

# Employment should top crisis agenda

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**Abstract:** The global financial crisis has taken a toll on China's economy and employment. Due to shrinking exports, jobs have been slashed and difficulties have arisen in export-oriented manufacturing, labor-intensive industries and small and medium-sized enterprises (SMEs) in China's coastal regions. In this context, employment should be our policy target, and counter-shock and counter-cyclical policies should be integrated.

**Key word:** financial crisis, employment impact, rural migrants, employment pressures, proactive employment policies

China's export sector has suffered a great deal since the outbreak of the global financial crisis. Since October 2008, export growth has begun to decline, and the inflow of foreign direct investment (FDI) experienced negative growth. Repercussions of the crisis have spread to the real economy through the credit and capital market. Given that this crisis broke out in the world's largest economy, the U.S., and has global consequences, it will have a greater impact on China's economy than did the Asian financial crisis of 1997. China's economic growth and employment have already been hit hard, as seen in the waves of jobless migrant workers in coastal regions returning to their homes in rural areas. In response to the uncertain externalities, China's macroeconomic policies must focus on employment and combine counter-shock and counter-cyclical measures.

## I. Impact of the financial crisis on China

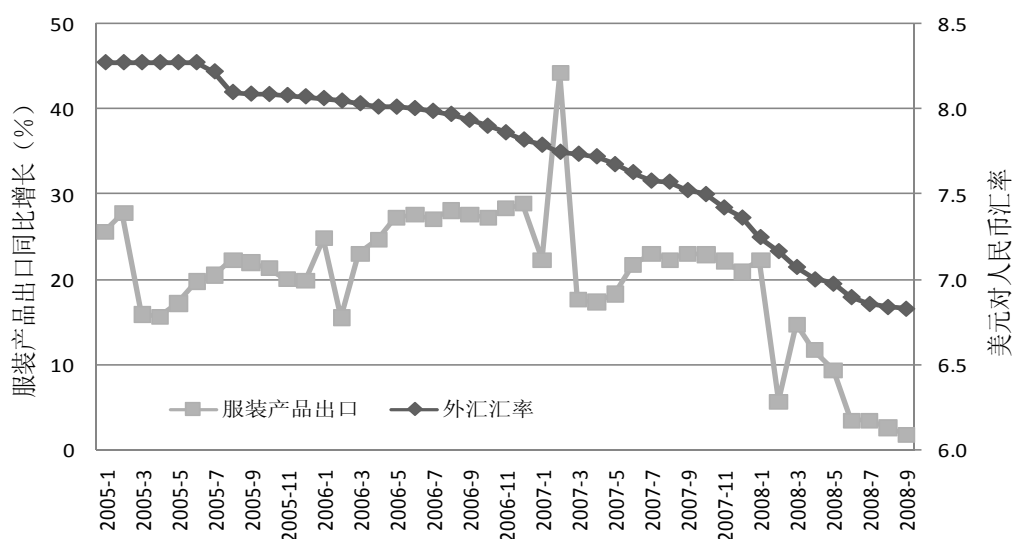
The financial crisis affects the Chinese economy in four ways: first, income effect relating to shrinking demand for imports in major crisis-hit countries; second, price effect of renminbi appreciation; third, investment effects relating to reductions in FDI inflow; and fourth, indirect effect caused by weakened demand for trade in services. The above four effects have exerted an all-round impact on China's trade, industrial development and economic growth, which in turn have threatened employment.

A major impact is on foreign trade. After the financial crisis took on a global dimension,

developed countries and regions like the U.S., EU and Japan suffered slowdowns, job cuts, rising unemployment, lower consumption and increasing bank savings, with a shrinking demand for imports from developing countries. Orders were cut or canceled, and the exports of developing countries like China have plunged. As revealed by customs statistics, in November 2008, China's exports fell 2.2% over the same period of the previous year, which is the first negative growth since June 2001. Meanwhile, import declined 17.9% year on year. As a great proportion of import goods are materials for processing, an import slowdown will hold back China's economic growth as well. According to IMF estimates (IMF, 2008a), global economic growth will drop to 2.2% in 2009, down 0.8 percentage points over the previous year. Of which, the figures of the U.S., EU and Japan will drop by 0.8, 0.7 and 0.7 percentage points respectively. Economic recession will further push down imports from the developed world, with a worsening impact on China's economic growth.

