Rise of China and the global overaccumulation crisis

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ABSTRACT
This paper assesses the sources of potential instability of China’s political economy by expositing the limits of the post-Mao regime of capital accumulation in historical and comparative perspectives. It argues that the new spatial and socio-political orders under this regime, while propelling China’s economic miracle, also contribute to the internalization of the global overaccumulation crisis, which has been haunting the world capitalist system since the late 1960s, into China’s national economy. Whereas decentralization of regulatory authority of the state accelerates overinvestment among local economic agents, breakdown of the Maoist social compact and the subsequent class polarization foster underconsumption. The resulting structural imbalance of the economy leads to the risk of falling profit across key sectors and China’s over-reliance on the export market, the expansion of which has hinged much on the debt-financed and unsustainable consumption spree in the US. A full-fledged overaccumulation crisis within China in the form of extensive bankruptcy of enterprise, surging unemployment and financial turmoil will certainly trigger extensive global repercussions, given China’s weight in the global economy. This crisis, nonetheless, is not inevitable, and can plausibly be averted through a recentralization of the state’s economic regulatory functions and income redistribution. No matter whether and how such a crisis unfolds, nonetheless, it is not likely to stop the shift of the center of gravity of global capitalism to Asia in the long run.

KEYWORDS
China; market transition; global capitalism; overaccumulation crisis; underconsumption; overinvestment.

In recent years, the world has been amazed by China’s rapid and seemingly never-ending economic expansion. The rise of China, given its economic
and demographic size, is poised to create huge impacts on the world system at large. China’s massive cheap export helps reduce inflation in the global economy. China’s increasing appetite for raw materials and capital goods fuels the economic growth of Australia, Brazil and Japan, among others. The virtually unlimited supply of cheap labor and potentially huge market of China enable many transnational corporations from core countries to balance their dejection at home with their upbeat expansion in China. Provided with its huge population, China’s march from the category of low income countries to the middle income one significantly alters the pattern of international income distribution (Firebaugh and Goesling, 2004). China’s entry into WTO and its alliance with other developing countries to form the G-20 caucus tilt the balance of power between developing and developed countries in the former’s favor. The gradualist path of liberalization of the Chinese economy is seen by many as a viable alternative model of development for the rest of the developing world, so much so that ‘Beijing Consensus’ recently becomes a catchphrase among intellectuals and policy makers disillusioned by the ‘Washington Consensus’ (Ramo, 2004). Some go as far as prophesizing the coming of a ‘Chinese Century’ a la the coming of the American Century a hundred years ago (Shenkar, 2004).

But within China, the excitement about the prospect of endless economic growth is increasingly counterweighted by an anxiety about a looming economic crisis. Liaowang weekly, a key mouthpiece of the Communist Party run by the official New China News Agency, published in a recent issue a high profile cover story entitled ‘warning signal of overcapacity is on’ (Liaowang, 2005). It warns that overinvestment in key sectors of the economy, in combination with relatively sluggish growth in domestic consumption, has created excess industrial capacity which, if not curtailed timely, could initiate an overproduction crisis marked by widespread bankruptcy of enterprises, massive unemployment, and even collapse of state-owned financial institutions strained by piles of non-performing loans. At a press conference during the annual session of the National People’s Congress in March 2007, Premier Wen Jiabao characterized the current path of development in China as ‘unstable, unbalanced, uncoordinated, and unsustainable’.

On the other hand, given China’s uninterrupted hyper economic growth, which has confounded every single prediction of crisis for the last two decades, these warnings seem to be too grim to be true. The problem of overcapacity, if any, may just be a temporary, cyclical problem which will run its course painlessly. But the experiences of Japan plunging into a decade-long crisis right at the peak of the ‘Japan as No. 1’ talk and the outbreak of the 1997/1998 Asian financial crisis in the middle of the widely envied ‘Tigers miracle’ do remind us of the plausibility of abrupt, unexpected turnabout of a booming economy, and that apparently temporary
aberration of an economy can be a manifestation of deep-seated structural imbalance.

This paper assesses the structural sources of instability in China’s political economy by expositing the dynamics and limits of the post-Mao regime of accumulation, defined as the spatial and socio-political framework in which the process of capital accumulation in post-Mao China unfolds. I argue that this particular regime, while having propelled China’s rapid economic expansion since the 1980s, also creates a deteriorating structural imbalance of the economy. This imbalance contributes to the internalization of the global accumulation crisis, which has been haunting the world capitalist system since the late 1960s, into China’s national economy. In what follows, I will first review the recent discussion on the global overaccumulation crisis. Then I will examine how the post-Mao regime of accumulation emerged, and how this regime accounts for China’s hyper economic expansion. By comparing the pattern of China’s economic growth and the patterns of other East Asian economies during their takeoff stage, I argue that this regime makes China’s economic growth less sustainable than earlier Asian miracles. At the end of the essay, I will discuss how a full-fledged overaccumulation crisis in China, which will certainly trigger extensive global repercussions given China’s weight in the global economy, can plausibly be averted.

THE GLOBAL OVERACCUMULATION CRISIS

In a report about the state of the global economy published in the fall of 2005, an IMF researcher stipulates that the rapid growth of China’s export dependent economy and America’s debt-financed and real-estate-bubble-induced consumption spree now constitute two intertwined processes that account for nearly half of global economic growth. The report also warns that the ‘excessive dependence of global growth on unsustainable processes in the United States and to a lesser extent in China’ has created an alarming imbalance in the global economy. Given that the US current account deficit and real estate bubble is clearly unsustainable and that the Chinese economy is increasingly jeopardized by its ‘excessive investment’ and ‘over dependence on demand from other countries’, the report concludes dismally that ‘the needed transitions to reduce imbalances’ is less and less likely to take place smoothly, and ‘the risks are weighted to the downside’ (Rajan, 2005). A year later, the chief economist of Morgan Stanley reiterates this pessimistic view and worries that ‘a US- and China-centric global economy hasn’t changed its stripes … A failure to rebalance has left an unbalanced world highly vulnerable to a slowdown made in both America and China … [T]he risks to global growth remain skewed to the downside’ (Roach, 2006a).
In other words, the recent global prosperity, attributed by many to globalization, hinges much on the reckless expansion of China’s production capacity, together with the contingent capability of the US to mobilize vast purchasing power from the future through excessive borrowing to fill the growing gap between global production and consumption. This imbalance-driven prosperity can terminate abruptly at any moment when US’s capability in living beyond its means evaporates. The imbalance is so threatening that a worry about a ‘return of depression economics’ emerges (Krugman, 1999). In particular, the Bank for International Settlement explicitly compares the current state of the global economy to the eve of the Great Depression in the 1920s, which was ‘a period of non-inflationary growth exuberant enough to lead many commentators to suggest [wrongly] that a “new era” had arrived’ (Bank for International Settlement, 2007: 139).

