Journal of International Development
J. Int. Dev. **22**, 758–771 (2010)
Published online in Wiley InterScience
(www.interscience.wiley.com) DOI: 10.1002/jid.1726

A DEFINING MOMENT? CHINA'S SOCIAL POLICY RESPONSE TO THE FINANCIAL CRISIS

ARJAN DE HAAN*,†
Institute of Social Studies, The Hague, The Netherlands

Abstract: This paper discusses whether China's response to the 2008–2009 financial crisis is a 'defining moment', whether it is leading to a departure of China's export-driven development model and whether the large stimulus package is strengthening its social policies and leading towards a more egalitarian structure. Two years after the crisis, it seems China has been very successful in managing the crisis, reaffirming political legitimacy, monitoring potential social unrest and introducing a wide range of promotive measures, even though this did not imply the sudden shift to promotion of household consumption some observers were arguing for.

Keywords: financial crisis; stimulus package; social unrest; social policy; harmonious society

1 INTRODUCTION

Crises are often defining moments in public policies. The Great Depression in the US led to the New Deal, and a redefinition of the social contract between the government and its citizens, but was also accompanied by protectionism which severely prolonged the economic crisis. The 1997–1998 Asian crisis led to new social protection policies across the region, but also the resolve to become less dependent on global fluctuations, and advice of the International Financial Institutions.

This paper explores whether China's response to the 2008–2009 financial crisis is such a defining moment. There was probably no country outside the OECD where the global

*Correspondence to: Arjan de Haan, Institute of Social Studies, Kortenaerkade 12, 2518 AX The Hague, The Netherlands. E-mail: dehaan@iss.nl
†This analysis is based on 3 years of experience as DFID social development adviser in Beijing. The current work at ISS is embedded in a research project codirected with Peter van Bergeijk and Rolph van der Hoeven, on 'A Crisis of Capitalism? A Crisis of Development!' The paper was first presented at the DSA conference in September 2009, and I am grateful for the stimulating feedback from participants and comments from two anonymous referees.

economic crisis hit harder and sooner than in China, even though its banking sector was relatively protected. The impact was most severe in the areas that were previously the most dynamic parts of the global economy: tens of thousands of factories closed down throughout 2008, and 20 million jobs were lost by February 2009. But public optimism that China would be able to 'weather the crisis' was maintained, and indeed in the second half of 2009 recovery did set in.[1]

The question this paper addresses is whether the crisis is likely to lead to a departure from China's export-driven development, and its impact on millions that have been involved in one of history's most dramatic economic transformations. China's response also has an enormous global impact, including on the rest of the Global South where development is determined increasingly by China's rise.[2] China plays a role in maintaining global financial stability but is looking to reduce global financial imbalances alongside its domestic stimulus and play a larger role in the international financial institutions.

The focus here is the domestic social policy response to the crisis, with an aim to contribute to the understanding of how social policies evolve and their congruence with economic policies and reforms. It assesses the policy response along the social policy framework as proposed by UNRISD and used in my *Reclaiming Social Policy* (de Haan, 2007), exploring how these characteristics are articulated during the crisis, including the project to build a 'harmonious society' now using the stimulus package, a change in growth model away from coastal-based export-promotion towards an inward-oriented model and the potential of an extended and more egalitarian social security system.

2 THE NATURE OF THE GLOBAL FINANCIAL CRISIS AND THE EMERGING ECONOMIES

Causes, manifestations and impacts of the global financial crisis that erupted in 2008 have been well documented, with the ILO estimating an increase in unemployment of 40–60 million,[3] and the World Bank that 89 million more people are trapped in poverty (Lin, 2009). The 2008 financial crises started in the US and rapidly impacted the rest of the world, including emerging market economies. 'Global financial intermediation is broken', wrote Alan Greenspan in *The Economist* of 20 December 2008. Cracks in the system had appeared in August 2007 with subprime mortgage problems, and this turned into a full-blown financial crisis in September 2008 with the default of Lehman Brothers. The stock market wealth may have declined by around 50 per cent, and $1 trillion of private capital flows to developing countries may have evaporated.[4]

The picture at the end of 2009 was that after the collapse there have been 2 years of severe economic downturn, with recovery expected in 2010. A preliminary UN forecast in October 2009 suggested a decline of the global economy of 2 per cent in 2009, and a recovery to 2 per cent growth in 2010, while world trade declined by 13 per cent in 2009

[1]It needs to be emphasised that this paper was drafted and revised as events were evolving very rapidly, with at the beginning of 2010 ever-greater optimism and recognition that China was weathering the crisis very well.
[2]Cook and Lam (2009), Kaplinsky and Messner (2008), Kaplinsky et al. (2006); a broader discussion of the theme of the rise of China is provided in de Haan (2009).
[3]Estimate May 2009; www.ilo.org/global/About_the_ILO/Media_and_public_information/Press_releases/lang-en/WCMS_106525/index.htm (accessed April 2010).
[4]Krugman (2009) describes the 2008 crisis against earlier crises of the 1980s and 1990s; also see UN Commission of Experts (2009) on www.un.org/ga/president/63/commission/financial_commission.shtml, and the World Bank (2009) 'crisis talks' website at http://crisistalk.worldbank.org/ (accessed July 2009).

