

China's Labor Market on Crossroad

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Abstract

This paper explores the development of China's labor market by examining labor market integration, the scale and scope of labor migration, and wage determination. It finds that labor market development has made dramatic progress since the reform, especially since the 1990s. There are still some institutional barriers to labor market development. It reveals some policy implications on how to develop the labor market and improve labor market integration.

Key Words: labor market institutional barriers structural adjustment

I. Introduction

Since the late 1990s, China's labor market has come under great pressure, as reflected by an increasing unemployment rate, and a declining labor force participation rate. The causes of the severe unemployment are threefold. First, due to the macro-economic downturn and rapid industrial structural change in the late 1990s, state-owned enterprises (SOEs), which lost their comparative advantage and competitiveness, have been unable to fully utilize their production capacity, and have become loss-makers. Second, the radical reform of the SOE employment system, known as "breaking the iron-rice-bowl", has worsened the situation. As a result, several million workers have been laid off from SOEs. Third, massive numbers of rural laborers have migrated to cities, seeking jobs and bringing competition

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into urban labor markets. During the period of 1995 to 2002, the surveyed unemployment rate increased from 4.0 percent to 6.1 percent, and the labor force participation rate declined from 72.9 percent to 62.5 percent (Cai, 2004).

To understand China's labor market requires us to bear in mind that the Chinese economy is a fast growing and radically changing economy. With the fastest economic growth rate in the world, there is no question that China would witness an increase of employment, and industry-structural change together with institutional transition, which generates double effects. First, with continual structural change throughout the entire reform period, the adjustment of industrial structure required by WTO membership leads the economy to follow its comparative advantage, which is in the labor-intensive industries, and therefore tends to create more jobs. Meanwhile, the same structural adjustment generates structural unemployment since it gives rise to new sectors with comparative advantages, and leads to the downfall of those without comparative advantages. Second, on the one hand, the market-oriented institutional transition has fostered the labor market and made labor force allocation much more efficient than before. On the other hand, marketization inevitably involves the reform referred to as "breaking the iron-rice-bowl", which brings about staff redundancies and lay-offs.

Therefore, there are two dimensions to labor market developments in China: while there is severe unemployment and underemployment, the labor market plays an increasingly important role in allocating the labor force. Based on exploring China's official labor market statistics, and analyzing some survey data, this paper examines the trend of labor market integration, discusses whether or not the severe unemployment is manageable, and suggests appropriate policies related to fostering the expansion of employment.

II. Informalization or Marketization?

Serious unemployment is causing two effects. The first effect is that it has to some extent strengthened the policy of local governments to protect local employment. Local governments have to be responsible for the stability of society at the local level and thus often implement short-term policies that obstruct expansion of the labor market. More often than not, local governments intervene in labor adjustment in enterprises and sometimes ask enterprises not to fire workers. In order to reduce employment competition between migrants and local laborers, they ask enterprises not to hire migrant laborers, and thus increase labor migration costs. The second effect is that the severe employment situation makes local governments dependant on the labor market in solving the problems of employment and reemployment, and leads them to adopt more deregulated policies that encourage development of the labor market,

small- and medium-sized enterprises, and more diversified employment. These two effects have both led to the informalization of employment.

The increase in unemployment rate and decrease in labor participation cause many to have the impression that there has been no increase in employment in China since the 1990s, or even that there has been an absolute decrease in employment. For example, Rawski (2001) takes “zero employment increase” as evidence to question China’s GDP growth performance since the late 1990s. If we just observe the state and urban collective sectors that were traditionally only absorbers of urban employment, then employment has indeed declined year by year since the latter part of the 1990s. However, because China’s economy has become diversified, there have been huge changes in employment structure. On its own, changes in employment in the state and urban collective sectors no longer fully reflect changes in total employment.

In practice, urban employment has been growing ever since the reform started, and it reached 256.4 million in 2003, 8.6 million more than in the previous year. During the entire period from 1978 to 2003, the average annual growth rate was 4.1 percent – that is, 6.45 million extra jobs were created each year on average. In the same period, the proportion of state-owned units in total urban employment declined from 78.3 percent to 26.8 percent, the proportion of collective units declined from 21.5 percent to 3.9 percent, while employment created by other newly emerged units such as limited liability corporations, share-holding companies, private enterprises, enterprises with funds from Hong Kong, Macao and Taiwan, foreign-funded enterprises and self-employed business increased from zero to two-thirds of the total, making up a diversified range of employment¹.