Renminbi appreciation is another factor. Before the financial crisis, China's exports were already facing downward pressure due to renminbi appreciation. Between July 2005 and October 2008, the renminbi appreciated 21.2%. Over the past one year since September 2007, it appreciated 10.3%. By comparison, it took two years from July 2005 to August 2007 for the currency to appreciate by 10.9%. Renminbi appreciation has dealt a heavy blow to China's exports. For instance, in textiles, export growth averaged 24.0% between July 2005 and August 2007, and remained around 22.0% until January 2008. But it has been on the decline since then, with year-on-year growth at only 1.8% in September (see Figure 1). Renminbi appreciation has a price effect. With a given income, export demand will decline when price rises. After the financial crisis broke out, although the renminbi exchange rate against the U.S. dollar was relatively stable, it appreciated by a large margin against the euro and pound. Such an appreciation has weakened the international competitiveness of China's manufacturing goods and reduced its exports to the EU and the U.K.

**Figure 1: Renminbi appreciation and garment exports**



服装产品出口同比增长 (%)  
Year-on-year growth of garment export (%)  
美元对人民币汇率  
Exchange rate of the U.S. dollar against renminbi  
服装产品出口  
Export of garment  
外汇汇率  
Foreign exchange rate

Source: National Bureau of Statistics, Government Database of China Statistical Data Application Support System; Sina.com website  
<http://biz.finance.sina.com.cn/forex/forex.php>.

China is the biggest recipient of FDI. After the financial crisis broke out, financing difficulties have prevented multinational firms or investors from investing in emerging markets. In addition, rising manufacturing costs and slashed profits have also dampened investment return expectations, making China less attractive to investors. With fewer orders and under currency appreciation pressures, many export-oriented foreign and local firms operating in China are facing losses and even bankruptcy. Once their capital chain breaks, they must cut production or go bust, which means massive layoffs. According to the statistics from China's Ministry of Commerce, from January to November 2008, there were 24,952 newly approved foreign-funded firms in China, down 27.51% year-on-year. Paid-in foreign capital was US \$86.418 billion, up 26.29%. But November figures suggest that the monthly figure of newly approved foreign-funded firms was 2,216, down 38.32%. Paid-in foreign capital was US \$5.322 billion, down 36.52%.

The economic and trade slowdown has also affected trade in services like international finance and settlement. Meanwhile, as income drops, an impact on international travel and tourism is inevitable. Reductions of overseas tourisms and the budgeting of multinational firms have affected trade in services, local economy, employment and income.

## **II. Impact on China's employment**

The impact of the global financial crisis on China's employment is still unfolding. Given its global nature, the breadth, depth and severity of this crisis must be reckoned with. Despite vigorous global responses, it will take at least two or three years for this bust cycle to abate. Due to the slump in exports and inbound investment, China's labor market and employment will inevitably suffer.

The first victims were export-oriented firms and industrial sectors in the coastal regions of east China. In 2007, the coastal regions accounted for 60% of China's economy, with exports accounting for 91% of this share. Moreover, rapid export growth since 2001 mainly came from the eastern region. Under multiple shocks of renminbi appreciation, rising input prices and the financial crisis, export-oriented firms and industrial sectors in the eastern and southern regions are the most vulnerable. For instance, Guangdong province accounts for more than one-tenth of China's economy, with exports accounting

for one-third of the national total. Given its large export volume, export processing firms account for a big share of the province's manufacturing industry, but profit margins are thin. Under the above pressures, export-related employment growth in Guangdong declined from 760,000 persons in 2005 to 430,000 persons in 2007, down 330,000.

