

CHINA'S CHANGING DEVELOPMENT PATH: GROWTH, POLICY, AND IMPACT ON GLOBALIZATION

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1. Theme

The Worldwide Growth Rebound and the Challenge to Development

- Since the turn of the century, there has been substantial economic growth across the world. This seems to offer good potential for social and economic development. But, as yet, the potential has not been (mainly) translated into real development – because of constraints both in the external and internal fronts.
- Externally, the pressure for accumulating low-yield foreign exchange reserves and the trend of deteriorating terms of trade against developing countries – both being parts of the process of globalization after the 1997-98 East Asian crisis – imply outflows of the benefits of growth. Internally, growth has not been accompanied by a comparable pace of employment expansion because of systematic demand deficiency.
- Thus, whether or not developing countries are able to sustain economic growth in the face of the constraints, and to translate growth into development, are key issues today.

China as a New Paradigm of Development?

- China is an extreme case. Since the turn of the century, its economic growth has been among the fastest, its foreign exchange reserves have become the biggest, its terms of trade has been among the worst, and it has had problems of growth with insufficient job creation.
- Nonetheless, on the whole, China has basically achieved the targets of sustaining economic growth and translating the benefits of growth into real development. Accelerating economic growth with increasing labour compensation has been evident.
- This achievement is in the first place result of a capital-deepening growth path, which is evidently with strong productive efficiency and is thus potentially sustainable. It is also result of a mix of government policies , which both reinforce the growth path and promote wage-enhancing employment expansion.
- It is in relation to this nexus of growth path and government policies that the Chinese experience post-crisis might be considered as a paradigm of “new developmentalism”. And this is bound to make a far-reaching, systemic impact on globalization.

2. China's Nexus of Growth and Development

Growth, Employment, and Labour Compensation

- “Constructing a harmonious society” entails the achievement of three targets simultaneously:
 - (1) sustained rapid economic growth,
 - (2) the absorption of surplus labour into employment, and
 - (3) the steady increase in labour compensation.
- In the first half of the reform era, c.1978-1992, China managed to achieve targets (1) and (2), but not (3). In the second half, especially in recent years, China managed to achieve targets (1) and (3), but not (2). **[Table 1, Figure 1]**
- The main reason: policy efforts (details below), in connection with a fundamental shift in the economic growth path, from labour-intensive to capital deepening. **[Figure 2]**
- Main causes of the shift in growth path: a transition from consumption-led to investment- and export-led growth (plus profitability rebound and limitation on capital flights). **[Figure 3]**

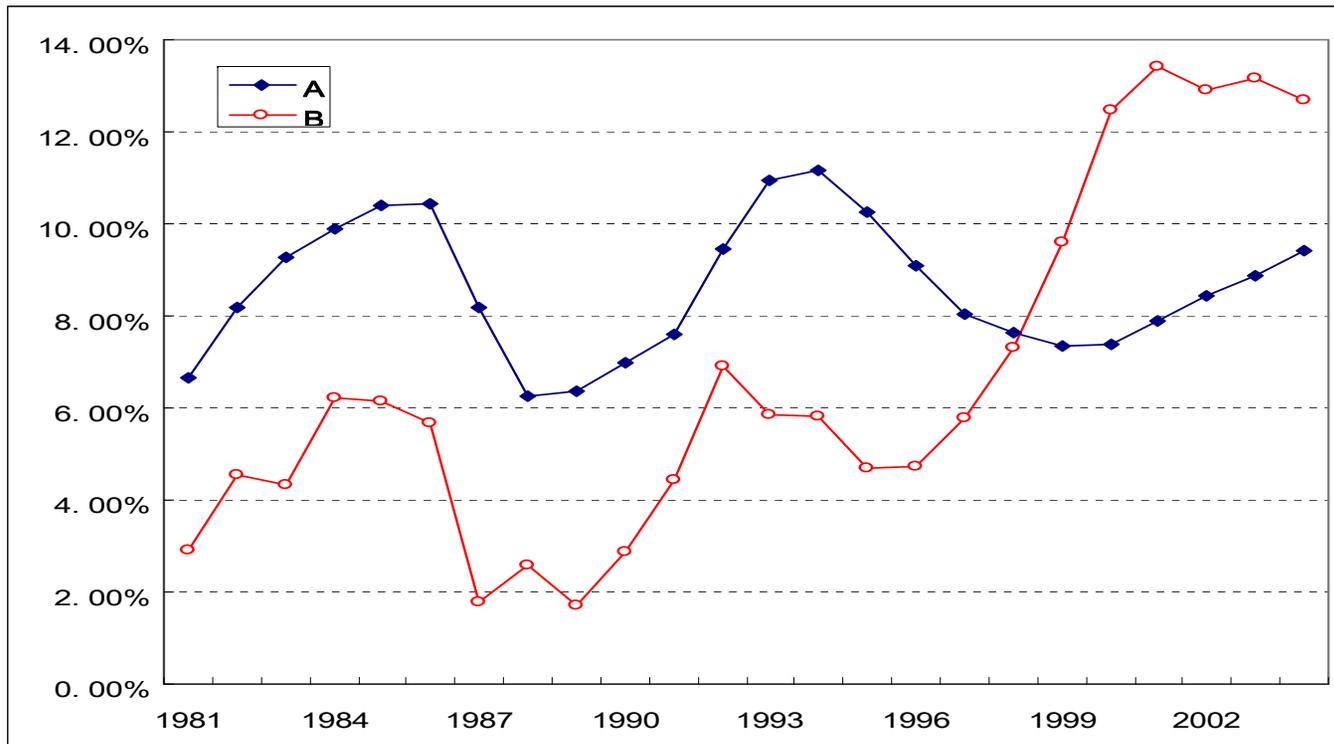
Table 1. Indices of China's Real GDP, Employment and Labor Force

