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Can Economic Transitions Be Planned? China and the 13th Five-Year Plan

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Summary

"*By failing to prepare, you are preparing to fail*" Benjamin Franklin once said. The current Chinese leadership seems to be well aware of this risk and it is trying to stay ahead of the curve. Chinese policymakers are seeking to engineer a gradual slowdown of the economy and a transition to a more sustainable, inclusive and balanced growth model. In this engineering exercise, the five-year plan plays an important role by (1) spelling out the reforms necessary to carry out the transition and the modalities of their implementation and (2) setting the targets, many of them numerical, which should be achieved.

There is however a fundamental question, whose relevance continues to increase as China moves from a command economy to a market-based one: can such a transition be planned? This Economic Brief discusses the issue by looking at how China's economic planning has evolved over time, at the strengths and weaknesses of the recently approved 13th Five-Year Plan (FYP), and the political economy behind it. Its main conclusion is that because of the growing complexity of China's economy and society, engineering such a transition is almost a "mission impossible". Still, economic transitions can be steered and *de facto* this is what the 13th FYP is trying to do.

Whether the 13th FYP will succeed remains to be seen. Significant progress has been made in certain areas and there is no doubt that the economy is in the process of rebalancing, both as regards the demand and supply-side of the economy. While the current FYP heavily emphasises policies in support of innovation, the greening of the economy and social inclusion, it is less clear on how to pursue reforms to address the economy's current macroeconomic and financial imbalances.

Another important conclusion we reach is that in the coming years, China's economic planning will have to reinvent itself. Even if it succeeds in steering a smooth transition to a more sustainable growth model, it will have to adapt to the conditions of an increasingly sophisticated, financially complex and service oriented middle-income economy which requires efficient markets as an information processing device. As a result, it will have to get rid of the remaining imperative elements that are still present as a legacy of a command-driven model of development.

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Introduction

In mid-March this year, the National People's Congress approved China's 13th FYP. The document sets the economic and social objectives to be reached in the next five years under the leadership of the Communist Party of China (CPC). The 13th FYP assumes a particular significance in China's aspiration to transform its growth model from investment and export-led to consumption and service-driven. The 13th FYP is therefore supposed to spell out the modalities of this transition and provide the authorities' vision of where China's economy and society should be at the beginning of the next decade.

The document approved by the National People's Congress tries to fulfil this task. However, as the Chinese economy becomes increasingly decentralised and complex, the power of five-year plans to steer it is inevitably declining. In addition, there is the risk that, by trying to micro-manage the structural changes under way, the planning exercise reintroduces a level of control in the Chinese economy that recent reforms have tried to weaken. Against this background, it is legitimate to wonder whether China's economic transition can be planned and, as a result, whether the FYP is still a meaningful tool for Chinese policymakers or has instead become an increasingly empty document that survives because it is part of the political liturgy established at the onset of the People's Republic of China (PRC).

To answer this question, it is instructive to look at the changing nature of China's economic planning. After the creation of the PRC in 1949, the country's leadership launched imperative, Soviet-style plans with a broad range of quantified objectives. However, at the Third Party Plenum of December 1978, the Party leaders recognised that, in order to foster economic growth, alongside the state, a greater role should be played by prices and market forces. Over time, the imperative nature of the plan faded (although it never fully disappeared), and the focus shifted to the mobilisation of public and private resources to achieve broader development goals. The growing complexity of the Chinese economy has made this "developmental state planning", with its pretence of being able to pick winners, less effective. As China has continued to evolve towards a market economy system, in recent years (in particular during the 11th and 12th FYP), economic planning has become increasingly less intrusive and more indicative, gradually favouring structural objectives over numerical targets and focussing on setting framework conditions within which market forces operate (at least in some sectors).

In this paper we consider how this hybrid form of plan (as it continues to keep also imperative and developmental dimensions alongside the indicative one) puts together the various elements of the economic transition and whether this has produced a coherent framework for policy action. Inevitably, to provide an answer to such a question, we have also to look at the political economy that lies behind the plan, and the strains and constraints that a growing civil society and a rapidly expanding middle class on the one hand, and powerful vested interests (*in primis* those related to State-Owned Enterprises – SOEs), on the other hand, are putting on China's decision making process and, as a result, on the plan itself.

One of our main conclusions is that the 13th FYP is still relevant in steering China's economy transition. But the transition to a complex and decentralised economy and society cannot be fully planned, as is becoming increasingly evident to the Chinese authorities. Therefore, while it is positive that the plan moves increasingly away from quantified targets and has now adopted a growth range instead of a specific number, the Chinese authorities, if they want to complete the transition successfully, will have to further relinquish their control of the economy. By the beginning of the next decade, to play a beneficial role in the further development of Chinese economy, the plan will have to become indicative in almost its entirety.

2. The evolving nature of China's five-year plans

2.1. Imperative planning, developmental planning and indicative planning

The first five-year plan was introduced in the Soviet Union in 1928. Interestingly for the purpose of this Brief, its aim was to plan the transition to industrialisation of the mainly rural economy of the Soviet Union. In addition, it also pursued the forced collectivisation of agriculture (by 1932 about 60% of peasant households had joined state farms or collective farms), with the aim of making it easier to redirect the agricultural surpluses (at the price of huge human losses) to the industrial sector. By the end of the first five-year plan, the number of workers employed in the industrial sector had tripled and the production in heavy industries doubled[1] , but at the cost of a drastic fall in output of consumer goods and in agricultural production. Because of the "successes" of the first plan, a second was launched in 1932 with the main objective of developing the Soviet heavy industries. After these experiences, in the Soviet Union the Five-Year economic plan was there to stay.

This type of planning has become known as "imperative planning" (also referred to as directive or mandatory planning). In the case of the imperative planning, a group of quantities of goods is set by a central planner "*totally overruling price signals and market forces. These quantities include production levels for almost all of the production of consumer and capital goods, human and physical infrastructure investments, and the amount and distribution of labour into sectors and geographical areas. Under that framework, international trade [is] also managed with respect to quantities*" (Yulek (2014)). Administrative control replaces market institutions and prices, and the planner is responsible for the allocation of resources.

