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The role of labour market
and sectoral policies
in promoting more and
better jobs in China: Issues,
evidence and policy options

Cai Fang
Du Yang
Wang Meiyang

Employment
and Labour
Market Policies
Branch



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Preface

The primary goal of the ILO is to work with member States towards achieving full and productive employment and decent work for all. This goal is elaborated in the ILO Declaration 2008 on *Social Justice for a Fair Globalization*,¹ which has been widely adopted by the international community. Comprehensive and integrated perspectives to achieve this goal are embedded in the Employment Policy Convention of 1964 (No. 122), the *Global Employment Agenda* (2003) and – in response to the 2008 global economic crisis – the *Global Jobs Pact* (2009) and the conclusions of the *Recurrent Discussion Reports on Employment* (2010 and 2014).

The Employment Policy Department (EMPLOYMENT) is engaged in global advocacy and in supporting member States in placing more and better jobs at the center of economic and social policies and growth and development strategies. Policy research and knowledge generation and dissemination are essential components of the Employment Policy Department's activities. The resulting publications include books, country policy reviews, policy and research briefs, and working papers.²

The *Employment Policy Working Paper* series is designed to disseminate the main findings of research on a broad range of topics undertaken by the branches of the Department. The working papers are intended to encourage the exchange of ideas and to stimulate debate. The views expressed within them are the responsibility of the authors and do not necessarily represent those of the ILO.

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¹ See http://www.ilo.org/global/about-the-ilo/mission-and-objectives/WCMS_099766/lang--en/index.htm

² See <http://www.ilo.org/employment>

Foreword

Promoting productive employment is a major challenge for emerging and developing economies and a key component of their socio-economic development agenda. Strong and effective labour market institutions, legislation and policies are important for creating productive and sustainable jobs, and thereby supporting the development and decent work goals. They help expand opportunities in the formal economy, provide workers with a basic livelihood through social protection floors, preserve the employment relationship and allow for targeted interventions during economic downturns to minimize the economic and social costs.

Sectoral policies are also important for supporting structural transformation from lower-value to higher-value products. This translates into better wages and more decent jobs. However, for such policies to be successful, they need to take into account a host factors, such as the skills and infrastructure needs of employers, the potential impact of trade agreements and existing supply chains, and the forward and backward linkage potential of the sectors in question.

The International Labour Organization (ILO) has been conducting research on labour market institutions and providing technical support to member States for a number of years. It has also acquired a knowledge base in sectoral policy analysis to assess the job-creation potential of specific policies.

Since the 1978 Economic Reforms, China has made impressive strides in the creation of productive jobs, poverty reduction and social development. This paper presents an overview of labour market and sectoral policies in China, underlining their role in supporting China's remarkable achievements in terms of economic growth, poverty reduction and employment creation. It forms part of a series of studies on pro-employment policies at the macroeconomic and sectoral level, illustrating how policy-makers can use an array of policies to ease the transition from declining economic sectors to emerging ones, thereby facilitating structural transformation. This study complements the ILO's growing body of literature on China, for example, *The role of monetary and fiscal policies in promoting more and better jobs in China: Issues, evidence and policy options* (Cai et al., 2016). The insights from this and other studies feed into the advice that the ILO provides member States in drawing up their national employment and development policies.

This paper was supervised by Professor Cai Fang, Vice President of the Chinese Academy of Social Sciences (CASS) in Beijing, along with his colleagues, Professor Du Yang, Chief of Division of Labor and Human Capital and Deputy Director of the Research Center for Human Resources, and Professor Wang Meiyuan, Professor at Institute of Population and Labor Economics. The preparation of the paper was supervised by Wang Yadong as part of a project called "The role of macroeconomic, sectoral and labour market policies to promote more and better jobs in selected middle income G20 countries" under the ILO-Korean Government Partnership Programme. The support of the Government of the Republic of Korea is gratefully acknowledged.

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Abstract

This paper presents an overview of labour market and sectoral policies in China, focusing on their role in promoting more and better jobs. It analyses the evolution of the labour market over the past 60 years, including the shift in focus from managing rural to urban migration in the framework of the Lewis' (1954) model to productivity-led growth. An issue of concern is the historic inequalities between official urban residents and migrant workers from the countryside due to the *hukou* – or a model based on household registration – system. The paper also examines the policy-setting and coordination mechanisms in place to ensure that the labour market and sectoral policies respond to immediate needs as well as longer term plans. In essence, current labour market and development policies focus on achieving sustainable and stable growth rates to create adequate productive job opportunities, increasing social protection coverage and strengthening active labour market policies. This is all the more relevant due to the impact of population ageing and underinvestment in human capital.

Key words: China, labour market analysis, labour market policies, Lewis growth model, migration, policy coordination and implementation, sectoral policies

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Abbreviations

ALMP	active labour market policy
CNY	Chinese Yuan/Renminbi
CPC	Communist Party of China
CULS	China Urban Labour Survey
FDI	foreign direct investment
GDP	gross domestic product
MOHRSS	Ministry of Human Resources and Social Security (China)
NBS	National Bureau of Statistics (China)
SBTC	skill-biased technological changes
SME	small- and medium-sized enterprise
SOE	state-owned enterprise
TFP	total factor productivity
TVE	township and village enterprise (China)
VAT	value added tax
WTO	World Trade Organization

1. Introduction

1.1 Overview

With fast growth in the past three decades, the size of the Chinese economy totaled 63.65 trillion Chinese Yuan (CNY) – equivalent to USD 10.28 trillion – in 2014. China has become the second largest economy in the world. GDP per capita reached CNY 465 300 (USD 7 517) in the same year. According to the World Bank’s *World Development Indicators* classification, China is an upper-middle income country. This economic performance in the past three decades is acknowledged as the “Chinese miracle”, where the total size of the economy in 2014 was 28 times larger than in 1978, and the GDP per capita 20 times larger.

Fast and inclusive economic growth is the foundation of job creation. China has strategically implemented policies to facilitate inclusive economic growth and continuous employment creation; these have driven changes in the Chinese labour market, leading to more and better jobs. Sectoral policies have successfully encouraged the development of labour-intensive sectors, which play a vital role in promoting employment growth.

This paper is organized as follows. Section 1 presents an overview of the labour market and employment trends in China over the past 30 years. Section 2 outlines the evolution of Chinese sectoral policies, including the policy framework and implications for employment. Section 3 describes the labour market policies. Section 4 discusses the interaction of labour policies, sectoral policies, and other macroeconomic policies. Section 5 explores the main challenges China faces in terms of continuing to create more and better jobs. Section 6 concludes the paper.

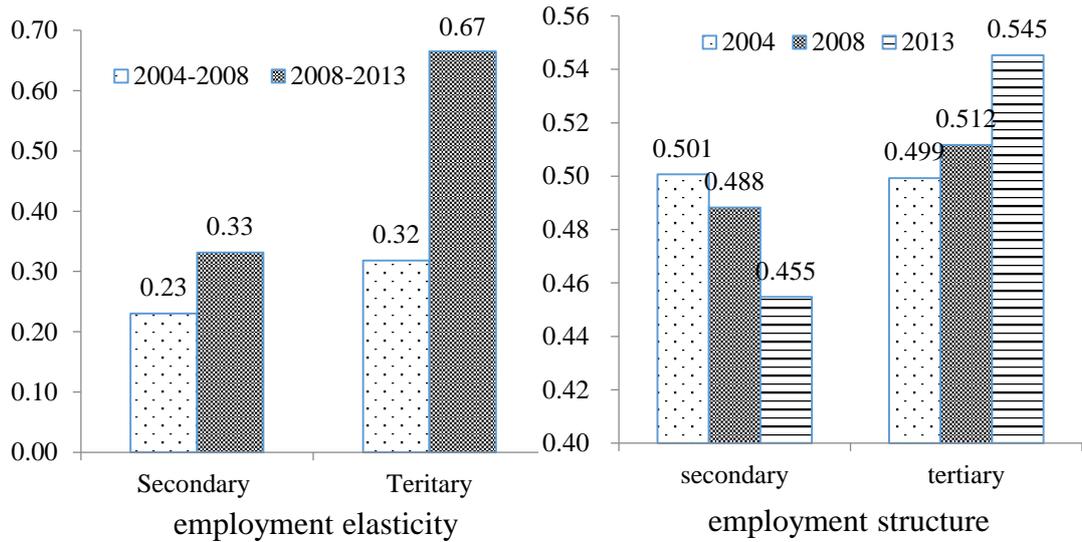
1.2 Pro-employment growth

With the largest population in the world, employment creation in China is of great importance to economic development. Although labour statistics based on the reporting systems are subject to limitations in gauging the actual size of employment (Cai, et al, 2013), there are reliable sources indicating that more jobs have been created. The first example is the growing number of rural migrant workers¹: in 2014, rural migrant workers totaled some 274 million, including 168 million migrant workers who moved out of their townships. Rural migrant workers who previously work in agriculture seek off-farm jobs, which triggered the great structural changes in the employment structure and economy of China. This labour mobility between sectors is of great importance to economic growth and is discussed in detail in Section 3.2.

The three economic censuses conducted by the National Bureau of Statistics (NBS) in 2004, 2008, and 2013 respectively, give us a broader picture of employment in the non-agricultural sectors. As per the censuses, employment in the secondary and tertiary sectors in 2013 was 202.9 million and 243.3 million respectively. From 2004 to 2008 the employment elasticities with respect to value-added in the secondary and tertiary sectors were 0.23 and 0.32 respectively, as indicated in Figure 1. From 2008 to 2013 the two elasticities increased to 0.32 and 0.67 respectively, reflecting employment-intensive growth.

¹ Under the *hukou* (household registry) system, rural migrant workers are workers registered as living in rural areas but have migrated to urban zones.

Figure 1 Employment elasticity and structure in the non-agricultural sectors



Sources: Authors’ calculation based on NBS (2014).

1.3 Improving job quality

The quality of employment in the Chinese labour market has been improving along with national economic development, particularly after China passed through the Lewis turning point in 2004² (Cai, 2010); this is evidenced by the following facts.

