China: Economic Development and Employee Wages

By Li Yin and Denis Collins  Li Yin is a doctoral student in the School of Economics and Business Administration, Beijing Normal University, in Beijing, China. Contact: yinli71@hotmail.com
Denis Collins is a professor of management in the School of Business at Edgewood College in Madison, Wisconsin. His research interests include business ethics, management, and organizational change. Contact: dcollins@edgewood.edu

Overview

China is undergoing a remarkable economic transformation and has had the world’s fastest-growing economy the past three decades. This case examines the evolution of economic development and worker wages in China. Beginning in 1949, the nation evolved from feudalism to socialism under the dictatorship of the Communist Party, which emphasized achieving income equality. In 1978, government policy shifted to a socialist market economy with a greater emphasis on private and foreign-owned enterprises. The economy grew rapidly, as has income inequality. These changes have been accompanied by an increasing number of labor disputes. In 2010, a string of suicides among workers at Foxconn Technology Group and a general strike by Honda employees aroused wide attention. What should Chinese government officials and Foxconn executives do about the labor problems?

China

China, with a population exceeding 1.3 billion people in an area approximately the same size as the United States, is one of the world’s oldest civilizations. The history of China begins with isolated tribes that evolved into separate regional kingdoms. Dynasties were created that passed governing control from one generation of family members to the next. Governed by autocratic emperors and their imperial courts, the kingdoms conquered one another in an effort to expand and consolidate power. The Qin kingdom unified China in 221 B.C. and developed a centralized dynastic system that lasted 2,000 years. Large bureaucratic administrations were created to manage political, economic, and social affairs over an immense land mass.

Chinese social, political, and economic philosophy was greatly influenced by the scholar Confucius (551–478 B.C.). According to Confucius, human beings could...
become morally perfect through the cultivation of virtues. Perfect individuals would create perfect families, establish perfect communities, and achieve the end goal of society—social harmony. The purpose of a Confucian-based government is to serve the people. Respect for parents, loyalty to the family, and benevolence are among the most important virtues to develop.

Confucianism ranks social groups. The highest rank is assigned to civil servants/scholars, followed by agricultural peasants, craftsmen, and lastly merchants. Profit making and taking advantage of others, among the primary activities of merchants, are contrary to Confucian moral principles. Confucius noted that “the mind of the superior man is conversant with righteousness; the mind of the mean man is conversant with gain.”

Some dynasties were more prosperous than others. The Italian merchant Marco Polo arrived in China with his father and uncle during the 1260s and found a vibrant empire governed by Kublai Kahn of the Yuan Dynasty. The Chinese are credited with inventing the compass, paper, printing, and gunpowder centuries before Western civilization inventors.

Nonetheless, an endless stream of internal rebellions was led by disgruntled military leaders and oppressed peasants. In the 1300s, China had a formidable navy and traded with other nations. All this changed in 1371 when Emperor Hongwu initiated a policy of isolationism from the rest of the world. The succeeding government sponsored a few more maritime voyages that reached the Middle East and Africa, and then China turned more inward and ignored maritime trade. The Great Wall, built in the fifth century B.C., had already blocked northern neighbors from entering China.

The lack of international trade led to economic stagnation and new internal rebellions. Succeeding emperors occasionally engaged in international trade, but it was mostly to export products, such as tea to Great Britain’s East India Company. Opium, one of the few imports permitted in some areas of China, created social havoc, contributing to increased drug addiction and two lost wars with Great Britain.

By 1900, China had become primarily a poor semi-feudal and semi-colonial society. China had a weak imperial court, warlords, an elite group of wealthy landlords, and the presence of Western and Japanese imperialists seeking control. A military defeat at the hands of Japan, economic crises, and multiple regional revolts led to the collapse of the Qing Dynasty.

In 1912, the Republic of China was established. The well-educated revolutionary Sun Yat-Sen, the “Father of the Republic,” served briefly as provisional president and requested that the provinces send delegates to serve in the National Assembly. Sun, and his eventual successor Chiang Kai-shek, struggled to unify China’s warring factions under the Nationalist Party’s one-party rule. The republic’s constitution provided the president with near dictatorial powers.

