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China's Neglected Informal Economy

Reality and Theory

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The informal economy—defined as workers who have no security of employment, receive few or no benefits, and are often unprotected by labor laws—in China today accounts for 168 million of the 283 million urban employed, but the official statistical apparatus in China still does not gather systematic data on the informal economy. Part of the reason for the neglect is the misleading influence of mainstream economic and sociological theories, which have come from the “economic dualism,” “three-sector hypothesis,” and “olive-shaped” social structure theories that held great influence in the United States in the 1960s. This article reviews the core elements of that modernization model, the “revolution” in development economics that followed in the 1970s and 1980s, and the “counterrevolution” from neoclassical economics that came with the rising ideological tide of neoconservatism. The article argues for a balanced theoretical perspective that can more appropriately capture the realities of the informal economy today.

Keywords: *statistical data; economic dualism; informal economy; development economics; neoclassical economics; social justice*

The “informal economy” has grown dramatically worldwide in developing countries since the 1970s, a phenomenon highlighted by agencies like the International Labor Organization (ILO) of the United Nations, the “Social Protection Unit” of the World Bank, and the Nobel Peace Prize selection committees. China, with marketization of its economy, has become part and parcel of this worldwide phenomenon in reality, even while its state statistical apparatus continues to neglect the informal sector. This article examines the available empirical evidence and analyzes how the

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same phenomenon has been differently understood by opposing economic theories. It calls for setting ideological excesses aside to bring out genuine insights, and joining those together to form a balanced theoretical perspective.

China's Informal Economy

The informal economy has become the largest sector of nonagricultural employment in developing countries and has drawn greater and greater attention from development economists. In "Asia,"¹ it has grown to about 65 percent of the total nonagricultural employment (and 48 percent in North Africa, 51 percent in Latin America, and 78 percent in Sub-Saharan Africa), according to the authoritative study by the ILO (2002). Even though the ILO has yet to take China into full account (in part because of want of data), this phenomenon has become undeniable in China of the marketizing reform era, even by its own sparse official data: in 1978, there were only an insignificant 15,000 employees outside the formal sector; by 2006, that figure had exploded to 168 million, out of a total urban labor force of 283 million, to make up 59.4 percent of the total (*Zhongguo tongji nianjian*, 2007: 128-29, Table 5-2; cf. Hu Angang and Zhao Li, 2006). The proportion occupied by the informal economy continues to expand in China and throughout the developing world, a fact that has been underscored by numerous studies, including those of the Social Protection Unit of the World Bank (see, as examples, Blunch, Canagarajah, and Raju, 2001; Canagarajah and Sethuraman, 2001; and Das, 2003).

The ILO, first established under the League of Nations in 1919 and awarded the Nobel Peace Prize in 1969 for its championing of social justice for laborers, defines the informal economy and its workers sensibly and practically: as workers who have no security of employment, receive few or no benefits, and are often unprotected by state labor laws.² For China, the best example would be the 120 million-odd *nongmingong* (peasant-workers) employed in the cities and towns, "leaving both the land and the home village" (*litu lixiang*), and another 80 million locally employed, who "leave the land but not the village" (*litu bu lixiang*).³ The great majority of these 200 million *nongmingong* do not enjoy official urban resident status and take the hardest, dirtiest, and lowest-paid work shunned by urban workers.

They work both in the formal economy as temporary, low-paid workers without benefits and outside the formal economy in small, so-called private enterprises (*siying qiye*, 私营企业; more below),⁴ or as self-employed *getihu* (个体户), or simply as unregistered laborers in a great variety of pursuits (more below). Indeed, the ILO, which had focused in the 1970s and 1980s

on an “informal sector” conceptualized as separate from and outside of the formal sector, has since emphasized the need to include workers who are employed in the formal sector on an irregular basis. It has accordingly revised the informal-sector concept into a broader one, the informal economy, to take account of both those working informally inside the formal sector and those working outside the formal sector (ILO, 2002).

Statistical data for China's informal economy are still relatively undeveloped, unlike for countries like India, Mexico, and South Africa, whose governments have worked together with the ILO to reorient their statistical categories and procedures to take full account of the informal economy.⁵ For China, the best way to obtain an overview approximation of the informal economy is to start with the National Bureau of Statistics' (NBS) figure for the total of urban employed persons (*chengzhen jiuye ren yuan*, 城镇就业人员), which is based on the reliable 2000 population census that included rural migrants who worked in the cities for more than six months a year, and deduct from it the numbers of regular employees in the officially registered and counted formal entities reported annually through the enterprises to arrive at the number of employees in the urban informal economy.⁶ Thus, for 2006, we start with the NBS's count of 283.1 million total urban employed persons, deduct the 114.9 million persons who are employed on a regular basis (i.e., the *zhigong*, 职工, or regular staff and workers) in different kinds of formal enterprises according to the categories used by the NBS (i.e., “state-owned units” [*guoyou danwei*, 国有单位]; “collective units” [*jiti danwei*, 集体单位]; “cooperative units” [*gufen hezuo danwei*, 股份合作单位]; “joint ownership units” [*lianying danwei*, 联营单位]; “limited liability corporations” [*youxian zeren gongsi*, 有限责任公司]; “share-holding corporations limited” [*gufen youxian gongsi*, 股份有限公司]; those “with funds from Hong Kong, Macao, and Taiwan” [*Gang Ao Tai shang touzi danwei*, 港澳台商投资单位]; and “foreign funded units” [*waishang touzi danwei*, 外商投资单位]; *Zhongguo tongji nianjian*, 2007: 138, Table 5-7), and arrive at the figure of 168.2 million employees in the urban informal economy, both registered (as so-called private enterprises and self-employed getihu) and unregistered, as shown in Table 1.

Most of the 168.2 million employees of the urban informal economy come from the 120 million-odd nongmingong working in the cities, for which our best source is the authoritative “Summary Report on China's Nongmingong Problem” (“Zhongguo nongmingong wenti yanjiu zongbaogao,” 2006), compiled at the instruction of Premier Wen Jiabao and under the leadership of the Research Office of the State Council, with the collaboration of a host of government units and scholars, and based on the systematic sampling of 68,000 households from 7,000 villages in thirty-one provinces

Table 1
Urban Employment by Registration Status, 2006

Registration Status	Number Employed (in millions)	%
Employed persons	283.1	100
Formal workers and staff	114.9	40.6
Informal workers		
Private enterprises	39.5	14
Self-employed	30.1	10.6
Not formally counted	98.6	34.8

Source: *Zhongguo tongji nianjian* (2007: 128-29, Table 5-2), *Zhongguo laodong tongji nianjian* (2007: 13, Table 1-8).

(and municipalities and regions).⁷ According to that report, 30.3 percent (or 36.4 million) of the 120 million work in manufacturing and another 22.9 percent (or 27.5 million) in construction, making for a total of about 64 million nongmingong who work in the urban “secondary industry.” In addition, a total of about 56 million nongmingong work in the urban “tertiary industry,” that is, services, including 10.4 percent, or 12.5 million, in “social services,” such as domestics, guards of residential compounds, barber shop and massage parlor personnel, delivery persons, garbage collectors, street cleaners, and so on; 6.7 percent, or 8 million, mainly service personnel in hotels or hostels and eateries; 4.6 percent, or 5.5 million, in wholesale and retail trade, mainly small shops, stalls, and vendors; and so on.

These nongmingong are second-class citizens who do not have regular urban resident status. They are generally low paid and work for few or no benefits. According to the “Summary Report,” the average annual wage of these peasant-workers in 2004 was 780 yuan a month, and the average number of hours worked was eleven a day. In other words, while working nearly 50 percent more time than regular urban laborers, they received an average of just 60 percent of the pay. Among them, just 12.5 percent worked with some kind of a contract. Only about 10 percent had medical insurance, and only 15 percent had retirement benefits.⁸ Many worked in small informal enterprises or else were self-employed, with no protection from labor laws or state-organized labor unions. Without urban resident status, many had to bear the added burden of no health benefits and special school fees for their children. From their ranks came the great majority of the 700,000 odd laborers crippled that year by accidents at work. These basic facts are confirmed by a host of other smaller-scale studies.⁹

They are also confirmed in the main, if not in all particulars, by the third of three systematic international income surveys carried out for the years

1988, 1995, and 2002, involving collaboration between scholars from abroad and those of the Chinese Academy of Social Sciences, called the Chinese Household Income Project. Those surveys took a subsample of the NBS household survey, using modified criteria intended to overcome some of the limitations of the NBS survey.¹⁰ For 2002, the survey covered a sample of 9,200 rural households in 120 counties and 6,835 registered urban households in seventy cities and included a subsample of rural migrants living in urban areas. That survey found that that migrants earned on average 50 percent less than urban residents,¹¹ even without taking into account differences in number of hours worked or differential access to health services and education (Gustafsson, Li, and Sicular, 2008: 12, 29; Khan and Riskin, 2008: 76).