DOI: 10.1002/jid

and is expected to pick up again to 5 per cent growth in 2010 (Vos, 2009). In August 2009 surprising news came out that France, Germany and Japan were exiting from recession, and unemployment figures in the US were also are starting to appear less bad than previously thought. There are doubts about how significant and sustained the recovery would be, and whether this was a recovery of the real economy or driven by government stimulus.

Of course, global impacts have been highly heterogeneous, across countries even within the OECD, and within countries. Crises are expected to have a particularly negative impact where people have fewer resources to cope with the crisis, social policies are too weak to respond adequately and economic policy instruments are limited. Throughout 2009, Africa and East and South Asia were still expected to maintain positive growth (2, 4 and 5 per cent, respectively), and also to pick up in 2010, while Latin America fared worst. Developing countries' exports declined. While global FDI has declined since 2008, developing countries were still expected to see a growth of 7 per cent, with the expectation for Asia at 6 per cent. International (net) private capital flows to emerging markets alone reached \$929 billion in 2007 but were expected to fall to \$165 billion in 2008.[5]

Governments' responses to the economic crisis have been forceful, and very different from the crisis of the 1930s, and indeed different from the advice that was given to East Asian governments after the 1997–1998 crisis. The focus has been to restore global financial stability, through large-scale government interventions across the world, and many measures introduced in response to increasing unemployment, and to support housing markets.[6] The fiscal stimulus is expected to be around 4 per cent of the world's produce, one-third of which emanates in the US and one-quarter in China – contributing to a huge increase in public debt, with medium-term consequences.[7]

The crisis once again highlights the extent of global interconnectedness including for the emerging market economies. The debate about the decoupling of emerging economies re-emerged after the onset of the crisis, with some observers seeing signs of greater independence of emerging economies or even 'de-globalisation' (Kose and Prasad, 2009). While developing countries may be badly affected by the crisis – particularly if the international community fails to provide the required additional support – emerging economies were expected to overcome the impact of the crisis relatively quickly, as the crisis did not emerge because of their bad policies, their banks generally have not been directly impacted, and they built up resilience after the 1997–1998 East Asia crisis (Naudé, 2009).

China illustrates these dynamics most clearly, with growth expectations remaining at 6 per cent and moving back to 8 per cent – the official growth target, deemed necessary for national stability – and exports showing gradual recovery from mid-2009 onwards. To understand both the immediate impact on and China's resilience to the crisis, it is important to highlight the way it has been integrated into the global economy.

3 CHINA'S ROLE IN THE CRISIS AND GLOBAL ECONOMY

China has rapidly become – again – 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.

[5]Data from Vos (2009), Filippov and Kalotay (2009) and *The Economist*, 7 February 2009.
[6]Zhang et al. (2009a) describe the social protection component of the crisis response in 49 countries.
[7]Vos (2009), Burtless (2009); public debt has been estimated at \$50 000 per person in the 10 richest countries or 114 per cent of GDP in 2014 (*The Economist* 13 June 2009).

DOI: 10.1002/jid

While still a lower middle-income country with a per capita income of around $2000, it has experienced three decades of intermittent high-level growth. Recent years saw economic growth of over 10 per cent per year, and when cracks in the international financial system started to appear, China's economy was overheating, followed by a government response to slow the economy down.

China's performance over the last 30 years has taken place under a developmental state, which has kept 8 per cent as growth target, and successfully implemented a series of economic and public policy reforms.[8] Growth was driven, first, by land reform and agricultural growth, and later rural industrialisation, based on the social and infrastructural development of the pre-reform period. Alongside capital formation, exports have been a main driver of recent economic growth, forming over a third of GDP recently, and about 7 per cent of total world trade in 2005, approaching 10 per cent post-crisis. While exports have been mainly in low-technology products, the share of high technology is growing and already substantial.[9] Foreign investments in China played an important role for its exports, and over time policy moved from joint ventures towards allowing wholly foreign-owned companies. The 2008–2009 crisis led to declining FDI during 2008 and 2009 (World Bank, 2009). Exports declined throughout 2009, by about 10 per cent, but experienced a rebound in the second part of the year (World Bank, 2010).

China developed large surpluses in current, capital and financial accounts for many years, and accumulated huge international reserves, which with the financial crisis has become a major concern and point of debate, but that (like other BRICS) put China in a strong position to deal with the consequences of the 2008–2009 crisis.[10] Capital flows and exchange rates continue to be controlled. The limited openness of the financial sector helped to reduce the direct impact of the global financial crisis on China, but the stock market was heavily affected.[11] China has also become an important investor abroad, by both private and state companies (doubling in number between 2003 and 2006), and supported by government policy. This has happened in natural resources, where it had a big impact on global prices before the crisis, and China continues to invest heavily now prices have dropped. These outward flows are a small percentage of total global flows and Chinese investment nationally, but the trend is unmistakable.