These grim analyses are mostly based on observations of short-term macro-economic trends and can easily be forgotten should their predictions fail to come true. Nevertheless, they echo the analyses proffered by the school of critical political economy which, under the influence of Marxian as well as Keynesian and Schumpeterian theories of economic crisis, diagnoses that the current imbalance of the global economy is but the latest expression of a prolonged global overaccumulation crisis. According to this school of thought, overaccumulation is a situation in which capital accumulates at a rate higher than what can prevent the average rate of profit across the capitalist system from falling. It can stem from overproduction, demand deficiency, or both. An outbreak of an overaccumulation crisis is an intense process of ‘creative destruction’ that wipes out the excesses in the economy through extensive bankruptcy of enterprises, large-scale unemployment, and turmoil in financial market.

It is exactly what the world capitalist system encountered in the 1970s, a decade characterized by ever more disruptive recessions and financial crises, endemic fiscal crisis of the state, and collapse of the Bretton Woods monetary system. The crisis stemmed from the escalating inter-capitalist competition ever since the late 1960s, when Europe and Japan recovered from wartime destruction, built up efficient industrial systems, and generated an oversupply of industrial products in the world market. This in turn led to the falling rate of profit in the manufacturing sector in most core countries. Capital and capitalist states from the core then attempted to reverse, or at least alleviate, the crisis by different strategies of what David Harvey calls ‘spatial-temporal fixes’ (Harvey, 1982). One strategy is to reallocate capital from the manufacturing sector into financial and real estate investments to delay the moment of profit realization (hence temporal fix). Another strategy is to open up and integrate new territories into the world market and to export surplus capital to these territories, where rate of profit is usually higher than the system-wide average (hence spatial fix). These attempts to fix the system were the origins of the neoliberal and
globalization project in the 1980s and 1990s, which was meant to deregulate capital market and to dismantle transnational trade and investment barriers all over the world. But this attempt can only ameliorate the crisis transiently at best. Over time, it increases global financial instability and turns the recipients of surplus capital into exporter of surplus capital, hence paving the way for larger-scale outbursts of the overaccumulation crisis (Arrighi, 1994; Brenner, 2002; Glyn, 2005; Harvey, 1982, 2003, 2005; Wallerstein, 1996).

With China becoming the ‘workshop of the world’ with an increasing concentration of world production capacity and global surplus capital, a full-scale overaccumulation crisis, if any, is likely to start there. According to Giovanni Arrighi and David Harvey, two among the few who update their analysis of global overaccumulation crisis by taking into account the current rise of China seriously, the geographical shift of the global accumulation process to China is making the country particularly vulnerable to economic turbulence (Arrighi, 2005; Harvey, 2003, 2005). For Arrighi, the history of the rise of Britain and the rise of the US shows that the reckless economic growth of any new center of capital accumulation always leads to intense economic crises (such as the 1772–1773 financial crisis in England and the 1929 stock market crash in the US and the subsequent Great Depression) until it successfully contrives new social, economic and political orders to manage the wildly expanding accumulation process within its territory. The rise of China as a new center of accumulation, inductively speaking, will be no exception (Arrighi, 1994, 2005). For Harvey, spatial-temporal fixes to the global overaccumulation crisis usually do no more than switching the crisis from one place and one time to another place and time. The export of overaccumulated capital from the core to the East and Southeast Asian tigers up to the mid-1990s created widely acclaimed miracles. But it also precipitated a regional overaccumulation crisis there, culminating in the Asian financial meltdown in 1997/1998. Today, when global surplus capital is migrating massively to China with the expectation of high profit, the potential of a national overaccumulation crisis within China rapidly builds up (Harvey, 2003, 2005).

The above analyses represent an ‘outside in’ approach that starts with a global analysis of world capitalist development and ends with a local analysis of Chinese capitalist development. Albeit offering us a cogent framework to view the rise of China from a global perspective, these analyses pay inadequate attention to the internal dynamics of China’s economic expansion. With this inadequacy, its assessment of the prospect of China’s development can only be grounded on lessons drawn from historical parallels, and can at best be speculative. It tells us an outbreak of crisis in China is likely, but says little about the particular circumstances under which this crisis will materialize, let alone the circumstances under which this crisis can plausibly be averted. In this paper, I complement this ‘outside in’
approach with an ‘inside out’ approach by focusing on the particular spatial and socio-political processes that channel the flow of global capital to China and mediate the localization of the global overaccumulation crisis into China’s national economy.

TRANSITION TO THE POST-MAO REGIME OF ACCUMULATION

China’s national regime of accumulation under Mao is grounded on centralized coordination of all economic resources by the state, repression of consumption, a draconian restriction of rural–urban migration, and intense extraction of agrarian surplus through rural collectivization and the ‘price scissors’ between agricultural and industrial products. The compliance of the population to this regime was warranted by a social compact under which the party-state guaranteed the provision of free healthcare, education, life-long employment, and other basic social services to workers and peasants through state-owned enterprises and rural communes. The Maoist path of development fostered high GDP growth rate and rapid expansion of a network of state capital over most of the period until the mid-1970s, when the growth momentum under this regime exhausted and the economy came to a standstill. But it also left China with a bulk of state capital and a vast pool of healthy and educated surplus laborers in the countryside (Selden, 1993; Wen, 2000).

