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# Rebalancing China's Emergent Capitalism: State Power, Economic Liberalization and Social Upgrading

Christopher A. MCNALLY, Boy LÜTHJE and  
Tobias TEN BRINK

Over the past 35 years, China's economic development strategy relied on the extensive use of factors of production relatively abundant in China. These include labour, land and some mining resources (such as coal and rare earths), as well as mounting reserves of capital in the first decade of the twenty-first century. State-guided policies channelled these factors into an export- and investment-driven model of development that was highly successful in terms of aggregate GDP growth. This model also proved to be quite adaptive when the financial crisis originating in US mortgage markets reverberated globally in late 2008. China was then able to rapidly jumpstart a slowing economy with a massive government-led stimulus programme that relied heavily on state banks extending credit for real estate and infrastructure projects.

As a result, China led the world out of recession in the wake of the 2008 crisis, seemingly demonstrating the advantages of its brand of state-guided capitalism. However, China's period of export- and investment-led industrialization is clearly beginning to reach its limits. In this sense, China's political economy stands at a major juncture in its development model (Naughton 2010; Kroeber 2009). The country's reliance on exports to stimulate growth exposes it to external shocks. And as China becomes the largest trading power in the world, global consumption demand outside of China is unlikely to be able to absorb increasing volumes of Chinese exports. In a similar fashion, investment-driven growth is beginning to show slowing returns within China. Most pointedly, a reliance on the speculative real estate sector to drive a large part of Chinese investment growth risks a property bubble and ensuing financial crisis.

The Chinese government seems fully aware of the growing risks contained in the old growth model. Building on some of the original emphases of the tenth and eleventh Five-Year Plans, the twelfth Five-Year Plan for 2011–2015 seeks to steer the Chinese political economy away from a pure focus on growth towards a balanced economic devel-

opment model. Special weight rests on boosting consumption and incomes while expanding public welfare services and environmental protections (Batson 2010). Rebalancing China's political economy is crucial not only for China's socio-economic development, but also for global economic growth and stability in general.

On the global level, consumption and savings patterns have become highly unbalanced over the past three decades. The United States consumes too much, creating a considerable current account deficit with the rest of the world. China, similar to other big surplus economies such as Germany, saves too much and spends too little, creating sizeable though recently diminishing current account surpluses. Rebalancing means that China needs to consume more and save less, while the United States must save more and spend less (Wolf 2010). This crucial issue of global rebalancing is often lost in debates about relative currency values, especially China's policy of keeping the value of the Yuan relatively tied to the US dollar.

While a more rapid appreciation of the Yuan would aid the unwinding of global imbalances, it is unlikely to address the most fundamental issue: prodding China to start spending more of its own savings to buy up imports. China as a whole continues to suffer from oversaving and underconsumption, a situation that if remedied could rebalance global trade and capital flows sustainably into the long-term (Alderman 2011). The solution to global imbalances thus lies in no small measure in China's ability to rebalance its own domestic political economy.

To be successful, rebalancing will have to initiate a pronounced shift towards a growth model based on increasing domestic consumption, rising incomes and environmental sustainability. At the centre of this stands the establishment of broad welfare, employment and retirement safety nets for the majority of China's citizens. The lack of such safety nets has caused many Chinese to be risk-averse and save more to counter the uncertainty. But it is not just the Chinese people who save prolifically; the state and most large corporations, many of them state-owned, are massive savers as well.

Rebalancing thus involves a fundamental change in China's traditional growth model. Several key policy arenas have emerged wherein this fundamental shift is to be implemented. First, the Chinese Communist Party (CCP) has again and again proposed to replace the growth fetishism – the “GDP maximization mania” – of most local cadres with

an overall emphasis on improving local governance and the quality of life for both urban and rural residents.

Second, policy proposals are aimed at tackling China's mounting inequalities and the resulting chasms along urban–rural, regional, inter-regional and inter-urban lines. This involves the establishment of centrally standardized social welfare systems for medical care, pensions, unemployment and disability insurance, as well as more equal access to education and urban residency.

Third, rebalancing policies endeavour to upgrade China's industrial structure. The aspiration is for China's economy to move away from labour-intensive manufacturing for export and focus more on high-technology products, the service sector and the domestic market. Heavy and energy-intensive industry is being de-emphasized. For example, in the twelfth Five-Year Plan real estate, steel and autos are no longer pillar industries; rather, high-tech, green and energy-efficient industries take centre stage. Industrial upgrading policies further aim to create higher wage levels and better working conditions, both of which can contribute directly to domestic consumption growth.

