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The Financial Crisis and China's "Harmonious Society"

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Abstract: The global financial crisis has had a large negative impact on China's economy, particularly on employment, but the government responses appear to have been effective. This article focuses on the social policy responses after the crisis, and how these are situated in the austere social policies that have come about since the economic reforms started in 1978, and the recent aims to create a "harmonious society" and the challenges and contradictions these contain.

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Introduction

Few countries outside the Organisation for Economic Co-operation and Development (OECD) were hit harder and sooner by the global financial crisis than China. While its banks were relatively unaffected, the impact has been severe in the areas that were previously the most dynamic parts of the global economy. In coastal China, an estimated 20 million jobs were lost, and tens of thousands of factories closed down throughout 2008. But there was public optimism among Chinese commentators and some international commentators about China's ability to "weather the crisis": The government responded rapidly with a wide range of stimulus measures, and the economic downturn did indeed bottom out from mid-2009 onwards even though at the time of this paper's finalisation (May 2010), it is unclear how sustainable the recovery will be.

China's response to the crisis has had and will continue to have an enormous global impact, including on the rest of the Global South where development has been increasingly determined by China's economic rise. In the medium term, China will look to reduce the global financial imbalances along with its domestic stimulus, and to play an ever-larger role in international financial institutions. Parallel to this changing global role, China's own development model is likely to become more inward-oriented, which will have an impact on tens of millions of Chinese that have been involved in – and partly excluded from – the most dramatic economic transformation in recent history.

The focus of this paper is China's domestic social policy response following the crisis, and it emphasises how this is embedded in a balancing of national and international economic interests. The crisis reinforced the urge to build a "harmonious society", as articulated a few years before the crisis, now using the stimulus package to do so. The Domestic response would imply a shift in the model of economic growth away from coastal-based export-promotion towards an inward-oriented model, a rearticulation of how links between economic and social policies are perceived, and the potential of extended and more egalitarian social services, accompanied by drastic institutional changes, notably in health and social security provisions. This of course is happening within the political framework of continued Party control, without signs of the political transformations that occurred in East Asia after the 1997-1998 crisis, and with remaining key development challenges, including regressive fiscal systems and power balances.

This paper first briefly discusses China's integration into the global economy, the global financial crisis of 2008-2009 and how this has impacted China. It then focuses on the austere social policies that accompanied China's economic reforms, and the emphasis on social services in the stimulus package. The final section formulates ideas, based on lessons learned from past economic crises, about whether what we are witnessing is a turning point in China's development model, and how the crisis affects the political project of a harmonious society.

Prelude to the Crisis: China's Integration in the World Economy

China's growing global economic importance is well known. While still a lower-middle-income country with a per capita income under 2,000 USD (or 4,000 USD in Purchasing Power Parity, or PPP), it has experienced three decades of high levels of economic growth, though not uninterrupted. When the cracks in the international financial system started to appear, China's economy had already been overheating, and its government had tried to slow down the growth of the economy (Yu 2009; Wong 2008; Roache 2007). While the world economy contracted in 2009, China's economy grew over eight per cent, partly driven by expansionary fiscal and monetary policy (World Bank 2009a, 2009b). China has become one of the world's largest economies, and definitely the fastest-growing one, even though tens of millions of people still live in extreme poverty.

Of critical relevance to how we assess the current crisis, China's development path has been directly linked to the world economy's phase of "super-capitalism" (Reich 2008): the expansion of the global economy found in China a population that was relatively well-educated and healthy, due to the social policies since the revolution. Moreover, the country was hungry for restoring its national economy after the economic and social disasters of the 1950s and 1960s. While agriculture and, later, rural industrialisation drove the restoration of China's economy in the 1970s and 1980s, exports have been a main driver of recent economic growth. We have now become accustomed to the image of China as global manufacturing house, but this is a very recent phenomenon. Export-promotion was part of China's policy during the 1980s, but exports and foreign direct investment (FDI) took off only in the 1990s, following an economic downturn, the civil unrest of the late 1980s (Zhao

Zhiyang's memoirs published in 2009 provide fascinating insight into internal political differences at the time), and Deng's Southern Tour in 1992. This was followed by the 1997-1998 East Asia crisis – in which China was not affected as much as it was in 2008 (Jia 2009) – which strengthened the urge to build up foreign reserves.

Before the 2008 crisis, exports formed about 40 per cent of GDP, with those to the US forming about one-third of the total (Seibert 2007; Yang 2008; Prasad 2009). While exports have been mainly low technology, the share of high technology is growing rapidly. Foreign investments in China have played an important role for its exports, and over time, policy moved from joint ventures towards allowing wholly foreign-owned companies. China developed an export bundle resembling that of a country that is four times as rich. While capital flows and exchange rates continue to be controlled, China built up large surpluses in current, capital and financial accounts, and accumulated huge international reserves (estimated at over two trillion USD), which, with the financial crisis, have become a major concern and point of debate. China has also become an important investor abroad, by both private and state Chinese companies, and it is playing an increasingly important role in the development path of Africa.

Thus, China's international economic interests follow directly from its domestic reform strategy. These processes are managed by a strong Party state that carefully balances global and domestic interests. China's integration into the world economy rapidly intensified during the 1990s, and this directly defined the way it was affected by the global crisis, to which we turn next.

The Global Financial Crisis and Its Impact on China

> The global economic crisis exposed the vulnerability of China's growth pattern in a dramatic fashion (Yu 2009: 8).