These developmental outcomes laid a solid foundation for the reconstitution of the accumulation regime by post-Mao leaders, who sought to rejuvenate the economy through market reform in the late 1970s (Naughton, 1995). The market reform started with rural decollectivization and opening up of the economy to foreign capital in the early 1980s, followed by the urban state enterprise reform and price reform in the late 1980s. In the 1990s, state enterprise reform accelerated and the question of privatization came to the forefront as the most contentious issue. The resulting post-Mao regime of accumulation is characterized by a decentralized governance of the market economy and the transformation of the socialist state into a capitalist authoritarian one.

The rise of decentralized market governance

The process of ‘transferring power to lower levels [of government] and allowing lower levels to gain more profits’, which underlines China’s market transition, was initially a conscious effort of the reformist leaders at the center to create a ‘bureaucratic constituency of market reform’ among local cadres as a counterweight to the conservative old guards, who favored command economy and had a vested interest in the centrally controlled heavy industry (Shirk, 1993: 334–5). Cut off from subsidies from the central government and allured by the opportunities for profiteering
activities, local governments with different preexisting resource endowments devised different strategies of wealth accumulation.

Some establish collective township and village enterprises or turn preexisting state enterprises within their jurisdiction into profit-oriented units (for a discussion of China’s ‘local corporatism’, see Lin, 1995; Oi, 1999; Walder, 1995). Some assume the role of ‘referees’ instead of direct ‘players’ in the local economies. They promote local development through such classical developmental state measures as making discriminatory rules and constructing appropriate infrastructure to facilitate the growth of select industrial sectors, on which local governments rely for tax revenue (for a discussion of ‘local developmental state’ in China, see Blecher and Shue, 2001; Nee et al., 2007: 41–4; Segal and Thun, 2001). Some rely on outright predation on the preexisting wealth of local societies and public asset through tax bully, corruption and selling of state-owned resources for private gains (Berstein and Lu, 2003; Lu, 2000). These three modalities of local strategies of accumulation are ideal typical rather than empirical entities. What matters is how these modalities are combined differently in different places (Tsai, 2002: 254; see also Baum and Shevchenko, 1999).

In lack of technical and management know-how as well as marketing networks in overseas market, most local developmental or entrepreneurial states depend heavily on labor-seeking and export-oriented global capital, including Chinese diasporic capital from other Asian states and transnational capital from core countries, to jumpstart and sustain local economic growth. The bulk of state capital accumulated in the Mao era conveyed large convenience to foreign investors, who can simply plug themselves into the preexisting network of production by establishing joint venture or multilayered subcontracting connections with local state-owned or collective enterprises. The unlimited supply of healthy and educated surplus labor from the countryside, a legacy of restricted rural–urban migration as well as rural public health and education investment during the Mao era, constitutes a major attractiveness to global manufacturing capital. China’s attractiveness is further enhanced by the competitive pressure among the numerous local states, which race with one another to attract foreign investment by offering them the most favorable terms possible, ranging from tax break to free industrial land. These advantages, which are attributable to China’s gigantic size and are not enjoyed by smaller Asian tigers, help explain the unprecedented thrust of economic expansion in China today.

A consequence of economic decentralization is the falling authority of the central government in regulating the economy. With local states becoming the leading agents or direct regulators of capital accumulation, the central government retreats to become an indirect player specialized in devising the macro-economic backdrop, such as interest rate, tax rate, exchange rate and preferential policy toward certain regions, against which local states pursue development (see Wang and Hu, 2001; Zweig, 2002).

Throughout the 1990s, the central government tried hard to reinvigorate its power over local governments, but only with half-success. Though the central government strengthened its command of tax revenue vis-à-vis local governments after the 1994 fiscal reform, local governments continued to control more than 70% of all government expenditures after the reform (Naughton 2007: 434–36). The attempt to recentralize decision-making process in such areas as financial regulation and commodities management over the 1990s, meanwhile, only resulted in a recentralization of bureaucratic power from county and township level to the provincial level, but not from the provincial level to Beijing. Ironically, this recentralizing reform further empowered provincial governments vis-à-vis the central government and aggravated the phenomenon of ‘perverse federalism’ (Mertha, 2005). The disobedience of local governments to central government’s regulatory measures is so severe that senior officials at the center recurrently complained that orders of the central government often failed to reach beyond Zhongnanhai, the residential cum office compound of the highest party-state leaders in Beijing (Zhongguo qingnianbao, 2005; see also Liaowang, 2006).

The making of a capitalist authoritarian state

While the relation between the central government and local governments is often conflict-ridden in economic affairs, they are in accord in keeping popular resistance unleashed by the market transition at bay. Before the late 1980s, the dissolution of the Maoist social compact is compensated by rising income offered by new market opportunities in the countryside and the shift from a scarcity to a consumer economy in the city, and most segments of the population benefited from the reform (Wang, 2000). The honeymoon ended in the late 1980s with the acceleration of urban reform, which was to turn state-owned enterprises into autonomous profit-making units and to replace fixed, centrally planned prices of key commodities with floating, market prices. Under the new pressure to make profits, many state-owned enterprises started eliminating the welfare packages for workers and replacing life-long employment with short-term contractual one.

Falling income and job security of industrial workers was concomitant with runaway inflation and rampant corruption induced by the price reform. The reform, which started with a ‘dual track system’ that fomented a coexistence of fixed planning prices and floating market prices for such key commodities as gasoline, cement, steel and other materials in short supply, enabled government officials and state enterprise managers to purchase...
these commodities at low planning prices and resell them at skyrocket-
ing market prices. Through this rent-seeking activity, many cadres, as well as
their kin and protégés, managed to amass enormous private fortune
and turned themselves into the first generation of China’s ‘cadre-capitalist
class’ (So, 2005; Sun, 2004). Inflation, corruption, and class polarization
reached a crisis proportion in 1988, paving the way for the large-scale un-

During the democratic movement in 1989, students and liberal intellec-
tuals stipulated that the economic chaos and corruption stemmed from
a mismatch between courageous economic reform and timid political re-
form, and that political liberalization could solve every predicament of
reform. The demands of workers participating in the movement, on the
contrary, were more social than political. They decried the dismantling
of the Maoist social compact and called for the protection of workers’
rights in the reforming state-owned enterprises (Calhoun, 1994; Lin, 1992; Wang,
2003). The party’s old guards, who detested market reform and feared
the demise of one-party rule, joined hand with the free marketeers and
the nascent cadre-capitalist class, who were intimidated by the protesters’
attack of their privileges, to quell the unrest. After a relapse of market re-
form under the post-Tiananmen dominance of the old guards for less than
three years, the free marketeers marginalized the old guards again amid an
intra-party factional struggle, and economic liberalization revived with far
greater ferocity in the early 1990s. A new political consensus based on un-
compromising authoritarian rule coupled with equally uncompromising
economic liberalization was in place, setting the tone of China’s develop-
mental path in the 1990s and beyond (Naughton, 1995; Wang, 2003).

