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**CHINA'S RESPONSE TO THE GLOBAL
FINANCIAL CRISIS: EXAMINING THE
INCENTIVES BEHIND CHINA'S STIMULUS PACKAGE**

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**NAVAL
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MONTEREY, CALIFORNIA

THESIS

**CHINA'S RESPONSE TO THE GLOBAL FINANCIAL
CRISIS: EXAMINING THE INCENTIVES BEHIND
CHINA'S STIMULUS PACKAGE**

by

Clement W. Herron

June 2018

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THE INCENTIVES BEHIND CHINA'S STIMULUS PACKAGE**

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Submitted in partial fulfillment of the
requirements for the degree of

**MASTER OF ARTS IN SECURITY STUDIES
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ABSTRACT

This thesis examines the incentives behind China's decision to implement its aggressive \$585 billion economic stimulus package in response to the global financial crisis, or GFC. The thesis assesses the explanatory power of economic, social, and political causal factors to explain China's decision. The main finding of this thesis combines all three factors to demonstrate that China's stimulus package was most likely implemented because the Chinese Communist Party (CCP) perceived that it was necessary to protect its regime. The economic argument demonstrates how China's government had to resort to an investment-led stimulus plan to generate economic growth through domestic demand after the GFC severely damaged China's export sector. The social argument establishes how tens of millions of people left unemployed by the GFC felt marginalized by the government due to the country's inequitable economic growth, which was perceived to have primarily benefitted the regime. This increased the potential for social instability, which would have been directed at the CCP. Lastly, the political argument determines how the regime was under significant political pressure to meet domestic and international expectations to sustain economic growth throughout the GFC. These findings underscore how the CCP prioritizes regime survival over long-term economic development.

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LIST OF ACRONYMS AND ABBREVIATIONS

AFC	Asian financial crisis
AIG	American International Group
CASS	Chinese Academy of Social Sciences
CCP	Chinese Communist Party
CDO	collateralized debt obligation
CDS	credit default swap
GDP	gross domestic product
GFC	global financial crisis
IMF	International Monetary Fund
LIC	local investment corporations
NBSC	National Bureau of Statistics of China
NDRC	National Development and Reform Commission
PBOC	Peoples Bank of China
PRC	People's Republic of China
SDC	scientific development concept

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I. INTRODUCTION

A. MAJOR RESEARCH QUESTION AND KEY FINDINGS

Prior to the 2008 global financial crisis, China was in the process of enacting significant reforms designed to improve the efficiency of its market economy. Among these reform efforts, China forced its inefficient state-owned enterprises to downsize, furloughed millions of state workers, and spent trillions of yuan to restructure and improve the solvency of its banking sector. In response to the crisis, China initially implemented an aggressive 4 trillion yuan (over \$585 billion) economic stimulus package in November 2008, which ballooned to over double that amount (or nearly triple by some accounts) by 2010.¹ China's stimulus package was among the fastest issued and largest in size in the world, helping its country to sustain economic growth while most other countries endured deep recession. Funds from the stimulus package were primarily allocated to large infrastructure projects that would employ millions of laid off workers. Although the stimulus package provided a temporary economic boost within China, it impeded the progress of its previous reform efforts well after the crisis subsided. The package's loose monetary policy and increased bank credit, coupled with urgent state messages to spend, implanted a moral hazard into the banking sector, reversed efforts to make state-owned enterprises more efficient, and made China's economy increasingly reliant on investment—all putting China on a track toward unsustainable levels of debt.² With such stark consequences to China's stimulus package, what were the incentives behind China's decision to implement its aggressive economic stimulus package after the global financial crisis?

¹ Christine Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," *OECD Journal on Budgeting* 11, no. 3 (September 1, 2011): 13, <http://dx.doi.org/10.1787/budget-11-5kg3nhljqrjl>; Arthur R. Kroeber, *China's Economy: What Everyone Needs to Know* (New York, NY: Oxford University Press, 2016), 216.

² Barry Naughton, "China and the Two Crises: From 1997 to 2009," in *Two Crises Different Outcomes: East Asia and Global Finance*, ed. T.J. Pempel and Keiichi Tsunekawa (Ithaca: Cornell University Press, 2015), 113–117.

The main finding of this thesis demonstrates that China's global financial crisis (GFC) stimulus package was most likely implemented because the People's Republic of China (PRC) perceived that it was necessary to protect its regime. To arrive at this conclusion, this thesis assessed the explanatory strength of three arguments (an economic, a social, and a political argument) that examined the incentives behind China's stimulus package. Each argument provided valuable contributions to answer the thesis question, but none of the arguments had the individual explanatory strength to fully answer the question. All three arguments were necessary to develop a comprehensive explanation of what incentivized the stimulus package. The economic argument demonstrated how the PRC had to resort to an investment-led stimulus plan to generate economic growth through domestic demand after the GFC severely damaged China's export sector. The social argument established how tens of millions of people left unemployed by the GFC felt marginalized by the PRC due to the country's inequitable economic growth, which was perceived to have primarily benefitted the regime. This increased the potential for social instability which would have been directed at the PRC. Lastly, the political argument determined how the PRC was under significant political pressure to meet domestic and international expectations to sustain economic growth throughout the GFC. Collectively, the three arguments explained how the PRC hastily implemented the stimulus package to meet its domestic and international expectations, prevent social instability, and to retain its legitimacy.

B. SIGNIFICANCE OF THE RESEARCH FINDINGS

The PRC's willingness to enact policies to protect its regime, despite contradictions to its previously stated goals or intentions, will be underscored in this thesis. Also, understanding the incentives behind China's GFC stimulus package will help analysts refine their assessments of how the PRC may react in a future economic crisis. In a broader context, the incentives that affected China's stimulus package may be applicable to how other countries decide to either implement interventionist economic strategies during financial crises or endure through austerity measures. Additionally, this thesis helps to dismiss some common misconceptions, such as China's strict adherence to decades-long strategic master plans and the inability of China's populace to influence its authoritarian

government. Short-term drivers can significantly influence the PRC's decision calculus, causing a policy reaction that contradicts their long-term stated objectives. Furthermore, this thesis will emphasize how China's populace, despite being under authoritarian control, holds considerable influential weight over the PRC's policy decisions.

C. LITERATURE REVIEW

This thesis treats China's stimulus plan as the dependent variable and examines several potential causal factors for the decision to implement this stimulus plan. To do so, this thesis will utilize several aspects from the significant volume of literature about China's GFC stimulus package. For instance, this thesis will incorporate literature that describes the mechanics of how the Chinese government implemented its economic stimulus package following the GFC.³ This thesis will also use literature that describes China's stimulus plan in a context to compare the speed and scope of China's economic recovery with the rest of the global economy.⁴ Another major focus of the existing literature that this thesis will utilize pertains to China's stimulus plan as a start date to represent a shift in China's domestic economic strategy, generally within a broader context to predict the future success, slowdown, or even collapse of the Chinese economy.⁵ Debates between the effectiveness of the "Washington consensus" and a "Beijing consensus" often accompanies studies about China's GFC response, but they will not be included in this thesis.⁶

³ For one of the more comprehensive examples see: Barry Naughton, "Understanding the Chinese Stimulus Package," *China Leadership Monitor*, no. 28 (Spring 2009): 1–12. <http://www.hoover.org/research/understanding-chinese-stimulus-package>; and Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," 5–6.

⁴ International Monetary Fund (IMF), *World Economic Outlook April 2009: Crisis and Recovery* (Washington DC: International Monetary Fund, 2009); Barry Naughton, "China and the Two Crises: From 1997 to 2009."

⁵ Kroeber, *China's Economy*, 216–218; David Shambaugh, *China's Future* (Cambridge: Polity Press, 2016), 7–20.

⁶ Mu Yang and Michael Heng Siam-Heng, *Global Financial Crisis and Challenges for China* (Singapore: World Scientific Publishing Co. Pte. Ltd., 2012), 93–110; Gracia Abad, "The Beijing Consensus in the Shadow of the Global Financial Crisis," *UNISCI Discussion Papers* no. 24 (October 2010): 45–60.

This review will describe four broad incentives behind China's stimulus package that were observed within the literature. Each of these incentives has its own value in understanding China's response to the GFC, but they leave explanatory gaps that obscure a comprehensive understanding of the incentives behind the decision to implement the stimulus package. To illustrate this problem this literature review will first describe the economic incentives that affected China's stimulus package. The second incentive involves the social problems, caused by unemployment and inequality, that amassed in China up to the point of the crisis and the PRC's use of the stimulus package as a means to rectify those problems. The third incentive describes the political circumstances behind the stimulus plan's implementation. Lastly, the fourth incentive explains the possible role of corruption related to China's stimulus package.

1. Economic Incentives

The economic incentives behind China's stimulus package include three observed aspects described by the literature: the restrictive monetary policies between 2007 and 2008, China's strong fiscal status at the onset of the GFC, and how China's leadership believed in Keynesian economics. The first observed economic incentive pertains to the consensus within the literature that describes a sense of urgency on the part of China's leadership, while the financial crisis was unfolding abroad, to reverse the macroeconomic effects from the restrictive monetary policies enacted since 2007. Naughton broadly explained how the Chinese economy, as well as the global economy, experienced "unprecedented economic growth" before the financial crisis.⁷ However, Naughton continued, China's inflation surpassed 5 percent by July 2007 (and would reach over 8 percent by July 2008), which prompted officials to employ a restrictive monetary policy by reducing credit and permitting its currency to appreciate.⁸ Lardy, while not diverging from Naughton's overall explanation, described China's restrictive monetary policies in 2007 as a concentrated plan that took place for nearly a year and a half from January 2007

⁷ Barry Naughton, "China's Response to the Global Crisis, and the Lessons Learned," in *The Global Recession and China's Political Economy*, ed. Dali L. Yang (New York: Palgrave Macmillan, 2012), 16.

⁸ Naughton, "China's Response to the Global Crisis, and the Lessons Learned," 17.

through the summer of 2008 to slow the growth of the economy.⁹ To prove the concern among China's policy makers over its aggressive growth during 2007, Lardy evidenced the multiple times China's central bank increased the deposit reserve ratio and the five instances it raised its benchmark interest rate. Combined, the explanations by Naughton and Lardy offer a useful illustration of the scope behind China's effort to curb inflation before the financial crisis and the concern it caused amongst China's leadership. Yang and Jiang contributed to this dialogue by citing Wen Jiabao's warning in January 2008, well before the events of the GFC, that "2008 could be the most difficult year for our own economy."¹⁰

Collectively, this literature highlights that the program of restrictive monetary policies employed from 2007 through mid-2008 was a significant endeavor. As the financial crisis quickly unfolded in the fall of 2008, especially after Lehman Brothers went bankrupt in September, China's policy makers felt pressured to reverse their restrictive monetary policies and to stimulate some sort of domestic demand.¹¹ The literature suggests that China's stimulus plan was incentivized by a need to avoid an uncontrolled economic downfall due to the combined effects of the restricted money supply and an overall cut in the export sector from the worldwide decline in demand.

The second observed economic incentive pertains to a common argument within the literature that China had a relatively strong fiscal status at the onset of the financial crisis, which justified the allocation of significant capital toward a stimulus program. Christine Wong emphasized this argument by noting China's decision to fund a stimulus package in 1998, after the Asian financial crisis (AFC), when its fiscal status was comparatively weaker than it was by 2008.¹² Wong did not provide any comparative

⁹ Nicholas R. Lardy, *Sustaining China's Economic Growth after the Global Financial Crisis* (Washington, DC: Peterson Institute for International Economics, 2012), 7.

¹⁰ Dali L. Yang and Junyan Jiang, "Introduction," in *The Global Recession and China's Political Economy*, ed. Dali L. Yang (New York: Palgrave Macmillan, 2012), 2.

¹¹ Naughton, "China's Response to the Global Crisis, and the Lessons Learned," 17.

¹² Christine Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," *OECD Journal on Budgeting* 11, no. 3 (September 1, 2011): 5–6, <http://dx.doi.org/10.1787/budget-11-5kg3nhljqrjl>.

figures of China's fiscal revenue from 1998 and 2008, but the premise is sound considering the significant revision of China's tax policy in 1993 that shifted the preponderance of fiscal revenue to the central government.¹³ Wong did note that by 2008, China's budget deficit was below one percent of its GDP and the national debt was low at only 19 percent of GDP.¹⁴ Naughton also used the AFC as a comparison to highlight China's fiscal strength in 2008, but he attributed China's "prudent policies" emplaced after 1998 as a contributing factor behind that strength.¹⁵ To add to the argument of China having a strong fiscal status, Naughton listed China's reserve of two trillion U.S. dollars, a near balanced budget (echoing Wong's observation), the profitability of the state owned enterprises, and the reduction of the total amount of nonperforming loans in the banking sector at below five percent.¹⁶

The third observed economic incentive within the literature claimed that China's leadership believed in Keynesian economic theory and that the GFC presented itself as an opportunity to vindicate their beliefs. This claim relied less on hard data points for evidentiary support, but more on the perception and analysis of various authors. Jiang Yang coalesced this perception in her analytical piece which argued that China's stimulus program was evidently countercyclical in application, even if it did not produce the Keynesian effects of stimulating demand.¹⁷ While her overall argument is outside the scope of this thesis, her evidentiary support suggested that China's leaders, particularly Hu Jintao and Wen Jiabao, seemed to personally believe in Keynesian economic principles.¹⁸ This claim, if correct, would be a useful contribution toward the aim of this thesis, but it still leaves open the question of why would they believe in Keynesian principles. Or, even

¹³ Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," 5. See Figure 5. "Monthly fiscal revenue (year-on-year growth)."

¹⁴ *Ibid.*, 6.

¹⁵ Naughton, "China and the Two Crises," 118.

¹⁶ *Ibid.*

¹⁷ Jiang Yang, "Vulgarisation of Keynesianism in China's Response to the Global Financial Crisis," *Review of International Political Economy* 22, no. 2 (2015): 362. doi: 10.1080/09692290.2014.915227.

¹⁸ Yang, "Vulgarisation of Keynesianism in China's Response to the Global Financial Crisis," 372.

if they are not actual Keynesian idealists, what incentivized them to apply a such an aggressive Keynesian economic strategy in their response to the financial crisis?

These questions lead back to the original question behind this thesis and highlight the value of researching the incentives that affected the Chinese leaders' decision. One theory Yang proposed to the questions above involved another comparison to the AFC. Yang argued that China's policy makers considered the economic stimulus package it implemented in response to the AFC as a success, which earned their confidence in utilizing a Keynesian strategy to offset an economic decline.¹⁹ This argument only partially addresses the underlying question of why China's leaders initially had such an affinity toward Keynesian policies.

Yang's argument also highlights some explanatory differences in the literature amongst the various comparisons in how China responded to the AFC and GFC. Instead of focusing on the apparent success of China's stimulus package in 1998, Naughton used the two crises to highlight how successive premiers Zhu Rongji and Wen Jiabao each used their respective crisis as an opportunity to advance their overall economic agendas.²⁰ Naughton noted how Zhu Rongji, arguably the more market-reform oriented premier, used the AFC to essentially do nothing regarding its currency valuation and pushed ahead to implement further reforms to improve the private sector.²¹ Afterward, Naughton explained how Wen, arguably the more state sector oriented premier (a topic that will be further discussed), used the GFC to prove the value of state-led intervention.

Naughton's observation of the two premiers highlights how perceptions in economics can make it especially difficult to find possible answers to this thesis question. The World Bank published a report in 1999 that analyzed China's responses to the AFC. The report attributed success to the non-interventionist decision to maintain the yuan's value and complemented Zhu's market-oriented reforms, however, the report also praised the Keynesian approach to issue a \$12 billion stimulus package to stimulate domestic

¹⁹ Ibid.

²⁰ Naughton, "China and the Two Crises: From 1997 to 2009," 125.

²¹ Ibid., 125.

demand.²² The literature appears to be split over how the AFC influenced the outcome of the GFC's stimulus plan. On one side, the perception Jiang illustrated of Wen being influenced by the Keynesian aspect of the AFC's stimulus holds validity. On the other side, Naughton's observation of the two Premiers can be perceived to weaken Jiang's argument since there was a significant non-interventionist approach and pro-market agenda to Zhu's AFC response plan. Depending on the twist in perception, the agendas of both premiers can stake a claim in the success of China's response to the AFC. This perception difference shows how economics alone cannot fully explain this thesis question.

2. Social Incentives

The second observed incentive within the literature pertains to the social problems within China that may have influenced its GFC stimulus plan. There is ample literature that describes the various social problems that was evident throughout China at the time of the financial crisis, but Naughton's explanation of the Chinese people's sense of "reform fatigue" could act as an independent variable in this thesis. Naughton attributed the "unemployment, inequality, [and] corruption" throughout China by early 2000 as negative side effects of the market-oriented reforms prescribed by Zhu's premiership.²³ As Naughton explained, those negatively affected by those reforms thought the government had "broken [its] social contract" with the people.²⁴ This sentiment, Naughton continued, may have contributed to the shift toward state sector favored policies and increased government intervention during Wen's premiership. By 2008, the GFC became an opportunity for Wen to directly address the reform fatigue and further advance his state sector focused and interventionist economic agenda.

There are several different pieces of literature that supports Naughton's reform fatigue hypothesis. Joseph Fewsmith used survey data published in 2008 and 2009 from the Sociology Institute of the Chinese Academy of Social Sciences to assert that "social

²² *China: Weathering the Storm and Learning the Lessons*, (Washington DC: The World Bank, 1999), 17–18.

