

ISSN 1753-5816

School of Oriental and African Studies University of London

DEPARTMENT OF ECONOMICS

Working Papers

No.153

**CHINA'S QUEST FOR ALTERNATIVE TO NEO-LIBERALISM:
MARKET REFORM, ECONOMIC GROWTH, AND LABOR**

Dic Lo

November 2007

economics@soas.ac.uk

[http://www.soas.ac.uk/academics/departments/economics/research/
workingpapers/econ-working-papers.html](http://www.soas.ac.uk/academics/departments/economics/research/workingpapers/econ-working-papers.html)

**CHINA'S QUEST FOR ALTERNATIVE TO NEO-LIBERALISM:
MARKET REFORM, ECONOMIC GROWTH, AND LABOR**

Dic Lo

School of Oriental and African Studies, University of London; and
School of Economics, Renmin University of China.

diclo@soas.ac.uk

ABSTRACT: Since the turn of the century, China's state and society have focused their efforts on "constructing a harmonious society". Viewed from the perspective of globalization, these efforts represent a quest for a model of development that deviates fundamentally from neo-liberalism. In particular, state policies and institutional reforms in recent years have tended to target at labor compensation-enhancing economic growth, rather than growth based on "cheap labor". This paper seeks to clarify the nature of the emerging Chinese economic development model, and, on that basis, to analyze its efficiency and welfare attributes. In conjunction with an analysis of China's economic growth path, which seems to have undergone a transition from labor-intensive growth to capital-deepening growth, it is argued that the new development model does represent a more feasible and desirable pursuit than neo-liberalism. The paper concludes with a discussion on the impact of this new Chinese development model on the future direction of globalization.

KEYWORDS: China, market reform, economic growth, labor

JEL Classification numbers: J88, O11, O53

The completion of this paper received financial supports from the *9-8-5 Research Funding Program* of the Renmin University of China (project entitled 'Technological Innovation and China's Economic Growth'), which is gratefully acknowledged. The author would like to thank Li Guicai for research assistance.

1. Introduction

Immediately following the outbreak of the East Asian financial and economic crisis, in the years 1998-2002, China's state leadership adopted a range of economic policies which, in effect, constituted a reversal of the previous, uni-directional pursuit of market reform (Lo 2001). While designed to be short-term, anti-crisis policies, it turned out that these policies have had significant long-term effects particularly in reinforcing the capital-deepening nature of the prevailing economic growth path. Meanwhile, from the early years of the new century, the leadership has arrived at a new policy line known as "constructing a harmonious society". One central element of this new policy line is the emphasis on labor compensation-enhancing economic growth, rather than growth based on "cheap labor". It is clearly discernible that this emphasis, and the policy line as a whole, represents a quest for a model of development that is alternative to the market fundamentalism of neo-liberalism.

The objective of this paper is to investigate into the causes, internal coherence and systemic importance of the indicated alternative model of development. In conjunction with an analysis of China's economic growth path, which seems to have undergone a transition from labor-intensive growth to capital-deepening growth, it is argued that the state and societal efforts associated with this new development model do represent a more feasible and desirable pursuit than neo-liberalism. On this basis, the paper also discusses the impact of China's on-going change in development model on the future directions of globalization. It is submitted that, in the context of China's prominent role in the expansion of the globalized labor force, the impact is bound to be systemic in nature.

This paper is organized in five sections, of which this introduction is the first. Section two seeks to clarify the main attributes of China's emerging new development model, with a focus on the causes and significance of the capital-deepening economic growth path. Section three turns to policy issues. It is argued that there is a high degree of coherence between the package of anti-crisis policies adopted in 1998-2002 and the subsequent state development policies, particularly labor policies, in the sense that they constitute an alternative model to neo-liberalism. Section four discusses the worldwide significance of Chinese development. Section five concludes the paper.

2. Implications of the Change in the Economic Growth Path

It has always been the prime objective of China's state leadership that economic growth and compensation-enhancing expansion in labor employment must both proceed smoothly, and in tandem. This has been especially true since the turn of the century, when the leadership turned to emphasize the necessity of correcting the excess in social polarization caused by market reforms, with the objective of "constructing a harmonious society".

The actual performance of the Chinese economy over the reform era, however, did not seem to fare sufficiently well with this state objective. It can be observed that there is a marked difference between the performance in the first half of the era and that in the second half. In the former period, circa 1978-92, sustained rapid economic growth was accompanied by expansion in labor employment at a comparable pace – but only at the cost of a prolonged trend of wage stagnation. Since the mid-1990s, the economy has managed to achieve rapid growth together with rising wage rates, but employment expansion has slowed down to socially worrying speed. It appears that there is no quick-fix for simultaneously achieving the three targets of economic growth, employment expansion, and wage increase. To unravel the complexities involved requires, in the first place, analyzing the underlying dynamics of the Chinese economy – that is, the changing nature of the economic growth path.

It is well-known that, in the first half of the reform era, China's economic growth was largely a labor-intensive one. Growth was largely propelled by the absorption of new entrants to employment. More precisely, it was a process of the massive transfer of labor from the rural-agricultural sector to industry and services, the latter two sectors (particularly industry) being characterized by much higher levels of productivity as well as much faster productivity improvement. Starting from the early 1990s, however, the economic growth path has tended to switch to a capital-deepening one. The substitution of capital for labor, particularly in industry, has become increasingly evident. As a result, the ability of economic growth to create jobs and absorb new labor to employment has tended to diminish.

Table 1 gives the data of the indices of China's real gross domestic product (GDP), labor employment and the total labor force. It is of note the change that occurred in the mid-1990s.

Up until that time, both output growth and productivity growth were already very fast. And these were accompanied by a trend of fast expanding employment, which exceeded the pace of expansion of the total labor force. Since the mid-1990s, output growth and particularly productivity growth have tended to accelerate. But, employment expansion has tended to lag behind that of the total labor force, implying a tendency of increasing unemployment.

