

## Consideration on China's New Normal Economic Growth

Dic Lo<sup>1</sup>

**Abstract:** Slowdown in economic growth is the defining characteristic of the 'New Normal' of the Chinese economy post-2008. Explanations of the slowdown have coalesced around the theses of demand deficiency and profitability decline. This paper dissects the theoretical reasoning and empirical backings of these theses, with a view to clarifying the structural-institutional conditions that underpin the economic performance. On that basis, the paper arrives at the judgement that, long term, whether or not China is able to sustain medium-speed growth or even to resume high-speed growth hinges on the rivalry between two models of economic transformation that have both been operating in the economy in recent years: namely, a production-oriented model versus a speculation-oriented model.

**Keywords:** New Normal, production-oriented model, speculation-oriented model, growth

### Introduction

Slowdown in economic growth is the defining characteristic of the 'New Normal' of the Chinese economy post-2008, amid the Great Recession that has engulfed the world as a whole. Initially, in the years 2008-2011, thanks to the government's massive fiscal stimuli, Chinese economic growth continued to maintain a fast pace that is close to 10% a year. The growth rate then dropped to below 8% levels in the years 2012-2014, and below 7% levels thereafter. As of mid-2017, there is little evidence that the growth slowdown would be reversed in the foreseeable future (China's National Bureau of Statistics, 2017).<sup>2</sup>

Is the growth slowdown cyclical in nature? Or is it a long-term trend? The term New Normal, which has been formally used by the Chinese state leadership, suggests that the slowdown is more likely long-term than short-term. Or at least that is the view of the leadership, not least in its openly stated vision that an 'L-shape' curve is almost definite for characterizing the transition from the high-speed growth phase of the past three decades to a new phase of medium-speed growth from

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<sup>2</sup> Unless otherwise indicated, all statistical data in this paper are from the data bank of China's National Bureau of Statistics (NBS) (<http://data.stats.gov.cn/easyquery.htm?cn=C01>) and issues of its publication, the *China Statistical Yearbook* (<http://www.stats.gov.cn/tjsj/ndsj/>).

now on (Neteast News, 2017; Xinhua news, 2016).<sup>3</sup> State economic policy and development strategy have thus been designed on the basis of this vision.

Insomuch as the growth slowdown is indeed a long-term trend, there arises the question of what the structural-institutional conditions that have accounted for the transition are. Answers vary, mostly coalescing around two theses: namely, demand deficiency and profitability decline. These answers are with different degrees of scholarly substantiation and empirical backing, and hence have yet to yield a consensus. The Chinese state leadership, for its part, has been eclectic in the face of the different answers and has designed policy measures to address the relevant concerns raised by these answers.

This paper is intended to clarify the reasoning of the alternative answers, and to put them in comparison, with a view to constructing an appropriate synthesis. Given that the alternative answers do have elements of empirical truth, the paper further seeks to address the question as to what structural-institutional conditions would be necessary for maintaining medium-speed growth – or even returning to high-speed growth. Foreshadowing, it will be argued that, for coping with the problems of demand deficiency and profitability decline, government policy needs to be designed in a way that consolidates a production-oriented model instead of yielding to the pressure of a speculation-oriented model. This amounts to reshaping the Chinese ‘model’ of economic transformation, in a world of speculation-prone financial expansion.

### **The Stagnation of Investment Growth and Demand-side Constraints**

Discernibly, in the New Normal, the immediate cause of the slowdown in economic growth is the precipitation of the growth in productive investment. Economic growth at an average annual rate of around 10% in the period 1980-2011 was accompanied by investment growth of 22% in nominal

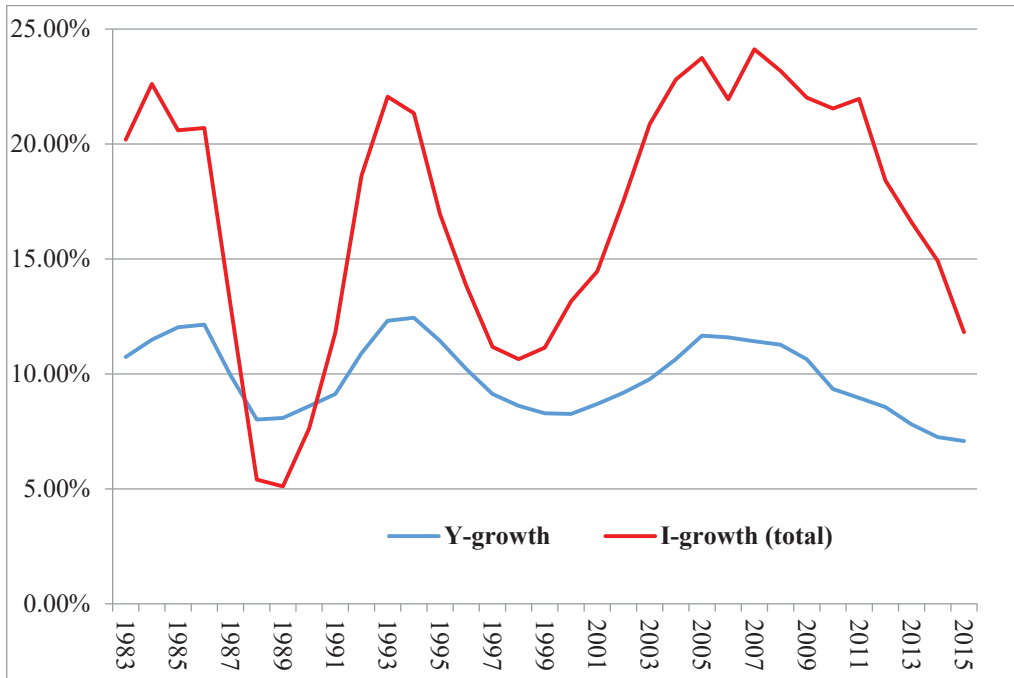
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<sup>3</sup> *Renmin Ribao* (The People’s Daily), the mouthpiece of the Communist Party of China, carried an interview with a so-called ‘authoritative person on the economy’ on 9<sup>th</sup> May 2016, in which that person used the metaphor of the ‘L-shape’ curve to characterize the long-term outlook of Chinese economic growth; see <http://news.163.com/17/0310/10/CF5MQBHL000187VE.html>. The official Xinhua news agency also released that interview on the same day; see [http://news.xinhuanet.com/2016-05/09/c\\_1118833995.htm](http://news.xinhuanet.com/2016-05/09/c_1118833995.htm).