The causes, manifestations and impacts of the global financial crisis that erupted in 2008 have been well documented. The crisis started in the US but very rapidly impacted the rest of world, including emerging market economies. Cracks in the system had appeared in August 2007, and with Lehman Brothers' September 2008 default, a full-blown global financial crisis ensued. Stock market wealth may have declined by approximately 50 per cent. Global GDP declined by two per cent in 2009. According to

Krugman (2009: 165-166), rather than the crisis being nothing that had been seen before, it was "like everything we've seen before", a combination of the bursting of the real estate bubble, a wave of bank runs, liquidity traps, and crises in international capital flows and currencies. By August 2009 signs of recovery started to appear, and the world's economy is expected to grow again by two per cent in 2010, though particularly Europe continues to be marked by uncertainty.

Governments' responses to the economic crisis have been forceful, and apparently very different from their responses to the crisis of the 1930s and to the 1997-1998 crisis. The focus has been to restore global financial stability, through large-scale government interventions across the world, and a range of micro-level measures has been introduced in response to increasing unemployment, and, for example, to promote housing markets, in the medium term rapidly increasing public debt.

The impacts have been highly heterogeneous, across countries, and within countries. The crisis is expected to have a negative impact in developing countries, where people have fewer resources to cope with the crisis, social policies are too weak to respond adequately, and economic policy instruments are limited. Emerging economies where the stock markets were directly affected by the crisis, and where the crisis was followed by devaluation of the currency (e.g. Brazil and India), appear to be weathering the crisis well, and macroeconomic fundamentals continue to be strong (Naudé 2009). Impacts on trade and investment are of course very different across the globe, including because of the drastic changes in prices accompanying the crisis and following the preceding price spikes in primary commodities. World exports (in US-Dollar values) contracted by 24 per cent in 2009, and are expected to grow again by 11 per cent in 2010. For South and East Asia the decline was 17 per cent, and the expected 2010 growth 11 per cent (UNDESA 2010). Global FDI may have declined by about 15 per cent in 2008, as the financial crisis was transmitted through tighter credit, lower corporate profits, and eroded business confidence. FDI in developing countries was still expected to see a growth of seven per cent, with the expectation for Asia at six per cent (Filippov and Kalotay 2009). In China, in the first seven months of 2009 FDI saw a decline of 20 per cent compared to the same period in 2008 (IIF 2010), while an increase was again noticed in the second half of 2009.

In stark contrast to OECD countries' economic growth, but comparable to India, China's economic growth remained high: 6.1 and 7.9

per cent in the first two quarters of 2009, respectively. China maintained its eight per cent growth target, and as 2009 went by it became increasingly likely it would achieve this. The limited openness of the financial sector has helped to reduce the direct impact of the global financial crisis on China's banking sector, though Fan Mingtai (2008) warns that faulty information may be distorting the picture. However, the crisis did soon impact the real economy, through shrinking exports and through the stock market.

The economic crisis has had a visible impact on employment in China, though official figures are not available (see Duckett and Hussain 2008). Large numbers of unskilled workers lost their jobs, but estimates of unemployment are far from clear. *The Financial Times* reported that 67,000 factories closed during the first half of 2008, and local newspapers suggested 6.7 million jobs disappeared in Guangdong alone. Most of the unskilled, newly unemployed workers were migrants, who – as was widely reported – were expected to return to their areas of origin. According to estimates generated by the Ministry of Agriculture and informed by research using focus group discussions that suggested 10-15 per cent of migrants were not returning after the holidays, 20 million people became unemployed.

China closely monitored the return of migrants because of the fear of social unrest. Over time, the fears of unrest seemed to have disappeared somewhat. However, the China Study Group reported that the numbers of so-called "mass incidents" was higher in 2009 than ever before, and that workers' protests are becoming more autonomous (China Study Group 2009). Premier Wen emphasized that "even greater complexity in the domestic and international situation", and the security chief thought maintaining social stability "was still extremely onerous" (*The Economist* 2010). Arguably the ethnic tension and violence at the Guangdong toy factory, which was followed by the violence in Xinjiang, was related to job losses.

Adding up all categories of new job seekers – unemployed migrants, job-searching college graduates, laid-off workers and others, along with the officially registered unemployed and new market entrants – Schucher (2009) estimates a number of 42 million, with about 15 million jobs created. Graduate unemployment has been rising for some time. Officially, urban unemployment was four per cent in mid-2008, and only very slowly rising, but reports have clearly indicated that the number of new jobs created is not sufficient to match the number of new graduates. In mid-2009 some observers argued that the government was less concerned with unemployment in rural areas than that of educated, urban workers.

Observations suggested that young migrants often did not return to their villages, and that many returned early from the New Year's holidays in search of jobs, again closely monitored by officials and police (Bradsher 2009). In September 2009 the labour minister suggested numbers of jobs for migrants would be five per cent below that of a year earlier, and that excess supply of labour would continue for "a long period of time" (*Reuters* 2009). National Bureau of Statistics (NBS) figures published mid-September 2009 suggested that at the end of June 2009, 4.2 million rural migrant workers were still unemployed outside of their hometowns (*China Daily* 2009d). Moreover, China Labor Watch reported a distinctive trend of worsening labour conditions as a result of the crisis (Li Qiang 2009). While recent years have seen improvement in protection of labour, after the crisis, measures were taken to reduce statutory labour costs, arguing this would be required to maintain jobs (Global Action 2009). In January the ministries of Human Resources and Social Security issued a joint statement urging employers to avoid or reduce mass layoffs by reducing wage costs, placing workers on leave or creating "flexible working arrangements". In February the State Council advised local governments to cut employment costs temporarily by reducing or suspending social security premiums.