China's role in Africa has attracted much attention, even though the Asia region is much more important for China. Trade between China and Africa increased rapidly, to over $100 billion in 2008, which makes China Africa's third largest trading partner. China's main imports from Africa are oil and gas; while exports to Africa include machinery, vehicles, textiles and other manufactured products. Foreign direct investment in Africa grew to $26 billion in 2007, even though it remained a small part of total FDI in Africa (3 per cent in 2007) and of China's total outflows (6 per cent). Cook and Lam (2009) describe the

[8]See, for example, Zhang *et al.* (2010). A key aspect of policy reform in China is its gradual and decentralised nature. Policy reforms are piloted, and scaled up when successful and politically feasible, with locally specific rules. Policy-making is evidence-based ('scientific development'), and development 'de-politicised'. A developmental state is here defined simply as a government which focuses on national development of the economy rather than mere regulation; there is no presumption that there is just one type of developmental state, and China's experience is of course very different from Japan's; full discussion of this is beyond the scope of this paper.
[9]China developed an export bundle resembling a country that is four times as rich (Prasad, 2009, p. 120). However, as an anonymous referee pointed out, as processing trade is very high in China, trade data may not properly represent technology development. Processing exports were hit particularly hard by the crisis (World Bank, 2010, p. 4).
[10]International reserves are estimated at over $2 trillion. Fiscal revenue was estimated at $1 trillion at the turn of 2009–2010, with an increase of 12 per cent over 2009 (*China Daily*, 11 January 2010).
[11]Fan (2008). The Shanghai stock market fell by 48 per cent between May and November 2008. The Chinese banking sector appears to have been little affected, but faulty information may be distorting the picture.

DOI: 10.1002/jid

possible effect of the crisis on the impact of China on Africa, expecting the relative importance of China will continue to increase, while Zhang *et al*. (2009b) highlight the search for new opportunities as a key element of China's crisis response.

It is of course too early to form a view on the extent to which the crisis is changing China's insertion into the global economy. The judgement by *The Economist* (13 June 2009) that we witnessed the end of export-led growth was shared by many Chinese officials. The economic stimulus package was seen not only as a temporary counter-cyclical policy but also as a restructuring of its economic model, promoting domestic consumption. We describe this government response later, but first turn to the social policies that have accompanied China's economic success of the last three decades.

4 CHINA'S SOCIAL POLICY UNDER 30 YEARS OF REFORM

China's social policies since the start of the economic reforms have been marked by a close congruence with its economic policies and ideology.[12] China's social policy, like East Asia's has a strong 'productivist' focus. Social policies have been pro-active – but selective – designed to play a key role in its pattern of economic growth and entry to global markets, and in nation building. Egalitarian norms predominate in public debate, often under authoritarian practices, with a focus on productive opportunities, and based in Confucian perceptions of the family as main provider of welfare.[13]

Public spending including in sectoral allocations to social sectors are tightly controlled.[14] Provisions are strictly targeted, with tight eligibility criteria, and supported by a very low poverty line (which was recently increased to a level close to the international $1.25/day line). Social spending has remained low and often skewed to sections of the working population, mostly in urban areas, but excluding migrant workers. Labour is tightly controlled, and rights of migrants remain restricted.[15] However, the state continues to be seen as the guardian of public welfare, with a strong emphasis on the productivity of public investments, rather than seeing it as merely residual spending.

Social policy changes in China are driven by two sets of dramatic changes. The first is the radical demographic shift from rural to urban areas. In the 1980s/1990s public policies came to focus on enabling moving out of agriculture, but current health and social security reforms also have strong rural components, alongside targeted anti-poverty programmes. Increasingly, ageing of the population is playing a role, leading to an urgent need for pension reform (Salditt *et al*., 2007).

Second, the economic reforms have implied a radical privatisation of the economy, and the 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 of education, health and social security – leading to extremely high rates of

[12]The following builds on the social policy framework of UNRISD (Mkandawire, 2004, UNRISD, 2006), Gough (2008), de Haan (2007, forthcoming-a) and de Haan and Sabharwal (2008). Social policy is defined as the broad set of public interventions and institutions that intentionally enhance well-being, and as complementary (rather than residual) to economic policy.
[13]Kwon (2005), Cook (2009) and London (2009).
[14]According to Song (2009) inclusion of extra-budgetary revenues would lift the fiscal revenue figure above that of many OECD, and fiscal revenues doubled from 10 to 20 per cent between 1998 and 2008; this makes the state's importance much larger than the international figures suggest.
[15]Global market integration is helping to change this; China's signing of ILO conventions have contributed to addressing rights of migrant, child and bonded labour.

DOI: 10.1002/jid

household savings, and probably substantial churning in poverty status as when particular healthcare costs became prohibitively high for large parts of the population. Social security coverage in the new and international enterprises has remained low and uneven.

