Worksheet 13.1

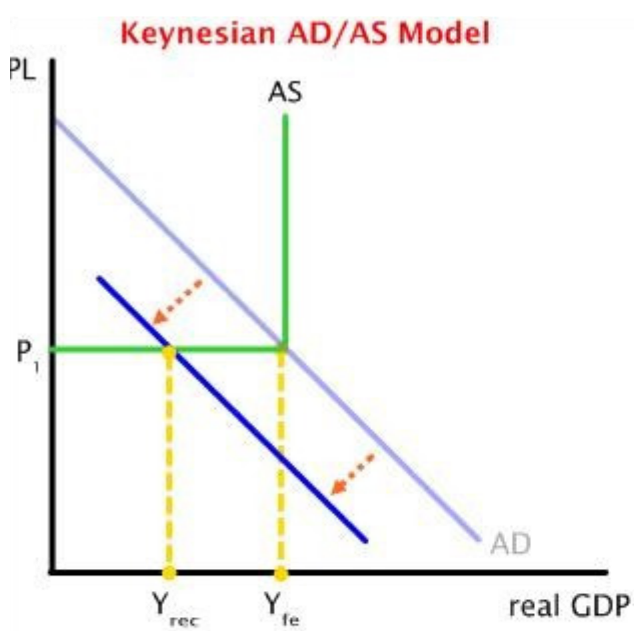
What Will Become of the Chinese Worker?

The days of full-employment in China appear to be over. For decades under communism, the unemployment rate in China stood at an official level of 0%. Of course, being guaranteed work by a state-owned farm or steel factory didn't exactly mean that all adult Chinese were 'working', rather that they were 'employed'. The 'iron rice bowl' of communism disappeared in the decades following Mao's death during the period of 'reform and opening' begun under Deng Xiaoping in 1979.

Upon its opening to the world markets, China embarked on three decades of transition from command to market economic principles, characterized by near double digit growth. The demand for workers in its export sector, centered mostly in the Eastern cities from Shenzhen in the south to Shanghai and Beijing in the north, led to the largest rural to urban migration in human history, as nearly 300 million Chinese left the countryside to seek employment in the country's massive export sector.

Today, the very engine of China's growth is sputtering to a halt. The demand for Chinese exports is falling as unemployment rises and incomes fall among its trading partners in Asia and the West. Subsequently, the flow of labor from the countryside to the city has reversed, and for the first time in its long history, China is experiencing urban to rural migration.

Millions of rural migrant workers lost their jobs in the cities of eastern China during the global economic slowdown of 2008-2009, leading to a reverse migration of unemployed to their homes in China's countryside. Unrest among the newly unemployed workers caused concern for the authoritarian government of China.



Prices and wages are inflexible downwards. Weak AD leads to severe recession and no self-correction. Active role for government needed to restore full-employment through fiscal and monetary stimulus.

What does the new demographic trend mean for the world's most populous nation? Bad news, most likely. The hope of work in the city dwindles with the demand for Chinese products, but the agricultural sector, which is the main source of employment in the countryside, shows little promise of employment for the millions returning home.

China's farming industry has become less, not more, labor intensive over the decades since 'reform and opening'. The acquisition of capital has supplanted the need for human labor in rural farming, which is one of the 'push factors' that led to the massive internal migrations to cities in the first place. The 'pull factor' leading the masses to the coastal metropolisis, of course, was employment in a factory producing goods to be exported to foreign markets.

