

China's Economic Transformation and Reform Orientation-From Industrial Leading to Service Leading

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Abstract: At present, China's economic development is at an important historical turning point. Facing the new situation of complex and changeable internal and external development environment, how to accurately understand the characteristics of the new normal economy, and to cultivate leading industries to support China's economic development, are key issues which must be addressed at the starting point of the new development stage. Through research and analysis in this paper, it is found that service industry is qualified to lead China's economic transformation and serve as the growth momentum.

1. The Research Questions

Over the past 30 years and more since reform and opening-up, China has made remarkable achievements in its development; economic and social development has maintained a steady and rapid growth. Successfully overcame the poverty trap, China has transformed from a low-income country to a upper- middle income country, and entered the middle and late stage of industrialization. [In 2010, the World Bank grouped countries with different income levels according to their gross national income (GNI) per capital. Countries with GNI below \$1005 are low-income countries; with GNI between 1006-3975\$ are lower middle income countries; with GNI between \$976 and \$12275 are high middle income countries; with GNI more than \$12276 are rich countries.] At the same time, the economic development of China has entered the new normal state; economic transformation and driving force shifting have aroused interests among economists. In the future, will China's economy still be dominated by the second industry? Can the service sector become a new impetus of economic development? These issues deserve in-depth research and discussion.

Gang Li (2013) believes that by 2020, the main driving force of China's economic growth will still be the secondary industry. The tertiary industry is difficult to become the driving force of China's economic growth. [1] Zeng Lin, an expert at the China Research Center in Meccato, Germany, argues that the impact of China's service sector is overestimated. The main reason of high proportion of the service sector in China's GDP is the decreased impetus in manufacturing and other industries. The service sector only maintains steady growth. Zuo-jun Li and Yun Wei (2014) believe that in next decade, the leading industries of China will be high-end manufacturing, high-tech industries and modern services, of which the modern service industry has the greatest development potential. [2] Shou-lian Tang (2014) studied the development of service industry in United States, Britain, France, Germany as well as other countries and regions in post-industrial society, and found that in these countries and regions, service industry is positively related to economic growth level; the proportion of added value of service industry is positively related to income level; the proportion of industrial added value is negatively related to income level. He believes that the post-industrialized society is dominated by service industry; the third industry plays a decisive role in the development of post-industrialized societies. [3] Radi, an American think-tanker and senior researcher at the Peterson Institute for International Economics, believes that service industry will become the biggest driver of China's economic growth and will continue to play an important role.

From the perspective of economic development history, after the mid-term of industrialization, all advanced countries have realized the transformation from industrial economy to service economy. According to the research of Chenery and his colleagues, when the economy development of a country enters the middle and late stage of industrialization, its service industry will show a trend of accelerated development. [4] The transformation from a big industrial country to a big service country is an important basis of China's new normal economy, a major symbol of our modern economic structure, and an important condition for China to stride across the middle-income trap and become high-income countries. According to Maslow's hierarchy of needs theory, people must pursue for the satisfaction of spiritual needs after their physical and material needs are met. The development experience of developed countries shows, when the per capita GDP reaches a certain level, the consumption structure gradually will become a development-oriented and enjoying one; the focuses of residents' consumption will shift to education, culture, health and other fields. That transformation provides a broad space for the development of modern service industry.

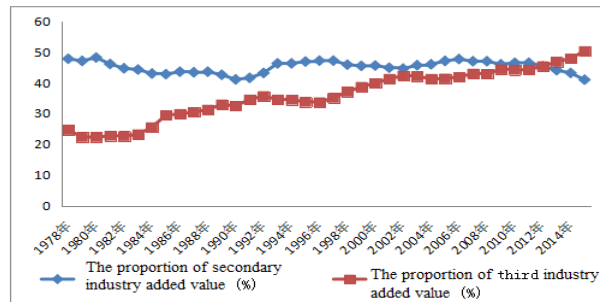


Figure 1. The proportions of second and third industries to China's GDP from 1978 to 2015

