

Economic and Social Disturbance in China: Causes and Effects

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Abstract : *Social instability is a concept that economists rarely analyse, and yet it can lurk behind much economic policy-making. China's leadership has often publicly expressed its concern to avoid 'social instability'. It is viewed as a threat both to the political order and to the continued rapid growth of the economy. This threat to growth in turn endangers the maintenance of social stability. This paper examines the likely economic determinants of social instability, using both surveys and other evidence. After explaining the determinants of China's rapid growth, the paper goes on to examine the likely mechanisms by which social instability can affect the growth rate. There is a case for more research on the role of social instability in the economic development process.*

Key Words : China; economic, growth; happiness; disturbance, social instability

Introduction

It is relatively unusual for development economists to analyse the economic causes and consequences of social instability. Yet it is not unusual for governments of developing countries to worry about social instability, especially if they lack democratic legitimacy. This worry can in turn be important to their economic policy-making. The Chinese government during the period of economic reform provides a good example. Social instability is viewed as a threat both to the political order and to the continued rapid growth of the economy. China's leadership has often publicly expressed its concern to maintain social stability. For instance, according to Shirk, the term 'social instability' had appeared 700-800 times a year over the previous decade. It is arguable that such concerns have moulded economic policy-making. The reform leadership's economic policy was essentially to accord overriding priority to the achievement and maintenance of rapid economic growth. In this way China became a 'developmental state'. For the first quarter of a century of economic reform, rapid growth was viewed as the one true path to secure political legitimacy and to avoid social instability. However, the remarkable transformation of China's economy and society that rapid growth entailed itself posed new threats. The leadership's subsequent secondary objective of achieving a 'harmonious society' is a response to the need to maintain social stability in the evolving circumstances.

The causes of economic disturbance: Income and its change

In order to analyse the causes of social instability in China we examine the determinants of subjective well-being. The reasoning is that unhappy people, dissatisfied with life, are more likely to be socially discontented than happy people, and that the causes of unhappiness suggest pointers to the sources of social discontent. The China Household Income Project (CHIP) national household survey of 2002 provided questions on subjective well-being, and there was a separate module on subjective well-being in the questionnaire for the rural subsample. In this way it is possible to analyse the effects of income and its growth, economic inequality, and economic insecurity on subjective well-being. The key dependent variable is derived from the question, common to all three subsamples: how happy are you nowadays? Five possible answers were allowed: very happy, happy, so-so, not happy, not at all happy. This can be used as a cardinal variable (with the answers being scored 4, 3, 2, 1 and 0 respectively) or as an ordinal variable. In the former case linear regression, and in the latter case ordered probit analysis, is conducted. Both were estimated but in no case did the choice of method affect the interpretation significantly. We report only the cardinal results as they are simpler to interpret. In the rural subsample, for which a separate question on satisfaction with life was available, the choice of dependent variable made no significant difference to the interpretation: the terms subjective well-being, life satisfaction, and happiness are used interchangeably. The sensitivity of subjective well-being to both past changes and expected future changes in income implies that subjective well-being depends on income relative to reference time. Sociological research suggests that people are better able to remember, or project, their income than they are at remembering, or projecting, their aspirations. Thus aspirations tend to be anchored in the present. The argument of this section suggests that higher income is good for happiness and that economic growth, both perceived past and expected future, is good for current happiness. This is very much in line with Chinese government thinking: higher living standards, and improvements in living standards, help to keep people happy and, by implication, provide protection against social instability. Between 1990 and 2008 household income per capita increased in real terms by 8.4% per annum. 7 Surely, average happiness rose over that period? The

authors draw together all the available pieces of evidence on life satisfaction in China in the period 1990-2010 to provide a time series, and conclude that overall there was no increase in life satisfaction between the start- and the end-year.