It is observable that after the reform, the labor force began and continued to migrate between rural and urban areas, and among different regions and sectors. Based on 1 percent sampling data of the 2000 Census Long Form², 131 million internal migrants were counted, who by definition changed their places of residence (township and community) between 1995 and 2000 for more than 6 months. Of all migrants, those who changed their places of residence without changing their residence registration account for 65.1 percent, of whom 45.9 percent migrated in order to seek work opportunities. That is, totally 39.1 million migrant workers worked in places other than their places of residence, for more than 6 months in 2000.

As a result of labor mobility, a large proportion of urban employment consists of migrant workers, especially in the less regulated/monopolized sectors. Comparing two

¹ National Bureau of Statistics (NBS), *China Statistical Yearbook*, various issues.

² China’s 2000 Census includes short and long questionnaires. Everyone was required to fill out the short questionnaire. A 10 percent sample of the total population filled out the long questionnaire.

sources of urban employment data can confirm this. Currently, official statistics on employment come from two statistical surveys. One is the Comprehensive Labor Statistics Reporting System (CLSRS), which collects urban employment information from all independent accounting units. The other is the household survey-based Sample Survey on the Population Changes (SSPC) which covers the population of the whole country. The difference between the larger number of urban employment collected from SSPC and the smaller number of employment from CLSRS results in a different employment category (see Table 1). Apart from the missing of urban local workers caused by weakening coverage of the reporting system and unregistered informal employment, most migrant workers also fall into this unregistered category of urban employment.

To see how many migrants have taken unregistered jobs and how they are distributed among sectors, we compare the administrative figures of total urban employment by sector in 2000, with figures from the 2000 census (see Table 2). The first column presents the urban total employment figures and their distribution among sectors. The second column comprises the corresponding figures from the 1 percent sampling data of the census long form, which

Table 1. Difference in Total Employment between SSPC and CLSRS, 1990-2003

(Unit: million)

	SSPC total	CLSRS total	% of difference
1990	170	147	13.6
1991	175	153	12.6
1992	179	156	12.5
1993	183	159	12.7
1994	187	168	9.9
1995	190	173	8.9
1996	199	175	12.0
1997	208	177	14.9
1998	216	159	26.4
1999	224	156	30.5
2000	232	150	35.3
2001	239	148	38.3
2002	248	151	38.9
2003	256	157	38.6

Source: National Bureau of Statistics (NBS), *China Statistical Yearbook*, various years.

Table 2. Employment Comparison: CLSRS and Census by Sector

(thousand, %)

	CLSRS total	Census total	Missing workers (%)	Urban residents	Rural-urban migrants	% of migrants
Total	144594	171734	18.8	118660	29319	17.1
Mining and quarrying	5975	4060	-32.0	3416	316	7.8
Manufacturing	39334	56739	44.2	36745	13774	24.3
Electricity, gas and water	2838	3398	19.7	2610	153	4.5
Construction	8598	10680	24.2	6777	2674	25.0
Geological prospecting	1102	695	-36.9	553	32	4.6
Transport and telecomm.	8588	12220	42.3	9506	1096	9.0
Trade & catering services	29338	35271	20.2	23561	7091	20.1
Finance and insurance	3268	3450	5.6	2389	147	4.3
Real estate trade	1004	1533	52.7	1014	143	9.3
Social services	9220	11680	26.7	7653	2132	18.3
Health and social welfare	4881	5530	13.3	4201	311	5.6
Educ., culture and broadcast	15658	11189	-28.5	8446	719	6.4
Science and polytech services	1745	1379	-21.0	1025	35	2.5
Gov. & social organizations	11038	12483	13.1	9676	587	4.7
Others	2007	1427	-28.9	1088	109	7.6

Sources: NBS and Ministry of Labor and Social Security (MOLSS), 2001. *China Labor Statistical Yearbook 2001*; 1 percent sampling data of 5th National Census Long Form.

Notes: 1. In the census data, employment denotes those who are 15 years old and above.

2. Employment in the agricultural sector is not included in the table, because in the census data, urban employment in agriculture, forestry, husbandry and fishery is unusually high, which is caused by a change in the boundary between rural and urban areas in the census.

