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Freeing the Labor Market for China's Economic Development

CAI Fang

China may have lagged in the First Industrial Revolution, the Second Industrial Revolution, Globalization 1.0, and even Globalization 2.0, but it has fully leveraged the opportunities presented by Globalization 3.0, deepening its reform and opening up since the 1979 to catch up with developed countries and gaining a significant position in the Third Industrial Revolution. According to World Bank (WB) data, in 1978, China, as home to 22.3% of the world's population, only accounted for 1.1% of the world's GDP. In 2017, China's share of the world population dropped to 18.4%, while in constant U.S. dollars, its GDP proportion increased to 12.7%. From 1981 to 2015, the number of people living in poverty, calculated in terms of purchasing power parity per capita per day (using the 2011 U.S. dollar exchange rate), decreased from 1.89 billion to 750 million worldwide, while this figure in China decreased from 880 million to 9.6 million over the same period. This means that China contributed to 76.2% of poverty alleviation worldwide. It is fair to say that in this round of world economic convergence since the 1990s, China has made tremendous economic contributions.

CAI Fang is Vice President of Chinese Academy of Social Sciences

Theoritical basis for economic development

Hollis Burnley Chenery, former chief economist of the WB, argued that in developing countries, where not all development conditions are presented, certain development conditions can act alone in the short term, thereby fostering the formation of other conditions to promote sustainable economic development. This assertion can be used as a reference to explore what type of development conditions lead to this "butterfly effect," or to determine the "Chenery conditions" that give a country the initial impetus for economic growth. According to this logic, these conditions could in turn create other conditions for continued growth, placing the country in a virtuous circle of economic development. To examine these issues, it needs to understand China's economic development through a general framework of development economics.

Chenery himself believed that the use of foreign investment and foreign aid could possibly be such critical conditions for development. Based on his early experience, he found that the effective use of foreign investment and foreign aid can lead to improvements in technology and skill, reduce dependence on external resources, and put a country's economic growth on a sustainable development track. Jeffrey Sachs more generally emphasized opening up and free trade, which can help establish a strong connection between a country's economy and the world system. By doing so, not only can a country obtain opening-up dividends such as advantages of backwardness and division-of-labor effects, but also can push forward domestic reforms through pressure from international competition. The renowned financial commentator Martin Wolf focused on the global flow of knowledge and stated that the more a country introduces external knowledge, the faster it becomes a leader in the number of patents it output.

These inquiries into the critical conditions for economic development all boiled down to openness, and showed that this development condition is not an independent event, but rather a set of mutually reinforcing conditions and a series of events. These researchers or commentators obviously presented much more insightful findings than those economists who have constructed hundreds of explanatory variables and performed millions of regressions. However, to link these discussions and their conclusions with China's development achievements in the past 40 years, it must first tell a complete story, in which domestic reform and opening up are dynamically integrated, and then look back what factor played the role of the "Chenery condition" in that process. To this end, let us first review China's most prominent resource endowments and its largest institutional drawbacks before the launch of reform in the early 1980s.

The "Chenery condition" of China's development

Before the reform and opening up in 1978, China followed a highly centralized planned economic system, which lacks of sufficient incentive mechanisms, leading to restrained labor enthusiasm, resource misallocation, and low efficiency. Therefore, despite an unlimited supply of labor, it failed to activate economic development, making China one of the poorest countries in the world. In 1978, 82.1% of the Chinese population lived in poverty-stricken rural areas. Back then, the average net income per person in rural households was about only RMB133.6. Although 70.5% of China's labor force was engaged in the agricultural production, the agricultural productivity was extremely low.

Therefore, it was the starting point

as well as the destination of reform to establish an institutional environment and driving mechanisms that could mobilize labor enthusiasm, achieve full employment of the labor force, and increase the supply and efficiency of capital, so as to improve the overall resource allocation efficiency. Although China's reform did not have a predetermined blueprint at its start, the reform process that unfolded later and the reform results were satisfactory. The correct starting point determined the promotion logic, path, and results of the subsequent reform.

The implementation of the household contract responsibility system solved two fundamental problems. The first was the incentive problem in agricultural production, which was solved by transforming collective labor into household production, coupled with a series of policy measures including a substantial reduction in state procurement, and an increase in the purchasing price of agricultural products. As a result, agricultural output saw a substantial increase in a very short period of time, farmers' incomes increased significantly, and the rural poverty incidence greatly reduced. The second was the transfer of the agricultural surplus labor force by giving farmers the autonomy to allocate production factors, especially the labor force, and the reallocation of resources aligned to the increase in labor income and improvement in labor productivity. These two early reforms laid the institutional basis for a series of reforms in various fields and the transition toward opening up; they can therefore be regarded as creating the basic conditions for development.

A series of institutional reforms and policy adjustments based on the problem-oriented principle removed institutional barriers to the flow of production factors, and facilitated the large-scale transfer of the labor force from agriculture to non-agricultural sectors, and from the rural, central, and western areas to urban and coastal areas. First, this phenomenon—the largest population movement in human history during a time of peace—responded to the huge labor demand for urban economic expansion and export-oriented development in coastal areas. Second, the deepening reforms in related fields for absorption of the increased labor force to drive economic growth achieved more efficient reallocation of resources. Third, as it was an economic process and social event that centered on people, sharing was an inherent part of this process while efficiency improvement and growth fostering were achieved.