Despite heavy blows to the export industry, China in 2008 had the fiscal and macroeconomic space to implement a substantial stimulus (see de Haan forthcoming a for more detail). A range of economic measures were introduced: reduction in taxes, changes in value-added tax rebates to promote exports (previously used to slow down the economy), a loosening of credit (according to some, possibly leading to a bubble, and followed by reductions in lending mid-2009), measures to stabilise housing and stock markets, and subsidies for the purchase of consumption goods. Finally, the value of the CNY has been subject to much discussion: Even though the currency had appreciated over the preceding couple of years, its current value is still thought to be relatively low, thus promoting China's exports.

While some Chinese officials in the first half of 2009 shared concerns that we had witnessed the end of China's export-led growth, the measures taken indicate that China was simultaneously promoting domestic consumption, while trying to gain from the recovery of global demand. The Keynesian stimulus package will be discussed further below, but we first turn to the social policy model that has accompanied China's economic success since 1978.

China's Social Policy since 1978: From Productivism …

To assess China's economic responses to the crisis, including the fiscal stimulus, we must first analyse its social policies under its growth- and increasingly export-led model since the reforms started. Social policy is defined here as the broad set of public interventions and institutions that intentionally enhances well-being, and is complementary (rather than residual) to economic policy (Mkandawire 2004; UNRISD 2006; de Haan 2007 and forthcoming b; de Haan and Sabharwal 2008). Social policy changes in China since the 1970s have been driven by two sets of dramatic changes, which both contribute to the emergence of new vulnerabilities alongside rapid poverty reduction, and to high rates of private savings due to the absence of adequate protection against health and other risks.

First, the radical and continuing demographic shift from rural to urban areas is shaping the social policies accompanying China's economic strategy. In the 1980s and 1990s public policies came to focus on enabling a move out of agriculture, but current health and social security reforms also have strong rural components, alongside targeted anti-poverty programmes. Increasingly, following the demographic dividend of a rapidly declining birthrate, the ageing of the population is playing a role, leading to concerns regarding pension reform.

Second, the economic reforms have, of course, implied a radical and very conscious privatisation of the economy, and collapse of the social services previously provided through communes and state-owned enterprises. Dramatic rises in incomes have been accompanied by a virtual collapse of public provisions, education, health and social security, particularly in rural areas where land rights remain central to social security. Alongside rapidly rising inequalities in income and human development, the population probably experienced substantial "churning" in poverty status (moving in and out of poverty) as healthcare costs became prohibitively high for many, and household savings have risen to extremely high levels. Table 1 shows changes in GDP components and household consumption. Household savings rates have been around 25 per cent, rising through the 1980s till the late 1990s (Horioka and Wan 2007), and appear to have risen again since 2005 (Seeking Alpha 2009). Social security coverage in the new – including export-oriented – enterprises has remained low, uneven and insufficiently regulated.

Table 1: Components of GDP Growth and Household Consumption since 1978

	Components of GDP Growth			Household Consumption Expenditure Index 1978=100	Urban-rural Consumption Ratio
	Final Consumption Expenditure	Gross Capital Formation	Net Exports		
1978	39.4	66.0	-5.4	100	2.9
1980	71.8	26.5	1.8	117	2.7
1982	64.7	23.8	11.5	135	2.4
1984	69.3	40.5	-9.8	163	2.2
1986	45.0	23.2	31.8	194	2.3
1988	49.6	39.4	11.0	222	2.6
1990	47.8	1.8	50.4	229	2.9
1992	72.5	34.2	-6.8	282	3.3
1994	30.2	43.8	26.0	320	3.7
1996	60.1	34.3	5.6	378	3.4
1998	57.1	26.4	16.5	418	3.5
2000	65.1	22.4	12.5	491	3.7
2002	43.6	48.8	7.6	553	3.6
2004	38.7	55.3	6.0	632	3.8
2006	38.7	42.0	19.3	748	3.6
2007	39.4	40.9	19.7	824	3.6

Source: National Bureau of Statistics 2008.

Despite the country's uniqueness, the nature of China's social policy can be described in the East Asian social policy analysis tradition, and it is in line with East Asian governments' antagonism to Western-style welfare interventions and the dependencies these would create (Holliday 2000; Kwon 2005; London 2009; Tang and Midgley 2010). Countries in the region, often under authoritarian regimes, introduced (state-led) welfare policies at a lower level of development than OECD countries, with China of course showing a "U-curve" rather than linear path following the collapse of the pre-1978 model. In China as elsewhere in East Asia, social policies have played a key role in nation-building processes, and in the case of China, social policies have also played a large part in the political project of maintaining the Party's position. Egalitarian norms predominate in the public debate, often under authoritarian practices and with a focus on productive opportunities. The state continues to be seen as the guardian of public welfare, while at the same time policies are based on Confucian perceptions of the family as the main provider of welfare.