Then the impact spread to manufacturing, foreign-funded firms and SMEs. Industrial goods account for more than 95% of China's exports. On the other hand, a great part of China's import goods are for export after processing. Thus manufacturing is vulnerable to trade declines. As the largest non-agricultural employer, manufacturing has to deal with employment pressures when exports go down. More than half of the FDI to China went to manufacturing. Urban employment of foreign-funded sectors stands at 15.83 million persons, and foreign-funded township and village enterprises employ 8.59 million persons. The two figures add up to 24.42 million persons. With reductions in both FDI and exports, the employment demand of foreign-funded firms will decline. Both large manufacturers and SMEs will be affected, but the latter will be hit harder. From January to September 2008, the 15,000 SMEs in Guangdong that went bust were primarily in processing, manufacturing and labor-intensive firms producing garments, textiles, electronic devices, plastic goods and so on.

The third set of victims is rural migrants and other low-skilled labor. Among manufacturing, exports and foreign-funded enterprises, a large proportion of the workforce are rural migrant workers. As the agricultural survey of 2006 shows, 132 million rural migrants work in towns and cities. Of these, 56.7% are employed in secondary industries such as manufacturing. About one-third are employed in the eastern region. Rural migrants are relatively young, and more than 70% have received only junior middle school education. Because they are low skilled, rural migrants are vulnerable to layoffs. After the enactment of the *Labor Contract Law*, their rights and interests are much better protected by law. For instance, with government assistance, wage arrears on the part of some bankrupt enterprises have been settled. But the jobless rural migrants are still not covered by urban unemployment figures and insurance systems. When jobs are gone, they have no option but to return to their countryside homes. According to the statistics of Rural Economy Research Center of the Ministry of Agriculture on 120 villages of 11 provinces, about 6.5% of rural migrants had returned to their countryside homes by October 2008. If there are 130 million rural migrants in total, some 8.45 million have returned to the countryside. If the November and December data are taken into account, the number would be even bigger.

Lastly, the financial crisis has caused downward pressure on the economy and squeezed urban employment growth potential. In the new round of economic growth, the year 2007 is at the crest of China's economic cycle. With counter-inflationary measures in the first half of 2008, the economy was going downward. China's economic cycle is usually five years, and the slowdown in the coming two or three years will take a toll on urban employment. Under the financial crisis, export and FDI downturn, manufacturing investments will decline and China's economic fluctuations will intensify, with possibilities of a further slowdown. Consequently, jobs in both manufacturing and services will be slashed, making jobs scarcer for urban populations like college graduates. When manufacturing firms face bankruptcies, both rural migrant workers and college graduates

will lose jobs.

### **III. Long-term unemployment consequences**

Compared with the financial crisis of 1997, the current crisis has had a greater impact on China's employment. Although both crises hit export-oriented sectors through export and FDI declines, the current one is much broader and more complex. First, the Asian financial crisis of 1997 broke out in China's neighboring countries and regions, whose dependence on China's exports was low. But the current crisis broke out in developed countries like the U.S. and has global repercussions. With spillovers on the real economy, this crisis has evolved into a global economic crisis (World Bank, 2008), and will deal a heavy blow to China's economy and employment due to the country's dependence on external trade.

Second, such an effect will be further magnified as long as renminbi appreciation pressures exist. During the Asian financial crisis, renminbi exchange rate was still pegged and therefore the economic impact of exchange rate fluctuations was not a big issue. After July 2005 when the floating renminbi exchange rate was adopted, the renminbi appreciated against the U.S. dollar at a brisk pace. Meanwhile, the renminbi was depreciating against the euro. But as the financial crisis affected European economies and gave rise to unemployment, the euro depreciated against the renminbi by a large margin. As North America and Europe are both China's export destinations, renminbi appreciation will weaken the low-cost advantage of Chinese goods and affect employment.

