

1

Introduction

Purpose of the book

China is in transition from a planned economy towards a market-oriented one. The economic reforms begun in the late 1970s have brought about remarkable economic growth, initially through transformations in the agricultural sector and subsequently through rapid export growth. The proportion of exports in the country's GDP has quadrupled in less than two decades, to 20 per cent in 1997. Whether China can sustain its rapid growth rate will depend heavily on the government's willingness to pursue further internal structural reforms.

Unlike its East European counterparts, economic reform in China has proceeded in a piecemeal manner, with the aim of establishing a 'socialist market economy under state planning'. This goal has been poetically described by China's most influential economist, Chen Yun (1995):

The bird must not be held tightly in the hand or it will die. It should fly, but only within the cage: without a cage, it will just fly away. If the bird is a market economy, then the cage is state planning. Naturally, the size of the cage has to be appropriate.

While the reforms have not been sweeping, partly to avoid socio-political upheaval, keeping 'the bird in its cage' is inherently problematic. Recent economic growth has not been accompanied by significant labour market reforms within state enterprises, which have remained heavily over-staffed and inefficient. This book contends that achieving sustainable economic growth will require a more thorough overhaul of the current labour market arrangements.

This book covers new ground in documenting and analysing institutional changes in the Chinese economy over the last 20 years from a labour market perspective, and offers empirical evidence that further labour market reform is necessary if high growth rates are to continue.

2 *Labour Market Reform in China*

Plan of the book

Prior to the reforms, rural and urban labour arrangements were inefficient and resulted in low productivity in both rural and urban sectors of the economy. Chapter 2 of the book analyses the drawbacks of these pre-existing labour market arrangements, and the remainder of the book is then divided into three parts.

Part 1 examines the impact of rural economic reform on labour markets in rural agricultural and non-agricultural sectors. It describes how economic reform brought about institutional change in the rural agricultural labour market and analyses the changes in labour supply behaviour and income distribution patterns (chapter 3). Emphasis is also given to institutional change in the rural non-agricultural labour market – in particular, employment and wage determination patterns in this sector (chapter 4). Finally, an interesting phenomenon that has emerged in the rural labour market – the widening wage gap between the rural agricultural and non-agricultural sectors – is analysed (chapter 5).

The implementation of urban labour market reforms and the impact of enterprise reform on the urban labour market are studied in part 2. The major reform measures implemented in the urban labour market since the beginning of the economic reform are introduced and their impact on wage determination in the state sector scrutinised (chapter 6). Following this, the impact of the current enterprise ownership structure on the determination of compensation and employment at the enterprise level is investigated (chapter 7). Particular attention is subsequently given to the important issue of necessary and possible paths for reforming China's urban social security system (chapter 8).

Part 3 analyses the unfolding patterns of rural–urban migration since the reforms began. The impact of massive rural–urban migration on China's economic growth is studied through empirical testing of a three-sector model (chapter 9). The issue of how to efficiently allocate migrant labour to regions with varying rates of economic growth is discussed: the main constraint in this regard is found to be a lack of reliable and impartial information about job markets in various parts of China (chapter 10). Finally, emphasis is given to the existing segregation of the rural migrant and urban resident labour markets and the impact of eliminating such segregation on the urban labour market – in particular, on unemployment, hidden unemployment and labour costs (chapter 11).

The book concludes in chapter 12 by providing an overview of its main findings and its contributions toward enriching our understanding of Chinese labour market reform.

2

Pre-reform labour arrangements

Before economic reform was initiated in 1978, China did not have labour markets in the conventional sense. Labour mobility was non-existent and all wages were centrally fixed by the government. When the Chinese Communist Party (CCP) came to power in 1949, China pursued a Stalinist economy, whereby assets and property belonged to the people. Consequently, workers were their own employers and they could not 'sell' their labour to themselves. Labour was thus not considered a commodity and wages were not perceived as being the price of labour. Furthermore, given the premise that workers were the ultimate owners of property, they could obtain work whenever they needed to. In addition, no one could dismiss anyone else: full employment and lifetime tenure were fundamental features of this system.