After World War II, the practice of elaborating and implementing imperative five-year plans spread to all the countries ruled by communist regimes. The PRC was no exception. The first Chinese FYP was introduced in 1953. Its objectives (rapid development of the industrial sector, collectivisation of agriculture) were similar to those of the first Soviet Union FYP. The main aim of the Plan was the realisation of 694 large and medium-sized industrial projects (including 156 with the aid of the Soviet Union), so as to lay the foundations for China's socialist industrialisation; to develop agricultural producers' cooperatives; and to put capitalist industry and commerce on the track of state capitalism so as to facilitate the socialist transformation of the society.

The success of the first plan was mixed. On the one hand, by 1957 most of the 694 major industrial projects were completed: steel production quadrupled, coal production almost doubled, and the gross value of industrial production was almost 130% higher than in 1952. Overall, industrial production increased at an average annual rate of 19% between 1952 and 1957, and national income grew at a rate of 9% a year. On the other hand, outcomes in agriculture were much less impressive. Between 1952 and 1957 average annual growth of agricultural output was about 4% a year. As investment in agriculture remained weak, growth in this sector resulted primarily from some gains in efficiency through cooperative farming (which passed from almost zero in 1953 to 93.5% in 1957). By the end of the First FYP, Chinese leaders became increasingly concerned over the relatively sluggish performance of agriculture. This led, *inter alia*, to the Great Leap Forward (GLF) which took place in the period of the Second FYP. Alongside the massive increase of industrial production per se, with complete disregard of economic efficiency and the quality of products (which led, for instance, to the building of backyard furnaces), the GLF aimed at raising agricultural output through an accelerated collectivization of farms, large-scale irrigation projects and new cropping methods of cultivation, but ended in the Great Famine.

The GLF was a paradigmatic case of trying to apply a rigid top-down system of quantitative organisation of production in a radical form, which abandoned the price mechanism in favour of production targets set at the highest level of aggregation which were filtered down to the level of each collectivised unit. The gross failure of the GLF subsequently led to some retreat in the "depth" of application of imperative planning, at least as a device for coordinating low level production decisions. For example, in agriculture there was some reinstatement of family rights to farm plots of land. The catastrophe of the GLF also provides part of the explanation for why Deng Xiaoping and other Party leaders engineered a radical shift in approach after Mao's[2] death.

As a result, in December 1978, in the midst of the implementation of the Fifth FYP, a major change in policymaking happened. The Third Plenary Session of the 11th CPC Central Committee decided to shift the focus of the Party to modernisation. This implied in-depth reforms in the economic and social fabric of the country, which in turn demanded a relaxation of the command economy that had prevailed after the creation of the PRC. This also implied a change in the nature of the planning exercise. Planning similar to that of "developmental states" (e.g., Japan, Korea, Taiwan) would be *de facto* introduced alongside imperative planning, creating a hybrid planning system.

"Developmental state planning" recognises a role of prices and market forces in the economic system as a key mechanism to coordinate lower level production decisions, which in itself represents a major shift in emphasis from imperative planning. Still, it is the state that keeps the control not only of the macroeconomic levers of the country, but also of strategic sectors (either directly through state owned enterprises or indirectly through administrative guidance to the private sector), and the state actively direct resources to those broad sectors deemed essential to the achievement of the developmental objectives of the state (Johnson (1982), Chang (1999)). Instruments such as a competitive exchange rate and financial repression are also used to reach these objectives. Developmental state planning was introduced first in Japan, Korea and Taiwan in the fifties (see Johnson (1982), Amsden (1989) and Wade (1990), respectively, as well as Bertoldi (1997)) and proved effective in managing the rapid transition of these countries from an emerging to an advanced economy in the case of Japan and from developing to emerging economies in the case of Korea and Taiwan (ultimately, in the early 2000s they also joined the advanced economies club). Not surprisingly, in the process of economic reform and gradual abandonment of a command economy (which was part of a more general political shift from a totalitarian political regime to an authoritarian one that, while retaining the monopoly of political power, would allow the Chinese citizens enjoying some limited freedoms - mostly but not exclusively - in the economic field), the authorities looked abroad for clues as how to achieve a successful transformation of the economy without jeopardising the key political role of the Chinese Communist Party (Woodhall (2014) and Knight (2012)). The growing role of the private sector in the Chinese economy would continue to be steered and monitored through the planning process, while retaining some elements of the old imperative planning system in sectors considered as strategic, such as heavy industries or network industries.

Chinese planning has continued to evolve. As economic reforms allowed for the private sector to thrive and the country was facing new challenges, both on the social and environmental front, the plan had to further loosen some of its mandatory and developmental characteristics and become increasingly indicative.

Contrary to developmental-state planning (and even more imperative planning), indicative planning does not try to allocate resources to achieve certain developmental objectives, but focuses rather on information pooling, expectation formation and policy coordination to address a number of market failures and set a stable environment which reduces uncertainty and henceforth favours economic growth (Estrin and Holmes (1983), Yulek (2014)). In indicative planning, "*price signals are respected and coercive powers of the plan are quite restricted. In these 'mixed' economic models, the public sector provided some of the investments … and it also introduced incentives for private investments in prioritised sectors*" (Yulek (2014)). In a system where private agents have full access to reliable information, indicative planning may lose part or most of its effectiveness. However, in transition economies like China (or in market economies that are undergoing important transformations after a major upheaval, as it was the case for Western European economies after WWII like France, Italy, the Netherlands), private agents may have to face more than imperfect information and have more volatile expectations, while policymakers may have to reduce conflicting strategies as well as to try develop synergies. In these cases, indicative planning, by providing the sense of direction of the economy and spelling out the incentives to achieve medium-term objectives and goals, can have welfare-enhancing properties (Estrin and Holmes (1983)), as well as reducing the uncertainty over the medium-term, therefore creating a more predictable environment for investment.