The Chinese Communist Party, influenced greatly by Marxist philosophy and the Russian revolution, was founded in 1921. In 1927, civil war broke out between the Nationalist Party and the Community Party of China, led by Mao Zedong. The civil war was temporarily halted in the 1937 when the two political parties formed an alliance to fight against Japanese invaders. Japan brutally occupied parts of China beginning 1937, the onset of World War II. An estimated 300,000 Chinese were massacred in Nanjing. Movement was restricted by occupying Japanese soldiers who terrorized civilians, physically abused men, and raped women.
After Japan surrendered to the Allied Powers in 1945, the fragile united front between the Communists and the Nationalists ended, and the Communist Party eventually won the two-decade civil war. Mao Zedong established the People’s Republic of China on October 1, 1949, as a socialist state and declared the Communist Party to be the only ruling political party.

Economic Development and Wages

Since the founding of the People’s Republic of China in 1949, the nation has experienced two stages of economic reform. During the first stage, from 1949 to 1978, Mao attempted to dramatically transform Chinese society into an ideal communist nation based on absolute obedience to, and unity with, government dictates. The second stage began in 1978, two years after Mao’s death, and has lasted to the present time. Mao’s successors maintained the Communist Party’s political monopoly but transferred some state-owned enterprises to the private sector and encouraged the formation of private and foreign-owned enterprises. Managers now have greater authority to determine employee wages, which has led to a broadening of the income and wage gap.

First Stage: 1949–78

Beginning 1949, China transitioned from a semi-feudal economy to a socialist economy. Poverty, unemployment, inflation, corruption, and illiteracy dominated the nation’s social and economic landscape following the Japanese occupation and two decades of civil war. Mao promised everyone a job, lifetime employment, housing, health care, pension plans, and the education of their children. The government sought to modernize the nation through industrialization and enhanced agricultural technology. According to Mao, achieving these goals required total obedience to Communist Party dictates.

Grounded in communist ideology, Mao’s two primary social goals were income equalization and heightened political consciousness. The Communist Party transferred business enterprises from private to state ownership and sought income equality through tightly controlled wage regulations. Karl Marx’s “from each according to his ability, to each according to his needs” became the guiding principle. Similar to Confucian ideals, Mao wanted the Chinese to sacrifice their self-interests for the common good.

Agricultural Sector

Mao’s first step was land reform because the nation needed to feed a huge population. The victorious Communist Party confiscated land from previously abusive landlords and gave it to the poverty-stricken peasant households that had been farming the land. Land shares were distributed equally, which often meant that the plot of land was too small for farmers to achieve self-sufficiency.

Economists differ on the degree to which this plan failed or succeeded as an economic policy, but it did serve to signal major political and social change. Taxes were needed to fund industrialization, which led to a gradual collectivization of agriculture. The process began with Mutual Aid teams. Peasants were strongly encouraged to join small farming cooperatives to manage the land, which then fed into higher-level cooperatives. The farming cooperatives were collectively managed under the influence of the Communist Party and pooled their resources. Activities
were coordinated through a centralized cooperative administration that sold supplies, determined affordable prices, purchased some crops, and established tax rates. Grains, eggs, and other crops were shipped to cities for urban dwellers to purchase.

Each family maintained a small private plot for supplemental foods such as vegetables and eggs. The remainder of their farming efforts contributed to the farming cooperative, which redistributed the food to each family. Government provided additional grains if the farming cooperative’s production had been insufficient. Surplus rural farming laborers were reassigned to the industrial sector, and vice-versa, based on the nation’s economic conditions and policies.

How were farmers paid? Farm laborers earned points based on their work contributions. The state determined what it considered a fair price and purchased farm products from the farming cooperatives. The financial proceeds were then distributed to the farm laborers based on the number of points earned. The government determined nationwide how much product each family could purchase and issued families coupons that gave them the right to purchase a specified number of products at specified prices, such as two kilograms of eggs per household per month. Many families, however, did not earn sufficient income to exercise their purchasing rights.

The results of all these changes were economically disappointing. In 1958, Mao initiated a new effort, the Great Leap Forward, with the aim of overtaking the capitalist nations of Great Britain and the United States within 15 years. But the government-controlled collectivist farming policy, and bad weather, led to an estimated 20 million Chinese dying of starvation in the early 1960s.

