

Driven to Excel: China's Quest for High-Tech

by

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*Anyone who tries to keep track of what is happening in China
is going to end up by wearing all the skin of his left ear from twirling around on it.*
— Robert Benchley¹

INTRODUCTION

There is little doubt that China is on the path toward becoming not only an economic superpower, but also a global technological competitor. While still years—and likely decades—away, the PRC has nevertheless made impressive strides in recent years toward realizing its high-tech aspirations. Barring a significantly disruptive event such as another Tiananmen Square, internal chaos, a widespread natural or environmental disaster, or international conflict, China's technology trajectory is likely to remain positive and could be steep. China's latest economic five-year development plan seeks to build on two and a half decades of reform and to transition China to a period of accelerated modernization based on improved science and technology. This paper briefly lays out China's strategic approach to S&T development, some key obstacles, and critical opportunities that will impact just how fast China might advance technologically.

RISING CAPABILITIES, NEW PERCEPTIONS

Almost every indicator of China's S&T and R&D capabilities is positive and the improvement has been at times dramatic. This is true in absolute terms and in some cases also relative to more developed economies.² Perhaps most importantly, China now stands third in the world in overall R&D spending (behind only the United States and Japan) and has achieved a level of 1.3 percent in R&D intensity (the ratio of R&D spending to GDP).³ This level of R&D intensity represents remarkably fast growth in R&D spending over the past decade (up from 0.6% of GDP in 1995) and is an unusually high level among developing countries.⁴ It also places China in a position to potentially experience an “S&T takeoff” as R&D spending nears 2-3 percent of GDP that historically has accompanied rapid and sustained levels of technological advancement among developed economies.⁵

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In addition, irrespective of statistics, the year 2005 may well be remembered as the year that China came into the public's consciousness as a potentially serious high-tech competitor. A number of recent events have highlighted China's rising status as a technological up-and-comer. These include the surprise takeover by China's leading high-tech firm, Lenovo, of IBM's personal computer division along with manufacturing rights for its ThinkPad brand laptops; an impressive initial public offering by the Chinese internet search company Baidu that brought in more than \$85 million in international investment and re-invigorated the flow of venture capital to Chinese start-ups; the publication of serious books with titles such as "The Emerging Chinese Advanced Technology Superstate"⁶; the proposed takeover of British icon MG Rover by Shanghai Automotive Industry Corporation (SAIC); the return by Chinese Taikonauts to space, demonstrating that China's first space shot was no fluke; and an attempted purchase of US oil company Unocal, reminding Americans in particular of China's need for greater energy resources to fuel its rapid economic and technological modernization. As a result of these and other noted advances, there has been a marked shift in recent years in the way scholars, press, and officials speak of China and the country's rising technological prowess. Consequently, the debate has shifted. It is no longer about whether China will become a technology superpower, only how soon.⁷

Despite the milestones listed above, China has a long way to go before becoming a global technology leader; it is still early days and much could go awry. While past setbacks and the likely obstacles China will have to confront in pursuing its high-tech aspirations have been well documented by numerous experts both Chinese and Western, China's technological prospects are less well defined. The recent and unanticipated progress China has made in advancing its technological capabilities in select industry sectors such as information and communications technologies (ICT), biotechnology, naval shipbuilding, and missile technology suggest that China's prospects deserve a careful reassessment.

Meanwhile, PRC officials and scholars have been busily formulating China's next long-term development plan—the 11th Five-Year Program (FYP)—which will govern PRC priorities and funding beginning in 2006 through 2010 and influence S&T thinking and policymaking for far longer.⁸ The proposed plan represents an important turning point in China's development. It will be the first developed under Hu Jintao's leadership and also the first to warrant widespread interest from a global community increasingly aware of China's growing high-tech capabilities. It is also, Mainland officials stress, the first such plan to be conceived of as (and termed) a "program" (*guihua*) in recognition of China's evolving market-based economy, in a move symbolic of China's growing distance from old-style, planned economic development.⁹ The idea clearly being conveyed is that of a leadership seeking to steer the ship with a guiding hand rather than through micro-management or bureaucratic interference in market forces that thus far have been serving well China's developmental goals.

