

The 14th Five-year Plan in the New Era of China's Reform

Asian Integration, Belt and Road Initiative and Safeguarding Multilateralism

Michel Aglietta, Guo Bai & Camille Macaire

Summary

China's 14th Five-Year Plan aims to inaugurate a structural change from intensive accumulation to innovation-driven growth, with two basic objectives: developing the domestic consumer market for an enlarged middle class, on the one hand; on the other, promoting the Belt and Road Initiative (BRI).

This is the "dual circulation" towards the 2035 long-run objective of achieving a socialist market economy, embedded into an "Eco civilization".

Concerning the domestic part of the strategy, China is pledging innovations combining political ecology and digital economy to handle climate change in pursuing an upgraded commitment to the Paris Agreement. For this ultimate goal, R&D spending is being strategically reinforced.

The international part aims at restructuring globalization towards a new geopolitical order. It is structured in three hierarchically intertwined steps. The first is the economic integration of Asia within the Regional Comprehensive Economic Partnership (RCEP), the largest trade agreement worldwide. The second level is the diversified network of infrastructures linking Asia, Africa and Europe along and around the old Silk Roads. The third part is the transcontinental network linking the Atlantic and the Pacific oceans through the Arctic Road and the Central and Latin America networks.

To succeed, this monumental project needs multilateral cooperation to overcome the huge financial leverage it is generating. Trust will be of the essence in attracting private capital. A tentative advance in Sino-European cooperation has been occurring within an agreement to expand mutual investment opportunities.

All in all, China is looking for a strategic repositioning into the global multilateral framework so that the Middle Empire returns to the center of the world.



In observing China, foreigners believe in a catching-up going forward, while it is, in fact, a restoration proceeding.¹ The World Bank has announced that China will change its status from an emerging market economy to an advanced economy before the end of the 14th Plan (2021–2025), given that its GDP per capita already reached US\$12,536 in 2019. Of course, GDP per capita in purchasing power parity (ppp) is much higher, at \$16,804.

The “new era” of China’s reform had started by late 2013, with Xi Jinping’s access to ultimate power.

Its foundation was laid down during the 13th Plan. Therefore, this policy brief will first show the continuity between the 13th and 14th Plans, before presenting the novelties of the 14th Plan in the domestic economy and in the international arena. The new concept linking both dimensions is *dual circulation*: it is the pivot of the 14th Five-Year Plan, first discussed by the CCP’s central committee on October 26-29, 2020, then by the National People’s Congress (NPC), which approved it in its March 2021 session.

The 14th Plan is a hinge stage in China’s reform for several reasons. First, it pursues and deepens the objective of the “new era” that started with the 13th Plan: changing the growth regime from capital-intensive accumulation, boosted by manufacturing exports within global value chains, to an innovation-led economy, enhancing total factor productivity driven by domestic consumption and the development of services. Drawing mainly on domestic resources would be a fundamental change in China’s growth regime. The 14th Plan inaugurates the addressing of long-run challenges both nationally and internationally – hence the concept of dual circulation.

Technologically, on the supply side, the 14th Plan envisages self-reliance in critical technologies, despite the economic cold war with the US. On the demand side, the shift to an advanced economy requires social policies to reduce inequalities between provinces and between social classes in the world’s largest domestic consumer market, sustained by a middle class of 400 million, in order to reach the 2035 goal of a socialist market economy.

Furthermore, the strong commitment to embark on a major energy transition is extremely important for the planet. Although the pledge of reaching carbon neutrality in 2060 is an enormous challenge that could be difficult to meet, this official long-term goal still commits China to an ambitious investment path in the production of renewable energy and electricity distribution, low-carbon transport and housing renovation, agricultural production and the restoration of natural habitats. In confirming this development, the 14th Plan puts China on the path to reaching its first-phase goal of capping emissions by 2030. It thus adds a new dimension to a “political ecology” seen by the

Chinese authorities as an integral part of the “socialist market economy”.

The above-stated objectives make the first part of the dual circulation. The second part concerns China’s view of the reorganization of international relationships. The weakening of the hegemonic posture and protectionist retreat of the United States in recent years has opened a new field of influence for China. Beijing is supporting countervailing forces, aiming at strengthening ties with the rest of the world, in particular emerging countries. This is why the second dimension of the double circulation is of utmost importance.

For China’s response, the core of the matter is the economic integration of Asia provided by the signing of the trade agreement RCEP (Regional Comprehensive Economic Partnership), which is the largest trade agreement in the world. It encompasses eastern Asian and most ASEAN countries (except for India) and extends to Australia and New Zealand. The countries involved do more than half of their foreign trade

between them and amount to 30% of the world population. China hopes to be the center of this trade zone in pursuing its financial opening and the joint internationalization of the renminbi.

Beyond the advancement of regionalization, China will pursue the BRI (Belt and Road Initiative) project. It is planned to be the framework of a “new globalization”, grounded in a “new type of multilateralism” based on reinforcing bilateral relations. For Beijing, this strategy aims at supplanting the neoliberal model that the 2008 Great Financial Crisis (GFC) has already been shaking.

This policy brief proceeds as follows. We first review the legacy of the 13th Plan and how it relates to the 14th Plan. Section three presents the general objectives of the 14th Plan and the principle of dual circulation, while the next two sections detail the domestic and international dimensions of the plan and their internal consistency.

■ 1. The legacy of the 13th Plan: regional disparity and convergence

Despite a collapse in economic activity in the first quarter of 2020 due to the Covid-19 pandemic, the Chinese economy has recovered faster than expected, and much faster than Western countries, thanks to the effective pandemic-control strategy and strong policy support,² with 2.3% growth in 2020 and 8.1% expected in 2021 by the IMF. However, the recovery has been uneven, highlighting pre-existing structural imbalances between sectors and regions.

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(1) See Kissinger (2011), *On China*, New York: Penguin Press.

(2) IBRD, World Bank Group (2020), *From recovery to rebalancing: China’s economy in 2021*, December.

1.1. The objectives of the 13th Plan and the pervasive structural problems

The 13th Plan had six objectives characterizing the launching of the “new era”. The huge stimulation plan in 2009, to preserve growth after the global Great Financial Crisis (GFC), had worsened imbalances in favor of debt-financed infrastructure investments, generating over-borrowing both by enterprises and local governments.