[Table 1]

The change in the character of the economic growth path is clearly indicated by Figure 1, which shows the trend of evolution of the incremental capital-output ratio of the Chinese economy. It can be seen that the ratio decreased steadily from 2.02 in 1982 to a low level of 1.51 in 1993, but then turned to move upwards to reach the high level of 3.55 in 2003. It might well be argued that the downward movement of the ratio in the first half of the reform era was largely due to improvements in Chinese economic institutions in the utilization of capital inputs. Yet, it is equally plausible that the movement reflects a tendency of substituting labor for capital, which is a salient feature specific to reforming or “transitional” economies. Characteristic of the development strategy of Soviet-type economies are their emphasis on heavy industrialization, and the associated capital accumulation makes it feasible for pursuing a new strategy of substituting labor for capital in the first stage of the reform era. Conversely, upon the exhaustion of the opportunities provided by the pre-reform capital accumulation, resuming a capital-deepening path of industrialization and economic growth might well be reasonable in terms of feasibility. In terms of efficiency attributes, such a development path most likely contradicts the relative scarcity, and hence comparative advantage, of the Chinese economy. But, theoretically, it could be associated with fast technological progress and strong increasing returns. There does exist a body of scholarly studies which confirm that this is indeed the case for China since the mid-1990s (see, e.g., Lo and Li 2006). Also recall the acceleration of China’s output and productivity growth during this period, as indicated in Table 1 above.

[Figure 1]

The change in the character of the economic growth path has important implications for labor employment. To ascertain the implications, a range of regression analyses can be carried out. First look at the industrial sector alone. We divide Chinese industry into two sectors: the

formal sector represented by “township-and-above independently accounting industrial enterprises” before 1998 and “all state-owned industrial enterprises plus above-scale (of more than five million yuan by sales value) non-state-owned industrial enterprises” from 1998, and the rest of Chinese industry. The regression model takes the following form:

$$(1) \ln L = \alpha + \beta \cdot DUM + \gamma \cdot \ln I + \delta \cdot DUM \cdot \ln I + \varepsilon$$

where, L is total employment (i.e., the number of employed workers), I is gross fixed capital formation which is taken to represent capital deepening. According to Chow’s Breakpoint Test, there is a significant difference between the structural relationship of the two variables for the two period 1978-1990 and 1991-2005, both for the formal and informal sectors of Chinese industry. Hence, we use the dummy variable DUM which is assigned a value of 0 for the first period and 1 for the second period. The I data series is expressed in 1978 constant prices. The price deflator for the first period is estimated as a weighted average of the price indices of industry and construction, the weight being 0.6 and 0.4, respectively. The deflator for the second period is official.

Table 2 gives the result of the regression analysis of equation (1). It can be seen that all the explanatory variables are statistically significantly correlated to the dependent variable, but there are differences between the formal sector and the informal sector regarding the correlation between $\ln L$ and $\ln I$. In the period 1978-1990, the correlation between $\ln L$ and $\ln I$ is statistically significant for both sectors. The value of the correlation coefficient is 0.257 for the formal sector and 0.309 for the informal sector, suggesting that the former sector is more prone to adopt capital-intensive technology. Moving on to the period 1991-2005, however, the correlation became much less significant. In the case of the formal sector, the correlation became negative, i.e., $0.257 - 0.260 = -0.003$. As for the informal sector, the correlation remains positive but the value of the coefficient, $0.309 - 0.206 = 0.103$, is only one-third of that in the first period. These results imply that Chinese industry, both the formal and informal sectors, has indeed followed a capital-deepening growth path.

[Table 2]

The approach adopted above can be extended to the analysis of both industry and the non-industry sector, i.e., the economy as a whole. We divide the Chinese economy into three

regions: Eastern (coastal) provinces, Central provinces, and Western provinces. The reason for this division is that the three regions have form a pattern of specialized division of labor, where Eastern has a higher degree of specialization in manufacturing and Central and Western have a higher degree of specialization in primary products. This difference is especially visible in their respective exports. We use the following regression model:

$$(2) \ln L = \alpha + \beta \cdot DUM + \gamma \cdot \ln I + \delta \cdot \ln X + \mu \cdot DUM \cdot \ln X + \varepsilon$$

where X is export value of the region, and is expressed in 1978 constant prices using GDP deflator, while all other variables are same as equation (1). The reason for using export as an explanatory variable is that export is a source of demand, and China has been largely specialized in exporting labor-intensive products.

Table 2 also gives the result of the regression analysis of equation (2). It can be seen that, again, all the explanatory variables are statistically significantly correlated to the dependent variable. The correlation between $\ln L$ and $\ln I$ is basically of the same level for the three regions. In contrast, the correlation between $\ln L$ and $\ln X$ is substantially different between Eastern and the other two regions before the 1990s: the value of coefficient is 0.095 for Eastern, 0.146 for Central, and 0.159 for Western. Entering the second period of 1991-2005, the correlation between $\ln L$ and $\ln X$ substantially decreased for all the three regions: the value of coefficient become 0.024 for Eastern, 0.027 for Central, and -0.016 for Western. It appears that the same tendency of capital deepening also applies to China's export sector, and export sectors of all the three regions.

The change in the character of the economic growth path should be seen in the broader context of China's economic transformation. Succinctly, the labor-intensive growth path that prevailed in the first half of the reform era was associated with a rapid expansion in consumption demand, which was in turn underpinned by an egalitarian pattern of income distribution. Yet, with the progress of market reforms and thereby the growing unevenness of income distribution, consumption expansion has substantially slowed down and the economy has switched from supply-constrained to demand-constrained. From the mid-1990s onward, insufficient aggregate demand has prevailed in the economy. And investment has replaced consumption as the main driving force behind the expansion in aggregate demand, as is

indicated in Figure 2. Consequently, China has tended to follow an economic growth path that is characterized by a process of “producing investment goods for producing investment goods”, meaning that it has become increasingly capital-intensive – not only because of normally expanding investment, but also because of the tendency to substitute capital for labor in the production process. This capital-deepening growth path has proved to be capable of generating rapid productivity improvement, but only at the cost of leaving less and less of the expanding labor force to be absorbed into employment.