Three Pillars of China's High-Tech Development Strategy

As already evident in recent years and reiterated in proposed language for the 11th FYP, China's modernization strategy rests on three strategic pillars: continued foreign direct investment (FDI), national investment in S&T development as the main driver of China's modernization, and civil-military integration (or spin-on) of dual-use technologies for military application. None of these strategies are entirely new, but they are today working increasingly in concert in China's drive

toward modernization. The result has been what appears to be fairly rapid improvement in China's S&T indicators and more advanced capabilities in key technology sectors.

FDI: A Crucial Pillar

In the run-up, and subsequent, to China's membership in the World Trade Organization, it became increasingly clear that the PRC had decided to fully embrace and exploit the opportunities offered by the global economy in its efforts to modernize. This is true not only for the economy but also in terms of China's S&T development strategy and defense industrial and military modernization efforts. This decision is significant in that China's future progress is, and will remain, intimately tied to continued high levels of foreign direct investment and the expertise and technology transfer that often accompanies it. PRC officials appear to believe this to be a good bet. Government statistics show that 70% of China's modern economy already stems from foreign trade, and officials have stated their expectation that China will continue to receive \$100 billion or more each year in FDI over the course of the next five years.¹⁰ If so, the PRC will continue to enjoy an unprecedented capacity to fund its near- and long-term high-tech aspirations without necessarily compromising other national priorities. Of course, if this judgment proves mistaken, then China's growth could stall or even decline precipitously.

But China's development strategy suggests that leaders in Beijing today view dependence on FDI more as a strength and opportunity than as a risk to China's development. This represents a significant departure from China's reputation as a country famous for its wariness of foreign influence, interference, and concern over dependence on foreign technology. China's current leadership, in keeping with efforts begun under Deng Xiaoping's "Open Door" policy and vigorously pursued and restructured under Jiang Zemin and Zhu Rongji, is seeking to attract ever-greater levels of foreign investment, overseas industry outsourcing, technology, and expertise. The difference today is that China's reliance on foreign investment is no longer seen merely as a necessary and temporary evil, but as a positive, long-term force in China's rapid and continuing economic modernization. This subtle shift in attitude is noteworthy and is tied to the present wave of economic globalization, which PRC leaders recognize China is in a unique position to exploit. While the PRC continues to seek technological independence from foreign sources (in the form of national development of intellectual property rights, patents, and technology standards), China no longer seeks to be technologically autonomous from the rest of the world. Rather, the PRC is striving to become a peer competitor by being active in the global high-tech economy.

Moreover, this approach to FDI, as reflected in the latest FYP, was not decided hastily nor exclusively by Party leaders and government officials. As on a number of other strategic issues re-evaluated over the past few years, China's leadership engaged numerous domestic and foreign experts in its planning process.¹¹ According to reports, preparations for China's 11th FYP began as far back as 2003 with a process of "tendering" reviews and recommendations from internal and outside experts. In what appears to be a first, Beijing sought expertise and suggestions from China's own research and academic institutions as well from officials of the World Bank, United Nations, and other outside experts.¹² Thus, China's leaders likely feel confident in the collected wisdom that underlies their current strategy for enhancing the country's economic and S&T development. This sentiment is evident in the tone and text of the 11th FYP, which emphasizes the need to accelerate as well as better manage economic growth and foreign investment but

reflects no doubt about the plan's strategic direction. The message is clear: more of the same; full steam ahead.

Also interesting in the FYP is the explicit call for enhanced international and regional collaboration on S&T endeavors. Such exchanges have been a factor in China's S&T strategy for decades, but the latest FYP calls specifically for enhancing economic and technological collaboration with other economies, particularly those that make up "Greater China" (Taiwan, Hong Kong, and Macau). Beijing's aim is to exploit to mutual advantage the complementarities among China's neighboring economies. This approach echoes the collaboration on ICT development ongoing among Mainland China, South Korea, and Japan. China's embrace of international S&T collaboration appears therefore even stronger and remains a strategically important part of China's S&T development plan.