²³ Naughton, "China and the Two Crises," 128.

²⁴ *Ibid.*

stability” had declined throughout China before the financial crisis took place.²⁵ Fewsmith’s analysis adds evidentiary support to Naughton’s suggestion that there was a perception among the populace that the Chinese government broke its social contract. In one example that Fewsmith noted, the survey data reflected an unemployment rate of 9.4 percent, twice the amount of the officially published rate.²⁶ An important factor behind the higher unemployment rate, as Fewsmith explained, is that the survey included input from migrant workers. The migrant workers, not able to collect the various social benefits given to locally registered residents, and excluded from various official statistical figures, were likely a major sector within the surveyed populace that felt disenfranchised by the market-oriented reforms. Another example Fewsmith highlighted from the survey data was a low “sense of fairness” in subject areas like “employment, regional differences, and income disparities.”²⁷ One of the more notable figures from the survey data showed that only 28.58 percent of approximately 7,100 respondents in 2008 believed that fairness existed in the category “Income disparities,” an over 11 percent decline from the same survey and similar sample size from 2006.²⁸ Additionally, the “Development among regions” category reflected a sizeable sense of unfairness in the geographic distribution of wealth with only 37.7 and 33.6 percent of respondents in 2008 and 2006, respectively, believing that the conditions within the category was fair.²⁹

Other literature that advanced Naughton’s reform fatigue hypothesis includes arguments that highlighted the Chinese government’s recognition to address the country’s wide income inequality and lack of social security. Peter Nolan, whose piece was written at the onset of the GFC, explained why the Chinese government eventually recognized the need to address its social inequality problems and argued how the GFC could have increased “the possibility of socio-political instability” if those problems were left

²⁵ Joseph Fewsmith, “Social Order in the Wake of Economic Crisis,” *China Leadership Monitor*, no. 28 (Spring 2009): 1. <http://www.hoover.org/research/social-order-wake-economic-crisis>.

²⁶ Fewsmith, “Social Order in the Wake of Economic Crisis,” 2.

²⁷ *Ibid.*

²⁸ *Ibid.*, 2, (table 2).

²⁹ *Ibid.*

unchecked.³⁰ To prove China's stark inequality, Nolan noted how China's Gini coefficient increased from 0.28 in the 1980s to 0.5 by 2005.³¹ He also used figures from the World Bank in 2007 to show how China's top 1 percent of income earners accounted for 61 percent of the country's household wealth and how the top 0.1 percent accounted for 42 percent of household wealth.³² These figures Nolan presented give statistical backing to the survey data that Fewsmith highlighted, especially since those surveys encompassed such a small portion of China's population. Nevertheless, when combined, Nolan and Fewsmith's analysis help to prove Naughton's reform fatigue hypothesis by not only showing how inequality existed, but how a perception of unfairness was evident among the populace.

Nolan's article further advances Naughton's hypothesis because it showed how the Chinese government recognized those social problems—thereby legitimizing them—and sought to mitigate their negative impact on the country's social stability. To prove the concern within the Chinese government, Nolan summarized the promulgated goals during the 17th Party Congress in 2007 to emphasize “the importance of speeding up reforms to improve access to welfare services, especially in poor areas and among disadvantaged groups of the population.”³³ Nolan's article continued to explain how the Chinese government attempted to realize the goals from the 17th Party Congress, to include the enactment of reforms designed to establish a “social safety net” for migrant workers.³⁴

The literature illustrated the importance of the 17th Party Congress to emphasize the Chinese government's intention to address the social issues caused by the market-oriented reforms. Alice Miller conducted a detailed analysis of the Chinese Communist Party's

³⁰ Peter Nolan, *Rebalancing China: Essays on the Global Financial Crisis, Industrial Policy and International Relations* (London: Anthem Press, 2014), 23.

³¹ Nolan, *Rebalancing China*, 20.

³² *Ibid.*, 20.

³³ *Ibid.*, 21.

³⁴ *Ibid.*, 22.

(CCP) decision to formally ratify its “scientific development concept” in October 2007.³⁵ The concept, as Miller explained, sought to “redress the lopsided focus on all-out economic growth as the sole criterion of successful development that had predominated in the Jiang [Zemin] era.”³⁶ Miller cited Hu’s intent for the concept, saying how it ““puts people first as its core,”” and explained how the CCP mandated its members at all levels to study how the concept could be implemented.³⁷ According to Miller, as the effects of the GFC started to spread internationally in October 2008, the CCP leadership issued guidance to seek solutions to the social consequences caused by the crisis that abide by the concept’s intentions.³⁸

Miller’s explanation of the scientific development concept certainly serves as evidence of the CCP’s concern about potential social instability, and the commitment communicated by the Party’s top leadership proves how Naughton’s described reform fatigue was a problem that needed to be rectified. Although Miller’s article helps to validate the notion that social problems were a factor in the implementation of the GFC stimulus plan, her concluding analysis insinuated that there were underlying political obstructions to the scientific development concept—despite the apparent “cohesion among the Party’s top leadership.”³⁹ Miller’s insinuation conforms to the other reviewed literature that characterized a significant political debate that occurred as Wen’s state-centric policies came to the fore over the market-oriented reform policies of his predecessor.

3. Political Incentives

The third overall observed incentive within this review pertains to the literature that described the political incentives behind the GFC stimulus plan. The observed political incentives include two aspects, the *guojin mintui* debate and the short sighted political

³⁵ Alice Miller, “Leadership Presses Party Unity in Time of Economic Stress,” *China Leadership Monitor*, no. 28 (Spring 2009): 1. <http://www.hoover.org/research/leadership-presses-party-unity-time-economic-stress>.

³⁶ Miller, “Leadership Presses Party Unity in Time of Economic Stress,” 1.

³⁷ *Ibid.*, 5.

³⁸ *Ibid.*

³⁹ Miller, “Leadership Presses Party Unity in Time of Economic Stress,” 10.

successes pursued by China's politicians. First, as mentioned in the previous section, a political debate occurred as the state-centric policies gained prominence prior to the GFC. Although Yang and Jiang's article on the term *guojin mintui* ("advance of the state sector and retreat of the non-state sector") was written in the context to describe a policy outcome as a result of the financial crisis, its overview shows that a political debate did occur throughout China regarding the effectiveness between market-oriented and state-centric policies.⁴⁰ Lardy characterized the term as a criticism that the market reform proponents would use against the state-centric policies.⁴¹ One notable aspect of Yang and Jiang's article is that they summarized the debate from multiple comments from various Chinese officials from various government institutions and universities. At the market-oriented end of the spectrum, Yang and Jiang noted how *guojin mintui* skeptics complained that "excessive government involvement would only distort the market mechanism and open up rent-seeking opportunities that empower the privileged."⁴² At the opposite end of the spectrum, *guojin mintui* proponents saw the state-centric policies as "absolutely necessary for a strong, resolute state to assume a central role in directing the economy and [to] protect China's core strategic interests."⁴³

Eventually the *guojin mintui* proponents developed into a political ideology called the New Left. Charles Freeman III and Wen Jin Yuan analyzed the formation of the New Left and explained how it derived from people that were dissatisfied with the market-oriented reform path and wanted to find solutions to China's social inequality problems.⁴⁴ The goals of the New Left, as described by Freeman and Yuan, seemed to align with the scientific development concept, except that their ambition included a more nationalist

⁴⁰ Dali L. Yang and Junyan Jiang, "Guojin Mintui: The Global Recession and Changing State Economy Relations in China," in *The Global Recession and China's Political Economy*, ed. Dali L. Yang (New York: Palgrave Macmillan, 2012), 34.

⁴¹ Nicholas R. Lardy, *Markets over Mao: The Rise of Private Business in China* (Washington, DC: Peterson Institute for International Economics, 2014), 148.

⁴² Yang and Jiang, "Guojin Mintui," 54.

⁴³ *Ibid.*, 56.

⁴⁴ Charles W. Freeman III and Wen Jin Yuan, *China's New Leftists and the China Model Debate after the Financial Crisis* (Washington, DC: Center for Strategic & International Studies, 2011), 4.

aspect by blaming the western economies for the GFC and wanting China to establish its own independent economic system.⁴⁵

The very existence of this debate shows that Wen's policies did not go completely uncontested and that the enactment of the state-centric policies had to overcome some significant political resistance. Edward Steinfeld noted that the market-oriented reform policies during Zhu Rongji's premiership became so popular, the entire political spectrum had shifted so much toward the pro-market side that moderate reformers like Zhu Rongji were "labeled in certain arenas [as] conservatives or traditional planners."⁴⁶ While that may have been an exaggeration, the resultant shift in the political spectrum, as Steinfeld explained, caused the actual state-centric conservatives to be completely left out of the policy debate and were "devoid of political footing, leverage, and voice."⁴⁷

By linking the observed economic, social, and political factors from the literature thus far, Naughton's explanation of how Wen used the crisis as an opportunity to advance the state-centric agenda is more persuasive—compared to when previously reviewed with only the economic considerations. Over time, the social problems associated with the market reforms became too large to politically ignore, causing the political spectrum to slowly shift back toward the state-centric and *guojin mintui* proponents. When the financial crisis struck in late 2008, the ensuing economic and social instability dangers seem to have provided enough political leverage and momentum for Hu and Wen to justify the massive stimulus package and their state-centric policies.

The second political incentive observed within the literature pertains to the politicians themselves and their personal ambition for success within the PRC. The literature described how the PRC used economic success as an incentive for promotion and increased political influence. As a result of this incentive structure, the literature suggested that the politicians often had short-sighted goals to achieve the greatest amount of

⁴⁵ Freeman and Yuan, *China's New Leftists and the China Model Debate after the Financial Crisis*, 6.

⁴⁶ Edward Steinfeld, "The Capitalist Embrace: China Ten Years after the Asian Financial Crisis," in *Crisis as Catalyst: Asia's Dynamic Political Economy*, ed. Andrew MacIntyre, T.J. Pempel, and John Ravenhill (Ithaca: Cornell University Press, 2008), 191.

⁴⁷ Steinfeld, "The Capitalist Embrace," 191.

economic success in the fastest time possible. Yang's article directly correlated the GFC stimulus package with this short-sighted political behavior. Yang described how the PRC's "obsession with short term results is embedded not only in Chinese thinking but also in China's institutions."⁴⁸ Her explanation of how party officials are frequently rotated to different localities showed how their incentive to find long term solutions for economic growth is compromised by the need to obtain quick results for promotion.⁴⁹ In addition, Yang noted that the central government's goal after the GFC was to achieve eight percent GDP growth, a target thought to sufficiently reduce unemployment.⁵⁰ While that was the central government's target, Yang explained that the local governments would subsequently increase their growth targets to assure they met the national standard. Under this incentive structure and with a looming economic crisis, it would be plausible that the GFC stimulus was issued knowing that it would encourage a frenzy among local party officials to find a multitude of ways to generate growth in order to impress their superiors.

Victor Shih was even more critical of China's short-sighted political structure. Although written a year prior to the GFC, Shih explained how China's reform process as a whole is "political... not a simple policy exercise by insulated, beneficent social planners."⁵¹ Shih described how the top economic leaders within the PRC, "the technocrats," were able to gain political power by using their technical expertise to consolidate financial decision making power amongst themselves to become "the indispensable problem solver."⁵² In addition, Shih continued, due to a promotion system that is based on the ability to handle the more emergent political problems, the technocrats were incentivized to only find short-term answers to quickly stabilize the situation without "jeopardizing [their] ability to resolve other pressing issues."⁵³ While that analysis was

⁴⁸ Yang, "Vulgarisation of Keynesianism in China's Response to the Global Financial Crisis," 375.

⁴⁹ *Ibid.*, 377.

⁵⁰ *Ibid.*, 375.

⁵¹ Victor Shih, "Partial Reform Equilibrium, Chinese Style: Political Incentives and Reform Stagnation in Chinese Financial Policies," *Comparative Political Studies* 40, no. 10 (October 2007): 1238, doi: 10.1177/0010414006290107.

⁵² Shih, "Partial Reform Equilibrium, Chinese Style," 1245.

⁵³ *Ibid.*, 1246.

written in the context of Zhu's premiership, the incentive structure among the technocrats seemed to remain through Wen's tenure. Shih, in an article written after the GFC, made the same observations about how the technocrats maintained control over "crucial macroeconomic levers," which allowed them to gain quickly political capital at the expense of longer term solutions.⁵⁴

4. The Role of Corruption

The fourth observed incentive behind the stimulus plan relates to corruption. The role of corruption in China's handling of the GFC was only a sporadic topic within the literature. Each time corruption was discussed, it was always placed as the dependent variable, with the GFC stimulus package used as a potential factor in the analysis to determine if the stimulus had contributed to corruption's prevalence throughout China. Even when used as an independent variable, the literature was not in agreement as to the GFC's effect upon corruption. In discussing how local officials received various forms of kickbacks for issuing contracts throughout China's "construction boom" of the 2000s, Arthur Kroeber wrote that corruption "almost certainly surged" after the GFC stimulus program allocated billions of dollars into infrastructure development.⁵⁵ Yang, in discussing the haphazard distribution method of the GFC stimulus funds, noted how approved funds were first used to pay for officials' salaries, or houses and cars for other insiders, before those funds went to their respective projects—a practice, Yang mentioned, that also occurred after the AFC stimulus dispersal.⁵⁶

Although those schemes seem very plausible, they are difficult to prove. Andrew Wedeman tested the assumption, posed by those like Kroeber and Yang, that the GFC stimulus directly caused an increase in corruption. Wedeman agreed about the conceptual causal relationship between the GFC stimulus and corruption, but his analysis concluded that the GFC "did not cause a visible surge in corruption or local protectionism. Nor did it

⁵⁴ Victor Shih, "'Goldilocks' Liberalization: The Uneven Path Toward Interest Rate Reform in China," *Journal of East Asian Studies* 11, no. 3 (September–December 2011): 459.

⁵⁵ Kroeber, *China's Economy*, 204.

⁵⁶ Yang, "Vulgarisation of Keynesianism in China's Response to the Global Financial Crisis," 377.

lead to a significant slackening of China's anticorruption effort."⁵⁷ Wedeman admitted that his study, published in 2012, was probably too close to the GFC stimulus event for the effects of corruption "to become evident," explaining that various factors such as investigation timelines and conviction rates need considerable time to develop to gather reliable test data.⁵⁸ A reapplication of his study using his research methods may produce different results, but unless actual decision makers from the GFC stimulus plan were implicated in some corruption scheme, it would only be of limited value in determining if corruption incentivized the implementation of the stimulus.

5. Conclusion

This literature review has shown that despite the wealth of existing analysis about the GFC, no single factor can explain the full incentives behind China's implementation of its massive stimulus package. The four observed incentives are complex, nuanced and interrelated with each other and cannot stand alone as independent explanations of the stimulus package. Part of this issue is that China's stimulus package is often used as an independent variable in the analysis of some other outcome. The other aspect is that multiple and complex factors need to be aligned to develop an understanding of how China's leaders were incentivized to issue the stimulus package. This review has shown that there are compelling macroeconomic explanations behind the stimulus, but it does not fully explain the aggressiveness behind its execution. The literature that highlighted the social problems prevalent throughout China at the onset of the financial crisis seem to justify a state-centric and interventionist response, but that reasoning alone is offset by a political structure that incentivizes quick, short-term solutions for personal political gain. Literature that described corruption throughout the financial crisis is limited, speculative, tough to prove, and not placed as a possible independent variable to the stimulus package. Each of the factors reviewed has its own value in understanding China's response to the

⁵⁷ Andrew Wedeman, "Corruption, Local Protectionism, and the Global Recession in China," In *The Global Recession and China's Political Economy*, ed. Dali L. Yang (New York: Palgrave Macmillan, 2012), 181.

⁵⁸ Wedeman, "Corruption, Local Protectionism, and the Global Recession in China," 184.

GFC, but that understanding would be increased by additional literature that attempts to combine those factors in one analytical study.

D. POTENTIAL EXPLANATIONS AND HYPOTHESES

The literature review demonstrated how there are potentially multiple explanations behind the implementation of China's stimulus package, but this thesis will examine three potential hypotheses framed as separate arguments: an economic, a social, and a political argument. This thesis will not investigate the corruption or the technocrat self-interest aspects from the literature review since proving corrupt or malicious intent behind China's stimulus package seems to be beyond the resources and capabilities of this project.

The economic argument posits that China's aggressive stimulus package was implemented because of the apparent panic among China's government to quickly reverse the effects of the restrictive monetary policies that were enacted a year and a half prior to the financial crisis. The Chinese government's concern of a compounded economic decline due to their restrictive monetary policy, coupled with a worldwide decline in demand to their export sector may explain their overly aggressive countercyclical stimulus plan and the massive expansion of bank credit. Additionally, the ample fiscal revenue gave the Chinese government the means to quickly initiate the stimulus package.

The social argument suggests that the Chinese government needed to appease the millions of unemployed workers, who already felt marginalized by the severe inequality throughout China, before they incited social instability throughout the country. The aggressive stimulus package was a necessary measure by the Chinese government to produce millions of new jobs and to demonstrate their willingness to distribute economic benefits to disenfranchised regions.

The political argument posits that the stimulus package was implemented to protect the PRC from political ruin for being unable to generate economic growth during the GFC. The PRC leaders were concerned that the regime could lose its legitimacy amongst the populace if the economic damages from the GFC were to go unabated. Those in the central government that favored market-oriented economic policy had to concede to those that

called for more state-interventionist economic policies to placate the more pressing challenges to the party.