The most recent Chinese five-year plans have become more indicative and less developmental. However, they still retain some characteristics of the old imperative plans, both in the way they are elaborated and in their content. The plans remain the key document where the leadership of the CPC, on the basis of a wide consultation inside and outside the party, spells out its vision concerning the economic direction of the country in the medium term and indicates how to achieve it through a wide range of tools, some that are typical of a command economy. The five–year plan still directly allocates resources and sets a number of quantitative targets for several economic sectors, in particular in infrastructural investment, construction and heavy industries. Developmental objectives also remain important, in particular with regard to the industrial modernisation and the climbing of the technological ladder. For certain aspects, the environment-friendly drive adopted in the 12th and, even more prominently, in the 13th FYP, can be considered part of the most advanced stages of a developmental planning[3] (Woodhall (2014)). Nevertheless, the indicative part of the plan is slowly taking over with a greater emphasis on changes to market regulation and rules, and qualitative statements on the direction of reform.

3. Engineering the economic transition in China: the 11th and 12th FYPs

As argued above, successive FYPs have played a crucial role in transforming China's centrally-planned economy, which followed a new path after the start of the "reform and opening up" process in 1978 by gradually fostering development and, more selectively, introducing market principles, in parallel to administrative planning targets, creating a dual track economy. Production "beyond the plan" was allowed to be marketed. As total output increased, the share of production that was "beyond the plan" rose over time, leading to many lower level production targets fading into irrelevance, before being abolished. The FYPs thereby first became more "developmental" and gradually more "indicative". They have enabled China's formidable growth performance over the past decades. In addition, the scope of the plan has broadened beyond fostering industrialisation and collectivisation to include social and environmental objectives (deemed essential to ensure stability and CPC's legitimacy).

A further shift came at the occasion of the 11th FYP (2006-2010), which no longer put a quantitative growth target as its main objective. By seeking a rebalancing of the economic growth model, it showed how economic, social and environmental objectives are intertwined. The plan thereby started to address the side effects that decades of breakneck economic growth have had on income inequalities and environmental damage.[4] By reducing the dependency on external demand and investments, GDP growth should be increasingly driven by domestic consumption. A similar shift in the supply side was sought after, reducing the importance of the manufacturing industry (and especially the polluting heavy-industry) in favour of the services sector. These policies were expected to enhance resource conservation, energy efficiency and environmental protection, as well as to promote a more balanced regional development and mitigate the urban-rural divide. The overarching goal was to secure a more sustainable and equitable development, leading to a more "harmonious society". The annual growth target was lowered to 7.5% in the 11th Plan, underpinning the aim to "double per-capita incomes for urban and rural residents by 2020" (compared to their 2010 level). The actual growth outcome surpassed the plan by a sizeable margin, as was often the case in the past, amounting to around 11% on average, despite the eruption of the global financial crisis.

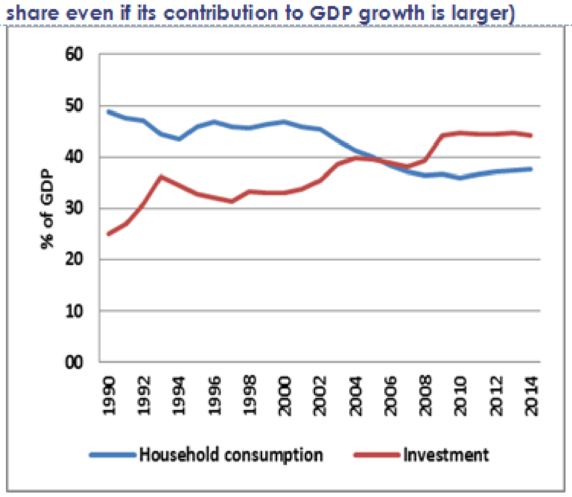
The 12th FYP (2011-2015) further emphasised higher-quality growth (whilst reducing the annual growth target to 7%). Former President Hu called for "inclusive growth" recognising that, while conditions in the rural areas had improved during the past period, income disparities with the urban areas had continued to widen. Other main objectives were "strong and sustainable growth" combined with a continued rebalancing of the economy. This should have been achieved by climbing up the technological ladder and by prioritising seven major industries[5] ; by strengthening efforts on education and innovation; and by efforts to develop the western regions and to upgrade social welfare systems.

Real growth slowed considerably during the 12th FYP (to 7.8% on average) notwithstanding efforts to stabilise activity and avoid a prolonged slump in the wake of the global financial crisis.[6] The way in which China reacted to the global economic crisis succeeded in sustaining demand, thereby avoiding a hard landing and a sharp increase in unemployment. But the massive demand stimulus was also at the root of a build-up of significant internal imbalances. In particular, much of the mostly credit-financed demand went into infrastructure investment and housing thereby driving an already elevated investment ratio further up from 41% of GDP in 2008 to 46% in 2010 (Kroeber (2016). Vibrant construction activity in turn stimulated demand for coal and steel and other basic industries, which were induced to expand their production capacities. As the stimulus faded out and the economy slowed, these sectors were left with significant unsold inventories and production over-capacities. Since, at the same time, debt of the non-financial sector increased by almost 90% of GDP in a time span of five years, the loan quality of the banking sector saw a marked decline.

Nevertheless, progress has been made in transforming the economy over the past ten years. As regards rebalancing, the services sector has clearly grown in importance (as economic growth slowed overall; accounting for more than half of the economy for the first time in 2015). On the demand side, the share of consumption in overall growth rose to about ⅔ in 2015. However, social- and environmental challenges have remained daunting.