Finally, a critical consideration in continuing to emphasize FDI as a pillar of China's S&T strategy is the evolutionary process of globalization. In addition to offshore manufacturing, globalization has led to more advanced forms of international investment and offshore outsourcing, namely overseas high-tech R&D. As a leading recipient of offshore investment and manufacturing during the 1990s, China has also witnessed a rapid rise in foreign-invested R&D over the past decade.¹³ PRC statistics list 750 foreign R&D centers in China as of the end of 2004, with more centers cropping up on a regular basis.¹⁴ Most of this R&D investment is found in high-tech industry sectors, particularly computer software, hardware, and telecommunications but also automotive, aerospace, and other manufacturing industries. According to official US data, American R&D investment in China has increased exponentially (from \$7m in 1994 to over \$500m in 2000), ranking 11th overall in 2000 in overseas US R&D investment (up from 30th place just six years prior). Although China's own studies show that foreign R&D investment has not necessarily improved the Mainland's technological and innovative capacity as much as PRC officials had hoped, the potential that this form of investment and technology transfer offers is essential to China's high-tech aspirations. Hence, foreign and domestic R&D investment is highlighted as a key element of China's high-tech strategy and 11th FYP, though with an emphasis on exploiting more effectively these technology transfer opportunities.

Effective exploitation and management of foreign and domestic S&T development will be China's main goal over the next five years. Though it sounds similar themes found in earlier development plans, the 11th FYP represents a critical transition period, between the rapid economic growth, high-level FDI, and high-volume technology transfers that China's early market opening measures prompted to a more managed, balanced, and sustainable but accelerated approach to modernization. This effort, in turn, will raise additional challenges for China's leaders. For instance, can the central government stay out of the way of business, allowing market forces and innovative impulses to dictate? Can China's domestic enterprises learn to innovate? Will policies, programs, and incentives that worked well in modernizing China's coastal areas translate as well in interior regions? And can China's substantial human resources meet the scientific, technological, and innovative challenges before them? While important for maintaining economic momentum, FDI can do little to address these challenges.

Transition to China's Third Modernization: S&T Development

A fundamental theme running throughout China's 11th FYP is continued economic development through more advanced science and technology ("comprehensively implementing a scientific development concept"). Accompanying this is the notion that progress and opportunity must be more evenly distributed across China. Thus, the plan calls for "harmonious development" aimed at benefiting all Chinese citizens, and not only those situated along China's booming coastal regions. It is noteworthy, as well, that Hu Jintao invoked similar terminology when speaking overseas recently, where he emphasized the potential for a "win-win" and mutually beneficial trade relationship between China, its trade partners, and neighboring economies.

The 11th FYP makes clear that China has formally transitioned from a primary focus on fast-paced economic growth that has characterized the PRC economy over the past two decades (the 2nd of Deng Xiaoping's "Four Modernizations" concept of development) to an emphasis on development of S&T as the major force in China's modernization drive (Deng's 3rd Modernization). The FYP stresses the need for improved scientific research, technological and innovative capacity, as well as better higher-education programs and institutions, all founded on expanded and improved infrastructure, particularly in China's interior and rural regions where investment has lagged behind coastal and urban areas. In other words, the strategy is to shift Westward the same economic dynamics and S&T-related investments and infrastructure that have proven successful in building China's capital and other east-coast cities into booming economies and increasingly high-tech settings. According to press reports, the strategy calls for officials to base investment decisions on regional comparative advantage, with coastal areas pushed to improve innovative capacity in higher-tech industries while interior central and western regions focus on their comparative advantage in labor-intensive industry sectors that utilize existing technologies.¹⁵ The plan also highlights the need for sustainable development, reduced energy consumption, and increased energy efficiency, in part through alternative energy research and technology development efforts.

In order to spread prosperity along with S&T-based development more evenly across China, the 11th FYP calls for nation-wide expansion of ICT technology, which will serve as the backbone for high-tech development and all forms of technology transfer (an extension of China's so-called "informatization" efforts). The plan drafted by Ministry of Information Industry to address 11th FYP challenges and mandates reportedly aims to "...extend telephone services to every village in the country and internet access services to every town by 2010. Furthermore, in 2020, every home will have telephone services and every village will have internet services."¹⁶ This effort has already begun with the establishment earlier this year of a national Universal Telecom Service project (*Cun Cun Tong*).¹⁷ Also key to the plan is increased convergence of high-tech equipment, services, and operators in order to improve capability, enhance innovation, and lower the cost of development, manufacture, and distribution of high-tech goods. In short, Beijing is aiming to bring globalization to all parts of China and making the necessary investments in the country's infrastructure, S&T workforce, institutional linkages, and policy reforms that will facilitate it. Among the specific areas to receive government attention under the 11th FYP is the transportation system and logistical services and distribution channels, particularly those in the interior where high costs, differences in regulatory practices, and local competition often inhibit foreign and domestic high-tech investment.