The causes of economic disturbance: Inequality

The rise in economic inequality that has accompanied economic reform and economic growth poses a threat to social stability. Having been very low by international standards at the start of economic reform, the national Gini coefficient of household income per capita was 0.40 in 1988 (then mainly regional) and 0.49 in 2007 (then the joint highest in Asia). The increase in income inequality took three main forms: inequality among households, across regions, and between urban and rural areas. Peering into the future, two important developments may affect the relationship between inequality and social instability, but they are likely to work in opposite directions. First, the dramatic socioeconomic changes that are occurring in China, such as the increasing number of migrants and the growing use of the internet, are probably broadening people's reference groups. This may make happiness increasingly sensitive to income differences over wider orbits of comparison. Second, the trend in income inequality will depend on the balance of countervailing forces. Although various forces that have raised China's income inequality over the reform period are likely to continue to operate, two main equalising factors will grow in importance. It is predictable that the labour market will tighten as China enters the second stage of the Lewis model and the fruits of economic development are more widely spread.

The causes of social disturbance: Insecurity

Prior to the reform of the state-owned enterprise (SOEs), which started in the mid-1990s, urban resident employees had enjoyed iron rice bowls – lifetime employment in mini welfare states provided by their employers. Over the following decade the urban economy underwent the drastic reforms needed to sustain rapid growth. The SOEs were closed, privatised or reformed, and many millions of their workers were made redundant. The iron rice bowl provided by firms collapsed and its replacement by broader social insurance arrangements was tardy and incomplete. Urban unemployment – both actual and threatened – rose sharply from previous very low levels and only gradually declined. Two new sources of insecurity can be mentioned, both pointing to the need to study their effect on the subjective well-being of young people and their parents. One is the impact on the labour market of the great expansion of higher education from 1999 onwards. In 1998 higher education enrolment was 3.4 million and in 2008 it was 20.1 million – nearly six times its level a decade earlier. The short term labour market consequences were severe, taking the form of a rise in unemployment among graduates, a longer average duration of their unemployment, and the gradual acceptance of jobs previously entered by non-graduates or of 'graduate jobs' at lower pay. Another new source of insecurity is the very uneven sex ratio among young people: official statistics show the ratio of males to females to be 1.21, 1.15 and 1.14 among young people aged 5-9, 10-14, and 15-19 respectively in 2008. This generates intense marriage competition among young men and their parents. There is evidence that the high sex ratio does indeed alter household behaviour. For instance, Wei and Zhang (2009) find that households with a son increase their saving in a competitive manner in order to improve their son's relative attractiveness in marriage. Knight et al (2010) find that rural households with a son have higher conditional income, which, after tests, they attribute to the incentive to provide for their son. Job and marriage disappointment and insecurity might well reduce people's well-being.

The causes of social disturbance: Governance

Even after more than thirty years of economic reform China still has a semi-marketised economy, involving much state intervention. This intervention serves both a political and an economic function. It ensures that the CCP remains in political command and generates formidable patronage resources for that purpose; it also provides the policy instruments to achieve and maintain a developmental state. However, the semi- marketised economy is a breeding ground for rent-seeking and corruption of bureaucrats and party officials, especially at local levels. A survey of local officials found that 'upholding social stability' was reported to be the most critical task they faced (Minzner 2005: 19). A 2005 survey of local bureau heads found that almost two-thirds perceived rapid economic development to be the most important means of maintaining social stability (Minzner 2005: 19, 20). The central government response to the threat has taken two main forms. Up to about 2005 rapid economic growth was viewed as the overriding means of protection against social instability. Since then a second objective has been added: top leaders have repeatedly linked their goal of a 'harmonious society' with that of avoiding social instability. However, it is arguable that the underlying problem remains: that is, the unreformed system of governance. The obstacles to reform of governance have been both political and economic: not only the CCP's determination to maintain its monopoly of power and

patronage but also its decentralisation of monopolistic powers to local officialdom in order to implement the developmental state objectives at local levels.