With increasing labour scarcity, China has witnessed growing wages for unskilled workers in the past decade. According to the *Monitoring Survey on Migrant Workers* conducted by the NBS (2014), the average wage for rural migrant workers have been growing 10.6 per cent per annum in real terms. Meanwhile, wage convergence has taken place across regions and between sectors.

When the economy creates sufficient job opportunities, workers have more choices and bargaining power on the job market. It is reasonable for workers to choose formal jobs instead of informal employment. According to the *China Urban Labour Survey (CULS)* conducted by the Institute of Population and Labor Economics, the rate of informal employment in the urban labour market declined from 37.5 per cent in 2005 to 30.1 per cent in 2010 (Du and Lu, 2013). Although the official labour statistics do not measure informal employment per se, a similar trend can be inferred from the revealed information. For example, according to the economic censuses, the share of “Registered Individual Employment” (*gèti*) in total non-agricultural employment declined from 30.5 per cent in 2004 to 23.1 per cent in 2008, and to 20.2 per cent in 2013.

The improving quality of employment is also reflected by the increasing social protection coverage associated with formal employment. In 2013 there were 242 million

² Lewis’ (1954) framework analyzes a developing economy as comprising two sectors: (i) a labour-intensive rural sector dependent on traditional technology, and (ii) a capital-intensive industrial – usually urban – sector dependent on modern technology. The separation results in a large supply of labour – often characterized as “unlimited” – in the rural economy. Migration from the rural to the industrial sector is an important component in Lewis’ development model, as the excess rural labour seeks better opportunities in the industrial sector. The Lewis turning point is the point at which the excess labour supply from rural areas reaches zero.

workers participating in the Urban Employee Basic Pension Insurance, 274 million in Urban Employee Basic Pension Insurance, and 164 million in Unemployment Insurance schemes respectively; all these social protection programmes are associated with formal employment.

1.4 The labour market turning point

In the past decade the Chinese labour market witnessed significant changes, as evidenced by the end of the labour force surplus from the countryside and appearance of labour shortages driven by both fast economic growth and the quick demographic transition. Although the changes might have taken place over an interval of time, some scholars believe that the year of 2003 was the turning point in the labour market (Zhang et al., 2011). Both the fast economic growth and the quick demographic transition have driven the labour market changes. As the second largest economy in the world, one percentage point of GDP growth creates more jobs than before, let alone the growing employment elasticity as noted earlier.

China's demographic transition is unique because both the strict population control policy³ and fast economic development contributed to a decline in fertility, which made the transition process quicker than in many other countries. Since 2012 the working age population has been decreasing by millions every year, which tightens the labour market situation.

The recent economic slowdown was associated with significant changes in the labour market. Although China is suffering from the lowest growth in the past two decades – 7 per cent of GDP per annum – employment is quite stable, with surveyed unemployment at 5.1 per cent.

Passing through the Lewis turning point indicates that China has successfully completed the transition from a low- to middle-income country. As China approaches high-income status, the growth pattern has to change accordingly from a labour- to a capital-intensive one. Consequently, the neoclassical growth model provides a more appropriate framework to analyse the changes than the Lewisian one. This is because the Lewisian growth model – characterized by a dual economy structure⁴ – features a massive surplus labour in agriculture and effectively an “unlimited” labour supply to the non-agricultural sectors, whereas the neoclassical one is subject to diminishing returns to capital due to the shrinking size of the labour force.

1.5 Policies to promote employment

Although China adjusted the focus of its labour market and sectoral policies in accordance to the different stages of economic development, the policies remain pro-employment in general. With the existence of massive surplus labour in agriculture, which is the typical feature of a Lewisian dual economy, there was a focus on policies to transfer labour from the agricultural to the non-agricultural sectors at the early stages of economic development. To facilitate the transformation, the key strategy of development was to create as many non-agricultural jobs as possible. In the meantime, China encouraged labour

³ The “One-Child Policy” originally encouraged urban households to have only one child, while rural households were usually permitted two and ethnic minorities were exempted. This has been revised in 2015 to a “Two-Child Policy” for urban areas in light of the dramatic fall in population growth.

⁴ A dual economy features two distinct economic sectors: (i) a labour intensive, low productivity agricultural sector and (ii) a less labour intensive, higher productivity manufacturing sector. Lewis uses this framework for his (1954) rural-to-urban labour supply migration theory.

mobility by removing the institutional barriers that blocked the reallocation of labour across sectors.

After reaching the Lewis turning point in 2004, the appearance of labour shortages made it possible to move the focus of employment policy from simply more jobs to both more and better jobs. Economic growth would shift from being led by the accumulation of production factors to being led by total factor productivity (TFP) enhancements. To a certain extent, whether a middle-income country can successfully reach high-income status depends on its ability to transform its growth pattern. Accordingly, sectoral and labour market policies should facilitate this transformation. Table 1 summarizes the features and objectives of sectoral and labour market policies in the Lewisian and neoclassical frameworks respectively.

Table 1 **Sectoral and labour market policies under the Lewisian and neoclassical frameworks**

	Lewisian model	Neoclassical model
<i>Economic growth</i>		
Stages	From low- to middle-income status	From middle- to high-income status
Path speed	High speed	Middle-high speed
Drivers	Accumulation of production factors	Productivity (TFP) improvement
<i>Labour market</i>		
Features	Unlimited labour supply	Appearance of labour shortages
Goals	More employment	Improving employment quality
<i>Structural Changes</i>		
Economy	Industrialization	Diversification of sectors
Employment	Off-farm employment	Improving employment structure in non-agricultural sectors
<i>Policies</i>		
Sectoral	Pushing for industrialization	Promoting structural change
Labour market	Removing institutional barriers to labour mobility	Flexible and secure labour market
<i>Poverty reduction</i>		
Goals	Reducing absolute poverty	Reducing relative poverty
Instruments	Economic growth and labour migration	Social policies targeting individuals

Source: Authors (2015).

2. The evolution of sectoral policies

Like the other economies in East Asia, the Chinese government plays a vital role in economic development. One of the important instruments to push the economic growth are sectoral policies.

2.1 The framework of sectoral policies in China

Sectoral policies in China are not invariable: policy-makers adjust policy directions and priorities based on the following two principles:

- 1) The first one is whether the sectoral policies are aligned with the comparative advantages of the endowment structure of the factors of production. Since the endowment structure varies with the level of economic development over time, it is reasonable for sectoral policies to respond dynamically.

- 2) The second principle is to refine sectoral policies in view of the impact of their implementation, i.e. based on the feedback from the monitoring and evaluation process, as well as the changes in the economic and labour market situation.

First of all, sectoral policies are based on the advantages of factor of production endowments, which change dynamically. When kicking off the ‘Reforms and Opening Up’ (*Gǎigé kāifàng*) initiatives – or Chinese Economic Reforms – in 1978, China had the features of a dual economy: a rich endowment of labour and a comparative shortage of capital. The rural reforms encouraged productivity improvements in agriculture significantly, which increased the supply of raw materials to light industries. Based on the comparative advantages of the distribution of endowments at the time, the target of sectoral policies was to create jobs through developing labour-intensive sectors. In the meantime, promoting exports would bring into play the comparative advantage of the large labour endowment.

At the middle-income stage, the labour market had significantly changed, as evidenced by the end of the seemingly unlimited labour supply from the countryside. The relative price of labour and capital changed accordingly. To adapt to the new endowment structure, sectoral policies encouraged the development of manufacturing with more value added, as well as the services sector.

Second, the policy tools varied at different stages of economic development as well. For example, before the economic takeoff, China was extremely short of capital, which limited the development of all sectors. In this case, the core aim of sectoral policies was to attract foreign direct investment (FDI) in order to ease the shortage of capital. China offered favourable terms to attract foreign capital, which effectively stimulated the expansion of labour-intensive sectors. At the middle-income stage, growing labour costs weakened the advantages of the labour-intensive sectors, and the sectoral policies started moving towards the promotion of productivity improvements. Accordingly, the key goal of sectoral policies was to provide the right price signals to reflect the scarcity of labour and capital.

Table 2. The features of sectoral policy by income stage in China

	Low-income status	Middle-income status
Endowments	Rich in labour, extremely short of capital	End of “unlimited” labour supply, short of capital
Advantageous sectors	Light industries, labour-intensive manufacturing	Move to manufacturing with more value added, shift to services
Policy targets	Industrialization, export orientation, and more jobs	Improving productivity, more and better jobs
Policy tools		
FDI	“Three plus one” trading mix*, attracting FDI to make up for the shortage of capital	Equal policies for both domestic and foreign investment
Investments	Encouraging investment by reducing the costs of capital formation	Encouraging investment in innovation
Taxation	Export rebates to promote exports, in particular labour-intensive products	Integrating taxation policies, restructuring taxation to support services
Regional programmes	Promoting regional development through projects	Integrating development across regions
Others	Land use and infrastructure.	Further relaxing regulations
Policy effects	Poverty reduction, transfer of labour	Completion of industrialization and the rural-to-urban labour transfer

*This refers to the paradigm of custom manufacturing with materials, designs or samples supplied and compensation trade.

Source: Authors (2015).

Third, China comprehensively makes use of other policy tools in conjunction with sectoral policies. For instance, construction of infrastructure plays a vital role in promoting the development of most sectors, although it is not included in the package of sectoral policies – rather it is considered part of fiscal policy. Given the positive externalities of investments in infrastructure, the Government has had to take on the responsibility of providing these public goods. Table 2 summarizes the main features of the sectoral policies in China at the different stages of economic development.

2.2 Promoting labour-intensive industries

Prior to the start of the Reform and Opening Up policies in the early 1980s, China implemented a “Catching-up” strategy focused overwhelmingly on heavy industries. In fact, the heavy industries employed large amounts of capital and limited labour, which ignored the endowment advantages of China at the time. To guarantee the implementation of such a development strategy, China set up a series of institutions, including the segmentation of the labour market through the *hukou* system and the economic planning system.