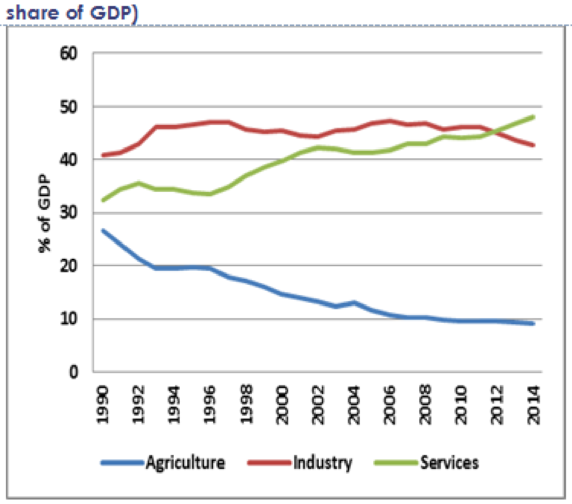
The patchiness of progress noted up until 2013 also reflects how preference was given to some sectors /

Graph 1: Rebalancing takes time… (consumption share of GDP well below the investment share even if its contribution to GDP growth is larger)



Source: IMF Ifs

Graph 2: …with better progress on the supply-side of the economy (services sector has the largest, and rising, share of GDP)



Source: WB New WDI-GDF

actors, notably SOEs in strategic sectors, thereby potentially undermining the role price signals could have in allocating resources in an economy. An IMF working paper describes SOEs as being "*guilty of over-investment because their implied cost of capital is artificially low*" (IMF (2012)). Indeed, when looking at how China needs to adapt its development path to be able to avoid the middle-income trap, the World Bank (WB) and the Development Research Center (DRC) argued that it must first "*implement structural reforms to strengthen the foundations for a market-based economy*" and go on to explain the need to redefine the "*role of the government and its relationship to markets*" in a way that fosters competition, specialisation and the efficiency of resource allocation while also protecting the environment (the WB and the DRC (2013).

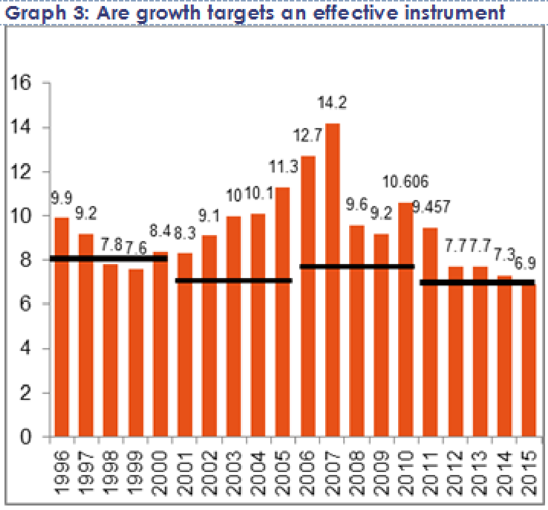
The mixed progress made during the 11th and 12th FYP could also reflect the governance- and incentive structure in China (and, in particular, within the CPC), where promotions seem to go hand in hand with high GDP growth, while (close to) disregarding its social or environmental consequences. Part of the 12th FYP period was also marked by the change in the Chinese leadership in 2012-2013 which initially focused much of its energy on power consolidation, *inter alia* through a war on corruption, while economic reform took a secondary place on the policy agenda despite a rhetoric emphasising its importance.

In particular, the current leadership has advocated broader and more far-reaching reforms. At the Central Committee meeting of the Communist Party, the so-called Third Party Plenum in November 2013, President Xi outlined how China was seeking "comprehensively deepening reforms". The market was set to play a "decisive" and not a "basic" role in China, suggesting a better pricing and allocation of factor resources ahead. Given the emphasis on investment-led growth, this should contribute to an improvement of the marginal efficiency thereof and thereby quality of growth over time. The Plenum also provided guidance on a wide range of financial, fiscal and land reforms, whilst at the same time confirming the central role of SOEs – suggesting a transformation that is more based on indicative planning and governance but still with "Chinese characteristics", which limits the scope of the market economy, at least in some sectors. While the Third Plenum was praised as an important pro-reform manifesto, implementation has been patchy and circumstantial so far, largely avoiding more controversial parts aimed at tackling the imbalances in the Chinese economy such as reducing overcapacity and restructuring the SOE sector.

4. The main objectives of the 13th FYP and the instruments to achieve them

At the core of the 13th FYP (2016-2020), adopted on 16 March 2016, is the completion of the transition towards "a moderately prosperous society". The plan recognises that this goal has to be achieved against a difficult international environment and mounting internal imbalances. Nevertheless, it claims that the goal is achievable if all policies are geared towards an innovative, harmonious, green, open and shared model of development. At the same time, policies must be implemented in a way that does not jeopardise economic, social and political stability.

Graph 3: Are growth targets an effective instrument



Source: IMF Ifs

As in the past, the 13th FYP continues to set growth targets. It reaffirms the objective set at the time of the 11th FYP of "doubling per capita income between 2010 and 2020", which by now translates into a target of average output growth of at least 6.5% per annum. However, in a gradual move away from the imperative and developmental approaches to indicative planning, the growth target for the first year of the FYP is expressed in a range (6.5%-7%), which can also be changed according to domestic and international conditions. This is an implicit recognition by the planners that, while the state has still a strong grip on the economy, its overall control is declining.

4.1. Supply-side reforms focus on innovation

Over the period covered by the 13th FYP, growth is expected to come from various sources. On the supply side, the planners indicate that 60% of China's growth should eventually be the outcome of scientific and technological progress. This should be interpreted in a wide sense and comprises the impact from all forms of innovations which the plan envisages to spark off in coming years and which should permeate every aspect of life. As noted by China's Premier Li Keqiang, China's economic transition will "live or die" based on the country's ability to innovate. Providing internet to a large part of the population, upgrading manufacturing, boosting modern services and supporting strategic emerging high-tech industries are some of the factors that should act as catalysts for innovation. Rising R&D expenditure (from currently 2% of GDP to 2.5% in 2020) and mass entrepreneurship should also be strong contributors. Moving up in the technological ladder should also be helped by China's "opening-up" and "going global", two important themes in the 13th FYP. This should translate into promotion of exports on a broad scale while, on the import side, high tech imports needed for the further development of China will be given priority.