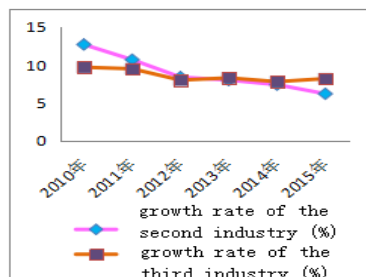


Figure 2. Growth rates of the second and third industries from 2010-2015

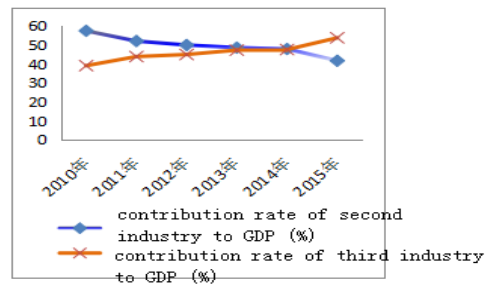


Figure 3. Contribution rates of the second and third industries from 2010-2015

2. Development Characteristics of China's Service Industry

2.1 The trend of service-led economy.

As China enters into the stage of new normal, the service industry is becoming more and more important to economic development. In terms of the proportion to GDP, the proportion of added value of service industry to GDP is becoming increasingly higher. In 2012 the number was equal to the proportion of secondary industry; in 2013 it exceeded the proportion of secondary industry for the first time. In 2015 the proportion reached 50.2%, exceeded the proportion of secondary industry by nearly 10 percentage points. A service-led economic pattern was initially formed. In terms of the growth rate, the growth rate of the secondary industry showed a downward trend during the 12th Five-Year Plan period, while the growth rate of the tertiary industry was relatively stable, and exceeded that of the secondary industry in 2013. In terms of the contribution rate to GDP growth, the contribution rate of the secondary industry declined continuously during the 12th Five-Year Plan period, while the contribution rate of the service industry to economic development increased continuously. In 2014, the contribution rate of the service industry to economic development was

basically equal to that of the secondary industry. In 2015, the contribution rate of service industry reached 53.7%, exceeding 12.1 percentage points of the contribution rate of secondary industry. It can be seen that under the background of new normal, the service industry plays an increasingly important role in promoting economic development. In the future, the service industry will continue to expand its influence on economic development

Table 1. Consumption composition of Chinese urban residents in main years (unit: %)

index	1990	1995	2000	2010	2011	2012	2013	2014	2015
Food consumption (%)	54.25	50.09	39.44	35.67	36.32	36.22	30.13	30.05	29.73
Garment consumption (%)	13.36	13.55	10.01	10.72	11.05	10.94	8.40	8.15	7.95
Residence consumption (%)	6.98	8.02	11.31	9.89	9.27	8.90	23.27	22.48	22.09
Household and facilities articles consumption (%)	10.14	7.45	7.49	6.74	6.75	6.69	6.11	6.18	6.11
Healthcare consumption (%)	2.01	3.10	6.36	6.47	6.39	6.38	12.54	13.21	13.53
Transportation and Communication consumption (%)	1.2	5.18	8.54	14.73	14.18	14.73	10.75	10.73	11.14
Cultural, educational and entertainment consumption (%)	11.12	9.36	13.40	12.08	12.21	12.20	6.15	6.54	6.75
Other consumption(%)	0.94	3.25	3.45	3.70	3.83	3.94	2.65	2.66	2.70
# Living consumption (%)	67.61	63.64	49.45	46.39	47.37	47.16	38.53	38.20	37.68
Development consumption (%)	32.39	36.36	50.55	53.61	52.63	52.84	61.47	61.80	62.32