Table 2: Government Spending as Proportion of GDP

	Gross Domestic Product 100 million CNY	CNY	National Government Revenue 100 million CNY	Govt. Revenue % of GDP	National Government Expenditure 100 million CNY	Ratio Local Government % Govt Exp.
1978	3,645.2	381	1,132	31	1,122	52.6
1980	4,545.6	463	1,160	26	1,229	45.7
1985	9,016.0	858	2,005	22	2,004	60.3
1990	18,667.8	1,644	2,937	16	3,084	67.4
1992	26,923.5	2,311	3,483	13	3,742	68.7
1994	48,197.9	4,044	5,218	11	5,793	69.7
1996	71,176.6	5,846	7,408	10	7,938	72.9
1998	84,402.3	6,796	9,876	12	10,798	71.1
2000	99,214.6	7,858	13,395	14	15,887	65.3
2002	120,332.7	9,398	18,904	16	22,053	69.3
2004	159,878.3	12,336	26,396	17	28,487	72.3
2006	211,923.5	16,165	38,760	18	40,423	75.3
2007	249,529.9	18,934	51,322	21	49,781	77.0

Source: National Bureau of Statistics 2008.

Social policies in the region are marked by a "productivist" orientation (Holliday 2000), which emphasises a congruence of social objectives with economic ones. Public spending, including in sectoral allocations to social sectors (to some extent seen as "non-productive", but see also Zhang 2008), is tightly controlled. We should look at this in the broader context of public revenues and spending. As has been widely documented, government revenue as percentage of GDP declined rapidly between 1978 and the mid-1990s. The 1994 fiscal reforms employed a policy of "tax-sharing", which reduced the role of provinces in revenue collection and increased the role of provinces in revenue expenditure, without clearly defining relationships with the lowest levels of government (Chan, Ngok, and Phillips 2008: 55). However, government revenue has picked up remarkably, doubling between 1996 and 2007. Table 2 gives an overview of government spending. While China's ratio of public spending to GDP is thought to be low by international comparison, such comparisons are difficult. Inclusion of extra-budgetary revenues would lift fiscal revenue above that of many OECD countries (Song 2009), and may have reached 32 per cent of GDP (Lu and Feng 2008: 75).

The federal nature of public spending is critical in this picture: Three-quarters of total public spending in 2007 was by local governments; put simply, the flipside of the local "autonomy" of policy reforms and piloting ("one country, multiple systems") is the need for sub-national government to ensure that funding is available. The model of public finance has made funding regressive, with the poorest areas struggling the most to fund projects (Zhang and Fan 2007; Wong 2009; see Table 4). The divisions established after 1949 still contribute heavily to a significant urban bias, and until recently the countryside remained heavily taxed, and local fiscal spending remains biased towards urban areas. Social spending, particularly in rural areas, is adversely affected by the model of public finance: Not only are total allocations to social sectors low, but a particularly large part of social spending is by sub-national governments (see Table 3; Shen and Zou 2006; Tao, Yang and Liu 2009).

Social policies have been pro-active (but selective), and they have been designed to play a key role in China's pattern of economic growth and entry to global markets. Generally, provisions are strictly targeted, with tight eligibility criteria, and supported by a very low poverty line, which has recently been increased but remains low by international standards. Public policies around, for example, capacity-building, and emphasis on adjustment of the public sector and the need for cost-recovery emphasise the productivity of public investments, reducing the potential for an effective safety net for the most vulnerable.

Table 3: National Government Expenditure by Area and Distribution, Local and National

	National Government Expenditure	Items as % of Total Expenditure	Central Government Spending	Local Government Spending	Local Govt. as % of Overall Spending
Total	49,781.35		11,442.06	38,339.29	77
General Public Services	8,514.24	17.1	2,160.17	6,354.07	75
Foreign Affairs	215.28	0.4	213.78	1.50	1
National Defense	3,554.91	7.1	3,482.32	72.59	2
Public Security	3,486.16	7.0	607.83	2,878.33	83
Education	7,122.32	14.3	395.26	6,727.06	94
Science and Technology	1,783.04	3.6	924.60	858.44	48
Culture, Sport and Media	898.64	1.8	127.21	771.43	86
Social Safety Net and Employment	5,447.16	10.9	342.63	5,104.53	94
Medical and Health Care	1,989.96	4.0	34.21	1,955.75	98
Environment Protection	995.82	2.0	34.59	961.23	97
Urban and Rural Community Affairs	3,244.69	6.5	6.20	3,238.49	100
Agriculture, Forestry, Water	3,404.70	6.8	313.70	3,091.00	91
Transportation	1,915.38	3.8	782.25	1,133.13	59
Industry, Commerce and Banking	4,257.49	8.6	1,442.45	2,815.04	66
Other Expenditure	2,951.56	5.9	574.86	2,376.70	81

Source: National Bureau of Statistics 2008.

Table 4: Government Expenditure by Region

Region	Gross Regional Product 100 million CNY 2007	Government Expenditure by Region	
		10,000 CNY	% Regional Product
Beijing	9,353.32	1,6495,023	18
Tianjin	5,050.40	6,743,262	13