	(a) Real GDP	(b) Employment	(c) Labor Force	(a) - (b)	(b) - (c)
1978	100.00	100.00	100.00		
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. Annual Growth Rate of Per Capita Real GDP and Real Urban Wage Rate (5-Year Moving Average, %)



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

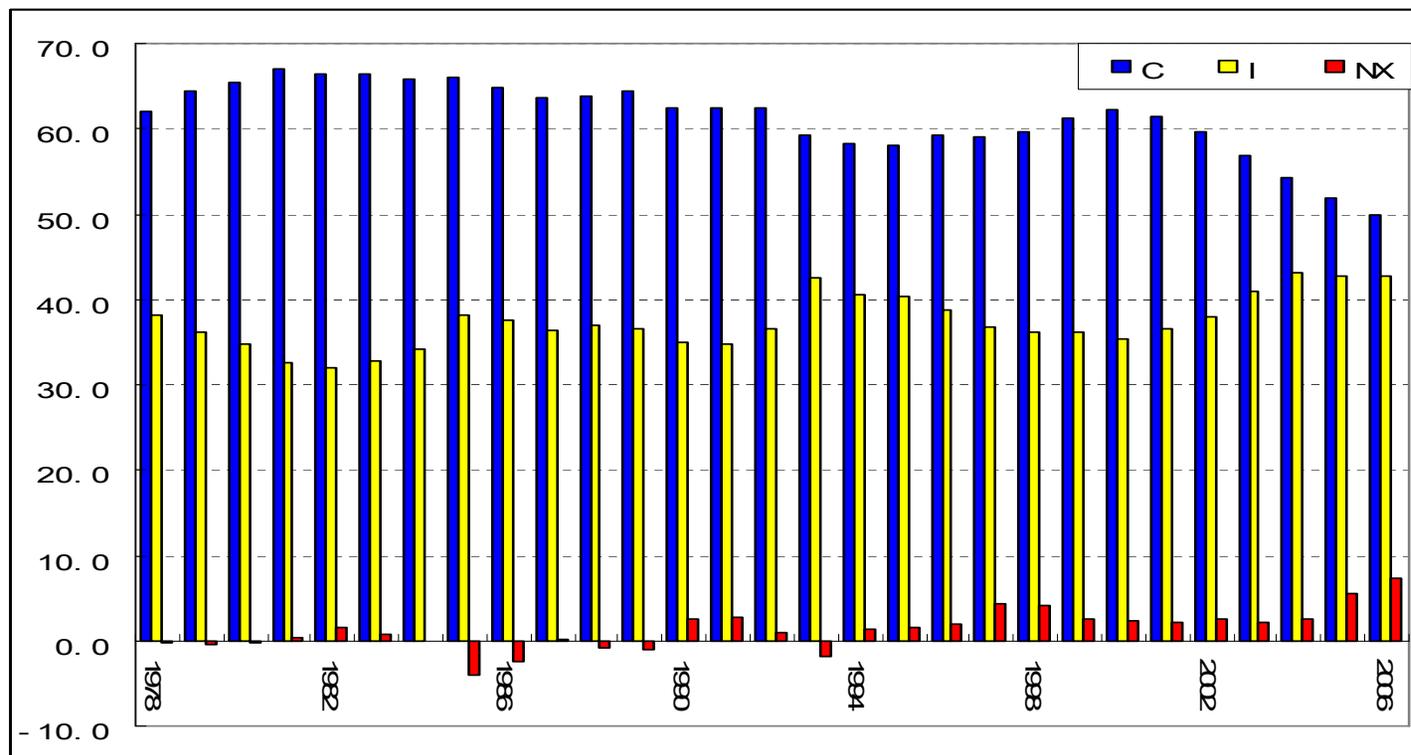
Sources: National Bureau of Statistics, *China Statistical Yearbook 2006*; *China Statistical Abstract 2007*.

