International Journal of Trend in Scientific Research and Development (IJTSRD)
Volume 8 Issue 6, Nov-Dec 2024 Available Online: www.ijtsrd.com e-ISSN: 2456 – 6470

Capital, Labor, and the Business Environment: Unraveling the Dynamics of Income Share and Economic Growth

Guoju Chen[1], Jing Ma*[2]

[1]School of Interpreting and Translation Studies; Guangdong Institute for International Strategies,
[2]Guangdong Institute for International Strategies,
[1,2]Guangdong University of Foreign Studies, Guangzhou, Guangdong, China
***Corresponding Author:** Jing Ma

ABSTRACT

This paper examines the impact of business environment optimization on enterprise development, labor income share, and capital accumulation. The study finds that improving the business environment, particularly through reforms in administrative approvals, credit supervision, and business registration, not only reduces market entry barriers but also fosters innovation and entrepreneurial vitality, thereby influencing industrial structure upgrading, labor income share, and capital accumulation. By analyzing experiences from China and other countries, this paper reveals that, during the early stages of business environment improvement, labor income share may initially decrease due to accelerated capital accumulation. However, as market mechanisms mature and industrial structures are optimized, labor income share eventually increases. The paper further explores the long-term impact of technological advancement, capital deepening, and globalization on labor income share, providing policy recommendations on how to balance the interests of capital and labor in income distribution.

KEYWORDS: *Business Environment, Labar Income Share, Deregulations*

How to cite this paper: Guoju Chen | Jing Ma "Capital, Labor, and the Business Environment: Unraveling the Dynamics of Income Share and Economic Growth" Published in International Journal of Trend in Scientific Research and Development (ijtsrd), ISSN: 2456-6470, Volume-8 | Issue-6, December 2024, pp.951-955, URL: www.ijtsrd.com/papers/ijtsrd72706.pdf

IJTSRD72706

1. INTRODUCTION

The business environment has become a crucial factor in determining the growth and competitiveness of enterprises, and consequently, economic development. In recent years, it has garnered significant attention from both academics and policymakers worldwide. Improving the business environment not only facilitates effective market competition and resource allocation but also enhances innovation capabilities, improves investment environments, and boosts enterprise competitiveness, thereby fostering sustainable economic growth. In China, a series of administrative and market-oriented reforms have driven rapid economic development over the past few decades. However, with the transformation of the economic structure and increasing international competition, balancing capital and labor income distribution, especially during the process of business environment optimization, has become a critical issue.

This paper aims to systematically analyze the multidimensional effects of business environment optimization on enterprise development, labor income share, and capital accumulation. By combining theoretical analysis with empirical research, the paper not only reveals the impact of policy reforms on labor income share but also explores the long-term effects of capital deepening, technological advancement, and globalization on labor income distribution. The findings offer a new perspective on understanding the interaction between the business environment and labor markets, providing practical policy recommendations to improve income distribution and promote high-quality economic development.

2. The Impact of Relaxing Entry Regulations on Enterprises

Both the public choice hypothesis and theories like capture theory (Stigler, 1971) or the "tollbooth" hypothesis (Shleifer & Vishny, 1993) suggest that government regulation can obstruct the proper allocation of resources. Moreover, strict governmental controls hinder market entry (Klapper et al., 2006), which ultimately limits economic growth. Improving the business environment encompasses various aspects. One of the key factors is how the government enhances intellectual property protection, which positively impacts business innovation and drives regional development and transformation (Wu Chaopeng & Tang Yao, 2016). Simultaneously, administrative approval processes, characterized by excessive procedures, events, and costs, create significant entry barriers, thereby increasing the sunk costs for entrepreneurs and suppressing new firm entry (Zhang Longpeng, 2016). Reforms in administrative procedures, such as reducing required documentation, shortening the time needed to obtain business licenses, or simplifying the approval processes, can significantly boost individual satisfaction, foster entrepreneurial enthusiasm, and improve the overall business environment.