In November 2013, the central committee of the CCP issued directives inaugurating the new reform period up to the 2035 horizon.³ The launching of the 13th Plan was the start of a new course of reform. Of its six objectives, the first and most important was the shift from intensive capital accumulation to innovation-led growth to enhance total factor productivity (TFP). The second was spatial development to integrate urban and rural areas, and to reduce the disparities between provinces. The third was green development for a low-carbon economy. The fourth was inclusive development to eradicate poverty and reduce inequalities. The fifth was financial reform and reduced indebtedness.⁴ The sixth was opening up to attract foreign investment and encourage Chinese enterprises to invest abroad.

The first and fourth objectives imply a transition from quantitative to qualitative growth, accompanied by fundamental social reforms to reduce inequalities. The government had announced the doubling of GDP per capita in the decade 2011–2020. Therefore, it retained a quantitative GDP growth objective when the central committee defined the objectives of the 13th Plan in October 2013. Household consumption increased a lot up to 2019, and the external surplus was limited to under 2%, from 7% in 2007. In 2020, household income per capita reached 43,834 yuan, against 19,109 yuan in 2010,⁵ more than doubling the 2010 level that was the objective of the 13th Plan. In real terms, official data from the National Bureau of Statistics points to a 2.1% increase per year of real disposable income per capita during the 13th Plan (2016–2020). Expressed in US dollars, the NBS shows household consumption per capita increasing from \$2,041 in 2010 to \$4,063 in 2019, before a weakening in 2020 due to the pandemic, as in other countries.

The “trade war” and “technological war” initiated by the US had important sectoral implications, yet little impact on the overall balances, mainly determined by domestic saving/investment disequilibria.

In China, the rise in consumption proceeded from a sustained increase in wages since 2010 (the average annual salary of

urban employees almost tripled to 90,000 yuan in 2019). A further rebalancing required either a deceleration in investment or a reorientation from low-return to higher-return investments. The boom in real-estate prices disturbed the rebalancing process in boosting asset prices and the wealth of owners, while reducing the income of borrowers via higher mortgage payments. Meanwhile, the net marginal return of capital did not improve

for small to medium-sized enterprise (SMEs) and for most firms – notably state-owned enterprises (SOEs) – with the persistent rise of the capital/output ratio.

For social wellbeing to be compatible with a large and attractive domestic market, basic social reforms, postponed in the 13th Plan, must be implemented: a uniform social security and retirement system with portable rights managed by the central government, a reform of hukou⁶ to align the social rights of migrants moving to large cities with those of the residents.

The second objective of spatial development has made progress in reducing the inequalities

between coastal and other regions. But more ambitious achievements must be fulfilled in the 14th Plan. The disparities between regions and between urban and rural territories will be analyzed in the next section.

The third objective, promising green development, has made progress with the creation of the Green Finance Task Force under the authority of the People’s Bank of China (PBoC). The release of a comprehensive taxonomy for green projects in 2015, supporting the development of a large domestic green bond market (second after the US in terms of bond issuance in 2019), has been representative of China’s drive to promote green finance. During its presidency of the G20 in 2016, China added green finance to the agenda of the G20, in co-chairing the Green Finance Study Group with the UK. In mobilizing development banks within the green finance task force, China has the capacity to diversify away from fossil fuel from the 13th to the 14th Plan.

China has augmented the weight of its total debt in GDP, like many other countries but at an unusually rapid speed. Between 2010 and the end of the third quarter of 2020, the total debt of non-financial sectors as a percentage of GDP increased by close to 110%, to reach 285% (as against an average of 225% in all emerging countries) with the issuance of bonds and the rise in bank credit. However, the reform of finance engaged in 2017 to contain shadow-banking activities has continued, so that non-bank lending has remained contained. During 2020, the Chinese authorities maintained an approach of strict repression as regards “shadow banking” (i.e. less transparent and more risky types of credit schemes). During 2020, outstanding amounts decreased by 1.5 percentage points, to 58.3% of GDP (as against 87% in

(3) Aglietta M. and Bai G. (2014), China’s Roadmap to Harmonious Society, *CEPII Policy Brief*, No 3, May.

(4) Aglietta M. and Bai G (2016), China’s 13th Five-Year Plan. In Pursuit of a “Moderately Prosperous Society”, *CEPII Policy Brief*, No 12, September.

(5) All figures are from World Bank statistics.

(6) Hukou is a system of household registration used in mainland China that officially identifies a person as a permanent resident in an area, and entitled to local social programs.

2016), according to Moody's. Moreover, the central bank has maintained a relatively conservative stance, with no quantitative easing, and limited rate cuts.

Finally, the reform of the financial system has grown the momentum to unify the bond markets, to narrow the gap between China's and international financial regulations, and to promote the international role of the renminbi, in order to attract international investors and to incentivize the investments of Chinese corporations abroad.

1.2. From the 13th to the 14th Plan: regional disparities, growth and socioeconomic integration

China has recovered from the pandemic much faster and much better than other large countries, but unevenly. As emphasized by the IBRD's December 2020 report, growth could be more resilient with market-oriented structural reforms to lower barriers to labor mobility and to provide a more equitable social safety net. Those reforms would encourage households of a broader middle class to reduce their precautionary saving and shift to services for a more diversified domestic consumer market.

In the years of high capital-intensive growth (1998–2007), after the Asian crisis and until the GFC, regional disparities increased strongly, but they abated thereafter, thanks to the surge of investments in lagging regions. A Bank for International Settlements (BIS) working paper shows that China's overall growth is dependent upon disparities between regions and that the reduction of disparities has changed the nature of China's growth in the wake of the new era.⁷

However, regional disparity could resume with the new envisioned innovation-driven growth model, because this model might increase the growth potential of metropolitan areas and techno scientific clusters in already developed coastal areas at the expense of other underdeveloped regions. It would be problematic because, if regional disparities across provinces and between urban and rural areas stop decreasing with the development of the digital economy, it could be an impediment to consolidating a country of moderate prosperity that implies a reduction of inequalities in all aspects.