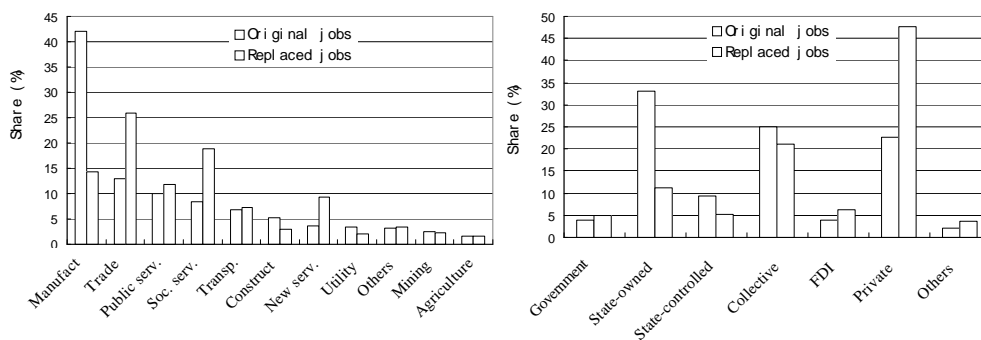
is consistent with SSPC in terms of definition, and shows 18.8 percent more employment than administratively collected data. The last column is the proportion of migrant workers in different sectors. We can clearly see the positive correlation between the extent to which census employment exceeds CLSRS and the proportion of migrant workers by sector. Although the sector structure in census data is not quite representative given the relatively small sample, the employment structure of migrants does show the actual situation in the urban labor market.

Another source of informal employment is urban reemployment. During the period 1998 to 2002, totally 41 million urban workers were laid off by their employers and about

two-thirds of them were reemployed. In being reemployed, they often either changed their types of post or changed their industries. In the samples of China's Urban Labor Market Survey (CULS)³, 949 people experienced job changes resulting from lay-off, unemployment, involuntary early retirement and voluntary turnover in the period 1996 to 2001. Comparing the difference in job concentration between original and replaced jobs shows that the structure has changed in urban employment (see Figure). Significant changes can be seen in three aspects. First, while manufacturing employed 42.1 percent of the total 949 urban workers before their jobs terminated, the proportion of reemployed workers in their second and third jobs dropped to 14.4 percent in manufacturing. Second, the proportion of workers engaged in the retail and wholesale trades and catering service in their original jobs was 13.1 percent, but it increased to 25.9 percent in their second and third jobs. Third, the proportion of workers in the social services accounted for 8.4 percent of the total as original jobs, increasing to 18.9 percent in redeployed jobs. In general, those industries which have absorbed most of the workers who changed jobs are more likely to be informal.

Another feature of job displacement is the transformation of ownership between the previous jobs and the reemployment jobs. Looking into the changes in ownership structure of employment before and after the job changes, one can clearly see what the relocation brought about. After this mobility, many former employees of SOEs, state-controlled and collective sectors, while being reemployed, transformed to non-public sectors. While the proportion of employment in wholly SOEs dropped from 33.1 percent to 11.2 percent, the proportion of private sector employment increased from 22.7 percent to 47.6 percent (see

Figure. Structural Comparison of Original and Replaced Jobs



Source: CULS, 2001-2002.

³ It was conducted in five large cities—Shenyang, Xian, Wuhan, Shanghai and Fuzhou in 2001 and 2002 by Institute of Population and Labor Economics, Chinese Academy of Social Sciences.

Figure). The experience of the reemployed former SOE workers provides a typical example. Of the total former SOE workers who had left state sector and later found new employment, less than one-fourth found their job in SOEs, about one-fifth found jobs in collective enterprises, whereas about 40 percent found their new jobs in the private sector.

This universal informalization of employment has brought about a reduction of security and safety in the labor market (Solinger, 2002). To see a bigger picture, this has greatly reduced the coverage of social security and other benefits related to work units that once existed, at least for urban workers. In the period 1990 to 2002, despite the fact that it was declared to be a period of rapid reform and rebuilding of the public pension system, the coverage rate of the public pension scheme for the employed only increased from 30.5 percent to 41.7 percent. This, to a large extent, goes along with a surge in short-term, temporary and non-contracted jobs and self-employment.