terms. In the next five years from 2012, investment growth slows down to an average of 15% per annum. In real terms, the average annual rate of investment growth is 17% and 15%, respectively, for the two periods. Also in real terms, investment growth slows down to 12% in 2015, 9% in 2016, and 4% in the first half of 2017.

This close relationship between economic growth and investment growth is indicated in Figure 1, which shows the trend of the two variables in five-years moving averages. The ups and downs of the two trends follow almost the same pattern throughout the reform era, only the fluctuations in investment growth are far more severe than those of economic growth. These repeated fluctuations suggest that the growth slowdown post-2008 does embody some cyclical components, albeit, this time round, the slowdown seems far more protracted than the previous rounds. Still, it is clear that a long-term relationship between economic growth and investment growth exists.

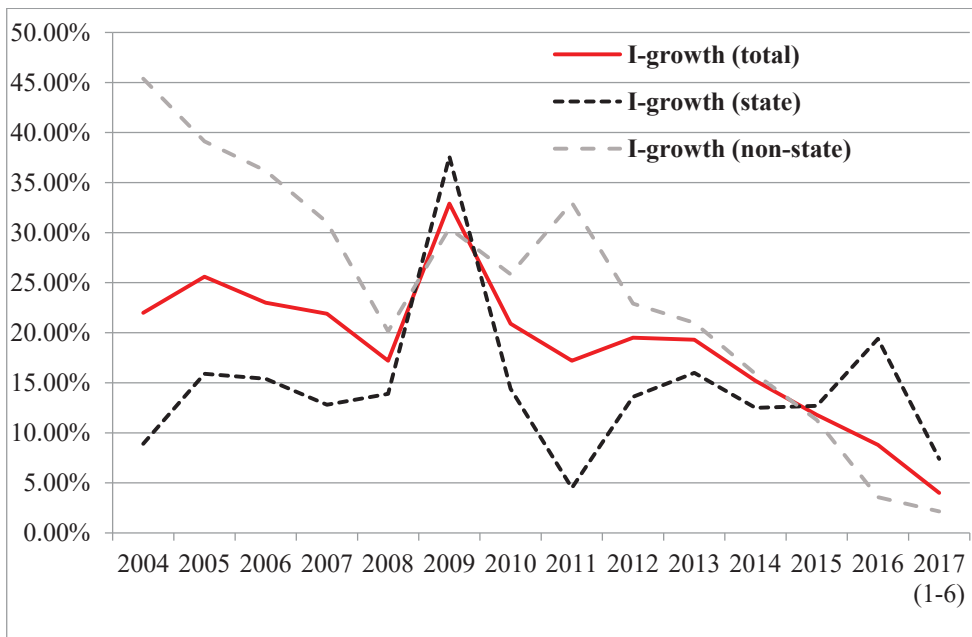
Viewed more closely, post-2008 and especially after 2011, the slowdown in investment growth has been mainly accounted for by non-state investment, which typically accounted for 60%-plus of the total volume of investment in recent years. Figure 2 shows that non-state investment registered an abrupt decrease in growth rate in 2008, from the levels of more than 30% in the previous years, down to 20%. It then rebounded in the next three years, thanks to state encouragements including the inducement by the massive expansion in state investment. Continuous decreases then set in from 2012 onward, dropping down to the rate of 4% in 2016 and further down to 2% in the first half of 2017.



**Figure 1. Real annual growth rates of GDP (Y) and investment (I), five-year moving averages (%)**

Sources: Chinese National Bureau of Statistics, China Statistical Yearbook 2016, and China Statistical Yearbook 2017.

Notes: Investment refers to total fixed-asset investment. Its growth rates are computed by using the investment price index as a deflator.



**Figure 2. Real annual growth rates of state investment and non-state investment (%)**

Sources: Chinese National Bureau of Statistics, China Statistical Yearbook 2016, China Statistical Yearbook 2017, and NBS data bank.

Notes: Investment refers to total fixed-asset investment. Its growth rates are computed by using the investment price index as deflator.

Conceptually, it is conceivable that abrupt decreases in the rate of investment growth could undermine economic growth in two ways. First, because investment is a component of aggregate expenditures, it could impose a demand-side constraint on economic growth in the current period. Second, because investment is normally the main underpinning of the expansion in productive capacity and the improvement in productivity, it could constrain long-term economic growth. In this connection, it is also worth noting that the predominance of non-state investment in the total implies that the Chinese economy as a whole is nowadays dominated by market-based, profit-oriented decisions – at least when the state does not reign in to counter-balance this predominance. No wonder, therefore, in the context of the Great Recession worldwide, the growth slowdown in China this time round has been more protracted than the previous rounds.