Since the Reform and Opening Up policies began, the strategy prioritizing heavy industries was given up. Instead, China explicitly encouraged the development of labour-intensive light industries. In the early 1980s, China devoted major efforts to developing light industries with the “Six Priorities” to encourage their development: firms in target sectors were prioritized in the provision of (i) raw materials, (ii) fuel, (iii) electricity, (iv) loans, (v) foreign exchange, and (vi) infrastructure and transportation. In the 1980s, when China was in short of supply of these production inputs, the Six Priorities had significant effects on promoting the development of light industries. From 1978 to 1982, the gross value of products in light industries grew 14 per cent per annum, which increased the share of light industries in the industrial sector as a whole from 43 per cent in 1978 to 50 per cent in 1982.

In addition to its evolving development strategy, China actively made use of foreign investment to make up for the shortage of capital at the early stage of economic development. China set up “Special Economic Zones”⁵ in coastal areas and took advantage of the ‘Three-plus-one’ trading-mix policies, which refers to custom manufacturing with materials, designs or samples supplied and compensation trade, to attract foreign investment. As a result of these policies, foreign capital provided the equipment, raw materials, design, and export destinations, while the domestic enterprises supplied the land, workshops, and labour. This pattern of collaboration with foreign capital effectively created jobs.

Rural industrialization through township and village enterprises (TVEs) also promoted the development of labour-intensive industries. In their golden age, the TVEs accounted for half of off-farm employment and output in non-agricultural sectors. At the early stages of economic take off, rural industrialization was considered the only way to create employment in China.

2.3 Manufacturing

Manufacturing has been the most important pillar of the Chinese economy and has been advantageous compared to other sectors since the 1978 Reforms. In 2012, the value added in manufacturing reached CNY 16.1 trillion, accounting for 31 per cent of GDP. According to

⁵ The Special Economic Zones were firstly proposed by the late Chinese leader Deng Xiaoping. In order to attract foreign investment, advanced technologies and management techniques, the Zones implemented special policies such as tax exemptions.

the economic census conducted by the NBS in 2013, employment in manufacturing totaled 125 million, the largest sector in terms of the size of employment.

Most sectors in manufacturing are labour-intensive. China has given high priority to manufacturing development, which makes China the ‘world’s factory’. Although we may not be able to go through the details of manufacturing policies, the following aspects indicate that policy-makers in China have valued the importance of the manufacturing in terms of its role in economic development and employment creation.

First of all, recent Five-Year Plans and other long-run schemes have emphasized sub-sectors of manufacturing. Since the 1990s, every Five-Year Plan selected sub-sectors that the Government would promote in the coming period. For instance, in the *Ninth Five-Year Plan* and *Prospect of 2010* issued in 1996, China identified six industrial sectors as pillars for the period 1996- 2010: the (i) mechanical industry, (ii) electronics, (iii) petrochemicals, (iv) automobile production, (v) light textiles, and (vi) construction materials. Among these sectors, some are labour-intensive, which has direct effect on employment creation. Although some sectors are not labour-intensive, they support the labour-intensive sectors through forward and backward linkages, and still have indirect effect on employment promotion.

In the *12th Five-Year Plan* (2011-2015), the Government proposed plans to upgrade and transform the manufacturing sector, which would facilitate the goal of better job creation. The policy targets included restructuring the key sectors in manufacturing, improving industrial distribution, strengthening research and development, promoting mergers and acquisitions, and supporting the development of small and medium-sized enterprises (SMEs).

In addition to development plans, the Government makes use of other policy tools to support the labour-intensive manufacturing sector. Since 1994, China has implemented an export rebate policy in order to encourage the development of export-oriented manufacturing, in particular in labour-intensive sectors. Export rebates are refunds of domestic tax contributions to exporters. In 1994, China enacted the *Regulation on Value Added Taxes*, which exempts exporters from having to pay value added taxes (VAT). To encourage exports, the Government refunds the taxes imposed on exporters during domestic production and distribution. In the past decades, the export rebate policy has been adjusted several times, but the size of the rebates for labour-intensive products has been increasing in general.

2.4 Services

Partly because manufacturing outshone other sectors, the services sector was not well developed in the first two decades of the reform period. During the period of the *11th Five-Year Plan* (2006-2010), the service sectors started growing fast. The value added of the tertiary sector grew 11.9 per cent per annum during the period, 0.7 percentage points higher than GDP growth rate in the same period, and 1.4 percentage points higher than the growth rate between 2000 and 2005. Thanks to this fast growth, the tertiary sector – for a long time the largest sector of the Chinese economy – accounted for 48.1 per cent of GDP by 2014, up from 39.3 per cent in 2000.

Sectoral policies play a vital role in promoting the development of services in China, which has stimulated the fast growth of this sector in recent years. While manufacturing dominates current economic growth in China, policy-makers have already realized the importance of the services for employment growth and economic restructuring. Policies to promote the development of the services sector are issued in succession. When drawing up the *12th Five-Year Plan* (2011-2015), the State Council issued the subsidiary *12th Five-Year Plan on the Development of the Services Sector* to highlight the importance of the tertiary sector. It is quite uncommon to make such a special plan directed at a specific sector and some detailed policies are proposed in this programmatic document. The key points are outlined below:

- 1) The Plan identifies the key subsectors that would be promoted by the Government in subsequent period. For the production servicing business, the key subsectors include financial services, transportation and logistics, high-tech, design and consulting, business services, human resources, e-commerce, as well as energy saving and environmental protection services. For consumer services, the Plan lists the key subsectors, including commerce and trading, cultural industries, tourism, health services, legal services, sports and elderly care.
- 2) The Plan proposes opening up the services sector more widely to external competition to make up for the lag in opening up relative to manufacturing. The details include promoting trade for services, increasing FDI in the sector, deepening the connections between Mainland China and Hong Kong (China), Macau (China), and Taiwan (China) in the services sector.
- 3) The Plan supports innovation in the services sector. According to the new policy, the Government will lift restrictions on entry into the sector, which means that all the services subsectors where entry is not explicitly restricted by law will be open to private capital. To support innovation in the services sector, the business tax will be replaced by a VAT.

The fast growth of the services sector in the past few years demonstrates the effects of policies facilitating the development of this sector. In 2004, the value added in tertiary sectors accounted for 41.2 per cent of GDP, while this share grew to 45.5 per cent in 2012. For the first time the value added in the tertiary sector surpassed that in secondary sector. By 2014, the value added in the tertiary sector accounted for 48.2 per cent of GDP in China.

2.5 Employment implications of sectoral policies

Appropriate sectoral policies facilitate employment creation; in China, they have played a substantial role by encouraging the development of labour-intensive sectors in manufacturing and services. Manufacturing was the sector with the greatest employment creation in the past decades. According to the economic census, that is believed to be the most reliable source for the actual size of employment by sector, employment in manufacturing increased from 83.9 million in 2004 to 104.3 million in 2008 and 125.2 million in 2013, which accounted for 39.4 per cent, 38.5 per cent, and 35.5 per cent of non-agricultural employment respectively. At the early stage of development, when labour-intensive industries were competitively advantageous, the employment growth in manufacturing was faster than the overall non-agricultural employment growth rate. From 2004 to 2008, employment in manufacturing grew 5.6 per cent per annum while the overall employment growth rate in the non-agricultural sector was 3.5 per cent per annum in the same period.

After the Lewis turning point, labour-intensive manufacturing faced the challenge of growing unit labour costs, which implied that technological changes would lead manufacturing to shift to more value added subsectors. In this case, manufacturing would provide more quality, rather than quantity, employment. From 2008 to 2013, employment in manufacturing grew 3.7 per cent per annum while the overall employment growth rate in the non-agricultural sector was 4.7 per cent per annum in the same period. However, taking migrant workers as an example, the 2013 average monthly wage in manufacturing grew 16 per cent in real terms, dwarfing wage growth in the other sectors.

The low-end services sectors are labour-intensive too, which had significant effects on job creation before the post-reform economic takeoff. China has been transforming its economic structure, moving from relying on secondary to relying on tertiary industry. Therefore services are going to be more and more important in providing more and better jobs. According to the economic census, employment in tertiary industry totaled 243.3

million in 2013 – a 57.8 per cent increase from 2004. The share of tertiary employment in total non-agricultural employment has been growing steadily: 49.9 per cent in 2004, 51.6 per cent in 2008, and 54.5 per cent in 2013.

3. Evolution of labour market policies

In the past decades the Chinese labour market has featured both an economic transition and an institutional transformation. As China passed through the Lewis turning point, labour market policies also needed to adjust in order to adapt to the changing context in this new stage of economic development. As noted earlier, the key strategy of economic development in a dual economy is to create as many employment opportunities as possible, while the core labour market policies aim to facilitate labour mobility between agriculture and non-agricultural sectors. At the middle income stage, the changes in factors on the demand side no longer dominate labour outcomes. The choices of means of labour market policy implementation become more sophisticated in this case.

First of all, workers tend to be more demanding with regard to better jobs after the Lewis turning point. In addition to rising wage rates and improving working conditions, workers have greater need for social protection. Therefore, it is crucial to define what types of social protection should be associated with employment, including the respective roles of employers, employees, and the public finance in its provision.

Second, as the economy tends towards the complete industrialization, the primary sector now accounts for less than one tenth of GDP, which means that agriculture can no longer serve as buffer, as it did in 1990s, when the non-agricultural sector faced an economic downturn. In other words, migrant workers now face similar labour market uncertainties and risks to those confronting urban workers. Since migrant workers are more likely to be those suffering from cyclical unemployment, labour policies should be more inclusive in addressing this emerging issue.

Third, labour market policies should be responsive to labour market changes driven by the labour supply, which differ from those driven by the skill-biased technological change (SBTC) happening in some developed economies. SBTC refers to the phenomenon when capital- and knowledge-intensive sectors are competitively advantageous, inducing more demand for high-skilled – rather than the unskilled – workers. In turn, the wage differentials between high- and unskilled workers encourage investment in human capital, which is the foundation of further productivity growth. The case in contemporary China differs from SBTC: wage growth is dominated by a shrinking labour supply. The growing wages for unskilled workers do not stimulate investments in human capital; they increase the opportunity cost of pursuing further education. As a result, the dropout rates of compulsory education have been increasing accordingly (Du, 2013), which will negatively affect industrial upgrading in the future.