In addition to the 120 million nongmingong, there are about 50 million regular urban residents who work in the informal economy, as shown in Table 2. Many of those are disemployed (*xiagang*, 下岗) workers who had lost their previous jobs in state-owned or collective enterprises and who now work mainly in the tertiary industry of services. Solid and comprehensive data are lacking, but to judge by a fairly systematic sampling of the disemployed workers of fifty-five cities in seventeen provinces done in 1997 at the height of the *xiagang* phenomenon, the majority were "middle-aged" (64 percent ages 30 to 50) and of relatively low educational background (56 percent with only a grammar school or lower-middle school education; only 5.7 percent had received a higher education in universities or technical colleges). The majority ended up working in the informal service sector in transport and trade, eateries, social services, and the like; in small so-called private enterprises; as self-employed individuals; or in the kinds of jobs that are just one rung above those taken by the nongmingong. Only a small proportion of those surveyed (4.7 percent) believed they had "benefited greatly" from the government's program to retrain and place disemployed workers ("Chengzhen qiye xiagang zhigong" ketizu, 1997; see also Ministry of Labor and Social Security, [2002] n.d.).

In terms of registration status by ownership form, the 168.2 million laborers of the urban informal economy include a total of 69.6 million who are officially registered, of whom 39.5 million work in registered so-called private enterprises and another 30.1 million as registered self-employed. As already noted, 98.6 million are simply not registered (with the State Administration for Industry and Commerce; see Table 1).

The so-called private enterprises are officially defined as enterprises owned by "natural persons" (*ziranren*, 自然人). They therefore do not include "limited liability corporations" or "share-holding corporations limited" that have corporate "legal person" (*faren*, 法人) status; enterprises

Table 2
Urban Employment by Registration Status and
***Nongmingong* versus Urban Residents (in millions)**

Registration Status	Number Employed
Total	283.1
Formal	114.9
Informal	168.2
Nongmingong	120
Urban residents	48.2

Source: *Zhongguo tongji nianjian* (2007: 128-29, Table 5-2); cf. “Zhongguo nongmingong wenti yanjiu zongbaogao” (2006).

“with funds from overseas Chinese in Hong Kong, Macao, and Taiwan”; or “foreign funded enterprises,” all of which may be considered “capitalist” (and, of course, also not those registered as state-owned, “collective,” or cooperative enterprises). They must therefore not be confused with what the term *private enterprises* would suggest in the American context, that is, all nongovernment enterprises. These Chinese “natural persons-owned” private enterprises in fact account for just 14 percent of all urban employed persons and should definitely not be equated in any sense with the whole or the predominant part of Chinese “capitalism” (*Zhongguo tongji nianjian*, 2007: 128, Table 5-2).

They are almost all small businesses. In 2006, there were a total of 5 million such entities registered, of which those registered in the cities and towns employed a total of 39.5 million workers (and those registered in “rural” areas, 26.3 million), making for an average of 13 workers per enterprise (*Zhongguo tongji nianjian*, 2007: 150, Table 5-13).¹² According to the sixth systematic sampling survey of these enterprises done (once every two or three years since 1993) in 2005, with questionnaires completed by one per thousand of these units throughout the country, just 1.13 percent of the enterprises were larger entities that employed over 100 workers.¹³ The great majority were small-scale enterprises averaging, we have seen, just 13 workers per enterprise. The largest proportions were in manufacturing (38.2 percent), shops and eateries (24 percent), social services (11.1 percent), and construction (9.1 percent). Workers in such informal units generally enjoy little in the way of benefits or job security or labor law protection (“Zhongguo siying qiye yanjiu” ketizu, 2005).

To be sure, the “employed persons” of these 5 million small private enterprises include their owners, who might be considered small-scale private

capitalists, as well as a small number of highly skilled and well-paid individuals. But the great majority of the 39.5 million persons included in the category are common employees working for less favorable terms than those in the formal economy.

As for the 30.1 million listed as urban self-employed *getihu*, they, together with another 21.5 million “rural”-registered *getihu*, worked in a total of 26 million such entities nationwide in 2006, to make up an average of 1.9 employed persons per entity—generally the person registered, often working with a relative or friend or two (*Zhongguo tongji nianjian*, 2007: 151, Table 5-14). These “self-employed” persons include small-shop and stall owners, old- and new-style artisans and apprentices, proprietors of small eateries and food stalls, repair shop owners, and the like. Employment in such entities, of course, generally does not come with benefits or job security.

Finally, there are the nearly 100 million unregistered urban informal employees. They operate at even lower levels with still less job security, many of them temporary help, such as domestics, home-based workers (like seamstresses and laundresses), delivery boys/girls, apprentices, street vendors, and the like. Together the three main groups of the informal economy (private enterprises, the self-employed, and the unregistered) add up to a composite picture of low pay, little job security, few or no benefits, and no protection under state labor laws—that is, our definition of the major characteristics of the informal economy.

These 170 million urban informally employed persons may be seen as at the level, or just a rung above, the 80 million peasant-workers who are locally employed in rural, nonagricultural informal units, including individuals working in the “township and village” industries (the secondary industry) and sundry services (the tertiary industry), especially transport (such as people hauling goods by truck, small tractor, pedicab, bicycle, or animal or human power) and trade (owners of small shops or stalls, itinerant vendors), and social services (traditional and semimodern and modern artisans, barbers, repairmen, and so on). These 80 million, of course, qualify fully as a part of the informal economy by our definition.¹⁴

Outside of the above, there are just under 300 million persons engaged mainly in “agriculture” (in the broad sense to include forestry, husbandry, and fishing and not exclusive of periodic involvement in commercial activities, as the NBS explains; *Zhongguo tongji nianjian*, 2007: 463, Table 13-4). These peasants may of course also be counted among those in the informal economy, according to our definition, for they enjoy few benefits and legal protections. Yet they do, in China, almost all own the use rights of their

“responsibility land” (at an average of about seven sown mu per rural laborer) (Huang Zongzhi, [2005] 2007), which lends some measure of “job security,” and are in that respect somewhat different from many of their counterparts in other developing countries, like India and Mexico. This aspect is of course a legacy of the planned economy of the Mao era and does serve the purpose of providing something like a livelihood floor akin to social security for the rural employed. Nevertheless, such peasants generally earn relatively little from the land (one reason for their willingness to go off to work as *nongmingong*). They are perhaps still better understood according to older categories, like “peasant” or “agricultural,” or “rural economy” or “primary industry,” rather than “informal economy,” which is intended to apply mainly to urban and nonagricultural employment. If we exclude peasants, we would then be thinking in terms of a three-sector economy—agricultural, informal, and formal—which seems to me preferable to a two-sector conception of just agriculture versus industry, modern versus traditional, or even informal versus formal.

The informal economy thus includes mainly the 200 million *nongmingong* plus 50 million informally employed urban residents, or a total of 250 million. While still a somewhat smaller number than the 300 million-odd engaged mainly in farming, it is 2.2 times larger than the number employed in the formal urban economy.¹⁵ If we exclude the 80 million *nongmingong* working locally near home, and consider *urban* to include only cities or towns of the county-seat level and higher (see note 7), then the informal economy employees would be 1.5 times those of the formal units. Regardless, in China, as in other developing countries, the informal economy has come to exceed by far the scale of the formal in terms of numbers employed.