As a hallmark of this crisis, unemployment pressures exist primarily among rural migrant workers, while urban registered unemployment suffered to a much lesser degree. However, urban unemployment will be affected in 2009 as well. Until now, the massive layoffs have occurred primarily in labor-intensive and export-oriented SMEs in the coastal region. As the crisis shifted from financial sectors to the real economy, and with China's economic slowdown and real estate slump, enterprises of resource and capital-intensive input goods are in difficulties and have to downsize. In Guangdong, for example, there are 26 million migrant workers, 20 million of whom are from other provinces. If layoff rates are 10% and 40% for them respectively, some 2.6 million to 10 million migrant workers may lose their jobs, which is equivalent to total urban registered unemployment (over 8 million).

But rural migrant workers are not all the same. Some opt to leave urban areas after being laid off. Others, especially those with families settled in the cities, are used to urban life and have become urban residents. Therefore it is less likely for them to return to the countryside. However, the employment of rural migrants shares similar features with urban informal employment (see Figure 2). The GDP elasticity of informal employment growth (ratio between employment growth and GDP growth) is higher and has wilder fluctuations than that of formal employment. The former's GDP elasticity is 0.92 and the latter's 1.06. With given job creation channels and conditions, when the macro economy goes wrong, employment growth will face the risk of a massive slowdown. Losing jobs will make life more difficult for urbanized rural migrants and their families.

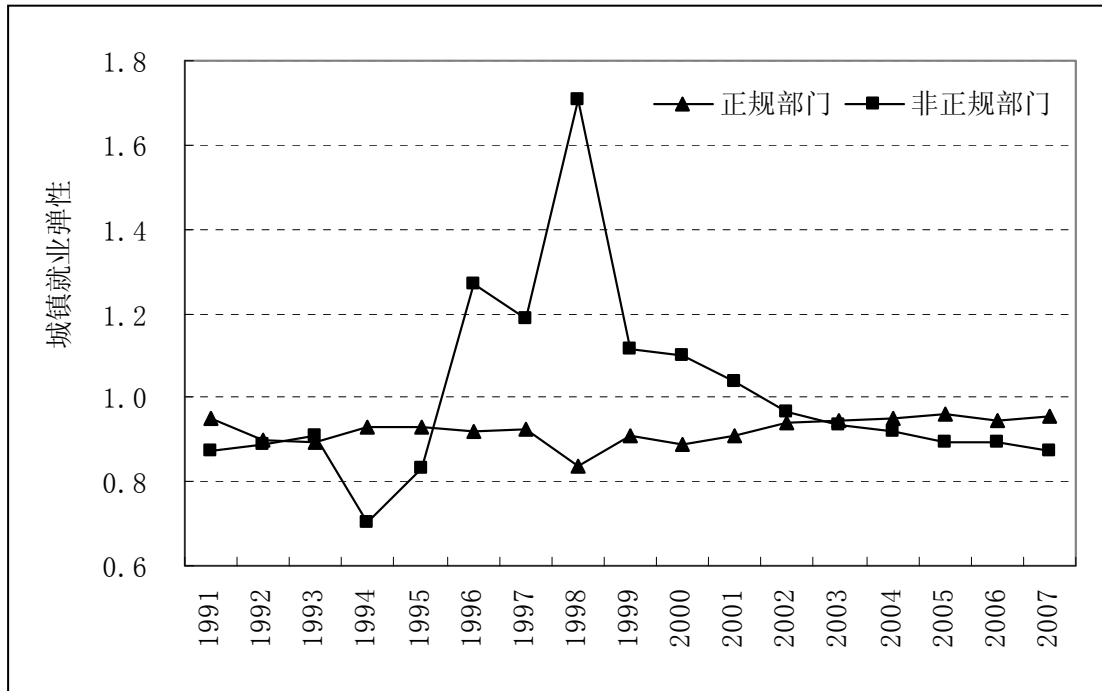


Figure 2: Characteristics of urban employment elasticity

正规部门  
Formal sector  
非正规部门  
Informal sector  
城镇就业弹性  
Elasticity of urban employment

