, the flames rise high, so don’t mind the population.” At that time and in the following period, Ma was obviously right. Although the opponents still verbally insist that Ma Yinchu’s Ma theory is Malthusian instead of Marxism, thus criticizing it, but in practice, they have to transfer 20m “Educated Youths” and even some urban youth in the late period of the Cultural Revolution to the countryside to ease the employment dilemma in the cities. However, we have to admit that since the reform and opening-up, we have apparently enjoyed the dividend of throngs of young people left by the traditional system, as indicated by the concept of demographic dividend.

For the same population, it can be either a once-feared burden or an unforgettable bonus, the distinction of which obviously has to be determined in relation to other socio-economic conditions and changes. I believe that, by virtue of reform, we have created a series of socio-economic conditions that constitute the real fertile ground for China’s economic miracle and transform the population from burden to dividend.

5. The role of industrialization and urbanization

From the experience of various countries, the change in the age structure of the population is only one of the necessary prerequisites for the simultaneous existence of high savings rate, high investment rate and high economic growth rate. Another prerequisite for the formation of the “three highs” is that the working-age population can be employed, especially in non-agricultural industries with high economic value added. Here, guiding the population to non-agricultural employment is a key factor because the non-agricultural industry has a high labor productivity. Therefore, the entry of the large-scale agricultural population into non-agricultural employment will lead to a substantial increase in the income of the employed population and drive the rise in income of the total population, and in turn lead to a virtuous cycle with mutual promotion of economic growth and increased productivity. At the same time, the transfer of labor from agriculture to non-agricultural industries has reduced the employment of the agricultural population, which will also have the effect of raising the income level of agricultural workers. As a result, the increase in the income of the entire population will inevitably lead to increased savings, which will provide support for the increase in investment, resulting in a virtuous cycle that features rising employment in non-agricultural industries, rising income, rising savings, rising investment and further growth of employment in non-agricultural industries.

The rise in the employment rate of non-agricultural industries is first and foremost related to the industrialization process. If the change in demographic structure constitutes the basis for the demographic dividend, then industrialization is a necessary condition for the demographic dividend. This idea means that the birth of the demographic dividend depends on the advancement of the industrialization process.

Recently, the international historian circle of Legal Metrology published a new research result, which holds that, in terms of economic and social development, industrialization is the most important event in human history in the past 3,000 years[2]. Other events are interesting but not important. Therefore, human history is “only divided by the world before the Industrial Revolution and the world after it,” because, from a bigger perspective,

the world's per capita GDP has remained basically unchanged in the two or three thousand years before 1800 and only gradually rose after the Industrial Revolution. On the micro-level, after the Industrial Revolution, human beings' lifestyles, social structures, political forms and cultural connotations have undergone fundamental changes. Before industrialization, the economic developments of all countries, including China, were invariably subject to Malthusian law. That is, in the case of constant productivity, natural disasters or wars lead to the death of the population, and then per capita income increases, providing conditions for the next round of fertility and population growth. However, after population growth, per capita land and per capita income decrease, the challenge of survival looms large, which in turn leads to war or plague, and the subsequent population is reduced again, and so on and so forth. Industrialization has broken this cycle because industrialization has empowered humans with "roundabout production," with which endless science and technology can be objectified and wealth can incessantly accumulate. All these conditions lead to an increase in productivity.

The next question is, now that industrialization is so important, what are the conditions for it, and why did it happen first in the UK? Western economists concluded that constitutionalism was implemented because the conversion of feudal society to capitalist society in the UK was achieved through a non-violent "glorious revolution," and in terms of ideology, it was attributed to the Enlightenment.

This is a topic that is interesting, challenging and has a worldwide impact. According to international standards, China's traditional industrialization has been basically completed, but we are clearly taking a different path from the UK and other Western countries. We used a violent revolution to overthrow the old semi-feudal and semi-colonial China. Under the leadership of the Communist Party of China, from the old democratic revolution, the new democratic revolution, to the socialist revolution and socialist construction, we have stepped onto the path of building a socialist market economy. What we are practicing is the rule of law under the leadership of the Communist Party of China, which is considerably different from the constitutionalism of the West. In the early stage of industrialization, our government played a leading role. Since the reform and opening-up, we have not only developed the private economy and promoted the "contract system" and other institutional changes, but also maintained collective ownership and achieved considerable progress through the growth of township enterprises. In summary, the government's active actions, the people's independent creation, a diversified property rights structure and the transformation of collective organizations constitute the major driving force of China's industrialization.