The Plan's proposed supply-side policies are not limited to measures stimulating innovations. There are also a number of policies that are likely to have more immediate effects such as creating favourable conditions for establishing and doing business by reducing administrative barriers and eliminating red-tape, liberalising prices in sectors such as petroleum, natural gas, electricity and transportation, and commitments to reducing the "negative list" of sectors from which foreign investment is barred.

In addition, the 13th FYP envisages the completion of an ambitious tax reform. The aim is to establish a modern fiscal and taxation system. The tax reform also includes a further restructuring of the tax administration, with individuals in the future being connected to an ID number, which should help contain tax evasion, fraud and corruption.

4.2 Tackling over capacity: Will the suggested reforms go far enough?

In some sectors like heavy industries, where overcapacity, low profitability and highly polluting production has become a growing burden for the economy, the 13th FYP foresees a heavy curtailment of both investment and employment. In an interesting twist, imperative planning is used not to boost production, but to cut it. The plan envisages that overcapacity in the steel sector is cut by 100-150 million tons and employment in the coal and steel sector reduced by up to 1.8 million jobs. To cushion the social impact of this reduction in overcapacity a fund has been established worth 100 million RMB to be spent over two years.

In terms of SOE reform, however, the 13th FYP remains below the expectations created by the Third Party Plenum. In a revival of developmental planning combined with imperative elements, restructuring of ailing SOEs is to be achieved mainly by encouraging merger of firms with the aim of reaping economies of scale, on the one hand, and creating national and international champions, on the other. Indicative planning elements that would work mainly through a strengthening of competition by creating a level-playing field between the private and the public sector, and by opening up to domestic and foreign private capital have moved to the background. This retrogression is all the more remarkable as it has proven to be a recipe for low profitability and engendering overcapacity problems in the past, and it is a testimony of the Party's preference in favor of short-term social stability over long-term economic efficiency.

Another area where the 13th FYP falls short of expectations is the development of services. Compared to the 11th and 12th FYP, the 13th FYP does not devote a separate chapter to the development of the service sector. This is due in part to the fact that the development of a modern service sector is considered to be of a cross-cutting nature and therefore included in various other chapters e.g. on developing the internet economy or on a modern education and health-care system. But in part it also seems to reflect a certain retreat from the idea that future growth will come predominantly from the services sector. While consumer services remain one of the mainstays of future growth under the "New Normal", the further development of the industrial sector and the expansion of infrastructure receive significant attention and reveal a clear intention of the planners to maintain a strong focus on these areas.

4.3. Investment remains an important source for growth

According to the Plan, investment should continue to play an important role, although its share in total growth should be on a declining trend, while the role of consumption should continue to be strengthened. Against this background, quality of investment becomes a crucial element in China's economic transition. It is not by chance that in the 13th FYP, investment is expected to be driven mostly by innovation and modernisation of the capital stock, and by the urbanisation process, while production capacity of heavy industries should be significantly cut down. Urbanisation is a necessary condition to ensure the spreading and inclusiveness of growth and that the achievement of a "moderately prosperous society" comes at the expense of a large migrant labour force which has benefited much less than other parts of the population from the rapid growth of past decades.

Urbanisation calls for a further development of infrastructural networks. Infrastructure is to be expanded significantly over the next five years. For instance, the Plan foresees 30,000 km of additional high speed trains, 50+ new airports in addition to the major project of the new International Airport of Beijing, 30,000 km of new highways, more than 150,000 km of roads in rural areas, enhancing city cluster and urban transport, upgrading port facilities, important water irrigation and conservation projects as well as a long "laundry-list" of projects in the energy sector (hydro-power, nuclear power, ultrahigh-voltage power transmission, smart grids, pipelines for oil and gas transmission etc.).

To the domestic dimension of investment in infrastructure, the 13th FYP adds for the first time an international one, through the emphasis put on the "One Belt One Road Initiative" (OBOR) launched by President Xi Jinping in September 2013 with the aim of connecting China to more than 60 countries in Asia, Europe and Africa. OBOR envisages the active involvement of Chinese institutions and companies in overseas infrastructure investment and its financing. It can be seen as a partial solution to Chinese over-capacity by linking domestic manufacturers to markets abroad. It is also a developmental strategy for chronically under-developed provinces and will act to ramp up infrastructure investment of many local governments.

4.4. More inclusive growth ahead

Despite the lower than expected emphasis on services, the 13th FYP still aims at radically changing China's growth model, making it more consumption-led and more environment-friendly. To stimulate consumption and to reduce precautionary savings, the Plan foresees a further strengthening of social-safety nets and an improvement of the health-care system. It also introduces an innovative scheme aimed at fighting poverty.

In terms of social safety nets, the 13th FYP, as its immediate predecessor, has a strong focus on facilitating the change in household registration ("hukou") for migrant workers, and easing access to residency permits with a view to granting urban residency to an additional 100 million migrant workers. This should lead to an increase of the registered urban population to 45% by 2020 (from 40% in 2015) and of the resident urban population to 60% (vs 56%). "Residency permits" generate basic social rights for migrants such as free access to public schools and public health service without extension to the full range of social protection and are therefore considered to be more acceptable by local authorities which are the ultimate providers of these (costly) services. Such a development would have an undeniable positive impact on the welfare of a significant share of the Chinese population and would help boost consumption (the WB and the DRC (2014)).

With regard to social-security reform, the Plan does not deliver a clear roadmap beyond the objective that basic insurance should cover 90% of the population by 2020. Improving the sustainability of the social-security system will be gradual and based on parametric changes (such as the extension of retirement age) rather than on a more comprehensive overhaul of an unfair and unsustainable system (OECD (2015)).