This reform, combined with opening up, development, and the sharing process, had multiple effects. From a domestic perspective, resources were reallocated while total factor productivity and labor productivity improved accordingly; from an international perspective, the most abundant production factor was transformed into industrial comparative advantages that enabled labor-intensive products to gain competitiveness in the international market; from the perspective of interconnection between domestic and international situations, the abundant factor of labor was leveraged to the maximum and exchanged for the relatively scarce factor of capital through the introduction of foreign capital and trade; finally, from the perspective of teleology, sharing was endogenous throughout the process of reform, opening up, and development. It is obvious that the gradual expansion of opening up is actually predetermined by the overall logical chain of reform, opening up, development and sharing.

The "Chenery condition" of the world's economic development

A brief description and analysis of globalization history will reveal that economic globalization does not necessarily result in global openness and participation. The Globalization 1.0 and Globalization 2.0 that human being witnessed were mainly a history of colonialism and globalization dominated by a single or a few hegemonic powers; the vast majority of colonial, semi-colonial, and developing countries, whether they were involved in or excluded from this process, whether they had passively or actively entered this process, did not benefit from it. It was not until the era of Globalization 3.0 that a pattern characterized by developing countries sharing dividends and a significant reduction in poverty worldwide came into being. In the meantime, as the problem of domestic income distribution has not been solved properly, people in many developed countries feel that they are not benefiting from globalization. Politicians have exploited the situation to steer the conflict toward trading partners in emerging economies. Some state leaders even act as initiators of the anti-globalization by adopting radical protectionism in international politics and highlighting populism in domestic politics.

Obviously, if globalization is to become a true enabler for global economic prosperity shared by all countries, both in developed and developing countries as well as at the international relations level, two essential conditions must be created. First, openness and inclusiveness must be achieved, which means allowing universal and equal participation by all countries. Second, there must be connection and interaction between domestic and international policies. In this way, opening-up measures such as foreign investment, international trade, and the global flow of knowledge can be connected to domestic reforms such as breaking monopolies, correcting price distortions, and removing obstacles to resource allocation. This will not only create globalization dividends shared by countries, but also create key conditions for the domestic economic development of each country by virtue of the international competitive environment and the global division system, so as to boost the economic development of each country and realize development of shared benefit for all people through domestic income distribution mechanisms and redistribution policies.

Similarly, the history of previous industrial revolutions has also shown that the outcomes of scientific discoveries, technological advances, and revolutions in the mode of production cannot automatically bring economic growth and shared benefit for all people. Only by participating in the global division of labor and competition, and removing the fundamental institutional barriers to development through reforms, thus fostering the key conditions for development, can a country make institutional and technological innovations that are conducive to growth. Only by doing so can a country seize the opportunity of the industrial revolution just as it catches the express train of globalization, in order to support sustainable growth in the long term.

Conclusion

In the period concurrent with Globalization 3.0, China has adhered to advancing reform and opening up, created "Chenery conditions" required for development, and achieved high-speed economic growth rarely seen in history. In this way, it has seized the opportunity of the Third Industrial Revolution and is gradually approaching the center of the globalization stage, and the forefront of a new round of industrial revolution. China has nearly one fifth of the world's population, and thus, the failures, successes and challenges during China's economic development should not only be viewed as an ordinary case, but need to be tapped for its general significance. On the one hand, such experience should be used to enrich and further expand development economics with an international outlook; on the other hand, it is necessary to review China's development using the logic of development economics itself for its future growth.

In 2019, China's total GDP reached USD14.5 trillion, and its per capita GDP was more than USD10,000. According to the WB's standard, this means that China is nearing the threshold of high-income countries. The fact that China is about to leave the middle-income stage does not mean that the "middle-income trap" in an empirical sense is no longer relevant. This concept reminds us that the higher the stage of economic development an economy is in, the more unprecedented and therefore more severe the challenges it faces. The rapid disappearance of the demographic dividend, the anti-globalization headwinds and changes in China's comparative advantage, and weakened market mechanism of income distribution all indicate that there are no longer low-hanging fruits of economic growth, benefiting from the globalization, and equal sharing the outcomes of development.

To cope with these severe challenges and to ease the growing pains, it still needs to find the answer from the logic of globalization and industrialization, and the "Chenery conditions" for the Chinese economy. When we say that the demographic dividend is an essential condition for China's economic growth, it actually means that the condition has enabled the Chinese economy to achieve extraordinary high-speed growth, thereby achieving rapid catch-up, but not eternal condition for development. If we emphasize the "Chenery conditions" with both incentive effect and resource allocation effect, it can conclude that the disappearance of the demographic dividend simply means the end of the high-speed growth stage, while adhering to improvement of "Chenery conditions" as required by the times and advancing deeper economic system reform and more all-round opening up will empower China to seize the opportunities provided by the Fourth Industrial Revolution and Globalization 4.0, and maintain sustainable economic growth in the long term.

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