**Industrial Sector** In the industrial sector, Mao nationalized the banking, energy, and communication industries, along with foreign-owned businesses. In 1955 and 1956, the government bought out the remaining private businesses.

In urban areas, most citizens were employed by state-owned enterprises and worker cooperatives. Some enterprises were controlled by regional or local governments that reported directly to the central government. The smaller worker cooperatives supplied services to local communities and products for the larger state-owned businesses.

The Communist Party established production quotas for the entire nation and individual business enterprises. Work units (factory, bank, school) were responsible for providing employees free apartments (or at a token rental price), medical care, and day care. Apartments and houses were very small, with many family members sharing one room, and services usually of poor quality.

The government implemented a uniform graded wage system nationwide for the industrial sector. Wages were determined based on the number of years of work service. For instance, in state-owned factories, young employees all received the same wage and, after a specified number of years, earned slightly more pay. Some worker cooperatives, which were typically neighborhood based, paid employees based on productivity.

Similar to the agriculture sector, work unit employees were allocated coupons giving them the right to purchase certain high-demand products, such as a bicycle or watch, but not the money for purchasing them. Government determined the number of products to be manufactured and allocated a limited number of coupons based on work unit size. Work unit managers then determined which employees would receive a coupon. It often took several years for an employee to save the money necessary to purchase the scarce product.
Cultural Revolution Despite these reforms, productivity lagged and there were continual shortages of food, clothing, and other basic goods. Centralized planning and ideological purity—attending political meetings and adopting the appropriate political consciousness—had replaced economic incentives. During the Great Leap Forward, poorly trained peasants used inadequate technologies to produce low-quality industrial goods. Factories made their production quotas, but often their finished products were unusable.

Government officials felt humiliated that the nation had achieved such poor results; at the same time, the Soviet Union, also governed by a monolithic Communist Party, had developed modern military weapons and launched a satellite into outer space. Communist Party leaders blamed Mao's failed policies. Mao, in turn, blamed the failure of the Chinese people to adopt the appropriate communist mindset of hard work for the sake of others.

In the 1960s, a cult developed around Mao and led to the Cultural Revolution, which lasted from 1966 to 1976. Party loyalty and purging enemies of the communist revolution, either real or fictitious, took precedence over economic performance. Communist Party leaders attempted to revise a nationwide effort, led by students and other young people (“Red Guards”), to expose and punish communist revisionists and subversive capitalists, which included many educators and work unit administrators. Accused offenders were forced to publicly confess their ideological sins and then sent to labor camps. Those declared guilty of revisionism were exiled or imprisoned.

Equality in all things, and intolerance to economic or social differences, took on greater significance during the Cultural Revolution. Coupled with the relocation of millions of people to first work on farms and then to industrialize central China, the economy worsened.

Second Stage: 1978–Present

Mao Zedong died in 1976. At the time, China’s economic development paled in comparison to nearby Asian nations, such as Japan and South Korea, which had adopted free market reforms. The government’s goal of full employment led to overstaffed and unproductive state enterprises. Centralized planning in both the industrial and agricultural sectors proved to be inefficient and failed to modernize the nation.

Since 1978, however, China’s annual gross domestic product growth rate has ranged between 4 percent and 15 percent. How did this remarkable economic transformation happen?

In 1978, the governing Communist Party, under the leadership of Deng Xiaoping, dramatically changed the nation’s economic policies to fuel economic growth. Deng shifted China from an isolated socialist economy toward free market capitalism and international trade. In an effort to create a “socialist market economy,” the Communist Party incrementally implemented free market reforms and reduced the amount of government planning and control. Many worker cooperatives were disbanded and production quotas eliminated. Deng also implemented a one-child policy in 1979 to control population growth. Families giving birth to a second child received severe financial penalties.

In agriculture, the government, still claiming land ownership, contracted the land out to rural farm families. Farmers were allowed to earn a profit working a piece of land if they first provided an agreed-upon amount of produce to the farming
cooperative at a specified price. This system gave farmers an economic incentive to reduce costs, increase productivity, and market the goods. For instance, entrepreneurs quickly transported bananas grown in southern China to northern provinces before the product spoiled. The farms became areas of entrepreneurial activities and fueled the rural economy.