While the 1980s focused on privatisation and economic growth while accepting increasing inequality, during the late 1980s and 1990s the forces for strengthening public services started to grow, resulting in reforms in education, health and social security. The change in political leadership in 2002 was a turning point towards more equitable social policies. Reforms under the 'harmonious society' banner became the Party's response to fear of social unrest.[16] Health crises like SARS gave further push for more effective public policy. Policy is clearly responding to political and citizens' pressure, with a focus on both better services and addressing corruption.

Social policies are evolving in tandem with rapid institutional change. These include a re-articulation of public and private spheres related to opening up of markets, decentralisation of public finance that has made funding for social provisions regressive and the reframing of rights for migrants workers breaking through the dualism of the *hukou* (household registration) system. Health reforms imply changing power balances between ministries of health and civil affairs, and the discussions on the forms that social provisions had to take (national health care vs. social insurance) is shaping the relationship between states and citizens.

Around 2008, thus, there was a very mixed picture of China's social policies. While responding to China's great transformation, and inevitably shaped by institutions and power constellations, notably the urban–rural dualism, there is a move towards (or return to) universal social policies. The policy shifts were based in and articulated strong notions of equity and of the idea of state responsibility for the welfare of the entire population; they were also an evident response to fears of social unrest. Fiscal prudence and an ideology of economic contribution rather than welfarism continued to dominate the thinking about social policy. This set the scene for the immediate and impressive response to the crisis in 2008, which is described next.

5 CHINA'S RESPONSE IN 2008–2009

China's banking sector remained largely isolated from the financial crash, and throughout 2009, optimism that China would be able to weather the crisis was maintained. But exports and thus employment took a deep plunge in 2008, which inevitably spurred much policy attention. Graduate and registered urban unemployment had been rising for some time, though estimates of unemployment in China remain unclear. Quantitatively the biggest impact was on factory employment, with estimates that 67 000 factories closed during the first half of 2008. Local newspapers suggested 6.7 million jobs disappeared in Guangdong, and government officials in Chongqing estimated 10 000 migrants a day were returning early before Chinese New Year. The generally accepted number of job losses became 20 million.[17] Most of the unskilled newly unemployed workers were migrants, who – as was widely reported – were expected to return to their areas of origin, though about half were

[16] This is described in more detail in a forthcoming article in the *Journal of Current Chinese Affairs* (de Haan, 2010). See Yu (2007) for a discussion of the social unrest. Other major government initiatives under the Hu-Wen leadership includes the 'new socialist countryside' and the review and reforms of migrant workers' issues.
[17] This number was generated by the Ministry of Agriculture, and based on focus groups discussions; see Schuchter (2009) for a detailed description of unemployment figures.

DOI: 10.1002/jid

found to have remained in cities till after the Spring Festival and very few engaged in rural employment (Cai *et al*., 2010, p. 37).

The return of migrants was closely monitored, because of the fear of social unrest.[18] Observations suggested that young migrants were often not returning to their villages but to local county towns. Many workers returned early from the New Year holidays in search of jobs, closely monitored by officials and police. Besides unemployment, a distinctive trend of worsening labour conditions as a result of the crisis has been observed, including measures to reduce statutory labour costs in an effort to maintain jobs as much as possible.[19] The crisis is likely to have sharpened tensions in the reproductive sphere, because of increased pressure on migrant workers with impacts on children and elderly, and increased pressure on women in labour markets enhancing their burden. But overall, the rural sector has appeared to function as the proverbial safety net at the time of crisis.

China's response to the crisis was one of a developmental state, with centralised responsibility for national development, while maintaining principles of decentralised policy implementation. Despite heavy blows to the export industry, China had the fiscal and macroeconomic space to implement a substantial stimulus, and appeared well prepared for the crisis.[20] First, alongside measures to stabilise housing and stock markets, changes in financial policy were very significant, at least as important as the fiscal response that is central to this section. Loosening of credit policies led to more than a doubling of new loans in 2009 compared to the previous year. According to some, this led to a speculative bubble and was followed by reductions in lending from mid-2009. But the new loans issued by subnational institutions have been very significant indeed.

Second, currency policy has been subject of much discussion. Even though the Rmb had appreciated over the last couple of years, its current level is still thought to be relatively low, supported by China's interventions to back the dollar and promoting China's exports, though China vehemently denies allegations that it 'manipulates' the currency. This is likely to continue to be central to the international debate as global imbalances continue to exist. If not caused by it the debate has been more heated as a result of this crisis.

Third, the government introduced a range of other economic measures in response to the crisis, including a reduction in taxes, a series of changes in value-added tax rebates to reduce costs and promote exports, and before Chinese New Year 2009 vouchers for purchase of consumer goods were distributed. Again, these measures can be seen as practical changes to the careful economic policy instruments, also balancing different vested interests: for example, the tax rebates were previously used to slow down the economy,[21] while reduction of taxes particularly for farmers has been government priority for some time.