This picture of the informal economy may also be seen historically. The big component parts of the current informal economy come from four sources: the rural industrialization and rise of informal township-village enterprises of the 1980s, the large-scale movement of *nongmingong* into informal employment in the cities since the late 1980s, the disemployment of state and collective enterprise employees and their entrance into the informal economy from the mid-1990s on, and finally, the rapid rise of informal private enterprises and of the informally self-employed *getihu* from the early 1990s on. Those massive developments are what have driven the rapid expansion of the informal economy since the 1980s.

A less obvious historical perspective might use an older class category employed by both Marx (who may be seen as antimarket) and Weber (as promarket): the petty bourgeoisie, to refer originally mainly to artisans and

small shopkeepers. Those existed in some abundance in China before 1949. Organized and/or categorized largely out of existence after 1949, they have returned on a massive scale in the reform era. They make up a major proportion of the self-employed getihu of today, in trade and transport and in other services, both old and new style. They have emerged together with what might be called “the new petty bourgeoisie,” that is, the new white-collar employees, linked mostly to new types of formal sector services. The old petty bourgeoisie are especially easy to overlook, given our long tradition (in both Marxist and non-Marxist economics) of preoccupation with producers of material goods to the relative neglect of those in services who might be considered producers of “nonmaterial goods.” The categories of new and old petty bourgeoisie spotlight the reemergence of services, in addition to rural industrialization and expanded urban industrialization. They have grown in part to serve the needs of the expanded working classes of the cities (for cheap goods and services) and in part to provide interfacing between the rural and urban economies (see my fuller discussion in Huang Zongzhi, 2008a).

If the empirical picture presented here is generally accurate, then the questions are: In what theoretical framework do we place this empirical reality? How do we narrate or construct it?

“Economic Dualism” and the American Model

The mainstream view in American development economics of the 1960s, and the mainstream view of economists in China today, is W. Arthur Lewis's model of “economic dualism.”¹⁶ Lewis's starting point is the fact of overpopulation and surplus labor in many developing countries, especially Asia. That fact of “unlimited supplies of labor” forms the basis of his two-sector conception, the traditional agricultural sector and the modern capitalist industrial sector. In the former, wages remain at subsistence levels, while in the latter, they rise with capital investments, expanded labor productivity, increasing profits, increased credit, expanded capital accumulation, greater output, and the demand for more labor. With development, the modern sector draws off more and more of the surplus labor in the countryside until it is exhausted and a turning point (later dubbed the “Lewis-ian turning point”) is reached. Thereafter, the neoclassical view of labor as a scarce resource, like any other factor of production, comes into play and wages will rise rapidly. Development, then, is above all about reducing surplus labor to generate an integrated labor market (Lewis, 1954; cf. Lewis, 1955).¹⁷

Lewis's analysis differed importantly in some respects from the neoclassical analysis of his time, such as that of Theodore Schultz, who shared with Lewis the Nobel Prize in 1979. For Schultz, the big point was that even in traditional agricultural economies, labor was a scarce resource and optimally allocated like any other, such that there was no such thing as surplus labor, which Schultz insisted on equating only with "labor of zero marginal productivity."¹⁸ A second important difference was that while Lewis saw agriculture as basically stagnated at a subsistence level, Schultz made the important contribution of highlighting its potential for development (Schultz, 1964; cf. Huang Zongzhi, 2008b). The two, however, shared in common their faith and optimism in market-driven capitalist development.

Lewis's analysis was subsequently mathematicized (or "formalized"), reinforced, and developed by John C. H. Fei and Gustav Ranis. In particular, Fei-Ranis highlighted how the developing countries' "redundant labor" in agriculture, cost-free because it was redundant, could be an important asset for economic development in the modern industrial sector—a point that of course strikes chords with the Chinese experience of the recent decades (Fei and Ranis, 1964; Lin, Cai, and Li, [1996] 2003). Lewis's model was also further refined by Michael P. Todaro, who added to it the concept of a "traditional urban sector," arguing that many who migrate to the cities, even in the face of high urban unemployment, do so not so much for actual increased income but rather out of the expectation of increased income. Their economic behavior was still based on "rational" probabilistic expectations of higher earnings—just that those would materialize only later. In the interim, they tended to work in the traditional urban sector, substantially lower paid than the modern sector (Todaro, 1969; cf. Todaro, 1989: 278-81).

Given the fact of China's overabundance of labor, along with state-enforced separation of the rural from the urban economy since 1958 by a rigid household registration system, it is not surprising that the economic dualism model should have seemed particularly relevant. I single out here for discussion the recent and substantial argument for the model by Cai Fang (2007), featured as the lead article in *Zhongguo shehui kexue*, widely considered the leading social science journal in China.¹⁹

In his article, Cai adds a couple of minor modifications to Lewis's original analysis but retains its core. First he adds to it the notion of the "demographic dividend": namely, in the demographic transition from a regime of high fertility–low mortality to low fertility–low mortality, there comes a phase in which the ratio of nonproductive consumers (the young and the elderly) to active producers in the population declines. That is an advantage in China's current situation, a factor not considered by Lewis.

Second is the institutional factor of China's urban versus rural household registration system, reflecting the reality of economic dualism, but which needs to be changed to facilitate full integration of the rural and urban labor markets. Neither of these modifications, however, affects Lewis's scheme in any important way, nor are they intended to by Cai. He in fact accepts Lewis's model in full, arguing especially that the "turning point" from Lewis's segmented dualistic market to an integrated labor market and market equilibrium is already on its way.

Cai's basic analysis is shared by Wu Jinglian, among others, who maintains (the very widely held view) that the solution to China's rural problems can be found only in urbanization and vigorous development of the modern urban sector to draw away surplus rural labor (Wu Jinglian, 2005a: chap. 3; n.d.). Like Lewis and Cai, Wu sees the rural economy itself as quite hopeless; development can come only from the modern urban sector. Elsewhere, Wu urges reliance on small- and medium-scale private enterprises as opposed to large-scale enterprises emphasized under the old central planning mentality (Wu Jinglian, 2002).²⁰

As a variant to the basic analysis above, Cai also calls on Simon Kuznets, who, in his classic presidential address to the American Economic Association in 1955, argued that earlier stages of economic development tend to be accompanied by greater inequality until the ripple effects of development bring greater equality (Kuznets, 1955). Cai does not note that Kuznets had based his empirical support mainly on the American, British, and German experiences and that Kuznets himself had emphasized that his model was "5 percent data and 95 percent conjecture" (Cai Fang, 2007: 10-11, cf. 5; Kuznets, 1955: 4, 26).

These "mainstream" views in development economics of the 1950s and 1960s draw on and are supported by another line of economic theorizing, namely, what might be termed the "three-sector theory" of economic development. That line of analysis is traceable to early writers such as the New Zealand economist Allan G. B. Fisher ([1935] 1966: especially 32-34) and the Australian economist Colin Clark (1940: 337-73), who first called attention to the emergent importance of the tertiary sector of services in the developed countries once basic necessities are met and leisure and the demand for personal services (including entertainment) rise. The clearest and most succinct expostulation has come from the French economist Jean Fourastié, who placed the three sectors in a simple linear progression, from the preponderance of agriculture to industry and finally to services. In "traditional civilizations" (like European countries in the middle ages or the developing countries of his day), according to Fourastié, "primary industry"

(i.e., agriculture) accounted for 70 percent of the workforce (industry 20 percent and services 10 percent); in the “transitional period,” agriculture’s share of the workforce shrinks to 20 percent while industry expands to 50 percent and services to 30 percent; in the “tertiary civilization” stage, finally, agriculture further shrinks to just 10 percent and industry, too, to 20 percent, while services expand to 70 percent of the workforce (Fourastié, 1949).

This three-sector theory and its perspective on development has also found considerable support in China; prominent among supporters is Li Jiangfan and his Center for the Study of Tertiary Industry at Zhongshan University. Li has argued strongly, and with singular focus, that the tertiary industry is the key to China’s present and future development, adopting by and large the conceptual scheme of Fourastié (Li Jiangfan, 1994; cf. Li Jiangfan, 2005). It is an argument drawn upon also by Wu Jinglian, among others (Wu Jinglian, 2005b).