Finally, one major aim of Chinese policies is to create a more environmentally sustainable model of development. Much of China's 35 years of rapid economic growth has been based on the extensive use of resources with little regard for environmental protection and sustainability. Big investments in water conservation and air pollution control are being rolled out. And in terms of overall planning, more emphasis on improving the energy efficiency of any given unit of GDP growth has now emerged as an important target for streamlining China's growth pattern.

All in all, rather than a reliance on exports and state-driven investment in heavy industry and infrastructure, domestic consumption-driven growth and innovation should be the Chinese economy's key drivers. This could diminish Chinese tendencies to over-save, rebalance both the domestic and global economy, and thereby diminish potential international frictions over trade and currencies.

The major challenges of rebalancing have been clearly articulated by the Chinese leadership and a series of potential remedies proposed. In general, policy solutions recommended by the government are seen positively by the Chinese people. Nonetheless, there are considerable obstacles in effectively implementing them. Most importantly, the power relationships created during China's 35 years of high-speed growth could

lock the country into that growth pattern. Some basic reforms might also only be possible with the greater political participation of those segments of the population that have stood as relative losers in the reform process (Page 2010). These include large sectors of the agrarian workforce, urban industrial and lower-rank service sector workers and the huge population of migrant workers. However, under the politics of China's "harmonious society" and CCP supremacy greater strengthening of popular control over economic decision-making looks unlikely, even at the local level.

The Chinese leadership thus faces a fine balancing act between assuaging those interests that have benefitted immensely from the old system – including most large private and state firms, as well as various professional classes including the state technocratic elite itself – while at the same time strengthening the economic prospects of those that have not, especially farmers and workers. Western and some Chinese observers tend to stress that rebalancing the Chinese political economy needs to focus on the further liberalization of various sectors of the domestic economy (cf. World Bank and Development Research Center of the Chinese State Council 2012). Arthur Kroeber, for instance, argues that rebalancing "requires major reforms of the fiscal and financial system, as well as deregulation of the service sector to improve opportunities for private investment" (Kroeber 2010). Liberally inclined economists hold that the imbalances in China stem from the continuation of state-set prices and other forms of state intervention (Batson 2010).

Initial policy pronouncements show that economic liberalization measures are, indeed, important components of efforts to rebalance the Chinese political economy. In particular, a rapid shift to a more service-based economy is being emphasized and seemingly already underway. Nevertheless, the view that the Chinese government must pursue a full-blown policy of economic and financial liberalization misunderstands the dynamics of China's political economy, both past and present. The CCP will, as before, move very gradually and cautiously, continuously attempting to avoid the risk often associated with economic liberalization that reforms could get out of hand and disrupt social stability.

In other words, the decision-making and institutional patterns that shaped the last 35 years of economic reform are likely to be repeated under the new leadership cohort led by Xi Jinping and Li Keqiang. Economic liberalization measures will be calibrated with concerted efforts to sustain and strengthen state control over the economy. State-centric reforms include measures advocated by more liberally inclined institu-

tions. They include, for example, strengthening the regulatory powers of the central state, local-central fiscal reforms and recouping dividend income from the largest state concerns for the Ministry of Finance (World Bank and Development Research Center of the Chinese State Council 2012). However, the central state does not aim to give up its control over the commanding heights of the economy by, for instance, privatizing large state concerns. The overall thrust of reforms continues to rely on profoundly statist measures, including efforts to recentralize, standardize and better regulate various aspects of the political economy.

Rebalancing thus contains marked efforts at refurbishing Chinese state capitalism. Yes, measured steps at economic liberalization will be undertaken, but fundamentally the leadership seeks to continuously restructure and improve central state control over economic decision-making. Following this pattern, policies aimed at social upgrading focus mainly on extending state-centric social welfare services to both urban and rural populations. This includes a massive programme of building sufficient public housing for those who cannot afford commercial housing. However, there has so far been little success in overcoming the basic social divide between urban residents and rural migrant workers, and between low-skilled and high-skilled work. The basic reasons for China's inequalities thus persist. In fact, China has not seen any significant increase in political tolerance of independent trade unions or collective bargaining – both of which could address these issues. And again following this pattern, financial reforms are likely to be circumscribed by the fact that the Chinese financial system ensures both economic and social stability. This means it is likely to remain subject to overall party-state control.