Finally, soon after the global crisis unfolded, and with impact on skilled and un-skilled employment felt earlier, China introduced a large stimulus package, of Rmb 4 trillion Yuan ($586 billion) over 2 years, by some calculations 12–16 per cent of 2008 GDP (or 6–8 per

[18]Unrest did not occur on a reported large scale. Protests appear to have been limited to factories. The ethnic tension and violence at one Guangdong toy factory was arguably related to job losses.

[19]http://flaglobalaction.blogspot.com/2009/05/china-answers-global-crisis-with-new.html. The Ministry of Human Resources and Social Security urged employers to avoid or reduce mass layoffs by reducing wage costs, placing workers on leave or 'flexible working arrangements'. The State Council advised local governments to cut employment costs temporarily by reducing or suspending social security premiums.

[20]Zhang *et al.* (2009) provide a chronology of the crisis response, emphasising that preparation for this was already on the cards before the Beijing Olympics.

[21]For example, to restrain exports, China eliminated or reduced tax rebates for 2800 products in July 2007 (*China Daily*, 20 June 2007).

DOI: 10.1002/jid

Table 1. China's stimulus package

	Billion Yuan	Percent of total package
Public infrastructure	1500	38
Earthquake reconstruction	1000	25
Social welfare	400	10
Rural development	370	9
Technology advancement	370	9
Sustainable development	210	5
Educational and cultural	150	4
Total	4000	

Source: NDRC March 2009; http://www.eeo.com.cn/ens/finance_investment/2009/03/07/131626.shtml; compare also Zhang *et al*. (2009b, p. 14).

cent on an annual basis). Most commentators agree that the real size of the package is less clear than the precise figures suggest. There are doubts about how much of the money is new money, or public funding that had been committed earlier (including for reconstruction after the May 2008 earthquake in Sichuan, also part of China's 'Western Development Strategy'). The package is not entirely a financial injection from the central government, as central funding is matched by contributions from (semi-) private sources and lower level government.[22]

While the government put much emphasis on boosting consumption as a rationale for the public policy response, the stimulus package had a heavy emphasis on infrastructure, as Table 1 shows. While income assistance forms more than half of the US's immediate stimulus package (Burtless, 2009), in China it is a mere 10 per cent. This is justified by the need to insert money into the economy quickly, and investing in infrastructure has been one of the strengths of China's economic model. However, physical investments have proven to have insignificant effects on increasing employment.[23] Some have argued that investments surged into high polluting and energy intensive projects.[24] China's growth model has been skewed heavily towards investment (more than half of GDP in the decade), while households are saving about a quarter of their disposable income and private consumption is only about one-third of GDP. While investment growth in the first half of 2009 was over 30 per cent, increases in sales of (industrial) goods were negligible – while crises in themselves of course make it less likely that households start spending more and save less.

At the same time, the government promised more than investment in infrastructure; it also enhanced promises for social sectors and attempts to promote household spending. Education was emphasised as part of the response, particularly vocational training and education of migrant workers.[25] While the crisis brought concerns about conditions in rural areas (and probably a realisation that the envisaged rural–urban transition is likely to slow down) it reinforced the efforts over the last years to improve conditions. More investment in

[22]The World Bank (2010) estimated that increase in government-led spending was about 6 per cent of the 2009 GDP, but emphasized that only a small part of the stimulus was reflected in the budget (but total new bank lending amounted to a massive 30 per cent of GDP). As a result, China's budget deficit increased from 0.4 per cent in 2008 to 2.8 per cent in 2009.
[23]Yang (2008) and Cai et al. (2010) simulate different investment scenarios, using an input–output methodology.
[24]http://www.eeo.com.cn/ens/feature/2009/07/10/143395.shtml.
[25]For example, during the China Development High Level Forum in March 2009 (*China Daily*, 21–22 March 2009).

DOI: 10.1002/jid

affordable housing was announced. And in particular, the government announced additional spending of US$ 123 billion to promote a universal healthcare system. This implies a significant increase in the speed with which healthcare reforms are implemented, after a phase of experimentation and trialling in all 3000 counties. Precisely how much speeding up this implies is hard to assess as previous policy documents had remained vague about implementation. In any case, the investment in health services post-crisis are made possible by the previous very cautious health reform, which have set in place the infrastructure which now allows absorption of increased funding.

The stimulus package attracted a fair amount of criticism, and indeed some of the announcements in the social sector appeared to be a reaction to this. Investment in social sectors is considered too low by analysts like Tang Min who argues that funding for social welfare should go up to 35 per cent of government revenue (which compares with 10 per cent of the stimulus package).[26] The investment in construction and equipment might even reduce access to healthcare facilities, because of health institutions' incentives to recover costs. There is much doubt about the extent to which the stimulus package will be able to reduce the high savings rates of households. In any case, the directions for China's social policy post-crisis were not fundamentally different from those of the past, with some of the labour regulation in fact going in reverse. While the commitment to increase household consumption definitely exists, the public policies – in line with the 'productivist' tradition of China's developmental state – continue to be cautious about pumping more money through the emerging healthcare and social security institutions.