Moreover, this surge was debt-financed, which has led to entrenched financial imbalances, making this model unsustainable. In particular, strong heterogeneity across provinces has persisted. The less-developed provinces

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display the highest debt burden and the lowest bond-issuance capacity. This is why the 14th Plan will try to achieve a more efficient allocation of labor and capital while mitigating spatial disparities in ensuring more equitable public services and investment in human capital in all regions.

It is encouraging to see that after the "Go West" movement enhanced the infrastructure of the central and western regions in China, a number of central and western cities are now on center stage in the new era of reform, featuring innovation and high technologies. Cities such as Chengdu, Wuhan and Chongqing are among the best-performing cities in China, in terms of both GDP growth and innovation-driven economy. The worrying side of the story is about the deepening of China's north-south divide.

The share of GDP of the northern regions (15 provinces to the north of the "Qinling-Huaihe line") in China's total GDP dropped from 42.9% to 35.4% from 2012 to 2019. GDP per capita in the south, relative to the north, increased from 0.97 to 1.3. Such a divide is expected to worsen in the new era of reform, with the decline of traditional capital-intensive economy, the expected medium-term drop in the prices of coal and crude oil, and the North's lack of human and technological capital.

1.3. Starting the 14th Plan: the prudence of China's macroeconomic policy in 2021

According to the IMF, China's macroeconomic performance is and will remain outstanding compared to Western countries from 2020 to 2022 (Table 1).

Table 1 – GDP growth (%)

	US	Euro zone	China	World
2019	2.2	1.3	6.0	2.8
2020	-3.4	-7.2	2.3	-3.5
2021	5.1	4.2	8.1	5.5
2022	2.5	3.6	5.6	4.2

Source: IMF, World Economic Outlook Update, January 2021.

However, the recovery in China is uneven. While industrial production has more than recovered to pre-Covid growth, retail sales and fixed asset investment in the private sector are still dragging. Exports have shown strong resilience in pandemic-related shipments. Disequilibria show up in stimulation-driven infrastructure investment and in buoyant real-estate prices, raising authorities' concern about

financial vulnerabilities that were already well entrenched. Good economic prospects and a conservative monetary stance

(7) Kerola E. and Mojon B. (2021), "What 31 provinces reveal about China", *BIS Working Papers*, No 625, January 28.

have maintained the levels of bond yield at a high level in the country, fueling large inflows of capital stemming from investors in search of financial returns. Although this trend has benefited the financing of the economy, it also contributed to a rise in the renminbi detrimental to international competitiveness (close to 10% against USD in the second half of the year) and could prove destabilizing if reversed.

Those vulnerabilities will require the combination of, on the one hand, a moderately accommodating monetary policy to reverse the price slide into negative inflation and to allow retail sales to recover fully, and, on the other, tightening financial regulation to calm heating housing markets in big cities and curb monopolistic e-commerce giants, as has started to be done with the halting of the initial public offering of Ant Financial.

Despite the common deleterious health threat of Covid-19 and the associated need for full economic recovery, the opposition between US and Chinese fiscal policies in 2021 is startling: in the US, a \$1.9 trillion fiscal plan to drive the macroeconomic recovery; in China, a reduction in fiscal deficit from 3.6% of GDP in 2020 to 3% in 2021. This discrepancy should continue nurturing imbalances, in particular with increased demand for Chinese goods. Financial markets show signs of a worried mood: a possible jump in inflation that would induce a rise in interest rates and a subsequent fall in asset prices. This audacious bet deepens uncertainty worldwide about the duration and profile of the post-pandemic recovery.

As explained by China's Prime Minister Li Keqiang before the NPC on March 5, 2021, the government has adopted a very careful hypothesis, which is not a forecast.⁸ The prime minister announced for the year 2021 a growth rate target above 6%, while financial markets reveal a consensus of 8% and the IMF

announces a GDP growth forecast of 8.1%. Because of high levels of debts in both the corporate sector and the housing market in prime cities, the government has been handling financial vulnerabilities since 2016, leading to a notable reversal in the trend of private corporations' debt levels, breaking part of the implicit guarantees, and reining in shadow financing. Taking account of global uncertainties and its successful management of the pandemic in 2020, the government prefers to enjoy more leeway to smooth the recovery path and curb the financial vulnerabilities if they are aggravated by the global impact of US policy. China's monetary policy is also quite prudent. To foster the recovery and to retain a means of action, M2 and total social financing will have to grow in line with nominal GDP growth rate at less than 10%.

(8) Li Keqiang (2021), *Report on the work of the government*, March 5, 2021.

2. From the urgent needs to the principles of the 14th Plan

The 14th Five-Year Plan aims at inaugurating a fundamental change in China's growth regime. It is starting the transition from the first centenary goal in 2021 – i.e. achieving a “moderately prosperous society”, acknowledged by the World Bank for the centenary of the Communist Party in 2021 to the second centenary goal of achieving a “fully developed socialist market economy” in 2049. The ultimate objective is to restore the Middle Empire at the center of Asia, eradicating the “century of humiliation” inflicted by Western powers and ultimately by Japan, from 1840 to 1945.

An intermediary step in the achievement of the second centenary goal is Vision 2035, which sets longer-horizon goals: self-sufficiency in key technologies, a rapid decrease in absolute carbon emissions, and universal coverage of basic public services. The 14th Plan is the first building block to achieve this vision.

2.1. The principles of the 14th Five-Year Plan: dual circulation

The concept ruling this transition is “dual circulation”. It was announced in a context of mounting commercial and technological rivalry with the United States, sluggish international demand, and the desire of many countries to reduce their dependence on China in the wake of the disruptions linked to the Covid-19 crisis. The dual circulation aims at strengthening the resilience of the Chinese economy to external shocks, while accelerating the trend towards “decoupling” the US and Chinese technology industries.

Domestic circulation is the first pillar in developing the consumer market of an enlarged middle class, grounded on innovation-based scientific and technological capabilities, aimed at self-reliant domestic growth. The promotion of high-tech will be supported by a massive R&D effort, targeted at 3% of GDP. China's Fifth plenum in October 2020 emphasized the importance of scientific and technological self-reliance linked to the strong domestic market. The higher R&D spending will be directed to strategic sectors such as biotechnology, semiconductors and new energy vehicles, to progress towards self-sufficiency.