E. RESEARCH DESIGN

This thesis will research the plausibility of each of the three hypotheses as a separate argument (an economic, social, and political argument) to uncover both the compelling incentives behind the stimulus package and explanatory gaps from each hypothesis. Collectively, the three arguments will provide a comprehensive explanation behind China's decision to implement its aggressive economic stimulus package. Primary source documents from Chinese media, PRC leadership speeches, and official government publications will be used to evaluate each of the three arguments from the perspective of the Chinese government. Academic literature will be incorporated within each of the arguments to add context to the primary sources.

The economic argument will use the quarterly monetary policy reports from the People's Bank of China for insight into the central government's intent during the GFC. Data from China's National Bureau of Statistics will be used to illustrate how the central government interpreted their economic situation, and Chinese media will be used to show the central government's description of its stimulus package.

The social argument will use annual survey data published by the Chinese Academy of Social Sciences to examine how the central government could have perceived the likelihood of social instability caused by high unemployment and discontent from income inequality. Speeches from Hu Jintao and Wen Jiabao will highlight their intent behind their state-interventionist economic strategy.

The political argument will also examine various speeches from Hu and Wen to extract their political motives behind the stimulus package. Chinese media will be used to trace key events and discussions by the PRC leadership during the onset of the GFC in the autumn of 2008 to gain insight on how the PRC perceived the GFC threat as it developed in severity.

F. THESIS OVERVIEW

This thesis will develop an economic, social, and political argument and assess each argument's ability to persuasively explain what incentivized the PRC to implement the stimulus package. The second chapter of this thesis will describe the GFC, how it affected China, and the Chinese government's response to the crisis. The third chapter is the economic argument, where the economic circumstances that affected the design and implementation of the stimulus package will be analyzed. The fourth chapter is the social argument and it will analyze how the social effects of unemployment and inequality affected the implementation of the stimulus package. The fifth chapter is the political argument, which will assess how China's politics affected how the stimulus package came to fruition and created the expectations for sustained economic growth. The conclusion will incorporate the three arguments to provide a comprehensive explanation of how the stimulus package was devised to protect the PRC's regime.

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II. THE GLOBAL FINANCIAL CRISIS AND CHINA'S STIMULUS PLAN

This chapter describes the GFC, how it affected China, and the Chinese government's response to the crisis. First, this chapter will describe how the financial collapse in the United States quickly developed into a disaster for financial markets around the world. Next, this chapter will explain how the GFC affected Asia and its subsequent impact on China. Following a description of China's economic strategy prior to the GFC, this chapter will then describe how China responded to the crisis by examining the stimulus package itself and three initiatives used to quickly initiate the plan. Lastly, this chapter will conclude by emphasizing the huge investment made by China's government to offset its economic losses as well as the stimulus package's consequential effect of committing the country to its old investment-driven growth model.

A. THE FINANCIAL CRISIS AND ITS WORLDWIDE EFFECT

The U.S. economy went into a recession as early as 2007 as the bankruptcies of subprime mortgages began to erode the value of the complicated investment products, such as collateralized debt obligations (CDOs) and credit default swaps (CDS), that were engineered by financial institutions to profit from the seemingly reliable monthly cash inflows of mortgage payments.⁵⁹ As Mark Jickling noted, "the financial crisis that began in 2007 spread and gathered intensity in 2008, despite the efforts of central banks and regulators to restore calm."⁶⁰ The collapse of the U.S. housing market hastened a series of unprecedented failures in the financial sector which culminated in September 2008, to include: the \$100 billion U.S. government takeover of Fannie Mae and Freddie Mac on September 7, the \$50 billion sale of Merrill Lynch to Bank of America on September 14, the \$639 billion bankruptcy of Lehman Brothers on September 15, the \$123 billion U.S.

⁵⁹ Dick K. Nanto, *The Global Financial Crisis: Analysis and Policy Implications*, CRS Report No. RL34742 (Washington, DC: Congressional Research Service, 2010), <https://www.hsdl.org/?view&did=28102>, 4.

⁶⁰ Mark Jickling, *Causes of the Financial Crisis*, CRS Report No. R40173 (Washington, DC: Congressional Research Service, 2010), <https://www.hsdl.org/?view&did=737592>, 3.

government assistance package to American International Group (AIG) on September 16, the “transformation” of Goldman Sachs and Morgan Stanley from investment banks to bank holding companies on September 21, and the \$307 billion “thrift failure” of Washington Mutual on September 26.⁶¹ Analysts have identified several factors that caused the GFC. As Jickling explained, those causes range from an overall lack of regulation over the financial institutions, “imprudent mortgage lending” practices and a “lack of transparency and accountability in mortgage finance,” to “human frailty,” “bad computer models,” and even a “black swan theory,” which suggests those events were but “a once-in-a-century event.”⁶²

Despite the cause, or combination of causes, the U.S. financial failures after September 2008 had a devastating effect on the global economy. As Nanto explained, “the United States is the main guarantor of the international financial system... and a contributor to much of the financial capital that sloshes around the world seeking higher yields.”⁶³ The previously listed series of events in September 2008, especially the Lehman Brothers bankruptcy, caused a near standstill to the global flow of capital. T.J. Pempel noted that nearly \$27 trillion “was almost instantly erased from global stock markets” in the following month.⁶⁴ The International Monetary Fund (IMF) calculated that global GDP declined by approximately 6.25 percent in the last quarter of 2008—the IMF noted, in comparison, that global GDP had 4 percent growth the previous year.⁶⁵ To compare the GFC’s impact in various economies, the IMF noted how, in the fourth quarter of 2008, the GDP of advanced economies declined 7.5 percent compared to the 4 percent decline amongst emerging economies.⁶⁶ That disparity can be explained by the advanced economies higher exposure to, or direct involvement in, the types of overly-complicated and risky financial products that failed on Wall Street. For example, Iceland’s government had to nationalize its three

⁶¹ Nanto, *The Global Financial Crisis*, 155.

⁶² Jickling, *Causes of the Financial Crisis*, 5, 6, 8, 10.

⁶³ Nanto, *The Global Financial Crisis*, 4.

⁶⁴ T.J. Pempel, “Two Crises, Two Outcomes,” in *Two Crises Different Outcomes: East Asia and Global Finance*, ed. T.J. Pempel and Keiichi Tsunekawa (Ithaca: Cornell University Press, 2015), 17.

⁶⁵ IMF, *World Economic Outlook April 2009*, 4.

⁶⁶ *Ibid.*

largest commercial banks, which heavily invested in those products, to prevent their imminent default. According to Nanto, that action caused Iceland's government to "assume liabilities greater than the size of the national economy," forcing it to take out a \$2.1 billion loan from the IMF.⁶⁷

The GFC affected emerging economies differently from advanced economies. As explained by the IMF, the stoppage in the global flow of capital hurt emerging economies in two ways. First, the emerging economies whose industries were highly reliant on external financing from advanced economies suddenly found their sources of incoming capital significantly reduced.⁶⁸ For instance, Central and Eastern Europe were especially vulnerable to that loss of capital since \$1.6 trillion was invested in that region by financial institutions from G-10 countries.⁶⁹ Second, the GFC caused significant losses in the export sectors of emerging economies. As Nanto explained, "as industrial economies contract, demand for emerging market exports will slow down."⁷⁰ This is how the GFC primarily impacted East Asia, and it was not just limited to emerging economies. The reduction in demand from the advanced economies caused a worldwide decline in trade, which, as the IMF explained, negatively affected common East Asian exports such as "automobiles, electronics, and other consumer durable goods that are an integral part of the production structure across East Asia."⁷¹ Even an advanced economy such as Japan and the East Asian newly industrialized economies of Hong Kong, Singapore, South Korea, and Taiwan experienced more than a 55 percent decline in industrial production, a figure twice the amount of the world average.⁷²

⁶⁷ Nanto, *The Global Financial Crisis*, 17.

⁶⁸ IMF, *World Economic Outlook April 2009*, 5.

⁶⁹ Nanto, *The Global Financial Crisis*, 46. The G-10 includes Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

⁷⁰ Nanto, *The Global Financial Crisis*, 46.

⁷¹ IMF, *World Economic Outlook April 2009*, 71.

⁷² *Ibid.*, 71 (figure 2.2).

B. THE GFC'S EFFECT ON CHINA

The global reduction in demand was a significant problem for China's economy. According to Wayne Morrison, in 2007, exports were responsible for nearly a third of China's GDP growth.⁷³ So, as the IMF noted, with a 40 percent worldwide decline in exports and an ensuing 20 percent reduction in global industrial production after September 2008, the subsequent harm to China's economy was inevitable.⁷⁴ By February 2009, China's exports fell by over 25 percent, the country's largest recorded decline in exports.⁷⁵ Kroeber aptly articulated China's export vulnerability by saying, "The problem with relying so much on exports is that if your trading partners run into trouble, so do you."⁷⁶ The export trouble China experienced developed into an unemployment problem. According to Morrison, in 2007, "The Chinese government estimate[d] that the foreign trade sector employ[ed] more than 80 million people, of which 28 million work[ed] in foreign-invested enterprises."⁷⁷ The unemployment figures from early 2009 vary, but were nevertheless striking. For instance, according to Kroeber, "an estimated 23 million workers in export-oriented factories were laid off... by February 2009."⁷⁸ While that figure is high, it may not fully account for the migrant workers that typically worked in those factories, but likely fell under a separate accounting category in official government data reports. Nanto's report included official government figures, stating that approximately 20 million migrant workers were unemployed in 2008 because of the GFC.⁷⁹

The timing of the crisis during the Chinese New Year, the holiday where people customarily return to their families in the rural provinces (for many it is the only time all

⁷³ Wayne M. Morrison, *China and the Global Financial Crisis: Implications for the United States*, CRS Report No. RS22984 (Washington, DC: Congressional Research Service, 2009), <https://www.hsdl.org/?view&did=233536>, 1.

⁷⁴ International Monetary Fund (IMF), "Review of Recent Crisis Programs," approved by Reza Moghadam, IMF policy paper, September 14, 2009, <http://www.imf.org/external/np/pp/eng/2009/091409.pdf>, 5.

⁷⁵ Morrison, *China and the Global Financial Crisis*, 3.

⁷⁶ Kroeber, *China's Economy*, 217.

⁷⁷ Morrison, *China and the Global Financial Crisis*, 1.

⁷⁸ Kroeber, *China's Economy*, 216.

⁷⁹ Nanto, *The Global Financial Crisis*, 74.

year they are able to return home), amplified the severity of the unemployment problem for migrant workers. After the sudden layoffs in the urban and coastal regions, millions of workers returned home early in the holiday season to try to find the few available jobs (albeit at lower pay) in their home province.⁸⁰ For many, affording the trip home became difficult because company owners and factory managers often fled the worksites without paying the promised back pay or severance pay to the workers. In desperation, those workers resorted to protesting the local governments to receive their promised compensation.⁸¹ Despite the reported differences in unemployment figures, the estimates involved tens of millions of people and the timing of the crisis during the holiday period fueled tensions throughout the country, compelling the Chinese government to take direct action to calm the situation.

C. CHINA'S PRE-CRISIS ECONOMIC POLICY

As Yang and Jiang described, “The abruptness of the global crisis’ onset in 2008 caught China’s policy makers by surprise, because they had been preoccupied with preventing economic overheating and curbing rising inflation.”⁸² China’s GDP growth in 2006 and 2007 reached record highs at 12.7 percent and 14.2 percent respectively (see Figure 1).⁸³ Despite the influx of wealth added to the economy during those years (see Figure 3), China’s economic managers knew that growth was unsustainable because of its counterproductive effects of rising inflation and consumer prices. Inflation steadily rose throughout 2007 and peaked in the first quarter of 2008, rising from 2.8 percent to over 8 percent in that timeframe (see Figure 2).⁸⁴ Additionally, the housing sector reflected China’s problem with rising prices. Within the aforementioned timeframe, Lardy noted

⁸⁰ Keith Bradsher, “China’s Unemployment Swells as Exports Falter,” *The New York Times*, February 5, 2009, www.nytimes.com.

⁸¹ Edward Wong, “Factories Shut, China Workers are Suffering,” *The New York Times*, November 13, 2008, www.nytimes.com.

⁸² Yang and Jiang, “Introduction,” 3.

⁸³ “GDP growth (annual %): China, United States, Japan,” The World Bank (accessed January 31, 2018), <https://data.worldbank.org>.

⁸⁴ China National Bureau of Statistics, utilized in “China–Country Data: Consumer prices (% change pa; av),” The Economist Intelligence Unit, www.eiu.com.

how property prices appreciated to “double-digit year-over-year growth rates.”⁸⁵ To slow the economy and to reduce inflation and consumer prices, China’s government instituted a restrictive monetary policy that began as early as 2007 and lasted until the onset of the GFC in September 2008. With the surprise impact of the GFC, there may have been concerns amongst China’s policy makers that their year and a half long effort to slow the economy would complicate efforts to counter the damages of the crisis.

D. CHINA’S STIMULUS PLAN

The Chinese government decided to quickly and decisively respond to the dangers of the financial crisis. According to Naughton, a joint meeting between the CCP Politburo and the PRC State Council was held on November 5, 2008 to finalize the decision to implement a 4 trillion yuan (\$586 billion) economic stimulus package.⁸⁶ The 4 trillion yuan was to be dispersed over a two-year period on projects designed to mitigate the loss of export demand through a variety of domestic infrastructure projects. Zhang Ping, the Director of the National Development and Reform Commission (NDRC) in 2008, outlined the approximate stimulus funding allocations toward seven priority sectors as follows: 1) 1.8 trillion yuan toward “transportation infrastructure and power grid construction,” 2) 1.0 trillion yuan “for reconstruction in areas affected by the May [2008] earthquake,” 3) 370 billion yuan toward “improving rural livelihoods and infrastructure,” 4) 350 billion yuan for “environmental protection,” 5) 280 billion yuan toward “social security and housing,” 6) 160 billion yuan for “technological innovation,” 7) and 40 billion yuan toward “public healthcare and education.”⁸⁷ As Wong explained, the NDRC was charged to approve the proposed projects, in accordance with the priority sectors, that were submitted by the local governments and various ministries eligible to compete to receive stimulus funding.⁸⁸

⁸⁵ Lardy, *Sustaining China's Economic Growth after the Global Financial Crisis*, 7.

⁸⁶ Naughton, “China and the Two Crises,” 118.

⁸⁷ Zhang Hong, “NRDC Details Four Trillion Stimulus Package,” *Caijing Online in English*, December 1, 2008, <http://www.caijing.com.cn/english/>. The precise figures allocated toward the seven priority sectors slightly vary among sources, but generally only differ by a few percent. Also see: Nanto, *The Global Financial Crisis*, 76 (table 2); and Wong, “The Fiscal Stimulus Programme and Public Governance Issues in China,” 6 (table 1).

⁸⁸ Wong, “The Fiscal Stimulus Programme and Public Governance Issues in China,” 9.

E. HOW CHINA IMPLEMENTED THE STIMULUS PACKAGE

This research observed three initiatives that the central government incorporated to incentivize the stimulus package's implementation. First, the central government incentivized local officials to submit qualified projects. Second, since the central government decided not to fully fund each project, it had to open additional funding sources for the localities to further incentivize them to submit projects. Third, the central government created an urgent atmosphere to immediately execute the stimulus plan and to have its projects started as fast as possible.

The first initiative was to incentivize the localities to submit qualified projects for stimulus funding. By commissioning the NDRC as the lead approver of the stimulus funded projects, the central government, as Naughton and Wong described, had tapped into a “structured bargaining process between the center and the localities... [that was] very familiar to all the participants,” as it was a “legacy of the planned economy.”⁸⁹ As such, Wong explained that when under the planned economy, local governments would keep around project plans with “medium and long-term” time horizons to be used whenever funding became available from the central government.⁹⁰ Naughton expanded upon this explanation by noting how local government officials maintained their “wish list” of projects beyond the command economy period because of their “distinctive incentive system, in which they are evaluated for promotion largely on the basis of their performance in regional economic growth.”⁹¹ Infrastructure, and other like projects are, as Naughton continued, relatively quick and easy methods for local officials to generate economic growth during their term, which consequently creates “a virtually inexhaustible demand” at the local level to implement the types of projects that the central government was offering to help fund.⁹² This legacy was certainly helpful in getting projects submitted to the NDRC, but it was not enough to fully incentivize the localities.

⁸⁹ Barry Naughton, “Understanding the Chinese Stimulus Package,” *China Leadership Monitor*, no. 28 (Spring 2009): 4, <http://www.hoover.org/research/understanding-chinese-stimulus-package>; Wong, “The Fiscal Stimulus Programme and Public Governance Issues in China,” 11.

⁹⁰ Wong, “The Fiscal Stimulus Programme and Public Governance Issues in China,” 11.

⁹¹ Naughton, “China and the Two Crises,” 121.

⁹² *Ibid.*

The second initiative involved funding the localities. From the local officials' perspective, the catch in submitting a project, Wong noted, was that to receive the stimulus funds, the proposed projects had to be co-funded by the local governments up to a certain percent of the assessed total cost of the project.⁹³ Although the localities were in competition for the stimulus funds and, as Naughton explained, would have a greater chance to win funding if they proposed to pay a higher percentage of their project, the overall lack of money available within the localities to co-fund projects was a major problem.⁹⁴ Wong explained how the central government implemented new measures to help the local governments finance their co-pay commitments, to include: the issuance of 200 billion yuan in treasury bonds in March 2009, an official endorsement on the use of local investment corporations (LICs—corporate entities that would raise funds on behalf of local governments through a variety of sources, such as bundled bank loans, land leases, and corporate bonds⁹⁵), and by expanding the pool of eligible sources of co-pay funding, like accepting funds raised by LICs and from land revenue.⁹⁶ Those measures helped local governments raise co-pay funding, but credit expansion became the main fundraising mechanism.