Explanations of the slowdown in investment growth, and thereby in economic growth, have coalesced around the theses of demand deficiency and profitability decline. And both demand deficiency and profitability decline are said to be long-term rather than short-term phenomena. Hence, they must be deeply rooted in certain structural-institutional conditions that are intrinsic to the prevailing model of economic transformation.

For the thesis of demand deficiency, the reasoning is straightforward and the empirical evidence seems obvious. Research and journalistic reports abound about the excess capacity, and excessive exports that have caused trade frictions with other countries, of such sectors as steel, cement, and coal, especially after 2011. Most important, the stagnation of the sector of real estate and land development – after the unprecedented booms in 2007-2013 and despite the sporadic resurgences thereafter – is evidently the main cause of demand deficiency in many other sectors. Alongside the excess capacity are phenomena of sluggish sales and factory closures. As a result, the outcome of investment turns into the piling up of inventories, particularly in the form of the famous phenomenon of ‘ghost towns’, i.e., blocks of unoccupied or semi-completed residential properties. This undermines investment, including state investment that is typically much less sensitive (than non-state investment) to demand conditions.

It should be noted that demand deficiency is not tantamount to a lack of social needs. After all, in China today, there still exists ample space for the progress in urbanization and with it rural-to-urban migration. A huge number of peasant households are in need of joining the urban population, and of getting urban residential properties. It is simply because of their lack of purchasing power, or, because of urban residential properties being exceedingly expensive, that these needs can not be satisfied. The deviation between market demands and social needs indicates, once again, the predominance of profit orientation in the Chinese economy today.

The phenomena of excess capacity, together with their perceived causes, gives rise to a general thesis on demand deficiency under the New Normal: namely, the thesis of imbalances in the composition of aggregate demands. It is argued that Chinese economic growth has relied excessively on investment and export, with consumption growth lagging far behind. It is further argued that such growth path is unsustainable, both because the Great Recession worldwide tends to undermine China's export growth, and because investment growth only adds to productive capacity and therefore excess capacity over time. Finally, the argument that 'under-consumption' has been mainly caused by worsening income distribution, in the form of decreasing labor's share in national income, casts critical light on the prevailing model of economic transformation (Akyüz, 2012; Palley, 2006; Zhu and Kotz, 2011; Lo, 2013).<sup>4</sup> In any event, the fact that the Chinese state leadership has been attempting to 'rebalance' the economy by promoting the substitution of consumption for investment and export suggests that it takes the thesis of demand imbalances seriously.

### **The Multiple Causes of the Decline in Aggregate Profitability**

Profitability decline refers to the continuous decrease in the aggregate rate of profit for the economy as a whole. Conceptually, in a market economy, investment is profit-oriented and hence profitability decline is bound to have a negative impact on investment growth. In the case of China under the New Normal, where non-state investment accounts for a major part of total investment,

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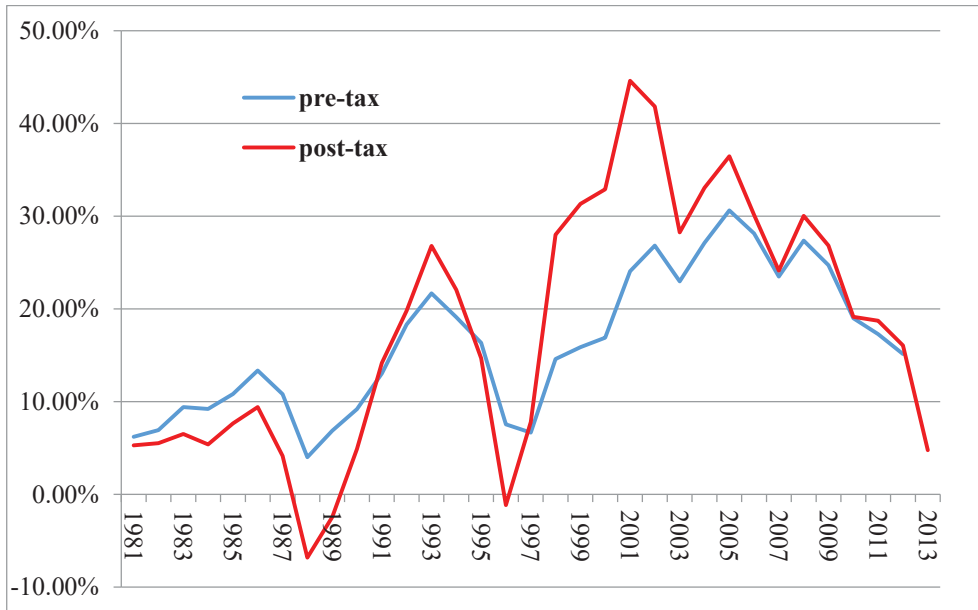
<sup>4</sup> For references on the causes and implications of demand deficiency and imbalances of the Chinese economy, see Akyüz (2012), Palley (2006), Zhu and Kotz (2011). Lo (2013) provides a theoretical and empirical critique of this thesis.

and both have registered slowdown in growth, it is conceivable that the growth slowdown might have been caused by profitability decline.