To migrants without *hukou* (household registration) identity in cities where they find a job, the informal jobs they take up are commonly regarded as “three-D-jobs” – dangerous, dirty and demanding, with little job security, poor working conditions, less work protection and social welfare. It is common for migrant workers to work overtime without extra pay, and their wages are low and very often in arrears, simply because the informal nature of those jobs makes it easy for employers to evade the formal rules regulating the labor market. According to a 1 percent sampling of the 5th National Census Long Form data, the proportion of migrants who work 6 days a week is nearly twice that of urban local employees, and the proportion of migrants working 7 days a week is 58 percent higher than that of local workers. Similarly, the reemployed workers’ wage, social security and working conditions have also worsened greatly. In Table 3, we compare the wage differences between no-job-change local workers, migrant workers and reemployed workers.

As a result of worsening social security, wage rates, and working conditions caused by employment informalization, labor-management relationship problems have been

Table 3. Hourly Wages Comparison between
“Formal” and “Informal” Jobs

(Unit: yuan)

	Shanghai	Wuhan	Shenyang	Fuzhou	Xian
Hourly wage of no-job-change workers	8.8	5.0	4.8	6.4	4.4
Hourly wage of the reemployed	4.7	2.5	3.6	4.3	4.1
Hourly wage of local workers	8.3	4.8	4.6	6.3	4.4
Hourly wage of migrant workers	5.9	2.8	3.7	4.0	3.3

Source: CULS, 2001-2002.

exacerbated. In 2001, in terms of labor disputes that have been processed by labor arbitration agencies, the proportion of cases involving labor compensation in private enterprises was 143 percent higher than in the state sector. In regard to related to security and benefits, the number of cases involving disputes in private enterprises was 14 percent higher than in the state sector. As for labor protection, the number of disputes in private enterprises was 221 percent higher than in the state sector. Here, these private enterprises were relatively formal ones, and at least they were registered. As for those enterprises that have not formally registered, the impact of their informal nature on labor protection, etc, is even more obvious.

On the other hand, the changing patterns of employment in terms of sector and ownership adjustments follow the direction of economic reforms and therefore are market-oriented. While causing problems in terms of job security, social protection and wage rates, this newly emerged area of employment and its mechanism can help utilize the immature labor market to relocate labor force and solve the problems of urban unemployment and rural underemployment during the transition period. So, we should understand the employment trend in a broader perspective. The development of a labor market involves a whole set of institutional arrangements. The labor market function differs when a country is at different stages of development. The current informal employment environment in China commonly enjoys the advantage of market forces, and has actually become the main path for a developing labor market. Therefore the first and most important step is to let the market work, and allow the other segments of the market function to develop accordingly. China so far still enjoys an abundant labor force and market-determined wage rates should thus be lower than in traditional sectors where wage rates are determined institutionally. While analyzing CULS, we find that there is wage discrimination against migrant workers, their earnings, compared with those of local workers, being given higher returns to human capital and little returns to political capital.

III. Integration or Fragmentation?

Despite the controversy and confusion surrounding employment and unemployment issues, labor market development in China does demonstrate some changing features, which not only indicate the progress of overall reform but also affect the sustainability of economic growth. Therefore an assessment of the development of the labor market is necessary for a full understanding of China's development and economic system transition. As the present labor and wage policies in China were originally based on a planning system, the extent of labor market development can be assessed from two angles.

The first is to see whether labor mobility has been augmented. The economic rationale

tells us that as long as the incentive mechanism works, laborers have strong motives to seek better opportunities of work and higher pay by moving from one place to another. Once the institutional barriers deterring labor mobility are dismantled, the move becomes actual and cannot be stopped. Meanwhile, as the government motivation for developing the economy intensifies, it can enjoy the gains of efficiency from reallocation of the labor force. Therefore, holding other issues constant, governments tend to encourage labor mobility. From experience of reform, people have observed the great increase in scope and scale of labor mobility between sectors and regions, through government motivation and efforts in pushing forward the reform. As a result, progress in labor market development differs across regions and sectors.

The second is to see to what extent work compensation reflects human capital and work effort, and to what extent wage rates reflect the demand for and supply of labor. On the one side, when workers have alternatives, they certainly choose what best fits their endowment of human capital and most rewards their efforts. On the other side, employers, to compete for the best workers, tend to do things to improve the extent to which the compensation they pay does reflect workers' human capital and their efforts in work. Moreover, with the increasing share of non-state sectors, wage rates move towards an equilibrium level determined by demand for and supply of labor. When there is severe unemployment, which brings about job separation and labor mobility, wage rigidity can no longer be sustained. In sum, it is to be expected that wage rates become more and more determined by market forces, as a result of labor policy reforms.