The improvement of the health-care system is another core priority of the Plan. Health-insurance coverage should reach 95% of the population, inter alia by facilitating the portability between urban and rural health-care insurance. The Plan also sets a number of ambitious targets with regard to the expansion of health-care services such as ensuring 2.5 practitioners per 1000 inhabitants. This will require a substantial increase in public health-care funding; in 2016 this increase amounts to 9.6%. To improve the cost efficiency and quality of the health-care system, private investment will also be encouraged.

Last but not least the 13th FYP places a special emphasis on poverty alleviation to which it devotes a separate chapter. Alleviating poverty has become a key element in building a ‘moderately prosperous society’. The target set in the Plan is to lift a further 50 million people out of poverty by 2020. This should be achieved through a combination of measures, including the creation of a poverty monitoring system, relocation of the poor from inhospitable areas, targeted education and training measures, better access to health care, and the provision of subsidies for starting up a business. These measures should be combined with policies aimed at rebuilding run-down areas and shantytowns and enhancing housing subsidies to poor households.

4.5. Going green

The transition to a new growth model would be incomplete without a reduction of the unbearable levels of pollution that are currently plaguing China. The 13th FYP is the “greenest” so far. Improvement of the ecological environment features in a separate chapter but the greening of the economy is a cross-cutting topic that is also included in the planning of several other policy areas such as financing, infrastructure, energy or regional development. Ten out of 25 priority targets are related to environmental policies all of which fall under a group of 13 binding targets (which must be achieved by 2020).

The FYP seeks to promote a cleaner and greener economy through strong commitments to environmental management and protection. The government envisages setting up cross-regional environmental protection and law enforcement agencies, requiring corporations to self-monitor emissions and disclose information on compliance with environmental regulations, and establishing a national carbon-trading market.

Borrowing from imperative and developmental planning, specific objectives for environmental protection were set and they include the reduction of total consumption of primary energy to less than 5 billion tons of standard coal, reduction of energy consumption per unit of GDP by 15%, reduction of carbon-dioxide emissions per unit of GDP by 40-45% and reduction of water consumption by 35%. The Plan includes a specific PM2.5 target, which is a remarkable step forward, as just a few years ago the Chinese government tried to block the publication of PM2.5 measurements by the US embassy in Beijing.

5. The economics and political economy of a Socialist Market Economy

5.1 Will the implementation of the 13th FYP ensure a smooth transition to the “New Normal”?

The Chinese economy has been growing at an impressive average rate of almost 10% over a period of 35 years, lifting more than 600 million people out of poverty. According to the World Bank’s data base on GDP growth, no other country in the world can boast a similar performance over this period. There is thus no denying that the “business model” behind this growth performance has created “one of the world’s greatest economic success stories” (Kroeber (2016).

Table 1: Seven fastest growing countries in the world 1980-2014

Country	GDP growth (1980-2014) (annual average %)
China	9.8
Iraq	7.1
Botswana	6.8
Singapore	6.7
India	6.3
South Korea	6.2
Myanmar	6.0
Source: World Bank	

However, going forward there is a need for fundamental changes if China wants to avoid the so-called "middle-income trap". Firstly, traditional drivers of productivity growth, such as strong capital formation and the transfer of labour from low-productivity activities in agriculture to high-productivity activities in industry, are rapidly losing strength. Secondly, as mentioned, the reverse side of the strong growth performance over the last few years has been a build-up of significant macro-economic imbalances, in particular industrial overcapacity, a real-estate bubble and high corporate indebtedness.[7]

A successful transition towards a new sustainable growth path would therefore require carefully balanced policies to underpin the structural transformation of economic growth towards consumption and qualitative investment, particularly in the services sector, and to reign in the build-up and eventually to reduce the high macroeconomic imbalances. Such policies geared towards a deleveraging of the economy would inevitably reduce growth for a period of time, but would support the sustainability of the growth path.

Against this background, a growth target of at least 6.5% per annum over 2016-2020 seems to be on the high side and feasible only with substantial additional support from fiscal and monetary policy. This, in turn, would hardly be compatible with the necessary deleveraging of the economy. Deleveraging would require a combination of interconnected actions, including the reduction of over-capacity, winding down of non-viable companies and resolution and/or recapitalisation of troubled banks. The 13th FYP does not give a sense of how urgently these challenges will be addressed.

Obviously, policies to deleverage the economy are strongly linked to macro-economic policies aimed at stabilising the economy in the short term. The exact nature of such short-term stabilisation policies is not necessarily the subject of a FYP oriented towards the medium and long term. However, what emanates from the Plan is that, for the time being, policies aimed at tackling China's imbalances will remain strongly state driven - such as the planned government–sponsored mergers of SOEs - while market elements, such as ensuring a level-playing field for public and private enterprises, are largely absent. Couched in terms of planning vocabulary, in important areas imperative and developmental elements still dominate indicative planning elements, witnessing resistance by the authorities to relinquish direct control in favour of defining the process elements while leaving the actual adjustment to the market.

The authorities are seemingly concerned that too much market-driven adjustment would lead to excessive volatility. Given the premium they attach to stability, they are willing to sacrifice a part of the efficiency gains that could be reaped through a market-based adjustment. There are, however, doubts about the feasibility and efficacy of such an approach in view of vested interests in SOEs and local governments, which have mounted substantial resistance to the reform policies of the central government. Moreover, the experimental 'stop and go' nature of some of the new policy approaches that the government has adopted in the recent past, instead of a fuller liberalisation, has made macro-economic stabilisation less effective.

As mentioned, the FYP puts strong emphasis on polices in support of innovation, the greening of the economy and social inclusion. Innovation policies in particular play a key role in the government's strategy to boost competitiveness by lifting productivity and upgrading the Chinese economy. These are important aspects of an emerging new economy and many of the policies included in the Plan seem to be promising in this regard. But innovation policies take time to yield tangible outcomes and it is unlikely that they will result in higher growth over night. Particularly, banking on a solution to China's debt problem via higher growth, i.e. boosting the denominator of the debt ratio, will prove illusionary, at least in the short to medium term. Policies to foster innovation do not dispense the authorities from making hard choices with a view to reducing the nominator of the debt ratio. Short-term palliatives such as the conversion of high-interest local government debt into lower-interest central government-backed bonds and debt-equity swaps in the private sector, which have been reconfirmed by the FYP, do not seem to reflect a willingness by the authorities to face these choices head-on.