The reality is more complex. Direct empirical evidence of profitability decline in the Chinese economy has been scattered, not least because there does not exist an official estimate of the aggregate profit rate. What does exist are series of profit data of the industrial sector alone. Figure 3 shows the annual rates of growth of both pre-tax and post-tax industrial profits. It is clear that both series registered very substantial decreases from high levels pre-2008 to low levels thereafter. By 2014, the growth of pre-tax profits turned to almost zero, whilst that of post-tax turned to negative. Nevertheless, in terms of the movements in the industrial profit rate (i.e., the ratio of profits to total capital), the picture is different. As can be seen from Figure 4, there is indeed a trend of declines in the pre-tax industrial profit rate both for state-owned enterprises (SOEs) and non-state-owned enterprises, but the levels of the profit rates remain rather high compared with those of the previous three decades. This said, however, the movements in the industrial profit rate might not necessarily represent those of the aggregate profit rate for the economy as a whole. Indeed, in the relevant scholarly literature, existing studies mostly come out with estimates indicating that the aggregate rate of profit has tended to fall since the early 2000s and this decline has accelerated post-2008 (Gaulard, 2013; Li, 2016; Xie and Li, 2016).<sup>5</sup> This being the case, something must have happened to account for this divergence between the industrial and aggregate profit rates. One possibility is the allocation of an increasingly bigger share of total capital to other sectors that are less profitable than industry, thereby pulling down the aggregate profit rate. This possibility is consistent with one of the three main explanations of the possible profitability decline in the Chinese economy: namely, the theory of rents squeezing profits, in addition to the theory of wages squeezing profits, and that of the rise in capital-to-output ratio undermining profitability.

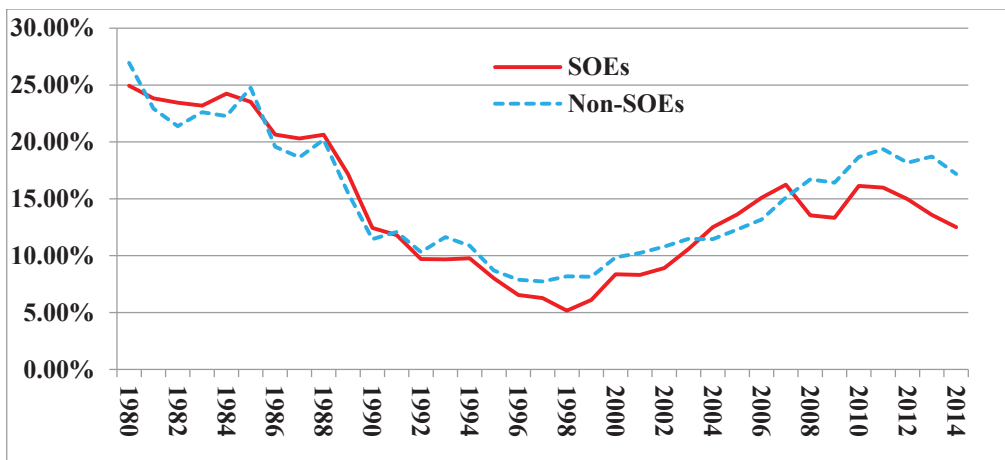
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<sup>5</sup> For scholarly works on estimating and interpreting the movements of the aggregate rate of profits in the Chinese economy, see Gaulard (2013), Li (2016), and Xie and Li (2016). These works all come out with the finding of profitability decline.



**Figure 3. Nominal annual growth rates of pre-tax and post-tax profits of industry, five-year moving averages (%)**

Sources: Chinese National Bureau of Statistics, China Statistical Yearbook 2016, and NBS data bank.



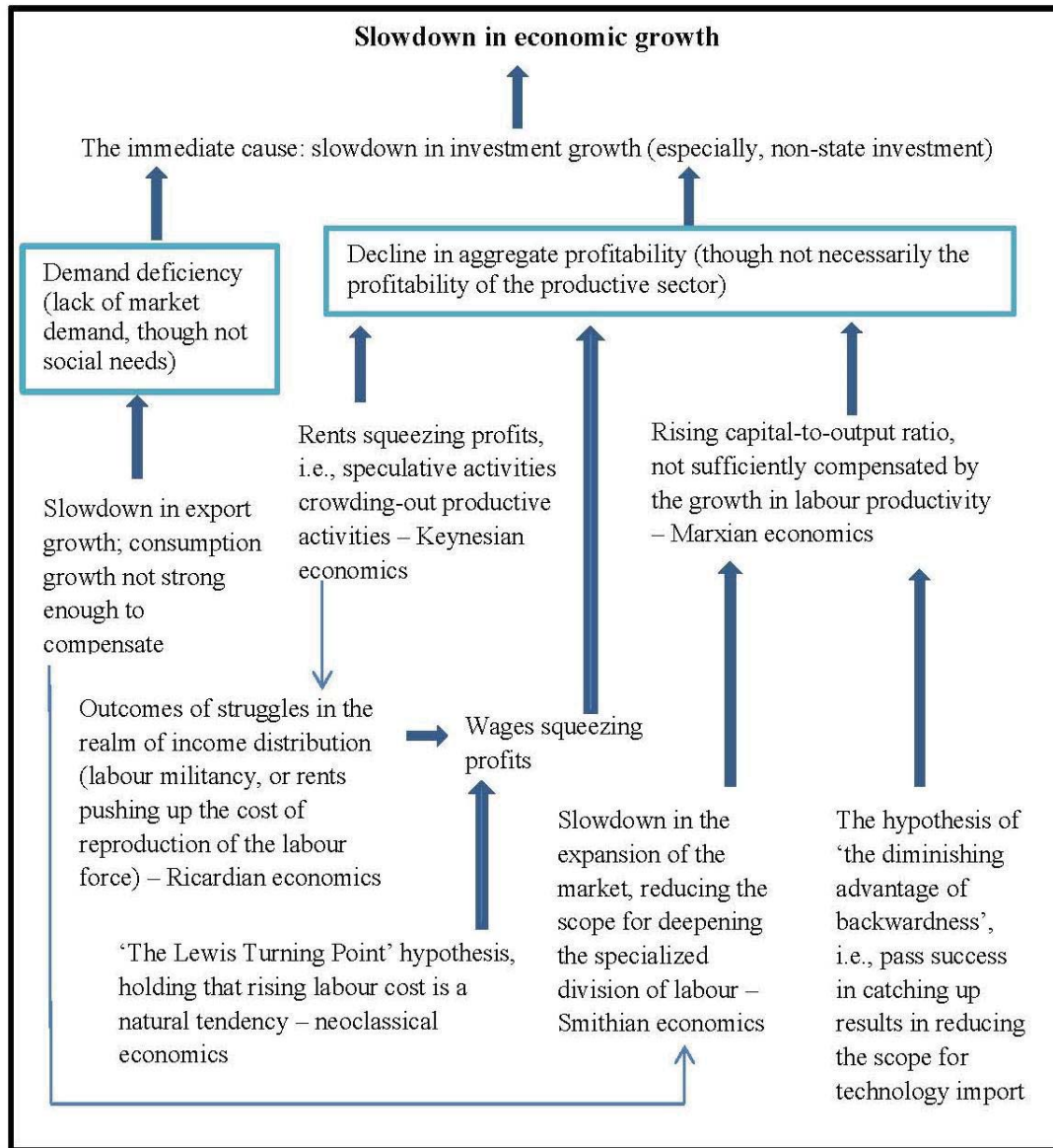
**Figure 4. Pre-tax profit rates of industrial enterprises (%)**