Last but not least, labour market policies should aim to keep labour relations harmonious. After the Lewis turning point, workers have more bargaining power due to the growing labour shortage. Increasing wage rates also raise workers' expectations with respect to working conditions. Labour disputes increase due to the gaps between expectations and actual outcomes. Accordingly, the labour market policies and institutions should incorporate stronger and more comprehensive social dialogue mechanisms to adapt to these changes and keep the labour market functioning smoothly.

3.1 The labour market policy framework in China

In a broad sense, labour market policies in China include all labour-related institutions, including labour-related laws. For this reason, it is good to describe the relevant labour-

related laws along with labour market policies: wage determination policies, collective bargaining policies, active labour market policies (ALMPs), and passive labour market policies.

Figure 2 on page 11 sketches the framework of labour institutions in China which have been improving in the past decades. There are two pillars sustaining the framework: labour market policies and labour-related laws. The Figure also describes how these labour institutions work and affect labour outcomes in China.

Compared to labour-related laws, labour market policies are more flexible. Policy-makers frame specific policies to resolve emerging issues in the labour market. For example, to encourage the labour transfer from agriculture to non-agricultural sectors, dozens of directives have been issued and implemented since the 1980s. Legislation is enacted to support the implementation of labour policies that have proved to be effective. For instance, the *Employment Promotion Law* enacted in 2008 supports the active labour market policies implemented over the past decade in China.

3.1.1 *Labour market policies*

With the changing situation, policy-makers in China dynamically adjust labour market policies. At the early stage of the 1978 Reform and Opening Up policies, China was a typical dual economy. The focus of labour market policies was how to transfer the surplus labour out of agriculture and provide jobs for them in the non-farm sector. Therefore, in the first two decades, labour market policies addressed the transfer of rural surplus labour, which could be looked upon as the prelude to and then a component of ALMPs. In the following section, we discuss how the policies on labour mobility evolved over time.

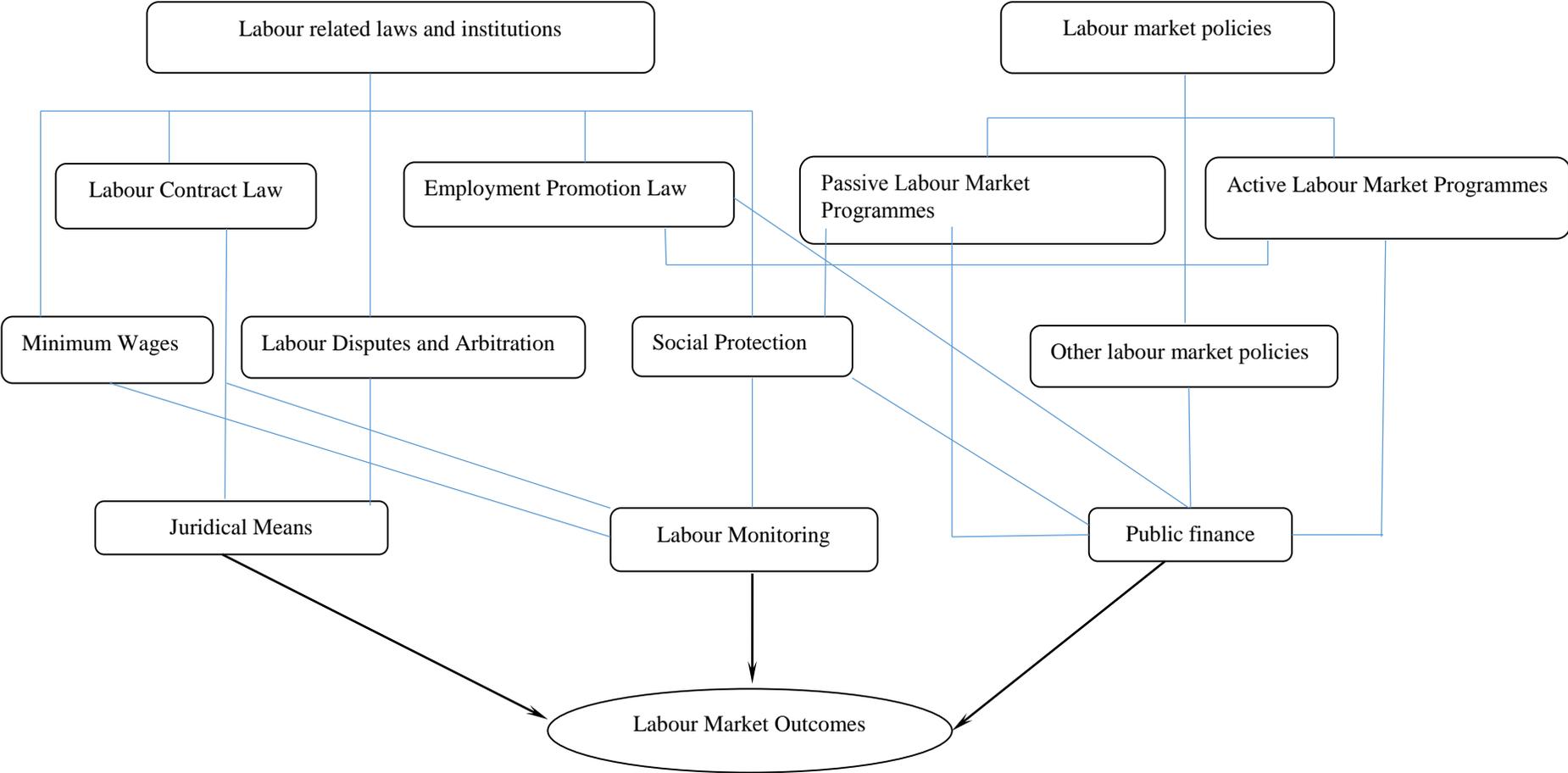
As far as the urban labour market was concerned, the restructuring of state-owned enterprises (SOEs) in the 1990s presented challenges for the employment system founded in the planned economy era. To meet the needs of the labour force allocation, on the one hand, the Government promoted reemployment of laid-off workers from SOEs. On the other hand, China started to set up a social protection system that was compatible with the market economy. Section 3.3 introduces ALMPs and the employment policy priorities in detail.

Due to the reduction of institutional barriers to mobility in the labour market, demographic transition and fall in the number of unskilled workers available, wage convergence between skilled and unskilled labour has taken place. Meanwhile, wage rates for unskilled workers have been increasing, which also drives low-productivity employment. Based on these changes in the labour market, workers would adjust their expectations concerning the wage rates, working conditions, and benefits associated with employment. In this context, the emphasis of labour market policies has shifted to regulating employment relationships in order to keep the labour market stable. Since improving employment quality has been the main target of labour market policies in the past decade, China has issued a series of labour-related laws to regulate employment, which are discussed in the following subsection.

3.1.2 *Labour related laws*

Although labour-related laws differ from policies in how they function, they are fundamental components of the labour institutions that promote more and better jobs. At different stages of economic development, the Chinese Government has actively used legal instruments to achieve the employment goals.

Figure 2. The framework of labour market institutions in China



Source: Authors (2015).

The 1994 *Labour Law* and the 2008 *Employment Contract Law*

Under the planned economy system, employment was determined by planners while firms lacked the autonomy to hire or fire workers, or decide their wages. Since the Chinese Economic Reforms started, this system of the so called “iron rice bowl” (*tiě fàn wǎn*) – which guaranteed income and job security – has been abolished gradually. China has been transitioning from a planned system to a market-driven labour allocation system. In order to regulate the labour market, the *Labour Law* was adopted by the Standing Committee of the National People’s Congress in 1994. For the first time, the employment contract was introduced to define the employment relationship.

The *Employment Contract Law* took effect in 2008. The Law aims to improve the employment contract system, specify the rights and obligations of the parties in employment contracts, and to protect the rights and interests of employees. The *Employment Contract Law* is built on the basic framework of the labour contract system established by 1994 *Labour Law*, but gives more detailed provisions on the conclusion, performance, amendment and termination of the employment contract, collective contracts, employee placements, part-time labour, monitoring, inspection and legal liability.

Two important aspects of the new 2008 Law are (i) the regulations on the nature of contracts that employers were obligated to provide workers, and (ii) the increased severance payments to fired workers. The new Law stipulates that the employment contract should become an open-ended one, on condition that a worker completes two fixed-term contracts, or works ten years for the same employer. Employees who sign open-ended contracts must be terminated with just cause. Given that many employers in China use the fixed-term contract system as a means to terminate employment without cause, this restriction is meaningful. The probation period for new contracts is limited from one to a maximum of six months, depending on the contract length. New regulations also limit the use of temporary work agencies or labour service companies, which provide labour dispatching services in order to circumvent obligations to regular employees. With respect to severance conditions, the new Law requires a 30-day written notice in advance when terminating a fixed-term contract without extension, and severance pay equal to one month’s payment of each service year (a half month’s payment if service time was less than 6 months); but double severance payment is required for an unfair dismissal. The Law also enhances the power of trade unions at the enterprise level, and requires that company work rules be approved by employees before they can take effect.

The 2008 *Employment Promotion Law*

As noted earlier, in 1990s, the restructuring of SOEs caused labour market dislocations in urban China. With the mass of laid-off workers and rapidly rising urban unemployment in the early 2000s, local governments adopted a series of active employment policies, which included financial policies to support economic restructuring, building public and non-public employment service system, establishing a social security system, enhancing employment and re-employment training, and providing re-employment support and assistance. These active employment policies have played an important role in promoting employment.

The effects of implementing these policies were positively evaluated. Therefore, the Government proposed that the Standing Committee of the National People’s Congress adopt the *Employment Promotion Law* in 2008 based on the success of these policies. The objective of this law is to promote employment and regulate the relationship between economic development and employment growth. The articles in this law relate to, among others, employment equity, employment service, monitoring and inspection, vocational education and training, and employment assistance.