In pursuing the common development of the whole country, the 13th Plan has already undertaken a revitalization of rural areas with arable land protection, the construction of water conservation facilities and improving agricultural varieties to reinforce inclusion as well as food safety. Rural-urban integration will improve with better infrastructure (roads and telecommunications).

Another key element of the domestic pillar is the improvement of the social security system, in order to free part of the massive precautionary savings and reduce inequalities. This strategic orientation will, however, be constrained by financing issues. The Chinese authorities indeed underlined the need for a smooth

normalization of the policy mix through conservative budgetary and monetary stances, to avoid reinforcing debt levels and financial risks. Social expenses will thus remain under close control.

International circulation is the second pillar, to attract foreign investors and incentivize China's corporates to invest abroad in support of the Belt and Road Initiative (BRI). New technologies require rare earth materials (copper, cobalt, lithium, nickel) that China hopes to acquire in establishing strong links with its infrastructure investment along BRI countries. The objective of coordinating domestic and international development is labelled "ecological civilization".

However, there are serious financial risks. Analysts in investment banks (Goldman Sachs, JPMorgan) point out that the shift to a

green economy might generate another global commodity super cycle, similar to what occurred at the turn of the 21st century. This time it could happen because the growth of an electrified economy in the coming decades will be underpinned by the availability of battery metals.

The rise of productivity in all electricity-driven industrial value chains depends on the understanding between firms' decisions in allocating capital and public regulation. To meet this challenge, China's leadership wants to reinvent state-directed capitalism. The commercial legal system is being transformed, with the objective of being more responsive to the needs of businesses and boosting productivity. Bankruptcy and patent laws have been introduced, which is a significant step, even if China is still far from meeting international standards in that regard. This is why technical standardization (China Standards 2035) is part of the 2035 vision. Nonetheless, improvements are already significant. Setting up companies takes just nine days instead of several weeks.⁹ The boundaries between public and private firms are expected to be less sharp, with the injection of private capital, both domestic and foreign, into SOEs. These reforms move in the direction of President Xi's agenda, announced in 2013 at the origin of the new era: let the market play "a decisive role" in allocating resources, while reinforcing the leading role of the public sector in setting up long-term goals and guiding the process for overcoming uncertainty with strategic planning. In particular, China's R&D effort in innovative industries could ensure a strategic technological advance for China in key sectors in the coming years (big data, artificial intelligence, 5G, etc.). The deployment since late 2019 of an operational Central Bank Digital Currency, due to be fully operational in 2022, is a powerful example of this approach.

Finance is crucial in allocating resources according to long-term goals. Therefore, curbing financial vulnerabilities due to inherited over-indebtedness, and curtailing the anti-competitive behavior of Fintech giants imply a strengthening of financial regulation, as soon as 2021, against shadow banking expansion.

(9) World Bank, Doing Business project.

2.2. Foreign interpretations of the 14th Five-Year Plan

Concerning foreign attitudes to the 14th Plan, a prominent contribution is that of Nicholas Stern and Chunping Xie,¹⁰ who insist on the dangers of a global depression because the conjunction of supply disruptions and fallout in demand is much more severe than with the GFC, spreading social and political strains around the world. There will be no lasting recovery without a global structural transformation towards the UN sustainable development goals, focusing on the handling of climate change. Since China overcome the pandemic early and has committed to the objective of carbon neutrality, the authors

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emphasize that the country is well placed to invest for the sustainable activities of the future. The government enshrined the concept of "ecological civilization" in the constitution in 2018. The international component of dual circulation, to be detailed in the last part of this policy brief, is also crucial. Offering financing solutions for developing countries, which face the loss of remittances, capital flights and a fall in commodity prices in Africa and Latin America, can be part of the BRI. Demand for commodities can be spurred by the expansion of the domestic consumer market. Labor-intensive investments are planned in both China and Europe for renewable energy, public transport, housing renovation and natural-habitat protection.

As stated above, carbon intensity has declined by 18% during the 13th Plan and is expected to go on reducing at the same speed. Old coal-fired power plants have been replaced with less-polluting ones in China's north-east, with the decline of heavy industry, which was the most prominent sector in the former intensive-growth regime, because it was not possible to retrain and move mine and foundry workers to low-carbon activities in other regions. However, the 13% reduction in energy intensity countrywide during the 13th Plan means that more coal-fired plants have been dismantled than new ones have been built. Therefore, China can deploy key actions, beginning with the 14th Plan, to achieve an "eco-civilization" by 2035. It should accelerate the transition to cleaner energy in prohibiting entirely any more investment in coal-fired electricity. This will be challenging, considering the current trend: the country put 38 gigawatts of new coal-fired power capacity into operation in 2020 – more than three times the amount built in the rest of the world. Yet, according to Nicholas Stern, in managing the demand for electricity with smart grids, the declining costs of electricity production with wind and solar PV could achieve 62% of electricity production from non-fossil fuels by 2030. Carbon taxation also has a role to play, combined with policies to

(10) Stern N. and Chunping Xie (2020), "China's 14th plan in the context of Covid-19: rescue, recovery and sustainable growth for China and the world", *Grantham Research Institute on climate change and the environment*, LSE, Policy Insight, September.

retrain and reallocate coal miners, in generating incentives and overcoming market failures.

Geographical rebalancing for new urbanization in establishing clean, compact and connected cities is also an objective to reduce regional inequalities (see section two). Health and education will be more evenly distributed. Metropolises will benefit from data-based innovations reducing congestion (“smart cities”) with the retrofitting of buildings to make them more energy-efficient and climate-resilient.

Sunjoy Joshi of the Observer Research Foundation in New Delhi (India)¹¹ focused on the long-term 2021–2035 view, in which China will build up the basis of its “socialist modernization”. He acknowledged the new concept of “dual circulation strategy”, interpreted as the promotion of import substitution and expansion of domestic demand. According to this peculiar view, dual circulation means three types of actions: diverting funds to high-end manufacturing, reduced dependence on food and energy imports, and less overseas lending and investment. The author emphasized RCEP, in which India has refused to participate, as the trade agreement that will weld ASEAN countries in a closer relationship with China.