As Lardy explained, the central government's "plan from the outset was that the vast majority of the funding for the stimulus program would be financed by increased bank lending made possible by monetary easing."⁹⁷ A major indicator of that plan, which several analysts observed, was the central government's stated intention to only use 1.18 trillion yuan of fiscal revenue to fund the 4 trillion yuan stimulus package.⁹⁸ The monetary easing measures began as early as September 2008, as China's economists began to both react against the series of financial failures that occurred within the United States and to shift

⁹³ Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," 9.

⁹⁴ Naughton, "Understanding the Chinese Stimulus Package," 4.

⁹⁵ Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," 10.

⁹⁶ *Ibid.*, 9–11.

⁹⁷ Lardy, *Sustaining China's Economic Growth after the Global Financial Crisis*, 11.

⁹⁸ Lardy, *Sustaining China's Economic Growth after the Global Financial Crisis*, 11; Naughton, "China and the Two Crises," 120; Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," 1.

back from their contractionary measures used to control their own housing bubble in 2007.⁹⁹ To increase the money supply for the subsequent increase in bank lending, the People's Bank of China (PBOC, China's central bank) instituted the following measures, such as: "cutting the benchmark deposit and lending interest rates on five occasions, lowering required reserve ratios on four occasions, [and] eliminating quantitative ceilings for financial institutions' credit lending."¹⁰⁰ The combined effect of those respective actions would, as Lardy explained, incentivize new lending, increase the money available to banks to issue new loans, and would increase the total number of loans that banks could issue.¹⁰¹

The third initiative was to create an urgent atmosphere, so the participants would immediately begin implementing the stimulus plan. With the policy incentives aligned (a competitive bargaining system for local project funding, a flexible co-pay mechanism, and a loose monetary policy to expand credit), the central government needed the plan to begin immediately. Naughton's account of China's stimulus plan places a significant amount of weight on the effect caused by a CCP correspondence document called "Central Document No. 18," issued after the joint Politburo and State Council meeting on November 5, 2008.¹⁰² This document, that Naughton claimed to extrapolate from indirect sources, included the aforementioned investment priority sectors, monetary policy intentions, and overall goal to boost domestic demand, however, Naughton stressed that its dissemination through "party channels" instilled the sense of urgency throughout the government to act immediately.¹⁰³ Five days later, Naughton continued, the NDRC held an emergency meeting to disperse the first 100 billion yuan provided by the central government before the end of the year and to communicate to the rest of the government that they needed to

⁹⁹ Lardy, *Sustaining China's Economic Growth after the Global Financial Crisis*, 7.

¹⁰⁰ Monetary Policy Analysis Group of the Peoples Bank of China (PBOC), *China Monetary Policy Report Quarter Four, 2008*, Beijing: Peoples Bank of China, February 23, 2009, <http://www.pbc.gov.cn>.

¹⁰¹ Lardy, *Sustaining China's Economic Growth after the Global Financial Crisis*, 7–10.

¹⁰² Naughton, "China and the Two Crises," 120; Naughton, "Understanding the Chinese Stimulus Package," 2; Naughton, "China's Response to the Global Crisis, and the Lessons Learned," 17.

¹⁰³ Naughton, "Understanding the Chinese Stimulus Package," 2.

“urgently implement the center’s increased investment and other measures to increase domestic demand... [and to] make every second count.”¹⁰⁴

F. THE RESULTS

The three initiatives that the central government used to incentivize the stimulus plan worked. Nearly the entire state sector, local governments, agencies, companies, corporations, and banks, interpreted the new policies and their urgency directly from the CCP as a license to cut corners. Naughton recalled how within days of the stimulus plan’s announcement, emergency strategy meetings were held in localities throughout the entire country to take advantage of their opportunity to capitalize.¹⁰⁵ As Wong and Naughton noted, not more than a month after the plan’s announcement, 18 provinces (out of a total of 31) submitted “shovel-ready” projects to the NDRC worth a combined cost of over 25 trillion yuan—nearly 80 percent of China’s GDP that year.¹⁰⁶ The sheer mass of submitted projects within that short time frame most likely overwhelmed the NDRC’s capacity to thoroughly assess and compare the potential of each project. As a result, multiple projects with questionable long-term viability were probably approved.

Figures from the banking sector were just as enormous. Wong noted how a PRC State Council meeting in December 2008 issued a goal for banks to reach the 4 trillion-yuan mark in total new loans issued for the year.¹⁰⁷ Combined, the urgent signaling from the CCP along with the guidance from the State Council reinforced a perception that the new loans would be essentially “guaranteed by the government.”¹⁰⁸ From a loan officer’s perspective, this “effectively eliminated all personal responsibility for [their] lending decisions.”¹⁰⁹ As a result, overall lending exploded, especially to the localities that were awarded projects. According to the PBOC, 1.2 trillion yuan of new loans were issued

¹⁰⁴ Ibid.

¹⁰⁵ Naughton, “China and the Two Crises,” 122.

¹⁰⁶ Naughton, “China and the Two Crises,” 121–122; Wong, “The Fiscal Stimulus Programme and Public Governance Issues in China,” 11.

¹⁰⁷ Wong, “The Fiscal Stimulus Programme and Public Governance Issues in China,” 7.

¹⁰⁸ Ibid., 13.

¹⁰⁹ Ibid., 12.

between November and December 2008 alone, bringing the total amount of new loans issued that year to over 4.91 trillion yuan (overshooting the State Council's mark by a trillion yuan), an 18 percent increase in new loans from 2007.¹¹⁰ From Wong's account, new loans issued in 2009 almost doubled the previous year's amount, reaching over 9.6 trillion yuan, and subsequently, 2010's figures slightly declined but still dwarfed those from 2008 with over 7.9 trillion yuan issued in new loans.¹¹¹ The credit expansion aspect of the stimulus plan produced in an unprecedented amount of new loans issued within China in a mere two year period, but has resulted in the numerous long-term economic challenges that the country has had to face ever since.

G. THE SIZE AND CONSEQUENCES OF THE STIMULUS PACKAGE

Economic stimulus plans were issued all over the world to counter the effects of the GFC, however, China's effort was among the world's largest. As the previous loan figures have shown, the substantial 4 trillion-yuan stimulus package that was initially announced turned out to be far larger after the crisis subsided. While bank loans comprised of the main funding effort to finance the stimulus, China also used bonds and fiscal deficit to generate financing. The estimates vary, but factoring in those three financing sources, China's total stimulus from 2008 to 2010 could have ranged from 9.5 trillion yuan (\$1.39 trillion), from Wong's account, to 11 trillion yuan (\$1.61 trillion), from Kroeber's account.¹¹² To compare, the United States in February 17, 2009 announced a \$787 billion stimulus package (which only represented the amount to be paid by fiscal deficit) which amounted to about 5.5 percent of GDP.¹¹³ In contrast, China's total stimulus effort in 2009,

¹¹⁰ PBOC, *China Monetary Policy Report Quarter Four, 2008*, 4.

¹¹¹ Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," 12.

¹¹² Wong, "The Fiscal Stimulus Programme and Public Governance Issues in China," 13; Kroeber, *China's Economy*, 216.

¹¹³ Nanto, *The Global Financial Crisis*, 39 (table 1); "GDP (current US\$): United States, China," The World Bank (accessed January 28, 2016), <https://data.worldbank.org>.

according to Wong, was about 6.5 trillion yuan (\$952 billion), comprising approximately 18.6 percent of GDP.¹¹⁴

Comparing the American and Chinese stimulus packages also emphasizes the difference in how the GFC affected the two economies. As Naughton explained, the U.S. stimulus package “was an attempt to offset a collapse in credit extended in other parts of the economy, whereas there was no such collapse in China.”¹¹⁵ The United States and other advanced economies were primarily focused on injecting liquidity back into its finance sector. China’s stimulus package, like others in East Asia, focused on repairing the losses from its export sector. In China’s case, it attempted to offset its decline in exports by generating domestic demand through the stimulus package. The central government’s three initiatives to incentivize the stimulus package’s implementation worked, but it came with significant long-term consequences.

The inability to shift China’s growth model away from its reliance on investment was one of the main consequences of the stimulus package. As Kroeber explained, China’s economy just before the GFC reached a point where its economic growth needed to transition from a model based on a reliance on investment to a model based on efficiency.¹¹⁶ Heavy investments in China’s infrastructure facilitated the country’s capacity to generate fast economic growth, but, as Kroeber warned, investment-led growth eventually “has an expiration date.”¹¹⁷ Investments will suffer diminishing returns unless methods to improve efficiencies are developed. Kroeber noted how by 2008, China’s “investment was about 41 percent of GDP, exceeding the top levels reached by Japan, South Korea, and Taiwan during their most capital-intensive phases of growth.”¹¹⁸ China’s leaders recognized this problem and slowly sought to implement policies to address this issue before the onset of the GFC. Despite those intentions, the massive size, scale, and execution of the stimulus

¹¹⁴ Wong, “The Fiscal Stimulus Programme and Public Governance Issues in China,” 13; “GDP (current US\$): United States, China,” The World Bank (accessed January 28, 2016), <https://data.worldbank.org>.

¹¹⁵ Naughton, “China and the Two Crises,” 123.

¹¹⁶ Kroeber, *China’s Economy*, 213.

¹¹⁷ *Ibid.*

¹¹⁸ *Ibid.*, 215.

package committed China to the investment-led growth model, sinking the country deeper into debt while trying to sustain economic growth with increasingly fewer returns on its investments. The implications of this vary but the forecasts are generally not optimistic. Kroeber, for instance, posited that China's continued dependency on the investment growth model cannot be continued indefinitely.¹¹⁹ He warned,

at some point the return on investment becomes so low that the debts cannot be repaid. At that point one of two things can happen: there can be a financial crisis (because many loans go into default, hurting the banks); or the economy can go in to recession (because even if special arrangements enable borrowers to avoid default, too much capital is tied up in projects delivering no economic benefit).¹²⁰

Kroeber's warning underscores the consequences of the GFC stimulus package, however China's leaders, nonetheless, made that decision to prolong that growth model. The following chapters will assess the incentives behind their decision.

¹¹⁹ *Ibid.*, 221.

¹²⁰ *Ibid.*

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III. THE ECONOMIC ARGUMENT

This chapter will analyze the economic circumstances that affected the design and implementation of China's stimulus package. The sudden loss in China's export sector as a result of the GFC cut off a significant source of economic growth. The only remaining source for economic growth was through an increase in domestic demand. Since high unemployment, as Kroeber explained, made it "unrealistic to expect Chinese consumers to suddenly start spending a lot more money," the government's last recourse for economic growth was to increase its investment spending.¹²¹ Through the lens of this economic predicament, this chapter will describe three economic conditions that affected how the stimulus package was designed and implemented in China's effort to generate domestic demand through investment. The first condition this chapter will describe pertains to China's monetary policy before the GFC and its effort to prevent the economy from overheating and to lower inflation rates and consumer prices. The second condition relates to the stimulus package's emphasis on generating new employment to mitigate the decline in consumer spending. Lastly, the third condition that will be described pertains to how China's ample fiscal revenue and solvent banking sector further incentivized the central government to increase investment spending, learning from the experiences following the AFC.

This argument presents a very strong explanation of the PRC's incentives to implement the stimulus package based on how the three economic conditions together help to explain the composition, size, and urgent implementation of the GFC stimulus package, as well as how they impacted China's growth model. The first and third conditions helped explain how the stimulus package expanded to its enormous size. The second condition explained why the stimulus package focused on labor intensive infrastructure projects, and all three conditions contribute to the explanation behind the package's urgent implementation. The economic circumstances help explain how China gave minimal consideration to the stimulus package's effect on its growth model, but leaves explanatory

¹²¹ Kroeber, "China's Economy," 217.

gaps as to the circumstances behind why China's government lowered the growth model priority as it designed and implemented the stimulus package.

A. CHINA'S MONETARY POLICY BEFORE THE GFC

The first economic condition that contributed to the design and implementation of the stimulus package was the need to quickly reverse the restrictive monetary policy that was in place prior to September 2008. As depicted in Figure 1, China experienced a 4.5 percent decline in GDP growth between 2007 and 2008. Initial stages of the GFC were partly responsible for that decline in 2007, but, like applying the emergency brakes to a runaway train, there was a substantial effort by the Chinese government to prevent economic overheating and to curtail inflation and rising consumer prices. For instance, to absorb the excess liquidity in China's economy in 2007, its central bank raised its benchmark deposit and lending rates six times and its deposit reserve requirement on ten separate occasions.¹²² Zhou "faced public scrutiny and criticisms" since inflation and housing prices continued to rise despite the central banks efforts.¹²³ As depicted in Figure 2, inflation, measured by the consumer price index (CPI), rose all throughout 2007 and continued to rise into 2008, peaking at 8.1 percent in the first quarter.¹²⁴ The subprime mortgage crisis in the United States was only gaining momentum by the second quarter of 2008, but its effects were mostly interpreted by the PBOC as another contributory factor of inflation, saying that: "given the weak U.S. dollar, speculative activities, and other factors, commodity prices will remain at a high level and create a risk of imported inflation."¹²⁵

¹²² Monetary Policy Analysis Group of the Peoples Bank of China (PBOC), *China Monetary Policy Report Quarter One, 2008*, Beijing: Peoples Bank of China, May 14, 2008, <http://www.pbc.gov.cn>, 7; Wang Donglin, "Zhou Xiaochuan, Liberator of the Renminbi," *Zhongguo Zhengquan Bao*, December 29, 2007.

¹²³ Donglin, "Zhou Xiaochuan, Liberator of the Renminbi."

¹²⁴ China National Bureau of Statistics.

¹²⁵ PBOC, *China Monetary Policy Report Quarter One, 2008*, 49.

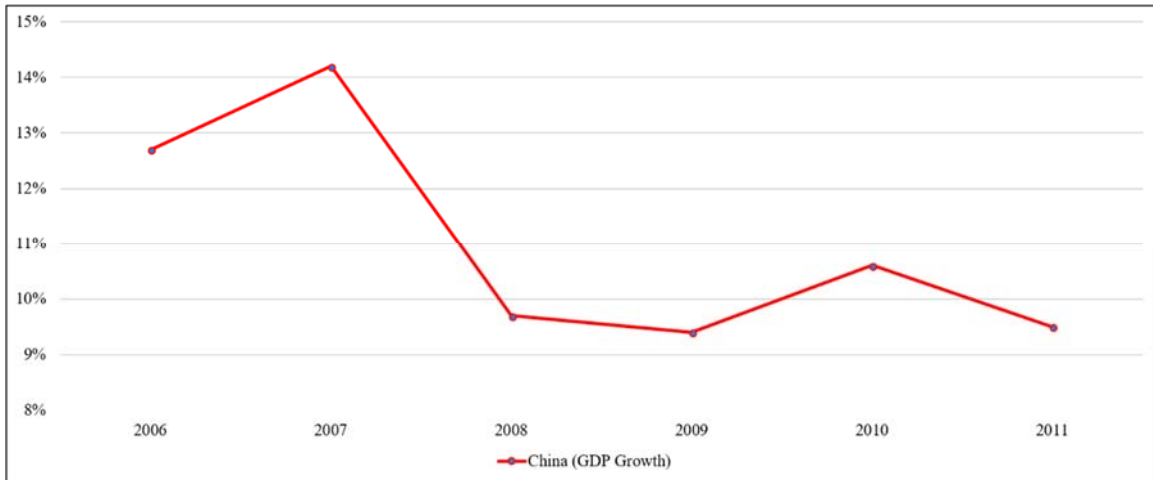


Figure 1. China's Annual GDP Growth¹²⁶

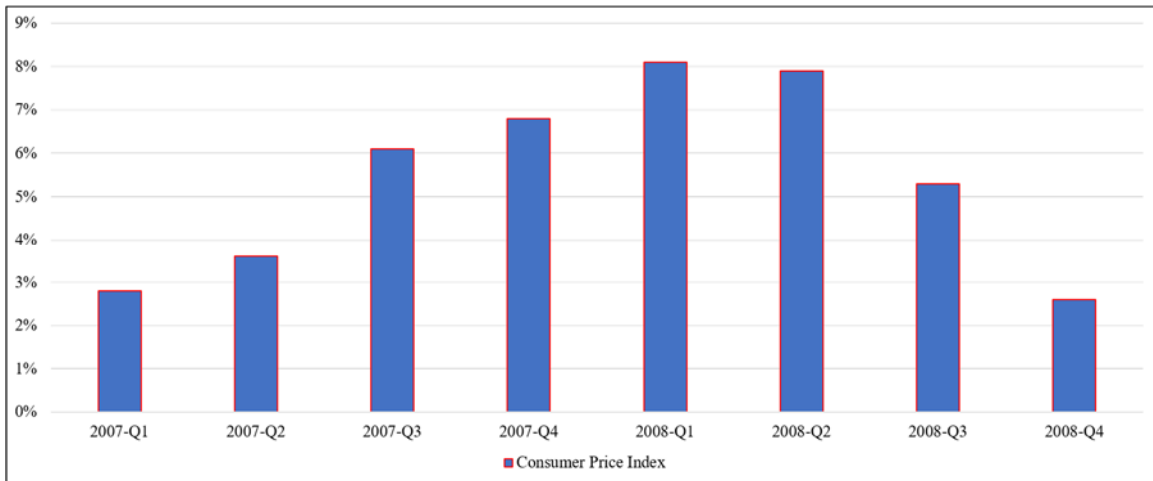


Figure 2. China: Percentage Change in Consumer Price Index¹²⁷

Cooling the overheating economy and controlling rising inflation and consumer prices were top priorities for China's Central Committee and the State Council, resulting in the tight monetary policies employed by the central bank through the first half of 2008.¹²⁸ The PBOC, in its 2008 first quarter report, forecasted a weakened demand for exports in

¹²⁶ Source: "GDP growth (annual %): China, United States, Japan," The World Bank (accessed January 31, 2018), <https://data.worldbank.org>.

