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**THE REALISTIC CHOICE OF REALIZING ECONOMIC SECURITY IN  
CHINA --BASED ON THE VIEW OF EXPANSION OF DOMESTIC  
DEMAND**

**Abstract:**

While poor and weak economy is the greatest insecurity, economic security is the fundamental, key and kernel part of a nation's comprehensive security. First and foremost, economic security is a domestic issue, and insufficient domestic demand is the most serious economic problem in China. Expansion of domestic demand is of realistic significance to the solution of current contradiction of supply and demand, realization of sustainable development, and maintenance of the economic security in China.

**Keywords:**

Economic Security; Expansion of Domestic Demand; Consumption and Investment

Traditional view of security regards military security as the core and foundation. With the end of the US-USSR dual-polar system and the cold war, the view of economic security has been attached importance, especially the outbreak of the financial crisis in South East Asia in the late 1990s made the international community realize that poor and weak economy is the greatest insecurity<sup>1</sup>. Economic security is the fundamental, key and kernel part of a nation's comprehensive security. Economic security is defined as the status and capability of preventing the national economy from such international and domestic disadvantages as interference, threat, invasion and destruction so as to improve the international competitiveness, realize sustainable development, and preserve economic preponderance. At present, the Chinese economy has entered the increasing path of demand restriction type, in order to ensure the sustainable economic security in China; on the one hand, we must take efforts to expand external demand, transfer excessive production capability to the outside, on the other hand, what is more important is to adopt the strategy of expanding domestic demand persistently, coordinating the relationship between consumption, optimizing the structure and means of consumption and investment, realizing sustainable development of Chinese economy, actively propelling diversified manpower investment, for the purpose of converting a nation with a big population into a nation with talents and improving our economic competitiveness internationally.

### **1. Expansion of domestic demand is the essential path to ensure the economic security of China**

Economic development mainly reflects in two aspects: the restriction of supply and the restriction of demand, while both Say and Keynes have already proved that, "Modern market economy is market-oriented economy<sup>2</sup>." For open national economy, demands can be divided into two parts: domestic demand and external demand. As for economic growth, external demand is mainly restricted by the national economic situation, policy, systems and industrial structure of other countries, which is indefinite; while domestic demand plays a dominant and decisive role in economic development, it will determine the balanced growth of a nation's economy and the optimization of

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<sup>1</sup> Xu Guihua. National Strategic Options in China' Economic Security [M]. Shanghai: The Press of Fudan University

<sup>2</sup> Niu Baode. Modern Market Economy is Demand-oriented Economy [J]. Market Economy Study, 2001(1)

the economic structure, and play a decisive role in determine its competitiveness and capacity to resist external risks.

From the statistics of the economic growth of China in recent years, among the three engines driving economic growth, the main engine used to be exportation before 2008. With the decline of external demand after the financial crisis in 2008, China has been relying on the expansion of domestic demand as the key strategy to drive economic development, mainly investment and consumption. This strategy has been reflected in the China's 12th Five-year Plan and the Government Work Report of recent 5 years. In this term, China's economic development pattern changes gradually, and its industrial structure upgrades, the issues of insufficient domestic demand, and irrational structure still existing. Insufficient domestic demand in China is illusive and structural<sup>3</sup>, while the illusive insufficient domestic demand is reflected by the boost up of the purchasing power of the Chinese residents, but a weak consumption desire; structural insufficiency indicates that the current insufficient domestic demand is not an absolute insufficient demand, but a speedup of investment and slowdown of consumption which result from the systematical and structural factors, and essentially different from Keynes' theory of "insufficient effective demand"<sup>4</sup>. For instance, the reality of the binary economic system hinders the growth of the consumption scale, and optimizing of its structure, while the issue of system holds back the technological innovation, and the diversification of investment. In order to solve the issue of insufficient domestic demand, we cannot only rely on the absolute growth of the economic scale, but follow a path of adhering to the domestic demand oriented economic growth by focusing on develop the economy scientifically, and changing the means of economic development, removing the systematical obstacles restricting the increase of domestic demand, for the purpose of reducing the disadvantageous factors disturbing the economy of

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<sup>3</sup> Zhang Yong. Domestic Demand Optimizing and Financial Transformation [M]. Beijing: Guangming Daily Press, 2013:99-103.

<sup>4</sup>According to Keynes, insufficient effective demand derives from 3 psychological laws: the law of diminishing marginal propensity to consume, the law of diminishing marginal efficiency of capital, and the law of liquidity preference. These three laws will take effect under the following implicit conditions: people's revenues have reached a certain level, and tend to improve their living standard; under a certain technological premise, investment has been saturated to some extent; it is highly monetized in economy

China, realizing the goal of sustainable economic development, enhancing competitiveness, and ensuring economic security.