Also interesting is the interpretation of the dual circulation by Goldman Sachs’s investment strategic group.¹² In their opinion, dual circulation has strong sectoral implications. It means a new growth strategy that prioritizes domestic demand as the strategic underpinning for growth. The priorities would be to combine technology independence, boosting domestic demand and maintaining high-level opening-up. Social welfare and environmental sustainability will require both cutting capacity in heavy industries carrying future stranded assets and providing subsidies for renewable energy.

Within this overall framework, the purpose of sections four and five is to provide an analysis of concrete objectives of the domestic (section four) and international (section five) dimensions of dual circulation.

3. Main pillars of domestic circulation: building a unified consumer market, rethinking urbanization, progressing in energy transition and ecosystem rehabilitation

3.1. Transforming the consumer market for a digital economy.

Building a strong domestic consumer market is central in the 14th Plan. According to the McKinsey Global Institute, which

(11) Joshi S. (2020), First step of the new long march: the 5th plenum and the 14th plan, Observer Research Foundation, October 23.

(12) Investment Strategy Group (2020), “The new five-year plan and beyond”, Goldman Sachs, November 9.

built its 2021 China Consumer Report through gathering multiple surveys, the Covid-19 crisis has accelerated five trends in China: digitalization, decline in global exposure, rising intensity in non-price competition, a new attitude to the spending of young consumers, and the much larger role of the private sector.¹³

Concerning digitalization, China’s digital ecosystem has become the most sophisticated in the world, with 850 million internet users on the demand side and a quarter of unicorn companies worldwide on the supply side (start-ups valued at more than \$1 billion).¹⁴ In 2019, e-commerce made up 24% of total retail sales, against 11% in the US and 9% in Germany. Covid-19 has accelerated B2C interactions via online channels.

With the acceleration of investment-led and export-driven growth after China’s entry into the WTO, the share of consumption in GDP declined substantially as China became the “manufacturer of the world”. The massive stimulation plan driven by public investment after the GFC led to a fall in the share of consumption in GDP, from 64% in 2000 to 50% in 2010. Then the macroeconomic dynamic changed radically. Starting in 2010, wages increased steadily and the Go West policy took momentum after 2012. With an emphasis on qualitative growth, the 13th Plan (first plan of the new era) began a reversal. The share of consumption climbed back to 55.5% in 2019. The objective is to recover a share of 60% before the end of the present decade along a steady increase on the path to the long-run objective of establishing a socialist market economy by 2035. Because growth has been increasingly dependent on local innovations, the 14th Plan

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expects domestic consumption to account for more than 60% of GDP growth by the end of the decade. Increased competitive intensity is evident in divergent performances across sectors and companies. Vulnerable companies suffer cash flow troubles. Because of the knock-on effect on employees, the

government is supporting vulnerable companies via the banking system, to allow SMEs to bounce back.

The McKinsey post-coronavirus consumer survey indicates changes in consumer behavior, especially in young consumers’ spending. The new habit among the middle and upper classes is to save more, learn wealth management, plan consumption, distrust impulse spending and limit consumer loans; 40% of respondents to the survey plan to increase their sources of income via wealth management investment, mutual funds and health insurance. Health-conscious purchase decisions have raised awareness of product quality and safety.

(13) Seong J., Ngai J., Woetzel J. and Leung N. (2021), Fast forward China: how Covid-19 is accelerating 5 key trends shaping the Chinese economy, Mac Kinsey Global Institute, China Consumer Report.

(14) Kevin Wei Wang, Jonathan Woetzel, Jeongmin Seong, James Manyika, Michael Chui, and Wendy Wong, Digital China: Powering the economy to global competitiveness, McKinsey, December, 2017.

However, the problem of non-performing debts in the residential sector can be a serious obstacle in the development of the consumer market. From 2016 to 2019, China's residential-sector leverage ratio rose by 16.3%, according to the BIS.¹⁵ With the accommodative fiscal and monetary policies in response to the Covid-19 crisis, this ratio rose by a further 3.9% in the first six months of 2020, reaching 59.1%. Despite the careful consumer behavior observed in the consumer survey described above, the abrupt fall of income in the first semester of 2020 has raised non-performing debts both in the residential sector and in personal loans. The third quarterly report of China Merchants Bank showed an 81.3% year-on-year increase in non-performing loans on credit cards. The risk for microfinance companies is even more serious. Therefore, effective disposal of non-performing debts is urgently needed.

Fortunately, in recent years, the personal loan delinquency market has been developing, the legal and credit systems have been improving, and financial technology is developing rapidly. The institutional and technical conditions for debt restructuring are thus becoming gradually available. In August 2020, China's first personal bankruptcy law was passed in Shenzhen. Digitalization allows online court sessions, online delivery of judgments and online execution of assets, shortening dramatically the legal process.

Under those reforms, the social credit system is getting stronger. In December 2020, the CCP Central Committee issued an "Outline for the Implementation of the Rule of Law Society (2020–2025)", proposing to reinforce the law-abiding credit records of citizens and organizations, and establishing a unified social credit code system based on citizens' ID numbers and organization codes. Hence the Chinese authorities could use technical support from Fintech development for the disposal of personal non-performing loans.

3.2. A new type of urbanization as a major driver of the consumer market economy

In section 2.2 we emphasized the importance of the "Go West" policy to reduce inequalities, both territorial and social. The 14th Plan is likely to amplify the process in facilitating migration from rural areas to cities; 60.5% of the total population lived in cities in 2019, and 65% are projected to do so by 2025 according to the 14th Plan. The target implies 10 million people moving into cities each year. Since average productivity in cities is about three times that in rural areas, migration can be a productivity driver. However, public policies are needed for reskilling and income-supporting in the transition. Moreover, the influx of new residents in the cities might exert pressure for further rise in house prices.