Source: National Bureau of Statistics (yearly)

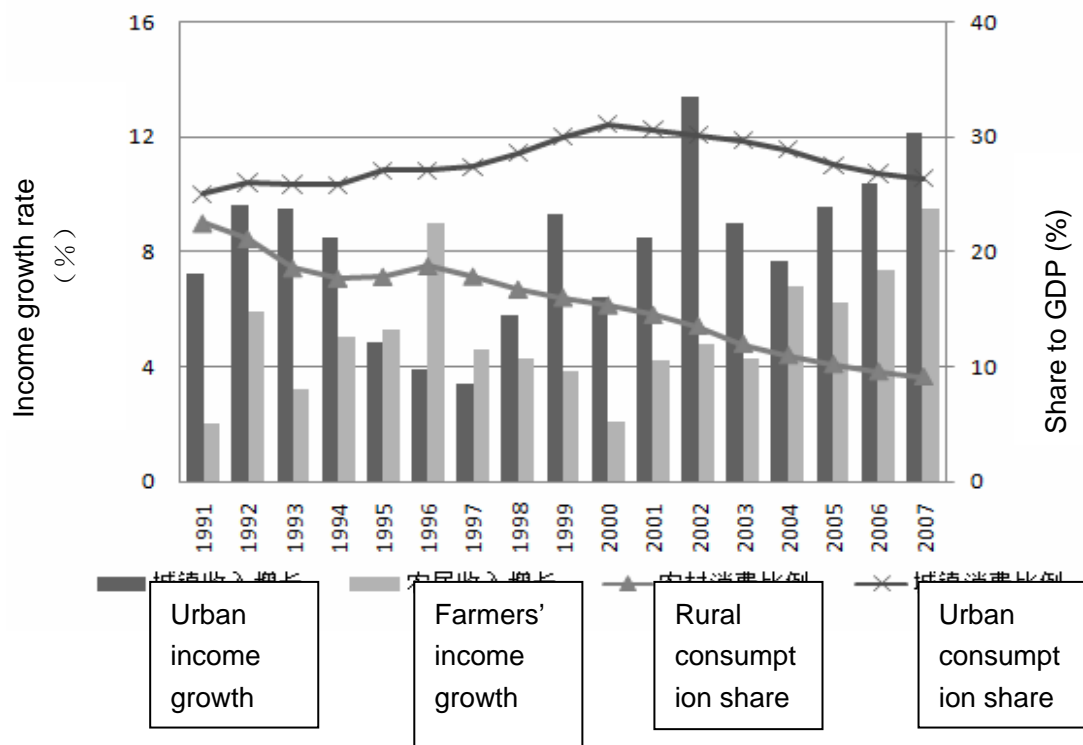
In the long run, the employment impact of financial crises is a cyclical phenomenon. It exists in all countries and whenever the economy slumps, massive layoffs will occur. When the economy booms, conversely, jobs will be abundant. Therefore, we need to distinguish cyclical fluctuations from long-term labor supply and demand situation. Demographic structure is a long-term slow variable. The impact of China's demographic changes on the structure of the working age population, together with China's long-term growth, will reach the Lewis Turning Point. Actually, the Lewis Turning Point refers to a certain period of time, rather than a given year. Even if the employment impact of the financial crisis delays this turning point by one to three years, the long-term trends of China's labor market remain the same. With global economic recovery and China's rapid economic growth, long-term labor market trends provide opportunities for transforming China's economic growth pattern.