This perspective is not limited to the field of economics. It extends also to sociology, centering around the equation of “modern society” with an “olive-shaped” social structure. The concept is traceable to the schema first advanced by American sociologist C. Wright Mills in his classic book, *White Collar: The American Middle Classes*, published in 1951 (1956). The idea was a simple one: American society was moving at the time dramatically toward a society in which the majority of the people would be in the “new middle classes,” most especially the new white-collar workers, whose numbers had expanded greatly in the preceding half century. Among the many works that have applied this concept and vision to present-day Chinese society is the highly influential study of social differentiation in Chinese society led by Lu Xueyi. In it, Lu asserts that Chinese society is already well on its way toward the “modern” olive shape, as opposed to the more unequal and traditional “pyramid shape.” The change, according to Lu, is proceeding apace at the rate of an increase of 1 percent (in the proportion of the population accounted for by the “middle class[es]”) per annum (roughly the same rate as that of Chinese urbanization). By the year 2020, Lu projects, Chinese society will be 38 percent to 40 percent middle class. (That vision of enormous numbers of Chinese new middle-class consumers, of course, has been a powerful impetus for foreign firms investing in China.) The emphasis is clear: with economic development, China is marching inexorably along the path of Americanization (Lu Xueyi, 2002; 2003; 2007; cf. my discussion in Huang Zongzhi, 2008a), a vision shared by both Wu Jinglian (2008a) and Cai Fang (2007).

At bottom, then, the current mainstream view in China, in economics and in sociology, might be simply characterized as that of Americanization.

It forecasts development that heads inexorably toward ever greater numbers and proportions moving from the traditional sector into the modern, from the countryside into the cities, and from the poorer classes into the middle classes. That was the picture that had been dominant in the American academic world in the 1960s and one that came to form the core of so-called modernization theory of the time. It was, we have seen, in its first instance based on abstractions from the experiences mainly of the West, especially the United States (but also England, France, and Germany). Extended to the developing world, the model allowed for modifications, such as overabundant rural populations and time delays, as in Lewis's economic dualism and Todaro's traditional urban sector, but remained true to its original core vision of inevitable "modernization" powered by market-driven capitalist development, to end just like the United States.

In the United States itself, however, the modernization model, along with all of the presumptions of neoclassical economics, would come under searching attack after the 1960s until it fell completely out of favor in the American academic world, so much so that the term *modernization* came to be equated almost with simple-mindedness (more below). But that "revolution" in development economics would be followed, in turn, by something of a "counter-revolution" (in the words of Todaro, 1989: 78-85) in the 1980s and 1990s, as neoclassical economics gained such powerful predominance through the rise of American neoconservatism that it came to be equated almost with the whole of economics itself. In the past few years, however, the dominance of neoconservatism appears to be coming to a close with American failures in Iraq, the widespread decline of the United States in international prestige, and the horrific financial crisis in the fall of 2008. These observations jump well ahead of our story, however; below we turn first to the criticisms of modernization theory in the 1970s and 1980s.

The Informal Economy

Critique of the economic dualism model and of modernizationism came first not so much from theorists as from the empirical work of applied economists and economic anthropologists. The fact was that the developing world ("Third World") of the 1960s and 1970s experienced urbanization at a rate far exceeding that of growth in employment in modern industry; the majority of rural migrants into the cities, in fact, ended not in the modern sector of the economy but rather in something in between the rural and the urban. Michael Todaro, we have seen, attempted to take account of this empirical reality in the "Todaro model." But it was really researchers doing

firsthand investigations in Third World countries who first focused on the distinctive realities of substandard urban employment in the “informal sector,” a more precise term than Todaro’s “traditional urban sector.”

The first study came from the ILO’s Kenya report in 1972 (ILO, 1972). It was a large-scale effort involving a team of forty-eight researchers headed by two prominent development economists, Hans Singer and Richard Jolly (both of the Institute of Development Studies of Sussex University and both to be knighted later, in 1994 and 2001, by Queen Elizabeth). The modern urban enterprises, usually capital intensive and with foreign investment, were generating only limited employment (despite Kenya’s growth rate of 6-plus percent a year at the time). Most urban laborers were in fact not entering the modern industrial sector but becoming instead what the authors termed the “working poor” employed in the informal sector, comprising mostly small-scale, unregulated (often harassed by the state) enterprises (the most visible being street hawkers, but also carpenters, tailors, repairmen, cooks, and the like), distinguished from the regulated (and state-supported) larger businesses and enterprises. Moreover, far from being simply “traditional,” the informal urban laborers worked also in distinctly “modern” activities—modern construction, trade, machine repair, furniture making, taxicabs, and so on. Since these realities were clearly at variance with the (two sector and simple development from traditional to modern) predictions of the economic dualism hypothesis, the authors employed instead the formulation of a formal versus an informal sector. They called for government policies to stop discriminating against the informal sector and to support it for its growth potential and its contributions to urban employment.

That ILO study was followed shortly by a study of Ghana by (economic) anthropologist Keith Hart (who later became the director of the African Studies Centre of Cambridge University). Like the ILO, Hart employed the category “informal sector,” highlighting especially the self-employed rather than the wage earner (Hart, 1973). His data, like the ILO’s, showed the large size and low earnings of the informal sector.

After those came a host of other studies, such as the study of India by the Dutch economic anthropologist J. C. Breman. Breman both confirmed the findings of the earlier works and pointed to remaining conceptual problems, such as informal employment within the formal sector itself, already discussed above (Breman, 1980). And social-economic historians, among many others, joined in later to show that in the European experience as well, the presence of growing numbers of workers in the cities had created the demand and the market for low-priced goods and services, usually met

by the “petty bourgeoisie,” the majority of them in small-scale enterprises and shops, including many self-employed. The interfacing between cities and countryside, and between modern and traditional, had likewise required a host of small traders, artisans, service and transport personnel, and so on (Crossick and Haupt, 1995; Mayer, 1975; cf. Huang Zongzhi, 2008a).

The ILO has played an important role throughout both in generating basic data from a global perspective and in its advocacy of “decent” work conditions for all laborers worldwide. The subsequent accumulation of empirical information and data about the informal economy in Third World countries became so compelling that, as noted above, even the World Bank established the Social Protection Unit (of its Human Development Network), under which many papers have been published on the informal economy, already referred to above. The purpose of the studies, as is evident from the names of the units themselves, is for social protection and human development. It is also no accident that the 2006 Nobel Peace Prize should have gone to Muhammad Yunus, who had dedicated the Grameen Bank to addressing problems of the most vulnerable among the nonagricultural laborers in the informal economy—the rural women in Bangladesh (Yunus, 2006).

In China, however, there has been relatively little attention to the subject of the informal economy. Serious research has only barely begun. One study worthy of special mention is the short article by Hu Angang and Zhao Li (2006), which laid out the broad outlines of the available statistical data. The Chinese Ministry of Labor and Social Security, founded in 1998, took the first steps by convening an ILO conference in 2002. It has also been active in programs that help to upgrade the skills and education of workers in the informal economy and help to place those disemployed from the formal economy. What has been done, however, remains paltry when compared to the full dimensions of the problem. And the ministry's (Department of Planning and Finance) compilation of labor statistics continues to neglect the informal economy (more below).

Ideologized Theoretical Debates

The ILO's formulation of the concept of an informal sector, and later the informal economy, held important theoretical promise, but the foreground of theoretical debates was quickly occupied instead by ideological arguments between Marxist and neoclassical (neoliberal) economists. Among the Marxist challengers to the theory of economic dualism, one of the best known was André Gunder Frank, who sought to turn modernizationism on its head: Far from bringing inevitable development and closing the gap between city

and countryside, imperialism imposed an “internal colonial structure” between the “metropolis” and its “satellites.” Far from being separate and independent from the cities, à la Lewis’s model of economic dualism, the countryside tended to become permanently “dependent” on the metropolis, in the same way that Latin American countries have become dependent satellites to the United States. Imperialism, in the name of modernization, was in fact causal of dependency and underdevelopment, not the reverse. For Frank, the key economic logic was the Marxist conception of extraction of surplus value—that is, exploitation of the difference between the value created by cheap labor and the wages paid to it. “Dependency” was above all a matter of the flow of such “surplus” from the peasant economy of the countryside to the colonial metropolis and from the underdeveloped satellite countries to the developed nations (Frank, 1973).