The Third Pillar: Dual-use Commercial S&T as the Basis for Defense Industrial Development

As a growing number of analysts are pointing out, China's defense industrial capabilities are improving along with the country's S&T indicators, both at a surprisingly rapid pace over the past few years. China's defense industrial sector's recent breakthroughs or participation in developing indigenous or modified-for-military-use technologies include sectors such as fiber optic cable, grid-computing and high-performance supercomputers, core network routers, telecommunications switches, and small-size reconnaissance satellites.¹⁸ In addition to advances in information technology and microelectronics, China is reported to be significantly improving its modern submarine, space, and missile systems.¹⁹

What accounts for this seemingly sudden improvement? First, it must be noted that China has been working to improve its defense industrial capacity for nearly two decades, which suggests that the advances apparent today could merely be the result of substantial time and effort. Another consideration is how much of this new capability is directly the result of foreign technology transfer. To some extent this is obviously true given China's purchase of advanced weaponry and technology from Russia, Israel, and others. But part of the explanation also lies in China's growing indigenous capacity to develop, absorb, and integrate advanced commercial technology and to adapt it to military use.

China's approach to defense industrial development has evolved since Deng Xiaoping first announced the strategy of "Combining the Military and Civilian Sectors" (*junmin jiehe*) in the mid-1980s. Today, the emphasis is less on defense conversion (spin-off) than on spin-on activities by civilian and defense industry enterprises for, or in concert with, China's military (the PLA or People's Liberation Army). China's emphasis on "coordinating military and economic development" is noted in the latest FYP draft as well as in Beijing's most recent *Defense White Paper*.²⁰ This dual-use approach to defense industrialization is based on both opportunity and necessity.

There is insufficient space here to outline the many challenges facing China's defense sector, which continues to be plagued by historical difficulties of bureaucratic infighting, a lack of horizontal integration (due to institutional stove-piping), an ineffective incentive structure for researchers, and so on.²¹ But a number of these obstacles are being overcome (or sidestepped) as Beijing tries to enhance interaction between the defense sector and China's burgeoning commercial high-tech sector.²² One reason is that, as is the case in the United States, Europe, Japan and other advanced economies, the majority of China's overall R&D spending and personnel today resides in industry—not in the government or public sector. Consequently, China's defense industry and military are increasingly reliant on commercial-sector R&D. This is significant in that, according to experts, "industrial R&D is the most closely linked to the creation of new products and production techniques."²³ It is also the foundation of modern revolution in military affairs (RMA). Thus, to the extent that the spin-on model works, China's efforts to enhance its economic fortunes through increased S&T investment should also help advance China's defense industrial development efforts. In turn, China's military modernization efforts could lead to innovative commercial applications based on defense-related R&D.

CONCLUSION

The most interesting question we've yet to ask perhaps may be: what will be the impact of one billion plus people, economically unfettered and online, on 21st Century technological innovation? While an exaggeration, this concept is not entirely fantastic. If China is able to successfully expand its economic growth model into its central and Western regions and to connect its enormous populace to the Internet with all the knowledge this affords, there is no telling what might come about as a result (state censorship of China's Internet notwithstanding). Along with rising prosperity, there would likely also come unprecedented new ideas, novel technology applications, and possibly even invention, for which China was once famous.

But to realize anything close to this scenario, China's leaders must overcome enormous challenges. Chief among them—as recognized in the 11th FYP—is how to maintain a continuous high rate of growth without overheating the economy and while translating domestic and foreign technology achievements into economic prosperity in both urban and rural, Eastern and Western areas of China's vast economy. There's also the recognition today in Beijing that the price of rapid economic growth over the past two decades has been rising unhappiness among China's "have-nots" as well as vast environmental damage across the country. If S&T is to continue to advance in China, these costs must be addressed and a sustainable development model effectively enforced.