Figure 2. Incremental Capital-Output Ratio (5-Year Moving Averages)



Note: Incremental Capital-Output Ratio = dK/dY , where dK = total fixed-asset investment, dY = GDP of current year minus GDP of last year.
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 3. Composition of GDP by Expenditures (%)



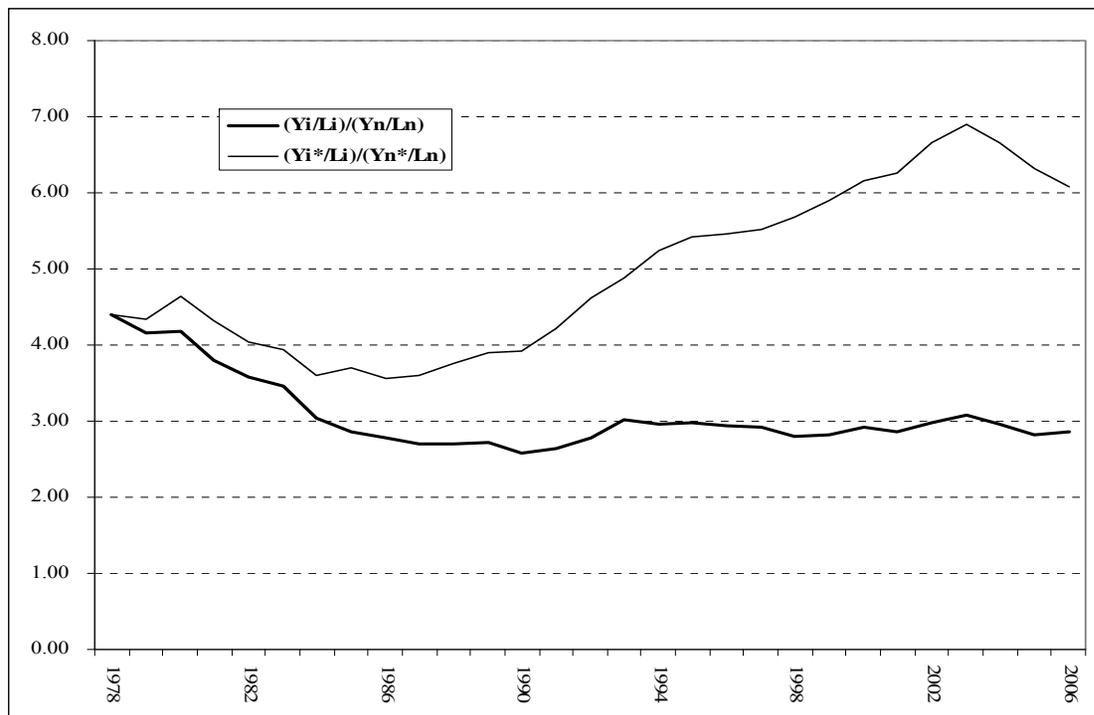
Sources: National Bureau of Statistics, *China Statistical Yearbook 2006*; National Bureau of Statistics, *China Statistical Abstract 2007*.

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

The Economic Growth Path

- The efficiency attributes of the capital-deepening growth path are associated with a process of rapid industrialization. Since the mid-1990s, there has been an acceleration of the transfer of productivity gains in industry to the rest of the economy. **[Figure 4]**

Figure 4. Relative Labour Productivity of Industry, 1978-2006



Sources: China State Statistical Bureau, *China Statistical Yearbook* and *China Statistical Abstract*, various issues.

Notes: Y = GDP and its components at current prices, with *denoting data at 1978 constant prices. L = total labour employment. The subscripts i and n denotes the secondary sector (i.e., industry plus construction) and the rest of the Chinese economy, respectively.

- Simple regression analysis of Chinese data of 1978-2006, in line with the “Kaldor-Verdoorn Laws”, and takes the following forms, gives the results in Table 2. **[Table 2]**

$$\dot{\hat{x}}_t = \alpha + \beta \dot{Q}_t \quad (1)$$

$$\Delta \dot{\hat{x}}_t = a - b(\dot{\hat{x}}_{t-1} - \hat{\dot{x}}_{t-1}) + c \Delta \dot{Q}_t \quad (2)$$

- First, it is found that there are long-term, dynamic increasing returns at the sectoral level within industry, non-industry, SOEs and non-SOEs.
- Second, SOEs are more capable of generating dynamic increasing returns, but being less capable of adapting to short-term fluctuations, compared with non-SOEs.
- Third, industry is found to be more capable of adapting to short-term fluctuations than non-industry, but being less capable of generating dynamic increasing returns.