Based on free market success in the agricultural section, the Communist Party initiated similar economic reforms for the industrial sector. Individuals could own and operate small businesses without government interference. State-owned enterprises were now expected to earn a profit, which required greater managerial latitude to determine employment levels, prices, and wages. Managers were granted greater decision-making authority, including an option to pay employees based on performance and offer bonuses for increased productivity. The more profitable the factory, the more money managers had available to pay employees and reinvest in the company. In terms of housing reform, families were given the option to purchase their current house/apartment or receive cash that they could use toward the purchase of new commercially built homes.

In 1980, the government initiated an “open door” policy for international investors by creating a Special Economic Zone in Shenzhen that offered tax incentives and flexible regulations, such as favorable export and import policies. Shenzhen is near the island of Hong Kong, which at that time was British controlled. Initially, foreigners were skeptical about the government’s intentions given the Communist Party’s political ideology and lack of economic infrastructure. The first overseas investors came from Hong Kong and Taiwan and from Chinese living overseas, people more familiar with the language and culture. In a short time period, Shenzhen transformed from a small fishing village into a major industrial and financial center.

Special Economic Zones were expanded to other coastal cities, attracting nearby Japanese multinational corporations. Finally, U.S. and other foreign multinationals invested in China, drawn by the low wage rates and the government’s promise to improve roads, railroads, telecommunications, and energy. Cities and provinces soon competed against one another by offering favorable tax incentives to attract multinationals.

Initially, foreign-owned companies were allowed to enter the nation as joint venture partners so China could prosper from their technological and managerial expertise. Soon, however, foreign investors were allowed to own and operate private businesses. The new policy attracted many multinationals that could pay a Chinese laborer 10 percent of the wage paid in the United States. From China’s perspective, the foreign-owned firms provided better quality products at lower prices. In order to compete with foreign-owned businesses based on price, state-owned firms had to improve operations, which entailed either reducing employee wages or laying off employees.

These economic changes led to increased corruption. New entrepreneurs bribed government officials to avoid government regulations and taxes. Politicians sold companies to family members and sought illegal payments from investors wanting to buy formerly state-owned enterprises. In 1987, more than 150,000 Communist Party members were punished for abusing their authority and corruption.7

In the mid-1990s, limited term contracts replaced lifetime job security in state-owned enterprises. Contrary to previous government policy, bankrupt companies were allowed to fail. Private investors could purchase the entire, or parts, of the
formerly state-owned enterprise and revive operations with more modern technology and management techniques. In 1995 alone, 30 million employees were laid off from state-owned enterprises. Those laid off no longer had the safety net created under communism.

The adoption of more modern technology and management techniques also impacted the agricultural sector. The new machinery made many farm laborers, already experiencing poor living standards, expendable. An estimated 200 million displaced farmers migrated to cities looking for work and competed against previously laid off workers for low-paying jobs. As a result of these major social and economic upheavals, rural poverty has declined significantly from 250 million people in 1978 to 26 million in 2004.8

By 2007, approximately 5.4 million registered private enterprises in China employed more than 200 million people.9 Private enterprises account for more than half of all companies in China and 60 percent of the nation’s gross domestic product. Annual household median income has increased from $293 in 1985 to approximately $3,600 in 2009,10 which still significantly lags the $49,777 median household income in the United States (see Exhibit 1 for comparisons). In addition, health care coverage and adult literacy have declined at various times during the 1990s and 2000s.11

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<th>Exhibit 1 Comparing China and the United States12</th>
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<td><strong>China</strong></td>
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<td>Land size</td>
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<td>Population (2010)</td>
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<td>Household median income (2009)</td>
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<td>Number of millionaires (2009)13</td>
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<td>Population below poverty line (2007)</td>
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Politically, China remains predominantly a one-party nation. Minor parties participate in the political system with Community Party approval. Membership in the National People’s Congress is largely determined by the Communist Party. However, the Communist Party has lost some control over people’s lives due to the economic reforms. People create their own businesses and social organizations, such as member-only business clubs. Volunteer organizations have been created based on similar hobbies or interests. The most dramatic suppression of political freedom occurred at Tiananmen Square in 1989 when hundreds of student protestors were massacred. The government attempts to censure email and Internet searchers, but not always successfully.