[Figure 2]

The failure to achieve sufficient employment expansion should also be weighed against the success in achieving the increase in labor compensation, and *vice versa*. It is noted that, until the mid- to late-1990s, labor compensation had experienced very sluggish growth, quite in contrast to the sustained rapid growth of the economy. Indeed, there have been widespread reports that, outside the formal, mainly state-related sector, the wage rate had been almost frozen for fully twenty years since the beginning of reform. This was especially true in the labor-intensive, export-oriented industries in the coastal provinces, owing to the almost unlimited supply of unprotected, un-unionized labor from the rural areas of inland provinces. Even in the formal sector, the trend of evolution of the wage rate has seriously deviated from that of per capita GDP. As can be seen from Figure 3, before the turn of the century, the growth rate of the real urban wage rate persistently lagged behind that of per capita real GDP. Moreover, in the years of enterprise downsizing and mass unemployment in the 1990s, there was a situation of the two indicators moving in opposite directions: the growth of the real wage rate slowed down, amid the growth of per capita GDP accelerating. It is basically from the turn of the century onwards that there has emerged a reverse situation. Now, the growth of the real wage rate substantially exceeded that of per capita GDP, although both are in the same direction of moving upwards.

[Figure 3]

The preceding analyses in this section thus depict a complex picture of the changing dynamics of China’s economic transformation, and the efficiency and welfare attributes thereof. It is within this context that the new policy line of the state leadership, aimed at “constructing a harmonious society”, can be properly assessed.

3. The Quest for an Alternative Development Path

To re-cap, the preceding section makes clear that the achievement of the treble policy targets – of sustained rapid economic growth, employment expansion, and wage increase – is by no means a straightforward matter. In particular, there is no guarantee that maintaining the prevailing capital-deepening growth path, or returning to the previous labor-intensive growth path, would automatically achieve the treble targets.

It will be instructive, for the purpose of policy discussion, to focus our exposition on the prevailing capital-deepening economic growth path. This growth path might well be efficient, in the sense that it is characterized by fast productivity improvement due to technological progress and dynamic increasing returns. It might even be necessary because of demand constraints, and for the sake of upgrading Chinese industry and enhancing its competitiveness in the world market. But, without generating sufficient jobs to alleviate the pressure for employment, the growth path might not be socially sustainable. In this light, government policies in the areas of macro demand management, income redistribution, welfare provision, labor market regulation, as well as those concerning international transactions, all need to be designed in a coherent manner taking into consideration of the broader context.

3.1. Macro Policies

In recent years, deficiency in aggregate demand has been a prominent feature of the Chinese economy. The economy was already on a downturn trend on the eve of the East Asian financial and economic crisis. Demand deficiency was the central issue, probably due to the upsurge in market reforms in the early- to mid-1990s. In particular, the privatization and downsizing of state-owned enterprises (SOEs) in 1995-97 resulted in mass unemployment, while the complete commercialization of state banks resulted in their behavior switching from excessive lending to excessively cautious lending.

In the face of the worsening external environment caused by the East Asian crisis, the Chinese state leadership turned to adopt four major categories of anti-crisis policies between 1998 and 2002. These policies, namely, are: (1) several Keynesian-type fiscal packages for

expanding investment demand, which were financed by debt issuing of unprecedented scales; (2) a range of welfare-state policies, which included lifting up the benefits for retired or unemployed workers, raising the payments of public sector employees, and lengthening the paid holidays of workers – all aimed at reversing the trend of stagnant consumption expansion; (3) policy measures to re-vitalize the state sector – including the setting up of four state asset management companies responsible for taking over a substantial share of non-performing loans from state banks and for a program of debt-equity swap, which were aimed at improving the financial conditions of SOEs and the balance sheets of state banks; and (4) a cautious approach to reforming the regime of external transactions – in particular, the leadership has in effect shelved the target of liberalizing the country's capital account.

These policies, in essence, represent a retreat from the previous stance of pursuing the uni-directional movement towards the idealized, canonical market economy. Thus, while designed to be short-term anti-crisis policies, they turned out to be very powerful in shaping the long-term path of economic development.

Consider fiscal stimuli. Initially, the annual budget approved by the National People's Congress in March 1998 maintained that fiscal deficits – which had persisted for every single year since 1982 (except in 1985 when an explosive upsurge in imports generated a huge customs revenue for the state budget) – be cut by 10 billion yuan from the 1997 level of 58 billion yuan (0.78% of GDP). This was already below what was needed to achieve the target, set in the 1994 fiscal system reform, of balancing the budget by the year 2000. Yet, from the second quarter of 1998, the leadership shifted to adopt an active fiscal policy to stimulate economic growth. The actual deficits in the year turned out to be a hefty 92 billion yuan (1.18% of GDP). Along with the continuous employment of the active fiscal policy, deficits expanded further in subsequent years: 174 billion in 1999, 249 billion in 2000, 252 billion in 2001, and 315 billion in 2002 – i.e., 1.94%, 2.51%, 2.29% and 2.62%, respectively, of GDP. In the mean time, over the five years of 1998-2002, the state issued a total of 660 billion treasury bills for long-term construction investment. These, together with complementary investment by other economic agents (central ministries, local governments, and enterprises), amounted to a total investment scale of 3200 billion yuan (*Renmin Ribao* [People's Daily], 18 March and 10 December 2002).

Viewed from a long-term perspective, the fiscal activism of 1998-2002 does represent a shift away from the pursuit of budget balance and minimal government intervention in the economy. This pursuit was clearly discernible in the fiscal system reform of 1994 and was pre-dominant in the design of government economic policies until early 1998. Yet, in the event, budget deficits did not diminish but rather expanded very substantially between 1998 and 2002. Budget deficits as a ratio of GDP for the first time approached 2% in 1999 and it did exceed that level in the next four years. Perhaps even more conspicuously, government debt issuing for the first time exceeded 3% of GDP in 1997 and it has remained so thereafter. In terms of its impact on the economy, official estimation states that, in the face of the persistence of deflation that was caused by the sluggish expansion in both domestic and external demand, government investment during 1998-2002 had the effect of contributing to 1.5-2 percentage points of the growth of GDP in each of the five years. Moreover, because the investment was concentrated mainly in infrastructure, it did produce significant crowding-in effects in the sense that it paved the way for the subsequent massive expansion in total investment in the economy as a whole from 2001 onwards.