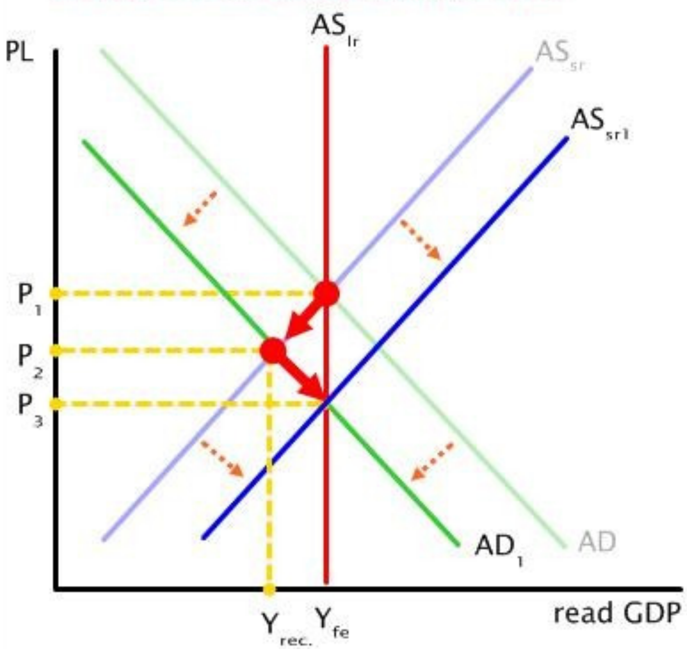
Today China's workers find themselves in the worst possible situation. There is now a 'push factor' of 15-20% unemployment, combined with the high cost of living in the cities. Likewise, the struggle of living as an outsider in a big city creates an incentive for Chinese workers to return to their familial homes in the countryside. However, once they've returned home, they find the same lack of opportunity that caused them to leave in the first place. Urban unemployment may shrink as a result of the reverse migration of workers, but rural unemployment will rise.

For the first time in decades, China is faced with a problem that only a year ago (when growth reached 11%) it seemed unlikely it would ever have to ever face: catastrophic unemployment. Economic theory would suggest, therefore, that China is facing a situation where falling demand for its output has led to rising unemployment due to the downwardly inflexible nature of workers' wages. According to the Keynesian AD/AS model above, if demand for Chinese output is not restored on its own (which seems unlikely as the West enters deep recession), then the government must take an active approach to stimulating demand through expansionary fiscal and monetary policies.

Keynesian theory, formulated during the Great Depression of the 1930s, says that in times of recession, spending in the economy is unlikely to increase on its own due to the huge increases in unemployment and corresponding lack in consumer and investor confidence. An active role of government, therefore, is needed to supplant the fall in private spending, and create new income, spending, and economic growth.

In contrast to this 'demand-side' theory of macroeconomics, the neo-classical economist would argue that China's government would do best by letting the economy 'self-correct' in times of economic slowdowns. The graph below shows that as demand for China's output falls in the short-run, unemployment will rise and the price level will fall as firms find it hard to sell their output. Because millions are out of work, and because prices are lower, labor will be willing to accept lower wages, encouraging firms to increase their employment of labor, shifting aggregate supply outward and ultimately restoring full-employment at a new, lower price level than before the downturn began.

Recession in the extended AD/AS model



This classical *laissez faire* theory of 'self-correction' has by most account been proven **false**, as most major recessions, most notably the

Great Depression itself, were ended only after massive intervention by the national government.

The most promising solution to the looming social and economic nightmare it faces, is for the Chinese government to push forward massive fiscal stimulus plans aimed at putting the tens of millions recently jobless back to work. This may sound like a return to communism at first, but government money can be spent to create jobs in private enterprise, producing goods, services, and infrastructure that leads to real long-run economic growth fueled by domestic, not foreign, demand for Chinese output.

For too long China has depended on demand from the rest of the world to grow its economy. Faced with the largest economic crisis of the modern era, the Chinese Communist Party should take it upon itself to reduce the nation's dependency on foreign demand and stimulate growth through new public spending on infrastructure, education, health care and social security for the hundreds of millions of Chinese who are left to fend for themselves once they've reached retirement age. Meaningful fiscal stimulus aimed at improving the lives of the common citizen, who has been so adversely affected by China's over-dependence on export-oriented growth, may be the best response to the most dire social and economic turmoil the country has faced since the end of the Mao era over 30 years ago.

Questions:

1. What is China's most worrying macroeconomic problem currently? Inflation? Recession? Unemployment? Deflation? Trade imbalance? Income distribution? Which of these does falling demand for China's exports affect most?
2. What are the social and economic costs of rising unemployment and why is it so important for a government to combat it?
3. Discuss the differences in the Keynesian and the Classical models in their explanation of what will happen to unemployment after a fall in aggregate demand.