In the 1990s, massive layoffs of workers in state-owned enterprises and
complete dissolution of the welfare system embedded in state sectors swept
all major cities, creating a new urban underclass. While continuous in-
flow of global capital brought dazzling prosperity to select coastal urban
regions, infrastructure investment and social services provision in most
inland rural areas dilapidated, resulting in widening inter-regional and
rural–urban income disparity. As of September 2007, the average urban
income has reached 3.3 times of the average income in the rural area, up
from 2.5 times in 1997 (Xinhuawang, 2007). Meanwhile, the incipient ‘in-
sider privatization’ of state-owned enterprises heralded the formation of
a new class of oligarchs, Russian style (Li and Rozelle, 2003; Wang, 2006).

The new rich, including the cadre-capitalist class, self-made business-
men, middle class professionals, and the like, are the main beneficiaries of
the Communist Party’s new political consensus of the 1990s and became the
party’s new social base. Over the decade, the party was ever more enthusi-
astic in recruiting young college graduates and other new middle classes
(Walder, 2004). In 2001, the party moved further to open the door for pri-
ivate entrepreneurs to become card carrying members. These beneficiaries
of economic liberalization are more antinomies than pioneers of political reform. Large-scale surveys repeatedly reveal that most professionals and entrepreneurs in China are sternly opposed to political liberalization, for fear that it would trigger tyranny of the lower classes and threaten their private gains (e.g. Chen, 2002; Li et al., 2005). In this manner, China’s party-state has reticently transformed itself from a socialist authoritarian state, which upheld the planned economic system and undertook the accumulation of state capital, to a capitalist authoritarian state, which defends the private accumulation of capital and guards the interests of its beneficiaries against any resistance from below.

PATHWAY TO A NATIONAL OVERACCUMULATION CRISIS

The post-Mao regime of accumulation makes China’s extraordinary economic expansion possible. The autonomy and competitive pressure among local states urge them to constantly increase their individual attractiveness, and hence China’s overall attractiveness, to global capital. The post-Tiananmen authoritarian rule keeps discontent at bay and ensures that the Chinese economy could grow in a hyper, polarizing fashion without the need on the part of global capital and other reform’s beneficiaries to sacrifice for large-scale income redistribution through high taxation and manufacturing wage increase. But at the same time, this accumulation regime has been cultivating a structural imbalance of the economy. As we shall see soon, the decentralization of market governance accelerates over-investment, and unchecked social polarization constrains the growth of domestic consumption power. This imbalance seems particularly perturbing when we compare China’s pattern of growth with the patterns of other Asian tigers at their comparable stages of development.

Overinvestment

During the initial economic ascendancy of Japan, South Korea, and Taiwan, central governments played a key role in mobilizing and allocating precious financial and other resources to support the growth of strategic industrial sectors. This ‘pick the winner’ process is not only crucial in the early stage of industrial takeoff, but also essential to the subsequent industrial upgrading of these economies (Evans, 1995; Haggard, 1990; Wade, 1990). The decentralized economic growth in today’s China deviates from the model of centralized developmental state (So, 2003). Many local states in China act ‘developmentally’ in that they proactively facilitate growth of selected industrial sector, and these developmental efforts are often well planned and executed at the local level. The totality of these efforts combined, however, entails anarchic competition among localities, resulting in uncoordinated construction of redundant production capacity and
infrastructure. Foreign capitals, with the expectation that the Chinese market and world market for Chinese products will grow incessantly, also race with one another to expand their existing industrial capacity in China. Though export-oriented foreign investments yield decent profit so far as the world market, the US market in particular, remains robust, investments made by many state-owned, domestic market-oriented enterprises are increasingly excessive and unprofitable.

Idle capacity in such key sectors as steel, automobile, cement, aluminum and real estate has been soaring ever since the mid-1990s (Rawski, 2002). It is estimated that over 75% of China’s industries are currently plagued by overcapacity (Rajan, 2006), and that fixed asset investment in industries already experiencing overinvestment accounts for 40–50% of China’s GDP growth in 2005 (Xie, 2006). For example, the State Development and Reform Commission predicts that output in the automobile industry will be more than double of what the market can possibly digest by 2010, if production capacity is not curbed duly (Xinhuawang, 2005). The buildup of excess capacity is exacerbated by the lack of geographical and intersectoral mobility of domestic enterprises that increases their propensity to invest in already saturating localities and sectors. On the one hand, many provincial or municipal governments erect protectionist barriers against investment from other provinces or cities. It fragmented the national economy and constricted the room for virtuous expansion as well as consolidation of domestic capital, creating a ‘one country, thirty-two economies’ malaise (Huang, 2003: 140–8). A survey finds that 85.8% of state-owned enterprises invested only in the same city and 91.1% invested only in the same province (Kiester and Lu, 2001: 26). On the other hand, underdevelopment of financial market makes it difficult for enterprises to divert their savings to invest in underinvested new sectors that yield higher profit, hence restricting their choice to fixed asset investment in their own sectors (Rajan, 2006).