The implementation of these Stalinist policies on a country-wide basis was no simple matter, not least because of China's huge population. Difficulties arose not only because of the requirement that each person be given a job for life, but also because of imbalances between the treatment of the rural vs. the urban labour force. Housing, medical expenses and food were heavily subsidised in the urban sector. As a result, urban workers were more costly to maintain in comparison to rural ones.

This dichotomy reflected the Chinese government's strategy of mutually exclusive rural and urban labour markets. As a corollary, rural people were excluded from working in the cities, and received no social security benefits. The reason for this 'neglect' appears to be that, given the nature of traditional farming techniques (labour-intensive, with small-size plots), the marginal rate of technical substitution between land and labour was relatively high. Hence, it was easy for the agricultural sector to absorb the abundant labour supply and avoid open unemployment. This encouraged the government to leave rural residents out of any consideration of the design and development of social security arrangements.¹ Perkins and

¹ Interestingly, there is not much in the way of documented justification for this policy.

4 *Labour Market Reform in China*

Yusuf (1984) suggest another reason. They argue that China had very low grain output in the early 1950s and was not in any position to implement a policy of large, forced grain deliveries from the rural areas. Preventing rural–urban migration thus had the dual advantages of keeping more people in the countryside to increase grain production while limiting the number of city dwellers who needed grain products. Both of these considerations may have played a part in China’s highly restrictive labour mobility policies in the pre-reform era. Whatever the reasons for the policy, the complete immobility of labour was a major constraint to economic growth in pre-reform China.

Inter-regional labour migration within both rural and urban sectors was also restricted, as was labour mobility among firms within each urban region. There were some exceptions – for example, rural university graduates or army officials could gain urban residency. Various formal promotions and a few cases of family reunion also qualified for limited inter-urban migration.

These restrictions on labour mobility were implemented through the *household registration system* (or ‘*hukou*’), which forced individuals to register with local authorities to gain residency, thereby determining where they lived and worked. Basically, people spent their lives in the place where they were born. These restrictions generated serious problems for the Chinese economy including considerable hidden unemployment in the countryside and low productivity and inefficiency in the cities. They also meant that labour arrangements and income determination systems in the urban and rural sectors differed markedly.

Pre-reform labour arrangements in the cities

Employment

Central planning meant total government control over every aspect of labour arrangements: job-seekers would be assigned employment. Assignment was normally through educational institutions (high schools, technical schools, or universities) or through local communal offices (*Jiedao Banshichu*) where people would register their residency. The State Ministry of Labour and Personnel assigned an employment quota to each provincial or city government. This would trickle down through the system until the quotas were finally allocated to each school or local communal offices.² Jobs were then allocated to individuals who belonged

² There was some flexibility in the size of the employment quota at each level.

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Xin Meng

Excerpt

[More information](#)*Pre-reform labour arrangements* 5

to each particular school or communal office and who needed a job. Individuals were not allowed, and were also unable, to find jobs by themselves.

Major employers such as the state or collectively-owned enterprises or government departments were not allowed to recruit freely. Every workplace was given an annual employment quota, which was a result of negotiations among firms, their associated government departments and the local Bureau of Labour and Personnel. However, the final decision was made by the local government departments and the Bureau of Labour and Personnel. Once assigned to a job, employees were not allowed to quit, change jobs, or move to another firm other than by way of a promotion. Moreover, firms were not allowed to dismiss workers unless they had committed criminal acts.

By having such an authoritarian structure of job allocation, and by restricting rural–urban migration, the ideological goal of full employment was achieved during periods when the economy was running smoothly. However, when the Chinese economy was thrown into upheaval by political forces (as happened during the Great Leap Forward and the Cultural Revolution), special arrangements had to be made to maintain the facade of full employment.

In the case of the Great Leap Forward (in the late 1950s and early 1960s), grain output declined by 24.4 per cent, industrial productivity fell by 5.4 per cent and the national income fell by 4.1 per cent between 1957 and 1960. To maintain full employment and to increase agricultural production in the face of this disaster, about 20 million urban employees were forcibly transferred to the agricultural sector (Chen and Yu 1993).

There was a similar response during the Cultural Revolution, when production stagnated and schools and universities closed down. Hundreds of thousands of young urban people had nowhere to go. Once again, the government's solution was to move them to the countryside, where they were not needed: about 17 million high school and university students were treated in this manner between 1967 and 1970 (Chen and Yu 1993); here, they became part of the hidden rural unemployed. When the Cultural Revolution came to an end, all those who had been forced into the countryside created a huge unemployment problem when they returned to the cities, and the massive influx forced the government to belatedly admit that China did have an unemployment problem (Feng 1982; White 1988).

