



Aggregate Demand, Productivity, and “Disguised Unemployment” in the Chinese Industrial Sector

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Summary. — Many economists argue that the Chinese state and collectively owned enterprises are fundamentally inefficient and better economic performance requires large-scale layoff of the state and the collective sector workers. This paper argues that the productivity of state and collectively owned enterprises depends on the level of aggregated demand. If the government undertakes expansionary policies and raises the level of aggregate demand, a substantial part of the disguised unemployment can be eliminated. In the long run, for the demand expansion to be sustained, it is necessary to improve income and wealth distribution and promote the general development of political, social, and economic democracy.

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1. INTRODUCTION

Since the late 1970s China has undertaken market-oriented economic reform. Unlike in Eastern Europe and the former Soviet Union, until the early 1990s there had been no privatization of state and collectively owned enterprises. In the 1980s state and collectively owned enterprises continued to provide job security and other benefits to the urban sector workers. Rapid economic growth was accompanied by rising living standards for most people. In 1992, in the Fourteenth Congress of the Chinese Communist Party, it was decided that China's goal of reform was to build a “socialist market economy.” Next year, at the Third Plenum of the Fourteenth Party Congress, it was decided that the existing system of state and collectively owned enterprises was to be replaced by the “modern enterprise system” based on “clarified property right, clearly defined responsibility and authority, separation of enterprises from the government, and scientific management.” The Fifteenth Party Congress in 1997 took a further step, deciding that while collectively owned enterprises and small state-owned enterprises were to be privatized, large and medium-sized state-owned enterprises were to be restructured as shareholding corporations (Qian, 1999; Zhang, Huang, & Li, 1998).

The enterprise reform since the early 1990s has resulted in large-scale layoff of workers. In the 1980s there was virtually full employment in the urban sector. But since the mid-1990s, urban unemployment has grown rapidly. During 1996–2000, the state and the collective sector had laid off 46 million workers (Hughes, 2002, p. 33). Table 1 shows the growth of urban unemployment during the 1990s.

Unlike in the 1980s, since the early 1990s while the economy has continued to grow rapidly, social inequality has reached unprecedented levels. As a result, a significant portion of workers and peasants have failed to benefit from economic growth. In fact, in recent years, the real living standards of unemployed and laid off workers, retirees, migrant workers, and peasants depending primarily on agriculture have actually declined. Urban poverty has been growing (Fan, 2002; Yang & Xin, 2002; Zhu, 2002). The deteriorating living conditions of the lower social classes and the rising inequality have undermined the legitimacy of the

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Table 1. *China's urban unemployment, 1991–2001*

	Registered unemployment (thousand)	Registered unemployment rate (%)	Unemployed laid off workers (thousand)	Actual unemployment rate (%) ^a
1991	3,522	2.3		
1992	3,639	2.3		
1993	4,201	2.6		
1994	4,764	2.8	3,000	4.6
1995	5,200	2.9	4,090	5.2
1996	5,528	3.0	5,910	6.2
1997	5,700	3.1	4,500	5.5
1998	5,710	3.1	6,140	6.4
1999	5,750	3.1	7,800	7.3
2000	5,950	3.1	6,570 ^b	6.5
2001	6,810	3.6	6,900 ^b	7.2

Source: The Chinese State Statistical Bureau provides statistics of registered unemployment rates in the urban sector. Workers who are “laid off” (*xiagang*) from state and collectively owned enterprises are technically not considered to be unemployed. But some economists have made estimates of numbers of laid off workers in recent years. These estimates are available in Mo (2002), Yang (1997, pp. 218–221, 2000, p. 150), Yang and Li (1998, p. 144), Liu and Gao (1999, pp. 299–304), and Zeng (1999, p. 524).

^aRatio of the sum of the registered unemployed and unemployed laid off workers to the urban labor force.

^bData for the laid off workers in 2000 and 2001 are for the state sector only.

market-oriented reform, generated large number of protests and social unrests, and raised serious questions to the current strategy of reform (He, 1998).

Many economists argue that state and collectively owned enterprises are fundamentally inefficient. A large section of the workers in these enterprises are unemployed in a disguised manner and have to be laid off in order to improve efficiency. These arguments are not universally accepted. State and collectively owned enterprises play important social functions and their performance may be improved without privatization and large-scale layoffs. In this paper I will argue that by pursuing active macroeconomic policies and raising the level of aggregate demand, the productive efficiency of state and collectively owned enterprises can be improved and a substantial part of the so-called disguised unemployment in these enterprises can be eliminated without large-scale layoffs.

Section 2 of the paper presents the mainstream arguments of inefficient state and collectively owned enterprises and disguised unemployment. The section also discusses some criticisms of the mainstream arguments. Section 3 develops an alternative interpretation. It argues that the underutilization of the labor force in state and collectively owned enterprises may be caused by insufficient aggregate demand and an increase in the level of aggregate

demand could lead to higher productivity and eliminate at least a portion of the disguised unemployment. Section 4 tests the hypothesis using data of Chinese industrial enterprises with independent accounts. Section 5 discusses the likely effects of expansionary macroeconomic policies on productivity and employment. In the long run, certain institutional changes (such as egalitarian income and wealth re-distribution, securing the economic and social rights of workers and peasants, and tax reforms) are required to sustain the demand expansion. Supply-side policies to improve productivity and employment are also considered. Section 6 concludes the paper.

2. STATE AND COLLECTIVELY OWNED ENTERPRISES AND “DISGUISED UNEMPLOYMENT”

(a) *State-owned enterprises: the mainstream critique*

The mainstream literature on the Chinese economy argues that public ownership of capital is in fundamental conflict with the basic requirements of a market economy. While the market economy requires separation of government and business, state ownership by its nature implies intimate relationship between

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