## **2. Main issues of China's domestic demand under the new normality**

In the past 30 odd years China's economy has kept a rapid developing speed, and created developing miracles one after another. Anyhow profound changes have occurred in the internal supporting conditions and external demanding environment such as declining of external demand, backwards of industrial structure transformation, intensifying limitation of resources and environment, which force China to transform the developing pattern of the Chinese economy, and enter the new normality of "increase at medium and fast speed, intensified means, optimized structure, and driven by innovation". The new normality of economic development emphasizes the main driving function of domestic demand on economy, and takes optimizing the investment structure, releasing consumption potential and cultivating new ways of consumption and industries as the focal point. Since the financial crisis in 2008, China has adopted the strategy of expanding domestic demand, and achieved tremendous achievement such as keep an economic growth rate of 8%, and becoming the second largest economy in the world. However, we have also recognize that despite the improvement in domestic consumption and investment, compared to the development goal of economic development new normality, such problems exist as inadequate propelling power for sustained economic development, and great risk of declining.

### *2.1. Unbalanced proportion of consumption and investment*

While domestic demand includes consumption demand and investment demand, irrational domestic demand structure mainly means unbalanced proportion of consumption and investment. Since the carryout of the opening and reform policy, especially the financial crisis in 2008, China has kept a relatively high investment intensity, while from 2001 to 2013, the annual average of total amount of fixed capital in investment accounts for 41.29% of the GDP, 20% higher than average of the world, which has played an evident role in propelling the economy in a short term; on the contrary, the growth of the consumption proportion especially the residents consumption proportion slowed down, accounting for an average of 38.3% of the GDP, 20% lower

than the average proportion in the world<sup>5</sup>, which plays a less important role than investment in propelling the economy. While excessive investment growth will definitely result in excessive production capacity, low consumption proportion will worsen the situation of excessive production capacity, and that this kind of high investment and low consumption model cannot attain sustainable development.

### *2.2. Irrational structure of consumption*

Among the domestic consumption expenditure structure, the proportion the residents' consumption expenditure is rather small, while the proportion of government consumption expenditure is continuously increasing. Since the government expenditure is obtained from tax revenue, high government expenditure means reducing the consuming capability of the residents. The consumption capability of the rural residents is rather low among the residents' consumption. The urbanization rate in China in 2014 was 53.7%<sup>6</sup>, while the consumption expenditure of the rural residents was greatly lower than that of the urban residents, and the gap between the consumption structures reflects the revenue gap between the urban and rural residents. At present the Gini coefficient of China is over 0.5, and the gap between the urban areas and the rural areas, and the gap between different regions, even the gap between the rich and the poor in the same area are too big, which lead into the polarization in consumption. While the high income groups have strong desire for purchasing luxuries and weak purchasing power for common commodities, the low income groups have strong desire for common commodities but weak purchasing power. This results in the disjunction of consumption demand and the supply structure, and further affects the upgrading of the consumption structure.

### *2.3. Unscientific investment structure and growth pattern*

From historical statistics, in the process of investment in China, 15 major industries such as iron and steel, cement, glass, paper making, printing and dyeing, and rare earth have encountered the issues of excessive production capacity, waste of resources, low level repeated construction, inefficient economic development and insufficient investment in the new energy field.

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<sup>5</sup>Kang Ke. The Changing Tendency of the Domestic Demand and Adjusting Direction of Economic Structure in China [J]. *International Finance*, 2014(12):55

<sup>6</sup> National New Urbanization Plan (2014-2020)

According to statistics, the utilization rate of the production capacity in crude steel, cement, electrolytic aluminium, flat glass, wind power equipment, photovoltaic industries in the year 2013 was 70%, compared to the international industrial standard; the production capacity was severely excessive<sup>7</sup>. Moreover the investment increase in China mainly relies on the government investment without the participation of civil capital, which results in large amount of fiscal deficits and bank loans increasing financial crisis.

### **3. Specific measures to expand domestic demand continuously from the perspective of economic security**

Insufficient domestic demand is the major problem of the current economic security of China, while to expand domestic demand is the important guarantee of the maintenance of the sustained development of economy, and the necessary option to boost economic competitiveness. Since is a country with a large population, and people as the customer, the increase of economy is sensitive to the decline of demand; on the contrary, the propelling power of the demand expansion to economic growth is also unexampled among other countries. In quantity, it is reflected by the expansion of the scale of the economy, and the enhancement of the national economic power, while in quality, it is reflected as the optimizing of the industrial structure and lifting of the competitiveness. Therefore, under the new normality, confronted with the decline of the internal demand, and insufficient domestic demand, in order to ensure the sustainable security of the Chinese economy, and to realize the transformation and upgrading of the economic growth, the strategy of sustainable expanding domestic demand, and the following measures should be taken:

#### *3.1. To adjust the proportion of investment and consumption*

A reasonable proportion of consumption and investment can evidently reduce the dependence of the economy on external demand, and achieve a sustainable economic development. Both consumption and investment are the basis of the expansion of the domestic demand, “The governmental investment without the support of consumption is of no vitality<sup>8</sup>.” In a certain

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<sup>7</sup>Economics Teaching Department of the National Administration Institute. *New Normality of the Chinese Economy* [M]. Beijing: People’s Press, 2014:159