Figure 2.1 presents total urban employment as a percentage of total employment for each year since 1952. The two distinctive periods of

6 Labour Market Reform in China

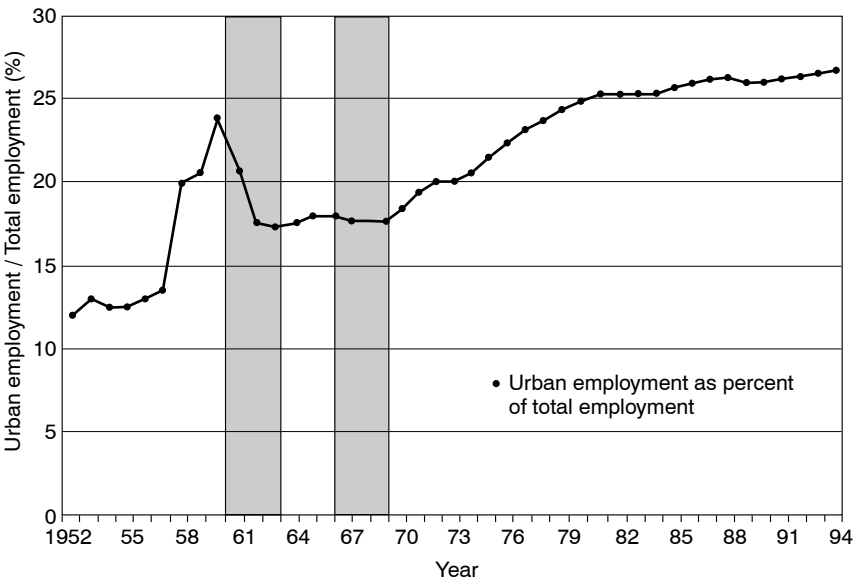


Figure 2.1 Share of urban employment, 1952–1994
Source: SSB (various years a), table 1–8.

economic upheaval, between 1960 and 1963 and between 1966 and 1969, are evident (the shaded areas in figure 2.1). The share of urban employment to total employment declined from 23.6 per cent in 1960 to 17.3 in 1963 and again from 18.0 in 1966 to 17.5 in 1969.

Urban wages

Wages in the urban areas were also centrally determined and controlled by the Bureau of Labour and Personnel, with two major implications. First, establishments had no right to determine their employees' wages (Shan 1991). Wages were based on personal criteria such as educational levels and work experience (Shan 1991).³ The wage-setting system provided a precise wage for each individual. Second, urban establishments were given an annual total wage bill quota by the Ministry of Labour and Personnel. The wage bill quota was a direct function of the enterprises' employment allocation – that is, the fixed employment quota times the precise level of wage for each individual employed in the enterprise.

³ In the case of government officials, 'work experience' implies the period since the individual joined the Communist Party and became 'Revolutionary'.

However, firms were not financially independent. All monies earned were given to the government. In return, all costs were covered by the government. Wages were thus effectively funded by the Ministry of Finance, via the provincial Bureau of Finance, the local Bureau of Finance and then on to each firm. If, for instance, a firm was allocated a higher employee quota, an appropriate increase in the wage bill would be automatically forthcoming.

The grade wage system that was introduced in the early 1950s, and continued with hardly any changes until the late 1970s, was based on the Soviet model, having eight distinct levels for factory workers and technicians (working-class wage ranking) and 24 levels for administrative and managerial workers (cadres' wage ranking) (Wang and Li 1995). Seniority and qualification were the two main determinants of the grade system, which also accounted for relevant industry and regional differentials. 'Seniority' had two different meanings here. For those who started working after 1949, seniority meant the length of time that they had been in any state or collectively-owned workplace. For those who had joined the CCP before 1949, seniority implied the period since the individual became a member.