On the whole, it could be argued that the Chinese state leadership was quite successful with its fiscal activism in the period 1998-2002. Central to the activism was the adoption of a range of expansionary fiscal policies to stimulate aggregate demand and therefore economic growth, with an objective of helping enterprises as well as the government to “grow out of indebtedness”. This is in sharp contrast to the policy recommendation from international financial institutions, for East Asian economies as well as for China during this period, which typically argue for balancing government budgets through austerity. In the event, China’s actual economic development indicates that the adoption of fiscal activism was justified. Apart from surviving the most difficult years of 1998-2001, from 2002 onwards, economic growth has reversed the almost ten-years downward trend and has indeed accelerated. Budget deficits, though remaining large in actual amounts, has thus tended to decrease as a ratio to GDP. The same trend of development has also been evident at the micro level. The reversal of the policy of downsizing and privatization did not result in worsening financial performance of enterprises. Instead, in the context of the rebound in economic growth, the profit rate of enterprises (including SOEs) has risen successively for every year since 1998.

The 1998-2002 fiscal activism has had a further, somewhat unexpected impact on the long-term development of the economy, in the form of strengthening the movement of the growth path towards capital-deepening. Because the government policies were mainly aimed at stimulating investment, the trend of the composition of aggregate expenditure increasingly skewing to investment has not been reversed but has rather accelerated (as is clearly indicated in Figure 2). This, while being helpful to the efficiency and sustainability of economic growth, has had serious deficiency in terms of employment growth. Moreover, it appears that even the investment expansion subsequent to the fiscal activism has been insufficient to compensate for the sluggish growth in consumption demand. The enlarging deficiency in aggregate demand is clearly evident in the massive expansion in the surplus of foreign trade in goods and services, which reached an astonishing high level of 7.3% of GDP in 2006.

3.2. Labor Market Policies

In a sense, it would not be much off the mark to assert that, before the turn of the century, the Chinese leadership had basically adopted a *laissez faire* approach toward labor employment outside the state sector. This is particularly evident in the declining influence of the only existing, official trade union, the All China Federation of Trade Unions. Union members as a proportion of the total of employees with the secondary and tertiary sectors decreased from 49% in 1981 to 29% in 2000 (Figure 4). Nevertheless, in recent years, union membership has had a substantial rebound. As a proportion of the total of employees with the secondary and tertiary sectors, it climbed back to a level of 36% in 2005.

[Figure 4]

The rebound in unionization owes much to the enforcement by the central government of the stipulation that enterprises of all types of ownership are required to allow for the setting up of unions or for workers joining unions. This requirement has for a long time been sternly resisted by local governments, private employers, and most notably foreign capital funded enterprises (particularly multinational corporations). Yet, from the point of view of the state leadership, this is essential to the promotion of collective bargaining over labor compensation. And collective bargaining is, in turn, considered to be indispensable for reversing the trend of decreasing labor's share in the national income.

This notwithstanding, there is no sign that China's enterprise system is to return to that of the formal sector in the first half of the reform era, where workers as a collective had a powerful influence over their compensation as well as over the division of enterprise surplus as a whole. The withering of public firms as a proportion of the corporate sector simply makes this impossible. Even in the public firms that remain, and even in large-scale SOEs (which are traditionally the core of the public sector), the bargaining power of workers vis-à-vis the management is minimal nowadays. This is because the employment relationship has already been fully marketized. The traditional system of life-time employment, which was characteristic of China's socialist system pre-reform, is now history. Instead, the employment relationship is now governed by market-determined contracts. It was still the case that labor contracts covered only 41% of total urban employment in 1995. By 2000, however, the proportion reached 95%.

In this connection, it is noted that the trend of wage rate growth rebound in recent years, shown in Figure 3, has also been ascribable to a variety of further factors. In addition to increased unionization, government protection of labor rights in the drafting and enforcement of employment contracts are reportedly of increasing significance. And the acceleration of economic growth, together with its capital-deepening orientation, has also resulted in a very rapid growth in labor productivity, therefore contributing to the wage rate growth. It seems the treble targets of rapid economic growth, employment expansion and wage increase have in a significant measure been achieved, thanks to the concerted working of the economic growth path itself and the appropriate government policies.

But, there is an intrinsic problem with this economic condition – namely, the problem of unemployment. The very fast wage growth since the turn of the century, shown in Figure 3, has not resulted in the rebound of the growth of consumption. Instead, as shown in Figure 2, the decline of consumption as a proportion of aggregate expenditure has accelerated precisely during this period. And the deficiency in aggregate demand has tended to worsen, as is also shown in Figure 2. The sustainability of the on-going economic growth path and employment expansion, at least in the social (if not economic) sense, is thus still in question.

3.3. Assessing the State Policies

It appears that the state policies detailed above in this section – together with other related policies such as the increased protection of labor rights, the enforcement of minimum-wage legislation, the emphasis on income redistribution to avoid further worsening social polarization, the expansion in social welfare provision, as well as the on-going attempts to reconstruct a government-funded health-care system – do have their coherence. They are all conducive to the pursuit of compensation-enhancing employment. They are also consistent with, if not also conducive to, the capital-deepening economic growth path. The hope-for employment expansion thus ultimately rests on the labor-absorption capability of the services sector, as has been emphasized by the government. In other words, the sustainability of the prevailing pattern of economic growth and employment expansion, and therefore the relevant state policies, depends on whether the fast productivity gains in industry can be effectively channeled to the development of the labor-absorption capability of services.

A question naturally arises as to why wouldn't (or shouldn't) the state leadership adopt an alternative policy line – of promoting a return to the labor-intensive path of economic growth that prevailed in the first half of the reform era. This alternative clearly fits better into principles of the market, particularly the principle of comparative advantage. And it has widespread supports from influential Chinese economists. It has been argued that this alternative growth path is not only (allocatively) efficient but also equitable, in the sense that it would create more jobs and thus its immediate benefits would be spread to a bigger proportion of the population. Insofar as it would result in a negative impact on labor compensation, the argument goes, this could be offset by redistributive government policies and the system of social welfare provision.

The assessment of the prevailing policy line thus needs to take into consideration its cost and benefit relative to its alternative. Note that, in principle, it is in no sense a straightforward matter of judging which of the two policy lines is better, or easier to pursue. Yet, for the sake of arguments, the assessment could be carried out in the following way. Consider growth. The productive efficiency associated with capital-deepening growth should be weighed against the allocative efficiency associated with labor-intensive growth. The net outcome of this trade-off is necessarily an empirical issue, and, as has been indicated earlier, the productivity and output growth of the Chinese economy in the second half of the reform era appears to have

out-performed that of the first half. In the context of a demand-constrained economy, where the scarcity of resources is not necessarily a binding constraint, it can be further argued that allocative efficiency is likely to be less important than productive efficiency in underpinning economic growth. Again, as indicated, it is evident that China has been in a state of serious and worsening deficiency in macroeconomic demand since the mid-1990s.