It is true that the government still intervenes in the labor market, and that the employment arrangements and wage determination of SOEs are influenced more by institutional forces than by market forces. However, since the proportion of SOE workers in total urban employment has decreased, SOE employment longer represents the urban labor market. Diversification of employment and pluralism of sectors unavoidably strengthen competition in the labor market, and consequently the labor market plays a more and more important role in labor allocation. After two and half decades of reform, the labor market in urban China has divided into two sectors: a traditional sector, where market force does not fully play a role in allocation of the labor force, and the newly emerged sector where the market mechanism does allocate the labor force.

Both the progress and the backwardness of labor market development in China can be observed in this dualism. While many successful reforms have been made in labor policies, a host of institutions inherited from the planning system still maintain this fragmented dual labor market, deterring labor mobility between rural and urban sectors. Among other policies, the *hukou* system is the origin and the legitimacy of policies and regulations impeding labor mobility, wage convergence and labor market integration. To

assess the progress of the development of the labor market, and to reveal the unfinished reforms in labor policies, we need to examine (1) how labor markets are integrated among regions, (2) what institutional barriers remain which lead to a sectoral monopoly, and (3) why migrant workers are still discriminated against in job entry and wage determination.

1. Labor market integration among regions

According to economic theory, both labor mobility and market-based wage determination would lead to a trend of labor market integration. The extent to which labor markets integrate is indicative of how developed and how competitive a market economy system is. The formation of a single wage rate is one of the most important features for an integrated labor market. Under a competitive market environment, both enterprises and individuals can freely enter any sector and region, and migrate to others to seek the best work opportunities. Through perfect labor mobility, regional differences in wages tend to be eliminated – that is, competition and mobility tend to equalize marginal productivity of labor in all markets, and workers with the same level of skills tend to receive equal wages.

Assuming each Chinese province is a local labor market, in which local wage rates are determined, changes in the aggregated deviations of wage rates in all provincial markets reflect the general trend by which they diverge from a single wage. An increase (or decrease) represents wage divergence (or convergence) among provincial labor markets. Taking the manufacturing sector in Beijing as a reference group, and controlling for sectoral factors causing wage difference, we first calculated the relative wages in all provinces, and then calculated the annual mean value of deviations among labor markets from 1995 to 2002. The results show a declining deviation of both nominal and real wages. During this period of eight years, the aggregated wage deviation has decreased by 14.7 percent in nominal terms, and by 14.3 percent in real terms. Even if we cannot infer a general trend of labor market integration in China due to the short time series, at least the results do not support Young's (2000) and Poncet's (2002, 2003a, 2003b) conclusions that labor markets in China become more and more segmented between regions.

Regional wage deviation can be also examined by ownership. Some scholars (e.g. Meng, 2000) observe that labor market segmentation is typically embodied in SOEs. Thus, by preventing enterprises from autonomously hiring and laying off workers and laborers from freely entering the labor market, state ownership was an important cause of labor market segmentation during the planning period. Since the late 1990s, the SOEs have experienced dramatic restructuring, laying off redundant employees and causing a dramatic increase in lay-offs and unemployment during the period.

Is this reform an advancement of general marketization, or is it just a cyclical drop in employment? Applying the same method as above to process SOE data, the wage deviations

of SOEs are calculated. Despite the general trend of wage convergence in manufacturing, wages in manufacturing SOEs slightly diverged among regions in recent reform years, from 10.1 in 1998 to 10.9 in 2002. Based on this observation, it is not risky to infer that the labor market integration effect generated by SOE reform, characterized by laying off redundant workers, has not so far offset the fragmentation effect associated with immobility of SOE workers among regions. Therefore the consequence of SOE reform should be evaluated by overall labor market integration, not merely by changes in regional wage deviations of SOEs.

2. Sectoral monopoly-induced wage difference

The wage difference between enterprises according to ownership is an important component of the total difference in wages, because the segregation of ownership in China causes labor market fragmentation. For example, for the SOE monopolized sectors, labor market entry requires certain individual status identity – significantly *hukou* identity. This is especially true since urban unemployment became severe after the late 1990s and the local and central governments had to bear the responsibility of redeploying laid-off workers and unemployed former SOE workers. The domination and monopoly of SOEs continue the institutional rigidity of wage determination and thus cause deviation from market equilibrium in wages within certain industries, resulting in the persistent differences in wage rates among sectors.

