Labour Mobility and Unemployment in China

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Abstract

One of the main targets of the reforms which began at the end of the 70s, was to create a free and flexible labour market in China. To do so, it was necessary to dismantle the Maoist organisation in the working units, which secured lifelong employment (the so-called “iron rice bowl”). Several schemes were devised in order to increase manpower supply. Of course, every year, new youngsters flooded the labour market, and when hired, they were given three year contracts, even in State-owned enterprises (SOEs). But there were many other sources of manpower supply: peasants who could now leave their home communes, fired employees from SOEs, redundant civil servants and dismissed soldiers from the People Liberation Army. There was massive unemployment consequently, which creates social unrest and threatens political stability.

The current problem is how to reduce unemployment without going back to the old system. Many different schemes have been tested, mainly based on creating employment in the tertiary sector. On the other hand, some economists suggest that China must further its specialisation in labour intensive industries. Our standpoint is different. As a developing country, China needs to upgrade its manufacturing industry. Industrial enhancement by means of an efficient industrial policy, together with a strong effort in education should be the policy leading to a more balanced labour market. Only in this context, the tertiary sector may help to improve the employment situation.

Furthermore, unemployment risks hinder growth, as the local market won’t develop enough, on account of job uncertainties. More consistent unemployment benefits could counter these undesirable effects. China could thus improve its social protection system, which is, for the time being, one of the weakest in the region. These benefits may be subsidised by an effective collection of personal income taxes, which so far remains uncovered.

1 The views expressed are exclusively the author’s.
Setting up a labour market in China

The creation of a labor market played a key role in the reform process that began in the late 1970s. It was intended to introduce labour mobility, resulting in better allocation of labour in the productive system, improving enterprise profitability and reducing production costs. China hoped that improving economic efficiency would accelerate development, further broaden the domestic market, and lead to more positive international specialisation.

I. Dismantling the Maoist heritage

Treatment of the labour force during the Maoist period mirrored the Soviet model, with rapid industrialisation funded at the expense of farmers. China's dual economy has resulted in a dual system for labour.

The people's communes that organised life in the countryside provided peasants with near-subsistence level pay. They were not entitled to social security, which was limited to the five necessities of life for destitute persons without a family, namely food, medical care, clothing, housing and burial expenses. Education and health care were provided by the commune.

In urban areas, the cash wage paid by "work units" (enterprises owned by the State) was only a small part of a bigger package, because basic needs were provided directly in kind by the work unit, including housing, medical care, pre-school child care, schooling, and pension for retired workers. Workers were guaranteed lifetime employment and generally the jobs were passed on to their children when they retired. Some workers never even bothered to retire. Although their working days were over, they remained on the employee registers and continued to receive their wages. The difference, however, was inconsequential because the retirement pension was paid out of the enterprise's ordinary cash inflows, and the difference between wages and pensions was small.

Because of the difference in treatment between members of rural and urban communities, living standards appeared to be far better in towns and cities than in the countryside. The population was registered in its place of residence – with a kind of internal passport, the hukou – that prevented people from moving, and most important, confined peasants to their commune; those who left relinquished all social rights. Furthermore, this measure aimed to facilitate central planning of grain resources required for food.

2 This practice was so widespread in the late 1970s that it was explicitly prohibited by the 1986 Regulation on Labour Contracts. See Morin, Alexandre and Pairault, Thierry: La Chine au travail (I), les sources du droit du travail (China At Work: The Sources of Labor Law, in French), Gestion de l'entreprise en Chine et Centre d'Etudes sur la Chine moderne et contemporaine, Ecole des Hautes Etudes en Sciences Sociales, Paris, 1997.
In addition, because the authorities sought to promote autarchic development in relatively small territorial entities, municipalities were carved out to include cities within rural areas and rural areas within cities, blurring the distinction between the two. As a result, the statistics overstate the population that would be considered "urban" by Western standards.

The inherited situation had created rigidities in labour supply. These were all the harder to overcome because their elimination meant the loss of numerous guarantees and benefits, particularly for the urban population.