To conclude, the FYP is strong on policies that aim at strengthening potential growth. Whether such policies can easily be implemented will be discussed in the next section. The Plan is significantly less strong on policies that address current imbalances. To the extent that such policies are the subject of the Plan, the adjustment seems to be driven heavily by government intervention. As China has successfully emulated the development strategies of other South and East Asian countries, the question arises whether there is something to be learned from the more successful of these countries like Japan and

Korea which from a certain level of economic development have switched from a more developmental approach towards indicative planning based essentially on market-adjustment mechanisms.

5.2 Will the Chinese authorities walk the talk?

While the blueprint for reform spelled out in the Third Plenum and its operationalisation in the 13th FYP make a compelling case for the reforms needed to secure the transition to a new growth model, they say much less on how these reforms will be achieved and implemented. However, this issue is as important as the identification of the needed reforms.

Few governments have the capacity to plan for and implement a multitude of reforms in parallel. The size of China, its governance structure, multilayers of governments and vastly heterogeneous provinces add to the challenge. While China is not subject to the political cycle in the same way as democratic countries are (where elections campaigns appear to be articulated around policies that can secure 'the next election' and the time to undertake difficult reforms may be only a fraction of the time in office), the promotion and 'selection' system within the CPC also creates a suboptimal incentive structure that can be an obstacle to the implementation of crucial reforms. The importance of generating economic growth (to secure promotions) may be one important reason why annual growth targets are typically exceeded at local and provincial levels, while the environmental ones in general fall short of the stated objectives. Moreover, 'growth at any cost', often driven by investment with very low marginal productivity and financed via credits, has contributed at the fuelling of macroeconomic imbalances that China is facing.

The governance system also affects a country's ability to undertake planned reforms. A well-functioning and inclusive institutional system is crucial for the successful implementation of key reforms[8]. In this respect, China's lack of inclusive political institutions has been highlighted as a risk factor that could hinder the transition to a different growth regime (Acemoglu and Robinson (2012)). This does not mean that China has not set up a number of judicial and economic institutions as the economy has developed, but that these tend to operate with "Chinese characteristics".[9] Against this background, there is a high degree of uncertainty concerning China's leadership's willingness and capacity to implement major in-depth reforms.

Questioning the leadership's willingness and commitment to reform may appear at odds with a well-crafted plan in a country run by a political élite that does not have to run for re-election. Still, the economic transition, which goes hand in hand with a slowdown in growth, will create winners and losers and can therefore be politically destabilising. As the Party is ensuring its survival by delivering economic and social stability, it has to secure certain levels of economic growth and job creation. In addition, as the size of the middle class has increased in China, other aspects come also into play (such as the need to foster a greener growth model and to provide more and higher quality services).

Against this background, the pace of implementation of the transition is related to its impact on the paramount stability objective. If the transition can be achieved in an orderly manner - and therefore the risks of social or political upheaval are perceived as relatively small - the Chinese leadership may well see the full implantation of its reform blueprint as its best bet not only to stay in power, but also to perpetuate it over time. On the other hand, if reforms are generating economic and social volatility, the wish to ensure short-term stability may have the upper hand, even at the price of keeping in place an unsustainable growth model. This is because the long term is subordinated to the short-term survival of the ruling élite (a lesson learned by the collapse of the Soviet Union). As economic transitions of the scale we are currently witnessing in China rarely go without conflicts, the tension between short-term volatility and long-term sustainability is shaping China's reform path. There is no guarantee that this path will produce the outcome desired ex-ante by the Chinese leadership: in the end it will be the result of multiple compromises which may or may not produce a stable and politically-viable new growth model.

As regards China's capacity to undertake reforms, its track record has been mixed. China's remarkable economic performance since the late 1970s would not have been possible without a capacity to act, adapt and press ahead with difficult and controversial reforms. For instance, in the 1990s, it was able to escape the Asian financial crisis, while addressing significant home-grown problems in the banking sector[10] and implementing a first round of reforms in the SOE sector in a forceful manner (Lee (2009)). On the other hand, other reforms, dealing for instance with the growing indebtedness of the corporate sector in general and the SOEs in particular, have been more difficult to implement, because of the strong resistance by powerful vested interests (Leutert (2016)) as well as social concerns.

Based on the pace of reform implementation since the announcement of the reform blueprint at the Third Plenum in 2013, the jury is still out as regards Chinese authorities' ability to deliver on promised reforms. Progress has been made in financial sector reform; tackling corruption; cutting red tape; and in improving debt management of local governments. In other areas, such as SOE reforms, curbing pollution; aligning the power and spending responsibilities of central and local governments; rural land reform; as well as reform of the household registration (hukou) system - and notwithstanding the efforts undertaken - substantial measures still have to be taken (Bertoldi and Melander (2015)).

A heavy-handed reaction following the sharp equity market adjustment in June/July 2015, together with an unexpected and disruptive adjustment to China's foreign exchange regime in August 2015, have led market participants to question not only the authorities' ability to deal with an economy that is increasingly driven by market principles, but, if this is the case, their willingness to loosen their grip on economic levers. Ultimately, this crucial question will have to be settled at the highest level. It will determine the speed and direction of the transition.

6. Conclusions

Can China's economic transition be planned? The Brief has tried to show that, because of the growing complexity of the Chinese economy and society, this is close to a "mission impossible". Still, China's transition can be steered and this is what the 13th FYP is trying to do. Whether it will succeed remains to be seen. Significant progress is being made in certain areas (strengthening of social safety nets, financial reform, expanding the service sector) and there is no doubt that some significant economic rebalancing is taking place. On the other hand, the uneven pace of reforms, the increasingly evident limits of the existing system of economic governance, and the persistence of large structural problems (amid large and rising macroeconomic imbalances) raise doubts on whether the 13th FYP will be able to deliver on its objectives.