Both education and seniority played an important role in the wage determination of those who started working after 1949. A university graduate obtained a cadres' level-23 wage for the first year after graduation and 1 year later would automatically be promoted to level 22. Blue-collar workers and normal school graduates with 9–12 years of schooling received the apprentice's wage level on entering a firm. Similarly, a technical school graduate with 9 years of normal schooling plus 3 years at a technical school would receive level 3–4 of the working-class wage level.⁴

Regional wage differences were based on the cost of living, using the early 1950s' measures of consumer prices in each region. Beijing, for example, was ranked in region 6, whereas Shanghai was a more expensive region and was placed in region 8. The higher the price, the higher the rank and the higher the wage levels. On the other hand, industrial wage differences were related to specific differences in working conditions.

An illustration of this grade system is given for administrative and managerial workers for four regions in table 2.1. The table uses grade 24 as a benchmark to show how the wage distribution differed within each region. At the bottom of the table, the regional income differentials are also presented by using grade 24 in region 4 as the benchmark.

⁴ The rankings for the 8 working-class levels were placed in ascending order – that is, the lowest was level 1 and the highest was level 8. The rankings for the cadres were placed in descending order, with level 1 being the highest and level 24 the lowest.

8 Labour Market Reform in China

Table 2.1. Examples of relative wage grade level for administrative and managerial staff, by regions (all indices are relative to the lowest level)

| Grades | Regions | | | |
|--------|---------|-------|-------|-------|
| | 4 | 6 | 8 | 10 |
| 1 | 15.48 | 13.48 | 13.41 | 13.47 |
| 2 | 13.96 | 12.15 | 12.09 | 12.15 |
| 3 | 12.44 | 10.83 | 10.77 | 10.83 |
| 4 | 11.06 | 9.63 | 9.57 | 9.62 |
| 5 | 9.94 | 8.66 | 8.62 | 8.66 |
| 6 | 9.24 | 8.05 | 8.00 | 8.04 |
| 7 | 8.07 | 7.03 | 6.99 | 7.03 |
| 8 | 7.21 | 6.28 | 6.25 | 6.28 |
| 9 | 6.55 | 5.71 | 5.68 | 5.71 |
| 10 | 5.66 | 4.93 | 4.90 | 4.94 |
| 11 | 5.21 | 4.55 | 4.52 | 4.55 |
| 12 | 4.61 | 4.01 | 3.99 | 4.00 |
| 13 | 4.14 | 3.62 | 3.59 | 3.61 |
| 14 | 3.69 | 3.21 | 3.19 | 3.21 |
| 15 | 3.31 | 2.88 | 2.87 | 2.88 |
| 16 | 2.94 | 2.57 | 2.55 | 2.57 |
| 17 | 2.63 | 2.30 | 2.29 | 2.29 |
| 18 | 2.34 | 2.03 | 2.02 | 2.03 |
| 19 | 2.08 | 1.81 | 1.81 | 1.82 |
| 20 | 1.87 | 1.63 | 1.63 | 1.63 |
| 21 | 1.68 | 1.44 | 1.44 | 1.44 |
| 22 | 1.32 | 1.30 | 1.29 | 1.29 |
| 23 | 1.15 | 1.15 | 1.14 | 1.15 |
| 24 | 1.00 | 1.00 | 1.00 | 1.00 |
| 24 | 1.00 | 1.21 | 1.28 | 1.34 |

Source: Author’s calculations based on relevant documents.

Wage increases were awarded only according to government regulations. For example, after 3 years at apprenticeship level, individuals received an increase in wages to level 1 of the working class, and 3–5 years later their wage level would automatically increase by a level; in the cadre class, all university graduates had their wages increased to level 22 after 1 year of service. Apart from these wage increases accruing to seniority, there were also occasional uniform across-the-board wage increases, by means of a central government policy directive. In principle, wages were effectively fixed for very long periods (Korzec 1992). During the Cultural Revolution, for example, there was no general wage increase for almost 12 years. As can be seen in figure 2.2, the urban average real wage level was almost held constant for the whole period 1952–78. The shaded bar in figure 2.2 represents the end of this period and the beginning of the period of economic reform.