Table 2. Structural and Institutional Characteristics of Economic Growth, 1978-2006

	α	β	A	B	c	Adjusted-R ²	
						Equation (1)	Equation (2)
Industry	3.447	0.543 **(2.634)	0.026	0.487 **(2.731)	0.565 *** (3.120)	0.180	0.337
Non-Industry	-1.939	1.001 *** (9.945)	0.058	0.347 (2.040)	0.960 *** (10.663)	0.784	0.814
SOEs	1.333	1.207 *** (5.800)	0.319	0.112 (1.200)	1.037 *** (12.559)	0.547	0.857
Non-SOEs	3.414	0.647 *** (5.284)	0.182	0.916 *** (4.670)	0.756 *** (7.581)	0.499	0.755

Sources: China National Statistical Bureau, *China Statistical Yearbook* and *China Statistical Abstract*, various years.

Note: Data analyzed are Chinese dat of 1978-2005. Figures in parenthese are t-ratios; ***, ** and * indicate statistical significance at 1%, 5% and 10% confidence levels, respectively.

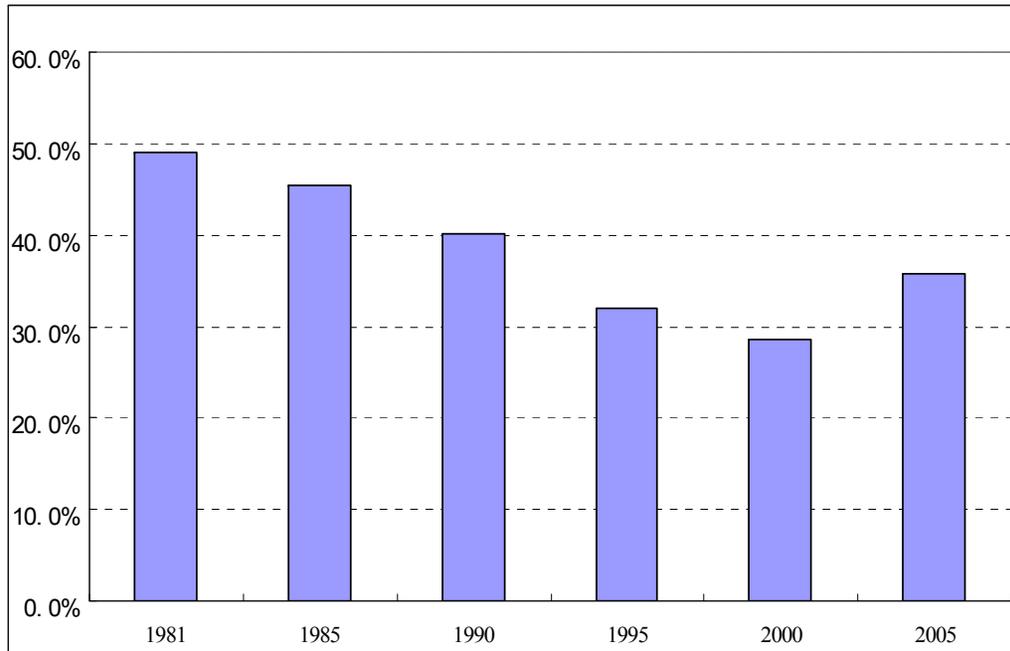
Policy: the Long-Term Effect of the 1998-2002 Anti-Crisis Package

- In the face of the worsening demand deficiency caused by the 1995-97 marketization high tide and the subsequent East Asian financial crisis, the Chinese leadership adopted a policy package in the years 1998-2002.
- This was consisted of:
 - (1) Keynesian-type fiscal stimuli for expanding investment demand;
 - (2) Welfare-state policies aimed at reversing the trend of stagnant consumption expansion;
 - (3) Measures to re-vitalize the state sector, particularly to improve 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 target of liberalizing the country's capital account has been effectively shelved.
- 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 in the direction of capital-deepening.

Policy: Labour and “Constructing a Harmonious Society”

- Essential to the Chinese state leadership’s pursuit of “constructing a harmonious society” is the emphasis that the trend of increasing social polarization must not be left unchecked. And one important aspect of social polarization is the fact that, until the turn of the century, labor’s compensation had experienced very sluggish growth. **[Figure 1, above]**
- Outside the formal, mainly state-related sector, the wage rate had been almost frozen for fully 20 years since the early 1980s. 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.
- New policies: new employment contract law, enhancing labour rights protection, the target of establishing collective bargaining in all enterprises by 2010, and the stipulation that unions should be set up in all enterprises – all breaking with the previous *laissez faire* approach towards labour employment. **[Figure 5]**

Figure 5. 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.