Turn to the consideration of employment. It seems straightforward that a labor-intensive growth path must create more jobs than a capital-deepening one. Yet, this is not necessarily the case for a demand-constrained economy, i.e., a situation of aggregate expenditure being less than the full-employment output level. If the situation is caused by factors unrelated to the wage rate being too high, just like what we have characterized in the preceding sections of the Chinese economy, a fall in the wage rate (for inducing the substitution of labor for capital) would not necessarily result in an increase in employment. Everything depends on, first, the net impact on labor's share in national income and thereby on macroeconomic demand, and, second, the balance between the distribution-induced impact on macroeconomic demand and the wage-induced impact on capital-labor substitution.

At this point, the issue of demand also implies a question of feasibility for pursuing a return to the previous, labor-intensive growth path. Note that the trend of China's aggregate expenditure skewing to investment rather than consumption has accelerated in recent years, despite all the redistributive and labor compensation-enhancing government policies. There is indeed a serious question, in the domestic front, as to what would be the sources of demand outlets for the increased labor-intensive, mostly consumer goods. Exporting might be a viable alternative. And it has been, witnessed the ballooning trade surplus in recent years – and the fact that made-in-China labor-intensive manufactures are now flooding the world market. The consideration of market outlets, and thereby job creation, might even be an important reason behind China's willingness to maintain an anomalous economic relationship with the United States in recent years. Yet, trade frictions, and the pressure on China to contribute more demand to the world economy, have become a normalcy in China's economic relationship with the USA and other major trade partners. Given all these hurdles in both the domestic and external fronts, the question of feasibility for the labor-intensive growth path appears to be at least no less serious than that of the capital-deepening growth path.

4. Chinese Development in the Light of Globalization

Globalization since the later years of the 1990s, that is, after the 1997-98 East Asian financial and economic crisis, appears to have brought about both hopes and disappointments for world development. There has been substantial growth rebound worldwide, from the “lost decades of development” of the 1980s and 1990s. But, there have also been serious obstacles to the translation of the benefits of economic growth into real development. The pressure on developing countries to accumulate costly foreign exchange reserves, deteriorating terms of international trade against manufacturing-oriented developing countries, and the phenomena of growing unemployment and rising income inequalities, are the most prominent of the obstacles.

Theoretically, these worldwide trends might be interrelated. The accumulation of official reserves in developing countries is a necessary response to the threat of financialization, that is, the rapidly rising predominance of speculative financial activities in the world economy. And, as Robert Wade (2006) has observed, financialization implies a tendency of financial interests dissociating themselves from real investment and the productive process in general. There is thus an intrinsic contradiction with financialization: the speculative pursuits of profitability tend to crowd out productive activities, therefore resulting in systemic demand deficiency and undermining the sources of profitability.

This contradiction need not imply that capital accumulation and with it economic growth on the world scale must be unsustainable. As David Harvey (1989, 2003) has argued, capital accumulation in the era of globalization hinges on the balance between the indicated contradiction, on the one hand, and the cheapening of productive inputs, on the other hand. It is in this connection that national and international policies associated with neo-liberalism can be seen as essential to the current round of globalization. These policies facilitate the cheapening of productive inputs, labor in particular, and their incorporation into the system of capitalism. Yet, this same process, by expanding the spatial scope of capitalism and creating new centers of accumulation, also tends to reproduce the problem of systemic demand deficiency on expanded scales. The successful achievement, or otherwise, of the balance

between these positive and negative factors of profitability will thus remain the central problem of capitalism in the era of globalization.

In the institutional dimension, as Harvey has further argued, financialization necessarily requires flexible production. Logical to the rising mobility of capital is the inclination towards minimizing fixed investment and maximizing profits via absolute surplus-value production. A central tenet of neo-liberalism is precisely to create flexible institutions in the form of the casualization of employment, which is made possible via the creation of an “unlimited supply of labor” and the elimination of arrangements that could undermine the flexible working of the labor market, such as unionization and legislative protection of labor. This appears to be what has actually occurred to date.

Nevertheless, this neo-liberal tenet has no prior claim to superiority even in the sense of underpinning the kind of flexible production that is needed for surviving competition in the world market. In line with the literature on techno-economic paradigms (Lo and Smyth 2004), it could be posited that the behavioral flexibility of the productive system could arise from two different, contrasting types of institutional arrangements. One consists in casualization, that is, “flexible institutions, flexible behavior”, which is based on the principles of the detailed division of labor and de-skilling of work. The other arrangement is rigid, or long-term-oriented institutions, constructed on the basis of the social division of labor – that is, “rigid institutions, flexible behavior”, where behavioral flexibility arises from collective learning and horizontal co-ordination. Theoretically, there is no *a priori* reason to believe that which of the two types of arrangements is more competitive than the other. In reality, however, the triumph of neo-liberalism, in conjunction with the drive of financialization, has resulted in the predominance of the “flexible institutions, flexible behavior” model across the world. This has been so despite the observation that, on historical record, the alternative “rigid institutions, flexible behavior” model embodies a much higher degree of solidarity, egalitarianism and social justice, and the argument that the alternative model is less prone to produce systemic demand deficiency that could undermine economic growth (Dore 2002).

In the context of the condition of world development as depicted above, China’s development experience and policy efforts since the turn of the century deserve special attention. In the first place, there should be no mistake to assert that China has been an

extreme case with respect to the recent world-level economic trends. China has registered the fastest economic growth in the developing world; and this is a reversal of its growth slow-down from the very high rate of the early 1990s. It has built up an abnormally high level of the ratio of foreign exchange reserves to import needs – abnormal, that is, relative to the high and still rising level of the average of all developing countries; and this implies providing massive subsidies to the countries issuing reserves currencies. It has had a trend of the terms of international trade that is far worse than the average of developing countries. Finally, as indicated in the preceding sections, unlike its own experience up until the mid-1990s, China’s on-going acceleration of economic growth has not been matched by a comparable pace of employment expansion; and this is despite the fact that China has firmly established itself as “factory of the world”, which implies sucking in manufacturing jobs from the outside world, since the turn of the century.