Table 2. Consumption compositions of Chinese rural residents in main years China (unit: %)

index	1990	1995	2000	2010	2011	2012	2013	2014	2015
Food consumption (%)	58.81	58.63	49.13	41.09	40.36	39.33	34.13	33.57	33.03
Garment consumption (%)	7.77	6.85	5.75	6.03	6.54	6.71	6.06	6.09	5.97
Residence consumption (%)	17.35	13.90	15.47	19.06	18.42	18.39	21.11	21.03	20.99
Household and facilities articles consumption (%)	5.29	5.23	4.51	5.34	5.92	5.78	6.08	6.04	5.92
Healthcare consumption (%)	1.44	2.58	5.57	10.52	10.48	11.05	11.69	12.08	12.61
Transportation and Communication consumption (%)	5.37	7.81	11.18	8.37	7.59	7.54	10.08	10.25	10.51
Cultural, educational and entertainment consumption (%)	3.25	3.24	5.25	7.44	8.37	8.70	8.93	8.99	9.17
Other consumption(%)	0.72	1.76	3.14	2.15	2.32	2.50	1.92	1.95	1.8
# Living consumption (%)	66.58	65.48	54.88	47.12	46.90	46.04	40.19	39.66	39.00
Development consumption (%)	33.42	34.52	45.12	52.88	53.10	53.96	59.81	60.34	61.00

The rapid growth of service consumption. After 38 years of rapid economic growth, the Chinese society has successfully transformed from survival stage with main objective of solving the problem of food and clothing to development stage with an important objective of solving the problem of development. The consumption type has upgraded from live model to development model. (Living consumption mainly includes food and clothing consumption; development consumption includes consumption of housing, household equipment, health care, transportation and communication, cultural, educational and entertainment, as well as other services consumption.) From Table 1 and Table 2 it can be seen, the per capita consumption expenditure of urban residents in living consumption accounted for 67.61% in total consumption expenditure of 1990, while in 2015 the figure decreased to 37.68%. The proportion of development consumption increased from 32.39% to 62.32%. The per capita consumption of rural residents in living consumption accounted 66.58% in total consumption expenditure of 1990; the figure decreased to 39% in 2015. The proportion of development consumption increased from 33.42% to 61%. In the next 5 to 10 years, with the

acceleration of population urbanization, the development-oriented consumption demand of urban and rural residents will increase at an average double-digit rate per year.

The consumption demand is upgrading from material consumption to service consumption. This paper takes the service demands of urban and rural residents in three aspects, namely medical care, transportation and communication, as well as culture, education and entertainment as the example. For urban residents, from 1993 to 2015, the per capita consumption expenditure increased by 19.5% annually. The average annual growth rate on medical care, transportation and communication, as well as culture, education and entertainment expenditure was 26.05%, which exceeded the growth rate of per capita consumption expenditure by 6.55 percentage points. For rural residents, the average annual growth rate of per capita consumption expenditure was 21.05%. The average annual growth rate of expenditure of medical care, transportation and communication, as well as culture and education and expenditure was 29.54%, which exceeded the growth rate of per capita consumption expenditure by 8.49 percentage points. It shows that the consumption of Chinese residents is gradually changing from material consumption to service consumption.

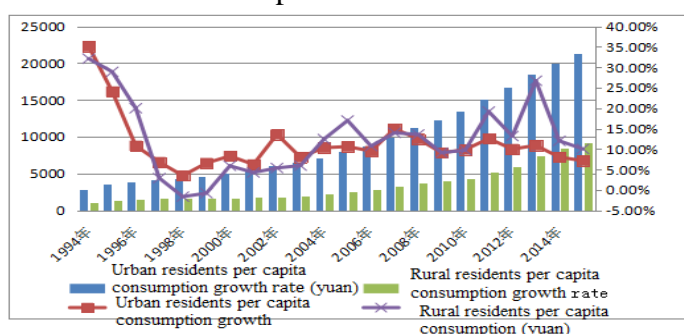


Figure 4. Per capita consumption levels of urban and rural residents and growth rates from 1994 to 2015