Region	Gross Regional Product 100 million CNY 2007	Government Expenditure by Region 10,000 CNY	% Regional Product
Hebei	13,709.50	15,066,482	11
Shanxi	5,733.35	10,499,228	18
Inner Mongolia	6,091.12	10,823,054	18
Liaoning	11,023.49	17,642,805	16
Jilin	5,284.69	8,837,597	17
Heilongjiang	7,065.00	11,872,711	17
Shanghai	12,188.85	21,816,780	18
Jiangsu	25,741.15	25,537,217	10
Zhejiang	18,780.44	18,067,928	10
Anhui	7,364.18	12,438,342	17
Fujian	9,249.13	9,106,446	10
Jiangxi	5,500.25	9,050,582	16
Shandong	25,965.91	22,618,495	9
Henan	15,012.46	18,706,135	12
Hubei	9,230.68	12,773,257	14
Hunan	9,200.00	13,570,310	15
Guangdong	31,084.40	31,595,703	10
Guangxi	5,955.65	9,859,433	17
Hainan	1,223.28	2,451,967	20
Chongqing	4,122.51	7,683,886	19
Sichuan	10,505.30	17,591,304	17
Guizhou	2,741.90	7,953,990	29
Yunnan	4,741.31	11,352,175	24
Tibet	342.19	2,753,682	80
Shaanxi	5,465.79	10,539,665	19
Gansu	2,702.40	6,753,372	25
Qinghai	783.61	2,821,993	36
Ningxia	889.20	2,418,545	27
Xinjiang	3,523.16	7,951,540	23

Source: National Bureau of Statistics 2008.

Alongside a conscious congruence with its economic strategy, social policies have evolved in tandem with China's very rapid institutional changes. These include drastic reconfigurations of public and private spheres following the opening up of markets and the dismantling of state-owned enterprises, and of power balances (and related ideologies) between ministries such as those of Health and Civil Affairs in the reform of health services. The gradual reframing of rights for migrants workers breaking through the dualism of the *hukou* system created during the pre-reform decades will also have enormous implications for the well-being of large numbers of citizens. The transformation of public institutions into more accountable and equitable organisations has become a key feature of the policies for a "harmonious society", as described in the next section.

… to a "Harmonious Society"?

While the 1980s focused on privatisation and economic growth, explicitly accepting the rapidly rising inequalities, during the late 1980s and early 1990s the forces for strengthening government in public services started to grow, following the withdrawal of state-owned enterprises (SOEs) from social provisions, and resulting in initial and very careful and/ or gradual reforms in education, health and social security (Chan, Ngok, and Phillips 2008; Lu and Feng 2008). Examples of early reforms include the urban *di bao,* the social assistance "Minimum Living Standard Scheme", which was piloted in Shanghai in the early 1990s (see Davies et al. 2009 for analysis and critique of Shanghai's reforms), and extended rapidly since the late 1990s. A voluntary pension system was introduced in 1986, and pilot schemes initiated during the early 1990s, but the experiments collapsed during the 1990s. In 1986 the Leading Group for Poverty Reduction was set up, with an annual budget of about ten billion CNY, and 15 per cent of the country's counties were designated as "poor counties". More recently, various measures have been taken to promote the rural economy and a "new socialist countryside", promoted for example at the October 2008 Plenary Session of the Communist Party's Central Committee (Wu 2008). Ahlers and Schubert (2009) judge the "new socialist countryside" project to be more than just a political slogan.

Policy initiatives during the 1990s also started to rebuild the education and health provisions that had faltered since the late 1970s. Primary education was made free of charge, and allocations to education have risen consistently over the last decade. In the early 1990s the government emphasised the need for improvement in health indicators, and in the late 1990s it started to experiment with approaches towards health system changes, with the objective of enhancing access. With healthcare to a large extent privatised in the immediate post-reform period, in the 1990s discussions started to focus on the forms that social provisions had to take, notably of national healthcare versus a social insurance system – in the end producing a mixed system, though with insurance at its core. The medical health insurance New Cooperative Medical Scheme (NCMS) is now in operation nationally, with all counties developing their own decentralized system of implementation. This aims to reduce rural-urban differences, with central government commitment to increase public health spending particularly in poor areas. The post-2008 stimulus package as we discuss below included a significantly increased outlay for the health sector.

While the foundations of China's political system may have remained unchanged, with institutional change described as "trapped transition" by Pei Minxin (2006), policy-makers are responding to political and popular pressure, with significant implications for and transformation of models of policy implementation at local levels. Since the mid-1990s, social policies have played an important role in this response, but the urgency with which the Chinese government is now effecting these policies increased greatly with the change in top leadership in 2002, the SARS crisis in 2003, and since 2004, when concerns about social inequalities became a hot topic on the political agenda, thus foreshadowing the political project for a "harmonious society". During the 1990s, after Deng Xiaoping's Southern Tour, economic reform-minded ideas had maintained the upper hand. But concerns about social inequalities grew too, and by the end of the 1980s, academics and researchers were pointing at a "justice gap" in the reform policies. These voices had gained strength by 2004, no doubt influenced by the intensifying and changing nature of protests since the late 1990s (Kelly 2006: 9; Wong 2009: 950), and by the need felt by the Chinese leadership to reach out to the common people (Yu 2007).

In February 2005 at the Party School, Hu Jintao announced that the Chinese Communist Party (CCP) and the central government had made it an important task to build a harmonious society, as "China is facing thorny domestic issues, as well as complicated and volatile international situations" (*People's Daily* 2005). The doctrine of harmonious society (*hexie shehui*) highlights the

> importance, guidelines, goals and principles of building a socialist harmonious society; coordinating development, social equity and justice; cultural harmony and consolidating the ideological foundations for social harmony; and improving public administration to build a society of vigor and order (Kelly 2006; see also Zheng and Tok 2007; Geis and Holt 2009).