To make matter worse, major state-owned banks, rather than discipline enterprises and direct them away from excessive and low return investments, encourage these investments through lax lending practice. These banks, as the financial arms of the central and local governments, deliver easy credits to insolvent or profligate state-owned industrial enterprises, of which roughly 40% incurred losses in 2006 according to government figures (Bank for International Settlement, 2007: 56). In contrast, private enterprises, even very successful ones, are at a disadvantageous position in obtaining financial support from major state banks. The irony that losing state enterprises can obtain credit more easily than profitable and promising private enterprises sets China far apart from the developmental experiences of other East Asian developmental states, where state funded industrial banks efficiently allocate resources to the ‘winners’, not ‘losers’ (Shih, 2004; Tsai, 2002: 29–35).
The state banks’ priority of extending loans to keep unprofitable state-owned enterprises afloat is to maintain social and political stability by slowing massive layoffs by these units. In addition, these loans are often result of exhortation by local party bosses, who command overwhelming influence over local branches of state banks and are inclined to fuelling local investment boom to boost local growth figures and short-term government revenue gain. These loans constitute a channel through which resources are redistributed from the profit-making economic units, which deposit their savings in the banks and pay tax to the government, to the losing ones. This malign redistribution of financial resources magnifies the sectoral overinvestment into a generalized risk to the economy through the pile-up of non-performing loans in the financial system (Economist, 2005; Lardy, 1998; Rawski, 2002). As the Bank for International Settlement remarks:

In China, the principal concern must be that misallocated capital will eventually manifest itself in falling profits, and that this will feed back on the bank system, the fiscal authorities and the prospects for growth more generally. After a long period of credit-fueled expansion, this would be the classic denouement. Indeed, this was very much the path followed earlier by Japan [before the prolonged crisis in the 1990s]. (Bank for International Settlement, 2006: 144)

The non-performing loans to all outstanding loans ratio has been falling since the late 1990s. But it is largely a result of recurrent governmental overhaul that involves massive government bailouts and transfer of these loans to state-owned asset management companies, rapid expansion of new loans, and even deliberate underreporting of non-performing loans (Dobson and Kashyap, 2006; Naughton, 2007; New York Times, 2006). According to a recent estimation by Ernst & Young, the total amount of non-performing loans having accumulated in China’s economy has reached 900 billion dollars in 2005, which is more than 40% of China’s GDP and outstrips China’s massive foreign exchange reserves at the time (Financial Times, 2006). A recent survey shows that after years of bank reform, major state banks continue to lend without taking into account the profitability and risk of their borrowers (Podpiera, 2006). As Nicholas Lardy points out, this continuous reckless lending could renew the accumulation of bad debt and ‘erase some of the very hard-won progress in bank reform in the last eight years’ (quoted in Economist, 2006).

The spurt of debt-financed overinvestment in state-owned enterprises and local governments is not new to China. The Chinese economy did witness a similar spurt in 1993–1994, when market liberalization resurged after a brief recess following the crackdown of the democratic movement. The State Council responded at that time with a series of macro-economic austerity measures to limit credit supply and force state-owned enterprises
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to cancel many of their investment projects through administrative orders. The economy cooled down promptly (see Huang, 1996). It is well possible that the current surge of overinvestment will eventually be contained just like the ending of the last cycle in the mid-1990s, as the government has already introduced a spate of austerity measures since 2003. But the caveat to this optimism is that the scale of overinvestment now is much larger than it was ten years ago. And after ten more years of sweeping economic liberalization, the central government now commands much less leverage than it did in the mid-1990s over entrenched local interests, which are reaping enormous short-term profit from the investment boom. As we will discuss at the end of the paper, the result of the latest macro-economic adjustment initiative is so far disappointing.

Underconsumption

All East Asian tigers at their initial stage of industrial takeoff were governed by authoritarian regimes. But these regimes were disciplined by Cold War geopolitics. Just next door to Communist China, they were anxious to root out any plausible socialist influence among the lower classes. They achieved this goal through preemptive redistributive policies like land reform and provision of free education as much as through repression of independent labor and peasant organizations. By letting the fruits of economic expansion trickle down to the lower classes, the rural population in particular, these authoritarian regimes became economically inclusive, even though they were awfully exclusive politically (Deyo, 1987; Haggard, 1990). The reduction in income disparity and rising income among the lower classes helped create sizeable domestic markets in these newly industrializing economies. Though the success of these economies are mostly attributable to their export-led growth, domestic consumption also plays an indispensable role in the takeoff process by buffering the economies against the vagaries of the world market, in addition to providing infant industries with sufficient internal demand before they could compete internationally (Grabowski, 1994).

In contrast, under the post-Tiananmen consensus among the ruling elite, the party-state single-mindedly pursues rapid economic growth without directing enough attention to the alleviation of social polarization. Class, urban–rural, and inter-regional inequalities expand hand in hand with the economic miracle. Poverty spreads and intensifies in the rural inland area and the old bastions of state industry besieged by extensive unemployment (Riskin et al., 2001; Wang and Hu, 1999). As jobs created by export-oriented global capital could not catch up with the jobs disappearing from battered state-owned factories, China appears to have experienced a net loss of manufacturing jobs since the mid-1990s, with the share of manufacturing in total employment never reaching the levels found at the
peak of manufacturing employment in the smaller newly industrializing economies (Evans and Staveteig, 2006: 9–14). The peasants-turned-workers in the coastal boom towns are not doing much better. Owing to the colossal size of the pool of surplus labor and the ‘despotic factory regime’ under the auspices of the party-state, manufacturing wage growth amid China’s economic miracle is dismal in comparison with the growth in other East Asian Newly Industrializing Economies (NICs) during their miraculous moments (see Figure 1) (Glyn, 2005: 22; Lee, 1998).

During the most explosive phase of takeoff, South Korea and Taiwan remained modestly equilibrarian societies, with their gini-coefficients staying in the range of 0.3–0.4 throughout the 1960s and 1970s (most noteworthy, Taiwan’s gini-coefficient dropped from 0.5–0.6 in the 1950s to 0.3–0.4 in the 1970s). On the contrary, China’s gini-coefficient rose from 0.33 in 1980 to more than 0.45 today (Table 1). The pattern of income distribution change in China’s development is more reminiscent of the Latin American experiences than the East Asian ones, so much so that some begin to forewarn of the ‘Latin Americanization of China’ (Fan, 2003; Gilboy and Heginbotham, 2004).