Taking the “government sector” as a reference group and controlling for regional difference of wage, we estimated the marginal wage effects by sector in 1993, 1996, 1999 and 2002. The estimated coefficients indicate the advantage or disadvantage of wages in each sector relative to the “government sector”. For the four years examined, the biggest marginal wage effects are significantly found in the highly monopolistic industries dominated by SOEs, among which air transportation, railways, postal and telecommunications, and finance and insurance have been widely blamed because of their monopoly. The smallest marginal wage effects are mostly found in competitive sectors such as road transportation, beverage and catering, retail and community services. If we examine the magnitude and changes of marginal wage effects by dividing all sectors into two groups, ten sectors with the biggest coefficients and ten sectors with the smallest coefficients, a positive correlation between the proportion of SOEs and the marginal wage effect can be found. In the ten sectors with the biggest marginal wage effects, the average proportion of SOEs was 80 percent in 2002, whereas in the ten sectors with the smallest marginal wage effects, the average state share was only 45.6 percent. For the sectors of beverage and catering, construction and retail, less than 40 percent belonged to the state sector.

Having revealed the general trend of regional disparities in wages and the existence of a SOE monopoly in some sectors, one could expect that the contribution of a regional factor

Table 4. Sectoral/Regional Relative Contributions to Wage Difference

	1993	1996	1999	2002
Theil entropy	0.030	0.056	0.066	0.058
Sectoral contribution (%)	56.7	46.4	40.9	62.1
Regional contribution (%)	43.3	53.6	59.1	37.9
Atkinson index	0.061	0.101	0.116	0.102
Sectoral contribution (%)	59.0	46.5	44.0	64.7
Regional contribution (%)	41.0	53.5	56.0	35.3

Source: NBS and MOLSS: *China Labor Statistical Yearbook*, various issues.

to overall wage difference would decline, while the contribution of a sectoral factor to overall wage difference would increase. By decomposing Theil entropy and the Atkinson index that describe the overall wage difference, this expectation can be justified. As shown in Table 4, while the overall wage difference widened over time, with 93.3 percent of increase for Theil entropy and 67.2 percent of increase for Atkinson index during the period 1993 to 2002, the sectoral factor contribution increased from 56.7 percent (Theil) and 59.0 percent (Atkinson) to 62.1 percent and 64.7 percent, respectively.

3. Institutional discrimination against migrants

Even after two and half decades of market-oriented reform, the continuing existence of the *hukou* system brings about a wage differential between migrant workers and local workers in urban China. While the institutional differences in educational attainment and other individual characteristics between migrant and local workers do favor urban local workers in pay, *hukou* status generates wage discrimination against migrant workers in cities. First, migrants are confined to the labor-demanding and low-paid sectors, which causes the first type of discrimination. Second, even if they enter certain sectors and take certain jobs, they are treated differently from their local counterparts, which causes the second type of discrimination. Thus, we can decompose the overall wage difference between migrant and local workers into four components, which are (1) explained by individual characteristics (mainly educational attainments) in job entry, (2) explained by individual characteristics within sectors, (3) unexplained in job entry, and (4) unexplained within sectors⁴.

⁴ By sectors, here we combine posts with ownership, referring to self-employment, workers in public units, workers in non-public units and technicians and managerial staff in non-public units.

By analyzing data from a 1 percent sample of the 5th National Census Long Form, we find significant differences in job entry and pay between migrant and local workers. If we categorize in-charge persons in government, non-profit institutions and enterprises, professionals and technical persons and office staff as “white collar jobs” and workers in trade and services, agriculture, handlers in factories and transport and others as “blue collar jobs”, 92.3 percent of migrant workers are blue collared, while 32.17 percent of local workers are white collared. If the categorization is taken by the level of pay, 94.8 percent of migrant workers are engaged in low pay sectors, while 76.8 percent of local workers in low pay sectors. For all types of job, a difference in wage rates between migrant and local workers exists. On average, in CULS samples, the hourly wage of migrants is 4.05 yuan, 28.9 percent lower than that of local workers (5.70 yuan). By employing a ready decomposition method (Brown, *et al.* 1980), we find that of the total difference in wages between migrant and local workers, 31.8 percent can be explained by individual characteristics while entering a certain sector, 25.3 percent can be explained by individual characteristics in pay within sectors, 26.9 percent remains unexplained while entering a certain sector, and 16.0 percent is unexplained in pay within sectors. The latter two categories sum up a wage discrimination against migrant workers in urban sectors.