It was passed by the CCP in October 2006, and became a basic development goal in the Eleventh Five Year Plan. The harmonious society project is generally seen as the way the Hu Jintao/ Wen Jiabao administration distinguishes itself from its predecessors, and as a response to the unacceptable social costs and political risks of the reforms implemented since the late 1970s. Both Deng Xiaoping ("efficiency comes first, with proper attention paid to equity"), and Jiang Zemin had emphasised market reforms, the "socialist market economy", and a *xiaokang* (moderately well-off) society. But under pressure from the Left and the large numbers of cases of social unrest, "social justice" had come to the centre of political attention – even though interpretations and implications for policy continue to be debated, with the crisis providing impetus for further articulation, as we describe below.

By 2008, arguably, Chinese policies were moving towards universal social policies (White Paper 2004). This took place in the context of the enormous policy challenges of China's great transformation, and was shaped by institutions and power constellations, notably the urban-rural dualism, and the regional inequalities that were fuelled by fiscal transfers. The policy shifts articulated strong notions of equity, or at least an idea of state responsibility for providing opportunities for the entire population. Though the shifts were obviously a response to fears of social unrest, they were simultaneously an effort to address corruption within the public sector, and promoted improvements in access without necessarily providing significant additional funding. Fiscal prudence and an ideology of economic contribution rather than welfarism have continued to dominate the thinking about social policy. This set the scene for the immediate response to the crisis in 2008.

China's Stimulus Package

Soon after the global crisis unfolded, and having felt the impact on skilled and un-skilled workers even before, China introduced a large stimulus package of four trillion CNY (586 billion USD) over two years, by some calculations 12-14 per cent of 2008 GDP (or 6-7 per cent on an annual basis). There were doubts about how much of that money was new money, rather than public funding that had been committed earlier (including for reconstruction after the May 2008 Sichuan earthquake). The package was not entirely a financial injection from the central government, as central funding is matched – as is the practice in fiscally decentralized China, as described above – by contributions from (semi-) private sources and lower-level government, and to a large extent by bank lendings. Out of the four trillion CNY package, one quarter is in the form of direct grants and interest rate subsidies. Bank credits are the second-largest source, while local governments proposed their own package of 18 trillion CNY (Yu 2009: 10). Given the decline in value of assets associated with the global crisis, an injection of six to seven per cent of GDP may in itself not be sufficiently large to stabilise the economy. However, an immediate impact was felt (Roberts 2009, for example), though some observers believe a slowing down of the economy may follow when the impact of the stimulus would come to an end (the so-called W-shape of crisis and recovery), and concerns have been articulated about a possible financial bubble created by new bank lending.

The breakdown of the package is shown in Table 5. The stimulus package's emphasis has been on investment. This is understandable given the need to insert money into the economy quickly. Investing in infrastructure has been one of the strengths of China's economic model, and was reinforced by the central government's "frenzied response" to raise funds for infrastructural spending (Wong 2009: 951). But this emphasis also came under criticism. China's growth model has already been skewed heavily towards investment, while households are saving about one quarter of their disposable income, and private consumption is only about one third of the GDP. The positive economic impact of investing in infrastructure is likely to be only temporary, as this would promote supply and not demand. In the past, according to Yang Du (2008), physical investments have proven to have insignificant effects on increasing employment. While investment growth in the first half of 2009 was over 30 per cent, increases in sales of (industrial) goods were negligible. And some have argued that investments surged into high-polluting and energy-intensive projects, and would lead to falling investment efficiency (Zhang and Xi 2009; Yu 2009).

Table 5: China's Stimulus Package

	CNY (in billions)	% of Total Package
Public infrastructure	1,500	38
Earthquake reconstruction	1,000	25
Social welfare	400	10
Rural development	370	9
Technology advancement	370	9
Sustainable development	210	5
Educational and cultural programmes	150	4
Total	4,000	

Source: *Economic Observer* 2009.

At the same time, the government promised more than just "more of the same" in infrastructure. The economic stimulus package that was introduced was seen not only as a temporary Keynesian-type effort to mitigate the downfall, but also a restructuring of its economic model, particularly to promote domestic (private) consumption. Reinforcing the belief in China's continued economic growth, and continuing to show leadership during the crisis, Hu Jintao stressed: "Crisis creates opportunities, and we shall put more efforts in technological upgrading, and build up technology reserves for the future" (*China Daily* 2009c).

The stimulus package, alongside its emphasis on infrastructure and hardware, also contained much promise for social sectors, and for professor Zhao Xijun of Renmin University, for example, the

> decision to spend more on public sectors such as healthcare comes at a crucial moment as the country strides to expand domestic markets to offset negative impacts from global economic downturn (*Xinhua* 2009).

But for many commentators, the proposed investment in social sectors has been too little.

> The rush of local infrastructural […] projects [following the fiscal stimulus] stands in marked contrast to the wait-and-see posture of

> many local governments to the recent social spending programmes (Wong 2009: 951).

Tang Min argued that funding for social welfare needs to go up to 35 per cent of government revenue (*China Daily* 2009a). Guan Xinping suggested the government needs to invest more to educate and train youth and the unemployed, speed up the establishment of basic social security system, and strengthen public services (*China Daily* 2009b). Ding Yuanzhu of CASS argued for creating of effective social demand as a permanent cure for crisis (*China Daily* 2009b). Some expressed fears that the investment in hardware might even reduce access to healthcare facilities, for example, because of institutions' incentives to recover costs. It is unlikely that the fiscal stimulus will lead to a rapid decrease in personal saving rates (indeed the growth in 2009 seems mainly driven by increased investment).