¹²⁷ Source: China National Bureau of Statistics, utilized in "China-Country Data: Consumer prices (% change pa; av)," The Economist Intelligence Unit, www.eiu.com.

¹²⁸ PBOC, *China Monetary Policy Report Quarter One, 2008*, 49.

the following months, however it dampened its assessed impact on the economy by noting its large trade surplus among a diverse range of foreign economies.¹²⁹ Other notable economists, like Justin Yifu Lin, then a deputy in the National People's Congress and Senior Vice President of the World Bank, contributed to the central bank's early 2008 assessment concerning export demand by noting how "demand by the U.S., China's second-largest trading partner, would not decrease by a large margin as most of Chinese exports to it were low-and middle-end."¹³⁰

By August 2008, the central bank's plan for the second half of the year remained unchanged. Managing inflation and consumer prices through a tight monetary policy was the top priority as determined by the Central Committee and State Council.¹³¹ As intended, the consumer price index dropped from 6.3 percent in July to 4.9 percent in August.¹³² With one of the central government's top priorities being appeased along with the successful hosting of the 2008 Olympics that August, China's economy likely appeared to have been in a manageable state. Like its 2008 first quarter report, the central bank recognized the negative impact that the U.S. subprime mortgage crisis was having on the global economy after the second quarter, noting how "policy-makers in many economies face the dilemma of both maintaining price stability and promoting economic growth."¹³³ Again, the central bank countered those concerns by highlighting the "strong internal resilience and vitality" of China's economy.¹³⁴

The next month, the situation radically changed. In September, amidst the unprecedented financial failures unfolding abroad, the Olympic honeymoon abruptly ended, and China's economists suddenly found themselves devising a very loose monetary policy. This new policy was completely opposite to their year and a half long effort that

¹²⁹ Ibid., 48.

¹³⁰ "Inflation Major Concern of China's Lawmakers, Political Advisors and Netizens," *Xinhua*, March 2, 2008, www.xinhuanet.com.

¹³¹ Monetary Policy Analysis Group of the Peoples Bank of China (PBOC), *China Monetary Policy Report Quarter Two, 2008*, Beijing: Peoples Bank of China, August 15, 2008, <http://www.pbc.gov.cn>, II.

¹³² China National Bureau of Statistics.

¹³³ PBOC, *China Monetary Policy Report Quarter Two, 2008*, II.

¹³⁴ Ibid.

was just beginning to produce the desired results of slowing the economy to more sustainable growth levels, as well as lowering interest rates and curbing rising consumer prices (see Figure 2). The runaway train that was just brought under control now had to be throttled to top speed. The tight monetary policy employed from 2007 to mid-2008 proved that it takes time for desired macroeconomic changes to come to fruition. As such, the GFC posed extraordinary challenges to China's export dependent economy, and China's economists knew it would take an equally extraordinary countermeasure to quickly generate enough domestic demand to compensate for the imminent loss in its export sector.

The loose monetary policy became a critical aspect in the stimulus package's massive size and hasty implementation. The loose monetary policy had to be quickly implemented in order to provide funding for the local governments to co-fund stimulus-approved projects. Additionally, since previous macroeconomic changes proved to be slow, the central government's urgent messaging to implement the stimulus package, especially from "Central Document No. 18," and implicit backing of newly issued loans artificially hastened the effects of their new monetary policy.¹³⁵ The subsequent windfall of bank lending expanded the size of the stimulus package far beyond the announced 4 trillion yuan and contributed to the economy's reliance on investment-led growth.

B. THE ECONOMIC NEED TO RAISE EMPLOYMENT

The second economic condition that affected the stimulus package's composition and execution dealt with high unemployment and its debilitating impact on increasing consumer spending. Based on the priority sectors and funding allocation of the stimulus package, generating employment appeared to be its top priority. The top three of the seven total priority sectors involved construction heavy, labor-intensive infrastructure initiatives, consuming over 3 of the 4 trillion yuan initially allocated for the stimulus package.¹³⁶ To maintain their targeted GDP growth rates, Chinese officials throughout the GFC sought to keep unemployment low. In a media interview in January 2009, Zhou Xiaochuan, the governor of the People's Bank of China, expressed concern that the country "could miss

¹³⁵ Naughton, "China and the Two Crises," 120.

¹³⁶ Hong, "NRDC Details Four Trillion Stimulus Package."

its target of 8 percent economic growth” that year, noting how China at the time was “in a moderate economic slowdown and need[ed] measures to curb any abrupt economic downturn.”¹³⁷ The eight percent GDP target, as explained by Yang, was likely based on Okun’s Law, which suggests that a one percent rise in unemployment will result in a two percent decrease in GDP.¹³⁸ Given that relationship between unemployment and GDP, the stimulus package’s heavy emphasis on job creation helps explain its intended design.

The employment figures throughout China during the GFC varied but officials attempted to remain positive. For example, Wong, citing a Chinese business journal, noted how “government officials estimated that aggregate employment grew by 8.5 million in the first three quarters of 2009.”¹³⁹ Separately, the Chinese Minister of Human Resources and Social Security, Yin Weimin, stated that “China’s proactive employment policies and measures in response to the financial crisis... generated 10.13 million new jobs in urban areas in the first 11 months of 2009, exceeding the government’s target of 9 million new jobs for the entire year.”¹⁴⁰ Yin articulated China’s concern over unemployment throughout the GFC by highlighting the enormous size of the country’s labor force, which he said in 2004 had approximately 909 million eligible workers between the ages of 16 and 65.¹⁴¹ That number, Yin stressed, was 300 million more than the “combined populations of the seven most developed countries in the world—the United States, Japan, Germany, the United Kingdom, France, Italy, and Canada... This is the dilemma we are facing now.”¹⁴²

The dilemma that Yin alluded to helps to explain the urgency behind the Chinese government’s decisive action to institute the stimulus package. China’s enormous labor force held the potential to generate a substantial contribution to economic growth through its consumer spending power. Since the central government could only create growth from

¹³⁷ “China Could Miss 8 Percent Growth Goal Says PBoC Chief,” *The Standard Online*, January 13, 2009, www.thestandard.com.hk.

¹³⁸ Yang, “Vulgarisation of Keynesianism in China’s Response to the Global Financial Crisis,” 375.

¹³⁹ Wong, “The Fiscal Stimulus Programme and Public Governance Issues in China,” 14.

¹⁴⁰ Lan Xinzhen, “Establishing Job Security,” *Beijing Review Online*, January 14, 2010, www.bjreview.com.cn.

¹⁴¹ Lan, “Establishing Job Security.”

¹⁴² *Ibid.*

domestic demand and with consumer spending stifled from high unemployment, investment became the last means from which to create economic growth. The quicker the government could invest in projects that would employ the labor force, the sooner those workers could contribute to the creation of economic growth through spending.

C. LESSONS LEARNED FROM THE AFC

China's experiences from the AFC likely emboldened China's economists during the GFC to institute a larger, faster, and more aggressive stimulus package. China's central bank had a similar monetary policy prior to the AFC in 1997, which, as explained by the World Bank, primarily consisted of trying to achieve a "soft landing, reducing inflation dramatically while maintaining high official rates of GDP growth."¹⁴³ Like the GFC, the AFC came as a shock after the speculative attack on the Thai baht in July 1997, however, instead of instituting immediate measures to stimulate domestic demand to offset the decline in exports to Asian markets, a more gradual approach was taken by the government. It was not until over a year later, in August 1998, when China's government issued a stimulus package that included fiscal funds.¹⁴⁴ 100 billion yuan (\$12 billion) of fiscal deficit, approximately 1.4 percent of GDP, was allocated toward the AFC stimulus, with its disbursement targeted toward "large-scale" infrastructure projects.¹⁴⁵ A loosened monetary policy accompanied the fiscal spending to accommodate for a slight increase in bank lending to contribute toward infrastructure financing, making the overall stimulus to comprise about 2.5 percent of GDP.¹⁴⁶ Comparatively, China's AFC stimulus plan was extremely modest compared to that of the GFC, but it still received accolades for being appropriately sized and—probably more importantly—not reliant on outside actors like the IMF.¹⁴⁷ For an additional confidence boost, the World Bank called China after its AFC response "an anchor for East Asia economic stability in an environment of acute crisis."¹⁴⁸

¹⁴³ *China: Weathering the Storm and Learning the Lessons*, 5.

¹⁴⁴ *Ibid.*, 8.

¹⁴⁵ *Ibid.*, 9.

¹⁴⁶ *Ibid.*

¹⁴⁷ Naughton, "China and the Two Crises," 116.

¹⁴⁸ *China: Weathering the Storm and Learning the Lessons*, iii.

China's economic management is known for its experimentation, and the AFC acted as a valuable case study for the 2008 leaders of how to react in a crisis scenario. As Jia Kang, the Director of the Research Institute for Fiscal Science within the Ministry of Finance, noted about the GFC stimulus package in Chinese media, "The adjustment is more resolute and timely as China draw[s] lessons from the Asian financial crisis in 1998."¹⁴⁹ Days after the announcement of the GFC stimulus package, the *China Daily* featured an article that compared the two crises, noting how "China pulled through the [Asian financial] crisis mainly by increasing domestic spending," and how "That experience has proved useful now that the global financial crisis threatens to cause an economic recession."¹⁵⁰

D. SOURCES OF STIMULUS FINANCING

The third economic condition that impacted the design and implementation of the stimulus package pertained to China's ample fiscal revenue and solvent banking sector. With the credibility of a stimulus strategy established, the massive GFC stimulus package was further emboldened by the available means to fund the strategy, which was far greater in 2008 than it was in 1998. For example, China's budget revenue in 2008 was approximately 6.1 trillion yuan (19.2 percent of GDP), over six times greater than the 987.6 billion yuan (11.6 percent of GDP) available in 1998.¹⁵¹ The extensive growth of China's economy, aided by its improved interconnection with the global economy, coupled with the central government's improved tax collection measures over that ten-year period contributed to that upsurge in revenue. Additionally, China's buildup of foreign reserves after the AFC reached substantial levels, up to \$1.95 trillion by December 2008.¹⁵² Morrison noted how the U.S. Treasury Department estimated that by "June 2008, China's

¹⁴⁹ "China's 4 Trillion Yuan Stimulus Seeks Shift to Domestic Demand," *Xinhua*, November 9, 2008, www.xinhuanet.com.

¹⁵⁰ You Nou, "Lessons Come in Handy, But This Challenge is Bigger," *China Daily*, November 11, 2008, www.chinadaily.com.cn.

¹⁵¹ China National Bureau of Statistics, utilized in "China-Country Data: Budget revenue, Budget revenue (% of GDP)," The Economist Intelligence Unit, www.eiu.com.

¹⁵² Morrison, *China and the Global Financial Crisis*, 2.

holdings of U.S. securities totaled \$1,205 billion (up from \$922 billion in June 2007), making it the 2nd largest foreign holder of such securities (after Japan).”¹⁵³

Despite the ample fiscal resources available to China’s government during the GFC, the solvent banking sector became an additional source of funding that further incentivized the issuance of the large stimulus package. From the central government’s perspective, there was no need to use most of its fiscal resources when the banking sector was able and willing to assist. Compared to before the AFC, the banking sector was in a more solvent state by the GFC. As Naughton argued, the “difficult and protracted process of bank reform, recapitalization, and restructuring that had been carried out between 2003 and 2006 had left the banks with reasonably strong core capital and low burdens of non-performing loans” (below five percent by mid-2008).¹⁵⁴ In addition, because of the tight monetary policy prior to September 2008, banks were waiting for the opportunity to issue more loans in order to profit through favorable interest rates. As Lardy noted, it was in the best interest of the banks to issue more loans once the monetary policy was loosened because the interest rate on issued loans (at 6.64 percent on average for a one year loan in December 2008) was far higher than the interest earned on deposits with the central bank (at 1.62 percent).¹⁵⁵ These combined factors from the AFC—the successful AFC stimulus precedent, strong fiscal standing, and an eager and solvent banking sector that could minimize the fiscal contribution—became significant additional incentives for the central government to implement a heavily financed GFC stimulus package.

E. CONCLUSION AND ANALYSIS

The GFC’s curtailment of exports put China in a predicament where it had to boost domestic demand through investment in order to generate economic growth. The three economic conditions examined in this chapter emphasized the challenges and opportunities that affected the design and implementation of China’s stimulus package. The first two economic conditions, their restrictive monetary policy before the crisis and high

¹⁵³ Ibid.

¹⁵⁴ Naughton, “China and the Two Crises,” 118.

¹⁵⁵ Lardy, *Sustaining China’s Economic Growth after the Global Financial Crisis*, 9, note 10.

unemployment, were challenges to China's efforts to generate domestic demand. The third economic condition, the central government's ample fiscal revenue and solvent banking sector, was China's opportunity to initiate domestic demand through investment. The lessons learned from the stimulus package issued after the AFC instilled confidence in the GFC stimulus strategy.

This argument presented a very strong explanation of the PRC's incentives to implement the stimulus package because it helped to explain its composition, size, and urgent implementation. The high unemployment problem explained why over 75 percent of the initial stimulus funds were allocated to three of the seven priority sectors. Those three priority sectors were construction heavy, labor-intensive infrastructure initiatives that would produce millions of new jobs, giving China's huge labor force the income to contribute to economic growth through their spending.

China's shift to a loose monetary policy combined with its fiscal wealth and healthy banking sector helped explain the enormous size of the stimulus package. The central government had the fiscal capacity to quickly invest a hefty sum into the stimulus package, but that proved to be unnecessary since the solvency and self-interest of the banking sector allowed the central government to fund the stimulus at minimal fiscal cost. The loose monetary policy expanded the initial size of the stimulus package because the banks were incentivized to profit from the issuance of new loans. The windfall in bank lending, however, came after the central government created the perception among banks, through its urgent messaging, that their new loans would be backed by the government.

Lastly, all three of the economic conditions contributed to the urgent implementation of the stimulus package. The aforementioned urgent messaging was partly due to the central government's concern that their monetary policy shift would take too much time to provide stimulus funding to the local governments. Additionally, the faster the central government could correct its high unemployment problem, the quicker its labor force could contribute to generating economic growth. The central government's fiscal strength and solvent banking sector gave the government the capability, and incentivization, to follow through with its stimulus strategy.

The persuasiveness of this argument is weakened because it does not explain the circumstances as to why the PRC gave minimal consideration in how the stimulus package would affect the progression of its economic growth model away from investment-led growth to growth based on efficiency. The GFC's damage to China's export sector placed the government in a predicament where it had to rely on investment to stimulate domestic demand in order to generate economic growth. As such, China's experience from the AFC ought to have emphasized the temporary nature of a stimulus strategy, not allowing it to effect considerable deviations from the broader economic reform effort. The rush to shift the monetary policy and its impact on how stimulus projects were approved by the NDRC led to the investment of un-scrutinized projects that would become less efficient overtime. The composition of the stimulus package focused on immediate employment potential instead of its potential to make the economy more efficient. For example, only two of the seven priority sectors (environmental protection and technological innovation) focused on efficiency, and they received only 13 percent of the total initial stimulus funds.¹⁵⁶ Furthermore, the central government's urgent messaging to hasten the effects of its loose monetary policy undermined a decade-long effort to strengthen the solvency of the banking sector and the bank's newly established practices of issuing loans to ventures that had the inherent efficiency to repay its debt and generate future profit. The economic conditions examined in this chapter clarified how China's growth model was impacted, but they do not fully explain the circumstances as to why the Chinese government lowered its consideration of the growth model as it devised and implemented the stimulus package.

¹⁵⁶ Hong, "NRDC Details Four Trillion Stimulus Package."

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IV. THE SOCIAL ARGUMENT

This chapter will analyze how the social effects of unemployment and inequality affected the implementation of China's GFC stimulus package. This argument presents an extremely strong explanation (more so than the economic argument) of the PRC's incentives behind the stimulus package because it explains the package's composition, hasty implementation, and why the PRC lowered its concern over the country's economic growth model. The stimulus package was designed to quickly employ millions of people in regions that did not benefit from the country's increased economic growth. Additionally, previous concerns over the country's growth model were set aside to provide a fast solution to the immediate threat of social instability that the PRC perceived as a threat to its regime.

This chapter will reach those conclusions by first explaining how China's rapid but unequal economic growth created social contradictions in China's economy. Next, China's unemployment issue will be revisited to emphasize the severity of the problem and its potential to incite social instability. This chapter will then analyze China's inequality issues and how they developed into resentment toward the PRC. Lastly, this chapter will review the scientific development concept and examine how Hu Jintao and Wen Jiabao on one hand incorporated the concept's intent in the stimulus package to lower inequality through increased state intervention in economic development, but on the other hand undermined the concept's intent to create a sustainable growth model through the stimulus package's massive investment plan.