IV. Conclusions and Policy Implications

Labor market development is a core part of China’s economic transition. The market-oriented reform of labor policy is a process of institutional transition, on the one hand, and it is also dependent on reforms in other areas of the economic system, on the other. As a result of the overall reform, the labor market is maturing and more and more laborers have been allocated through market forces. Thanks to government programs aimed at assisting the laid-off urban workers, the unemployed and those discouraged to return to employment, and thanks to the labor market development that is absorbing the mass of rural-to-urban migrant laborers, the general labor market situation is manageable, despite the fact that noticeable employment pressure remains and there is continued tension in labor relations.

Having witnessed that, it is good to believe that China will continue to gain from its low cost of labor in manufacturing, which is also its main source of competitiveness during globalization. However, the fragmented labor markets that block labor mobility and maintain institutional wages are incapable of supplying labor to the regions and sectors with increasing wage rates. Therefore breaking up the segmentation of labor markets will sustain low wage rates, making China’s labor-intensive products competitive in the long run. We summarize what unfinished tasks remain for labor market development in rural and urban

China, and suggest measures and the path to accomplish the relevant reforms.

Firstly, removing the barriers to labor mobility between rural and urban areas would be the breakthrough for further labor market development. Complete abolition of the *hukou* system is a key element of the agenda for reform, which would eliminate the basis of legitimacy of all obstacles preventing the labor market from developing. The pace of migration policy reform, mainly of the *hukou* system, differ from city to city, because *hukou* status in different cities contains different benefits, or because there is a difference in the degree to which urban residents obtain public services through market forces among cities. Thus marketizing social services is a precondition for complete *hukou* system reform since the reform is part of marketization process. The *hukou* reform is in fact part of a coordinated package of reforms.

A key measure of the coordinated reform is separating entitlement of social welfare and public services from *hukou* identity. Under the situation where laborers migrate with *hukou* containing benefits, individual decision to migrate is made not only by comparing employment opportunities, but also by comparing the *hukou* advantage between regions. This produces an extra incentive for migrating, and the potential disorder and congestion in the migration process could become an excuse to delay reform. In practice, the actual concern in discussing the *hukou* system reform is to lay an institutional foundation for free labor mobility and equal entitlement to employment, social security, and other public services among all citizens. Thus, eliminating any benefits that the *hukou* identity contains not only purifies the reform and makes its objective clearer, but also lessens resistance from groups with a vested interest in the *hukou* system, and thus eases possible social turbulence caused by the reform.

Secondly, breaking up the SOE monopoly is also a prerequisite for free labor mobility among industries and ownership. Although SOE reform has not shown significant success in terms of the viability of SOEs in a competitive environment, the reform can be said to be a success in terms of the declining proportion of SOEs and the increasing role of the non-state sectors in the economic growth of the country as a whole. Therefore, alleviation and eradication of SOE monopoly can be expected through the expansion of non-state-owned enterprises and small businesses that bring competition to markets. The key policy-orientation is to create equal competitive conditions for both state and non-state enterprises in order to enhance the viability of SOEs and the ability of the non-state enterprises to enter all competitive industries.

Thirdly, further reform of the social security system should aim to enhance its portability. Rebuilding the social security system and widening the coverage of basic programs have been the major concerns of previous reform, because only when there is no need for the government to cure unemployment by intervening in the decision-making of enterprises, can the labor market freely work. However, even if all urban workers were covered by the programs, the lack of portability of social security programs deters labor mobility among

regions, sectors and forms of ownership.

Finally, adopting a labor market regulation model that works for China is urgently needed in the policy-making agenda. The first commandment for policy choice is to get the incentives right by guaranteeing the basic role of the labor market in allocating the labor force. The overall market development since the 1990s is not the leading cause of mass layoffs and unemployment; instead, it is the reason for expanded employment and effective reemployment. Therefore government policies and regulations, while serving to regulate the labor market and to ease the tension of labor relations, should not do anything to reduce the competition and flexibility of the labor market.

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