If Frank’s critique of neoclassical marketism, and of its variant in economic dualism, appears quite ideological and even accusatory, Immanuel Wallerstein’s “world systems theory” seemed more objective. Unlike for Frank, imperialism for Wallerstein was not the consequence of exploitative intent of nations or individuals so much as a depersonalized worldwide system that took hold between the sixteenth and eighteenth centuries. This “world capitalism system” came to be differentiated into three zones, the “core,” the “periphery,” and the “semiperiphery.” Surplus value flowed from the periphery to the core. (The semiperiphery, at once extractor of surplus and extracted, was important because it prevented complete polarization of the world and helped to maintain the system.) Such flow of surplus, Wallerstein acknowledged, did not mean that workers got poorer and poorer; rather, their lot had improved. Nevertheless, in worldwide perspective, the gap between the core and the periphery had not shrunk but has, rather, continued to expand (Wallerstein, 1979).

Marxist-inspired theorists, like Frank and Wallerstein, helped to usher in the “revolution” in development studies in the 1970s and 1980s, but it was followed by the subsequent “counterrevolution” from neoclassical economics (again in the words of Todaro, 1989). That counterrevolution was of course helped greatly by the collapse of communist rule in the former Soviet Union and in Eastern Europe, leading to the hegemony of triumphalist market fundamentalism under Ronald Reagan (and “Reaganomics”), George Bush, and George W. Bush. The crucial difference was that the use of foreign cheap labor was not understood in terms of the Marxist concept of exploitation but rather in terms of the neoclassical notion of optimizing market forces.

That neoclassical counterrevolution was propelled in part by the accompanying rise of the “new institutional economics,” associated with theorists

like Friedrich A. Hayek and R. H. Coase, both of the University of Chicago, and Douglass North. Hayek, for his part, began with persuasive arguments against neoclassical economics for its presumptions of perfect reason, perfect knowledge, and complete information when real persons cannot hope to attain such (Hayek, [1948] 1980: chap. 1, 2, and 4). But those criticisms, it turns out, actually served in the end for Hayek the purpose not so much of a critique of neoclassical market fundamentalism but rather of a wholesale attack on socialist planned economies—it was they who in Hayek's view really carried “scientism” to an extreme. On balance, Hayek held, imperfect individuals making their choices in a free market through the mechanism of prices most nearly approximates the ideal of an optimal economic system. The allocation of labor, of course, is part and parcel of this scheme (Hayek, [1948] 1980: chap. 6; for a good discussion of Hayek, see Wang Hui, 2004, vol. 4, part 2: 1438-92). Needless to say, in such an analytical framework, it makes no sense to speak of the extraction of surplus value from (informal economy) laborers.

R. H. Coase too presented his arguments as a modification of the simple neoclassical scheme of optimal allocation of resources through just individual entrepreneurs and the price mechanism. He highlighted the necessity for “transaction costs” in economic activities and explained the rise of firms and private property rights in terms of the need to minimize such costs (Coase, [1988] 1990). And Douglass North took as his point of departure the critique of neoclassical economics' neglect of “the state” and of “institutions.” North's view of institutions, it turns out, means finally the crucial importance of efficient and exclusive property rights. In his overview of economic history, property rights such as those in modern Western nations alone allow for full economic development (North, 1981). For Coase and North, too, it would make no sense to speak of the exploitation of workers.

All three—Hayek, Coase, and North—remained unreservedly opposed to state interference in the market and to government involvement in social welfare. Despite their ostensible criticisms of neoclassical economics, all remained committed to its faith in market mechanisms—that individuals pursuing utility maximization and firms profit maximization in a free market are what optimizes the allocation of resources and makes for the maximum benefit to the greatest number. The new twist for Coase and North is the notion that only exclusive property rights can make for low transaction costs and economic efficiency, but otherwise they helped only to reinforce the core neoclassical article of faith: the less government interference with market forces, the better.

The new institutional economics seems to many of its followers more persuasive than simple neoclassical economics, because it appears to take

full account of political (legal) institutions. For many Chinese economists, given their deep revulsion against a horrendous state bureaucracy and the rigidities of a planned economy, institutional economics has held particular appeal, both for its emphasis on the creative energies of a market economy and for its call for private property and minimizing the role of the state. Many “mainstream” Chinese economists have taken it to be the perfect theoretical prescription for a reformist China. Its influence in China today exceeds that of any other variety of economics (see, for example, Wu Jinglian, 2005a: especially 18-20). (Some among those who use institutional economics, to be sure, have lent “institutions” a much broader interpretation than its original, narrow sense of property rights in Coase and North, equating institutions with China’s entire political system [*tizhi*] and state policies; see, for example, Fan Gang, 2008; Fan Gang and Chen Yu, 2005; Fan Gang and Hu Yongtai, 2005. Some, perhaps, have deliberately employed theories of institutional economics as a convenient tool for writing about the otherwise highly sensitive subject of political reform.)

In hindsight, however, most of the original arguments and counter-arguments between Marxist and neoclassical (and institutional) economists have perhaps more to do with politics and ideology than with academic study, for the two sides could not help but be caught up in ideological issues of the Cold War. Thus, Hayek’s sensible criticisms of neoclassical economics for its assumption of perfect rationality and knowledge, its obsession with equilibrium analysis, its tendency to equate theoretical propositions with reality, and its excessive reliance on mathematical analyses were all buried in the end by his ideological preoccupation with criticizing planned economies and state intervention. The criticisms with which he began came in the end to be deflected onto planned economies, while opposition to state interference in the economy, even at the level only of Keynesian economics, was what came through finally as his true preoccupation. At the same time, Frank’s and Wallerstein’s sensible critiques of capitalist imperialism for its exploitation of cheap labor (and extraction of raw materials) in developing countries came to be identified in the end, whether intentionally or not, with a complete rejection of market economy in favor of centralized planning.

The weaknesses of planned economies, of course, have been amply demonstrated by the turn to marketization of the former communist states. There can be little question that centralized planning had given rise to burdensome and rigid bureaucracies, not to speak of “soft budget constraints” and chronic “shortage” (Kornai, 1980). And the core Marxist notion of surplus value, based on its labor theory of value, seems simply

unable to take full account of the roles of capital and technology or of market-determined (supply-and-demand-determined) value. If anything, the swing against Marxist economic theory and planning has perhaps gone too far, denying any contributions whatsoever even of its vigorous development of heavy industry, its successful provision of health and education services, and its decent treatment of laborers.

With the waning of neoconservative dominance today and the current financial crisis reminiscent of the Great Depression of the 1930s, perhaps we can come to see also the weaknesses and blind spots of neoclassical economics. Those pointed out by Hayek years ago were only too real. Moreover, unmitigated pursuit of profit and unchecked market mechanisms clearly have led time and again to severe excesses, well-defined property rights or not. Part of the blame for the “financial tsunami” of 2008 must be placed on the neoclassical dogma against almost any kind of state intervention in the workings of the market.²¹ The idealized rationality of neoclassical economics, moreover, cannot account for the greed and exploitation, or the fear and panic, evident historically in market-driven capitalism (e.g., in imperialism, the Great Depression, and the 2008 financial tsunami). Institutional economics added the twist of the property rights argument to neoclassical economics but remained completely attached to the dogma of unconditional opposition to state intervention in the market and involvement in social welfare.

In hindsight, each side of the Marxist-versus-neoclassical economists' arguments has been as lopsidedly ideological as the other. In the process, truly incontrovertible insights of each have been obscured by their own ideological excesses. Neoclassical economics and institutional economics are surely correct to emphasize that a market economy and private property rights can release creative entrepreneurial and competitive energies far greater than a planned economy, just as Marxist economics is surely correct to point out the excesses, inequalities, and maltreatment of laborers that can accompany an unbridled capitalist pursuit of profit, whether in the imperialist past or in the global-capital present.