The Law specifies the obligation to use public finance for employment promotion and elaborates that the Government should give active financial support to employment

promotion. It also includes provisions for building public and non-public employment service system. It requires the Government at all levels to provide a fair employment environment and eliminate employment discrimination.

Labour Disputes Mediation and Arbitration Law

With the growing labour scarcity, workers have more and more bargaining powers in the labour market, which induces growing expectations with regard to wages and working conditions. The gaps between the expected and the actual outcomes may cause disputes between employers and employees. In fact, with improved outcomes, the Chinese labour market has already witnessed growing labour disputes. Settling labour disputes through legal framework is one of the essential components of labour market institutions.

The *Law of Labour Disputes Mediation and Arbitration* was adopted by the Standing Committee of National People's Congress in 2007 and came into effect on 1 May 2008. This law is formulated to resolve labour disputes fairly, protect the rights and interests of the two parties and promote harmonious and stable employment relations. It covers, among other things, labour disputes mediation, arbitration, application and acceptance, hearing and award. The Law enhances the protection of the rights and interests of both parties in the employment relationship from unlawful procedures and guarantees the effective implementation of the *Employment Contract Law*.

3.2 Mobility of the rural surplus labour

China first initiated the reform agenda in rural areas. With the introduction of the Household Responsibility System⁸, labour productivity in agriculture significantly improved in the 1980s. Since then, China has faced the challenge of how to transfer surplus labour out of agriculture. Encouraging labour mobility has been one of the key components of labour market policy.

The socio-economic environment varies at different stages of economic development, which requires the adjustment of the policies associated with the transfer of labour accordingly. Table 3 on page 14 summarizes the features of the policies at different periods since the early 1980s.

At the early stage of rural reform, the significant improvement of labour productivity in agriculture revealed the extent of underemployment in the agricultural sector. In the meantime, the educated youth who were sent to the countryside during 1960s-1970s⁹ began to return to the cities in the late 1970s and early 1980s, which increased the employment pressure in urban areas. To solve the employment dilemma in both rural and urban areas, policy-makers advocated local rural industrialization to absorb the surplus labour from agriculture, which they called "Leaving the land without leaving the hometown" (*lǐtǔ bù líxiāng*). To achieve this policy target, township and village enterprises (TVEs) were encouraged. Farmers were allowed to engage in off-farm activities that had been forbidden

⁸ Previously, the agricultural sector had been collectivized as part of the 1958 Great Leap Forward (*Dà yuè jìn*). Under the Household Responsibility System, collectively-owned arable land was contracted to individual households, and farmers were allowed to claim the residual farm production after the payment of obligatory taxes and the sale of a quota to the State at the planned prices. Labour productivity in agriculture improved as a result.

⁹ During the 1960s and 1970s, massive numbers of graduates from high schools were sent to countryside to relieve the pressure on employment and food supply in urban areas, as well as for re-education, as part of the Cultural Revolution (*Wénhuà dàgémìng*) and "Up to the Mountains and Down to the Countryside" Movement (*Shàngshān Xiàxiāng Yùndòng*).

Table 3. The evolution of policies regarding the transfer of surplus labour

Period	Background	Policy targets	Policy tools	Effects
1979-83	Appearance of surplus labour in agriculture after rural reforms; Employment pressure in urban areas	“Leaving land without leaving hometown”	Restrictions on rural to urban labour mobility and solving the problems of rural surplus labour; Encouraging the development of TVEs	Appearance of local off-farm employment; Small amounts of migration – around 2 million in total
1984-88	Completion of the first stage of the rural reforms; TVEs create demand for labour; Fast growth in the urban economy	Providing job opportunities for rural surplus labour; Meeting the demand for labour in urban areas	Relaxing the <i>hukou</i> system in small towns; Allowing migrant workers to do business in urban areas; Allowing SOEs to hire migrant workers	By the end of 1980s, rural migrants in urban areas totaled some 30 million
1989-91	Tightening macroeconomic policies to contain the overheating economy with serious inflation	Control of rural-to-urban migration flow in conjunction to the macroeconomic adjustments	Strict restrictions on the mobility of rural migrant workers; Requiring urban SOEs to fire rural migrant workers;	Falling migration in 1989
1992-2002	Formal acceptance of the market economy system; A booming urban economy; The 1997 Asian financial crisis; Restructuring of SOEs	Guiding the rural-to-urban migration flow	Designating experimental counties to study the transfer of surplus labour; Trying to regulate the migration flow by issuing residential and employment certificates; Reforming the <i>hukou</i> system in small towns	A significant increase in rural-to-urban migration – in 2002 there were 104.7 million rural migrant workers in total
2003-present	Significant development of the export-oriented economy; Passing the Lewis turning point, driven by both the demographic transition and economic development	Treating migrant and urban workers equally	Abolishing miscellaneous fees imposed on migrant workers; Including migrant workers in the public employment services’ work; Establishing social protection programmes for migrants; Including migrants in ALMPs	Migrant workers totaled 168 million in 2014; Shortage of unskilled workers; Growing wages for unskilled workers; Wage convergence between on-farm and off-farm activities

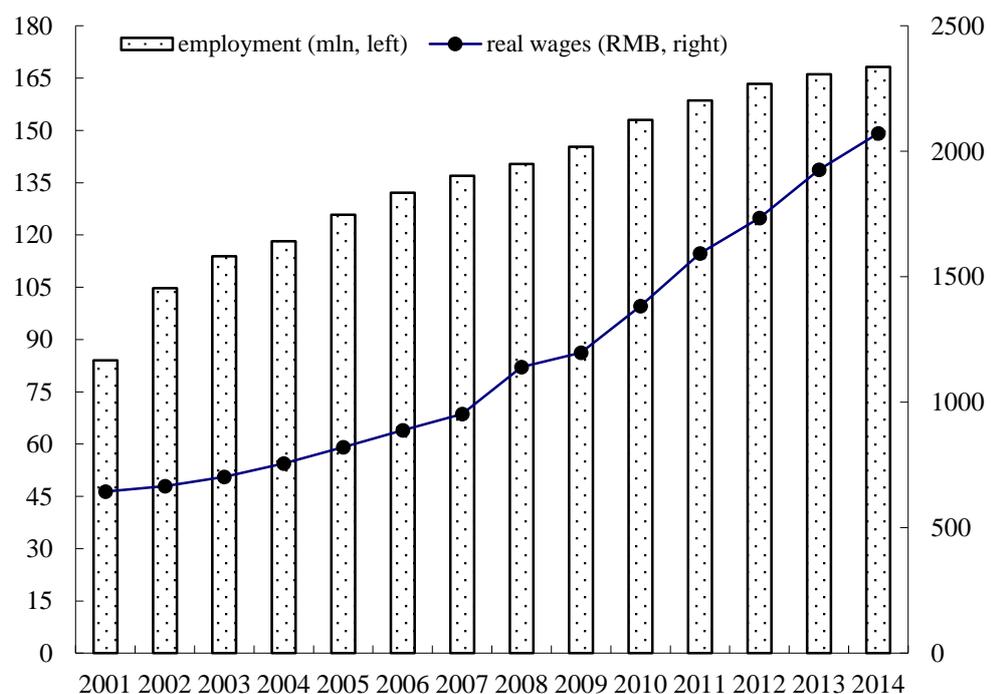
in the period prior to the Economic Reforms. Meanwhile, the fast growing urban economy created job opportunities, so China started to permit SOEs to hire migrant workers from the countryside.

However, the course of transferring the rural surplus labour was not always smooth. At the end of the 1980s, China had to deal with an overheating economy, as evidenced by serious inflation and an explosion of fixed asset investments. As part of the macroeconomic adjustment policy, rural-to-urban migration was interrupted by controlling the migrant flow. This episode just took a few years, and migration policies were brought back to normal in 1992, when China officially accepted the market economy system.

Despite the macroeconomic fluctuations in the 1990s, rural-to-urban migration had been increasing as a result of liberalizing migration policies. Labour policies positively responded to labour mobility. In the areas from which workers migrated to the cities, experimental counties were designated to pilot ways of promoting the labour transfer. In the destination areas, the local governments were required to manage the migration flow by issuing residential and employment certificates rather than simply rejecting migrant workers as they had done before.

A significant improvement in labour migration policies took place this century. After China's entry into the World Trade Organization (WTO) in 2001, labour-intensive industries grew significantly, which created productive jobs for migrant workers. The changes in the policies include the following. First, local governments were required to abolish miscellaneous fees previously imposed on migrant workers. Second, instead of regulating migration, local governments are required to provide employment services for migrant workers. Third, some developed regions designed social protection programmes for migrants. These employment-friendly policy changes stimulated labour mobility between rural and urban areas, which has become the largest migration flow in history. As indicated in Figure 3, the rural to urban migration has been increasing steadily. In 2014, migrant workers who moved out of township for more than six months totaled 168 million. Their wage rates have been growing too. At the 2014 price levels, average monthly earnings for migrant workers were CNY 2072 – more than three times of the level in 2001.

Figure 3. The number of migrant workers and their average real wage



Source: NBS (2014).

Although the enforcement of policies has experienced reversals and variations at different stages, China has never suspended the process of transferring the rural surplus labour. The development of labour mobility has been consistent with the liberalization of the economic system in general. To some extent, the changes in policy regarding labour migration epitomize the overall reform agenda in China.

First of all, giving farmers the right to freely choose their own employment facilitated the development of the labour market at the early stage of economic development.

Second, policy-makers had to make good use of market mechanism when supporting the transfer of rural surplus labour. In the first two decades of the reform period, TVEs employed more than 100 million farmers who were regarded as agriculture surplus workers. By 2014, there were more than 160 million migrant workers moving out of their township. Labour mobility has been driven by market forces rather than the Government's actions. In the future, to achieve the goal of more and better employment, China still needs the market mechanism to play key role in employment promotion.

Last but not least, policy-makers dynamically adjusted the key policy areas in response to the changing context of socio-economic environment. In the last century, the core policy of labour transfer was to remove the institutional barriers that blocked labour mobility. In the past decade, it has shifted to incorporating migrant workers into the social protection system.