Yet, China is not simply a “case”. It could be asserted that a main aspect of globalization is the expansion of the world labor market associated with the incorporation of China into the system. According to the International Monetary Fund (2007), weighing countries’ labour force by their export-to-GDP ratio, the effective global labor supply quadrupled between 1980 and 2005, with East Asia contributing about half of the increase. And, over this period, there has been an accelerating trend of massive relocation of industry and jobs from the rest of East Asia to China. Using the same indicator of employment adjusted by the export-to-GDP ratio, as of 2005 year-end, China’s share of the world total of workers producing for the global market reached 25%. No wonder, in addition to its growth performance, the condition of labor employment, compensation and work standards in China has increasingly become a matter of worldwide concern.

Because of its significant and rising position in the world economy, China’s attempt to construct an alternative model of development is bound to make a systemic impact on the future direction of globalization. As noted, the worldwide cheapening of labor over the past quarter-century and particularly since the early 1990s has been, in a very significant measure, associated with the incorporation of China’s labor force into the world market. Now that there have emerged strong state and societal efforts in China to resist the cheapening drive, some fundamental adjustments in world development are likely to occur. Whatever the precise

nature of the adjustments, the triumph of neo-liberalism is likely to be less complete in the future than in the previous quarter-century. Real development worldwide has a stake in the success or otherwise of China's attempt to construct an alternative to neo-liberalism.

5. Conclusions

In the context of the opportunities for and challenge to development under globalization, it is of general importance to clarify the dynamics, achievements and limitations of the on-going Chinese development experience. This paper undertakes to carry out a study along this direction. The central proposition of the paper is two-fold. First, the prevailing economic growth path is in the main efficient, and is potentially capable of increasing labor's compensation and solving the problem of sluggish growth in employment. Second, the economic growth path, which is capital-deepening in character, is a result partly of the marketized economic system, and partly of the anti-market social and economic policies that arise in response to the excess of marketization before the turn of the century.

Granted that the prevailing pattern of China's economic transformation is sustainable, whether or not it represents a new model of development in the context of globalization after the 1997-98 East Asian crisis, moreover, is of far-reaching policy implications. The analyses and discussion in this paper might offer some thoughts on this.

References

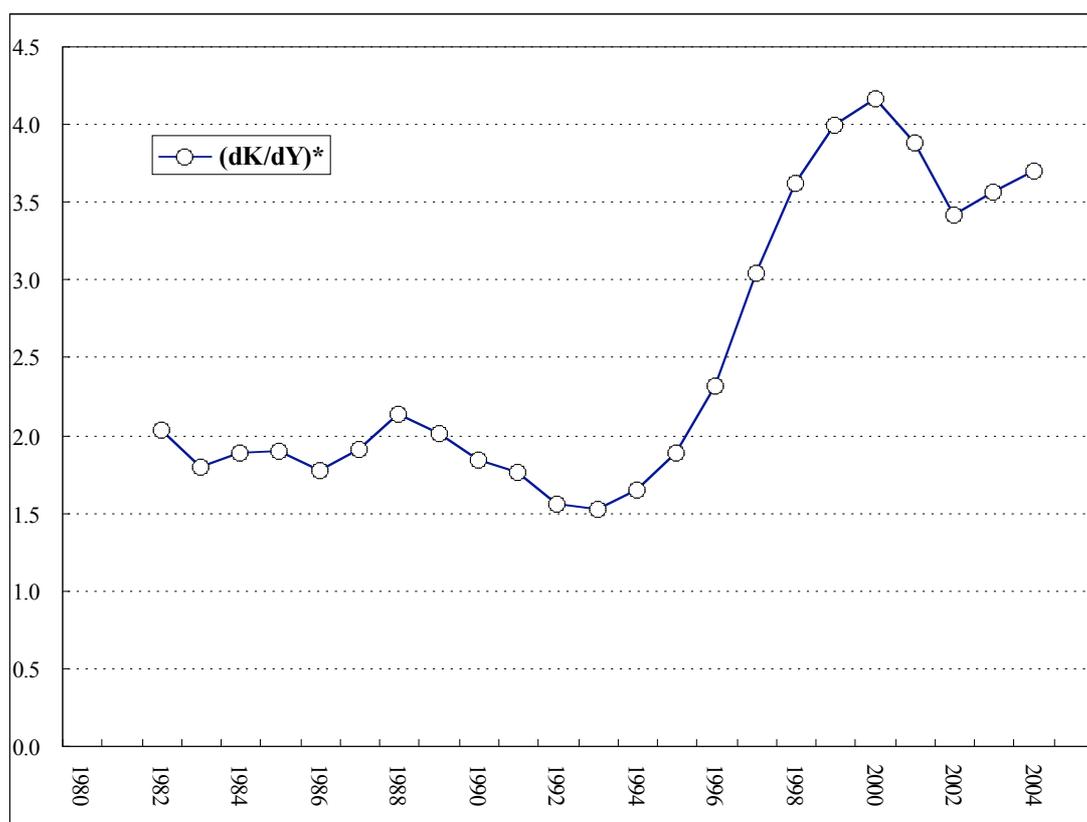
- Dore, Ronald (2002) 'Stock market capitalism and its diffusion', *New Political Economy*, 7 (1): 115-127.
- Harvey, David (1989) *The Condition of Postmodernity: An Enquiry into the Origin of Cultural Change*, Oxford: Blackwell.
- (2003) *The New Imperialism*, Oxford: Clarendon.
- International Monetary Fund (IMF) (2007) *World Economic Outlook*, April, Washington, D.C.: International Monetary Fund.
- Lo, Dic (2001) 'China after East Asian developmentalism', *Historical Materialism*, 8, pp.251-262.
- Lo, Dic, and Guicai Li (2006) "China's economic growth, 1978-2005: structural change and institutional attributes", Department of Economics working paper no.150, School of Oriental and African Studies, University of London, www.soas.ac.uk/departments/departinfo.cfm?navid=437.
- Lo, Dic, and Russell Smyth, (2004) 'Towards a re-interpretation of the economics of feasible socialism', *Cambridge Journal of Economics*, 28 (6): 791-808.
- Wade, Robert (2004) 'On the causes of increasing world poverty and inequality, or why the Matthew effect prevails', *New Political Economy*, 9 (2): 163-188.
- (2006) 'Choking the South', *New Left Review*, no.38: 115-127.