A Misleading Picture of Empirical Reality

The one-sided acceptance of neoclassical economics and of the American model by mainstream economics in China today has in fact greatly influenced not just the presentation of statistical data but also the kinds of data

gathered and not gathered. To a great extent, the indecent treatment of laborers of the informal economy is simply assumed away. For example, the widely used China Labor Statistical Yearbook reports both the “average earning of employed persons in urban units” and the “average wage of regular staff and workers in urban units,” one being 20,856 yuan a year and the other 21,001 yuan a year. The result is to convey the misleading impression that informal and regular workers’ earnings are very close to one another (*Zhongguo laodong tongji nianjian*, 2007: 52, Table 1-28; 82-83, Table 1-43). But these data in fact apply almost entirely to regular staff and workers, or just 115 million of the 283 million urban employed, and include only the small number (a total of just a few million) of irregular workers officially reported by the enterprise units. They do not include the informal (but registered) private enterprises and self-employed entities, much less the unregistered nongmingong and urban residents, that subcontract for work under the formal units (*Zhongguo laodong tongji nianjian*, 2007: 2, Table 1-1; 24, Table 1-14; *Zhongguo tongji nianjian*, 2007: 135, Table 5-6; 142, Table 5-9). In 2004, the nongmingong working in cities, we have seen, in fact averaged just 780 yuan a month, or 9,360 yuan a year, a great difference from the national average earning of 16,519 yuan reported for that year by the labor statistical yearbook.

The same applies to data on the number of hours worked by employed persons. We find in the tabulated data that all age groups and occupations and education levels range between forty and fifty hours (*Zhongguo laodong tongji nianjian*, 2007: 119, Table 1-68). This of course obscures the findings of the summary report on the 120 million nongmingong, which found that they worked an average of eleven hours a day, six or seven days a week—again something known to most informed Chinese citizens just from people they know or know about as well as verified by a host of smaller-scale studies (e.g., the studies of Beijing, Hefei, and Wuhan cited in note 9).

The data on the tertiary industry is another example of misleading statistics. Conceptually, the NBS defines the category as “all other economic activities not included in the primary or secondary industries.” It includes the following in the most recent breakdowns: “Transport, Storage and Post”; “Information, Transmissions, Computer Service and Software”; “Wholesale and Retail Trades”; “Hotels and Catering Services”; “Finance and Insurance”; “Real Estate”; “Leasing and Business Services”; “Scientific Research, Technical Services, and Geological Prospecting”; “Management of Water Conservancy, Environment and Public Facilities”; “Services to

Households and Other Services"; "Education"; "Health, Social Securities and Social Welfare"; "Culture, Sports, and Entertainment" (the old "Education, Culture and Arts, Radio, Film and Television," with "Education" now separated out); and "Public Management and Social Organization" (the old "Government Agencies, Party Agencies, and Social Organizations") (*Zhongguo tongji nianjian*, 2007: 135-37, Table 5-6; 131, Table 5-4).²² The majority of these are very modern-sounding categories, such as IT (information technology), real estate, finance, universities and research institutes, film and television, and state and party officials. They fit closely the image of the white-collar new middle class. Small wonder, therefore, that economists like Li Jiangfan (1994, 2005) should have come to represent the whole of the tertiary industry as the most advanced of the three sectors.²³

Once again, however, the data are in fact limited to only the formal economy, with about 60-plus million in services (and 50-plus million in the secondary sector, mainly manufacturing and construction). That leaves out completely the 56 million *nongmingong* working informally in services as well as a large proportion of the 50 million-odd informally employed urban residents—the majority of those working in services. By lumping together under the tertiary-industry category IT personnel, state officials, and high-level researchers with informal employees, such as domestics, street cleaners and garbage collectors, delivery persons, servers in eateries and hostels or hotels, owners of small stalls and street vendors, residential compound guards, and so on, it becomes easy to picture almost all of the tertiary industry as white collared, or soon to be.

In short, by leaving out laborers of the informal economy from its data, what the Ministry of Labor and Social Security has done, whether intentionally or not, amounts to a gross distortion of empirical reality. Ironically, these data are presented by a ministry that serves ostensibly as the unit corresponding to the ILO of the United Nations. It is time for China to begin to compile and present systematic data on its gigantic and growing informal economy, as numerous other countries have done. Only then will the statistical data begin to approximate the emergent realities of Chinese society and economy.

The combination of lack of systematic empirical data with a theoretical outlook from the dogmas of market fundamentalism and modernizationism is one cause of the disregard for empirical reality in favor of theoretical projection. Thus is it possible for some of China's leading sociologists, despite their command over fairly detailed studies of the *nongmingong*, to argue that Chinese society is already well on its way to a "modern" "olive

shape” and to predict confidently that by year 2020, the white-collar “new middle class” in China will amount to fully “38 percent-40 percent” of the population (Lu Xueyi, 2003: 9; 2007: 12). All this is done by disregarding the fact that the informally employed have exploded from an insignificant proportion to nearly 60 percent of the urban labor force, that the informal economy has grown much faster than the rate of expansion of the supposed middle class, and that the informal economy today employs 2.2 times more persons than the formal economy.

A moment’s reflection will show just how very far China remains from the turning point of the Lewis model. Employment in the urban formal sector has increased by only 20 million laborers after 30 years of marketizing reforms, from 95 million in 1978 to 114.9 million in 2006 (*Zhongguo tongji nianjian*, 2007: 128, Table 5-2).²⁴ To reach the Lewis-ian turning point, in which all available surplus labor would be employed by the modern formal economy, formal employment would have to expand first by another 168.2 million to absorb those now in the informal urban economy and then absorb yet another 150 million surplus labor (as estimated by the “Summary Report”) in the countryside. Formal employment, in other words, must expand by 16 times more than the number added to the formal economy in the past 30 years. Much easier said than done! And that would still leave 80 million employed in local township-village enterprises and 150 million employed in low-paid farming.

China’s social structure, far from taking on an olive shape, is in fact coming to resemble more a flask shape. There has indeed been some enlargement at the top, in the numbers of high- and medium-level party and state officials, new capitalists, and technical personnel, so that it is no longer a simple pyramid shape, but the bottom, with its 250 million in the informal economy and 300 million peasants, remains the bulkiest part. The danger for China is that such a flask-shaped social structure would become a long-term feature of society, with a minority high-income modern formal economy sitting atop a majority base of low-income informal workers and peasants.

The reality is that China’s gigantic population, while certainly a useful resource in its recent economic development, is also a huge burden. Its dimensions are such, and its difference from the United States so great, that China is simply not within sight of having an agricultural employment that is a mere 1.6 percent of total employment as in the United States (in 2004). A large agricultural workforce as well as a large pool of surplus labor seems of necessity a fundamental characteristic of China for a long time to come.

Some may argue here, what about the so-called East Asian model or the “four little dragons” model? Are not countries such as Japan, South Korea, and Taiwan similar to China in terms of population (as well as general

culture), and yet have they not successfully made the transition to developed economies with a large middle class? Here it must be pointed out again that the dimensions of the problem are very different. Due to a very different historical background from China's, Japan's agricultural employment today is a mere 4.5 percent of its total,²⁵ almost as different from China as the United States. Even Taiwan's 6.6 percent figure, or South Korea's 8.1 percent figure, is very far removed from Chinese realities (not to speak of the city-states of the two remaining "dragons," Singapore and Hong Kong) (*Zhongguo tongji nianjian*, 2007: 1020, 1002). In terms of the relative dimensions of the population problem and the absolute scales of the economies, Taiwan and South Korea are much closer to, say, Shanghai and its suburban counties than to all of China. The appropriate comparison would be between Taiwan or South Korea and Shanghai municipality, not all of China. Needless to say, the size of the rural labor pool is a crucial determinant of the size and proportion of the informal economy. From this point of view, Asian developing countries, such as India and Indonesia, studied by the ILO, are far more relevant to the realities of China. It is of course entirely possible that China may one day overcome the problem of rural overpopulation; in the meantime, however, the problem must be faced up to and not imagined away or assumed to disappear shortly.

All this is not meant to denigrate the informal economy. Without doubt, it has provided employment for many who might otherwise have none; it has given peasants an additional and alternative source of income, greatly expanding the total incomes of peasants; also without doubt, the 200 million nongmingong and the 50 million disemployed urban residents have made enormous contributions to the development of the national economy. One can also find evidence of gradually rising informal incomes in the most developed cities. There is no reason, I believe, to deny the truth of any of these points. And indeed the studies by the ILO, the World Bank's Social Protection Unit, and Hu Angang and Zhao Li have all emphasized these positive aspects of the informal economy.