3.3 Active labour market policies and prioritizing employment

In addition to liberalizing the labour market to encourage labour mobility, in the 1990s, China made efforts to establish an employment system compatible with market economy. As a result of the reforms in the SOEs and the Asian Financial Crisis in 1997, massive lay-offs took place in the late 1990s and unemployment grew. To deal with this dislocation in the labour market, the Chinese government introduced active labour market policies (ALMPs) for the first time.

In 1998, the State Council held a national conference on how to guarantee the basic living standard and promote the reemployment of laid-off SOE workers. In the conference, the ALMPs were launched. Reemployment projects were picked up as the major policy tools responding to the high unemployment rates in urban China. The State Council issued the *Notice on the Basic Living Standard Guarantee and Reemployment for Laid-off Workers of State-owned Enterprises* after the working conference. In 2002, the Communist Party of China (CPC) Central Committee and the State Council called for another larger scale of national conference on reemployment, and issued an important document, the *Circular of the CPC Central Committee and State Council on Further promoting the Reemployment of Laid-off and Unemployed Workers*.

After these two milestone events, local governments were required to develop specific implementation methods and operational measures in their local context, which enriched and improved the contents of the ALMPs, and shaped the framework of proactive employment policies with Chinese characteristics.

The framework of China's ALMPs can be summarized as the "Five Pillars", "Six Aspects" and "Ten Policy Tools". The Five Pillars refer to macroeconomic policies aiming at (i) employment promotion, (ii) targeting laid-off workers for reemployment as well as the unemployed, (iii) coherent policies between employers and job-seekers, (iv) regulations to reduce lay-offs, and (v) social safety nets to guarantee the basic living standard of unemployed workers. The Six Aspects refer to the areas in which to develop job opportunities: (i) development of the private sector, (ii) the services sector, (iii) development of SMEs, (iv) labour-intensive sectors, (v) encouraging flexible employment, and (vi) exporting labour services. The Ten Policy Tools include tax exemptions, micro-credit,

subsidizing social security, employment assistance, financing, construction of social safety nets, labour dispatching, and construction of employment service platforms at the community level.

After years of efforts, China has made outstanding progress in implementing ALMPs. First, China set up the public employment service system. Public employment agencies have been established at the city and district levels in all medium and large cities, and in some small cities. Neighbourhood labour and social security platforms have been created at the prefecture level in all cities, and labour market information networks have been established in nearly 100 medium and large cities. The Government also encourages and formalizes the development of non-governmental job agencies. The public employment agencies at all levels, provide easy access to employment services, including job-seeker registration, vocational guidance, and handling social insurance relations. According to the MOHRSS, by the end of 2007, there were 37 897 employment agencies in China which had helped 19.81 million people find jobs.

Second, the Government set up training systems and reemployment service centers in large SOEs to provide training and reemployment guidance to laid-off workers; the centers also take responsibility for subsidizing the livelihoods of laid-off workers. The training system has trained more than 13 million laid-off workers and unemployed; 60 per cent of them find jobs within six months of finishing training. In addition to the training system in SOEs, the Chinese Government also makes full use of existing education resources to carry out re-training for reemployment, such as skills-training for technicians and entrepreneurship training.

Third, when facing a serious labour market dislocation, the Government encourages laid-off workers and the unemployed to start their own businesses and find jobs in different ways, for example, part-time work, labour dispatching, seasonal work, and other flexible employment arrangements. Laid-off workers and the unemployed pursuing private business opportunities can get tax deductions or exemptions. Loans and micro-credits have also been established to support business start-ups.

Fourth, ALMPs target disadvantaged groups: the Government targets Laid-off workers and the unemployed who have difficulty in finding jobs - especially males over 50 or females over 40 years of age who are less educated or unskilled. The Government provides employment assistances to the targeted group, for instance by subsidizing social insurance and salaries through the reemployment funds.

Although the Government has played a key role in employment promotion when the labour market falls into serious dislocation, it is impossible to solely rely on the State to create jobs. Once the macroeconomic trend gets back to the normal, however, the labour market per se should be the main mechanism to promote employment. In this case, the Government should make more efforts to removing the institutional barriers in various ways.

As an extension of ALMPs in the new century, the Chinese Government further proposed a strategy to prioritize employment, which puts the employment creation in first place among all tasks of government.

3.4 Inclusive labour markets

As one of the essential labour market institutions, China started working on the construction of a social protection system that is compatible with the market economy in late 1990s. For the first time, social insurance programmes for old age pensions and medical care were introduced to rural areas in the past decade. Aiming to increase the coverage of its social insurance programmes, the Chinese Government has successfully provided most Chinese citizens with basic social protection in a very short period. Although China has already made

great progress in coverage, the social protection system is facing a lot of challenges, for instance, the segmentation of the system by *hukou* status, the tradeoff between benefits protection and efficiency, and the efficiency of its governance.

The evolution of the social protection system in China has followed the economic transition. Prior to the Reforms in the early 1980s, China did not have any specific social insurance programme to secure the livelihood of the Chinese people. Instead, a strict socio-economic segmentation between rural and urban areas was applied. In urban areas where state or collectively owned economies were dominant, employment was fully protected with various associated benefits – the “iron rice bowl”. In contrast, the social protection in rural areas was negligible: all the protection for rural workers relied on the limited output from the land. Although the planned economic system has been abandoned, as we see later on in this paper, it still has an effect on the social protection system in contemporary China.

China started to build a social protection system compatible with the market economy in the 1990s. The reform of SOEs brought about labour market dislocations in urban areas, as evidenced by mass lay-offs and the appearance of massive unemployment. In addition to ALMPs, the Chinese Government devoted itself to establishing a social protection system in order to support workers who lost their jobs.

The evolution of the social protection system enlarged the gap in social welfare between urban and rural areas, which is a de facto barrier to labour mobility. In the 21st century, some social protection programmes have been extended to rural areas, including the medical care and pension systems. However, the design of both the urban and the rural social protection systems are based on the *hukou* household registration system. Identified by the locality of the *hukou*, social programmes vary across regions with segmentation between rural and urban areas. The *hukou* system significantly affects the formulation and implementation of social programmes in China. Although the Central Government has made up its mind to reform the overall *hukou* system and the huge variations between social programmes are still the most serious barriers to the reform agenda.

The current social protection system consists of two types of social programmes. One is contributory social insurance, for example pension programmes and the medical care system. The other is non-contributory, i.e. the social assistance programmes. In order of relative importance, however, there are three major pillars in the current social protection system: the pension system, the medical care system, and the social assistance system. All the components of the social protection programmes were designed in separate rural and urban segments, leading to substantial gaps in coverage. Although some new programmes – for instance, the New Cooperative Medical System and the Rural Pension System – have been implemented in the countryside, the disparities in coverage are still obvious. To some extent, rural residents have gotten better off since the new social protection programmes were introduced in rural China. However, China has been faced with the challenge of how to integrate the different systems and reduce the gaps in benefits between different groups of people.

3.5 Future labour market policies: Key elements

The long run target of labour market policies

To achieve the goal of more and better jobs, labour market policies should target the labour transfer from the agriculture in the long run when the economy is featured by duality à la Lewis (1954). The Chinese experience illustrates that supporting the creation of a more integrated and mobile labour market is an effective way to create employment. Although detailed policies regarding to labour transfers fluctuated over time, China has kept encouraging the development of a market-driven labour market regime between rural and urban areas in general.

Active labour market policies (ALMPs) to smooth cyclical unemployment

When suffering from aggregated demand shortfalls, the negative impact on the labour market may cause cyclical unemployment. In this case, the failure of the labour market may cause employment dislocation, which implies that governments should take the responsibility of maintaining the stability of the labour market. This is why China kicked off the ALMPs when facing serious labour market shocks, and then upgraded them as part of the national development strategy through the 2008 *Employment Promotion Law*.

Reducing the natural rate of unemployment during the transition

As a transition economy, one of the important policy targets is to reduce the natural rate of unemployment, since certain institutional barriers may cause frictions in the labour market. One of the functions of the ALMPs is to strengthen the public employment services, which can help reduce the natural rate of unemployment by facilitating the job search and matching process as well as with re-training. In the past decade, the natural rate of unemployment in China was relatively low, at 4.1 per cent (Du and Lu, 2011). The contribution of ALMPs cannot go unnoticed.

Accumulating expertise for reducing labour market fluctuations during restructuring

China will restructure the economy as it approaches high-income status, which is likely to bring about an increase in structural unemployment. This will require policy-makers to build on existing expertise to respond to the labour market adjustment in time.

4. The interaction of sectoral, labour market and macro policies

Chinese policy-makers believe that employment is the foundation of people's livelihood. China officially proposed the *Employment Priority Strategy* in 2011 when the 12th *Five-Year Plan* (2011-2015) was initiated. The Chinese Government synthesized the sectoral and labour market policies to implement this *Strategy*.

4.1 Prioritize employment in macroeconomic policies

Although job creation has always been the most important task for the Chinese Government, putting employment promotion as the very first priority among macroeconomic objectives only occurred in 2002. When coping with the global financial crisis in 2008 and 2009, the Chinese Government started to implement more active employment policies. Since then, employment promotion has been listed among the macroeconomic objectives, including promoting employment indirectly through economic growth. Former Premier Wen Jiabao (2010) explicitly elaborated that targeting eight per cent of annual economic growth was to keep employment stable. A lower growth rate might cause unemployment problems. This is why China keeps fast economic growth as an essential element of its development strategy. In 2010, the Chinese Government also explicitly prioritized employment among the socioeconomic development tasks in the 12th *Five-Year Plan*. Premier Li Keqiang (2014) pointed out the relationship between employment and economic growth. Li thinks that China may put up with a little bit higher or lower growth rates, but there is a minimum growth "threshold" to guarantee full employment. He also explained that the motivation for the Government expected growth rate target of 7.5 per cent is for employment concerns. He added, employment is the foundation of livelihood: No employment, no incomes.