3. Some Worldwide Trends and China

The Worldwide Growth Rebound

- It appears as if, finally, the promise of globalization has come true. The very sluggish growth of per capita income across most parts of the developing world over the 1980s and the 1990s, often known as “the lost decades of development”, seems to have been replaced by hefty growth since the turn of the century.
- Between 2000 and 2005, the average annual growth rate of per capita real GDP for all low- and middle income economies was 3.7%. This is more than double the average rate of the 1980s and the 1990s, 1.3% and 1.8%, respectively.
- For both low-income economies and middle-income economies, the growth performance in 2000-2005 is also substantially better than that of the 1960s and the 1970s, the latter two decades being part of the “Golden Age” of post-war world development. **[Table 1]**

Table 3. Average annual growth rate (%) of per capita real GDP, 1960-2005

	1960-1970	1970-1980	1980-1990	1990-2000	2000-2005
China	2.9	3.7	8.8	9.3	8.3
India	1.1	2.3	3.6	4.2	5.3
S Korea	6.0	8.4	7.7	4.7	3.9
Brazil	2.6	6.5	0.7	1.3	1.0
USSR/Russia	4.0	4.7	1.3	-4.7	6.6
Low-income economies (excluding China & India)	2.0	1.8	2.2	1.2	4.2
Middle-income economies	3.5	2.1	1.2	2.2	3.9
Low- & middle-income economies			1.3	1.8	3.7
East Asia and Pacific			5.9	5.7	6.9
Europe and Central Asia			1.2	-1.7	5.2
Latin America & Caribbean			-0.3	1.7	0.9
Middle East & North Africa			-1.1	0.7	2.2

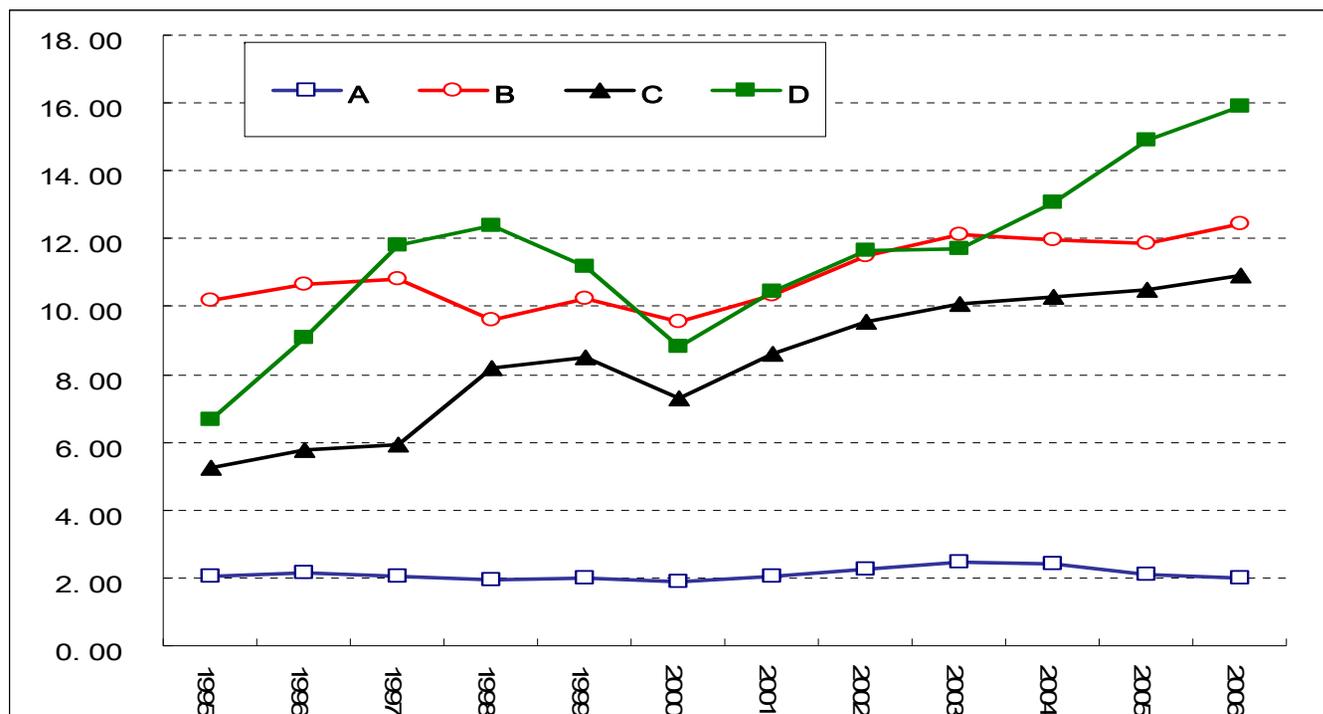
South Asia			3.4	3.7	4.8
Sub Saharan Africa			-1.3	-0.1	2.0
High-income economies			2.7	2.2	1.5
Sources: World Bank, <i>World Development Report</i> and <i>World Development Indicators</i> , various years.					
Note: Figures are average annual real growth rate of per capita GDP (%).					