Table 1. Indices of China's real GDP, employment and labor force

	(a) Real GDP	(b) Employment	(c) Labor Force	(a)-(b)	(b)-(c)
1978	100.00	100.00	100.00	0.00	0.00
1980	116.00	105.50	105.46	10.50	0.04
1985	192.90	124.21	123.18	68.69	1.03
1990	281.70	161.26	160.57	120.44	0.69
1995	502.30	169.52	169.25	332.78	0.27
2000	759.90	179.53	181.88	580.37	-2.35
2005	1195.50	188.84	191.43	1006.66	-2.58
2006	1323.42	190.28	...	1133.14	...

Sources: National Bureau of Statistics, *China Statistical Yearbook 2006*; National Bureau of Statistics, *Statistical Communiqué of National Economic and Social Development in 2006*, www.stats.gov.cn.

Figure 1. Incremental Capital-Output Ratio (5-Year Moving Averages)



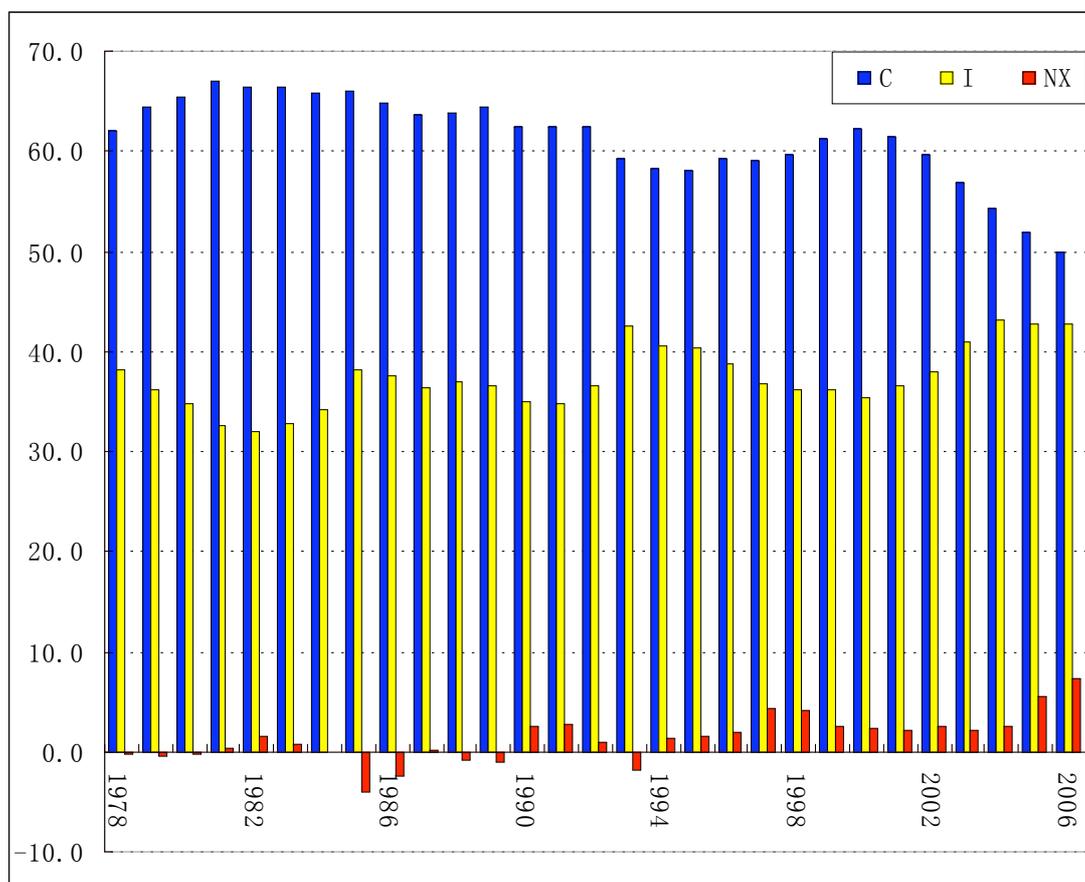
Sources: National Bureau of Statistics, *China Statistical Yearbook 2006*; National Bureau of Statistics, *Statistical Communiqué of National Economic and Social Development in 2006*, www.stats.gov.cn.

Note: Incremental Capital-Output Ratio = dK/dY , where dK = total fixed-asset investment, dY = GDP of current year minus GDP of last year.

Table 2. Regression Analysis: Employment, Investment and Export

Equation (1): $\ln L = \alpha + \beta \cdot DUM + \gamma \cdot \ln I + \delta \cdot DUM \cdot \ln I + \varepsilon$						
(Data are of Formal and Informal sectors of Chinese industry, 1978-2005)						
	α	β	γ	δ		Adj- R^2
Formal	7.136 (15.084)***	1.721 (2.020)*	0.257 (3.409)***	-0.260 (-2.163)**		0.306
Informal	8.572 (55.923)***	1.576 (8.764)***	0.309 (14.548)***	-0.206 (-8.622)***		0.974
Equation (2): $\ln L = \alpha + \beta \cdot DUM + \gamma \cdot \ln I + \delta \cdot \ln X + \mu \cdot DUM \cdot \ln X + \varepsilon$						
(Data are of the economies of Eastern, Central and Western regions, 1978-2005)						
	α	β	γ	δ	μ	Adj- R^2
Eastern	8.730 (151.011)***	0.524 (7.452)***	0.081 (3.426)***	0.095 (4.662)***	-0.071 (-7.380)***	0.992
Central	8.348 (117.978)***	0.895 (9.817)***	0.067 (2.851)***	0.146 (8.786)***	-0.119 (-9.739)***	0.992
Western	8.623 (64.833)***	0.856 (4.134)***	0.057 (1.996)*	0.159 (10.592)***	-0.175 (-4.195)***	0.976
Sources: National Bureau of Statistics, <i>China Statistical Yearbook</i> , various issues.						
Note: Figures in parentheses are t-ratios; ***, ** and * are significant at 1%, 5% and 10% confidence levels, respectively.						