4.2 Setting employment targets in the Five-Year Plans

The *Five-Year Plan* is the most important blueprint mapped out by the Chinese Government, which outlines the economic and social development targets for the coming five years. To some extent, the priority of Government work and the interaction of policies are reflected by what are included in the plan per se. For example, the *12th Five-Year Plan* lists seven overall objectives that the Government would work on in the coming five years, where employment growth ranks the first. Putting employment on the top of the listed objectives indicates that employment is central to the Government's work. In addition, among the other objectives¹⁰, Objective Number Five – to keep improving people's livelihood – is highly correlated with employment too.

The very first objective in the plan is described as “*stable and fast economic growth*”, which clearly highlights the interactions between the employment and other policies. Except for employment, the other goals include targeting 7 per cent GDP growth per annum, stable price level, and an equilibrium balance of international payment. Putting these goals together implies that the Government has to consider them simultaneously.

In more detail, in the *12th Five-Year Plan* has two indicators on employment set up as the Government's target to maintain the employment situation stable. The first one is to contain the urban registered unemployment rates below 5 per cent. The second one is to create 45 million jobs in the five years or 9 million per year in urban areas. Although the definitions of the two indicators are subject to debate, inclusion of employment targets in the *Plan* already indicated that the Chinese Government highly values employment promotion.

4.3 Including employment growth in regional development programmes

The regional development programmes are essential components of development policy in China. The large scale regional development programmes include the *Poverty Reduction and Development Programme*, the *Western Development Programme*, the *Plan to Revitalize North East China*, and the *Rise of Central China Plan*. The Chinese Government tries to bridge the gaps in economic development across regions by implementing these programmes. When designing the programmes, employment has always been one of the necessary concerns to be addressed.

China started implementing the regional development programmes in the 1980s when the Central Government committed itself to reducing absolute poverty in rural areas. At that time, the poor were concentrated in certain regions of Central and Western China. To make the poverty reduction policies efficient, poverty alleviation programmes targeted those regions with concentrated poverty. One of the most effective ways to reduce poverty was to promote labour migration out of the poor areas. Encouraging labour mobility, migration and remittances has been an effective tool for poverty reduction (Du et al., 2005). In the poverty reduction programmes, promoting labour mobility has been a vital policy instrument.

The other regional development programmes also include employment promotion as essential components. For instance, in the *Plan to Revitalize North East China*, the programme set up detailed employment targets, including the development of labour intensive sectors, promotion of SMEs, provision of public employment service, and

¹⁰ In the *12th Five-Year Plan*, the main objectives are listed as: (i) maintaining fast and smooth economic growth; (ii) making progress in economic restructuring; (iii) significantly improving science, technology and education; (iv) significantly improving in resource conservation and environmental protection; (v) improving people's livelihood; (vi) strengthening the social work; and (vi) deepening the Reform and Opening-Up policies.

assistance to groups with difficulties obtaining reemployment. Local governments are required to provide public jobs in order to help households with no employment have at least one job. Similar arrangements are also found in the other regional development programmes.

4.4 Coordinating policy: The inter-ministerial meetings

To address specific issues in employment and promote coordination across the various Government departments, an institutional arrangement called the “Inter-Ministerial Meeting on Employment” was established. This inter-ministerial meeting is usually convened by the Chair of the State Council, and the members include the Ministers of the relevant Ministries that are in charge of certain aspects of employment policy.

In 2003 the State Council proposed establishing an “Inter-Ministerial Meeting on Reemployment” to address the issue reemploying laid-off SOE workers. The participants in this Meeting included the Ministers of Labour and Social Security, of Finance, and from the National Development and Reform Committee. Local governments are required to set up similar institutions to cope with the re-employment issues at the provincial level. The key function of this inter-ministerial meeting is to increase interaction and communication across different Government agencies and implement the employment policies. Every three months, participants are required to report the progress in work to the inter-ministerial meeting.

In 2006 the State Council set up the “Inter-Ministerial Meeting on Migrant Workers” to coordinate this emerging issue, including 31 ministries and committees, succeeded by the “Leading Group for the Work on Migrant Workers” meeting in 2013. This inter-ministerial meeting drafts policies on migrant workers and coordinates difficult issues across ministries. It also has the obligation to monitor policy implementation at the local level and report to the State Council. It has regular plenary meetings every half year and irregularly scheduled meetings to deal with specific issues.

In 2004, Inter-Ministerial Meeting on Employment of College Graduates was set up, comprising 10 ministries. The meeting is held every half year to coordinate employment issues regarding college graduates.

This mechanism is also applied to the formulation and implementation of industrial policies. For instance, to encourage the development of “Strategic Emerging Industries”, the State Council set up an inter-ministerial meeting, including 24 ministries. The meeting is chaired by the National Development and Reform Committee under the leadership of the State Council. The Ministry of Human Resources and Social Security (MOHRSS) participates in some of these meeting, and is in charge of the employment and skill development dimensions of the programme.

5. More and better jobs: Challenges and options

Both the Chinese economy and the labour market are facing a series of challenges. As it approaches high-income status, China has to find new ways to sustain economic growth, which is supposed to be driven by productivity improvements rather than by the accumulation of factors of production. In addition to the transformation of the growth pattern, China is being challenged by fast population ageing, which implies that full employment will no longer be sufficient to solve the problems, and improvement of employment quality is getting more and more urgent.

Meanwhile, the current labour market institutional arrangements leave room for reform. For instance, comprehensive reform of the *hukou* system may further boost the labour supply and ease labour shortages. Reforms in the education system to strengthen human capital

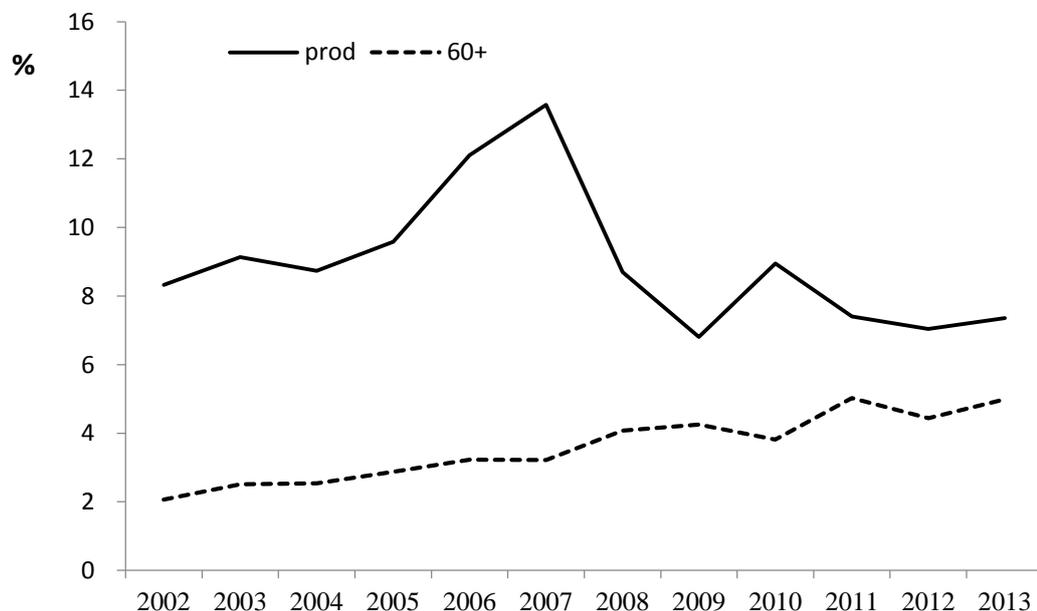
accumulation would help ensure the sustainability of economic development in the near future.

5.1 The challenge of demographic change

As a middle-income country, ageing presents a particular challenge for China. One of the biggest concerns is that China may not have enough economic resources to support the growing number of elderly persons. Regardless of the pension scheme, the system relies on the transfer of output produced by the active labour force to support the elderly. In this regard, it is good to know whether pension fund resources are sufficient by looking at the labour productivity and ageing trends. In 2013, more than 202.4 million persons were 60 years old or above, which accounted for 14.9 per cent of the total population in China; those aged 65 or above accounted for 9.7 per cent of the total population (NBS, 2014). It is estimated that, there will be 234 million people aged 60 or above; they will account for 16 per cent of the total population in 2020. Those aged 65 or above will account for 11.2 per cent of the total population in 2020.

Instead of using the actual number of workers, we measure labour productivity by using the average output per person, and the denominator is the total number of persons aged between 22 and 59, while the nominator is GDP at constant prices in 2001. There is some advantage in using the total number of persons at working age, rather than the actual official employment rate. The former tells us the pure demographic effect of productivity changes without considering labour market fluctuations which arise from various short term factors. The reason we define the lower bound of the age group as 22 is because persons aged between 16 and 21 have very low labour participation rates due to the expansion of higher education (Du and Lu, 2013). We define the upper bound at age 59 because almost all workers retire upon reaching age 60 in accordance with the current retirement age.

Figure 5 Growth of labour productivity and ageing



Source: authors' calculation based on NBS (2014).