2.2 Population urbanization facilitates the development of service industry.

According to international experience of urban development, if the urbanization rate lies between 30% and 70%, the urbanization process is in the stage of accelerated development. According to statistic data released by the National Bureau of Statistics, the urbanization rate of China's permanent population in 2015 was 56.1%, about 1.2 percentage points higher than the world average. China is in the period of rapid urbanization development. If the new urbanization construction grows at an average annual rate of 1%-1.2%, the urbanization rate of China's permanent population will reach more than 60% by 2020. Judging from the development experience of past years, every one percentage point increase in the urban rate of the permanent population will lead to 0.77 percentage point increase in the proportion of service industry added value. [5] It is estimated that even if the urbanization rate of population increases by only about 4 percentage points in next four years, the service sector's share of GDP will probably increase by about 3 percentage points. During the 13th Five-Year Plan period, with the rapid transformation from large-scale urbanization to population urbanization, China's "semi-urbanization" means that nearly 400 million migrant workers will enter the city. On one hand, population agglomeration, the transformation of production mode and the improvement on residents' living standards provide huge development space for commerce and trade, catering, real estate, education, culture, sports, health care and other industries. On the other hand, the agglomeration of industries, the refinement of social division of labor and the improvement on population quality will bring great opportunities for the development of producer services such as logistics, finance, information, intermediary and technical services.

2.3 Service industry has become the major sector of employment.

In the past 10 years, the employment figure of service sector has been increasing continuously. The figure reached 272.82 million in 2011, exceeding the figures of agricultural and secondary industry employment for the first time, and becoming the largest employment sector in national

economy. In 2015, the employment figure of service sector reached 328 million 390 thousand, accounting for 42.4% of the total number of employed persons. From the perspective of new employment, in recent years, more than 5 million people are employed by the service industry in each year, which is equivalent to the number of new employment in the secondary industry. The service industry has become a main channel of employment.

In 2013, China's service sector accounted for 46.1%, exceeding the proportion of the secondary industry for the first time. It is a milestone in the industrial restructuring and upgrading of China. Now we cannot say that Chinese economy has shifted from the industrial-led pattern to a service-oriented economy, but the process is undergoing and accelerating. In the future, the service sector will become the driving force for China's economic development.

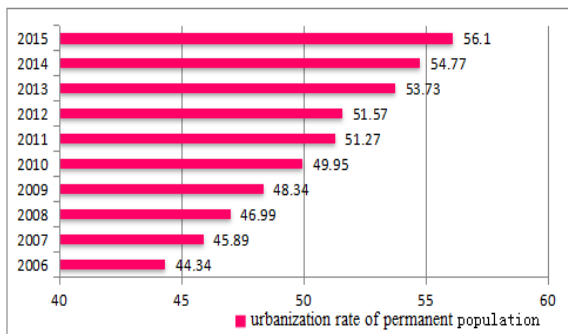


Figure 5. China's urbanization levels from 2006 to 2015

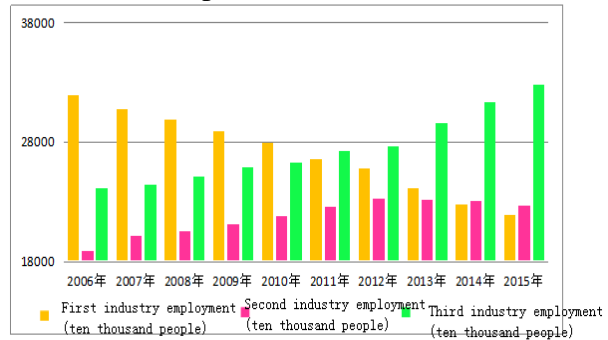


Figure 6. Employment in three industries from 2006 to 2015

3. Main Factors Restricting China's Service Industry to Become the Leading Industry

Although the proportion of service industry in China reached the historical peak of 50.2% in 2015, it was still far below the average level of 70.1% in developed countries in 2000. Compared with BRICS countries with similar development levels, the proportion of China's service sector is also on the low side. In 2013, the service sector accounted for 69.3%, 60.3% and 57% in Brazil, Russia and India respectively. In South Africa the number was as high as 68.3% in 2011. In terms of contribution rate, the contribution rate of Chinese tertiary industry in 2015 was 53.7%, lower than that of South Africa, India, Brazil and Russia. Under the background of new normal state, there are many factors that restrict China's service industry to become the leading industry.