<sup>8</sup>Xu Jingyong,. *An Analysis of the Current Growth Situation of the Chinese National Economy* [J]. *Social Sciences Study*, 2001(1):34

sense, investment demand derives from the consumption, and itself cannot be the long term propelling power of the economic growth, while the consumption demand is the decisive demand. From international experience, the investment rate will first rise with the growth of the economy, and starts to decline steadily when it rises to a certain height it will be stable with a slight decline; while consumption rate will first decline to certain extent, and then starts to rise. According to Chenery's theory of industrialized stage, with the termination of the upgrading of consumption structure and industrial structure, the investment rate and consumption amount will become stable. However, with a serious unbalance between the proportions of investment and consumption in China, high investment well definitely rely on tremendous external demand, anyhow, under the current situation of declining external demand and insufficient domestic demand, it is necessary to adjust the relationship between investment and consumption, focusing on boosting consumption demand, and upgrading the structure of consumption structure, meanwhile, actively explore overseas market in order to transfer the excessive production capacity, optimize domestic investment structure and means for the purpose of realizing the corresponding development of consumption, investment and exportation.

### *3.2. To boost consumption demand and transform consumption attitudes*

While demand restriction is the main issue at present, it will be of greater significance to stimulate consumption than to increase investment. According to Keynes, income is the main factor to determine consumption, the marginal utility is diminishing, and it will be more effective to raise the income of the poor than to increase the income of the rich so as to promote consumption. The first way to boost consumption demand is to expand employment opportunities, increase the employment rate of the residents, mainly that of the university graduates and migrant labors, and establish a mechanism of regular pay increases, which will increase the revenue of the residents, but will be also beneficial to maintain social stability. The second way is to actively promote urbanization in order to transfer the excessive rural labor force to the city, at the same time create employment opportunities for them, raise the revenue of the rural laborers, reduce their living burden, and inspire their consuming potential. The third way is to improve the social security system, to deepen the reform in education, medical care, housing and social insurance system, offer much more government transfer payments, actively improve the social security system in the countryside, so as to reduce the expenditure

burden of the residents, and change their strong money saving willingness into consuming willingness. The last way is to change consuming attitudes. According to Maslow's Hierarchy of human needs, it is necessary to upgrade and improve the quality of the consuming needs of different consuming groups, actively nurture new consuming hot spots, give a full play of public opinion, media propaganda and the leverage of the market, to guide the residents to form scientific, economic, green, and low carbon consuming concept, and promote the development of such industries of energy saving and environmentally friendly industries, culture and tourism, mobile internet, cultural innovation and e-commerce, for the purpose of achieving a virtuous cycle of economic development and ecosystem.

### *3.3. To optimize investment structure and transform investment means*

In order solve the problem of excessive production capacity, waste of resources, and low efficiency in investment, the government should actively plays a leading role in investment, to guide the investment focus on such fields as people's livelihood projects, agriculture, water projects, high-end manufacturing, energy saving and environment preservation, social welfare projects, especially to increase the investment in infrastructure construction<sup>9</sup>. Studies have shown that 1% increase in the total amount of the existing infrastructure will bring about 1% increase in GDP in developing countries. To increase the investment in infrastructure can boost market demand, relieve the pressure of employment, supporting the development of domestic economy, and enhance the international competitiveness of the nation. Meanwhile, it is necessary to attract civil capital investment, broaden the range and fields of civil capital investment, and break down the systems hindering civil capital investment. Energetically introducing the PPP model (the cooperation of the government and social capital) in infrastructure and public service projects, which have large investment amount, need long term stability, and have an agile price adjusting mechanism and high marketization level, can not only relieve the pressure of the governmental debts, but also is the requirement of the realization of the modernization of national governance, and the new normality of the Chinese economy.

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<sup>9</sup> At present the existing amount of China's infrastructure is only 38% of Western European countries, and 23% of North American countries, which has vast room.(Source: Assistant Finance Secretary of the Ministry of Finance, Sun Xiaoxia's Address on the Symposium on PPP Program Training)



### 3.4. *To diversify labor capital investment*

“Among all investment, the most valuable is the investment on human themselves<sup>10</sup>.” Rapid development of hi-tech is the basis for the optimizing and upgrading of the industrial structure. However, the creation of new technology and new products are not created without any foundation, while it needs tremendous investment, especially labor capital investment to support the research, development and utilization. Labor capital is the source and driving force of modern economic growth and development. Although China is a country with a big population, laborers who can be qualified as labor capital are scarce. The scientific view on development, people oriented as its core, obliges that China shift its track from resource and capital oriented investment to the improvement of labor quality, promotion of technological progress, and improvement of the efficient use of resources and funds. In the process of increase labor capital investment, it is obligatory to promote the diversification of investors, while mainly based on national investment, at the meantime, to establish incentive mechanism of labor capital investment and utilization, to guide enterprises, institutions, NGOs, families and individuals to increase their labor capital investment, for the purpose of establishing a diversified labor capital investment model, shifting from the most populous nation to the most talented power, providing talent and intelligence support for the sustainable economic development and improvement of the international economic competitiveness.

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<sup>10</sup>Marshall. The Principles of Economics [M]. Beijing: China Social Sciences Press, 1999

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