- It might be premature to judge whether the on-going growth rebound in the developing world reflects a long-term trend of catching-up with the income level of advanced economies, as the orthodox doctrines of globalization would expect it so, or rather just a recovery from the recession of the second half of the 1990s.

The Cost to, and Constraints on, Development

- Whatever the nature of the growth rebound, the benefit might not have been mainly translated into economic and social development. Amid the growth rebound, there have been concurrent trends that appear to be negative for the developing world.
- These include the outflow of seigniorage from the developing world, the worsening terms of trade against developing countries, and the problem of increasing unemployment. **[Figure 6, Figure 7]**
- It can be further conjectured that there is likely to have been a trend of decreasing labour's share in national incomes, and, in relation to this, increasing inequality within and across national economies.

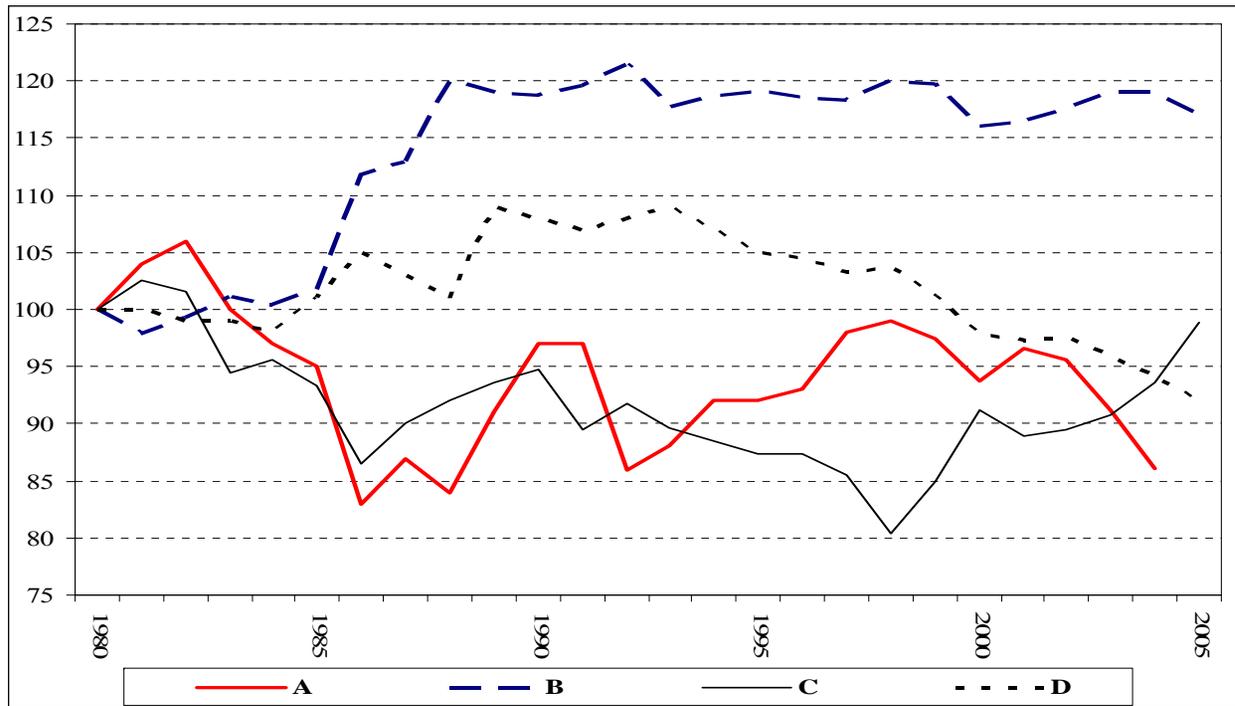
Figure 6. Foreign exchange reserves as ratio to average imports (months)



Notes: Data are end-of-year foreign exchange reserves of central bank divided by the monthly average import value of the past 12 months; A = developed countries ('industrial countries' for foreign exchange holding and 'advanced countries' for imports in the IMF categorization); B = developing countries; C = East Asian economies (mainland China, Hong Kong, Taiwan province of China, South Korea, Singapore, Malaysia, Thailand, Indonesia and the Philippines); D = China (mainland China, not including Hong Kong, Macau and Taiwan province of China).