The virtuous circle of rapid growth

The purpose of this section is to show the ways in which China's economic growth may be vulnerable to an adverse shock. It explains how the Chinese economy entered a virtuous circle of high confidence, high investment, high growth, high confidence, and so on. The reform leadership that came to power in 1978 gave overriding policy priority to rapid economic development in order to restore the political legitimacy that had been lost during the years of stagnating living standards, the Great Leap Forward, and the Cultural Revolution. This involved overturning the inefficient incentive structures that had previously prevailed and replacing them with incentives designed to achieve the new policy objective. One set of incentives involved harnessing market forces but the other, less obvious, set was designed to solve the principal-agent problem. With the abandonment of central planning, central government delegated many responsibilities and powers to lower tiers of government, so creating a need for central government to control local governments. Entrepreneurial expectations of rapid economic growth were necessary for high investment. The developmental state was crucial. Incentives were provided at all levels of government: bureaucrats were rewarded for promoting investment, and business people could take investment decisions with confidence that supportive growth policies would be pursued and would be successful. Neither saving nor funds held back investment. Enterprises that were owned or controlled by government had access to a ready supply of bank loans at low rates of interest, and the non-state enterprises that were not linked to government were sufficiently profitable to be able to rely on their own retained profits. The fact that investment – mainly in high technology sectors and much of it embodying new technology – was so high in turn accelerated the growth of TFP. This is an example of the positive feedback effects that have kept the virtuous circle going.

Social disturbance as an adverse shock

There is an international literature on the effects on investment, or economic growth, of some of the factors that might cause social instability. For instance, Mauro (1995) analysed a cross-country data set which included proxies for corruption and found that corruption lowers private investment, thereby slowing down the rate of economic growth. This result was both statistically and economically significant. Alesina and Perotti (1996) tested the hypothesis that income inequality, by fuelling social discontent, increases socio-political instability, which in turn, by increasing uncertainty, reduces investment. Socio-political instability (proxied by measures of political unrest) and investment were treated as endogenous variables in their crosscountry data set. The hypothesis was supported, and the inference was drawn that inequality retards the growth rate through its adverse effect on socio-political instability. Although China's degrees of corruption and inequality have not so far prevented rapid economic growth, it is plausible that, if they were to generate more social instability, they could slow down growth. Labour unrest is another potential threat. China Labour Bulletin (2012) provides an account of growing worker protest in the first decade of the 21st century. Workers do not have the formal right to organise, to bargain, and to strike. However, the emerging shortage of labour and the rise of internet and mobile communication have made workers more demanding. The government subordination of the one official union, ACFTU, has not prevented the organization of increasingly effective collective protests by workers. These are most common in the private manufacturing sector. Many relate to existing rights and benefits, such as demands for wage arrears or against redundancies, but a growing number concern demands for additional rights and benefits, such as improved pay or working conditions. Such protests have so far been localized but they might not remain so in future. Thus, adverse shocks have so far failed to slow down China's rapid growth except very temporarily, and they might not do so in future. Nevertheless, the threat posed by social instability, both to the political order and to the growth rate, is probably growing as people's aspirations rise and society becomes more sophisticated, better informed, and more capable of coordinated action.

Concluding comments

Two general points emerge at the level of theory. First, an underlying hypothesis of this paper is that there can be processes of cumulative causation at work - implying the presence of multiple equilibria that are only locally stable. One cumulative process concerns the ways in which social instability can escalate, and the other the ways in which the rate of economic growth can deteriorate. The scenario to guard against is one in which social instability harms entrepreneurial confidence and thus investment and growth, so generating further social instability, which beyond a tipping point becomes infectious. This process might be initiated by an event which causes the society to enter the second stage of Hirschman's 'tunnel effect', referred to

above, that is, when enough people begin to see inequality not as a sign of available opportunities but as a sign of unequal opportunities and distributional injustice. Policy interventions may be required to stop such processes. Second, insofar as policy concern for inequality arises from people's feelings and/or the effect of their feelings on social instability, there is a case for going beyond economists' conventional aggregate measures of inequality, in two ways. One form of decomposition would be to examine inequality relative to relevant reference groups. Another form would be to separate inequality into the part that is generally accepted (such as the rewards for productivity) and the part that is generally regarded as unjust (such as inequality of opportunities). These distinctions are easier to make conceptually than in practice, but they are worth exploring.

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