The increasingly skewed distribution of income constrained the expansion of the mass consumption market. Figures from World Bank suggest that share of wage income in China’s GDP declined from 53% in 1998 to 41.4% in 2005, and that ‘[t]he declining role of wages and household income in the economy are the key driver behind the declining share of consumption in GDP’ (He and Kuijs, 2007: 11–12). As Figure 2 shows, growth of

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**Figure 1** Manufacturing wages during catch-up, 1950–2005. Sources: US Bureau of Labor Statistics, Foreign Labor Statistics for Japan and Asian Tigers; China Statistical Yearbook, various years, for China.
### Table 1 Gini coefficients of China in comparative perspective

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<tr>
<th>Year</th>
<th>China</th>
<th>S. Korea</th>
<th>Taiwan</th>
<th>Brazil</th>
<th>Mexico</th>
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<td>0.470</td>
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consumption in China is hardly stagnant, but it has fallen short of catching up with the exuberant growth in investment since 1989.

China’s high national household saving rate seems to foretell a potentially large consumer market. But in fact, these savings are difficult to be mobilized into consumption power, as most of them are precautionary savings for unexpected medical expenses, retirement income, children’s education, and the like, in the context of general welfare breakdown and employment insecurity. In addition, it is estimated that more than 80% of the total household saving deposits is commanded by less than 20% of the population, suggesting that this financial resource is highly concentrated among the urban elite, who would prefer spending their money on imported luxuries to spending it on low-cost products manufactured in the domestic labor-intensive industry, if they are willing to spend at all (Kraay, 2000; Meng, 2003; Xu, 2005).

The much lower than expected growth in consumption demand, whereas bringing difficulty to domestic firm in dispensing their
inventories, also frustrates many foreign businesses, which have high expectation of taking advantage of China’s supposedly huge market. *The Economist* complained on behalf of these disheartened foreign investors that ‘for most foreigners, the market will turn out to be smaller than expected and take longer to develop; and because so many foreign businesses are piling in, competition is likely to be fierce . . . How can foreign firms generate acceptable returns in China?’ (*Economist*, 2004). In a similar vein, the *Forbes* magazine laments China’s much tougher than expected market for foreign automakers by pointing out that ‘[r]ising competition in China has led to manufacturing overcapacity and a rapid decline in car makers’ profit margins there to a level largely in line with the rest of the world, at 4% to 6%’ (*Forbes*, 2007).

**Growing imbalance**

China’s gross fixed capital formation to final consumption expenditure ratio, which offers us a sense of the imbalance between investment and consumption, has exceeded the level that most other Asian economies reached
on the eve of the Asian Financial Crisis (Figure 3). This escalation of investment to consumption ratio is also reminiscent of what US and Japan witnessed on the eve of the Great Depression in the 1930s and the ‘lost decade’ of the 1990s, respectively. According to many, these crises, despite the diverging details of their unfolding and different timings in the development of twentieth-century global capitalism, are comparable overaccumulation crises commonly rooted at a conjuncture of debt-financed expansion of excess industrial capacity, asset inflation, and sluggish domestic demand (Aglietta, 1979; Bello, 1998; Devine, 1983; Erturk, 2002; Murphy, 2000; Palat, 2003; Wade, 2000).

To be sure, provided with China’s huge foreign exchange reserves and strict capital control, it is unimaginable that a financial crisis beginning with drastic currency devaluation and sudden capital flight, just like what other Asian economies encountered during the Asian Financial Crisis in 1997/1998, would ever materialize there. But the anxiety that the growing imbalance in China’s economy will eventually lead to an intense outbreak of enterprise bankruptcy, hike in unemployment, and destabilization of the banking sector, an anxiety which is shrouding the party-state, is not ungrounded.
### Table 2 China’s CPI, 1996–2007 (negative figures in bold)

<table>
<thead>
<tr>
<th>Year</th>
<th>Overall</th>
<th>Clothing</th>
<th>Household facilities</th>
<th>Transportation &amp; communication(^a)</th>
<th>Vehicle</th>
<th>Communication equipment</th>
<th>Food</th>
<th>Housing</th>
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<td>-3.2</td>
<td>1.7</td>
</tr>
<tr>
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<td>-2.3</td>
<td>-5.5</td>
<td>-4.2</td>
<td>-8.1</td>
<td>-4.2</td>
<td>1.7</td>
</tr>
<tr>
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<td>-2.3</td>
<td>-6.2</td>
<td>-4.1</td>
<td>-10.1</td>
<td>-2.6</td>
<td>4.8</td>
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<td>2001</td>
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<td>-1.9</td>
<td>-2.3</td>
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<td>-1.9</td>
<td>-5</td>
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<td>-17.9</td>
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<td>2007</td>
<td>6.5</td>
<td>-1.3</td>
<td>1.8</td>
<td>-1.7</td>
<td>—</td>
<td>—</td>
<td>17.6</td>
<td>4.8</td>
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</table>


\(^a\) Including vehicle, communication equipment, fuels and services.
The accumulation of excess industrial capacity, gluts, and relatively sluggish consumption growth leads to falling prices of finished products in key industrial sectors. Deflation has been a concern of Chinese economists and the government since the late 1990s. The data on consumer price index suggests that the economy escaped from deflation after 2000 and entered into a period of rising inflation. But further breakdown of the data shows that deflation continues to haunt key industrial sectors. In fact, much of the CPI growth is attributable to a continuous surge in primary products costs and housing expenditures (Table 2).

Deflation of finished products and inflation of raw materials and fuels together foment what Shan Weijian (2006a) calls ‘biflation’, which squeezes the profit margins, as measured by profit divided by total revenue, of Chinese firms (Table 3).

Various studies employing different data and approaches illustrate that profit rate, as measured by profit as a percentage of the stock of capital, in key sectors as well as the economy at large is falling as well (Fan and Felipe, 2005; Islam et al., 2006: 149–54; Shan, 2006a, 2006b).5

The growing economic imbalance and the worry about profitless growth lead many to question the sustainability of the current boom and anticipate an economic crisis to come. This anticipation began to surface among Chinese economists as well as China watchers in the West as early as in the aftermath of the Asian Financial Crisis (e.g. Fernald and Babson, 1999; Lin, 2000). But this fear was soon allayed by the continuation of robust economic expansion driven by debt-financed investment, FDI inflow and export growth. These upward trends were not unrelated to the

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**Table 3** Falling gross profit margin of Chinese industrial enterprises, 1995–2005

<table>
<thead>
<tr>
<th>Year</th>
<th>All ‘large and medium industrial enterprises’ (%)&lt;sup&gt;a&lt;/sup&gt;</th>
<th>All ‘large industrial enterprises’ (%)&lt;sup&gt;b&lt;/sup&gt;</th>
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</thead>
<tbody>
<tr>
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<tr>
<td>2005</td>
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</tbody>
</table>

<sup>a</sup>Data based on Jefferson *et al.* (2003); including both domestic and foreign firms.