Sources: Chinese National Bureau of Statistics, China Statistical Yearbook and China Industrial Economics Statistical Yearbook, various issues, and NBS data bank.

Notes: Pre-tax profit rate = (total taxes + total profits) / (working capital + net value of fixed assets). Non-SOEs in this figure refer to non-SOEs in the formal sector of Chinese industry.

These three explanations warrant a close dissection, and the logical flows in Figure 5 can help to illustrate this.





**Figure 5. Alternative explanations of the slowdown of Chinese economic growth under the New Normal**

The theory of rents squeezing profits refers to the expansion of non-productive, even counter-productive activities, which tend to crowd out productive activities. In line with Keynesian economics, such expansion typically arises from financialization of the economy – that is, unfettered financial liberalization leading to the predominance of speculative financial capital in the economy as a whole. In the case of the Chinese economy under the New Normal, financialization takes the form of the massive expansion and then the booms and busts of the real

estate sector, and of the stock market. This process involves the participation of productive enterprises in speculative activities, the inward and outward flows of international ‘hot money’, and the phenomenon of capital flights. This process entails the breakdown of the separation of commercial banks from the securities markets, and the increase of loopholes in the controls over cross-border capital flows – the undermining of the two lines of defense in the Chinese financial system against financialization. Ultimately, therefore, financialization has been in a significant measure caused by some particular policy orientation of the state.

The theory of wages squeezing profits appears to be more popular in the existing journalistic, as well as scholarly, literature. The empirical backing is quite obvious: that ‘cheap labor’ is no longer available in China. As will be seen in the next section, since the turn of the century, the growth in the real wage rate has persistently and substantially outpaced that of per-capita income, resulting in the increases of the share of labor compensation in national income. Three different theses have been supplied to explain this development:

- First, the thesis of the ‘Lewis Turning Point’ contends that China has reached the point of exhaustion of labor reserve, thus inevitably leading to wage rise. This thesis is based on the famous Lewis Model of labor transfer from the ‘traditional’ sector to the ‘modern’ sector. It assumes the neoclassical theory of the ‘iron law’ of wage determination, meaning that, in a market environment, income distribution is purely technically determined. It also implies that wage growth cannot exceed the limit imposed by the ‘iron law’, as otherwise economic growth will not be sustained (Garnaut *et al.*, 2014; Lu and Cai, 2014; Song and Zhang, 2010).<sup>6</sup>
- Second, the thesis of ‘wages squeezing profits’ contends that profitability decline has been mainly caused by labor militancy (or at least the increase in the social-political protection of labor rights). This thesis is in line with Neo-Ricardian economics, where social factors are deemed more crucial than technical factors in the determination of income distribution. In this connection, whilst neoliberal economists accuse wage rise of

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<sup>6</sup> Garnaut *et al.* (2014), Lu and Cai (2014), and Song and Zhang (2010) are representative of the view that the Chinese economy has reached the Lewis Turning Point, and that deepening (market-oriented) reforms are necessary for China to avoid the so-called ‘middle-income development trap’.

being detrimental to profitability and therefore economic growth, Neo-Ricardian economists rather argue for the opposite: that wage rise has fostered consumption growth, and thereby has been conducive to economic growth under the New Normal (Piovani, 2014; Qi, 2017; Hart-Landsberg and Burkett, 2011; Panitch and Gindin, 2012).<sup>7</sup>

- Third, the thesis of ‘wage rise being no more than a delusion’ contends that wage growth under the New Normal has in fact lagged behind the rise in the cost of living, and this is because the official data of the consumer price index have systematically understated the rise in the cost of living. Moreover, the argument goes, the rise in the real cost of living has been driven by the prices and rents of urban real estate, which are the product of speculative financial activities. This thesis thus falls back on the Keynesian theory of rents squeezing profits.