6 LESSONS FROM PREVIOUS CRISES

Reinforcing the belief in China's continued economic growth, and showing leadership during crisis, Hu Jintao stressed: 'Crisis creates opportunities, and we shall put more efforts into technological upgrading, and build up of technology reserves for the future' (*China Daily*, 30 June 2009). The crisis has been seen and presented as an opportunity to invest in long-term objectives like skill development and green technology. This section discusses some lessons of past crises and speculates about possible impacts in China.[27]

Much knowledge has been accumulated about crises responses, as the references to lessons learnt from the Great Depression in the US and elsewhere indicate. The burgeoning literature on social protection provides evidence on what has worked and what not, and this knowledge was quickly mobilised after the crisis. East Asia including China has drawn conclusions from the 1997–1998 crisis (Stiglitz, 2009), and Kwon (2009) highlights the feeling that South Korea was much better prepared for the crisis in 2008. After 1997, although China was not as much affected as it is now, the government concluded that it needed to enhance its fiscal position while avoiding the continued recession Japan fell into.[28]

[26] *China Daily*, 3 April 2009. Guan Xinping and Ding Yuanzhu argued that the government needs to invest more to educate and train youth and unemployed, speed up establishment of basic social security system, strengthen public services and creating effective social demand as permanent cure for crisis (*China Daily*, 24 June 2009).
[27] The description of lessons of past crises is based on a workshop organized by DFID China on request of State Council's the Development Research Centre, Beijing, February 2009 (see Sen, 2009).
[28] Jia (2009) discusses China's 1997 response, after 10 millions jobs were lost, and Premier Zhu Rongyi's promise to maintain 8 per cent growth, and (effective) use of fiscal stimulus.

DOI: 10.1002/jid

While the literature emphasises that policies to mitigate the impact of crises need to be in place before the crisis hits, it is of course true that during crises there is insufficient time or administrative or fiscal capacity to design good policies. Moreover, natural crises often accompany economic ones, such as droughts during the both the Great Depression and the Asian Financial Crisis, and the food price crisis before the 2008 crisis. The evolution of the New Deal in the US during the 1930s illustrates the large number of initiatives and agencies that were established, and only few were successful (Mitchener, 2009). China appears an unusual case, as social security and health services have gradually been expanded, providing an ideal venue for absorbing increased funding, even though it is unlikely that the fiscal stimulus will have an immediate large impact.

Evidence from previous major downturns suggests crises are not merely cyclical phenomena, and they are seen as windows of opportunity and catalysts of political commitment for change. The New Deal in the US meant a radical transformation, not only in terms of an increase of government as a share of GNP: the relationship between the federal and state and local governments was also irrevocably altered by 1935, including improved coordination and public finance (Mitchener, 2009). After 1997–1998, Thailand put in place a wide range of supportive measures including expansion of health care and pensions for the poor, and mobilised civil society and the private sector (Teokul, 2009). In Indonesia, the economic crisis was followed by social mobilisation which contributed to democratisation, while decentralisation and local decision-making were strengthened. These institutional changes were critical to the new social protection measures put in place (Murniningtyas, 2009). In the case of China, it appears that the crisis was effectively used as an opportunity to reaffirm leadership, as indicated above.

Measures put in place during crises can have long-term implications. FDR's 1935 statement 'I place the security of men, women, and children of the nation first' is a symbol of radically different public responsibility and policies. 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 society not only in terms of government spending but also in terms of perceptions of state responsibility and relations between central and local government. The East Asia crises in 1997–1998 have led to a range of initiatives in financial and banking sectors, and around monitoring impacts of economic changes, and new policies of social protection, many of which appear to be there to stay.

Crises are the time when the critical role of social policy alongside economic policy (rather than being 'residual') comes to the fore, both as an economic stabiliser 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 crisis, even though the notion of the welfare state as an instrument for economic development still exists. The crisis triggered a range of responses, including increasing social spending, and a rapid response to establish social protection instruments. The crisis contributed to a new social consensus for economic reform alongside strengthening the welfare state, and new inclusive policy institutions such as a tripartite committee to promote reform, integrated national health insurance cooperation and a notion of social rights under-building the welfare state (Kwon, 2009). Crises, thus, tend to galvanise the forces for progressive social policies and can promote consensus for more inclusive policies.

DOI: 10.1002/jid

7 IS THE CRISIS A TURNING POINT FOR CHINA?

Three interrelated aspects of the government's response suggest a turning point in China's development policies, within the contours of the reform strategies of China's developmental state. First, the global financial system is of considerable concern to China, and its strategy is unlikely to be the same as in the past. While it is stressed in China that the financial crisis was the fault of the US, China's accumulation of reserves was a considerable part of the system that fuelled the US's borrowing. Calls for an alternative reserve currency may be more symbolic than realistic in the near future, but the new interdependence has been clearly demonstrated by the US's efforts to reassure Chinese partners of the safety of their deposits. The crisis did not cause this interdependence – globalisation since 1978 has – but it has made it remarkably clear, and helped to fuel economic nationalism in China.