The reforms began with a change in the law, including a 1986 Regulation on Labour Contracts and a Regulation on enterprises. The 1986 Regulation on Labour Contracts abolished guaranteed lifetime employment. Labour contracts have a term ranging from one to five years, and there is no provision for renewal. Since October 1, 1986, state sector enterprises no longer have the right to hire permanent workers. This has led to a steady rise in the number of workers on terminable contracts, which reached 50% of their employees in 2000.

Two other measures introduced in 1986 play a crucial role in the formation of a flexible labour market: the Regulation on Discharging Employees and the Law on Enterprise Bankruptcy. The Regulation on Discharging Employees is aimed primarily at improving labour efficiency in State-owned enterprises. It allows termination for failure to comply with enterprise working methods or when a worker is unqualified for his or her work. It does not allow employees to be discharged for economic reasons, which is provided for only under the Law on Enterprise Bankruptcy. The unpopular measures were not applied much in the years just after they were introduced, but were used on a large scale in the late 1990s.

Measures intended to keep the rural population in place have become less effective since the reforms began. While the hukou has not been abolished, it is no longer enforced strictly, because with the disbandment of the communes authorities have less control over the rural population. Peasants have rushed into cities in search of new employment opportunities, since neither farming nor even the collective town and village enterprises can absorb the labour supply. Once migrants leave their place of residence, they are no longer entitled to social security; in urban areas they tend to congregate in outlying quarters with others from their original communities; they are underpaid and their jobs are insecure.

China's labour pool reserve has grown since then, with in flows from:

- new entrants to the labour market,

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• bankruptcies of State-owned enterprises and collective-owned enterprises,
• downsizing in public administrations and State-owned enterprises, which provide the largest contingent,
• demobilisation by the armed forces,
• expiring fixed-term labour contracts,
• workers in insecure employment, and
• migration from rural areas.

In the light of the demographic factors, the low level of labour training and the difficulties facing China's economy, the substantial unemployment arising from the surplus labour pool threatens political stability and the very possibility of development in China.

Employment and ownership

The SOEs accounted for most urban employment (close to 80% at the start of the 1980s), with the remainder in the collective sector4. SOEs continued to hire through 1996, but they have steadily cut jobs since then (Chart I). The collective sector, after creating jobs in the early days of the reforms, began to shed jobs in the early 1990s, long before the SOEs. Lost jobs in the SOEs and collectives have not been fully offset by job creations in other enterprises with a different status (resulting from total or partial privatisation of SOEs). For instance, between 1996 and 1998, the State-owned and collective sectors lost close to 24 million jobs, while other types of enterprises, including former SOEs which have become share-holding corporations (either limited liability corporations with State capital or listed on the stock exchange) created 10 million jobs. Over 13 million jobs were destroyed in all, not to mention the insecure nature of some jobs, including in the "household individual enterprise" sector which accounts for most of the jobs created, essentially in proximity services, and as street or market vendors. Since then, the market labour has further deteriorated, as employment in the private sector – the growth rate of which has obviously been decreasing – entered negative territory in 2000. As for employment in the public sector (SOEs and Collectives), it is still falling, though at a slower pace.

Chart I

4 This sector originated in the former commune-based workshops. Since the start of the reforms, this type of enterprise, which can have different, hybrid forms of ownership, has grown rapidly, even in cities. The enterprises are dependent on the local authorities, primarily for funding and for the supply of raw materials. Even since the central government closed bank subsidiaries in small localities and restricted credit, they have been in crisis.
Rural unemployment is even more formidable, with about 150 million surplus workers. Some migrate illegally to the cities where they compete against urban workers on the labour market; this has reached such proportions that most cities demand a special authorisation before rural workers can be hired, and discharged urban workers are given priority on the labour market.