Job cuts have weakened the momentum for income growth and consumer demand. Due to the fragility of urban informal employment, the income growth of ordinary workers and low-income families is subject to uncertainties. Under given income growth channels and conditions, when the labor market tumbles, income growth will also face the risk of an

abrupt slowdown. The first round of unemployment will decelerate income growth, which means less consumption. Actually, total retail sales of consumer goods began to show price effects in the first half of 2008, *i.e.* sales boomed as CPI went down. Since June, income effect began to hold sway. Despite falling CPI, consumption growth noticeably slowed. As exports and investment drop, domestic consumption will decline and further drag down GDP growth, putting pressure on jobs and income.

The current statistical system fails to fully reflect the diversification of economic sectors and employment channels, as some people's income cannot be statistically taken into account. Statistical income and informal income have different economic growth elasticities. A major driver of economic growth over the past few years has been SMEs and the non-public economy. But employment growth derives not only from formal jobs. Informal jobs are important for the income growth of ordinary families, which means that their income growth depends more on sources outside statistical calculations. This kind of income growth has a lesser economic growth elasticity. When the economy grows rapidly, urban and rural employment growth will be rapid as well, and both statistical and informal income growth will accelerate. Meanwhile, there is more room for growth and elasticity in informal income that does not fall into statistical surveys. However, in an economic slowdown, greater informal income elasticity means informal income growth will decline to a greater extent.

Figure 3: Urban and rural resident income and consumption



Source: National Bureau of Statistics, *China Statistical Yearbook 2008*, China Statistics Press

As Figure 3 shows, the income of farmers has been growing faster over recent years. In 2007, per capita net income of farmers increased 9.5%. But compared to urban income growth, farmers' income growth has been slow in most of the years since 1990. Urban income growth approached the rate of GDP growth, pushing up urban consumption, which accounts for almost 30% of GDP. On the other hand, due to slow growth of farmers' income, it is difficult for rural consumption to take off. Since 1990, the share of rural consumption to GDP declined from 23% to 9% in 2007. Income earned by rural migrants in the cities is a major source of farmers' income growth. Salaries account for nearly 40% of farmers' income. With fewer jobs and lower income, rural consumption becomes more sluggish. On the other hand, urban resident income continues to have a strong growth momentum, widening the already big rural-urban income divide.

#### **IV. How to secure economic growth and employment**

In today's interlinked world, international flows of goods and capital will inevitably expose China to external economic fluctuations. On the other hand, China's internal economic situation will affect the global economy as well. When external demand shrinks, some export-oriented productions should be adjusted, upgraded or relocated to meet domestic consumption and maintain China's economic growth at above 9% through investment and consumption.<sup>8</sup> In minimizing the impact and maintaining growth, people's welfare and employment should be our top priority.

##### **1. Balance exports with domestic consumption**

The central authorities have issued fiscal, tax and credit support measures, such as raising the tax rebate, lowering corporate value-added tax (VAT) and expanding SME credit, which will help maintain sound corporate financial position and offset renminbi appreciation pressures. But in the long run, if the global economy and external demand remain sluggish, uncertainties like effects of diminishing orders will continue to be a problem for export-oriented manufacturing, foreign-funded firms and SMEs. Overdependence on exports makes China's economy vulnerable to external shocks and helps nothing toward steady growth.

A solution would be to offset export losses by expanding domestic consumption. The government can provide tax cuts and credit support for the hardest hit export firms to sell their products in the domestic market, especially the rural market. Product types and functions can be adjusted to cater to local demand. Compared to cities, there is a greater market potential in the countryside for tools, home appliances and consumer goods. Considering that export goods are usually more expensive, subsidies can be given to make them affordable to rural families.

**Policy incentive:** aside from VAT cuts, another option is to apply the tax rebate to domestic sales. With the rebate rate pegged to sales volume, enterprises can enjoy a lower tax rate and more profits, while maintaining stable production and employment.



When the global economy takes an upswing in the future, stable output will allow these firms to shift to the export market as well.

**Employment and income:** when external conditions are adverse, production and sales must be stabilized to protect employment. Through unemployment early warning, layoff reporting and employment subsidies, the government should keep existing jobs stable. Second, investments should go to labor-intensive industries to create new jobs. Third, business venturing should be encouraged through credit, tax and technical support.