Another significant reform is the shift toward credit-based regulation, addressing gaps left by government deregulation and the impacts of "easy entry" on the credit systems of market participants. These findings are supported by various scholars who argue that improving the business environment can enhance entrepreneurship, increase market actors, expand capital, and facilitate capital accumulation. Chen Hui (2017) used the case of the Hengqin New Area in Zhuhai to demonstrate how the government's deregulation of loan controls, reforms to reporting systems, and administrative procedures lowered entry barriers, while simultaneously strengthening market oversight and promoting legal frameworks for business activities, thus reducing institutional and legal risks for businesses.

Since 2016, scholars have increasingly adopted empirical research methods, often focusing on regulatory policies affecting market entry. Internationally, research has long found that reducing policy intervention can positively influence economic development. For instance, Branstetter et al. (2014) used data from developed nations to show that relaxing market access and improving the investment environment could effectively foster economic growth and entrepreneurship. Alfaro and Chari (2014) studied India's deregulation of industry entry controls in the 1990s and found that relaxation of regulations not only did not hinder business development but actually encouraged the entry of more small and medium-sized enterprises. Similarly, the optimization of the business environment can promote business innovation (Amici et al., 2016). In China, studies using data from the 2008 World Bank report on the business environment and the 2011 China Household Finance Survey have shown that improvements in local administrative approval systems have not only reduced entrepreneurial tendencies but also decreased the scale of entrepreneurship (Zhang Longpeng, 2016). More recent studies have examined the improvements in the business environment from an economic perspective, particularly focusing on administrative reforms. For example, Xia Jiechang and Liu Cheng (2017) used data from city-level municipalities and enterprises to conduct macro and micro-level quantitative analyses, concluding that administrative reform aimed to reduce social costs by selecting businesses, significantly reducing transaction costs. Moreover, the reform of administrative procedures has a positive effect on upgrading industrial structures, especially in the private sector, with certain spillover effects. Though these spillovers vary by region, the reform of approval systems undeniably influences industrial upgrades (Lu Xianxiang & Li Hui, 2021). Additionally, administrative reforms primarily impact the applications for utility model patents and industrial design patents, showing a greater effect on the patent applications of domestic companies, especially those in frontier technology sectors (Wang Yongjin & Feng Xiao, 2018). Thus, the literature indicates that administrative reforms are crucial in driving economic development, optimizing the business environment, fostering innovation and entrepreneurship, lowering market entry barriers, and positively influencing enterprise growth, particularly in the services sector.

In addition to administrative reforms, commercial registration system reforms have become a vital part of improving the business environment. Studies have shown that the transformation of government functions is crucial in this process, influencing both administrative approval systems and broader commercial reforms (Ai Lin & Wang Gang, 2014).

3. Factors Affecting the Labor Share of Income

Based on the relationship between the optimization of the business environment and enterprise production, many scholars and studies have pointed out that improvements in the business environment can effectively promote business development. Generally, the development of businesses leads to an increase in the labor share of income. However, in the early stages of business environment optimization, the labor share of income has been observed to initially decrease before eventually rising. For example, the labor share of income in China fell from a peak of 51.4% in 1995 to 46.2% in 2003, and continued to decline throughout the first decade of the 21st century. As a labor-intensive country, this trend seems contrary to the theory of comparative advantage. Therefore, it is necessary to clarify the factors that influence the labor share of income during the optimization of the business environment.

International scholars have long noted differences in labor income shares across countries. Shastri and Murthy (2005) used data from India (1973-1997) and found a 19 percentage point decline in the labor share of income, attributing this to technological changes in industry. Subsequent research, even when accounting for self-employed income, did not change this finding. Harrison et al. (2002) found that, over a period of 30 years, the labor income share tended to decline in poor countries but rise in wealthier ones.