(15) In BIS credit statistics, Debt ratios for household sector, updated March 1, 2021

The main problem lies in first-tier cities, e.g. the most affluent metropolises. This is why local governments are tightening price control in these first-tier cities, by various means: for instance, in Shanghai, a full VAT increase on sales of houses within five years, strict control on housing credit, and purchase restrictions within three years after divorce; in Shenzhen, purchase restriction conditions, an increase of 10% in the minimum down-payment ratio for non-ordinary housing, and a rise in taxes on second-hand house transactions. The idea is to incentivize migrants to move to second- and third-tier cities.

An important problem constraining the consumer purchasing power of rural migrants to cities is the registration system or *hukou* that denies to migrants the social advantages of their city of residence. The incomplete transfer of social rights can be troublesome, especially for children's schooling and medical insurance across regions. In 2017, 17% of migrant workers were enrolled in an unemployment insurance program, as against 44% of the local urban labor force.¹⁶ However, most cities – except the first-tier cities like Beijing and Shanghai – have relaxed *hukou* so that it no longer constrains urban consumption. The 14th Plan confirms the reform; it will abolish the *hukou* system in cities of up to three million people. Cities with 3-5 million people will also loosen residency requirements.

A major trend in the new urbanization that can incentivize rural migrants is a shift of activities from coastal megacities to clean, compact and connected cities via networks of railways in the interior. With the help of fiscal transfers from central government to preclude further indebtedness, dense cities could design clean and efficient buildings, and ensure more evenly distributed health and education services. In already developed

areas, a restructuring is planned to limit congestion, retrofit buildings and create high-tech innovation zones.

The new model of urbanization is a structural reform that links the 14th Plan to the 2035 long-run objective of both prosperity (through reform of the *hukou* and increased coverage of safety nets) and sustainability (through more efficient spatial organization), supporting the overhaul of the growth regime towards a political ecology.

3.3. Energy transition and ecosystem rehabilitation towards "eco civilization"

China's 14th Plan is an opportunity to link climate goals to medium-term socio-economic objectives, because the commitment to capping emissions by 2030 has set a clear direction to economic development. Achieving market neutrality in 2060 means that China will need to achieve net-zero emission from the peak in 2030 in only 30 years, a much faster speed than other

(16) <https://www.piie.com/blogs/china-economic-watch/chinas-migrant-workers-need-help-economic-downturn>

countries like Japan or the EU – which is questionable. About energy intensity and carbon intensity, the 14th Plan is indeed as prudent as it is for macroeconomic objectives. The target for energy intensity is a 13.5% fall to 2025, about the same as the decrease realized in the 13th Plan (–13.3%) according to official figures. The target for carbon intensity is –18%, as much as the target for the 13th Plan, and slightly lower than the fall actually realized during it (–18.8%). However, analysis of the policies that would be deployed must look beyond official targets to probe into possible concrete policies. A research paper from the LSE has set important proposals on the energy transition in the perspective of sustainable development.¹⁷

Moving away from coal is the primary objective in generating most electricity from renewables and other non-fossil fuel sources. It is especially difficult for China. The energy intensity of its economic activities is amongst the highest in the world, according to IEA statistics. In particular, China uses its large resources in coal for electricity production (68% of total electricity supply vs. 29% in the US). The transition away from coal should be done in house heating, in technological restructuring of industries and in prohibiting the construction of new coal-fired plants. The pressure to retain coal mining comes from local governments that draw royalties from mining operations. Therefore, fiscal transfers by the central government from revenues drawn from a national carbon tax or a unit permit scheme should be distributed to poorer provinces. Furthermore, affected coal communities should be supported with monetary compensations and there should be retraining programs for converting workers towards new employment opportunities.

Energy security is also a crucial question, with the rise of intermittent renewable energies. There is an urgent need for a robust smart grid system using digital technologies to facilitate supply-side flexibility in clean energy sources for confronting demand-side fluctuations of electricity. Developing reserve systems in natural gas could be an important complement to get rid of coal.

The demand for electricity will be increased by new energy vehicles that will accelerate the phasing-out of internal-combustion engines. Innovative investment in charging piles and supportive facilities to recharge in an efficient way must be enhanced.

However, the transformation of energy and the induced change of the industrial structure are far from being the only ways to handle climate change and, more generally, environmental degradation. The Dasgupta Review on the economics of biodiversity is a fundamental document, as important as the 2007 Stern Review on climate change.¹⁸ It disqualifies fully

standard macroeconomics that ignores natural capital in determining inclusive wealth. Capital assets being entirely substitutable under the microeconomic assumption of subjective

value theory, the aggregation delivers a growth model without limits. Opposite to this, the interdependence between ecology and economy is grounded in the planetary limits of the Earth system.¹⁹

Another way to put it is to recognize that social wellbeing has nothing to do with GDP. It depends on inclusive wealth that is composed of produced capital, human capital and natural capital. There is an equivalence theorem that stipulates that social wellbeing is optimal when inclusive wealth is maximized. Yet,

some environmental assets, like ecosystem services, cannot be quantified as components of natural capital. Nonetheless, they participate in the productivity of natural capital in terms of social wellbeing; as much as technical progress improves the productivity of produced capital, education and health improve the productivity of human capital. Biodiversity has a regenerative capacity to keep biogeochemical cycles within planetary limits, if they are not degraded to the point that they cross tipping points, leading to irreversible loss of social welfare.

Alongside official goals of reducing carbon emissions, China has started to conserve and restore ecosystems and biodiversity. For example, according to the Dasgupta Review, a program aiming at reducing soil erosion has transformed 30 million ha of desert land into forests or grasslands in 25 provinces. The conversion program has sequestered substantial amounts of carbon and has mitigated flooding. To measure the ecological benefits of such initiatives, China's environmental scientists have devised measures of flows of ecosystem services aggregated in a single monetary measure, the Gross Ecosystem Product (GEP). Seven focal ecosystem services have been studied: food production, carbon sequestration, soil retention, sandstorm prevention, water retention, flood mitigation, and provision of natural habitats. GEP measures have been estimated by using spatially integrated ecological-economic modelling, then applying economic valuation methods to estimate the monetary value of those services. A range of valuation techniques are used to estimate the values of those services.

Alongside GEP, efforts are underway to track changes in the stock of natural capital to account for the appreciation or depreciation of those assets. A total of 63 areas, comprising close to half of China's terrestrial land area, that are critical for ecosystem services have been identified and made a priority for conservation and spatial planning (UNEP, 2016). They are labelled "restricted development zones" in the national regional development strategy of China.