II. From a labour pool reserve to large-scale unemployment

Since 1997, when dismissals aimed to improve enterprise profitability began, unemployment has become massive. In 2000, the official figures for unemployment, corresponding to the economically active urban population seeking jobs who were officially registered in the re-employment service centres (the shiye category) came to 6 million, or 3% of the economically active population – but this accounts for a tiny portion of total unemployed persons. The overwhelming majority of unemployed persons are xiagang workers who, while "definitively" laid off, continue to have ties with their enterprise. Each year since 1997, between 10 and 12 million wage employees have been relegated to the xiagang category. They are estimated to number approximately 20 million, or 12% of the economically active urban population and 70% of the unemployed. These are frequently older workers with poor skills, who are unlikely to receive vocational training and who therefore have little chance of finding a new job.

The xiagang category should be phased out by 2002, because the contracts binding laid-off workers to their former enterprise have a term of three years and there should be no new contracts after the current ones expire. Starting in 2002, xiagang who fail to find a job will join the shiye category. The urban unemployment rate in the narrow sense (shiye, plus xiagang workers minus reemployed workers) comes to 18%. When including the “hidden” employees in State-owned enterprises, who are neither paid nor
dismissed, accounting approximately for 20% of the employees\(^5\), the unemployment rate will reach 27%, or approximately 56 million unemployed persons (Chart II).

**Chart II**

<table>
<thead>
<tr>
<th>Unemployment (millions, 1998)</th>
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<tr>
<td>shuye</td>
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<tr>
<td>xiagang</td>
</tr>
<tr>
<td>re-employed</td>
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<tr>
<td>hidden unemployed</td>
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</tbody>
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source: ZGLDITJNJ

Cited by Gipouloux, op. cit.

Accordingly, about one fourth of urban wage employees are de facto jobless, although most are not classified as "unemployed" and therefore not entitled to unemployment benefit.

**III. Fighting unemployment and its consequences**

Unemployment threatens not only continued growth but social and political stability as well.\(^6\) The authorities are attempting to avoid those consequences, which would be disastrous for the regime. Frequent unrest by xiagang workers, peasants, the unemployed, and pensioners is a constant concern for the authorities, who have attempted to control this segment of the population by different means.

Because of the changes in the ownership regimes of China's enterprises, the system of social security provided by the work unit is no longer appropriate. The reforms began in 1986 with the introduction of unemployment insurance, at the same time that lifetime employment was abolished\(^7\). They seek to achieve three objectives: extension of social security to collective and private enterprises; a unified system operating on a territorial basis, and the transfer of charges from state sector enterprises to municipal budgets. Since the reforms began, funding has theoretically been provided jointly by

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\(^5\) An estimate from the Development Research Center of the State Council.


\(^7\) For details on the beginning of the social security reforms starting in 1986, see Hochraich, D., *La Chine, de la révolution à la réforme*, Paris, Syros.
employers and employees – with possible participation by the State, instead of funding provided exclusively by the State through the work unit (Hussain8).

Implementing these reforms will inevitably raise multiple problems. The extension of social security remains theoretical for the time being. First, enterprises in the collective and private sectors are not paying the contributions they owe. Second, because of the crisis facing State owned enterprises, benefits often go unpaid, especially when the enterprise is in a state of actual or virtual bankruptcy. Social security has been centralised under the Ministry of Labour, renamed the Ministry of Labour and Social Security, which has subsidiaries in the cities, the Municipal Labour and Social Security Bureaux. The municipalities pay part of the amounts owed by the State-owned enterprises (particularly after more-or-less violent protests by those entitled to benefits), insofar as their finances allow – bearing in mind that in some cases their finances are strained by the failure of the same local conglomerates. But the transfer of actual authority to the Ministry of Labour and Social Security will take years, because it is impossible to fund the territorial accounts that would be used to pay out the corresponding benefits. Despite the reforms, management and payment are still incumbent on the work units. Financial difficulties prevent work units from paying their share, while a large majority of other categories of enterprises do not obey the law and fail to pay the contributions they owe. Consequently, most wage employees are not effectively covered by social security, and the social welfare accounts are in deficit (box).