But that does not change the fact that those in the informal economy remain second-class citizens, the majority of whom work under substandard and often inhumane conditions for much less pay and benefits than those in the formal economy. It is in light of that fundamental reality that the ILO and the Social Protection Unit of the World Bank have made it their goal to improve the work conditions and incomes of people in the informal economy. Their message is simply "decent" terms of employment for informal workers. And it is a message predicated on a concern for both social justice and sound, sustainable development. Gross inequalities and inequitable treatment for so

many laborers make neither human nor economic sense. Raising the floor of informal employment will benefit not only the laborers but also their productivity and, therefore, domestic consumption and the national economy as a whole.

The two seemingly opposed lines of argument above are in fact not at all mutually exclusive. The fact of low pay and unequal status in the informal economy calls for state actions for social justice, while the fact of its enterprising promise calls for state actions to support its development. Ending the household registration system that segregates urban from rural residents would be one step, full protection for the employees under state labor laws another, provision of financing and credit to encourage the development of enterprises in the informal economy another, and provision of full health, education, and other benefits still another. All this, of course, is not to call for state administration and control, much less management or planning, but rather to seek removal of institutional obstacles, regulation against market excesses, and provision of services—a transition, in sum, from the present hugely burdensome controlling and extractive state to a service state. We can also extend this line of thinking to villages and to agriculture (see Huang Zongzhi and Peng Yusheng, 2007).

The difference between the ideological neoclassical point of view and the more empirical informal-economy point of view is that while one is preoccupied with a particular variety of economic theorizing, the other is concerned about actual economic development and also about social equity, and not just academic research but also its application. While one substitutes a wished-for model for empirical reality, the other is concerned about recognizing, and doing something about, real-life problems. While one causes the neglect of, and even discrimination against, the informal economy, the other calls for fair treatment and appropriate support for it.

Setting Ideologies Aside

In the neoclassical “American model,” the basic dogma is market fundamentalism: the less state regulation and interference in market forces, the better. The free market will lead to optimal allocation of resources and optimal efficiency and will generate development for the maximum benefit to the greatest number. (For neoconservatives, it will even bring liberal democracy.) In the economic-dualism model, all this is accepted, except for a time lag caused by an overabundance of labor in the traditional sector of developing countries. The three-sector thesis of agriculture to industry to

services and the sociological model of pyramid to olive shaped with a bulging middle class merely elaborate on the same model.

The new institutional economics, at least in its mainstream theorizing, has basically reaffirmed that model's theory about the role of the state. The state should, through law, see to clear and efficient private property rights so that market mechanisms can work their magic, but it must otherwise not interfere in the market, indeed especially not take on programs for social welfare. The core belief remains the neoclassical one: that individuals seeking rationally to maximize utility and firms to maximize profit, through the workings of a free market, will optimize resource use and bring development to most people.

But the facts of the informal economy belie this logic. Labor in most developing countries, especially China and India, is clearly overabundant (in the relative sense).²⁶ Under those circumstances, especially, the logic of the market and of the rational profit-maximizing firm is certainly to seek to drive wages as low as the market can bear and work hours as long as laborers can tolerate. Given the oversupply of labor and an absence of state regulation, why would a textile company or a restaurant owner pay more or accept less work, when in most cases there are many others ready to take the job? That is what lies behind the empirical reality that most informal laborers are working 1.5 times the number of hours of those in the formal economy, for just 60 percent or so of the wages, without benefits. The danger for China is that given its huge supply of labor, this state of affairs could continue indefinitely.

Perhaps it is time for us to separate out the truths from the ideological excesses of each side. While neoclassical economics and institutional economics are surely correct to emphasize that the market and private property can generate powerful creative entrepreneurial energies, they are surely mistaken in their neoconservative belief in the free market as the panacea to all social-economic problems. That extreme tendency of marketism has in fact led once more to the brink of economic disaster, of proportions not seen since the Great Depression. The same tendency lies at the root of inhumane work conditions to which many in China's informal economy have been subjected. The fact is, as Muhammad Yunus has argued, our neoclassical construction that the entrepreneur not only is, but ought to be, bent on profit maximizing, because those impulses would somehow work through market mechanisms to result in an economic system of optimal efficiency, has actually helped to create the often rapacious behavior of capitalists, almost as a self-fulfilling prophecy (Yunus, 2006).

At the same time, while Marx was surely correct to point out that capitalist pursuit of profit can result in gross inequalities and exploitation, the

extreme tendency of communist states in the past to reject markets completely and rely entirely on centralized planning led to hugely burdensome bureaucracies and grossly rigidified economies. That of course should also be acknowledged.

As a matter of historical record, the American economy has been the product neither of just one ideology nor the other, neither the laissez-faire economy nor the interventionist state. With the Great Depression, marketism had given way to state welfare actions and institutions. The current financial crisis, similarly, is leading to massive state interventions. The fact is that the American economy has been in the main the product of a continuing tug-of-war, and interactions and mutual influence, between the ideals of the free market and the ideals of state interventions for social equity. It has been, historically and in actual practice, neither simply one nor the other. And it is because of that fact, perhaps more than any other, that the United States might yet be able to avert economic disaster from the 2008 financial crisis. Perhaps it is time that we acknowledge that both the neoclassical and the Marxist traditions of economic theory need to be de-ideologized to bring out the true insights of each.

China's informal economy illustrates the differences between the two perspectives well. The free marketeers cheer its provision of employment, and creativity and entrepreneurship, and they are right. They are against state suppression or excessive control of these informal entities, and they are also right. But the most ideological among them oppose any state efforts for social justice, preferring to trust market mechanisms to achieve the greatest good for the greatest number, and they are wrong. The Marxists, by contrast, point to the unfair and inhumane treatment of peasant-laborers, and they are right. Many call for state provisions of public services and welfare, and on that score, they are also right. But the most ideological among them would tightly control or ban the informal economy, even return to bureaucratic management or the command economy, and they are wrong.

What is needed is for the present Chinese state to be changed from the hugely burdensome controlling and extractive state of the planned economy to a service-oriented state, with perhaps also some measure of active involvement in development (the "developmental state").

If ideologies can be set aside, the answer might in fact be a fairly straightforward one: an appropriate balance between the market for creativity, dynamism, and competition and the state for oversight (against excesses), support, and social equity. The latter does not mean, of course, that private efforts for social justice are to be rejected, only that it is up to the state, working in conjunction with the private sector, to ensure the provision of public services and social welfare. While Muhammad Yunus

places his hopes on man's better and more altruistic side, through what he hopes to be "social enterprises" (complete with a stock exchange and stock ratings of such enterprises) working for the betterment not of the self but of society (Yunus, 2006), we might reason differently: the harnessing of entrepreneurial drive and inventiveness of a privatized market economy in fact requires that the state act appropriately to regulate against market excesses, provide public services, and ensure social justice.

Social justice for the informal economy, of course, would not be about social equity at the cost of economic development. Appropriate equity or social justice is, as many have long pointed out, in fact a key to social-political stability and hence also to sustainable economic development. (What would be the economic cost of social-political instability?) The balancing and uniting of state intervention for social justice with market dynamics for creative development seems to me the true meaning behind the Nobel Peace prizes to the ILO and to Muhammad Yunus—for their shared commitment to "decent" work conditions for all laborers of the world. Perhaps that is also the meaning that China's "market socialism" should have.

Notes

1. The International Labor Organization (ILO) included in its tally India, Indonesia, the Philippines, Thailand, and Syria and did not include China.

2. This is in part because of its practice-oriented organizational structure, with equal representations from government, employers, and workers on its governing body and its annual International Labor Conference (Nobel Peace Prize, 1969). The 2002 report cited here was the work of a team of renowned researchers, codirected by Martha Chen of Harvard and Joann Vanek of the United Nations Statistics Division.

3. These are the numbers estimated for 2004 by the team of researchers who produced the authoritative "Summary Report on China's Nongmingong Problem" ("Zhongguo nongmingong wenti yanjiu zongbaogao," 2006) (more later).