**Wage:** the government should refrain from direct intervention in raising wages, and should even avoid adjusting minimum wage standards when employment pressures are heavy. However, tax cuts and similar steps will encourage enterprises to stabilize and raise wages. Moreover, collective wage negotiations should be encouraged, but wage levels should be consistent with labor productivity growth and inflation rate, so as to accommodate the interests of both sides in times of economic difficulties.

**Income distribution:** the threshold for the personal income tax is currently too low and has curbed middle-income household spending. Raising this threshold will help tap the spending potentials of this important income group, and is also conducive to sound economic growth. In the long run, high school and college education should be expanded to turn out highly qualified workers. This is crucial to China's long-term competitiveness and growth of personal income.

**Social safety net:** middle and low-income families in China have an excessive propensity to save money due to concerns about inadequate social security. In this context, personal consumption can be expected to rise if the government establishes pension insurance systems for rural residents and migrant workers, improves the personal pension account, and expands rural minimum subsistence protection. Once launched, pension reform will push fiscal investment up to 1 trillion yuan in 2008 and 2009, with a positive effect on consumption. Before World War II, the U.S. had severe income inequalities. But thanks to social security efforts, it enjoyed more than three decades of post-war prosperity. Rapid income growth and security for the poor have proven to be effective in stimulating personal consumption.

## **2. Optimize fiscal investment for industrial restructuring and upgrading**

The central authorities will allocate 4 trillion yuan for infrastructure and welfare development till 2010. According to the released statistics of 24 provinces and cities, local matching funds will amount to 18 trillion yuan. If unreleased statistics are taken into account, central and local fiscal input will approach 30 trillion yuan. The effect of such proactive fiscal policies on the economy and employment depends on where and how the investments are used.

Well-designed fiscal measures will enhance investment efficiency and bring into play the scale-up effect of "seed" capital. The priorities include infrastructure, energy and raw materials, education, healthcare and social security. Of the 100-billion-yuan additional investment for the fourth quarter of 2008, only 13 billion yuan was earmarked for healthcare, education, culture and social programs. The majority went to infrastructure, energy, raw materials and the like.

The effect on employment varies among industries. An industrial chain consists of upstream and downstream industries, with direct and indirect effect on employment. Infrastructure industries have long chains with intensive capital input, but their direct effect on employment is weak. Infrastructure-related industries like steel, cement and energy are capital intensive and have a lesser effect on employment. With the policy priority on employment, however, fiscal investment should be restructured to achieve the best result.

Opening infrastructure to investment from private capital will bring into play the effect of “seed” fiscal capital. As private capital accounts for a small share in the infrastructure sector, its moderate increase will not threaten the dominance of state capital in this sector. The access of private capital to infrastructure, energy and raw materials will expand social investment and save fiscal resources for urgent causes such as SME support and welfare programs.

Major fiscal projects should aim at the “multiplier effect” on employment and domestic consumption. Projects should be selected according to market demand, with a consistent effect on growth and employment. Contracts should be awarded to SMEs and labor-intensive enterprises, giving priority to those related to major projects and favorable to job creation.

Despite long-term stable labor market situations, the repeated shortage of migrant workers and rising labor wages are sending a signal for China’s economic restructuring and industrial upgrading. The current financial crisis has forced some industries and enterprises to adjust and respond to their diminishing comparative and competitive advantages. In this sense, if current investments are well-guided, the financial crisis will hasten the transformation of China’s growth pattern.

Meanwhile, we should draw on the lessons of Japan. When Japan’s economy was maturing, the Japanese government adopted strong intervention policies that pushed Japan’s industrial upgrading in the short run but left a legacy of heavy policy dependence. The dominance of large enterprises and heavy industries deprived Japan’s industrial sectors of flexibility for adjustment. Hence, China’s fiscal policies should aim to guide and match, rather than to take over. With scientific assessment and planning, industrial upgrading and location should be managed in a dynamic way to provide guidance according to the market situation and factor endowment, rather than to intervene.