While a new growth model is taking shape in China, it remains unclear at this stage whether it will be close to that imagined by the CPC leadership and the planning authorities. Even more important, there is no certainty that it will be stable and sustainable.

As an economic tool, the 13th FYP is probably the swan song of 20th century economic planning in its various forms (imperative, developmental and indicative). Should it succeed in steering China's economic transition to a new growth model, then it creates the bases for its gradual demise. Certainly, new five-year plans will be introduced in future, but, in an increasingly decentralised, consumption and service-led economy, an encompassing plan aimed at steering the entire economy and its various components would be unworkable and not make much sense. Even if it becomes fully indicative, the scope of the FYP would have to be downsized, as some of the public goods it is supposed to produce (information pooling, formation of expectations, reduction of uncertainty) can be provided more efficiently by other means, including by private agents. The changing nature of the plan will also require a rethinking of China's economic governance system and the institutions managing it, *in primis* its planning agency, the powerful National Development and Reform Commission. As it has happened already in a number of East Asian countries, the latter will have to relinquish part of its powers to focus on its policy coordination role in favour of a stronger Ministry of Finance, a more powerful and independent Central Bank as well as regulatory and supervisory authorities in sectors such as financial markets, energy or telecommunication.

If the 13th FYP fails to deliver, the usefulness of such an exercise will be put in question. In such a case, either future FYP become quasi-propagandistic documents, where the CPC spells out its priorities for the five-years to come, but real economic policy-making will be in large part divorced from it; or the FYP will be used to reverse the course of reforms and reintroduce stronger forms of command economy. Should this happen, the plan would not lose its centrality in China's decision-making process. However, its role would fundamentally change, as its task would become to ensure that the failed transition does not jeopardise the political stability of the country. The plan would no longer be an instrument to foster policy coordination and steer economic transition, but would rather become a tool to ensure that interests of different economic and social groups are sufficiently satisfied to keep political stability, even at the price of efficiency losses, growing imbalances and/or environmental degradation.

Whatever the outcome, to remain relevant in the economic governance of the country, China's planning will have to reinvent itself (for instance, does it still make sense to have, as in Soviet times, a fixed planning period when medium-term challenges can span from two to ten years?), and adapt to the conditions of an increasingly sophisticated middle-income economy still in quest of a sustainable growth model.

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[1] According to Soviet Union's official statistics (whose reliability is doubtful), electricity expressed in billions of Kw passed between 1927 and 1933 from 5 to 13, coal (million tons) from 35 to 64, oil (million tons) from 12 to 21 and steel (million tons) from 4 to 6. See Cheremukhin, A, M Golosov, S Guriev, and A Tsyvinski (2013), "Was Stalin Necessary for Russia's Economic Development?", NBER Working Paper No. 19425 and Acemoglu, D, and J Robinson (2012), *Why nations fail: The Origins of Power, Prosperity, and Poverty*, Crown Business.

[2] Mao Zedong was among the founding fathers of the Communist Party and of the PRC, which he ruled until his death in 1976. In reaction to Mao's autocratic leadership style (and the outcome of e.g. the GLF and the Cultural Revolution), the CPC opted for a collective leadership thereafter.

[3] Woodhall (2014) identifies a sequence of stages for the developmental state: "During Stage 1, the primary task is to erect the institutional scaffolding to nurture strategic industries and sectors. In Stage 2, export-led growth brings industrialisation along with predictable consequences, including badly degraded environment and friction with trading partners. As a result, during Stage 3, state actors must decelerate the high-growth machine and liberalise some of its mercantilist components … [In] Stage 4 state actors will be pressed to address the challenges of globalisation and sustainable development" (p.5).

[4] Former Premier Wen said already in 2007 that China's growth model was "*unbalanced, uncoordinated and unsustainable*". For instance, the Gini index rose from 32.4 in 1990 to 42.6 in 2002 and has remained basically unchanged thereafter (Naughton, 2007), while the share of total income held by the top 10% increased from 25.3% to 30% according to ILO data. Moreover, China became the largest CO2 emitter in 2006 and was also the largest coal producer and consumer; contributing to soaring air, land and water pollution (where UNEP estimates that 75% of river water is unsuitable for drinking or fishing, while about 40% of the population lives in regions facing water scarcity (West J., Schandl H., Heyenga S. and Chen S. (2013), "Resource Efficiency: Economics and Outlook for China", UNEP).

[5] The seven priority industries identified in the 12th FYP were: new energy; energy conservation and environmental protection; biotechnology; new materials; IT, high-end equipment manufacturing and clean energy vehicles. The aim was to enhance their contribution to growth from 2% to 8% of GDP by 2015.

[6] The Chinese State Council introduced an RMB 4 trillion (corresponding to US$586 billion) stimulus package in Nov. 2008. The two-year package, supporting ten sectors incl. infrastructure and social welfare, was the largest set of measures ever taken in China.

[7] In its 2016 Article IV report on China, the IMF lists a number of "rising vulnerabilities" incl. high and rising credit growth; a propensity for asset-price booms; an increasingly large, leveraged and opaque financial system; and the stress among esp. SOEs in sectors and region with overcapacity.

[8] See e.g. Rodrik (2008) underlining that it is markedly more difficult to "sustain" than to "ignite" growth during the earlier part of catching up, with the former requiring much better institutional underpinning to "maintain productive dynamism and endow the economy with resilience to shocks over the longer term."

[9] See e.g. Ling Li (2015) on how the Party's supremacy over the state makes judicial independence close to impossible in China.

[10] Wang Qishan, who is heading the current anti-corruption, became first known outside China when successfully managing sizeable non-performing loans of various SOEs in the Guangdong province at the time of the Asian crisis.