Moving away from coal is the primary objective in generating most electricity from renewables and other non-fossil fuel sources. It is especially difficult for China.

(17) Hepburn C., Ye Qi, Stern N., Ward B., Chenping Xie and Zenghalis D. (2021), "Towards carbon neutrality and China's 14th Five-Year Plan, *LSE Policy Insight*, January.

(18) The Dasgupta Review, the Economics of Biodiversity, London HM Treasury, February 2021.

(19) Rockström J. and Edenhofer O. (2020), The global resilience imperative, *Project Syndicate*, May.

4. The 14th Plan from the domestic to the international dimension: Asian integration, Belt and Road Initiative and the progress of China Standards 2035

According to Claude Albagli, president of the CEDIMES,²⁰ the BRI is the “basic restructuring of globalization”, in opposition to the “horizontal Wall Street model of universal financial globalization” that showed its limits with the GFC. The BRI is reshaping globalization into three circles. The first is Asian integration focused on RCEP, the largest trade agreement worldwide. It will induce progress in the internationalization of the renminbi and therefore support the reform of regulation in domestic capital markets to attract foreign corporates and financial investors. The second is the reawakening of history in reopening roads that were closed by the emperors of the Ming dynasty from the mid-15th century onwards. It follows the direction of the old silk roads, while diversifying the trajectories through Central Asia and East Africa to Europe. The third will be a system of transcontinental networks, both digital and infrastructural, to cover the planet.

The functions of the BRI must meet different requirements to fulfill the 2035 long-term goals. The first is supplying primary commodities, including rare earth; the second is safeguarding energy supply; the third is getting components (semi-conductors) for advanced technology; the fourth is developing new means of transport (electric vehicles, magnetic ultrahigh-speed trains); the fifth is securing outlets for a large range of export products, and the sixth is the ability to differentiate partners.

4.1. RCEP and the integration of Asia

The regional comprehensive economic partnership (RCEP) was signed on November 15, 2020 by 10 ASEAN countries and five Asian Pacific ones (China, Japan, South Korea, Australia and New Zealand). The 15 countries account for about 30% of the world's people and output. The scope of the agreement will mainly stimulate intra-East Asian integration. As a giant trade agreement, with zero tariff covering 90% of the goods traded, RCEP will contribute to relocating supply chains from China to ASEAN countries with lower labor costs, because it will reduce trade tariffs and foster intra-zone investments. It will lead to a 10% increase in member countries' trade, according to the Brookings Institute (Petri and Plummer, 2020).

Indeed, RCEP is an important pillar of China's new strategy to play a leading role in Asia after the ongoing US-China

decoupling.²¹ The trade agreement gives China the assets for regional leadership after the retreat of the US in launching the trade war (Guimbard and Jean, 2020). However, under the Belt and Road Initiative, Asian integration is not enough. China also aims at building better connectivity with Europe.

4.2. An advance in Sino-European cooperation?

On December 30, 2020, the EU and China reached an agreement, the Comprehensive Agreement for Investment (CAI), to expand mutual investment opportunities. It allows China to strengthen its economic ties with non-American partners and Europe, so as to assert strategic autonomy. The agreement facilitates investment in manufacturing and services. It promotes competition on a level playing field between China's SOEs and European corporates, and commits China to greater transparency in subsidies and prohibition of forced transfer technologies.

There is a more fundamental reason for this agreement to arise at this peculiar time. Back in March 2019, the European Commission labeled China a “systemic rival promoting alternative models of governance”.²² But the pandemic of 2020 has accelerated a paradigmatic change in Germany: the German political leadership has become aware that the country needs a new industrial policy, especially at a time when the disruption of value chains around Europe had jeopardized the all-important automotive industry. Not only Angela Merkel, but also Bundestag President Wolfgang Schäuble have advocated European economic sovereignty, meaning a state capacity for industrial policy coordinated at the European level. The German recovery plan is focused on sustaining key industries with strategic Franco-German investments to reshuffle industrial value chains in Europe. On the Chinese side, European investments could facilitate entry to the Chinese domestic market in a wider range of sectors, and fuel technological development in the country. Indeed, it is one of the drivers of the international circulation.

However, the scope of the agreement is limited for the time being,²³ while EU sanctions over alleged Chinese human rights abuses in Xinjiang have jeopardized the agreement as well as the overall diplomatic relationship with China. The positive side is that it is an investment agreement and not a trade deal. The negative side is that it gives limited market access to few sectors, and the issue of SOE subsidies is addressed only partially, while the question of reciprocity is not part of the final document.

RCEP is an important pillar of China's new strategy to play a leading role in Asia after the ongoing US-China decoupling.

(20) Albagli C. (2020), *Les routes de la soie ne mènent pas où l'on croit*, L'Harmattan.

(21) Miller T. (2017), *China in the Asia-Pacific. The Belt and Road to leadership*, China Economic Quarterly, June.

(22) <https://ec.europa.eu/commission/sites/beta-political/files/communication-eu-china-a-strategic-outlook.pdf>.

(23) Garcia Herrero A. (2021), *Economic benefits of China Comprehensive Investment Agreement to remain limited*, Natixis, March.

Indeed, this emerging of a new economic landscape implies a more in-depth, doctrinal change to rebalance international relationships, especially with China, in the perspective of implementing the Paris Accord on climate, because it implies collaboration in innovative activities for GHG abatement.

4.3. The BRI: reinstating the Middle Empire at the center of the world

The BRI entails a deep restructuring of trade value chains and of the international financial order. In terms of infrastructure, the BRI contributes to building a global electricity network, allowing cross-regional allocation of power surpluses worldwide. China's grand strategy for the BRI can thus change the pattern of globalization with the support of massive infrastructure investment via long-term financing.

Yet the program is still ill-defined, and debates are numerous about its actual financial size. Essentially, BRI supports Chinese engineering firms in infrastructure projects in other emerging countries, mostly funded by Chinese private and public banking institutions.

