

By Invitation

# Why Xi is pushing for high quality growth

Breakneck first phase is over and now China has to clean up and switch to a more sustainable growth model, but that too has its challenges



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In his address at the 19th Party Congress last year, President Xi Jinping made a push for environmentally sustainable development as part of a slate of many new policy initiatives for China.

“Human beings must respect nature and observe the laws of nature... Any harm we inflict on nature will eventually return to haunt us,” he said in his call for accelerated efforts to promote green development.

China’s future modernisation must be characterised by “harmonious coexistence between man and nature”, Mr Xi stressed as he made the case for a new “ecological civilisation” for a “beautiful China”.

This was no mere political rhetoric. Mr Xi was really serious about green development as evidenced by the array of proposals and other policy follow-ups to achieve his goal. These included establishing a more effective legal framework to promote green production and green consumption as well as a sound structure to support a low-carbon, high quality economy, which he has termed “circular development”. He also held out the promise of green technology innovation and green finance to promote energy-saving and environmentally friendly industries.

At the annual Economic Work Conference on Dec 18, Mr Xi’s green development initiatives were translated into new policy priorities for this year, with the pursuit of “high quality economic growth” as the main focus.

The government has made it clear that future economic development is not aimed at maximising GDP growth in quantity terms but a better, higher quality growth, with “green GDP” playing a bigger part.

China’s growth of the past four decades, starting with Deng Xiaoping’s economic reforms in 1978, has indeed been spectacular, with its gross domestic product growing at near double-digit rates for some 35 years. With such dynamic growth, China is now the world’s foremost manufacturing powerhouse and the world’s second largest economy. It is living testimony to the legacy of Deng, who captured it neatly in two of his well-known aphorisms: “Development is China’s bottom line” and “To get rich is to be glorious”.

For leaders of developing countries, high growth is a much

sought after goal as it creates employment and facilitates institutional and social reforms. But China has also had to pay a very high price for its relentless pursuit of high growth.

China today, being the world’s largest primary energy consumer, is also the world’s largest carbon emitter, accounting for one-quarter of total global carbon emissions. Its environment has borne the brunt of unbridled growth as manifested in severe air, water and land pollution. The smog in its big cities is estimated to have caused 1.5 million premature deaths a year.

To most Chinese citizens, Mr Xi’s call for higher quality economic growth is all about introducing measures to reduce pollution and improve the environment. But the whole issue is far more complicated.

It is also about introducing new policy models that will change the nature of future economic growth in order to realise Mr Xi’s goal.

What are the challenges and implications of this shift?

## MEASURING GREEN DEVELOPMENT

Economic growth is essentially increases in GDP over a period of time. For high quality growth, the total GDP has to include more “green GDP”, that is economic activities that are more environmentally friendly or are considered to have positive social impact. But such a way of accounting for high quality growth is easier said than done.

The conventional GDP measurement just counts all final economic activities (or total value-added) at market prices. The process is supposed to be largely value-free and morally neutral when counting those economic activities.

Economists have tried to devise a new system of GDP accounting to include more economic activities (for example, culture and health) with greater welfare content. But such an exercise is fraught with many conceptual and empirical difficulties. It is hard to measure or price these socially more desirable economic activities. It is even harder to compare those kinds of GDP across nations.

At most, a separate “green development index” can be prepared as an appendix to conventional national income accounts. GDP alone just cannot adequately measure quality growth.

Even the very concept of economic growth itself is not free from controversy. For the developing world, economic growth is unreservedly welcome for providing basic needs and poverty reduction. For a mature developed society, however, many intellectuals would not unquestioningly embrace high growth, especially the idea of growth for growth’s sake.

Economist Edward Mishan was an early critic of economic growth. In his book *The Cost Of Economic Growth* (1966), he argued that



economic growth in creating material goods would also be offset by many negative effects from the loss of happiness and peace of mind to the loss of greenery and fresh air. His arguments preceded the Green Movement today.

More formal discussion of the underlying problem of high quality

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growth can be traced back to the Cambridge economist Arthur Pigou, who highlighted a simple but highly significant social truth: Interests of individuals and society do not always coincide.

When an individual is maximising his economic welfare, there arises a divergence between maximising “net private marginal benefit” and the “net marginal social benefit”. This gives rise to “spillover effects” that are today called “externalities”. Pollution is one example of an unintended side effect from a given economic activity.

This in turn leads to debates about having a tax to compensate the public. Such is the Pigouvian tax, which preceded the carbon tax today. But it is not easy to account for all these side effects.

Suffice it to say that any attempt to identify and measure “high quality economic growth” is fraught with enormous conceptual and empirical difficulties.

## CHINA’S PRAGMATIC APPROACH

Given these challenges, what is China doing to shift its economy towards high quality growth?

The policy measures are essentially pragmatic in nature and involves a three-pronged strategy.

The first, launched a few years ago, involved a direct assault on pollution. Back in early 2014 when Beijing was hit by severe smog, the central government made a decisive break from the past: It declared a war on pollution and backed that up with tighter regulations and stricter enforcement.

The government dispatched “environmental inspection teams” to assess conditions in various parts of the country. Local governments were issued the new environmental guidelines and held responsible for any infraction.

Meanwhile, action was also taken to shut down polluting plants and to replace traditional coal-burning household heating systems with new devices run on natural gas or electricity. The results were almost immediate. Beijing’s air quality has since remarkably improved, with the number of blue-sky days increasing every year.

The second prong involves providing the right macroeconomic environment for high quality

growth. Essentially, this is about restructuring China’s investment-driven growth to one that is more consumption oriented.

Last year, consumption contributed over 60 per cent of the nation’s 6.9 per cent GDP growth. The growth in consumption is tied to the rise of the service sector at the expense of manufacturing. Overall, this switch in China’s engine of growth allows for a more sustainable, greener economy.

However, most service activities are domestic activities, which are, technically speaking, also “non-tradeable”, with low productivity growth potential. Lower productivity growth ultimately translates into lower economic growth. As a result, higher quality growth invariably carries trade-offs for lower growth, as happened in most developed economies.

In the long run, high quality growth needs to be sustained by a “dynamic” macroeconomic environment that is competitive and productivity driven.

Thus, the third policy package to support high quality growth involves long-term policies that promote innovation and rapid technological progress, especially for the digital “New Economy”.

During the transition, the government will continue to strengthen existing policies of financial deleveraging, capacity reduction and “supply-side reform”. The longer-term target is China’s own version of “Industry 4.0”, which involves strategies of transforming the current “Made in China” model to “Created in China” by 2025.

## REGIONAL PERSPECTIVE

China is moving along a path once taken by the developed East Asian economies of Japan, South Korea and Taiwan. They too suffered serious pollution and environmental degradation during their initial phase of industrial take-off. Young Japanese today will be surprised to learn that in the early 1970s, air quality in Tokyo was so foul that there was a market for small packets of oxygen sold at busy traffic junctions.

With successful development comes a natural push for high quality growth. As income rises and the middle class expands, the demand for a better quality of life also rises. Successful development also creates more resources for the government to clean up the environment. Government officials and political leaders also have their built-in incentives to fight pollution, because they breathe the same air and drink the same water as the common people.

What we are seeing now in China is the latest iteration of East Asia’s development strategy is: Develop first, clean up later.

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