Early studies on the decline in labor income share focused on its close relationship with industry, often investigating the phenomenon from a microeconomic perspective. Huang Xianhai and Xu Sheng (2009) found that the decline in labor share in China was a widespread phenomenon across all sectors and not just a result of economic cycles. They suggested that capital accumulation might be crowding out labor. However, they also noted that this trend might not persist. Other scholars using panel data on Chinese firms found instances where the labor income share increased, especially during state-owned enterprise reforms and changes in monopoly power. Additionally, the transformation and upgrading of industrial sectors have also influenced the labor share of income (Bai Zhongen & Qian Zhenjie, 2009). Scholars have also recognized that, in economic development, the labor share of income is essentially influenced by privatization and the restructuring of state-owned enterprises, which has led to the emergence of small and medium-sized enterprises. Marketization and globalization have also increased the role of foreign investment in China, which has gradually given capital more bargaining power in income distribution, ultimately reducing the labor share (Luo Changyuan & Zhang Jun, 2009). Li Daokui et al. (2009) pointed out that capital deepening is limited and follows a U-shaped pattern. The core of this trend lies in labor transfer. Due to the lag in labor transfer between industrial sectors compared to the speed of capital expansion, labor returns tend to be lower than their marginal productivity during early stages of economic development. Only once labor has sufficiently transitioned can the labor share begin to rise.

Generally speaking, China's industrial upgrading has two key features: capital-biased technological progress and a reduction in the proportion of labor-intensive sectors. These two trends contribute to widening the wage gap between sectors. Meanwhile, technological progress driven by industrial upgrading has a stronger positive effect on labor income shares due to wage increases. However, capital deepening, which characterizes catch-up economic development, is closely linked to economic growth and industrial transformation, and tends to crowd out labor income during the economic development process, leading to the phenomenon of "profits eroding wages" (Wang Danfeng, 2011). Luo Chuliang and Ni Qingshan (2015) used data from Chinese industrial enterprises and found that the strong preference for capital-intensive technology, combined with low interest rate policies that stimulated capital deepening, was an important explanation for the decline in labor income shares. Capital deepening is a response to uncertain market conditions, allowing firms to protect profits, but it contradicts the goal of industrial upgrading, thus exerting suppressive effects. However, when capital deepening surpasses a critical threshold, it can promote the rationalization of industrial structures, mitigating the negative effects (Yu Donghua & Zhang Weiguo, 2018). In the early stages of capital deepening, it is often closely tied to enterprise development. Therefore, excessive financial repression can further suppress the labor share of income.

The final category of literature discusses the specific transmission mechanisms. As the market economy develops and industrial structures upgrade, the primary sector gradually declines, and the secondary and tertiary sectors-especially the tertiary sector-shape the overall income distribution pattern. The tertiary sector, in particular, can improve the labor share of income (Jiao Yinxue & Bai Peiwen, 2022). Industrial upgrading also leads to a more rational industrial structure, enhancing the allocation of labor income and providing more opportunities for skilled labor in the tertiary sector (Yang Yun et al., 2020). Zhou Mao et al. (2020) demonstrated that industrial upgrading significantly increases the labor share of income, attributing this to the optimization of resource allocation across and within industries. As industrial upgrading boosts the demand for skilled labor, it raises relative wages and increases the proportion of labor in the workforce, ultimately enhancing the labor share in income.

Although the literature reflects well the trends in labor income share changes, it primarily focuses on developing economies and does not fully explain the trends in labor income shares in developed nations. This gap has led scholars to explore deeper factors influencing the labor share, including biased technological progress. For instance, research using data from 1978-2012 suggests that biased technological progress can explain certain changes in the labor income share (Wang Linhui, 2018). Karabarbounis and Neiman (2014), Wei et al. (2013), and Chen Yang et al. (2023) found that the global liberalization of business policies and the resulting technological progress in enterprises have intensified capital-biased technological advancement, which has exacerbated capital deepening worldwide, leading firms to substitute labor with capital. This trend has suppressed wages for certain laborers and reduced their share of income.