<sup>b</sup>Large enterprises as defined as enterprises with revenue of 5 million yuan or above; data based on National Bureau of Statistics of China (various years) and Shan (2006a: 30), including both domestic and foreign firms.
heightened optimism about China’s economy at home and abroad enlivened by China’s entry into WTO and its successful bid for hosting the 2008 Olympics in 2001. But this great expectation among investors further deepens the economy’s imbalance, as it intensifies overinvestment without contributing much to the growth of domestic consumption.

When the investment–consumption gap keeps enlarging, China becomes ever more dependent on its booming export sector to neutralize the increasing menace that the excessive capacity in the domestic market-oriented sector generates. Ballooning foreign reserve resulting from rapid export growth fuels a credit expansion in the banking sector, boosting debt-financed investment further and in turn exacerbating the buildup of excess production capacity to be countervailed by further export growth. A cycle of surging export and surging investment ensues (see Washington Post, 2006). In sum, China’s pattern of economic growth today is marked by a high and ever increasing dependence on export and debt-finance investment on the one hand, and low domestic consumption on the other (Figure 4). Though the earlier ‘East Asian developmental miracles’ are known for their high investment and low consumption rates, they dwarf in comparison with China. China’s current fixed asset investment rate (above 50% of GDP) is nearly double of Taiwan’s and South Korea’s rate at their

Figure 4 Growth pattern of China, 1980–2006. Source: China Data Center.
peaks of industrial growth in the 1970s (which was about 25–35%). Its private consumption rate (below 40%), on the other hand, is much lower than Taiwan’s and South Korea’s rate in the 1970s (which was about 60–70% for Korea and 50–60% for Taiwan).

It is doubtful whether China’s formidable export engine, so far the economy’s single most profitable component that neutralizes the risk of an overaccumulation crisis, will last indefinitely. In the three decades following the Second World War, the success of the export-led development strategy of the Asian tigers rested mainly on the fact that only a limited number of small developing economies pursued this strategy. The exports of these economies were easily absorbed in the world market. But when many more developing countries adopted the strategy in the 1980s and 1990s, the world market, flooded with cheap manufactured exports, became ever more volatile. China is exceptionally vulnerable given the enormity of its economic size and export volume (Asian Development Bank, 2005; Mead, 1999; Palley, 2002). Worse, China’s exporting trade is highly concentrated in the US consumer market, which currently absorbs more than 30% of China’s total exports (including re-exports via Hong Kong, see Roach, 2006a, 2006b). The expansion of the US consumer market, which depends on a debt-financed consumption spree and creates a mega current account deficit, is obviously going to end before long.

When the US economy readjusts via either a fall in the dollar or a bursting of its real estate bubble, or when China’s export outlet is reduced by a substantial appreciation of the yuan or by protectionist measures of the US or other economies, China’s capability in exporting its manufactured products will plummet, and the sizeable export-oriented global capital stationed in China can rapidly deteriorate from ‘good’, profitable capital into ‘bad’, surplus one. Some may argue that a slowdown in US’s appetite for consumer goods can be easily substituted by the prospective revival of the European and Japanese markets. But this optimism does not match with the reality that US consumption spending was 20% larger than that of the euro-zone and 3.5 times that of Japan in 2005, and that the current rates of expansion of consumption spending in the latter two economies were well below 2% (Roach, 2006a). In other words, the US consumption spree is an irreplaceable source of dynamism of China’s export sector and its economy at large. If the gap between domestic industrial capacity and domestic consumption in China is not sufficiently narrowed in time, the end of exuberant consumption of the US can unleash an outbreak of over-accumulation crisis in China.

**TOWARD PREEMPTIVE REBALANCING?**

Under the post-Mao regime of accumulation, economic decentralization created a situation in which local states compete with one another for
investment-driven and export-oriented economic growth. This uncoordinated competition nurtures overinvestment in the Chinese economy. At the same time, the social polarization that began in the late 1980s and accelerated under the post-Tiananmen authoritarian rule constrains the growth of domestic consumption in China. The trends of overinvestment and underconsumption, when combined together, make China increasingly susceptible to a national overaccumulation crisis. With China’s weight as the major territory for global surplus capital to park and realize their profits and as the major export market for raw materials producers as well as capital goods manufacturers, a national overaccumulation crisis in China, if it occurs, will surely generate widespread global repercussions.

China’s propensity to crisis is structural rather than cyclical, but the vulnerability to crisis is, of course, far from the inevitability of crisis. The highest echelon of China’s party-state elite is well aware of the risk that the economy is facing, and they have been actively devising preemptive policies to redress the imbalance. Following the Asian financial Crisis of 1997/1998, China’s State Council launched a series of income redistribution programs to boost domestic demand, with an expectation that they could end China’s precarious dependence on export and debt-financed investment for economic growth. These initiatives include directing state investment and inducing foreign investment to the impoverished, rural Western interior and increasing peasants’ disposable income through tax and fee reduction. They aim to open up China’s rural market, which is a vast and uncharted frontier for many consumer goods in contrast to the more or less saturated urban markets. They also include the institutionalization of a comprehensive social security system that would encourage urbanites and villagers alike to spend more for the present and save less for future uncertainty. Beginning in late 2003, the central government launched a series of macro-economic adjustment measures to curb excessive investment via administrative orders and tightening of credit supply to local governments and state-owned enterprises.