The 1986 Regulation on Discharging Employees was intended primarily for State-owned enterprises, but has been extended to other categories of enterprises, including joint ventures and foreign funded enterprises. Four categories of beneficiaries were provided for: workers of bankrupt enterprises, those discharged just before bankruptcy, workers whose contracts have expired, and workers made redundant. In 1993, three other cases were added: workers who lost their jobs because the enterprise was wound up, workers whose enterprise stopped production due to restructuring, and workers in cases where the authorities decided that wage employees would receive unemployment compensation. The law explicitly bars workers who migrated from the countryside from entitlement to unemployment compensation.

The above mentioned 1986 law provided for the creation, at all levels of government9 – down to villages and districts – of re-employment service centres under the control of the local authorities, where the unemployed can register for unemployment benefit and seek a new job. The re-employment service centres have increased, from 3,000 when they were first set up to approximately 36,000 at the end of 1998,10 about one-fifth are managed by non-government organisations or private persons. These agencies do not always operate properly, as jobs are not always allocated in an objective

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9 China is divided administratively into provinces, municipalities, districts, townships and villages.
10 See Gipouloux, op. cit.
manner. Further, unscrupulous employers may hire job seekers in order to benefit from tax incentives, only to dismiss them a few weeks later.

The xiagang, who account for most of the unemployed, are treated differently: they receive job offers, sometimes even abroad. If they refuse three jobs, their contract is terminated. The jobs offered the xiagang are far less attractive than the ones from which they were laid-off, in terms of pay and working conditions.

Stable jobs are generally replaced by insecure jobs. When jobs exist at all, they are handed out through personal connections, with authorities helping friends and acquaintances. A considerable number of people find no work at all. Because of the scope of the phenomenon, and after downsizing public administrations, local authorities have opted to hire the xiagang in this sector. Alternatively, pressure can be put on them to return to the countryside.

*Vocational training does little to enhance skills*

Retraining is generally provided free of charge, but more and more training programmes require payment. Because of the low level of initial skills, the retraining is extremely basic, generally consisting in "changing attitudes," that is, getting "laid-off" employees to accept poorly paid, insecure jobs. So strong is the pressure on "laid-off" employees to set up individual businesses that some enterprises, under an obligation to retrain and pay a "living allowance" to their xiagang, offer to pay the allowance in a lump sum. This leaves the employees with enough capital to set up a micro-enterprise, typically to sell food or low-cost items in sidewalk stalls, streets and markets.

*Difficulty in financing unemployment insurance, with unemployment benefit below the minimum living standard*

Payment of unemployment insurance contributions is now compulsory for all urban enterprises, including small private enterprises. But collection is far from exhaustive, because of difficulties in collecting contributions from small private enterprises. The current coverage rate is estimated to be slightly under 50%. The percentage is considered low, particularly because a structure effect comes into play: jobs in the state and collective sectors – where the coverage rate is high – are falling fast, while the other sectors have a very low (5%) coverage rate. The number of beneficiaries is very low (fewer than 30% of persons registered as unemployed). Because of the rise in unemployment, contributions have been increased to 3% (2% paid by employers and 1% by employees). Despite the higher contributions, unemployment insurance accounts are in deficit in most Chinese cities.

The compensation paid to the shiye unemployed was previously proportional to their earlier wages, but is now only a flat percentage (between 60% and 70%) of the

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11 Hussain, A., op.cit.
minimum wage, which varies with the estimated cost of living in each city or region. The xiagang "laid-off" workers are granted a basic allowance, that decreases as they approach the end of the 3-year period during which they are entitled to the xiagang status, on the order of 170 yuans a month (US$20) but which varies with each city or province. This very low allowance is still higher than the minimum living standard or the unemployment allowance to which the shiye are entitled.

The contradictions in employment policies reveal the current degree of disarray now that growth is creating fewer jobs. Disconcerted authorities have considered prohibiting some categories of the population from looking for a job. There have been proposals to require secondary-school level graduates to continue studies for another three years or to require that women stay at home. But those proposals appear just as unrealistic as the idea of sending surplus workers to the countryside.