4. By the categories used in this article, informal employees in the formal economy should include not just the temporary employees officially reported by the formal units but also the unreported "private enterprises," "self-employed" entities, and unregistered workers who subcontract for work under those formal units. To simply start with the total number of reported employees and deduct the regular employees yields a total of just a few million, leaving out the great majority of the *nongmingong*. See, for example, the numbers of total employed and of regular employees reported in manufacturing and in construction (*Zhongguo tongji nianjian*, 2007: 135, Table 5-6; 142, Table 5-9).

5. China, however, has taken first steps to work with the ILO through its Ministry of Labor and Social Security, including active participation in the 2002 ILO annual Labor Conference (Ministry of Labor and Social Security, [2002] n.d.).

6. In 2000, the National Bureau of Statistics (NBS) adjusted its totals for employed persons (urban and rural) in accordance with the decennial population census of that year, thereby taking into account informal urban employees not reported through the annual reports of the

registered enterprises, which was its other principal source for data on employment (*Zhongguo tongji nianjian*, 2007: 117, footnote, Table 5-1). However, there may be double counting of persons in the rural and urban totals by including the nongmingong both in the urban employed total and in the rural employed total. The population census, for example, in principle does not count those who are away more than six months a year but, in fact, includes them if “the main income is brought back home and thus economically integrated with the household” (*Zhongguo tongji nianjian*, 2007: 496, 498). Banister noted multiple inconsistencies between the two streams of data, the inconsistent uses of the *urban* and *rural* categories, and the lack of accurate data on the nongmingong “migrants” (Banister, 2005: 17-19, 19-20, 23-24), but she did not have access at the time to the 2006 “Summary Report,” discussed later.

7. Like the NBS employment data, the “Summary Report” defines *urban* as the level of the county seat (“county town”) (*xian chengguan zhen*, 县城关镇) or higher, leaving out the smaller towns in the county. The population census, however, uses a broader definition, including all towns, thus leading to certain inconsistencies between the two streams of data (*Zhongguo tongji nianjian*, 2007: 123-24, 180, 182).

8. Despite the impressive steps taken by the government in the past eight or nine years to expand health coverage, workers’ medical insurance, and retirement benefits, detailed by Wang Shaoguang (2008), the nongmingong remain largely outside those systems.

9. A fairly detailed study of two districts of Beijing in 2002, for example, found that while the surveyed urban residents earned an average of 1,780 yuan a month, the nongmingong earned just 949 yuan. A third of the surveyed nongmingong worked more than twelve hours a day; another one-sixth, more than fourteen hours a day (Li Qiang and Tang Zhuang, 2002). A 2007 study of Hefei city, based on 836 returned questionnaires, found similarly that 80 percent earned less than 800 yuan a month, and 86 percent worked ten to fourteen hours a day, 53 percent without a single day off (Fang Yunmei and Lu Yuxiang, 2008); another 2007 study of Wuhan, Guangzhou, Shenzhen, and Dongwan, based on 765 usable questionnaires, found that nongmingong wages had improved substantially since 2004 (49.5 percent of the nongmingong earned more than 1,000 yuan a month), but they still worked an average of sixty-five hours a week, and their hourly wage amounted to just 63 percent of the 2005 national average of the *zhigong* (regular staff and workers) (Jian Xinhua and Huang Kun, 2007). The most comprehensive and authoritative study, however, remains the “Summary Report” and its broad sample.

10. For example, they took into account imputed rents from owner-occupied housing but still were not able to take account of the “implicit subsidies associated with public services such as health and education” (Gustafsson, Li, and Sicular, 2008: 15-17). Differences in number of hours worked, it should be pointed out, are also not considered.

11. This is on a per employee basis. If we include family members and count on a per capita basis, then their earnings are just 35 percent lower, in large measure because most leave family members at home in the village.

12. These data are based on the use of *urban* (*chengzhen*) to include only county seats and above, as discussed in note 7.

13. At year-end 2003, there were 3.44 million such enterprises. To be sure, a small number are larger enterprises that would conform to our usual image of a capitalist enterprise.

14. The “*Zhongguo nongmingong wenti yanjiu zongbaogao*” (2006), we have seen, estimates a total of 200 million peasants engaged in off-farm nonagricultural work, of whom 120 million work in the cities and towns (i.e., county seats and above) and 80 million locally. The fact that the 120 million working in the cities have rural household registrations and that a majority of them do not register formally with the State Administration for Industry and Commerce is the reason why nearly 100 million (98.6 million, as shown in Table 1) do not

show up in the statistics based on the annual reports from the registered enterprises. They do, however, appear in the 2000 population census, which included such temporary urbanites.

15. This article is not able further to take account of the rising numbers of rural laborers who work in farming away from home—something obvious to those who have conducted field research in villages, especially suburban villages and wealthier villages in the eastern coastal region. That neglected new farm-proletariat, too, should be considered a part of the informal economy, but for now, we have little means of estimating the size of that group with any measure of accuracy.

16. I remember well the class I took with Lewis as an undergraduate at Princeton University in 1958, some years before he permanently joined the Princeton faculty.

17. Although Lewis's 1955 book, *The Theory of Economic Growth*, is often cited as his "classic," it is his earlier 1954 article, "Economic Development with Unlimited Supplies of Labor," that contains his truly path-breaking ideas of lasting import (Lewis, 1954, 1955; cf. Tignor, 2006: 273ff).

18. But Lewis was surely right about the overabundance of labor, even if not technically about "labor of zero marginal productivity," for he failed to understand the logic (of diminishing marginal labor productivity) of agricultural involution (see my detailed discussion in Huang Zongzhi, 2008b).

19. His earlier coauthored book with Justin Lin and Li Zhou, by contrast, advanced a more simplistic argument of China's "comparative advantage" in abundant labor (the argument that Fei-Ranis had advanced much earlier) and the failure of the earlier planned economy to take advantage of it (Lin, Cai, and Li, [1996] 2003). Zhang Shuguang, for example, has criticized the book for its singular emphasis on policy, its lack of attention to theories of institutional economics, and its complete dismissal of the achievements of the planned economy period (Zhang Shuguang, 2007).

20. Wu's writings about empirical problems are often multidimensional and closely grounded in reality, not committed in doctrinaire ways to any one theoretical tradition. My own favorite example is the recent interview of him by Zhang Jianjing (Wu Jinglian, 2008b; cf. Wu Jinglian, 2005a). Yet there can also be no doubt about Wu's fundamental agreement with the economic-dualism analysis.

21. The U.S. Securities and Exchange Commission's (SEC) chairman, Christopher Cox, for example, admitted that the SEC's oversight program "was fundamentally flawed from the very beginning," because it allowed investment banks "to opt in or out of supervision voluntarily" (*New York Times*, 2008b). And former Federal Reserve Chairman Alan Greenspan for more than a decade "has fiercely objected whenever derivatives have come under scrutiny in Congress or on Wall Street" (*New York Times*, 2008c). Before a congressional hearing on October 23, 2008, Greenspan admitted that he might have been wrong to place so much faith in market self-regulation (*New York Times*, 2008a).

22. The English translations used here are those of the NBS itself.

23. The NBS actually instituted in 1985 a four-level graded differentiation of "tertiary industry," with level 1 to include transport and trade and eateries and hotels; level 2, finance and insurance; level 3, education, research, and the mass media; and level 4, state and party officials. The newer categories cited here were adopted in 2003 (Li Jiangfan, 2005: 14).

24. The expansion of employment in modern services, of course, was offset to a great degree by the massive disemployment of laborers in the state sector. But even if we count only the newly employed, say, 80 million, they still amount to just one-quarter of the total yet to be absorbed, after thirty years of "miraculous" near-double-digit growth.

25. This is in part because in Japan, as Clifford Geertz pointed out many years ago, the modernization of agricultural production—that is, the coming of chemical fertilizers, tractors,

and scientific seed selection—occurred when the agricultural population remained essentially constant (Geertz, 1963: 130-43), while in China it tripled, thereby eating up almost all the labor productivity gains from modern inputs (Huang, 1990).

26. Arthur Lewis was certainly right about that, even if not about “labor of zero marginal productivity.” What I intend to assert here is relative, not absolute, surplus in labor.

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