**Economic Inequality and China’s Labor Union**

In many ways, China’s experiment with capitalism parallels the U.S. industrialization experience in the late 1800s and early 1900s. Some people are better situated than others to benefit from free market capitalism. Despite a national household median income of only $3,600, China ranked fourth in the world with 477,000 millionaires. China also ranked second in the world with 130 billionaires in 2009, compared to none in 2003. Those who already possess economic resources gain wealth and power more quickly than those at the bottom of the economic ladder.

Economic equality, which had been the centerpiece of communist ideology, is being replaced with entrenched economic inequality. The Gini Index measures the inequality of income distribution within a nation. A value of 0 represents absolute equality and a value of 100 represents absolute inequality. According to the 2009 United Nations Human Development report, between 1992 and 2007, China’s Gini Index (41.5) was slightly higher than that of the United States (40.8).

Economic inequality and instability have escalated labor unrest in China. Strikes and protests for higher wages and better working conditions are becoming more common.

China has the largest trade union in the world, the All-China Federation of Trade Unions (ACFTU), with more than 134 million members. ACFTU, the only legal union in China, consists of 10 national industrial unions, 31 regional federations, and more than 1.7 million trade union organizations. The government controls the ACFTU. It is not an independent trade union and does not engage in collective bargaining. ACFTU affiliates are common in state-owned enterprises and less common in private enterprises. In 2008, 18 percent of all employees were unionized. Membership is highest in urban areas, where 52 percent of all employees belong to a union.

ACFTU was founded in 1925 by the Chinese Community Party to organize labor. The ruling Nationalist Party saw ACFTU as a political threat, killed many of its leaders, and disbanded the union. The trade union was reinstated when Mao gained political power in 1949. The Communist Party used ACFTU as a mechanism for controlling workers and accomplishing economic goals. The government chose union leaders, whose primary responsibility in the 1950s was to implement government directives. Some ACFTU leaders sought a more traditional role for the union, leading to the ACFTU being dissolved during the Cultural Revolution for being revisionist. ACFTU was re instituted in 1978 when Deng took over leadership of the Communist Party and was given the role of implementing democratic
management at the workplace. ACFTU affiliates were allowed to strike over hazardous work conditions, but not for economic reasons.

**Labor Law**

Deng’s elimination of guaranteed job protection, and not rescuing bankrupt state enterprises, created a rise in unemployment. The Communist Party responded by passing a new labor law in 1994 that required limited-term contracts at state-owned enterprises. The law also established a five-day, 40-hour workweek with overtime pay after 44 hours a week. But many enterprises ignored the law, and, aided by bribes, government officials did not enforce it. Some laborers, desperate to maintain employment, continued to work 12 hours a day, six or seven days a week.

Since the ACFTU does not engage in collective bargaining, laborers express their dissatisfaction with wages and working conditions through strikes and public demonstrations. This makes local Communist Party officials and trade union leaders look bad. Government officials encourage the strikers to go back to work where they could address their concerns through labor arbitration.

In 1987, about 4,000 labor arbitration hearings were convened. The number rose to 135,000 in 2000 and 700,000 in 2008. If dissatisfied with the arbitration decision, employees can file a lawsuit. Lawsuits, usually over unpaid wages or benefits, have also risen dramatically, from 17,000 in 1992 to 280,000 in 2008.

The 2008 Labor Contract Law increased worker rights but reaffirmed the ACFTU as the only legal union in China. Stipulations in the new law prohibited dismissal without cause of employees with 10 years seniority, established wage standards for probationary employees, limited overtime hours, and provided laid-off employees one month’s severance pay for every year employed.

Low wages in a growing economy make it more difficult for people to pay for basic essentials. In July 2010, new minimum wage laws took effect. In Beijing, the minimum wage increased 20 percent, to $140 a month, or $1,680 a year. The minimum wage in Shenzhen increased to $161 a month.

Labor disputes over low wages and inadequate working conditions are more prominently reported in the media. Initially, Chinese officials, wanting to attract more foreign investment, tried to censor media from reporting on labor disputes. But their efforts have failed because protestors coordinate their activities by using new communication technologies such as text messaging, Internet blogs, and video postings.