*Part of the population below the poverty threshold*

The measures implemented have failed to prevent a large-scale increase in urban poverty – to the contrary. Not only unemployment but also retirement benefits are insufficient and contribute to the lower standard of living of the bulk of urban Chinese (box). The figures cited, however, are subject to considerable uncertainty. Experts consider that there could be 40 million individuals in difficulty in the cities (Rocca). While the government estimates there are 10-12 million urban dwellers living below the absolute poverty threshold (out of a population of 370 million), some estimates run twice as high. These are families with monthly income between 90 and 120 yuan a month (between US$11 and $15). With the measures related to joining the WTO, the number of unemployed persons could increase by a further 40 million.13

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12 Employment increased by 1.1% and growth by 8.8% in 1997; employment rose by 0.5% and growth by 7.8% in 1998; and in 1999 employment rose by less than 0.4% while growth rose by approximately the same rate as in 1998. See Rocca, op. cit.

Box: Retirement pensions sometimes below the minimum living standard

Only a tiny portion of the Chinese, namely the urban population registered as such, is entitled to a retirement pension. In rural areas, the older generations are supported by their children, particularly by their male children. Rural dwellers without a family are entitled to a minimum allowance, but not those who migrated to cities without being registered there. Whatever the growth rate, the demographic transition is already causing serious problems for pensions, with the one-child policy further increasing population aging. The increase in the burden of dependent elderly people is offset by the reduction in the number of dependent young people. All told, estimates show the dependency ratio remaining stable or even falling slightly in coming decades. Still, if the demographic imbalance between active and non-active members of the population does not worsen, the ratio of pensioners to active contribution-paying workers will increase, making pay-as-you-go pensions unviable. Pensions are divided into two parts: (1) a minimum living standard, which varies with the region, does not depend on earnings during employment, and is funded entirely by the State; and (2) a variable tier funded by the employee and employer contributions according to the principles of a pension fund.

The pension problem is particularly complex because China has a variety of enterprises with considerable differences in demography and in pension schemes. The State-owned enterprises have wage employees with a high average age, although for several years they have been hiring under fixed-term contracts, which cover 50% of their personnel. Because of the age structure of the population, most pensions (70%) are paid by State-owned enterprises, while collective-owned enterprises pay 11% and private enterprises pay 5.5%. The average amount received per pensioner in 1999 was US$66 dollars a month. Although the pension comes to about 80% of wages, the amount of the allowance can be below the minimum living standard because money wages are low and a large part of pay comes in the form of benefits in kind. Further, because of the failure of enterprises that should have paid pensions, and because administration and resources are not centralised, allowances can go unpaid. In addition, the territorial accounts are not funded properly: contributions are not collected, and the available cash is earmarked to other outlays instead of being invested to earn a return. Widespread corruption also contributes to the low return on investments.

IV. Unemployment, social security, growth and development: a hard-to-solve equation

Unemployment results from the contradictions facing China's economy: a technology gap and obsolescent capital stock, poor capital allocation, and overstaffing leading to poor profitability. To improve the profitability of China's enterprises, surplus workers must be released. Since State-owned enterprises began to restructure in 1997, China's economy has suffered from a lack of "solvent demand" and from overinvestment in light industries – those where production was inadequate before the introduction of

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14 Hussain, ibid.
15 See NSB : China's Statistical Yearbook, p. 765.
"market socialism." The employee cuts will only cause further contraction of the market, which will continue in the absence of substantial policies in the area of social security and employment.

*Maintaining "solvent demand" through adequate social security*

Increased unemployment and inadequate social security are the primary causes of the slowing in the growth of domestic demand, which is weighing heavily on China's growth. The authorities, aware of the need to maintain growth rates strong enough to curb the rise in unemployment, have set up a policy of infrastructure public works projects capable of creating jobs. But the jobs created are inherently insecure. In the context of persistent employment insecurity, when the population must pay for expensive health services, housing and education, the policy's effects on household consumption are fading. The projects are also a financial drain for the State, absorbing US$45 billion between 1997 and 2000 or the equivalent of one-and-a-half points of GDP each year.