A. CHINA'S SOCIAL CONTRADICTIONS

China experienced substantial economic growth between the AFC in 1997 to the GFC in 2008, growing nearly five times in size within that time span (see Figure 3)—a feat not seen anywhere else in the world. This enormous growth, which was enabled by the market-oriented reforms of Zhu Rongji, came with a host of social inequality problems that had to be rectified by Hu and Wen. As Kroeber noted, “The Chinese government's official Gini index peaked at 0.49 in 2008–2009” and “Some private estimates put the number as high as 0.55. If we accept the government's figure, China's income inequality is

substantially greater than that of all developed countries.”¹⁵⁷ In addition, Nolan noted how the top 1 percent of China’s income earners account for approximately 61 percent of the country’s total household wealth.¹⁵⁸ The problems associated with the disparity between China’s overall rising economic growth along with the unequal distribution of that newfound wealth was commonly referred to within China (ranging from academic circles to the top PRC leadership) as contradictions. For example, in 2007, Professor Xu Hongwu from China’s National School of Administration summarized China’s “conspicuous contradictions and problems” as “the widening of the gap between urban and rural areas, the increasing employment pressure, the expansion of the gap between different regions... and social development lagging behind economic development.”¹⁵⁹ Hu, in a similar context, spoke about China’s “deep-seated contradictions and problems” pertaining to the country’s past reform efforts in his address to the 17th Party Congress that same year.¹⁶⁰

¹⁵⁷ Kroeber, “China’s Economy,” 197.

¹⁵⁸ Nolan, *Rebalancing China*, 20.

¹⁵⁹ Yu Song, “PRC Expert on CPC Constitution to Include ‘Scientific Development Concept,’” *Zhongguo Tongxun She*, October 6, 2007.

¹⁶⁰ “Text of Hu Jintao Report at 17th CPC National Congress,” *Xinhua*, October 24, 2007, www.xinhuanet.com.

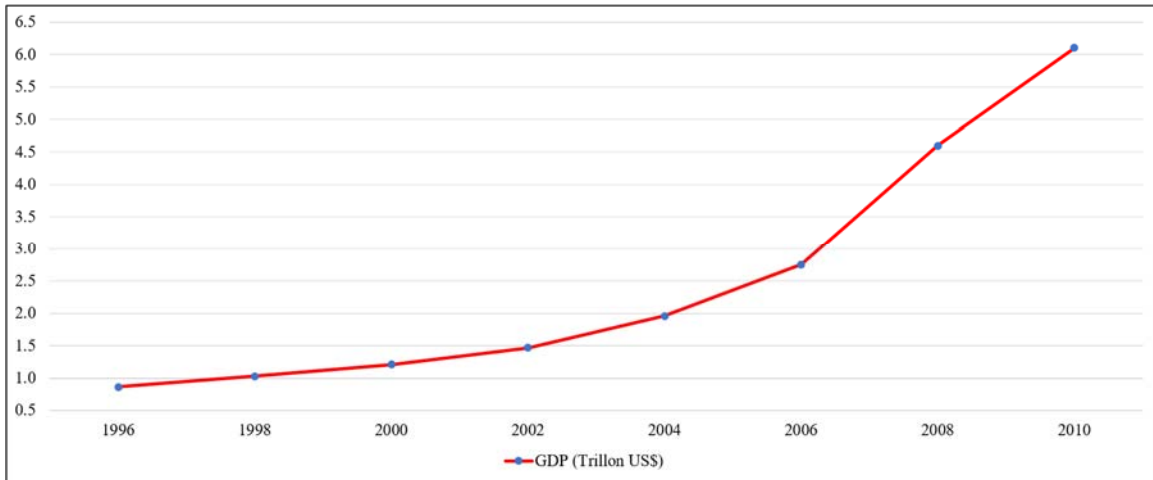


Figure 3. China's GDP (Trillion US\$)¹⁶¹

B. SOCIAL INSTABILITY CONCERNS FROM HIGH UNEMPLOYMENT

A significant effort to both identify and determine the severity of the various social contradictions occurred within China before and throughout the GFC. One approach that the Chinese government has utilized to monitor the country's social contradictions has been through annual survey data analysis provided by the Chinese Academy of Social Sciences (CASS). The data acquired by CASS provides valuable insight into the sentiment of the Chinese public that is not readily identifiable by China's officially published statistics.

CASS identified China's high unemployment problem as a potential cause of social instability. For example, in the 2010 *Blue Book*, Fan Zaiqin, Song Erdong, and Yan Congbing of the Statistics Department in the Ministry of Public Security stated that "due to impacts of the financial crisis, China's export-oriented economic growth pattern is experiencing a serious crisis, and the concentrated emergence of all kinds of contradictions that have existed for a long time in the area of social employment is making tremendous influence and impacts on social stability."¹⁶² Li Peilin and Li Wei in the 2009 *Blue Book* simply stated that "Employment is the foundation of the people's livelihood. According to

¹⁶¹ Source: "GDP (current US\$): China," The World Bank (accessed March 14, 2018), <https://data.worldbank.org>.

¹⁶² Fan Zaiqin, Song Erdong, and Yan Congbing, "An Analysis of Public Security Conditions in 2009," in *2010 Analysis and Forecast of China's Social Situation (Blue Book on Chinese Society)*, ed. Ru Xin, et al (Beijing: Social Sciences Academic Press (China), 2010), 92.

the research, employment difficulties and unstable work is one of the important pressures in life faced by the people.”¹⁶³

With employment having such a crucial role toward China’s social stability, its unemployment rate ought to be accurately measured. Unfortunately, as Timothy Weston described in his account of China’s labor problems, China’s unemployment rate is “notoriously difficult to calculate.”¹⁶⁴ One significant issue is that China’s government does not publish an official nation-wide unemployment rate. The National Bureau of Statistics of China (NBSC), the entity charged with maintaining and publishing official government figures, only releases an unemployment rate that accounts for people that hold official registration (or Hukou) to live in urban areas that register themselves as unemployed.¹⁶⁵ As seen in Figure 4, this practice makes it particularly challenging for those outside of the PRC (if the PRC privately holds nationwide figures) to maintain cognizance over China’s unemployment situation. The red line within Figure 4 depicts the NBSC’s annually published registered unemployment rate in urban areas. The NBSC data from 1997 to 2000 is suspiciously constant, which makes the credibility of their dataset, as Frank Tang noted, “questionable,” especially since China’s state-owned enterprises were forced to lay-off a significant percentage of its workforce following the AFC.¹⁶⁶ In attempts to gain a more accurate account of China’s unemployment situation, organizations like the World Bank and the International Labor Organization formulate models and estimates—as depicted by the blue line in Figure 4—of China’s nation-wide unemployment rate (in this case their data is based on available figures of China’s total labor force). Such models are not perfect, but like in Figure 4, they highlight high and low periods of unemployment that either conflict with or are not as noticeable from the NBSC

¹⁶³ Li Peilin and Li Wei, “The Survey Report on the Issue of People’s Livelihood in China of Year 2008,” in *2009 Analysis and Forecast of China’s Social Situation (Blue Book on Chinese Society)*, ed. Ru Xin, et al (Beijing: Social Sciences Academic Press (China), 2009), 28.

¹⁶⁴ Timothy B. Weston, “Fueling China’s Capitalist Transformation: The Human Cost,” in *China’s Transformation: The Stories Beyond the Headlines*, ed. Lionel M. Jensen and Timothy B. Weston (Lanham, MD: Rowman and Littlefield, 2007), 69.

¹⁶⁵ Frank Tang, “China to Start Releasing Proper Unemployment Figures in 2018 after Decades of Downplaying the Problem,” *South China Morning Post*, December 26, 2017, www.scmp.com.

¹⁶⁶ Tang, “China to Start Releasing Proper Unemployment Figures in 2018 after Decades of Downplaying the Problem.”

figures alone. Additionally, those models help identify time periods to receive greater analytical scrutiny, such as the unemployment spike depicted in 2008.

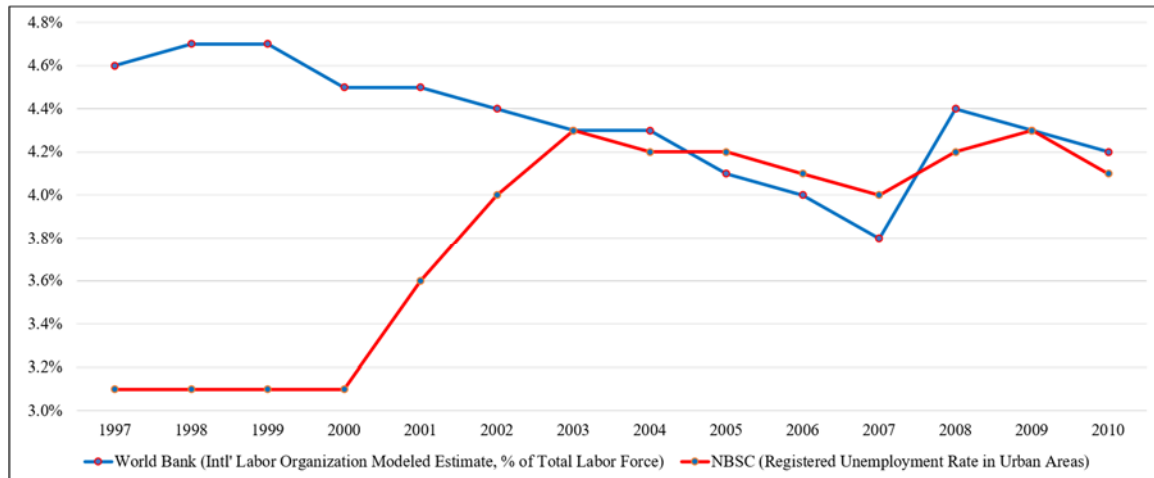


Figure 4. China Unemployment Rate Comparison¹⁶⁷

China’s unemployment rise in 2008 was not unexpected, but the severity of the unemployment was worse than depicted in Figure 4. The exclusion of migrant workers in the NBSC’s unemployment rate is another complicating factor in assessing China’s unemployment situation. The China Labour Bulletin (an independent Hong Kong-based labor activist organization for mainland Chinese workers) noted how “in the first half of 2008, large numbers of small and medium-scale enterprises, hit by higher raw material and transport costs and an appreciating currency, started to scale back production and lay off staff, mostly rural migrant workers not included in the official unemployment statistics.”¹⁶⁸ This statistical exclusion was also a problem for agencies within the Chinese government, which had to resort to independent survey information to gain understanding of the unemployment crisis unfolding in its country. For example, the Ministry of Agriculture conducted a survey among 150 villages in 15 “migrant worker-exporting provinces” before

¹⁶⁷ Source: “Unemployment, total (% of total labor force) (modeled ILO estimate): China,” The World Bank (accessed February 11, 2018), <https://data.worldbank.org>; “1997–2010 Employment Data,” National Bureau of Statistics of China, accessed March 19, 2018, www.stats.gov.cn/english.

¹⁶⁸ “Going it Alone: The Workers’ Movement in China (2007–2008),” *China Labour Bulletin*, July 2009, www.clb.org.hk, 9.

the Lunar New Year holiday in January 2009.¹⁶⁹ The survey revealed that of the 130 million migrant workers that returned to their rural home, 15.3 percent, or approximately 20 million, of those workers were unemployed.¹⁷⁰ For added perspective, that amount of newly unemployed persons in China's rural areas equated to nearly half the population of California.

The unemployment situation in China's urban areas was also worse than depicted from the NBSC's figures. Similar to the Ministry of Agriculture, CASS conducted a nationwide survey between May and September 2008 across "134 counties (cities and districts), 251 townships (towns and neighborhoods), and 523 villages (neighborhood committees) of 28 provinces, municipalities, and autonomous regions," and polled 7,139 residents.¹⁷¹ A variety of questions related to China's social situation were included in CASS' survey, and the results from the unemployment topic were, as mildly described, "not that optimistic."¹⁷² As shown in Figure 5, the survey indicated that China's unemployment rate in its urban areas (at 9.4 percent) could have been over twice the published NBSC unemployment rate (at 4.2 percent).¹⁷³ Not only did the survey reveal a significantly larger scale of unemployment in China's cities, it also revealed a disparity of how that unemployment affected each major region, adding another potential element of social instability at the time of the GFC.

¹⁶⁹ *China Labour Bulletin*, "Going it Alone," 9; "Senior Chinese Official Says 20 Million Jobless Migrant Workers Return Home," *Xinhua*, February 2, 2009, www.xinhuanet.com.

¹⁷⁰ *Xinhua*, "Senior Chinese Official Says 20 Million Jobless Migrant Workers Return Home."

¹⁷¹ Li and Li, "The Survey Report on the Issue of People's Livelihood in China of Year 2008," 15.

¹⁷² *Ibid.*, 20.

¹⁷³ Li and Li, "The Survey Report on the Issue of People's Livelihood in China of Year 2008," 21 (table 6); "2008 Employment Data," National Bureau of Statistics of China.

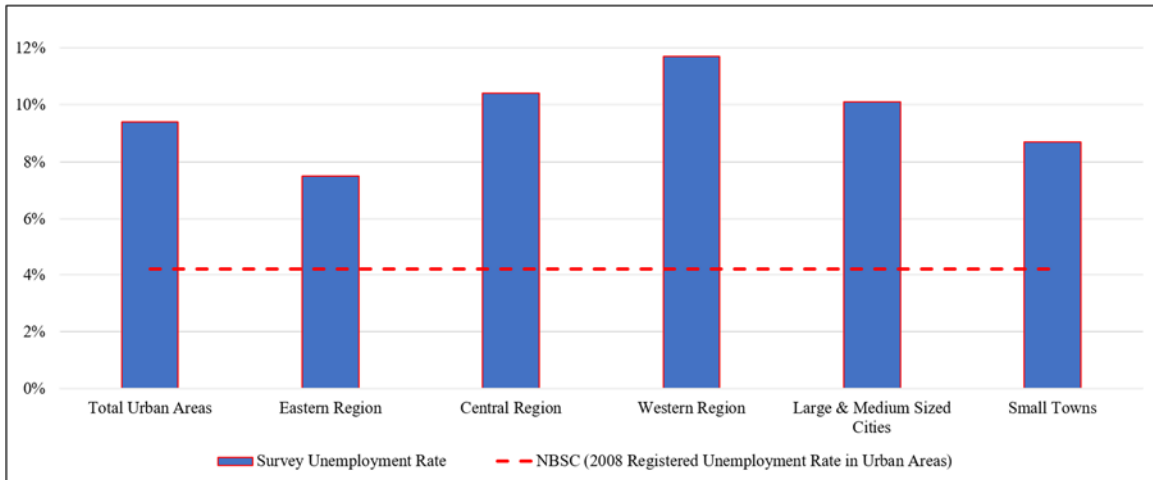


Figure 5. CASS Survey Urban Unemployment Rates (May–September 2008)¹⁷⁴

The high unemployment throughout China and its potential to incite social instability helps explain three notable aspects of the stimulus package. First, the unemployment’s potential effect on social instability explains why the central government allocated over 75 percent of the initial stimulus funding to labor intensive infrastructure projects.¹⁷⁵ Second, the central government’s recognition of the unemployed migrant worker problem explained why the stimulus package had a priority sector dedicated to rural infrastructure improvement. The stimulus package attempted to target the rural provinces full of unemployed migrant workers that returned from the cities and coastal areas. Third, the expanded size of the stimulus package through bank lending reflected the central government’s perception and concern that the high unemployment could develop into further problematic instability problems.

C. INEQUALITY

The dire unemployment situation alone probably could have generated enough cause for China’s government to issue its GFC stimulus package, but other social contradictions, like income inequality, placed additional pressure on the government to

¹⁷⁴ Source: Li and Li, “The Survey Report on the Issue of People’s Livelihood in China of Year 2008,” table 6; “2008 Employment Data,” National Bureau of Statistics of China.

¹⁷⁵ Hong, “NRDC Details Four Trillion Stimulus Package.”

rectify its social problems. As China’s overall economy grew richer after the AFC, the sentiment of those who did not benefit from the market-oriented reforms, or those ‘left behind,’ grew progressively stronger by the time of the GFC. For example, in the same CASS survey conducted from May–September 2008, respondents highlighted a “rather big” disparity in income allocation throughout the various regions in China.¹⁷⁶ As shown in Table 1, the survey revealed that the highest 20 percent of income earners in China made over 17 times more than the lowest 20 percent of income earners.¹⁷⁷ Like the unemployment data, this survey also highlighted how families in urban areas earned more than twice the amount than families in rural areas.¹⁷⁸ Urban incomes outpacing those from rural areas is not a surprising occurrence, however, with China’s situation in 2008, the 20 million unemployed migrant workers returning to the countryside only to earn less than half their previous income (if they can find work) can only exacerbate social instability. The wide income gaps, both regionally and nationally, caused the lowest income earners to develop resentment toward the system that allowed such disparity to occur.