The theory of the rise in capital-to-output ratio undermining profitability has been developed mainly by Marxist economists, although it could also be interpreted according to neoclassical economics. The neoclassical interpretation is straightforward: that sooner or later, along with economic development, the law of diminishing marginal productivity of capital would set in, and this is probably the case in China under the New Normal. The Marxist interpretation, known as the ‘law of the tendency of the rate of profit to fall’, is more nuanced and multifaceted (Lo, 2013; 2016).<sup>8</sup> This ‘law’ starts with the postulate that, along with economic development, in the production process, the ratio of the means of production, or constant capital (c), to labor power, or variable capital (v), would tend to rise. And because, at the systematic level, it is only labor power that creates surplus value (s), the result is that the rate of profit ( $r = s/[c+v] = [s/v]/[\{c/v\}+1]$ ) would then tend to fall. Note that, conceptually, this tendency could be offset by various counter-

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<sup>7</sup> For references on labor extraction and profitability decline in China, see the analyses by Piovani (2014) and Qi (2017). Hart-Landsberg and Burkett (2011) and Panitch and Gindin (2012) focus on the broader implications of labor extraction for Chinese economic development.

<sup>8</sup> Informed by the studies cited in the next footnote, Lo (2016) provides a detailed analysis of the convergence of the Chinese economy to the Golden Age Model since the turn of the century, and the disruptions caused by the process of financialization under the New Normal. See also Lo (2013) on the broader context of the convergence, refuting the popular theses that Chinese economic development has been based on ‘cheap labor’, and, as such, it has been suffering from problems of underconsumption and export-dependence.

tendencies that raise the nominator of the profit rate, i.e., the rate of surplus value ( $s/v$ ). It is worthwhile to see if counter-tendencies do exist in the Chinese reality.

- One possible counter-tendency is the increase in labor extraction, or work intensity relative to the wage rate. This is unlikely in China under the New Normal. As mentioned, the reality has rather been the tendency of rising wage rates and the share of labor compensation in national income. If anything, therefore, there exists stern resistance to the increase in labor extraction, and this resistance is consistent with the trend of profitability decline.
- Another possibility is the slowdown in productivity growth due to demand deficiency, or, more precisely, due to slowdown in the expansion of the market and therefore the scope for deepening the specialized division of labor. This possibility is consistent with the theories of both Adam Smith and Karl Marx, although the latter tends to put more emphasis on market expansion due to international trade. The reality is that China has been facing demand deficiency domestically and the Great Recession in the world economy.
- Yet another possibility is the slowdown in the pace of technological progress. In the case of China, this in large measure is associated with the diminishing potential of the ‘advantage of backwardness’, i.e., decreases in the scope for technology imports. Put another way, because of its past success in catching-up, China today is much closer to the world frontier of technology than it was previously – hence the increasing difficulties for technological progress based on importing. A fundamental reshaping of its structural-institutional conditions is thus needed for technological progress based on more indigenous innovations.

On the whole, the preceding review suggests that the cause of the slowdown of Chinese economic growth is complex. Focusing on investment stagnation, it is found that there exists a multitude of interpretations, each of which have sound theoretical reasoning. And all of them seem to have some elements of empirical truth, or at least are consistent with some empirical stylized facts. Without judging which interpretation contains more truth than the others, the next section will be devoted to analyzing what direction will be needed for Chinese economic transformation

in order to overcome the major hurdles to sustained economic growth as suggested by the various interpretations.

### Reshaping the Model of Economic Transformation

From the turn of the century until the initial years of the New Normal, the prevailing structural-institutional conditions of the Chinese economic transformation managed to achieve outstanding developmental outcomes. There were simultaneously the following achievements, all on unprecedented scales: rapid rises in both productivity and the wage rate, and rapid expansion in both investment and consumption. These achievements provided the material conditions for broader social development, including the enhancement of the market power of labor, the rebuilding of a publicly-funded healthcare system that covers almost the entire Chinese population, and the acceleration of the process of urbanization.

Table 1 shows the real growth of the gross domestic product (GDP) per worker, as a proxy for the growth in labor productivity, in various periods over the reform era. In the period 1978-2000, an average growth rate of 7.66% per annum was recorded. In the subsequent period of 2000-2012, the rate increased to reach the level of 9.67% per annum. This acceleration of the rate of growth in labor productivity from the first period to the second period is, at any rate, spectacular. Yet, the slowdown of growth subsequently in the years 2012-2016 to an average annual rate of 6.84% also appears to be eye-catching.