China’s one-child policy, which will remain in effect until at least 2015, is contributing to labor unrest. Government officials have declared the policy a success as experts estimate that the nation’s 1.3 billion population would be at least 250 million people higher without the policy, which has been in place since 1978. However, fewer young employees are now available at a time of increased work opportunities. The younger employees are more vocal about demanding higher wages and better working conditions, and more willing to quit jobs for higher paying work opportunities at other companies.

The new labor regulations and higher wages benefit laborers, but they also contribute to job loss. Some foreign-owned companies have relocated operations to Vietnam, Indonesia, and other developing nations, which offer fewer labor laws and cheaper labor.
2010 Labor Disputes

Most labor strikes in China are aimed at foreign-owned companies. Several high-profile strikes in 2010 occurred at Honda facilities in the Guandong province, in the industrialized southern region near Hong Kong. Another critical labor incident involved employee suicides at the Foxconn Technology Group campus.

Strikes at Honda

Honda has been operating in China since 1992. In May 2010, employees at a Honda transmission factory in Foshan went on strike for better wages. Many of the young Chinese employees earned $150 a month, whereas Japanese workers at the facility earned 50 times more than their Chinese counterpart for performing the same job. From 2009 to 2010, the company’s operating profit increased by 91.8 percent and net profit by 95.9 percent. However, front-line workers did not earn any pay increases.

The strikers demanded higher wages, better training, and trade union reforms. The local trade union opposed the employee strike, which intensified the labor dispute. The strike lasted three weeks. Third-party negotiations led to an agreement that eventually doubled monthly wages to $300 for the 1,900 factory employees. Shortly after this strike ended, Chinese employees at several other Honda facilities went out on strike and achieved similar pay increases.

Suicides at Foxconn Technology Group

Foxconn Technology Group is a Taiwan-owned $60 billion electronics company. Foxconn has been operating in China since 1998, where it employs 800,000 people. Products made in its Shenzhen factory are sold to Apple, Compaq, Intel, Dell, IBM, Cisco, Hewlett-Packard, and other high-technology firms. At Foxconn Shenzhen’s factory campus, 300,000 laborers are warehoused in dormitory rooms shared with eight other employees. Their work behaviors were tightly controlled, such as not being allowed to speak during working hours. Production mistakes often resulted in verbal abuse, physical punishment, and pay deductions.

In January 2010, Ma Xiangqian, a 19-year-old factory worker, committed suicide by jumping off his dormitory building. Over the next five months, 11 other employees committed suicide in a similar manner. Ma had left his farming community and travelled 800 miles to Shenzhen to work in the Foxconn factory. At the time of his suicide, he worked 11-hour overnight assembly line shifts, seven days a week, for $1 an hour. The previous month he worked 286 hours, including 112 hours overtime, a clear violation of Chinese labor law.

Film footage of security guards beating up disgruntled Foxconn employees fueled additional labor unrest. On June 1, Foxconn announced that the basic salary levels of workers would be increased by 30 percent. For new employees, monthly wages, not including overtime, were increased from $131.77 a month to $171.30. After three months of employment, wages would increase to $294 a month. Foxconn installed nets around some of its buildings to prevent additional suicide jumps.

Despite better wages, labor problems remain at Foxconn. Sixty students and teachers from 20 Chinese universities conducted a study of Foxconn operations, with 14 of them entering the company. Their October 2010 report noted that a substantial number of employees were exposed to unsafe working conditions and treated violently by hired security guards, allegations that Foxconn denied.
QUESTIONS

1. Summarize economic development in China from 1949 to the present.
2. Would you want to live under the communist economic system? Why?
3. Is China’s one-party rule ethical? Should China change from one-party rule to democracy? Why?
4. What is contributing to increased labor unrest in China?
5. Is Foxconn’s treatment of laborers ethical? Why? What should the Chinese government do about the labor problems? What should Foxconn do about the labor problems?
6. Should consumers in other nations boycott products made in Chinese factories until pay and working conditions improve? Why?

NOTES

3 In China, the family name appears first, followed by the given first name.
4 In addition to the previously mentioned sources, we would like to thank Adjunct Assistant Professor Binbin Fu at Edgewood College, who lived in China from 1961 to 1991, for helpful information.
6 Naughton, *The Chinese Economy*.
14 Ibid.
25 Ibid.