What emerges therefore is a complex picture. The CCP's project of rebalancing the political economy is likely to be characterized by the seemingly incongruous coexistence of circumscribed economic liberalization, concerted efforts to augment state power and partial state-centric endeavours to upgrade the socio-economic conditions of large swathes of the Chinese population.

## Different Perspectives and Analyses of China's Economic Rebalancing

This topical issue examines China's economic rebalancing efforts from different viewpoints. It starts with two articles that give a broad charac-

terization of China's political economy and analyse the intent, dynamics and potential of efforts to rebalance the Chinese economy. Both articles thus provide macro-studies of the challenges and possible trajectories of rebalancing.

In the first article, Tobias ten Brink applies instruments from comparative and international political economy to show that the Chinese political economy can be understood as a variegated form of state-permeated capitalism that is deeply integrated into the world economy. In his view, turning away from a previously successful export- and investment-driven growth model will be difficult to achieve since the current growth model has produced its own structural impediments to a transition from an export-oriented, low-wage, neo-Taylorist model to a domestically centred regime of accumulation. A continued dependence on exports in an unstable world economy, as well as powerful economic interests, may hamper a significant shift away from export-led growth towards increasing internal demand, wage levels and social security. Domestic and foreign enterprises are interested in maintaining the "low wage, low taxes" model. And, ten Brink argues, there are distinct limits to the central state's steering capacity due to weaknesses in its fragmented, competition-driven structure. By identifying several "paradoxes of prosperity", the author highlights the socio-economic risks and challenges that are sometimes underappreciated in more optimistic analyses of China's rebalancing of the political economy.

Christopher A. McNally provides a macro-analysis of policy initiatives designed to rebalance China's political economy, especially those contained in the twelfth Five-Year Plan and related pronouncements during the 2010–2012 period. While highlighting the basic contents and objectives of these initiatives, he shows that the Chinese leadership intends to focus on institutional solutions that can centralize, standardize and regulate the political economy under continued state guidance. China is, therefore, pursuing a policy package that can best be described as refurbishing its brand of state capitalism. While a series of economic liberalization measures are likely to be undertaken, these will continuously be balanced by efforts to augment state control and guidance over the political economy. Moreover, the considerable political obstacles that Chinese policymakers face in rebalancing the political economy emanate in large part from interests within the party-state, such as the large oligopolistic state conglomerates and local party cadres. These interests could prove to be the most wedded to the old order and have the politi-

cal resources to resist rebalancing efforts. Somewhat ironically, therefore, a more state- and party-centric approach is seen as necessary, since only the central party-state itself has the potential authority to overcome opposition to some of the more politically sensitive rebalancing measures. In the end, the CCP has no alternative but to rebalance the political economy effectively, since a failure to do so would risk a slackening of economic growth and ensuing social unrest.

While McNally and ten Brink examine the political economy of China's rebalancing efforts from a macro-perspective, the other contributions to this topical issue explore specific spheres of China's political economy. Julian Gruin analyses the role of the financial system. He contends that any assessment of the financial sector must take into account both its unique position at the centre of the broader political economy, as well as the duality of this role. First, the financial system represents a distinctly political mechanism for preserving centralized "steering" capacity over the trajectory of economic development. Second, it serves as a set of economic mechanisms for effectively allocating capital to those real economic sectors most capable of capitalizing on China's particular configuration of factors of production. Until about 2003, these two dimensions were largely in concordance, as the state-led banking sector proved both able to fulfil its political function, whilst simultaneously supporting China's growth strategy in effectively allocating capital to the high-priority investment and export sectors. Yet the system that once proved so capable of regulating monetary policy and macro-economic dynamics is now creating obstacles to correcting the imbalances that have emerged as a product of China's export- and investment-led growth strategy. The continuing emphasis that political elites place on the importance of the financial system in delivering both economic and broader social stability means that the financial system remains constrained by the requirement that authority over financial capital remain closely tied to state-dominated institutions and decision-making. Gruin concludes that it is this continuity in the political function of the financial system that renders it liable to have a significant retarding impact upon the direction and nature of overall economic rebalancing.