Table 1. Annual per Capita Income Disparity throughout China¹⁷⁹

<i>Region</i>	<i>Family Annual Per Capita Income (Yuan / US\$)</i>	<i>Ratio Between Highest 20% Income Group and Lowest 20% Income Group</i>
Eastern	12,130.54 / \$1773.95	13.8 : 1
Central	6,124.11 / \$895.58	11.6 : 1
Western	5,972.60 / \$873.43	17 : 1
Urban Areas	11,550.27 / \$1689.10	12.6 : 1
Rural Areas	5,284.67 / \$772.82	13 : 1
Nationwide	8,282.57 / \$1211.23	17.1 : 1

¹⁷⁶ Li and Li, “The Survey Report on the Issue of People’s Livelihood in China of Year 2008,” 19.

¹⁷⁷ Ibid.

¹⁷⁸ Ibid.

¹⁷⁹ Source: Li and Li, “The Survey Report on the Issue of People’s Livelihood in China of Year 2008,” 19, table 3. Although the survey was taken between May and September 2008, the family annual per capita income is based on 2007 figures.

The 2008 CASS survey also captured the resentment that people developed because of the inequality. Revisiting the data previously highlighted in Chapter 1, the CASS survey sampled the public's "sense of fairness" in 12 categories. The category with the lowest approval percentage (at 28.58 percent) was "income disparities."¹⁸⁰ Other notable categories with low approval ratings (below 50 percent) included "development of different regions" (at 37.7 percent), "work and employment opportunities" (at 41.05 percent), and "selection of party and government cadre" (at 47.22 percent).¹⁸¹

The party and government cadre questionnaire results probably piqued the interest and fears of the PRC. The same CASS survey demonstrated how the public's disdain over unemployment and income inequality could quickly transition into resentment toward the PRC. One survey question asked, "Which groups have benefited the most in the last 10 years?"¹⁸² From a listing of ten choices, "state cadre" received the highest rating at 68.8 percent, compared to "workers" and "peasant workers" which received the lowest ratings at 6.8 and 6.7 percent respectively.¹⁸³ In one last chilling indicator for the PRC, the CASS survey asked respondents, "Among which two social groups is it easiest for contradictions to occur?"¹⁸⁴ From the eight choices, the category "between cadre and the masses" was rated a close second at 23.6 percent behind the category "between the rich and the poor" at 24.7 percent.¹⁸⁵ Given China's revolutionary history, the government being perceived as the main beneficiary of the economy's success could have destabilizing consequences if the populace feels that it was at their expense. Additionally, the cadre being identified closely with the rich as a contradiction between the masses puts the responsibility, and blame, directly on the PRC to correct the situation. The unprecedented nature of the GFC had the potential to intensify those social problems into cases of real instability.

¹⁸⁰ Ibid., 27 (table 14).

¹⁸¹ Ibid.

¹⁸² Ibid., 25.

¹⁸³ Ibid., 26 (figure 2).

¹⁸⁴ Ibid., 25.

¹⁸⁵ Ibid., 25 (table 12).

The inequality problems may have revealed a crucial impetus behind China's overall stimulus strategy. The aforementioned survey data emphasized how the disenfranchised populace blamed the PRC for the country's inequality problems. The pressure to absolve itself of this blame helps explain why the PRC was willing to sacrifice the progression of the country's growth model. Investment was the quick solution to rectify the immediate inequality problems that could rally millions against the regime. The inequality problems also emphasized why the rural provinces received preferential stimulus funding for projects and why funding was reserved for social programs like social security, housing, healthcare, and education. Like the high unemployment concerns, the expanded size of the stimulus package was likely tolerated by the central government to assure some reduction in the country's inequality.

D. SCIENTIFIC DEVELOPMENT CONCEPT

Hu Jintao and Wen Jiabao recognized the negative trend of the social inequality problems developing throughout the country as the market-oriented reforms expanded the size of China's economy. The ratification of the scientific development concept (SDC) in October 2007 at the 17th Party Congress was intended to enforce a governmental policy shift away from an overreliance on unregulated growth based on market needs toward creating economic growth that reduces the social contradictions with active state intervention in the market. Miller noted that the SDC "sought to redress lopsided emphasis on sustaining high-speed economic growth as the sole criterion of policy success in favor of policies that also take account of the broader social and environmental consequences of economic growth."¹⁸⁶ This policy shift, according to Miller, had been Hu's goal since 2003.¹⁸⁷ Four years later at the 17th Party Congress, Hu used the country's social problems as a driving incentive to implement the SDC, stating how "there still has been no fundamental reversal in the trend of a widening gap in income distribution; [and] there are

¹⁸⁶ Miller, "Leadership Presses Party Unity in Time of Economic Stress," 4.

¹⁸⁷ *Ibid.*, 4.

still quite a large number of impoverished and low-income people in urban and rural areas.”¹⁸⁸

To express the necessity of the SDC and the increased role that the state would need to have in the economy’s development, Hu stated how “it is the fundamental requirement for the prosperity and development as well as long-term peace and stability of our country.”¹⁸⁹ Hu’s speech ought to have been enough to concern PRC members about the risks associated with unregulated, market-driven, growth and its potential to create social instability, however by October 2007, the high inflation rates likely shifted governmental attention away from wholeheartedly implementing the concept. Additionally, the economy’s historically high growth that year posed little incentive for government beneficiaries of that growth to change their governing behavior away from their GDP-focused mindset.

It took an unprecedented financial crisis to propel Hu’s policy objective of increasing the state’s role in the economy’s development. Not until after the reports of widespread unemployment and rising public resentment of inequality (which were being directed at the PRC) did the GFC’s threat to China’s social stability become clear to the entire government. Wen used the GFC to push the momentum for state interventionist policy during his March 2009 Report on the Work of the Government, saying how 2009 will be “the most difficult year for China’s economic development since the beginning of the 21st century.”¹⁹⁰ He specifically identified the GFC as the government’s “high priority” and described the implementation of “a massive plan to adjust and reinvigorate industries to... significantly increase social security benefits, expand urban and rural employment and promote development of social programs.”¹⁹¹

The GFC stimulus package showcased Hu’s policy intent to increase the state’s active role in economic development to address the social contradictions, but the effects of

¹⁸⁸ *Xinhua*, “Text of Hu Jintao Report at 17th CPC National Congress.”

¹⁸⁹ *Ibid.*

¹⁹⁰ “Full Text: Report on Work of the Government,” *Xinhua*, March 14, 2009, www.xinhuanet.com.

¹⁹¹ *Xinhua*, “Full Text: Report on Work of the Government.”

its investment-driven approach undermined the SDC's intent, as Hu stated at the 17th Party Congress, to produce "all-round, coordinated, and sustainable development."¹⁹² The stimulus package's funding priority sectors sought to address social contradictions like rural development, housing, healthcare, and education, as well as broader developmental issues like technical innovation and environmental protection.¹⁹³ The stimulus package did not, however, advance the SDC's intent for sustainable development—which, as explained in Chapter II, needed to come from efficiency—but instead made China's economy unsustainably reliant on investment.

E. CONCLUSION AND ANALYSIS

This chapter examined how unemployment and inequality affected China's GFC stimulus package. Throughout China's incredible economic growth after the AFC, multiple social contradictions pertaining to the unequal distribution of that growth developed among the public, which eventually manifested into resentment toward the rich and to the PRC. The severity of those contradictions was not clear through official NBSC figures, but separate government surveys illuminated the immediacy of those social problems. Hu attempted to remedy those social issues early in his tenure through the SDC, but the severity of the social contradictions continued to grow along with the economy. It took a massive external event like the GFC and its subsequent effect on employment to highlight the threat to China's social stability throughout the government. Once the threat was realized, the GFC stimulus package propelled state interventionist economic policy forward to reduce the high unemployment and inequality through investment but undermined the SDC's intent to foster sustainable development.

This argument presented an extremely strong explanation of the PRC incentives behind the stimulus package because it explained why China's unemployment and inequality problems drove the composition and hasty implementation of the stimulus package, at the expense of its growth model, to prevent social unrest targeted at the PRC. As the GFC unfolded, the tens of millions of unemployed workers (during the holiday

¹⁹² *Xinhua*, "Text of Hu Jintao Report at 17th CPC National Congress."

¹⁹³ Hong, "NRDC Details Four Trillion Stimulus Package."

season) coupled with data that indicated a rising resentment of state cadres amongst the populace, likely placed enormous pressure on the PRC to quickly find a solution. All seven of the priority sectors in the stimulus package were designed at some scale to create new jobs, but most of the initial funding went to the top three labor intensive, infrastructure-based, sectors that would employ millions of workers. The preferential stimulus funding for rural provinces and funding for social programs demonstrated the PRC's willingness to close the income and livelihood gaps between the various regions throughout China.

The PRC's willingness to sacrifice the progression of the country's economic growth model highlight how acute a threat those unemployment and inequality pressures were to the regime. Hu and Wen tried to rectify China's inequality problems through the SDC since 2003, but the GFC and its high unemployment intensified the inequality problems to a high enough level that became threatening to the PRC. This, unlike the economic argument, helps explain the circumstances as to why there was little consideration of the country's growth model in the design of the stimulus package. The unemployment and inequality circumstances of the GFC explain why Hu and Wen abandoned their sustainable growth ambitions and resorted to an enormous and hasty investment plan that would provide a vital reprieve from the pressure placed on the government by the disenfranchised masses.

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V. THE POLITICAL ARGUMENT

This chapter will assess how China's politics affected how the stimulus package came to fruition, the timing of its implementation, its massive size, and its funding disbursement. The first two sections examine how the stimulus package came to fruition after the strong pro-market, or neoliberal, support in China's government was weakened by the GFC and the New Left political movement. The New Left political movement, as Freeman and Yuan explained, advocated for economic growth that included social security and economic equality and derived its name to reflect its opposite position of the "pro-market, efficiency-first neoliberals or Rightists that favor[ed] continued emphasis on GDP growth."¹⁹⁴ The New Left political movement helped Hu and Wen capitalize on the opportunity provided by the GFC to promote their interventionist scientific development concept as the solution to the perceived neoliberal deficiencies that brought about the financial turmoil. The third section will examine how Hu and Wen's international and domestic messaging campaign tied the PRC's credibility to its ability to maintain economic stability.

This argument provides valuable contributions to the overall explanation of the PRC's incentives behind the stimulus package, but this argument alone is not as strong as the economic or social arguments because of the explanatory gaps concerning the stimulus package's urgent implementation and rushed project approval process that undermined the intentions of the SDC. The concluding analysis, however, will show how the political argument helps explain how the stimulus came to political fruition, how Hu and Wen's messaging campaign accounted for the package's timing in November 2008, and the package's massive receipt of capital.

¹⁹⁴ Freeman and Yuan, *China's New Leftists and the China Model Debate after the Financial Crisis*, 1–2.

A. HU JINTAO'S AND WEN JIABAO'S STALLED INTERVENTIONIST POLICY

Implementation of the SDC was politically stalled since Hu assumed leadership of the PRC in 2003. The SDC was Hu's policy initiative to promote state-led economic growth that shifted the PRC's emphasis from unrestrained GDP growth to "all-round, coordinated, and sustainable development" that addressed broader issues such as social security, income equality, technological advancement, and the environment.¹⁹⁵ Bo Zhiyue and Chen Gang used the term "neoliberal," which emphasized "the economic benefit[s] of unfettered markets, privatized state enterprises and a minimalist state role," in explaining the ideology that competed with the premise of Hu's policy.¹⁹⁶ Bo and Chen explained how Hu and Wen "seemed to recognize problems of the neoliberal ideology when they took power in 2003" and sought to incorporate greater control over the effects of the country's marketized economy. For example, in promoting the new concept in 2004 regarding urban and rural development, Wen stated that "it will not do just to rely on regulation by market mechanism to speed up agricultural and rural development and increase peasant incomes; the state must step up support and protection."¹⁹⁷ Hu and Wen continued to make these types of criticisms about the hazards of neoliberal ideology and the government's need to embrace the SDC and its interventionist policies in the years preceding the GFC. For instance, at the East Asia Summit Leaders Dialogue held at Kuala Lumpur in 2005, Wen openly described China's economic problems and the need to institute the state-directed reform policies by stating:

Although China's economic aggregates have reached a certain scale, yet its per-capita GDP still ranks after the 100th place of the world; development in urban areas, rural areas, and in various regions is very uneven; the employment pressure is huge;... the extensive mode of growth has not been fundamentally changed; and the contradictions between rapid economic and social development on the one hand and resources and the environment on

¹⁹⁵ *Xinhua*, "Text of Hu Jintao Report at 17th CPC National Congress;" Miller, "Leadership Presses Party Unity in Time of Economic Stress," 4.

¹⁹⁶ Bo Zhiyue and Chen Gang, "Ascendance of China's New Left Amidst the Global Financial Crisis," in *China and the Global Financial Crisis*, ed. Zheng Yongnian and Sarah Y. Tong (Singapore: World Scientific Publishing Co. Pte. Ltd., 2010), 242.

¹⁹⁷ "Wen Jiabao Expounds on China's Development," *Xinhua*, February 29, 2004, www.xinhuanet.com.

the other are becoming more prominent with each passing day. We need to work hard for a long time to solve these problems.¹⁹⁸

Also, in 2005, *Xinhua* reported on Hu's comments at a Politburo Standing Committee meeting where he stressed the need for the party's leadership to develop "progressiveness" in implementing the SDC.¹⁹⁹ Hu placed direct responsibility on the party's leading cadre for promoting the progressive nature behind the concept by saying "All communist party members must actively throw themselves into the educational activities about maintaining their progressiveness. Leading cadres, in particular, must play an exemplary role. Leading cadres must take the lead."²⁰⁰ In addition, Hu's comments at that meeting showed that the intentions behind the concept and its progressiveness was not completely altruistic but was regarded as a necessary measure to ensure the survival of the party. Hu stated, "The building of the party's progressiveness has always been a fundamental construction project essential for our party's survival, development, and expansion."²⁰¹ Hu returned to this party survival narrative three years later when the GFC unfolded.

Despite the strong demand signal from Hu and Wen, the government continued to frustrate the PRC leadership by slowly applying the SDC. In 2006, Wen pointedly criticized the slow implementation of the concept during an inspection of Henan province by stating:

The reason for the problems that have emerged in the operation of the economy is that the scientific development concept has not been really implemented in some areas and departments, that the extensive mode of economic growth has not yet been fundamentally transformed, and that some deep-rooted system and mechanism obstacles have not been eliminated.²⁰²

¹⁹⁸ "'Full text' of Premier Wen Jiabao's Speech Entitled 'China's Peaceful Development and an Opportunity for East Asia,'" *Xinhua*, December 12, 2005, www.xinhuanet.com.

¹⁹⁹ "Hu Jintao Speaks on CPC's Need to Maintain Progressive Nature," *Xinhua*, January 14, 2005, www.xinhuanet.com.

²⁰⁰ *Xinhua*, "Hu Jintao Speaks on CPC's Need to Maintain Progressive Nature."

²⁰¹ *Ibid.*

²⁰² Chen Weishe, "Wen Jiabao Inspects Henan Province," *Henan Ribao*, July 18, 2006, www.hnby.com.cn.

The following year in his 2007 government work report, after his obligatory observations of the successes of the previous year, Wen stated that the PRC leadership “also soberly noticed that while facilitating economic and social development, China still faces many contradictions and problems and there are some shortcomings and inadequacies in the government work.”²⁰³ In Wen’s explanation to correct the country’s economic problems, he first stated that the mission of the government’s work was to “comprehensively implement the scientific development concept,” and in his listing of goals and tasks for the government, he specified that “First, we must stabilize, improve, and implement our policies... Implementing policies means we must earnestly carry out various policy measures of the central government and enhance the executive power to truly implement all policies.”²⁰⁴ Hu and Wen’s consistent observations of China’s economic problems coupled with their complaints about the slow implementation of their policies over that multi-year period emphasize how the neoliberal ideology at the time was politically strong enough to stymie the directives of China’s top leadership. An interventionist economic policy was not politically feasible during that timeframe and the GFC became the opportunity that Hu and Wen needed to push their policies past the political roadblocks set by the neoliberal ideology.

B. LEVERAGING THE GFC AND THE NEW LEFT MOVEMENT

The GFC provided Hu and Wen with the opportunity to push the SDC forward after its implementation had been stalled for years. Such use of financial crises to advance policy initiatives is not a new occurrence. Arjan De Haan described how financial crises have been used as “windows of opportunity and catalysts of political commitment for change” in past instances.²⁰⁵ Naughton’s example of this instance described how China’s leaders after both the AFC and GFC utilized the panicked environment to intensify their policy

²⁰³ “Government Work Report by Premier Wen Jiabao at the Fifth Session of the 10th National People’s Congress on 5 March 2007,” *Xinhua*, March 17, 2007, www.xinhuanet.com.

²⁰⁴ *Xinhua*, “Government Work Report by Premier Wen Jiabao at the Fifth Session of the 10th National People’s Congress on 5 March 2007.”

²⁰⁵ Arjan De Haan, “A Defining Moment? China’s Social Policy Response to the Financial Crisis,” *Journal of International Development* 22, no. 6 (August 2010): 767, <https://doi.org/10.1002/jid.1726>.

ambitions.²⁰⁶ Zhu Rongji used the AFC as justification to impose the tougher market-oriented reform policies that precipitated the country's massive economic growth, while Hu and Wen used the GFC as an opportunity to amass the political capital necessary to advance their stagnant interventionist economic policy.