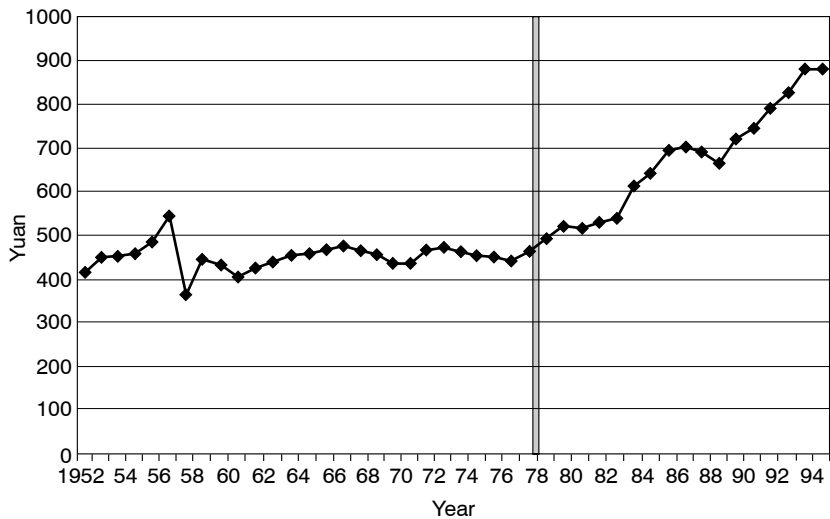


Figure 2.2 Urban average annual real wage level, 1952–1995 (yuan; CPI 1951 = 100)
Source: Author’s calculations, based on SSB (various years a), tables 1–10, 1–31.

In addition, the rigid wage determination system had been accompanied by a piece-rate wage system in some places and by a bonus system in others before the Cultural Revolution. The Cultural Revolution, however, abolished all of these incentive systems.

Social welfare

To keep wages low, most welfare benefits – such as housing, medical care, pensions, and sometimes even schooling and hospital treatment – were provided by the state-owned enterprises as an internal social security system. Each enterprise functioned as a microcosm of society, whereby all welfare was provided within the enterprise and accounted for as part of labour costs. Workers – and, in some cases, most of their family members – were employed for a lifetime with one workplace. As labour was completely immobile and enterprises were not financially independent, this system ran smoothly in its own peculiar way. Since open unemployment was non-existent, no unemployment benefit scheme was needed. However, every worker was entitled to a pension upon retirement. Depending on seniority, the pension was set at a percentage of the individual’s last

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Xin Meng

Excerpt

[More information](#)

10 *Labour Market Reform in China*

salary before retirement. Like the wage bill, funding for pensions was allocated by the government according to the number of retired employees and their previous wage and seniority levels.

Free medical care was provided to all employees and their direct family members. Hospitals were government-owned, which permitted inexpensive medical services and medicine. Firms used special government funds to pay hospitals annual amounts to cover the medical expenses incurred by their employees and family members.

Housing, on the other hand, was less equally distributed among employees than any other form of welfare. Although everyone with a job was entitled to highly subsidised housing, demand always exceeded supply. The reason for the excess demand was twofold. On the one hand, as housing was highly subsidised, rent-seeking behaviour always led to a high level of demand. On the other hand, the heavy industrialisation strategy adopted by the Chinese government in the pre-reform era focused government attention on investment at the expense of consumption. Housing was one of the areas which were largely ignored. It was reported that *per capita* housing area in urban China reduced from 4.5 m² in the early 1950s to 3.6 m² in 1978 (State Statistical Bureau [SSB] various years a).

Problems with the pre-reform urban labour arrangements

The labour arrangements of pre-reform China can be contrasted with a labour market system that places a greater emphasis on creating productive efficiency by the efficient allocation of labour. Such a system should result in the right person being allocated to the right job, generate the right technical proportion of labour to capital and provide labour with an incentive to increase productivity. If workers are not motivated, they will not work to their full capacity, and sometimes may even deliberately under-perform. This is the so-called 'shirking problem'.

The pre-reform urban labour arrangement in fact promoted shirking and inefficiency. The labour assignment system did not allow employees and employers to choose each other, resulting in mismatches between workers and jobs. Moreover, once mismatches occurred, the system did not allow for any corrections as individuals could not change their jobs while employers could not fire their workers. The rigid labour assignment system also allowed the government to allocate labour regardless of a firm's requirements. With increasing population pressure and an escalating labour force participation rate, full employment could be achieved only if the government forcefully assigned labour to firms. This resulted in widespread over-staffing.