It seemed the government over time responded to criticism by increasing or highlighting its commitments to social spending. Education, particularly vocational training and education of migrant workers, was emphasised during the China Development High Level Forum in March 2009. Along those lines, Premier Wen's *Report on the Work of the Standing Committee of the National People's Congress* of 9 March 2009, proposed strengthening the rural social safety net and promoted employment and reemployment (Zhang 2009).

In January 2009 the government announced spending of 124 billion USD in three years (0.8 per cent of GDP) to promote nationwide healthcare, and this will arguably be the centrepiece of China's social policy reforms over the coming years. The current investment – seen by some as a down payment for the longer-term reforms – follows years of debate and policy development, and the current crisis in a way provides both the need and the opportunity to use economic means to address social issues, through the relatively well-tested structure of governance. The healthcare reform followed the recognition of ballooning private households' healthcare spending, and the recognition that healthcare could not be considered a commercial product. The reform's main objective is universal coverage of basic healthcare through improvements in the public health system, medical care delivery system, the health insurance scheme (NCMS) mentioned earlier, and the pharmaceutical system. By 2020, the central government is expected to fully subsidize the "essential public health package". Government officials expect much from the expansion of the health insurance scheme as a mode of organising access to healthcare, with coverage already exceeding 90 per cent, while making available additional funding for investment in public facilities.

The direction of China's post-crisis social policy is thus not fundamentally different than it has been so far. Some of the labour regulations – very slowly having been expanded over the preceding years – in fact have been reversing direction, at least temporarily. There is much continuity, driven by – apart from the fiscal reserves that enable the stimulus – a dominant public policy perception of the close link between economic policies and the "harmonious society", and its tradition of learning-based and pragmatic reform. The eight per cent economic growth target continues to be central to social and economic objectives, social spending is rising but continues to be low, and weak social and unemployment insurance can only be reformed in the medium term. The expansion of services and gradual universalising of healthcare and primary education was initiated before the crisis, and the investment in health services post-crisis are made possible by the previous cautious health reforms, which have set in place the infrastructure that now allows absorption of increased funding. How then, can we conceptualise the impact of the crisis?

Crisis as a Turning Point?

The lessons the world has learned from the responses to past crises suggest ways to conceptualise the ongoing transformation.[1] Current US policy responses are informed by the lessons learnt from the Great Depression. East Asia has drawn conclusions from the 1997-1998 crisis, and in South Korea there is now a feeling the country is much better prepared than before (Kwon 2009). After 1997 Chinese policy-makers concluded that China needed to enhance its fiscal position while avoiding the continued recession Japan fell into. China's response also shows that it is keen to study the experiences of other countries and learn from them. This section explores whether past lessons can help to interpret ongoing events, and whether the current crisis may be a turning point in China's development model.

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1 This section is based on a workshop DFID Beijing organised on request of the State Council's Development Research Centre, Beijing, February 2009. See Gong 2009.

The international development literature emphasises that crisis response plans need to be in place before the crisis hits, because time and administrative capacities tend to be limited, and because natural crises often accompany economic ones (such as droughts during both the Great Depression and the Asian Financial Crisis). However, experience from the US during the 1930s illustrates the large number of initiatives and agencies that were established, on an ad hoc basis, and only few were successful, but the legacy of the responses has been very long (Mitchener 2009).

China's 2008-2009 response is consistent with its evidence-based policy model of "seeking truth from facts" that has marked the reforms since 1978 (Zhang, de Haan and Fan forthcoming). The Chinese government's response, as mentioned, is to a great extent driven by fears of social unrest. The government system is also keen and able to quickly evaluate the impact of policies, such as that of the expansionary credit policies of 2009 that led to inflation particularly in the housing sector. The government also responded to a perceived neglect of social sectors in the stimulus package. At the same time, as we saw in the last section, there is much continuity in China's emphasis on infrastructure investment. China has gradually expanded its social security systems over the last few years, thus providing opportunities for relatively accountable, enhanced public spending, but the extension will remain gradual, partly because of vested interests in infrastructure financing, and partly because of administrative, political and ideological concerns; thus in the eyes of some observers who had expected or hoped for a more drastic change, this implied an "opportunity lost" (Cook 2009).

Evidence from previous major downturns suggests crises are not merely cyclical phenomena. The US knows it cannot return to its previous high levels of credit-driven consumption, and global financial institutions will be adapting to a new reality. Lessons from earlier crises suggest they provide windows of opportunities and political commitment for change. The New Deal meant a radical transformation, not only in terms of an increase of government as a share of GNP, but by 1935, a radical transformation was also made in the relationship between the federal, state and local governments, the result of which was improved coordination and public finance (Mitchener 2009). After 1997-1998, Thailand's government put in place a wide range of supportive measures, including expansion of healthcare and pensions for the poor, involving and mobilising civil society and the private sector (Teokul 2009). In Indonesia, the economic crisis was followed by social mobilisation contributing to democratisation, while decentralisation and local decision-making was strengthened (Murniningtyas 2009).

Measures put in place during crises have long-term implications, even though the fiscal response of the New Deal did not manage to pull the economy out of the crisis. FDR's 1935 statement "I place the security of men, women, and children of the nation first" is a symbol of radically altered public responsibility and policies, and indeed the country's social contract. As narrated by Mitchener (2009) the impact of measures put in place in the 1930s are felt even today, through regulation in banking, labour and farming. The New Deal radically transformed the US economy and US society, not only in terms of government spending but also in terms of perceptions of state responsibility, and relations between central and local governments. The East Asia crises in 1997-1998 have led to a range of initiatives around monitoring impacts of economic changes, and new policies of social protection, many of which appear to be there to stay; the new social protection agenda even had a big impact on the global development debate.