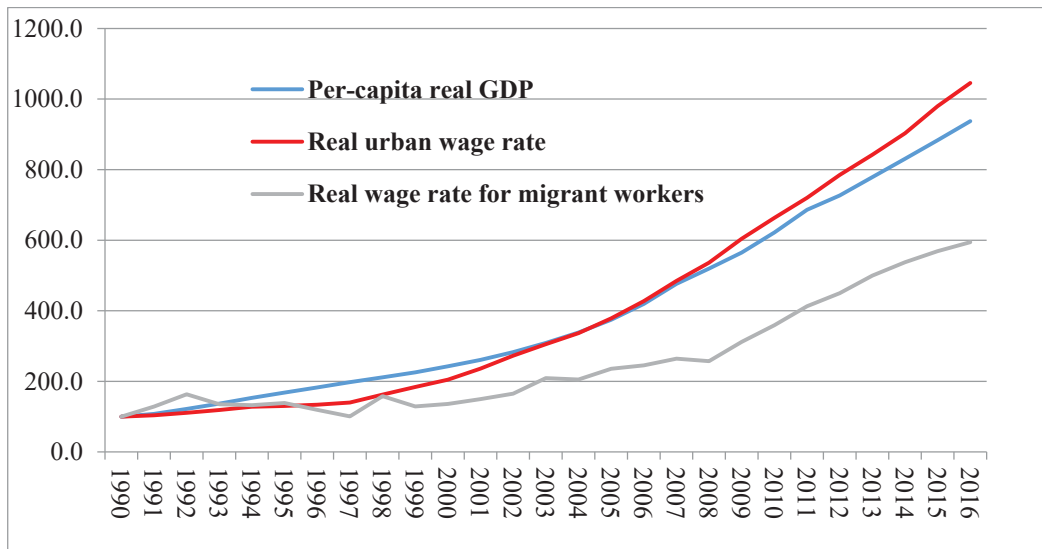
	(a)	(b)	(a)-(b)
	Real GDP	Employment	
1978-2000	9.68	2.02	7.66
2000-2012	10.19	0.52	9.67
2012-2016	7.13	0.29	6.84

**Table 1. Average annual growth rate (%) of real GDP and employment**

Sources: Chinese National Bureau of Statistics, China Statistical Yearbook 2016, and China Statistical Yearbook 2017.

The movements in the wage rate are equally worth noting. Figure 6 charts out the trends of the growth in per-capita real GDP, the urban real wage rate, and the real wage rate of migrant

workers from 1990 to 2016. It can be seen that per-capita GDP growth is basically on a par with urban wage growth, whilst the wage growth of migrant workers lags seriously behind – the average annual growth rate of the three indicators being 8.99%, 9.45%, and 7.10%, respectively, for the period of 1990-2016. Viewed more closely, it is clear that there is a reversal of the comparison between the growth of the two wage rates and per-capita GDP. In the period 1990-2000, the average annual growth rate of the three indicators was 9.27%, 7.44%, and 3.11%, respectively. In the next period of 2000-2012, the three indicators became 9.57%, 11.85%, and 10.49%, respectively. This comparison that is in favor of wage growth persists into the years of economic slowdown. In the period 2012-2016, the three indicators were 6.57%, 7.42%, and 7.21%. They all exhibited a substantial slowdown in growth, though.



**Figure 6. Indices of per-capital real GDP, real urban wage rate, and real wage rate for migrant workers**

Sources: Chinese National Bureau of Statistics, China Statistical Yearbook 2016, and China Statistical Yearbook 2017.

The trends of productivity and wage growth depicted above have been underpinned by investment growth, and accompanied by consumption growth. As can be seen from Table 2, in the period 1978-2000, the average annual real growth rate of consumption (deflated by the consumer price index) was 8.92%, which was close to the investment growth rate (deflated by the investment price index) of 9.35%. Entering the period 2000-2012, consumption growth increased slightly to 10.14%, amid the acceleration of investment growth to reach a high rate of 15.01%. Thereafter, in

the period 2012-2016, consumption growth fell back to 8.06% a year, whilst investment growth fell even more abruptly to 7.04%.

	Consumption	Investment
1978-2000	8.92	9.35
2000-2012	10.14	15.01
2012-2016	8.06	7.04

**Table 2. Average annual real growth rates (%) of consumption and investment**

Sources: Chinese National Bureau of Statistics, China Statistical Yearbook 2016, and China Statistical Yearbook 2017.

Notes: Data are consumption and investment (i.e., gross capital formation) components of GDP by expenditures approach. Consumption growth is deflated by the consumer price index; investment growth is deflated by the investment price index.

The synchronous fast pace of growth in the period of 2000-2012 between productivity and the wage rate, and between investment and consumption, stands in contrast to the performance both in the preceding period and in the subsequent years. In particular, this synchrony appears to be antithetical to the nexus of developments related to the worsening economic situation from 2012 onward, as detailed in the previous sections of the paper. The fast consumption growth, underpinned by wage growth, provided the demand conditions for economic growth. In the meantime, the wage growth was based on comparable productivity growth and thus would not undermine the momentum for investment growth. On the whole, a balance seemed to be in existence between these two pairs of variables, thereby generating the good outcomes in terms of both economic and social development.

What are the structural-institutional conditions that underpinned the synchronous growth of these crucial variables, and therefore the developmental outcomes? Why have the conditions been undermined under the New Normal? Elsewhere in the literature, there exists a thesis stating that, since the turn of the century, the Chinese economy has been on the path of converging to a model that is said to have operated in advanced capitalist countries in the ‘Golden Age’ of 1950-1973. This path of convergence, as well as the disruptions which it has faced, might help to explain the twists and turns of economic development from the early 2000s until the present time.<sup>7</sup>

Theoretically, the Golden Age Model can be characterized as having as its pillars the three agents of ‘Big Business, Big Labor, and Big Government’. Big Business refers to the prevalence of an investment-led, capital-deepening growth path and the associated predominance of large-scale enterprises. Rapid productivity growth based on dynamic increasing returns is the *raison d’etre* of Big Business. Big Labor takes the form of collective bargaining over wage settlement, therefore serving as a countervailing force of capital in the determination of income distribution. It also often has the property of promoting the collective learning that is conducive to productivity growth. Big Government refers to the welfare state, which is helpful both for lowering labor costs for individual business firms and for supporting the mass consumption that is necessary for the utilization of dynamic returns from mass production (Glyn *et al.*, 1990; Glyn, 2006; Lazonick, 2009).<sup>9</sup>