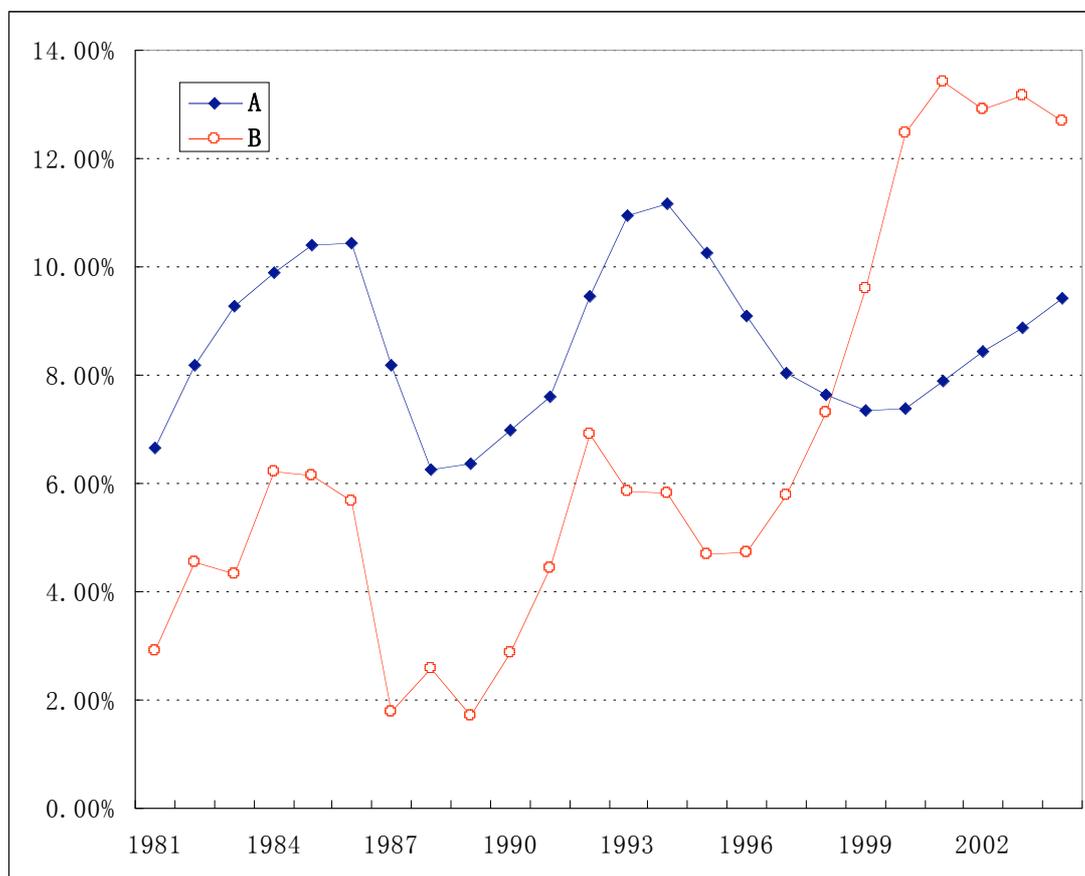
Figure 2. Composition of GDP by Expenditures (%)



Sources: National Bureau of Statistics, *China Statistical Yearbook 2006*; National Bureau of Statistics, *China Statistical Abstract 2007*.

Note: C = final consumption; I = investment; NX = net export of goods and services.

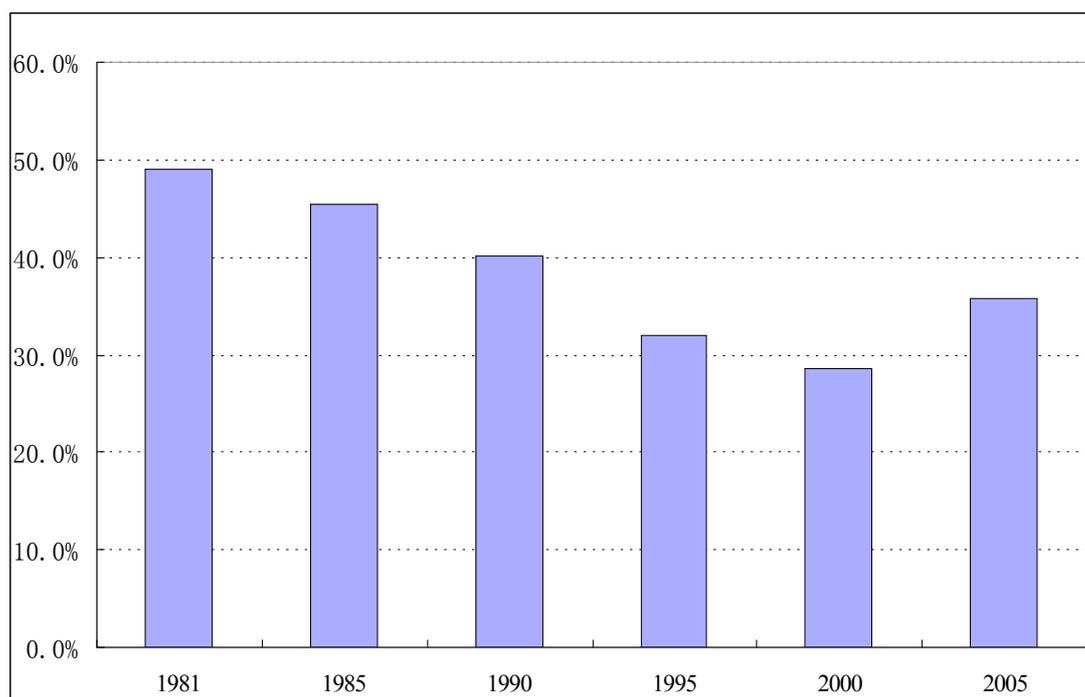
**Figure 3. Annual Growth Rate of Per Capita Real GDP and Real Urban Wage Rate
(5-Year Moving Average, %)**



Sources: National Bureau of Statistics, *China Statistical Yearbook 2006*; National Bureau of Statistics, *China Statistical Abstract 2007*.

Note: A = per capita real GDP; B = urban real wage rate.

Figure 4. Proportion of Unionized Workers (%)



Sources: National Bureau of Statistics, *China Statistical Yearbook 2006*; All China Federation of Trade Unions, *China Statistical Yearbook of Trade Unions*, various issues.

Note: Figures are the number of members of All China Federation of Trade Unions divided by the total number of employees in the Secondary and Tertiary sectors.