In the case of China we can also see such turning points, though the crisis seems to be accelerating these rather than initiating them. The global financial system is of considerable concern to China, and its strategy is unlikely to be the same as in the past. The realisation of the end of an era was evident in the earlier efforts China made to slow down the export economy. In some of the responses, it seemed as if economic policy-makers were already prepared for such a reversal, having studied lessons from other parts of East Asia, including about previous economic crises and downturns. The policy-makers may have realised that a new economic strategy could be the inevitable complement of its harmonious society. Calls for an alternative reserve currency are likely to be more symbolic than real in the near future, but the new interdependence has been clearly demonstrated by the United States' efforts to reassure Chinese partners of the safety of their deposits, and by China selling its US-based (and dollar-based) assets. The crisis did not cause this interdependence – the pattern of globalisation starting in 1978 did that – but the crisis has made this interdependence remarkably clear, and has helped to fuel nationalism in China.

Internally, after the crisis there was discussion about a watershed in China's development model. There were concerns that the export-led model of growth would no longer be sustainable (Song 2009), not only because levels of demand would not return to their previous levels, but also because of shifting of production of export commodities. Beijing Normal University professor Zhang Xiulan argued in 2009 that the "current financial crisis has greatly accelerated the development of a comprehensive system of social protection in China". As we have seen, such shifts are likely to be gradual, and subject to contestation. Groups of elites within the Party might capitalise on existing dissatisfaction (Pei 2009): The crisis may be sharpening the differences between the Populist Coalition led by Hu and Wen with its emphasis on balanced development, and the Elitist Coalition with its focus on economic efficiency and coastal development (Li Cheng 2009).

Further, crises are moments when the role of social policy as complement to economic policy (rather than being residual) come to the fore, both to stabilise the economy and to address rising unemployment and citizens' disaffection. In South Korea, there was a strong belief that economic policy was the best social policy, and this was proven wrong during the 1997-1998 crisis, even though the notion of the welfare state as an instrument for economic development prevails. While South Korea's welfare state was undergoing a longer term transformation, the crisis triggered a range of responses, including increasing social spending. The crisis and the surprise victory of the centre-left opposition in the presidential election cemented a new social consensus for economic reform alongside strengthening the welfare state. The crisis prompted new inclusive policy institutions such as a tripartite committee to promote the reform, integrated national health insurance cooperation, and a notion of social rights under-building the welfare state (Kwon 2009).

In the case of China, the crisis response builds directly on earlier efforts for a "harmonious society", and less stringent fiscal and monetary policies will not only support domestic household consumption, but will also allow for increased investment in the public services for which the foundation had been created before the crisis. It is important to highlight that the Chinese crisis response was formulated entirely internally, with none of the pressure that Thailand and Indonesia faced (though China did have intensified debates with its partner in the G-2, the US). The crisis response demonstrated the Chinese government's ability to formulate strong responses to new development challenges, with social policy playing a growing role in the broader national politics. There are no signs of political transitions like those witnessed in Asia after the 1997 crisis, and the Chinese leadership has used the crisis as an opportunity to reassert legitimacy (as it did after the Wenchuan earthquake), for example by reassuring the population that China would be able the weather the crisis.

Conclusion: Crisis as an Opportunity

A key lesson from crises seems to be that they tend to, or have the potential to, galvanise the forces for better social policies, and to galvanise a social consensus for more inclusive policies. Of course, in Europe the Great Depression galvanised something different: the rise of fascism and World War II (and indeed it probably was the war that ended the recession in the US rather than the stimulus of the New Deal). The crisis of 2008-2009, at present, looks to have been managed much better than that of the 1930s, through national rescue and stimulus packages, and an emphasis on continued international economic cooperation.

This crisis presented China with two main opportunities, but both with nagging drawbacks. First, the crisis led China to assert itself into global economic and financial fora, and to show that renewed confidence internally, though its economic future is by design tightly linked to that of the US. Second, the crisis presents China with the opportunity to adjust its export-led model of development with associated costs of rising inequalities and environmental costs toward a more inward-oriented and equitable development model, building on the efforts over the last decade to create a "harmonious society" and to rebalance the productivism of its public policies since the 1978 reforms. However, this transition will be a slow one, because of a path-dependency of focus on infrastructure, because of vested interests of the export industry, and given the aversion to welfarist spending. Moreover, China's proven model of a gradualist approach makes it unlikely that drastic policy changes will be attempted.

China is currently engaged in a dramatic transformation, with large-scale privatisation and rapid industrialisation managed under one-party control. The crisis in itself is not changing China's development model, but is providing the opportunities for a more equitable model. The next years will show whether China will be able to implement the necessary social policy instruments, under relatively favourable fiscal conditions, and a nascent social policy system which *may* be able to absorb the kind of new funding that is required, with the *potential* to enhance equality or at least halt the rapid rise in inequality of the last two decades, and with the *possibility* that this brings drastic changes to the current systems of regressive fiscal transfers. The way China chooses to respond on its public policies will not only have an enormous impact on hundreds of millions of its citizens, (particularly those that have recently escaped from poverty and those still suffering from chronic poverty), but will also have an impact on the global economy, and will be cited as an example for the Global South's potential to manage the fluctuations of the global economy.

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