Another critical issue for Beijing will be how to balance competing S&T interests.²⁴ The huge sums of FDI that China continues to enjoy added to rising levels of venture capital have helped to alleviate some S&T funding dilemmas and allowed greater PRC investment in long-term S&T efforts. But near-term demands for S&T funding will nevertheless continue to press Chinese officials at the national and local level. Leading experts have also noted the government's comparatively low level of funding for basic or fundamental R&D, but it remains to be seen whether this will remain a priority. The proposed FYP merely states "Basic research and frontier technology research should be strengthened."²⁵ Furthermore, it is unclear whether the latest FYP's focus on "harmonized" development will slow technological advancement in other parts of China, particularly the dynamic high-tech development clusters along China's coastal region. Only time will tell, but regulating China's several different economies (broadly delineated in East, Central, and Western China) will be enormously difficult and require officials in Beijing to manage inter- and intra-regional, provincial, and municipal competition and rivalries.

Yet China, more than any other country, lies at the center of what drives globalization: a large-size, low-cost, well-educated workforce and consumer population whose government offers attractive incentives for foreign investment and technology transfer with long-term potential for new market opportunities. China's room to grow Westward, often seen as a disadvantage in economic development terms, thus becomes a potential advantage in a globalizing world economy, if managed effectively. Another key advantage China has is its nationalistic drive to excel and regain its place among the world's technological leaders. This attitude is palpable on the streets of Shanghai and other rapidly developing municipalities along China's eastern edge. The potential this spirit could have in concert with rising standards of living in the interior regions should not be underestimated.

But, as the 11th FYP and recent statements by PRC leaders suggest, China at least for now seeks to advance technologically by further opening up its economy to the world to potential mutual advantage. In economic parlance, the PRC is following simultaneously a techno-national, techno-regional, and techno-global strategy that it believes, in a still-evolving period of globalization, will serve China's interests well through the end of the decade.

Endnotes

¹ Robert Benchley, "A Brief Course in World Politics," *Benchley Lost and Found* (Dover Publications, 1970).

² Albert Hu and Gary Jefferson, "Science and Technology in China," Prepared for Conference 2: China's Economic Transition: Origins, Mechanisms, and Consequences," Preliminary Draft (29 October 2004), accessed online at <http://people.brandeis.edu/~jefferso/res.html>.

³ In 2003, the United States R&D spending represented 38% of global R&D expenditures, with Japan at 15%, and China in third place with 9% (calculated in purchasing power parity PPP terms). This put China ahead of Germany (7%), France (5%), and the UK (4%). OECD, *Main Science and Technology Indicators*, 2004.

⁴ Hu and Jefferson.

⁵ See analysis by economist Gary Jefferson, who defines "S&T takeoff" as "... an abrupt increase in a country's ratio of research and development (R&D) spending to GDP from less than one percent to more than two percent. For ... large, high-income economies, this remarkable acceleration in the ratio of R&D spending to GDP occurred on average within the span of a single decade." Gary H. Jefferson, "R&D and Innovation in China: Has China Begun Its S&T Takeoff?," Prepared for the *Harvard China Review* (August 11, 2004), p. 1.

⁶ Ernest Preeg, *The Emerging Chinese Advanced Technology Superstate* (Association of Manufacturing Technology, 2005).

⁷ This is not to say that everyone views China's contemporary high-tech advancements as indicative of future competitiveness or even a concern for US economic and security interests. Skeptics abound. See, for instance, George J. Gilboy, "The Myth Behind China's Miracle," *Foreign Affairs* (2004).

⁸ The 11th Five-Year Program for National Economic and Social Development was approved by the 16th Chinese Communist Party Central Committee in October 2005. Related plans and programs drawn up by China's Ministries and other government departments will be reviewed at the 4th session of the 10th National People's Congress in March 2006.

⁹ The significance of this one-word change is noted in the Xinhua News Agency's coverage of the 11th FYP. See, "Chinese News Agency Summarizes Key Features Of 11th Five-Year Plan," BBC Monitoring International Reports (October 28, 2005) translated from text of the "Xinhua viewpoint" by reporters Zhang Sutang, Sun Chengbin, and Zou Shengwen, carried by official Chinese news agency Xinhua (New China News Agency), Beijing, in Chinese 0231 gmt October 26, 2005.

¹⁰ "China risk: Foreign trade & payments risk," *EIU RiskWire* (November 15, 2005).