The traditional development concept emphasizes heavy industry over service industry. Traditional Marxist theory holds that only manufacture, agriculture, construction, transportation as well as post and telecommunication industry are material production sectors; many areas of service industry are regarded as non-productive activities since they do not create values. The influence of that theory continues to present day. In the past 38 years of reform practice, China has formed a set of economic growth mode with GDP as the main goal. Local fiscal revenue growth and cadre assessment are the restraint and incentive mechanism, with administrative intervention and promotion as main methods. In that economic growth mode, the government has formed the development concept of focus on heavy industry rather than light and service industries, and pursue for large industrial projects to promote GDP growth. So far, in many places and departments, the service industry has not been regarded as an important industry. Many people take service industry as public welfare or pure ideology. Thus, many industries in the service sector rely too much on government input and are lack of self-development mechanism.

Low marketization degree; administrative monopoly is a universal phenomenon. To solve the structural contradictions faced by China's economic transformation, we need to speed up the opening of service industry market. At present, the degree of opening of industrial sector is about 80%, while the degree of opening of service sector is about 50%. The monopoly structure has not been broken in half of the service department. The marketization degree is relatively high in some traditional

industries, such as wholesale and retail trade, catering, transportation and some social services industries. Apart from these sectors, the marketization degree of many service industries is relatively low. At present, the financial, telecommunications, railway, civil aviation, education, publishing, health, media and other industries are basically in the state of monopoly and management control; the efficiency is low. For instance, at this stage, the marketization degree of China's environmental sanitation service industry is only 20%.

The service industry is not open enough; its international competitiveness is weak. China has become the world's largest country in trade in goods, but the scale of trade in services is still on the low side. In 2015, trade in services amounted to 713 billion US dollars, accounting for only 18.04% of the total trade. The value was lower than the global average. In terms of the total amount, foreign direct investment (FDI) in service industry is expanding continuously. In 2011, FDI in service industry reached 58.55 billion US dollars, accounting for 50% of all FDI, surpassing the foreign direct investment in manufacturing industry for the first time. However, the potential for China's service industry in attracting foreign direct investment is not fully explored; investment funds cannot obtain enough benefits. At the same time, in China, there are few service sectors open to the outside world. Of the 160 service sectors, China promised to open about 100 sectors when it joined the World Trade Organization, but only less than 30 sectors were fully open without conditions. [6]