Second, the crisis suggested that China's export model of growth – which started in the early 1990s and was reinforced after 1997/1998 – is no longer sustainable (Song, 2009), not only because levels of demand will not return but also because of shifting production. The realisation was evident in the earlier efforts to slow down the export economy, and as indicated the responses suggested that economic policy makers were already prepared for such a reversal, and that a new economic strategy could be an unavoidable complement of its harmonious society. The optimism shown by China's leaders is of course political, but so far the strategy seems to hold. The way the response unfolds will continue to be informed by the different vested interests in the export economy and elsewhere, and by the path dependence of the productivist and infrastructure orientation that has marked public policies since 1978.

Logically following this, third, is a strengthened emphasis on promoting domestic consumption. The expansionary fiscal policy has a strong focus on infrastructure, directly in line with approaches to western development and post-earthquake reconstruction. But there is also an increasingly strongly felt need to expand social services, for which the foundations have been laid over the last few years. At the same time, there is much continuity, and the changes are mitigated by the early recovery. The economic growth target continues to be central, and infrastructure investment and promoting exports remain cornerstones. Social spending continues to be low, but slowly creeping upwards. The gradual universalisation of health and education built on policy initiated before the crisis has been boosted by both the 'harmonious society' project and the crisis. The weak social insurance and unemployment system can only be reformed in the medium term, and so far China has not managed to create the automatic stabilisers that such insurance can provide, and efforts remain locked into the dualistic social policies that largely exclude migrant workers. The changes thus may be less dramatic than those of the New Deal in the US in the 1930s. But at the same time moves towards a larger state responsibility for citizens' welfare were already part and parcel of the more equity-oriented policies introduced under the Hu-Wen administration.

China's economic and societal models are directly linked to the form of political control, with legitimacy directly contingent upon continued improving well-being and growth, and China thus far managed economic reforms successfully and pragmatically, consciously avoiding big-bang strategies. During the crisis, and under the political pressure of the Chinese developmental state, links between economic and social policies are being reformulated. China thus continues to reform its social policy instruments, under relative favourable fiscal conditions. The nascent social policy system may be able to absorb the

DOI: 10.1002/jid

new funding that is required, which has the potential to enhance equality or at least halt the rapid rise of inequality of the last two decades including the current systems of largely regressive fiscal transfers.

The way this evolves in China not only will 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. It will also have an impact on the global economy and will be cited as an example for the global south of the potential to manage the fluctuations of the global economy. As we are in the midst of China's dramatic economic transformation, with its unique pattern of pragmatic reforms, more questions are thrown up than may have been answered in this article. This paper is therefore a modest contribution to the analysis of how social policies evolve alongside economic reforms and growth, and how crises that are an integral part of the global economy influence these dynamics. As it stands, China's crisis response for many offers too little promise for social sectors and reducing inequality. But with an economic recovery that is impressive yet fragile it appears relatively successful, and significant changes are introduced in line with China's path of gradual reforms.

REFERENCES

Burtless G. 2009. *Social Protection for the Economic Crisis: The U.S. Experience*. Mimeo. The Brookings Institute: Washington, DC.

Cai F, Wang D, Zhang H. 2010. Employment effectiveness of China's economic stimulus package. *China & World Economy* **18**(1): 33–46.

Cook S. 2009. China's development model: What is there to learn? *DevIssues* **11**(1): 4–6.

Cook S, Lam W. 2009. *The Financial Crisis and China: What Are the Implications for Low Income Countries*? Mimeo. IDS: Sussex.

de Haan A. 2007. *Reclaiming Social Policy. Globalization, Social Exclusion and New Poverty Reduction Strategies*. Palgrave Macmillan: Basingstoke.

de Haan A. 2009. Will China change international development as we know it? *ISS Working Paper 475*, The Hague.

de Haan A. Forthcoming. *Towards a New Poverty Agenda in Asia. Social Policies and Economic Transformation*. Sage: New Delhi.

de Haan A. 2010. The financial crisis and China's Harmonious Society. *Journal of Current Chinese Affairs* **2**.

de Haan A, Sabharwal G. 2008. South and East Asian social policy experiences: institutions and governance in the extension of social security. *Indian Journal of Human Development* **2**(1): 63–78.

Fan M. 2008. The Global Financial Crisis and China. *IDS Briefings on the Financial Crisis*. Available at: www.ids.ac.uk.

Filippov S, Kalotay K. 2009. Foreign direct investment in times of global economic crisis: spotlight on New Europe. *Working Paper 2009-021*, UNU-Merit, Maastricht.

Gough I. 2008. European welfare states: explanations and lessons for developing countries. In *Inclusive States: Social Policy and Structural Inequalities*, Dani A, de Haan A (eds). The World Bank: Washington, DC, pp. 39–72.