¹¹ China's leadership has sought input from diverse sources of expertise including think tanks, non-governmental organizations, and academic institutions in recent efforts to update China's nuclear weapons and missile defense strategies as well as on recent export control reforms.

¹² "Chinese News Agency Summarizes Key Features Of 11th Five-Year Plan," BBC Monitoring International Reports (October 28, 2005) translated from text of the "Xinhua viewpoint" by reporters Zhang Sutang, Sun Chengbin, and Zou Shengwen, carried by official Chinese news agency Xinhua (New China News Agency), Beijing, in Chinese 0231 gmt October 26, 2005.

¹³ On the evolution of foreign-invested R&D in China, see Kathleen A. Walsh, *Foreign High-Tech R&D in China: Risks, Rewards, and Implications for US-China Relations* (Washington, DC: The Henry L. Stimson Center, 2003).

¹⁴ This figure is cited in a recent report by the Ministry of Commerce's think tank, the Chinese Academy of Foreign Trade and Economic Cooperation in a report entitled "2005 Report of Transnational Corporations in China." Excerpts from the report are available online. See, for instance, "Overseas investment on the up," *China Daily Online* (1 February 2005) <http://www.chinadaily.com.cn/chinagate/doc/2005-02/01/content_414069.htm>.

¹⁵ "China To Develop Regions According To Comparative Advantage - Hong Kong Daily," *BBC Monitoring International Reports* (October 10, 2005) Text of report: "Three major economic zone domains may be redefined," published by Hong Kong newspaper *Ta Kung Pao* website on October 9, 2005.

¹⁶ "Telecom-11th-Five-Year-Plan," *China Business News On-Line* [Interfax News Agency] (November 18, 2005).

¹⁷ *Ibid.*

¹⁸ Tai-Ming Cheung, "Harnessing the Dragon: Civil-Military Integration and China's Defence Modernisation," Richard H. Yang, ed., CAPS Papers No. 36 (Taipei: Chinese Council of Advanced Policy Studies, January 2004), pp. 12-13; and James Mulvenon, "Digital Triangle: A New Defense-Industrial Paradigm," in *Economics and National Security: The Case of China*, eds. Kent Butts and Edward Hughes (Washington, D.C.: U.S. Army War College, August 2002).

¹⁹ "Chinese Puzzle," *Jane's Defence Weekly* (21 January 2004), pp. 24-29; US Department of Defense (DoD), *Annual Report on The Military Power of the People's Republic of China*, FY04 Report To Congress On PRC Military Power (28 May 2004).

²⁰ See Information Office of the State Council, “China’s National Defense in 2004” (December 2004). See also Cheung, particularly pp. 4-5.

²¹ For a comprehensive history of China’s military and defense industrial development, see David Shambaugh, *Modernizing China’s Military: Progress, Problems, and Prospects* (Berkeley: University of California Press, 2002), particularly Chapter 6: Defense Industries and Weapons Procurement.

²² Mulvenon, “Digital Triangle: A New Defense-Industrial Paradigm.”

²³ Martin Schaaper, “An Emerging Knowledge-Based Economy In China?: Indicators From OECD Databases,” STI Working Paper 2004/4 Statistical Analysis of Science, Technology and Industry, OECD, no. DSTI/DOC(2004)4 (22 March 2004), p. 42, available online at

[http://www.oalis.oecd.org/oalis/2004doc.nsf/43bb6130e5e86e5fc12569fa005d004c/2a1a9aff293c3a05c1256e5f005af275/\\$FILE/JT00160520.PDF](http://www.oalis.oecd.org/oalis/2004doc.nsf/43bb6130e5e86e5fc12569fa005d004c/2a1a9aff293c3a05c1256e5f005af275/$FILE/JT00160520.PDF) .

²⁴ The proposed FYP text cites the “five balances”: “balance in urban and rural development, balance in regional development, balance in economic and social development, balance in the harmonious development of man and nature, and balance in domestic development and opening up to the outside world.” “Text of Chinese Communist Party Proposal on 11th Five-Year Programme - Part 2,” BBC Monitoring International Reports (October 22, 2005) Text of Part 2 of Chinese Communist Party proposal entitled: “(Released by authorization) CCP Central Committee proposal on formulating the 11th Five-Year Programme for National Economic and Social Development”; as carried by official Chinese news agency Xinhua (New China News Agency).

²⁵ Ibid.