The pattern of China's industrialization and its effects are obviously different before and after the reform and opening-up. Before the reform and opening-up, the planned economic system and heavy industrialization impulse in disregard of the objective economic law have suppressed China's normal industrialization process. After the reform and opening-up, with the gradual establishment of the market economy system, the industrialization process began to follow the objective laws of the economy and proceeded smoothly.

In terms of the industrialization process and its effects after the reform and opening-up, a meaningful indicator is that the non-agricultural employment population accounts for a gradual increase in the proportion of the total employed population. Taking the change of non-agricultural employment population as a clue, we can divide China's industrialization process into four phases after 1978. The first phase was from 1978 to 1990. The industrialization at this stage was implemented under the impetus of the reform of the rural economic system. The main industry that was developed was the light industry. The second phase was from 1991 to 2000. The reform of the state-owned economic system and opening-up to the outside world constitute the main driving force for industrialization. The major industries that achieved rapid development are export-oriented processing industries and

general manufacturing industries. The third phase was from 2001 to 2012. At this stage, China's various reform and opening-up policies further deepened, and in terms of industrial development, it has shown a considerable trend of heavy industrialization. The fourth phase was from 2012 to the present. The rapid globalization, the fast development of the service industry and the proportion of the tertiary industry outstripping the proportion of the secondary industry are the prominent features of this stage. This condition means that not only is the proportion of non-agricultural employment in China still rising, but also that the optimization process has begun in the non-agricultural employment sector.

Speaking of the operating mechanism, high savings rate and high investment rate are the cause of industrialization and the fruition of smooth industrialization development. The causal cycle, which is endless, has resulted in long-term high growth in China. However, we can also find an exemplification of inconsistencies in Latin America in the 1970s without generating demographic dividends. At that time, some demographic changes in Latin America were conducive to economic growth. However, given that Latin American countries adopted the wrong industrialization development model, there was no such thing as the "three highs" in the later East Asia, which led to the loss of the opportunities for accelerated economy development.

In further discussion, the rise in the non-agricultural employment ratio not only reflects the industrialization process of the economy, but also clearly records the pace of urbanization. In fact, industrialization and urbanization are two sides of a coin. From the perspective of population distribution, a distinctive feature of cities that differs from rural areas is the relatively concentrated population. The basic driving force for the population to be able to agglomerate and form a city is the formation of a broad division of labor and exchange networks between people. Compared with the feudal cities and trade cities before the Industrial Revolution, industrialization has greatly promoted the market scale and even the development of cities in two aspects: first, industrialization has enabled the emergence of factories with economies of scale; second, industrialization has enabled a mutually reinforcing aggregation effect across factories and across industries. In turn, urbanization has also greatly promoted the development of industrialization through the scale agglomeration and expansion of the labor market, the intermediate goods market and the consumer goods market.

With the progress of industrialization, China's urbanization level has also increased rapidly after the reform and opening-up. In 1978, the ratio of the urban population to the total population in China was only 17.9 percent. In 1993, the proportion of the urban population rose to 27.99 percent and increased by about 10 percentage points in 15 years. After 1994, with the comprehensive development of the socialist market economy, urbanization entered the fast lane and the proportion of urban population jumped from 28.5 percent from 1994 to 54.77 percent in 2014 and increased by about 26 percentage points in 20 years.

The increase in urban population and employment also contributed to the rise in savings and investment rates. First, given that urban employment is concentrated in the secondary and tertiary industries with higher per capita income, the increase in employment and income will inevitably lead to an increase in the savings rate. Second, urbanization also means a substantial increase in infrastructure construction and real estate investment. Third, the process of urbanization not only directly promoted the increase in the savings rate and investment rate, but also led to an increase in investment through the upgrading of the consumption structure of urban residents. Although poverty problems still exist in China due to the unfair distribution of income, housing, automobiles, leisure and tourism are becoming new consumption hotspots for an increasing number of urban residents. A particular detail that is worth noting is that the adjustment of the financial structure with consumer credit expansion as the main content since the mid-1990s has effectively

alleviated the budgetary constraints of income and savings in the current period on the consumption of large consumer goods. It smooths the income of the consumer's life cycle and gives people the convenience of prepaying future income. All these factors will undoubtedly provide strong financial support for our citizens to achieve the third upgrade of the demand structure as soon as possible. These new consumer demands have, beyond question, created a large demand for new industries such as social infrastructure, municipal construction, automobiles, and housing, and these demands have generated long-term and sustained tremendous pressure on coal, electricity, oil and transportation. These demands and pressures invariably require the investment rate to be maintained at a certain level.