Jia K. 2009. The active fiscal policy in China during the Eastern Asian Crisis (in Chinese). *Paper Presented at the Workshop 'Social Policy Responses to Economic Crises*', 23–24 February 2009, Beijing.

DOI: 10.1002/jid

Kaplinsky R, Messner D. 2008. Introduction: the impact of Asian drivers on the developing world. *World Development* **36**(2): 197–209.

Kaplinsky R, McCormick D, Morris M. 2006. The impact of China on SSA. *Agenda-Setting Paper Prepared for DFID*, Institute of Development Studies, Brighton.

Kose E, Prasad MA. 2009. Financial markets and emerging economies. The decoupling debate is back. *Foreign Policy.* Available at: www.foreignpolicy.com/story/cms.php?story_id=5010.

Krugman P. 2009. *The Return of Depression Economics and the Crisis of 2008*. W.W. Norton & Company: New York.

Kwon H-J (ed.). 2005. *Transforming the Developmental Welfare State in East Asia*. UNRISD and Palgrave Macmillan: Basingstoke.

Kwon H-J. 2009. South Korean Transformation Post-1997. *Paper Presented at the Workshop 'Social Policy Responses to Economic Crises*', 23–24 February 2009, Beijing.

Lin JY. 2009. Economic development and structural change. *Lecture at Cairo University*, 5 November 2009. Available at: http://siteresources.worldbank.org/DEC/Resources/CairoSpeech.pdf

London J. 2009. Welfare regimes in the wake of state socialism: Viet Nam, China, and the Market-Leninist Welfare Regime. *Paper for the Conference 'Asian Social Protection in Comparative Perspective*', Singapore, January.

Mitchener K. 2009. Experience from the great depression. *Paper Presented at the Workshop 'Social Policy Responses to Economic Crises*', 23–24 February 2009, Beijing.

Mkandawire T. (ed.). 2004. *Social Policy in a Development Context*. Palgrave Macmillan: Basingstoke.

Murniningtyas IE. 2009. Indonesia after the 1997 crisis. *Paper Presented at the Workshop 'Social Policy Responses to Economic Crises*', 23–24 February 2009, Beijing.

Naudé W. 2009. The financial crisis of 2008 and the developing countries. *UNU-WIDER Discussion Paper No. 2009/01*.

Prasad ES. 2009. Is the Chinese growth miracle built to last? *China Economic Review* **20**: 103-123.

Salditt F, Whiteford P, Adema A. 2007. Pension reforms in China: progress and prospects. *OECD Social, Employment and Migration Working Papers 53*, Paris.

Schuchter G. 2009. China's employment crisis: a stimulus for policy change? *Journal of Current Chinese Affairs* **38**(2): 121–144.

Sen G. 2009. Lessons for China – a reflection. *Presentation at the Workshop 'Social Policy Responses to Economic Crises*', 23–24 February 2009, Beijing.

Song L. 2009. China's fiscal policy responses to the current international financial crisis (in Chinese). *Paper Presented at the Workshop 'Social Policy Responses to Economic Crises*', 23–24 February 2009, Beijing.

Stiglitz J. 2009. The global crisis, social protection and jobs. *International Labour Review* **148**(1–2): 1–14.

Teokul W. 2009. Thailand: applying 1997's lessons to the current global financial crisis. *Paper Presented at the Workshop 'Social Policy Responses to Economic Crises*', 23–24 February 2009, Beijing.

UN Commission of Experts. 2009. *Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, Interim Draft*, June. Available at: www.un.org

UNRISD. 2006. *Transformative Social Policy: Lessons from UNRISD Research*. Research and Policy Brief 5. UNRISD: Geneva.

Vos R. 2009. After us the deluge? Current economic prospects and the future of globalization. *Presentation at ISS*, The Hague, 29 October 2009.

World Bank. 2009. *Quarterly Update, June 2009*. World Bank: Beijing. www.worldbank.org/china

DOI: 10.1002/jid

World Bank. 2010. *Quarterly Update, March 2010*. World Bank: Beijing. www.worldbank.org/china

Yang D. 2008. The impact of the financial crisis in China. *IDS Briefings on the Financial Crisis*. Available at: www.ids.ac.uk

Yu J. 2007. Social conflict in rural China. *China Security* **3**(2): 2–17.

Zhang Y, Thelen N, Rao A. 2009a. Social protection in fiscal stimulus packages: some evidence. *UNDP/ODS Working Paper*, New York.

Zhang Z, Li W, Shi N. 2009b. Handling the global financial crisis: Chinese strategy and policy response. Mimeo, Durham University. Available at SSRN: http://ssrn.com/abstract=1377049

Zhang X, de Haan A, Shenggen F. 2010. *How Does China Cross the River? Narratives of Chinese Reforms*. World Scientific Publishing: Singapore and New Jersey.

DOI: 10.1002/jid