Boy Lüthje addresses recent changes in labour relations. He examines the wage-labour nexus in China's model of capitalism and its economic and social restructuring. Drawing on extensive empirical studies of factory and industry labour relations in key manufacturing industries, he points out that labour relations in the Chinese economy have become



increasingly differentiated. The combination of weakened traditional labour relations in state-owned enterprises, the proliferation of Western and Japanese modern management concepts (such as lean production) and the growth of a huge non-union sector – especially in exporting industries (such as apparel and electronics) – have resulted in a variety of regimes of production. China's basic social divide between urban residents and rural migrant workers draws the line between higher paid, relatively stable jobs and low-wage employment with high flexibility. However, wage-labour flexibility dominates even in the more protected core sectors of manufacturing due to the absence of collectively bargained, viable standards of work. The segmentation of production regimes limits the emergence of corporatist labour relations based on relatively independent trade unions and industry organizations. The lack of institutionalized labour standards based on collective bargaining is also a key reason why extensive regimes of labour exploitation can survive in most modern, domestically oriented industries, thus complicating the process of social upgrading, which is further explored by Florian Butollo.

Florian Butollo's article asks whether industrial upgrading in the garment and LED lighting industries of the Pearl River Delta could also lead to social upgrading, thus implying an end to the low-wage labour regime characterizing these industries. He reveals that there exists a multiplicity of upgrading trajectories, all of which have different implications for skill development and the nature of work. While the modernization of industries relies on the input of higher skilled work primarily in the fields of research and development (R&D) and marketing, this barely is the case with regard to the bulk of manufacturing workers. Theoretical assumptions that technological change may automatically lead to social upgrading are challenged by reality. Although labour intensity in the examined cases is diminishing in absolute and/ or relative terms, divisions within firms investigated between low-skilled and high-skilled work are reconfigured rather than overcome. All in all, Butollo identifies a failure in social upgrading since companies chose solutions entailing a reconfiguration of production systems based on low-skilled and badly paid migrant labour. On the manufacturing level, even signs of deskilling can be identified. According to Butollo, attempts to overcome the imbalances of the old growth model must therefore be adjusted to correct the bias of a technologically focused path of industrial upgrading by allowing trade unions to engage much more actively in the social upgrading of wages and working conditions.

## Recent Developments and Implications for the Future

The articles in this topical issue indicate that an effective move away from China's old development model reliant on export- and investment-driven growth will face considerable challenges. Concerted efforts at industrial upgrading have, on the whole, not created the high wages or secure working conditions that could improve the long-term prospects for sustained consumption growth. The financial sector stands at a crossroads with its deep-seated duality of serving both the economic and political goals of the Chinese party-state. And while the policy package put forward by China's leadership is logical and carries the potential to address several of the imbalances characterizing the political economy, powerful economic interests both within and outside the party-state could hinder the policy's intended objectives.

Therefore, several factors have the potential to limit a shift away from export- and investment-driven growth towards increasing domestic demand, wage levels and social security. This collection of articles was based on empirical materials covering the period up until the end of 2012. The new leadership cohort under Xi Jinping and Li Keqiang that came into power in late 2012 and early 2013 has continued the strong rhetorical emphasis on rebalancing China's model of capitalism. More forceful policy efforts were announced during 2013, including a tolerance for slower growth (though still above a new 7 per cent threshold), more selective prioritization of investment projects and the establishment of the China (Shanghai) Pilot Free Trade Zone, which has been set up to lead trials on the opening up of China's service sector. Financial reforms have also proceeded apace, with loan rates having been freed – though controls over deposit rates remain in place at all banks. Finally, several economic indicators show rapid growth in the Chinese service sector and continued urbanization.

Perhaps most significantly, debates have emerged over the actual degree of imbalance in the Chinese political economy. The objects of criticism and independent reassessment are the statistical databases collected by the Chinese government. Wang Xiaolu and his collaborators (Wang 2007; Wang and Woo 2010; Credit Suisse 2013) pioneered alternative household surveys that show how urban household income is being significantly under-reported in official surveys, especially that of high-income groups. These alternative surveys indicate that China's ag-

gregate GDP may have been underestimated by around 8 per cent, while the country's inequality – with a Gini coefficient of around 0.501 in 2011 – is even higher than official reports (Credit Suisse 2013). Wang's most recent work indicates that low-income groups' earnings actually grew at a much faster rate than that of high-income groups during 2008–2011, suggesting some success in increasing wages among the lower salaried population. Overall, though, almost every income group, including the poorer segments, has experienced a declining consumption ratio, albeit absolute consumption growth remains very strong in China (Credit Suisse 2013).