Sources: International Monetary Fund, COFER 2007, and *World Economic Outlook*, April 2007; Asian Development Bank, data bank.

Figure 7. Terms of international trade (1980 = 100)



Notes: A = China; B = developed countries ('industrial countries' in the IMF categorization); C = developing countries; D = East Asian newly industrializing economies (i.e., Hong Kong, Taiwan province of China, South Korea and Singapore). East Asian newly industrializing economies data are terms of trade in goods and services; others are terms of trade in goods.

Sources: International Monetary Fund, *World Economic Outlook* and *International Financial Statistics Yearbook*, various issues; World Bank, *World Development Indicators*, various issues.

China in the Light of International Comparison

- China has registered the fastest economic growth in the developing world.
- It has built up an abnormally high level of the ratio of foreign exchange reserves to import needs. 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.
- China's acceleration of economic growth has not been matched by a comparable pace of employment expansion. 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.

Table 4. Average annual growth rate (%) of real income, employment and labour force, 1998-2005

	(a) GDP	(b) Employment	(c) Labour force	(a) - (b)	(b) - (c)
China	9.1	1.0	1.1	8.1	-0.1
Hong Kong	5.0	1.2	1.3	3.8	-0.1
Japan	1.4	-0.3	-0.3	1.7	0.0
S Korea	5.8	2.0	1.5	3.8	0.5
Taiwan province of China	3.8	1.0	1.2	2.9	-0.2
Singapore	5.2	2.8	2.9	2.4	-0.2
Indonesia	3.6	1.1	1.9	2.5	-0.8
Malaysia	5.3	2.2	2.3	3.1	0.0
Phillipines	4.5	2.2	2.3	2.3	-0.1
Thailand	4.9	1.8	1.4	3.1	0.3
Sources: Asian Development Bank, www.adb.org ; and Japan Statistical Bureau, www.stat.go.jp .					

Beyond Comparison: China and Economic Restructuring in Broader East Asia

- The Chinese experience as depicted reflects a broader process of economic restructuring in the whole region of East Asia after the 1997-98 financial and economic crisis.
- Similar trends of faster-than-average economic growth, worse-than-average deteriorating terms of trade, and labour supply growth lagging behind employment expansion, have occurred in most economies of the region. **[Table 4]**
- There is reason to believe that these trends are related to the China-oriented process of region-wide economic integration, which is evident in the rapid increase in the shares of China trade in the total of foreign trade of the economies. **[Table 5]**

Table 5. East and Southeast Asian economies' China trade, 1995-2005

		China trade as share of total exports	China trade as share of total imports	trade balance with China (US\$ million)	trade balance with world except China (US\$ million)
Japan	1995	11%	12%	10941	95710
	2000	12%	15%	771	98724
	2005	20%	21%	6267	76667
3 NIEs	1995	17%	6%	37371	-45530
	2000	17%	8%	43237	-19838
	2005	23%	13%	73851	-25507
ASEAN-4	1995	5%	4%	1687	-28326
	2000	6%	6%	2832	52360
	2005	15%	12%	20457	35281

Sources: Asian Development Bank, www.adb.org; and Japan Statistical Bureau, www.stat.go.jp.

Notes: China in this table refers to mainland China plus Hong Kong. NIEs = South Korea, Singapore and Taiwan province

of China. ASEAN-4 = Indonesia, Malaysia, The Philippines and Thailand. Indonesia's and Thailand's China trade figures refer to trading with mainland China only. The Philippines' China trade figures refer to trading with Hong Kong only. Japanese figures are converted from yen to dollar at the year-average exchange rates.

The Systemic Impact of China on World Development

- A main aspect of globalization is the expansion of the world labour market associated with the incorporation of China into the system.
- Weighing countries' labour force by their export-to-GDP ratio, the effective global labour supply quadrupled between 1980 and 2005, with East Asia contributing about half of the increase. And there has been massive relocation of jobs from the rest of East Asia to China.
- As of 2005 year-end, China's share of the world total of workers producing for the global market reached 25%.