The World Bank's definition of the BRI is: "A China-led effort to improve connectivity and regional cooperation on a transcontinental scale through large-scale investments" (Bandiera and Tsiropoulos, 2019).²⁴ Claude Albagli has described the network in three circles, structuring the international part of the dual circulation to reestablish China's centrality.²⁵ Asian, historical and continental.

The Asian circle has predominantly an energy purpose. In the south there is a railway bridge starting from Kunming (Yunnan), going to Singapore, Haiphong (Vietnam) and Malaysia. One of them is currently halted by the rivalries between China and Vietnam, another by Malaysia's over-indebtedness. In the north-west, two railways go from Xinjiang to Turkmenistan and Kazakhstan, and to the Indian Ocean. The third one goes from inner Mongolia to Siberia and Moscow.

The revival of the historical circle consists of the two Eurasian railway corridors, Chongqing- Dusseldorf and Wuhan-Duisburg, served by China Railway Express. It is augmented by the Iran-Turkish line, connected to the northwest Asian line in Kazakhstan. The long maritime line is the pearl corridor of the Indian Ocean that links strategic ports: Chittagong (Bangladesh), Colombo (Sri Lanka) and Gwadar (Pakistan), follows the east African coast to Djibouti and continues to the Mediterranean Sea (Piraeus, Genova, Trieste).

(24) Bandiera L. and Tsiropoulos V. (2019), A framework to assess debt sustainability and fiscal risks under the Belt and Road initiative, *Policy Research Working Paper*, No 8891, World Bank.

(25) C.Albagly, op.cit., pp.147-191.

The continental circle will be entirely new. It consists of two parts: the Arctic railway route from Dalian (Manchuria) to Rotterdam, and the web of corridors over Latin America, connecting two oceans. China wants to invest in all Latin American countries to safeguard its supplies of primary commodities.

Whether Beijing will succeed in driving the economic initiatives embedded in the BRI towards building a "community of common destiny" will depend on its ability to create momentum among emerging countries and appear as a "benevolent developer". Suspicion about Beijing's final goals and negotiating strategies, and fear of over-dependency on one country, have marred BRI's image and nurtured anti-Chinese opinion worldwide. Garcia Herrero and Xu (2019) show that, although the general sentiment about the BRI remains positive in a number of neighboring countries (in Central Asia, Sub-Saharan Africa, East Asia & Pacific), its image deteriorated in almost every region between 2017 and 2019. Further erosion of confidence could be lethal to Beijing's grand strategy.

4.4. China Standards 2035

Competition in high-level technologies with the coming dominance of digitalization opens the way to ferocious rivalry about tech standards. Standardization is crucial in e-commerce that depends on the oligopolistic competition between digital platforms. The present role of international technical standards is perceived as a common good under US and European leadership. Can China rewrite the global technical standardization order?²⁶ Technical standards are product specifications to create interoperability. They are different from rules that are legally binding. Under present international doctrine, they are the result of negotiations among private companies and associations. Once they have been enacted they are compulsory. In international trade the settlement of disputes takes place in the WTO.

China's approach to technical standardization is quite different. It puts the state at the core of standardization. The system can be viewed as a public-private partnership. The framework is under the authority of the State Administration of China (SAC), which addresses the most fundamental issues of health and security standards. Most voluntary standards are dealt with by industry. Local standards are issued by local governments. Such a system can be viewed as favoring protectionism, as a means of China's industrial policymaking. This is why the doctrine of dual circulation that changes China's view of international competition impinges upon technical standardization in the 2035 goals. The SAC reform is the following: reducing the types of standards at 2 (national and association standards); integrating

(26) Röchling N. (2020), Technical standardization, China and the future international order, *Swedish Institute of International Affairs*, February.

them more deeply into the international standardization system; establishing administrative supervision for association standards; guiding an existing group of standard associations to meet the needs of innovative markets. All in all, "China Standards 2035" is a reform agenda to empower Chinese industry in creating a Chinese-style public-private partnership in which state supremacy prevails but the influence of industry is growing.

Active industrial policy in crucial economic sectors has helped China to facilitate commercialization to gain first-mover advantage (e.g. 5G in telecommunications). China has proven its ability to capitalize on advantages stemming from the dual character of its economy, which guarantees the predominance of the long-run view. The BRI will be the conduit to internationalize China's domestic standards, with the signing of multiple cooperative agreements on technical standards to attract developing countries (90 agreements with 52 countries already existed in 2019). This will be especially important in the current process of international discussions on global standards. Central long-run planning has the potential to reshape the future of international technical standardization in the realm of complex ecological investment.

All in all, "China Standards 2035" is a reform agenda to empower Chinese industry in creating a Chinese-style public-private partnership in which state supremacy prevails but the influence of industry is growing.

Conclusion

This policy brief has focused on dual circulation as the overriding principle, reorienting China's reforms to achieve the goal of a socialist market economy by 2035. The 14th Five-Year Plan is the first stage in this long journey. In the early days of the present decade, China is entering the realm of advanced countries, involving larger opportunities and responsibilities both

in domestic socio-political reforms and in geopolitics.

On the domestic side, changing the growth regime to develop the world's largest consumer market rests on an innovation-induced raising of total factor productivity. This would enhance the welfare of an enlarged middle class in accordance with deep social reforms to pursue and amplify the reduction of social and territorial inequalities and to shift resolutely towards a low-carbon economy.

On the international side, the guideline is the Belt and Road initiative for the return of the Middle Empire in the center of the world. Its purpose is threefold: integrating Asia, advancing cooperation with Europe, and setting up an infrastructure network that covers the planet and restructures globalization towards a new geopolitical order.

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About the authors

Michel Aglietta is emeritus professor at the University Paris Nanterre and scientific advisor in CEPII.

Guo Bai is assistant professor at China Europe International Business School (CEIBS).

Camille Macaire is Research Associate at Cepii and Economist at Banque de France.

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Contact: michel.aglietta@cepii.fr - ca.macaire@gmail.com



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Managing Editor: Vincent Vicard
Production: Laure Boivin
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Head of Publications: Isabelle Bensidoun

CEPII
20, avenue de Ségur
TSA 10726
75334 Paris Cedex 07
+33 1 53 68 55 00
www.cepii.fr
Press contact: presse@cepii.fr