Figure 5 above presents the annual growth rate of average labour productivity and of the total size of persons aged 60 years old or above. It is evident to see that the productivity growth rate dropped dramatically in 2007 and has been at a lower plateau since then. Considering that the potential economic growth rate is going to keep declining in the long

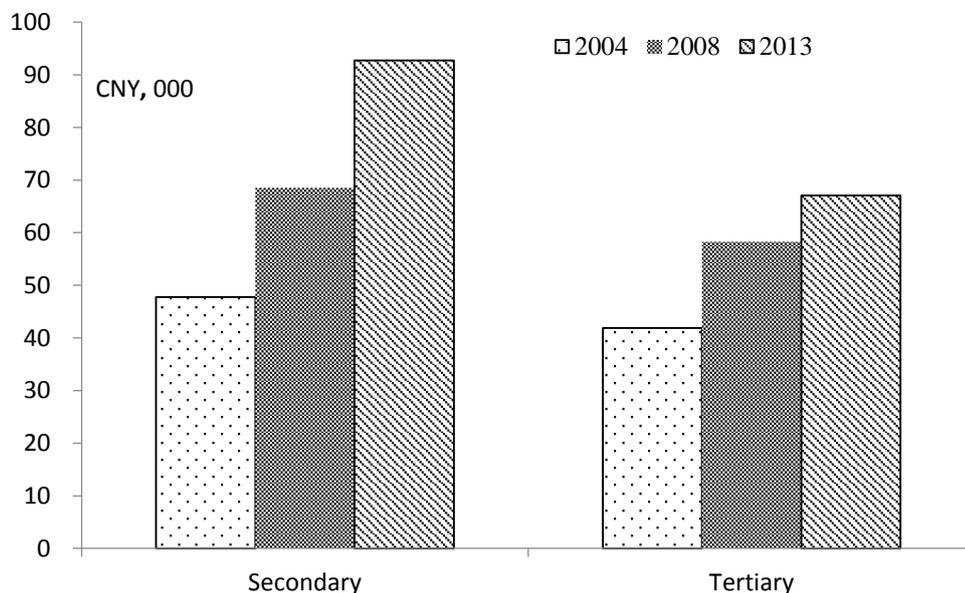
run (Cai and Lu, 2013), the average labour productivity would not grow as fast as before anymore. Figure 5 also indicates a convergence trend between the growth rate of labour productivity and the speed of ageing, which implies that China needs to take action to improve its social protection system before the speed of ageing catches up the growth rate of labour productivity.

5.2 Concerns about growing labour costs, productivity, and competitiveness

One of the stylized facts in the Chinese labour market is the growing labour cost of unskilled workers. The average real wage for migrant workers has been increasing 8.5 per cent per annum between 2001 and 2008. After the global financial crisis, it climbed up to 11.6 per cent per annum between 2009 and 2014, which is faster than the GDP growth rates in the same period. Although wage growth is a normal outcome of the labour market transformation and one of essential components of better employment, the fast growing labour costs – particularly when faster than the productivity growth – might bring about negative shocks to the employment rate and the economy. In recent years, the unit labour cost of manufacturing grew from 0.22 in 2008 to 0.27 in 2012, which weakens the competitiveness of labour-intensive sectors.

Therefore, the Chinese economy and labour market face the challenge of the productivity improvement, which is the foundation of employment quality. However, it seems that the current structural changes in China do not facilitate productivity enhancement. As Figure 6 depicts, labour productivity in the secondary sector grew steadily from 2004 to 2013, whereas productivity growth slowed down in the tertiary sector. However, the economic and employment structures have been shifting from the secondary to the tertiary sectors, which makes it more difficult to improve productivity.

Figure 6. Labour productivity in the secondary and tertiary sectors



Source: Authors' calculation based NBS (2014).

5.3 The negative impact of labour market changes

Fast growing wages for unskilled workers increase the opportunity cost of compulsory education, which might increase dropout from schooling and constrain productivity gains in

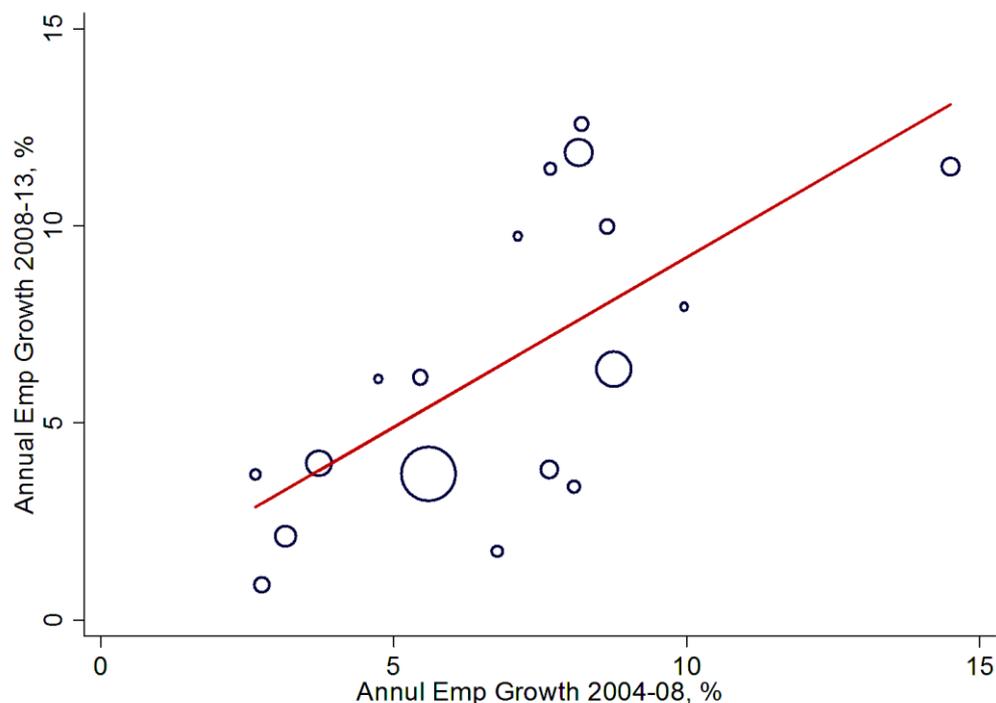
the longer term. Empirical analysis indicates that the dropout rates from compulsory education have already been increasing due to the wage growth (Du, 2013). It is more serious in the poor areas of rural China where the main sources of the labour supply will be in the future. This negative externality may not affect employment and economic development immediately. However, insufficient accumulation of human capital will not support the coming economic upgrading and restructuring, which increases the risks of structural unemployment in the labour market.

5.4 The coming restructuring

After passing through the Lewis turning point, there have been frequent shortages of unskilled workers, leading to wage growth in the labour market. The increasing labour scarcity changes the relative price of labour and capital, which induces technological changes and substitution between labour and capital at the firm level. In an aggregate sense, the increasing labour scarcity would bring about the economic restructuring in the economy, which might increase the natural rate of unemployment arising from a structural change.

Although it is quite clear to infer structural change from the price signals in the market for factors of production, the pattern of employment growth in China has not varied greatly in the past decade as indicated in Figure 7. The horizontal axis is the employment growth rate by sector between 2004 and 2008, while the vertical axis refers to the employment growth rate by sector between 2008 and 2013. Each bubble in the figure represents one sector, which is weighted by the employment size in 2013. The figure indicates that employment growth in China still relies on the sectors that had the fastest growth rate before 2008, which is inconsistent with the expected outcomes from labour market changes. This fact also implies that China needs more substantial reforms in sectoral policy to facilitate the economic restructuring.

Figure 7. Employment growth by sector*



*Each bubble in the figure represents one sector which is weighted by its employment in 2013. Source: authors' calculation based on NBS (2014).

5.5 Comprehensive reform of the *hukou* system

Comprehensive reform of the *hukou* system would be the most effective way to increase the labour participation rate. Some reforms have been implemented, but only in the form of localized pilot programmes. It is time to push the reform in a top-down way. The final goal of the reform is to separate benefits from *hukou* registration. To achieve this goal, the first thing to do should be integration of the social protection system, i.e. unifying the basic pension system with the basic medical care system, and other public services. Based on an integrated social protection system, China should speed up the agenda to equalize social protection between migrant workers and local residents.

5.6 Human capital for better jobs

Human capital accumulation in the past three decades has successfully supported the fast economic growth. Making nine-year compulsory education universal is a necessary condition to supply qualified workers for industrialization. To facilitate the upgrading of the economy, China needs to further improve the quality of labour.

One useful public policy is to extend the nine-year compulsory education to 12-years, which would make all the secondary education compulsory. Thanks to the demographic transition, the secondary-school-aged population has been declining: it will be less than 3.5 per cent by 2020. Moreover, including the whole secondary education into the compulsory system would be fiscally feasible.

6. Conclusions and discussions

The fast economic growth in the past three decades ended the dual economic structure in China. With economic development, China succeeded in the first economic restructuring where the economy industrialized and non-agricultural employment has become dominant. As a whole, China has escaped from absolute poverty, growing from low- to middle-income status.

Economic growth in China is pro-employment, the major policy instruments being labour market and sectoral policies. Promotion of labour-intensive sectors played an essential role at the very beginning of the economic takeoff, when the economy was extremely short of capital but rich in labour. China comprehensively made use of various policies to push the development of labour-intensive industries, including removing the barriers to labour mobility, attracting foreign investment in various sector, investing in infrastructure, and establishing favourable tax policies. The Chinese experience indicates that a range of policies – rather than a single policy – is necessary in order to achieve the employment goals.

China has witnessed significant changes in the labour market, which brought about the changes in policy in terms of targets and tools. In the era of unlimited labour supply, policies aimed to create employment so as to provide as many productive jobs as possible to reduce unemployment and underemployment. After the Lewis turning point, labour shortages and wage pressure mean it is more and more important for labour market and sectoral policies to promote better jobs since the workers have increasing expectations about the quality of employment. To facilitate the transformation, China needs to both improve the labour institutions and promote productivity growth as well.

Given the increasing constraints China faces – including population ageing, demand for quality employment, and diminishing returns to the inputs of factors of production – productivity enhancement will be the core of future development. In addition, the recent labour market changes have challenged China's manufacturing sector, as evidenced by the increasing unit labour cost. The labour market and sectoral policies have to deal with the

changes in comparative advantage, while promoting employment and economic restructuring.

To support the transformation, the policy-makers need to reassess the effectiveness of sectoral policy implementation. Choosing and subsidizing the prioritized sectors through government plans rather than market signals has already caused excess capacity of production and brought about potential risks to the labour market. In the future, a clear separation of the roles between policies and the market mechanism is of great importance to avoid the failure of previous practices in providing more and better jobs.

Regarding labour market policies, the following aspects are of great importance. First, China still needs to work on removing labour market barriers to keep encouraging the labour mobility. The policy areas include integrating the social protection system and deepening the comprehensive reform of the *hukou* system. Second, given that an array of labour-related laws have been enacted, China needs to balance labour market flexibility and labour market security in order to maintain labour market competitiveness and facilitate the transformation of the economic structure. Third, quality employment relies on human capital improvement; labour policies should encourage private investment in human capital. Meanwhile, public investment in human capital should be valued in the long run, as China has already done in the past three decades.

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