The ambition of these high-sounding measures notwithstanding, the key question is how the central government could warrant their full implementation. The resistance of entrenched local interests to the redistributive and macro adjustment measures is widespread, as Beijing’s concern about the economy’s long-term stability is in many ways contradictory with the local elite’s obsession with maximizing their short-term private gains. Local cadres in many regions simply neglect Beijing’s call for relieving peasants’ burden and continue their predation on peasants’ income and land (Chen and Chun, 2004; Li, 2002). These local interests are reluctant to check the expansion of debt-financed investment spree either. Figures show that despite the austerity measures, credit creation and fixed asset investment continued their exorbitant expansion in 2004 through 2007, and the latter reached 26.9% year-on-year growth rate in October 2007, whence the
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growth rate of retail sale was just 16.1%, a substantial portion of which is attributable to mounting inflation of primary goods (National Bureau of Statistics of China monthly statistical release).

Averting a full-scale overaccumulation crisis in the Chinese economy will involve more than technical policy change. A restructuring of China’s national regime of accumulation through reconfiguring its spatial and socio-political orders is necessary. The state could recentralize state power all the way to the central government to strengthen its capacity in coordinating the hitherto anarchic local developments. The party-state could also reestablish its ties and compact with the workers and peasants so that it could raise their consumption power and mobilize their support to break the resistance of entrenched local interests. Many speculate, or wish, that it is exactly what the new party leaders, who took power in late 2002, attempt to do. In 2006, they launched a propaganda war against what is dubbed as ‘monopolistic special interests’ (teshu liyi jituan) that have been impeding the rebalancing of the economy and preying on the underprivileged. This was accompanied by aggressive investigation and arrest of allegedly corrupt local party bosses in defiance of central government’s policy to curb overinvestment. They also renew the central government’s attempt to recentralize key powers, such as land and environmental regulation, from local governments all the way to Beijing (Liaowang, 2006).

Recent proliferation of labor unrest and resistance to land enclosure, which are more widespread, more persistent and hence more difficult to contain in comparison with the democratic movement in 1989, generates the fear of out-of-control unrest and demise of Communist rule among party cadres at different levels. This fear has strengthened the hands of the center against local elites, who are widely regarded as the origins of extensive discontent. The increasing awareness about the environmental limit to high speed growth further enhances the determination of the center to check the recklessness of local states, which have so far been pursuing rapid development at all cost (Economy, 2004; Naughton, 2007: 487–504). Despite these progresses, the restructuring of the current spatial and socio-political orders is not likely to be accomplished soon, as they have taken root over more than two decades of market transition. Before the completion of the restructuring, China could have no better choice than to continue relying on the world market, the US market in particular, to neutralize the risks generated by the economy’s imbalance. But as a correction of the US current account deficit is just a matter of time, China’s reliance on the US market cannot be indefinite. It is still not sure whether the correction of the US economy will be gradual and orderly, as many hope for, or will be abrupt and chaotic, as many fear. If it turns out to be the former, then there is a good chance that China could complete its readjustment before the time runs out, and China will be able to consolidate its centrality in the global economy in a relatively painless fashion.
If it is the latter case, then a disorderly readjustment of the US economy can well unleash a convulsion of the Chinese economy. The simultaneous downturn of the two will reinforce each other and generate a generalized global economic turmoil, and two alternative results will plausibly emerge. The first is that the incremental restructuring of the accumulation regime within China may accelerate in the pains of the turbulence and conflicts that the turmoil triggers, setting the rise of China firmly onto a more sustainable course. It is reminiscent of how the Great Depression hastened the US transition to the Fordist–Keynesian regime of accumulation, which already gestated in the Progressive Era. The second scenario is that China fails to fully recoup from such a crisis and its status as the new center of global accumulation is taken, at least partially, by other emerging Asian economies, with India and Vietnam as viable candidates. It could resemble how China’s redoubled growth countervailed the economic crisis of Japan and the Asian tigers in the 1990s. No matter which one of the above scenarios becomes reality, the shift of the center of gravity of global capitalism to Asia is likely to continue in the long run.

ACKNOWLEDGEMENT

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NOTES

1 As of 2004, 60% of all China’s exports and almost 90% of all high-tech exports were manufactured in foreign investment firms. It is a startlingly high figure in comparison with the figures for other Asian tigers in similar stage of takeoff – 20% for Taiwan in the mid-1970s and 25% for South Korea in the mid-1970s. In terms of FDI to gross capital formation ratio, China’s FDI dependence has been among the highest in East and Southeast Asia since the 1990s (Gilboy, 2004; Huang, 2003; Hughes, 2005).

2 For cases illustrating how uncoordinated development under decentralization of the state leads to excessive investment, see Huang’s (2002) discussion of the automobile industry for example. See also Rawski (2002: 364–5).

3 The Ernst & Young report expectedly exasperated the Chinese government, which retorted the report openly. Ernst & Young, allegedly under the pressure of the Chinese government, soon retracted the report.

4 For an empirical analysis of the negative correlation between income inequality and domestic demand in China, see Quan (2004) and Li (2003: 419–21). For an analysis of the negative impact of income and employment insecurity on consumption of urban residents during China’s market transition, see Luo (2004).

5 The estimation about falling profit rate is far from undisputed. For example, World Bank (2006) argues against this estimation and declares that profitability of Chinese firms has actually been soaring. Bai et al. (2006), though observing a decline in profit rate, argue that China’s profit rate is strong in comparison with
other major economies. These estimations are criticized as unsophisticated as they are based on taking problematic official statistics at their face value (Shan, 2006a, 2006b). But even if we accept that China’s profit rate is growing, we still cannot agree with the optimistic conclusion about the long-term sustainability of the Chinese miracle, for the growing profit rate is juxtaposed with an indisputably falling profit margins. It means that growth in profit rate, if any, is a function of increasing volume of sales instead of increasing profit of unit sales. When the increase in sale volume of manufactured products reaches its limit or reverse (see the following discussion about China’s reliance on export market and its pitfalls), profit rate can collapse abruptly. It is noteworthy that the US had been experiencing a decade of rising profit rate on the eve of the Great Depression (Aglietta, 1979; Dumenil and Levy, 1993).

Many have found that India, though still lagging behind China in many respects, enjoys a number of advantages over China that prepare it for more sustainable long-term growth. They include more egalitarian distribution of income, strong domestic consumption, a more developed financial system, and more efficient domestic corporations (see Huang and Khana, 2003).

NOTES ON CONTRIBUTORS

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