For a long period of time, China’s investment-driven growth pattern caused successive cycles of economic overheating and overcooling. When the economy overheated, excess capacity had to find the outlet through exports. However, most of China’s export manufacturing is of low value, and due to changes in the labor market and renminbi appreciation, its cost advantage is diminishing. Vulnerable to external risks, manufacturing firms in China’s coastal region should relocate their basic productions to central and western regions, leaving R&D and sales divisions in the coastal region.

### **3. Adopt a proactive labor policy**

The central and local authorities have responded to the financial crisis by introducing policies to expand employment and encourage business venturing. Specifically, the Chinese government has established records of returning migrant workers to provide

them with job information and guidance; refocused employment funds to strengthen skills training for rural migrant workers; opened almost all sectors to migrant workers and extended credit, guarantee and registration support to encourage farmers to start businesses; delayed the adjustment of the minimum wage standard; and covered jobless migrant workers into unemployment record if they had previous employment of more than half a year.

Some of the above policies are existing policies (job-seeking service and training) applied in the labor market, and others are new ones (covering jobless migrants into unemployment record) consistent with urban and labor market developments. We suggest that the new policies should be institutionalized to improve China's employment statistical record and unemployment insurance system. This measure will pave the way for establishing a social security system for rural migrants who work and live in cities.

In tackling urban unemployment, we can reference the past experiences of reemployment service. Labor and social security agencies should provide employment information and support to the jobless. Tax cuts, low interest loans, social security subsidies and job benefits should be given to the jobless. For those who are self-employed and for businessmen, microcredit can be given with favorable asset guarantee conditions. Small businesses should be granted favorable locations, startup service and low administrative fees, so as to encourage urban workers and rural migrants to start their own businesses that will create jobs. Given their mobility, it is hard to calculate the accurate unemployment of rural migrants. The concept of resident population can therefore be used to cover rural migrants who have lived in cities for more than half a year into the unemployment statistical system. In coordination with *hukou* (household registration) reform, unemployment statistical and insurance systems should be established in line with urbanization and labor market demand.

For returning rural migrants, employment service should be extended to rural towns, villages and communities. Laid off rural migrants should be trained to suit specific jobs in local areas. Meanwhile, rural migrants should be encouraged to start businesses in the countryside, with access to location, tax benefits, credit, employment support, and start-up services. State policies on infrastructure projects and domestic consumption should also create more jobs for rural migrants and enhance regional labor cooperation to help them find non-local jobs. Labor consultation and dispute settlement mechanisms should be established to protect labor rights and maintain social stability.

For jobless college graduates, we suggest making special efforts to address youth unemployment (Wang Dewen, Wang Meiyun, 2008). Higher education should be reformed to meet market needs with higher teaching quality and better student skills. In addition, policies and services should be introduced to encourage college graduates to work at grassroots levels and in central and western regions or start their own businesses. Special attention should be given to junior middle school and high school graduates, who constitute the majority of youth unemployment. In the stages of junior and intermediary education, school years can be moderately extended to enhance skills training, and cooperation between schools and employers should be facilitated to provide qualified human resources.

## **Notes:**

<sup>1</sup> According to the Nobel Laureate of Economics Paul Krugman, the global economy may plunge into a long-term recession like the “lost decade” experienced by Japan.

<sup>2</sup> According to economist Arthur Lewis, developing countries' industrial wages begin to rise quickly at the point when the supply of surplus labor from the countryside tapers off.

<sup>3</sup> According to *Asia Economic Prospects* released by the IMF (IMF, 2008b) in November, as the global economy enters recession, China's economic growth rate this year will be 8.5% down from 9.7% last year. The World Bank estimated in *China Economic Quarterly* released in November (World Bank, 2008) that taking into account various factors including economic policies, China's GDP this year will be 7.5%.

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