China's New Left political movement aided Hu and Wen's effort in leveraging the GFC to build political support for the SDC. As Bo Zhiyue and Chen Gang described, China's New Left movement emphasized "state power as the authority to redress the problems of injustice and other negative effects of privatization, marketisation and globalization."²⁰⁷ In addition, He Li noted that the New Left argued "for a strong central government to regulate the market and curb its tendency toward regional protectionism and fragmentation and toward monopoly and unequal competition."²⁰⁸ To compare ideologies, neoliberal advocates argued for minimal state intervention in the economy whereas the New Left advocates argued for strong state control and direction over the economy. As Bo and Chen explained, "The US-originated global financial crisis provide[d] a good opportunity for the New Left to counterattack neoliberalism."²⁰⁹ For example, the New Left advocates were quick to both blame neoliberal theory for the GFC and to trumpet the hypocrisy of the U.S. government's intervention efforts to rescue its financial sector. Chinese media published several New Left-leaning articles with sensational titles like, "US Financial Crisis: Natural Outcome of Neo-Liberal Policies," "Financial Tsunami Poses a Challenge to Neoliberalism," "A Collapse Caused by Greed," and "Rise of the Beijing Consensus?"²¹⁰ As He Li clarified, the PRC leadership did not fully endorse the New Left movement's recommendations, but it did "cherry pick" some of their "ideas, insight, and

²⁰⁶ Naughton, "China and the Two Crises," 111.

²⁰⁷ Bo and Chen, "Ascendance of China's New Left Amidst the Global Financial Crisis," 249.

²⁰⁸ He Li, "Debating China's Economic Reform: New Leftists vs. Liberals," *Journal of Chinese Political Science* 15, no. 1 (March 2010): 7, <http://dx.doi.org/10.1007/s11366-009-9092-4>.

²⁰⁹ Bo and Chen, "Ascendance of China's New Left Amidst the Global Financial Crisis," 254.

²¹⁰ Yang Pengfei, "US Financial Crisis: Natural Outcome of Neo-Liberal Policies," *Jiefang Ribao*, October 11, 2008, <http://www.jfdaily.com/>; Deng Yuwen, "Financial Tsunami Poses a Challenge to Neoliberalism," *Liaowang*, October 27, 2008; Wang Yusheng, "A Collapse Caused by Greed," *China Daily*, October 23, 2008, <http://www.chinadaily.com.cn/>; Ching Cheong, "Rise of the Beijing Consensus?," *China Daily*, October 28, 2008, <http://www.chinadaily.com.cn/>.

approaches” that best advanced their policy.²¹¹ The New Left’s ability to attribute blame of the GFC to Western-derived, neoliberal ideology as the financial chaos unfolded in the autumn of 2008 proved to be useful for Hu and Wen. As the New Left made the GFC into the prime example of the dangers of unrestrained neoliberalism, Hu and Wen were able to showcase the necessity of their state interventionist policy both domestically and to the international community. This opened the political possibility for a significant interventionist policy like the stimulus package to come to fruition when it was previously not possible.

C. HU JINTAO’S AND WEN JIABAO’S MESSAGING CAMPAIGN

Before the stimulus plan was issued in November 2008, Hu and Wen used a messaging campaign to portray China’s ability to confidently maintain economic stability to a very nervous international community while continuing to pressure domestic policy makers for solutions that corresponded with their SDC. The opportunity to portray China’s confidence to the international community presented itself after the disastrous financial failures occurred in the United States in September 2008. After Lehman Brothers declared bankruptcy on September 15, the \$85 billion U.S. Federal Reserve rescue package to American International Group (AIG) the next day, and the “\$700 billion economic stabilization proposal” announcement by the U.S. Treasury Secretary two days later, Hu had the opportunity to speak with U.S. President George W. Bush early the following week on September 22.²¹² China’s media carefully described the conversation as Hu having the implicit political advantage of the situation with Hu receiving congratulatory comments for the Beijing Olympics and for receiving a briefing—like an authority figure would receive from a subordinate—on the status of the U.S. financial situation by the American President.²¹³

²¹¹ He Li, “Debating China’s Economic Reform,” 19.

²¹² Nanto, *The Global Financial Crisis*, 155.

²¹³ “Chinese, U.S. Presidents Talk Over Phone About Ties, U.S. Financial Turmoil,” *Xinhua*, September 22, 2008, www.xinhuanet.com.

Two days later, on September 24, Wen sought to press China's political advantage during a brief trip to New York to address the United Nations General Assembly (UNGA) and prominent leaders in the U.S. financial arena. China's Foreign Minister, Yang Jiechi, described Wen's comments to other state leaders and media concerning the GFC on the sidelines of the UNGA.²¹⁴ According to Yang, Wen stated,

Faced with the crisis, we particularly need to have confidence, which is more important than gold and currency. Countries should enhance cooperation in responding to the crisis. China will work hard to maintain macroeconomic stability and to keep its financial and capital markets stable. This is of the utmost importance to stabilizing the world economy.²¹⁵

Additionally, on September 24, at a meeting with prominent U.S. financial leaders (to include the president of the New York Federal Reserve Bank, Chairman of Citigroup, the president of the Council on Foreign Relations, and Joseph Stiglitz, Nobel laureate in economics and Columbia University Professor), Wen declared that China would "promptly adjust its policy in light of the changes in the economic situation, strengthen the flexibility and target-timing of macroeconomic control and regulation, and maintain macroeconomic stability, financial market stability, and capital market stability."²¹⁶ Wen put China's reputation at stake with his bold statements to the international community by proclaiming its ability to maintain economic stability during the crisis.

Domestically, Hu and Wen continued to pressure its policy makers for state-interventionist solutions to the challenges posed by the GFC. On September 19 (the day after the \$700 billion U.S. bailout announcement) Hu held a mobilization rally with the Politburo Standing Committee and other CCP leading cadres "for further launching activities throughout the party on studying and practicing the scientific development concept."²¹⁷ At the rally, Hu used the GFC to coalesce party leadership around the SDC,

²¹⁴ Wang Xingqiao and Li Shijia, "A Solemn Proclamation of Reform, Opening Up, Peaceful Development, and Common Progress—Yang Jiechi Comments on Premier Wen Jiabao's Attendance at UN Meetings," *Xinhua*, September 26, 2008, www.xinhuanet.com.

²¹⁵ Wang and Li, "Yang Jiechi Comments on Premier Wen Jiabao's Attendance at UN Meetings."

²¹⁶ Li Shijia and Wang Jiangang, "Wen Jiabao Holds a Forum with Personages from US Financial Circles," *Xinhua*, September 25, 2008, www.xinhuanet.com.

²¹⁷ "Hu Jintao Urges Studying Scientific Development Concept at Mobilization Rally," *Xinhua*, September 19, 2008, www.xinhuanet.com.

remind the party of the concept's official ratification at the 17th Party Congress, and to emphasize its importance in demonstrating the party's ability to effectively manage China. For example, Hu called the SDC "the inevitable requirement for raising the party's ability to govern as well as maintaining and developing the party's advanced nature."²¹⁸ The next day on September 20, prior to his trip to New York, Wen held a mobilization meeting for the "in-depth study and implementation of the scientific development concept."²¹⁹ During that meeting, Wen stressed the importance of utilizing the SDC to maintain economic stability by stating:

Maintaining calm and steady and relatively fast development of the economy and preventing major ups and downs is the primary objective of the effort to promote scientific development. This year is the most difficult for economic development in recent years. The international economic situation is complex and volatile, compounded by international financial turmoil, and the global economy is palpably slowing down. The situation may further intensify. The impact of these changes on our country must not be underestimated.²²⁰

After Wen's New York trip on September 28, Hu held another meeting, but with the larger Politburo, to emphasize the damage that the GFC could cause to China's rural areas and how the CCP needed to "seize and make good use of the important strategic window of opportunity, [and] successfully accomplish the grand goal of building a well-off society in an all-round manner."²²¹ Until the stimulus plan was announced in November, multiple lower-level party meetings were held after the Politburo session—such as those from the "Central Leading Group for Deeply Studying and Implementing the Scientific Development Concept"—to devise interventionist solutions to the impacts of the GFC.²²²

²¹⁸ *Xinhua*, "Hu Jintao Urges Studying Scientific Development Concept at Mobilization Rally."

²¹⁹ "Wen Jiabao Addresses 'Scientific Development' Workshop, Comments on Food Safety," *Xinhua*, September 20, 2008, www.xinhuanet.com.

²²⁰ *Xinhua*, "Wen Jiabao Addresses 'Scientific Development' Workshop, Comments on Food Safety."

²²¹ "Hu Jintao Chairs Meeting of CPC Central Committee Political Bureau," *Xinhua*, September 28, 2008, www.xinhuanet.com.

²²² Xu Jingyue, "Central Leading Group for Deeply Studying, Implementing Scientific Development Concept Calls for Further Stressing Special Features of Practice in Course of Launching Campaign of Studying and Implementing Scientific Development Concept," *Xinhua*, October 26, 2008, www.xinhuanet.com.

The GFC stimulus package became politically feasible because of Hu and Wen's messaging campaign, which defeated the previous neoliberal political barriers to their state-centric concept by incorporating the international community, PRC leadership, and state media. Without the GFC, Hu and Wen would not have been able to compose a narrative of the SDC as the solution to the crisis' imminent dangers and would not have been able to pressure the government to implement their policy out of fear of losing domestic and international credibility. As Cheng Li reported, Hu referred to the GFC as ““a test of our ability to control a complex situation, and also a test of our party's governing ability.””²²³

D. CONCLUSION AND ANALYSIS

The political argument provides valuable explanations of how China's stimulus package came to political fruition, the timing of its implementation, its massive size, and why the funding had its targeted distribution, however, because of its explanatory gaps related to concerning the package's urgent implementation and rushed project approval process that undermined the intentions of the SDC, it is not as strong as the social and political arguments. This argument positively examined how the GFC allowed a state-interventionist policy such as the stimulus plan to come to political fruition after years of apprehension from neoliberal advocates. When the GFC occurred, China's New Left advocates trumpeted the failures of neoliberal ideology and the West's hypocritical intervention efforts to mitigate economic damage. The New Left's criticisms allowed Hu and Wen to promote their state-interventionist SDC as a solution to the neoliberal deficiencies thereby making the GFC stimulus package politically feasible.

The built up international and domestic political pressure to fulfill expectations to maintain economic stability helps explain why the stimulus package was hastily executed in November 2008 and why the package received massive amounts of capital. Wen's New York trip in September tied the PRC's credibility to his declarations to the international community that China would actively regulate its economy to maintain economic stability. Those declarations likely compounded the domestic political pressure that Hu and Wen

²²³ Cheng Li, “China's Team of Rivals,” *Foreign Policy*, no. 171 (March 2009): 88.

already had generated by emphasizing the GFC as a challenge to the PRC's ability to govern China. Furthermore, Hu and Wen's continued promotion of interventionist economic theory and the SDC created additional pressure for their policies to be successful in application. The large infusion of capital into the stimulus package was likely perceived to increase the likelihood of its success and to demonstrate that the state was taking bold action to control the economic situation.

Although this argument highlights the political urgency behind the stimulus package's execution, it alone does not fully justify why it was so urgent that the PRC became willing to compromise the solvency of its bank sector when it had strong fiscal capacity. If maintaining domestic and international credibility was a significant driver behind the timing of the stimulus, then the PRC could possibly have sufficiently demonstrated its governing ability and credibility through a package predominantly funded with fiscal revenue and carefully regulated bank lending. The haphazard bank lending that became the central funding mechanism for the stimulus package undermined the SDC's demand for state-directed, focused macroeconomic control.

Lastly, Hu and Wen's persistent advocacy for the SDC explained the targeted funding distribution of the stimulus package. Hu and Wen used the GFC stimulus package to attempt to correct the problem areas that they identified in their advocacy for the SDC. The stimulus package's funding allocation toward technological innovation, rural development projects, social programs (including social security, healthcare, and housing), and the environment conformed to the SDC's intentions. However, like the bank lending, the political argument does not completely justify the stimulus package's rushed project approval process. The CCP's strategy to quickly implement the stimulus plan came at the cost of giving the NDRC enough time to thoroughly assess the viability of each proposed project and to determine if those projects would effectively advance the SDC. The factors from the economic and social arguments are needed to fill the explanatory gaps from the political argument.

VI. THESIS CONCLUSION

A. CONCLUDING ANALYSIS

This thesis examined the economic, social, and political arguments of the incentives behind China's decision to implement its aggressive economic stimulus package after the global financial crisis. The social argument provided an extremely strong explanation (the best of the three arguments) of the PRC's incentives behind the stimulus package because it explained the package's composition, hasty implementation, and why the PRC disregarded its economic growth model. The economic argument provided a very strong explanation (not as strong as the social argument, but stronger than the political argument) because it helped to explain its composition, size, and urgent implementation of the stimulus package, however, it was unable to explain why China's economic growth model was disregarded. Lastly, the political argument, while still valuable, was not as strong as the social or political arguments because it partially explained the composition of the stimulus package and had explanatory gaps concerning the package's urgent implementation and rushed project approval process that undermined the intentions of the SDC.

This thesis concludes that the strongest and most comprehensive explanation for the decision to implement the stimulus package requires a nuanced and specific integration of economic, social, and political arguments. When combined, the three arguments proved that the stimulus package was most likely implemented because the PRC thought it was necessary to protect its regime. The PRC was incentivized to implement the stimulus package because sustained economic growth kept its legitimacy among the populace, who became increasingly dissatisfied by the government for the country's inequitable growth that seemingly benefitted only the regime.

The economic argument helped to explain how the stimulus package was necessary to generate growth as well as the stimulus package's composition and massive size. The investment-led stimulus created the demand for projects that would employ tens of millions of newly laid off workers, allowing that enormous workforce to contribute to economic

growth through the spending of their income. This accounted for the labor-intensive, infrastructure-based priority sectors in the stimulus package and its receipt of over three-fourths of the initial stimulus funding. The ample fiscal revenue, solvent banking sector, and positive lessons learned from the AFC stimulus strategy further incentivized the stimulus package's implementation. The attempt to employ millions of workers explained why massive sums of capital were invested in the stimulus package and the overall drive to boost domestic demand slightly explained the hasty implementation of the package. The economic argument may have explained the necessity for an economic stimulus to generate growth, but it did not explain why the GFC became an acute challenge to the PRC regime. This explanatory gap highlights why the economic argument alone could not explain the PRC's disregard for its economic growth model as it devised the stimulus package.

The social argument identified how the crucial impetus behind the stimulus package was to protect the PRC regime. The tens of millions of suddenly unemployed workers during the holiday season had the potential to develop into a volatile situation of social instability. The GFC increased the potential for social instability because those unemployed workers were likely among the populace that held increased discontent toward the PRC due to the country's inequitable economic growth, which was perceived to have primarily benefitted the regime. The PRC likely interpreted this social instability threat as a challenge to its regime and quickly crafted and implemented the stimulus package to mitigate the danger. This explains the hasty implementation of the stimulus package, why its seven priority sectors were designed to produce jobs in disenfranchised provinces, and why the package included initiatives to improve social security and equality. Despite the explanatory strength of this argument, it could not explain the PRC's predicament in needing to rely on an investment-based stimulus strategy to generate economic growth. The social argument, however, does emphasize that the PRC disregarded its growth model to address the more pressing challenge to the regime.

The political argument reinforced how the PRC likely perceived the GFC to be a challenge to its regime. After unsuccessfully trying to implement their interventionist economic strategy through the scientific development concept for nearly half a decade, the GFC became the opportunity for the PRC leadership to showcase the effectiveness of their

policy. The problem that the PRC leadership encountered was that their persistent advocacy created considerable domestic and international expectations for the government to sustain economic growth throughout the GFC. The GFC tested the PRC's leadership's legitimacy and ability to substantiate their economic policy. This partially explains why the stimulus package was hastily implemented and why the stimulus included priority sectors that reflected initiatives from the SDC. The political argument by itself, however, did not fully explain why the PRC disregarded the country's growth model as it planned the stimulus package. The social argument helps fill this explanatory gap. The pressure that the PRC was under to prevent social instability was compounded by the political pressure to meet the domestic and international expectations to sustain economic growth. The PRC sacrificed the country's growth model progression, despite its intent from the SDC, in order to quickly relieve the compounded pressure that threatened the regime.

B. KEY IMPLICATIONS

The findings of this thesis reveal three key implications about the Chinese government. First, this thesis underscores how regime survival in the short-term takes precedence over long-term economic development ambitions. The half decade of promoting and advocating for sustainable economic development through the SDC was quickly sacrificed to mitigate the immediate threat posed by the GFC. Economic management was still at the forefront of the PRC's priorities but, when it perceived itself to be threatened, quick solutions to the threat were given precedence.

Second, the Chinese populace holds substantial influence over the Chinese government in crisis situations. Even for an authoritarian regime, the tens of millions of disenfranchised unemployed during the holiday season was too large of a problem for the PRC to ignore or wait to dissipate. The PRC's rhetoric, especially through the long SDC campaign, established expectations among the populace that the PRC had to meet. Additionally, as demonstrated by the CASS surveys, people were forthright in expressing their frustration over the country's inequality problems and were candid in attributing blame to the government. The people's negative sentiment toward the government forced

the PRC to recognize their concerns and issue policy, however hastily formed, to appease the problems.

Third, lower-level party and government officials held considerable de facto veto power over policies within the PRC. The long campaign by Hu Jintao and Wen Jiabao to implement the SDC, and their open complaints over the slow implementation of their policies, demonstrated that not all orders from the top leadership were strictly followed. Lower government officials that favored the market-oriented reform policies had the political aptitude to maneuver around the top leadership's direction to accomplish their own objectives. It took a massive and unprecedented financial crisis to threaten the PRC regime to coalesce support to implement the stimulus package.

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