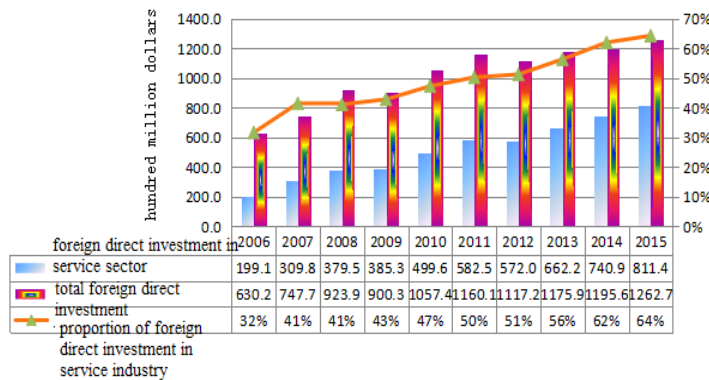


Figure 7. Foreign direct investment in China's service sector from 2006 to 2015

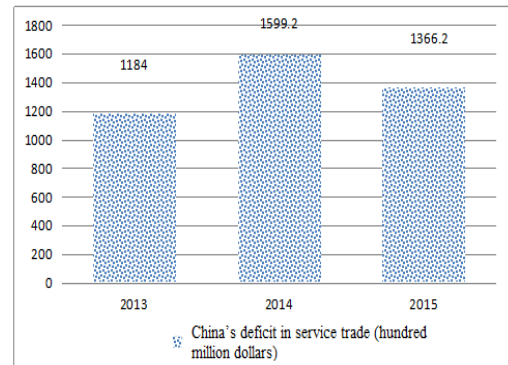


Figure 8. China's deficit in service trade from 2013 to 2015

The growth of service trade is still driven by domestic demand; the growth rate of import is higher than that of export. China's service trade has been in deficit for 20 years from 1995 to 2015; the scale of the deficit has been expanding. In 2013, the service trade deficit rose to a record of \$118.4 billion, accounted for 21% of the total volume of trade in services, ranking first in the world. In 2015, it reached \$136.62 billion, still ranking first in the world, and has maintained at the level of more than \$100 billion for three consecutive years. It shows that the competitiveness of China's service products is still low.

Table 3. Trade surplus/ deficit in service industry of major countries and regions in 2015

Unit: billion dollars

Country	Export value	Share of world exports	Import value	Share of world imports	trade surplus/ deficit
World	4675	100%	4570	100%	+105
USA	690	14.80%	469	10.30%	+221
The Great Britain	341	7.30%	205	4.50%	-84
China	288.19	4.90%	424.81	9.60%	-136.62
Germany	246	5.30%	292	6.40%	-46
France	239	5.10%	224	4.90%	+15
Japan	158	3.40%	174	3.80%	-16

4. Countermeasures and Suggestions to Promote China's Transformation from Industrial Leading Economy to Service Leading Economy

Liberating minds and changing ideas. The transformation of service industry from supporting to leading industry is an inevitable trend of social development. At present, the service industry has exceeded manufacturing industry and become the largest industry in national economy in both value added and employment figure. Government departments at all levels should further understand the importance of developing service industry, enhance the sense of responsibility and urgency on developing modern service industry, and make efforts to promote the development of service industry. The development of service industry should be regarded as a long-term, strategic task and be promoted with renewed concepts, ideas and measures.

Breaking the monopoly in service sector and introducing social capital to revitalize the industry. The development of service industry needs financial support; China has huge potential in social capital. Therefore, we should seek for a multi-channel, multi-level and multi-form investment mode, accelerate the strategic adjustment of state-owned capital in service industry, encourage transnational corporations to participate in the reorganization and transformation of state-owned service enterprises, expand the scale of foreign capital utilization in service industry, and open monopoly industries to social capital in an all-round way. We should try our best to revitalize social capital. All kinds of social capital should be allowed to enter the service sector on an equal footing; social capital should be encouraged to participate in infrastructure construction such as transportation and communications, in municipal utility such as urban water, gas and heat supply systems, and in social undertakings such as education, health, culture and sports.

Promoting institutional innovation in the service sector and creating favorable development environment. In the 13th Five-Year Plan period, external competitive environment and internal development conditions are changing and becoming increasingly complex. We should speed up the reform of service industry system and mechanism, promote institutional innovation through government purchase, and stimulate the internal vitality of service industry. When formulates industrial policies, the authority should give priority to the development of most areas in service industry, break up the industrial-led mechanism as soon as possible, accelerate the formulation and implementation of active guidance policies, so as to promote the development of service industry, and implement necessary preferential policies, so as to create a favorable environment for the development of service industry.

Speeding up the pace of opening up; forcing the industry to reform through opening up. For the third industry, openness can bring innovate ideas, and promote the competition and integration of domestic service industry. Therefore, China should adapt to the requirements of economic globalization, actively undertake the transfer of international service industry, and promote the development of service industry through reform and opening up. We should gradually open banking, insurance, securities, telecommunications, commerce, tourism, medical care, education, accounting, auditing, asset appraisal, international freight forwarding and other industries. We should actively encourage service enterprises with comparative advantages and conditions to go abroad to explore international markets and participate in higher-level cooperation and competition. We should also constantly increase the proportion of trade in services in the total export volume.

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