The government could consider increasing social expenditures by an amount equivalent to the amount devoted to the infrastructure projects, to compare the effects of the two measures. Raising income tax – a tax that is not collected efficiently, could finance the additional social expenditures. The effectiveness of this measure would have to be compared with expenditures for public works projects, for which a cost-benefit analysis – in terms of the utility of the works and in terms of the desired effect – remains to be completed (chart III).
Under these conditions, the question arises whether the Chinese government – which devotes barely 3% of GDP to social security, or less than other Asian transition economies\footnote{Despite the noncomprehensive nature of social security in Asian countries, between 6\% and 8\% of their GDP goes to different forms of social security.} – should provide greater resources for social security. Admittedly, some Chinese social protection is the direct responsibility of enterprises, so central government expenditures are only part of the total. However, most enterprises that should provide social protection are unable to do so, and the question has arisen, as seen above, of transferring all social security outlays to public expenditures, which justifies the comparison with neighboring countries that already have centralized systems.

Not only does China allocate the smallest percentage of GDP to social security of any country in the region, but the percentage has fallen since 1995. Financing for improved social security should be generated by increasing tax receipts from personal income tax, which is currently very low in China and is not collected efficiently (Chart IV).

On the other hand, exceptional public works projects are financed by long-term government securities, further increasing State debt. Even if public sector debt, in the narrow sense, does not currently amount to a very large percentage of GDP, the
percentage increases are high. Especially if one includes the indebtedness of broad sectors of the economy for which the State is ultimately responsible (i.e.: banks, state owned enterprises, and Asset Management Companies\textsuperscript{17}).

Chart IV

Unemployment will be absorbed only if industry is redeployed

Industry is currently destroying jobs; agriculture is overcrowed and absorbs peasants that can’t find jobs in the cities any longer. Whence the widespread idea that it would be appropriate to develop employment in the services (chart V).

\textsuperscript{17} These companies are charged of writing off bad debts in public banks.
Experts have suggested that China create a services sector capable of absorbing excess labour. While the sector is not highly developed at present, its current growth can be characterised as "informal employment" typical of poor countries. It would be hazardous to attempt to offset lost jobs in farming and industry by developing the services. In particular, one idea, that "unlike other developing countries, China has too few jobs in the services" and could therefore move in that direction, is particularly appalling. Not because the comparison with the developing countries is shocking in itself, but because those countries can in no case be held up as a model for China. Further, even sophisticated financial services have low potential for creating jobs, because of their intrinsic very low labour intensity.

In addition, the services sector is in phase with the trend in manufacturing, as illustrated by chart IV: the 1992-96 period saw strong employment growth in both sectors, though growth was stronger in the services. Manufacturing jobs are currently falling, and job creation in the services has slowed sharply. The increase in farming jobs can be attributed to rural migrants returning to the land because of the low probability of finding an urban job, but the pattern only increases hidden unemployment in rural areas.

The tertiary sector will not be able to create enough jobs to absorb the impressive number of unemployed that currently worries Chinese authorities. Many services will experience job cuts when the measures related to the WTO entry will be enforced, like the opening of the banking sector. It will then seek to reduce costs and this will result in a massive dismissal of staff. Industry alone can provide the technological externalities that will enable China to achieve strong growth without
creating disequilibria. At the same time, industrial redeployment should facilitate finding new “niches” for international specialisation in industries other than labour-intensive ones. Like all the developing countries, China is already specialised in labour-intensive industries; the problem is how to break away from that specialisation. This means that the labour-intensive industries needed for the domestic market, and which can also export their goods, must coexist with capital-intensive industries capable of ensuring technology enhancement.

The Chinese authorities cannot rely on foreign investment as a way of gaining access to modern technology. After joining the WTO, they will no longer be able to pressure foreign investors to provide that technology; one clause specifically prohibits such agreements.

This means they will have to count on themselves. That is one reason, but not the only reason, efforts will have to be redoubled in education at every level, beginning with the reintroduction of totally free schooling (which does not exist even in primary school).

References

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