In the case of China in the period of 2000-2012, along with rapid investment growth, was the famous phenomenon known as ‘guo jin min tui’ (the state sector advances, whilst the private sector retreats). The SOEs that embodied the advancement are large-scale, capital-intensive firms. They are the Big Business in China (China Economic Net, 2017).<sup>10</sup> Meanwhile, also in relation to rapid investment growth, was productivity growth. This formed the material condition for the equally rapid wage growth, which was further made possible by the nascent formation of Big Labor – evident not only in the wage growth itself but also in institutional and policy moves such as minimum wage legislations, the Employment Contract Law, collective bargaining, and unionization. Finally, Big Government takes the form of the state orienting itself towards rebuilding a comprehensive welfare system. Within a ten-year period, 2003-2013, a publicly-funded healthcare system was established to cover almost the entire population. The provision of

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<sup>9</sup> For a detailed exposition of the internal dynamics, and historical experience, of the Golden Age Model in advanced capitalist economies in 1950-1973, see Glyn *et al.* (1990). Glyn (2006) further compares and contrasts the ‘Golden Age model’ with the ‘neoliberal globalization model’ that prevails worldwide after 1980. Lazonick (2009) provides a complementary, more micro-focused work by comparing what he calls the ‘Old Economy Business Model’ with the ‘New Economy Business Model’.

<sup>10</sup> In 2016, of the 109 (mainland) Chinese firms that were among the *Fortune 500*’s biggest companies (by sales revenues) in the world, 80% were state-owned enterprises; for details, see <http://news.xhby.net/system/2017/07/21/030714725.shtml>.



affordable housing for urban low-income people, mostly immigrants from rural areas, has also been on the government agenda. Most far-reaching, the range of policy measures aimed at promoting labor compensation-enhancing economic growth, rather than growth based on ‘cheap labor’, testify to the new state orientation.

The recurring disruptions to the path of convergence to the Golden Age Model under the New Normal could also be attributed to state orientation. Discernibly, a process of financialization of the economy has occurred post-2008. By crowding out productive investment, speculative activities tend to undermine productive activities, leading to the problem of rents squeezing profits. Long term, by curtailing the foundation of wage growth (and hence consumption growth) via its negative impact on productivity growth, financialization also tends to worsen the problem of demand deficiency.

The clearest symptom of the financialization of the Chinese economy post-2008 is the speculative bubbles in the real estate sector and the stock market. The booms and busts in these sectors have been spectacular, attracting widespread concerns, not just in China, but rather across the world. In particular, the stock market crash in summer 2015 and the progressive devaluation of the Chinese currency from that time reflect the precipitation of capital in speculative activities, the inward and outward flows of international ‘hot money’, and capital flights.

At the aggregate level, financialization can be gauged by observing the massive expansion in the stock of ‘total social financing to the real economy’ (TSF). This indicator encompasses bank loans and a wide range of alternative forms of financing, carried out by a wide range of non-bank financial institutions. In the years 2003-2008, the ratio of TSF to GDP remained basically unchanged. Thereafter, it surged from 149% in the year-end of 2008 to reach 208% by the year-end of 2016. Along with the increase in TSF as a ratio to GDP, the stock of bank loans as a ratio to GDP increased from 93% in 2008 (slightly below the level of 97% in 2002) to 141% in 2016.

And other types of financing increased from 25% (the same level both in 2002 and 2008) to 68% in the meantime (People's Bank of China, 2017).<sup>11</sup>

Chinese banks, of which the biggest ones are all state banks, have traditionally been under tough government controls and regulations. The process of financial liberalization post-2008, however, has largely set them free to participate in speculative activities. There have been many reports of state banks conducting unregulated shadow banking activities in the pursuit of speculative gains. In comparison, non-bank financing activities have been subject to even fewer government controls and regulations. The fact that both types of financing have expanded tremendously can only result in the precipitation of capital in speculative activities. The other side of the coin is the crowding out of productive investment, which has reached crisis-prone levels since summer 2015.

### **Conclusions**

The cause of the slowdown in investment growth, and therefore economic growth, in China under the New Normal is complex. Both demand deficiency and profitability decline are ascribable to a multitude of forces that are rooted in the prevailing structural-institutional conditions as well as the internally divisive state orientation. Reshaping the model of economic transformation is thus needed for sustaining long-term development.

Since the turn of the century, there has been a rivalry between two alternative directions for Chinese economic transformation. These, namely, are the convergence to the Golden Age Model and the tendency of financializing the economy. Put another way, the rivalry is between the consolidation of a production-oriented model, on one side, and the transition to a speculation-oriented model, on the other side. It is discernible that the prevalence of the speculation-oriented model has mainly accounted for the economic problems that have actually occurred under the New Normal.

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<sup>11</sup> TSF data from the data bank of the People's Bank of China, accessed on 2 September 2017, <http://www.pbc.gov.cn/diaochatongjisi/116219/index.html><http://www.pbc.gov.cn/diaochatongjisi/116219/index.html>.

Against this background, it is understandable that, after the stock market crash in summer 2015 and the continuous worsening of economic performance, the Chinese state leadership has reoriented itself to turn to emphasize curtailing speculative activities and promoting productive activities. This effectively entails a resumption, or speeding up, of the convergence to the Golden Age Model. Whether this orientation can achieve the hoped-for outcome of medium-speed or high-speed economic growth, however, remains to be seen.

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