In another recent analysis, Zhang and Zhu (2013: 2; see also Pilling 2013) further dispute that Chinese household consumption is too low, arguing that this “widespread belief [...] may be a myth based on inaccurate official statistics”. The reasons for these inaccuracies are in particular an underestimation of housing consumption due to a poor methodology and – following Wang's work – major problems with household consumption surveys which significantly under-represent the consumption by rich households. Zhang and Zhu's re-estimation suggests that the rate of overall consumption in China is 10–12 percentage points higher than what official statistics indicate. This would put China's level of consumption in a similar range to Japan and the East Asian tiger economies during their industrial take-offs.

Similarly, Jonathan Garner and Helen Qiao of Morgan Stanley conducted “bottom-up” calculations, finding that household consumption is at roughly 46 per cent of GDP, 1.6 trillion USD higher than officially stated (*The Economist* 2013). Their calculations imply that hidden spending, in particular by high-income households, is not captured in Chinese GDP figures and that rebalancing is already under way. Even with these reassessments of official statistics, however, China's consumption rate remains a lot lower than the world average; on the flip side, the investment rate remains quite high, signalling substantial risks of chronic over-investment.

Indeed, if China's high investment rates are comparable to those of Japan during its high-growth phase, there is reason to fear that China could face the same fate as Japan and fail to create sustainable domestic-driven demand (Devine 2010). On the whole, though, the statistical reassessments highlight that the imbalances in China might not be as severe as generally assumed. Yukon Huang (2013) of the Carnegie Endowment

for International Peace even argues that for a fast-growing developing country, China's investment rates may be quite normal and desirable.

Regardless of which view one takes regarding China's degree of economic imbalance and its probable sources and consequences, the Chinese political economy is undoubtedly characterized by a heavy dependence on investment. The policies and institutional solutions pursued over the coming five years by the Chinese government will thus be crucial. At this point, the full policy package that the Xi-Li leadership intends to implement will only become clear after the Third Plenary Session of the Eighteenth CCP Central Committee to be held in early November 2013. And even this plenum is unlikely to cover in detail a host of policy proposals to spur financial liberalization, urbanization, better environmental protection and industrial and social upgrading. Much will depend on how local implementation plays out, especially given numerous constraints on how proposed policies are executed. Certainly, the experimental step-by-step approach taken by the government holds the promise of gradually working out novel institutional solutions in local trials, but continued economic growth is not synonymous with social growth.

The surveys by Wang Xiaolu point out that the existing system of income distribution remains highly unequal while the consumption ratio continues to decline (Credit Suisse 2013). These trends would have to be arrested and reversed for broad-based consumption growth to be sustained. Moreover, as ten Brink argues in this topical issue, most firms in China remain interested in preserving the "low wage, low taxes" model with local governments particularly eager to accommodate them. Reflecting this, China's model of ultra-flexible employment, embodied in the labour laws of the 1980s and only slightly altered by the Labour Contract Law of 2008, remains dominant. The slogan "let wage earners get rich" (Yao 2009), popular among Keynesian economists in China, might therefore still be some way off. China's lopsided growth with continued high inequality could have inherent staying power.

Thus empirically, it remains to be seen whether some recent progress in terms of economic rebalancing will suffice to generate stable and sustainable domestic consumption-driven growth in the medium term. This topical issue has attempted to clarify the background and contents of the urgent rhetoric that Chinese policymakers have embraced with regards to rebalancing the political economy. The contributors here have analysed several of the considerable constraints on the implementation

of reforms – constraints that are often at odds with official rhetoric. Ultimately, pure economic liberalization will have to be counterbalanced by strengthening the central state's socio-economic regulatory and steering capacities. Better social and environmental management, improved and enforceable rights for workers and consumers, and the overall social upgrading of the living and working conditions of large sectors of the Chinese population will need to accompany the upgrading of the technological, innovative and organizational base of the Chinese political economy.

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