Additionally, globalization is linked to the decline in labor income shares. The dominant position of foreign capital not only weakens laborers' bargaining power in competition with capital (Luo & Zhang, 2010), but also accelerates capital deepening and promotes capital-biased technological progress, significantly reducing the labor share of income.

In conclusion, the factors affecting labor income shares are largely driven by capital deepening in the market, although this deepening is not a result of distorted factors. On the contrary, the optimization of the business environment facilitates a "capital crowding out labor" effect, where capital initially holds greater importance and bargaining power, leading to a capital-driven economic development pattern. Meanwhile, labor is still in the process of transferring across industries, resulting in a temporary decline in the labor share of income.

4. Conclusion

This paper provides the following key conclusions based on the theoretical discussion and empirical analysis of the impact of business environment optimization on enterprise development and labor income share:

1. Business Environment Optimization and Enterprise Development: By simplifying administrative approval procedures, implementing credit supervision, and reforming business registration systems, the government can effectively lower market entry costs for enterprises, stimulate entrepreneurship and innovation, and thereby promote economic growth and industrial structure optimization.
2. Labor Income Share Changes: In the early stages of business environment improvement, the acceleration of capital accumulation typically leads to a decrease in labor income share. Capital deepening and technological advancement drive the adjustment of industrial structures, leading to the contraction of low-tech and labor-intensive industries, which depresses the overall labor income share. However, as industrial structures optimize and labor markets mature, labor income share eventually rebounds.
3. The Role of Globalization and Technological Advancement: Globalization and the introduction of capital-intensive technologies have contributed to the decline in labor income share, particularly in developed countries and emerging economies. The global movement of capital and the capital-biased nature of technological progress have enhanced capital's bargaining power relative to labor, exacerbating income inequality.
4. Policy Recommendations: To promote fair income distribution while advancing economic development, policymakers should focus on how to alleviate the crowding-out effect of capital on labor through ongoing market reforms, technological innovation, and industrial upgrading. Specifically, investments in education and technology training should be increased to enhance labor productivity, and financial market reforms should reduce distortions in the capital market, thereby enabling a more balanced economic development and income distribution.

In summary, optimizing the business environment not only promotes economic growth and enterprise innovation but also has profound implications for labor income share and capital accumulation. Future policies should continue to drive market-oriented reforms while focusing on achieving a more equitable distribution of capital and labor, ensuring sustainable and inclusive economic development.

Acknowledgment

This work was supported by the Youth Program of Guangdong Basic and Applied Basic Research Fund Committee-Regional Joint Fund (Grant No.2022A1515110873); Characteristic Innovation Project of Guangdong Provincial Department of Education (Social Sciences) (Grant No. 2022WTSCX014); Guangzhou Science and Technology Plan Project (Basic and Applied Basic Research Project) (Grant No.2023A04J0214).

Reference

[1] Alfaro L, Chari A. Deregulation, misallocation, and size: Evidence from India[J]. The Journal of Law and Economics, 2014, 57 (4): 897–936.

[2] Amici M, Giacomelli S, Manaresi F, et al. Red tape reduction and firm entry: New evidence from an Italian reform[J]. Economics Letters, 2016, 146: 24–27.

[3] Branstetter L, Lima F, Taylor L J, et al. Do entry regulations deter entrepreneurship and job creation? Evidence from Recent Reforms in Portugal[J]. The Economic Journal, 2014, 124 (577): 805−832.

[4] Harrison A.E 2002 "Has Globalization Eroded Labor's Share? Some Cross-Country Evidence" UC Berkeley Mimeo: 46.

[5] Klapper. L., L. Laeven, and R. Rajan, 2006"Entry Regulation as a Barrier to Entrepreneurship ", Journal of Financial Economics, Vol. 82, 591-629.

[6] Shleifer A., and R.Vishny, 1993, "Corruption", Quarterly Journal of Economics, Vol. 108, 599-617.

[7] Stigler, G., 1971, "The Theory of Economic Regulation", Bell Journal of Economics and Management Science, Vol. 2, 3-21.