4. Discussion and Concluding Remarks

Debate over the Prevailing Pattern of Growth and Employment

- The sustainability of the prevailing pattern of economic growth and employment expansion, and therefore the relevant government policies, depends on whether the fast productivity gains in industry can be effectively channeled to the development of the labor-absorption capability of services.
- Question: 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 prior to the mid-1990s. This alternative clearly fits better into principles of the market.
- 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.
- Counter argument – efficiency: the productivity and output growth of the economy in the

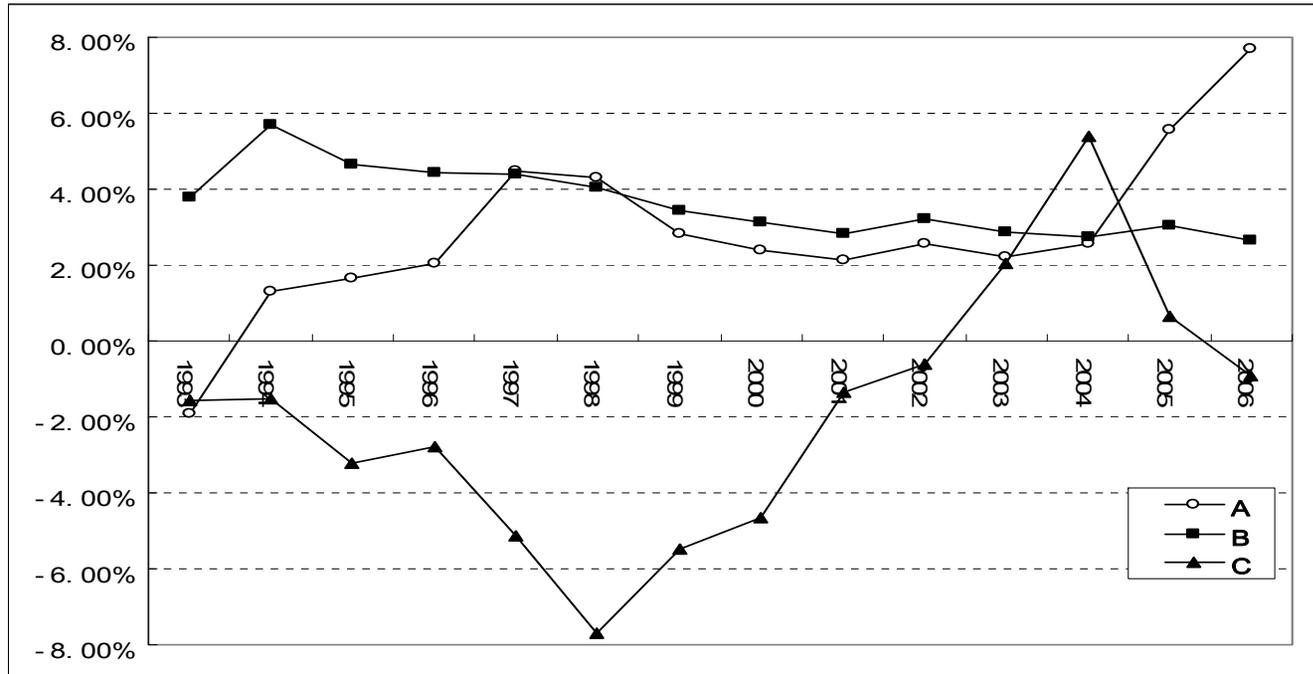
second half of the reform era appears to have out-performed that of the first half.

- Counter argument – feasibility: demand deficiency in the domestic front and worsening trade frictions in the external front impose tight constraints on further pursuing a labour-intensive economic growth path.
- Counter argument – welfare: which of the two growth paths is more beneficial for the majority of the population depends on the (re-establishment of the) redistributive system.
- In the theoretical literature of macroeconomics, there is a long-lasting debate concerning the relationship between wage, demand and employment. In the actual situation in China, the proposition that the net effect of wage reduction – via dampening macro demand – would tend to be employment-decreasing appears to be at least equally plausible vis-à-vis the opposite proposition that wage reduction is employment-enhancing.

New Developmentalism?

- In the literature of the political economy of globalization, there is a prominent proposition which states that the spatial, outward expansion of the system of capitalism hinges on the balance between two forces: the incorporation into the system of new productive inputs in order to maintain the profitability of capital, and the continuous reproduction of systemic demand deficiency at expanded scales due to this incorporation process.
- The condition of labour employment, compensation and work standards in China is of world-scale importance. Indeed, the incorporation of the Chinese labour force into the world market has been a fundamental feature of globalization.
- Whether or not China's prevailing pattern of growth and employment would persist would make a profound impact on world development, especially on East Asian development.
- The pattern and the related policies could therefore constitute a new developmentalism.

China's Cross-Border Capital Flows (as % of GDP)



Notes: A = balance of trade in goods and services; B = net inflows of foreign direct investment; C = other net capital inflows

= change in foreign echane reserves of Central Bank – A – B.

Sources: 《中国统计年鉴 2006》; 《中国统计摘要 2007》; 《中华人民共和国 2006 年国民经济和社会发展统计公报》; 国家外汇管理局网站。