When it comes to industrialization and urbanization, a question about the relationship between the two needs to be discussed.

The urbanization process triggered by high investment is bound to be inextricably linked with industrialization. China's practice shows that our urbanization is obviously caused by industrialization. The urbanization that took place in the wake of industrialization has caused the reality that China's urbanization lags behind industrialization. This idea has prompted criticism from many researchers. We believe that urbanization lagging behind industrialization is not the drawback of China's economic development. On the contrary, the fact that industrialization precedes and industrial development precedes urban development is precisely indicative of the success of China's economic development, and also the major experience of China's development path because it follows the natural development process of "increased investment–industrial development–increased employment–population concentration–increased savings–urban development–increased investment..." This development route has ensured that hundreds of millions of migrants are employed, thus avoiding the serious social problems of ubiquitous slums as an aftermath of premature expansion of large cities in some developing countries.

6. A short conclusion: the success of progressive reform

In the above, we started with the transfer of surplus labor, focusing on how the outcome of high savings, high investment, demographic dividend, industrialization, urbanization and other factors jointly achieved the miracle of China's high-speed economic growth for 40 years. Our analysis logic is as follows: with regard to the mechanism, the above factors were met in a timely manner and jointly contributed positive energy to China's economic growth, with the increase in the savings rate as the necessary condition and foundation, and the increase in the savings rate is attributed to the explosive expansion of the financial system at the beginning of reform and the formation of positive incentives for residents, enterprises and governments at all levels; and the expansion of the financial system and the formation of positive incentives are clearly the crystallization of the wisdom of Chinese-style progressive reform.

After experiencing a high-speed growth of 9.5 percent per annum for 40 years, China has now entered a new normal with the 40 extrinsic characteristics of medium- and high-speed growth and further transformed into a new track of high-quality development. The co-occurrences of decline in resource allocation efficiency, the fading away of demographic dividends, the reduction in capital accumulation efficiency, the strengthening of resource and environmental constraints, overcapacity, soaring leverage and the "quantitative easing and high price" paradox in the financial sector constitute both the cause of the decline in economic growth and a new challenge we are facing.

The new normal of China's economy does not only purport a decline in growth rate; its profound connotation is the improvement of the quality of economic development and of efficiency. The overall result is that the Chinese economy will take a new step and enter a new era. In our view, the new normal is different from the recession and depression in the conventional economic cycle. It is a new development in which economic development is out

of the normal track and a new path is taken. On a global scale, another path entails the reorganization of the supply chain, transformation of the economic structure, reshaping of the governance system and reengineering of the relationship between big powers. From a domestic perspective, in addition to the abovementioned global commonality, another path is to break away from investment-driven and export-driven growth and engage in quality, efficiency, innovation, tolerance, green and sustainable development, and thus cross the middle-income trap and embark on the road to the great rejuvenation of China. In short, the new normal signifies the nirvana of the Chinese economy.

However, the great rejuvenation of China is by no means at our fingertips. When we say that the new normal has opened up the road to new prosperity, it also means that it has created new strategic opportunities for us, providing new elements, conditions and environment for the new stage of our development. For opportunities to become reality, we still have to take the determination of the strong men to cut the arm to save the body, to actively promote reforms in various fields and to earnestly complete the historical tasks of transforming development styles and restructuring, for which some conditions are required and are only basically in place. China is in the process of completing the traditional industrialization and rolling out new industrialization, urbanization and agricultural modernization. Given that China's savings rate and investment rate remain high and will continue to be high for a long time, the capital base to support new industrialization, urbanization and agricultural modernization remains strong. Therefore, we have every reason to believe that the growth prospects of the Chinese economy remain bright. We are nonetheless confident that we will realize the new two-step strategy for economic development proposed by the 19th CPC National Congress.

Notes

1. The data are from the National Bureau of Statistics.
2. See Chen (2013).

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