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**CHINA'S LABOUR MARKET IN TRANSITION:
JOB CREATION, MIGRATION AND REGULATION**

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by
Richard Herd, Vincent Koen and Anders Reutersward

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ABSTRACT/RÉSUMÉ

China's labour market in transition: job creation, migration and regulation

Over the past decade, the share of jobs not controlled by the state has increased considerably, whilst employment in agriculture has declined, against the backdrop of ongoing urbanisation. Over 200 million people have been drawn into urban areas through official or unofficial migration, despite various obstacles to labour mobility, including the registration system and the associated restrictions to social service access. New labour laws were introduced in 2008 to better protect employees in a market now dominated by private-sector employers, notably via more systematic use of and adherence to written labour contracts, in particular of indefinite duration ones. To what extent the new legislation and implementing regulations will be enforced remains to be seen. For the time being, *de facto* employment protection is far less than *de jure*, with an enduring preponderance of fixed-term contracts, involving few restrictions. Minimum wages are set locally and have not kept up with average wages, nor are they effectively enforced. During the recent slowdown, average wages adjusted rapidly and employment was soon on the rise again. However, this episode also highlighted the need to integrate migrants better, not least by relaxing registration rules.

This Working Paper relates to the 2010 *OECD Economic Survey of China* (www.oecd.org/eco/surveys/china)

JEL classification: E24; J21; J23; J24; J31; J41; J42; J61; J63; J65; J71; J82; J83; K31; O53; P23; R23.

Keywords: China; labour market; employment; unemployment; urbanization; contracts; social service access; minimum wage; *hukou*.

Le marché du travail chinois en transition: création d'emplois, migrations et régulation

Au cours des dix dernières années, la proportion d'emplois non contrôlés par l'État a augmenté considérablement, tandis que les possibilités de travail dans le secteur de l'agriculture s'amenuisaient sur fond d'urbanisation ininterrompue. Plus de 200 millions de personnes ont migré – officiellement ou non – vers des zones urbaines, en dépit des nombreux obstacles qui freinent la mobilité de la main-d'œuvre, notamment le système d'enregistrement et les contraintes qu'il impose en matière d'accès aux services sociaux. Depuis 2008, le marché du travail est soumis à de nouvelles réglementations, visant à assurer aux employés une meilleure protection sur un marché aujourd'hui dominé par les employeurs du secteur privé : on soulignera le recours plus systématique au contrat de travail écrit, et en particulier au contrat de durée indéterminée. On ignore encore dans quelle mesure seront respectées la nouvelle législation et les modalités d'application. Pour l'heure, la protection réelle des employés est très inférieure à ce que prévoit le droit, et les contrats les plus répandus restent les contrats de durée déterminée qui offrent peu de protection. Le montant du salaire minimum est fixé au niveau local, sans référence au salaire moyen, et n'est d'ailleurs pas effectivement respecté. Dans la récente période de ralentissement économique, les salaires moyens ont été ajustés rapidement et l'emploi a connu une embellie. Toutefois, cet épisode a également mis en lumière la nécessité d'une meilleure intégration des migrants, notamment par un assouplissement des modalités d'enregistrement.

Ce Document de travail a trait à l'*Étude économique de l'OCDE de la Chine*, 2010 (www.oecd.org/eco/etudes/chine).

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Mots clés: Chine; marché du travail; emploi; chômage; urbanisation; contrats; accès aux services sociaux; salaire minimum; *hukou*.

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CHINA'S LABOUR MARKET IN TRANSITION: JOB CREATION, MIGRATION AND REGULATION

Richard Herd, Vincent Koen and Anders Reutersward¹

1. The labour market has been in the throes of a major transformation over the past decade. The share of jobs in firms that are not controlled by the state has risen, ending lifetime employment and increasing the role of the private sector. All forms of contract law are difficult to enforce in China, even when the parties are of equal standing. The labour law that was in place during this transition was no exception to this rule. It has proved ineffective in many basic areas such as ensuring that workers are actually paid and that employers join social security. A new set of labour laws were therefore introduced in 2008.

2. At the same time, employment in agriculture has shrunk as has, more recently, the share of the population living in rural areas. As measured by agriculture's share in employment, the country is more than half-way between the 80 to 90% typical of pre-industrial societies and the 5% or less found in advanced economies, many workers having moved from the land to work in towns. This change has thrown into sharp relief the problems faced by the government in maintaining the long-standing divisions both between rural and urban residents and between the residents of different cities. The labour market has drawn over 200 million people into urban areas in a decade through official or unofficial migration. Further large population flows will be necessary as the country becomes more urbanised and in order to make the best use of its human resources. Current policies assume that unofficial migration is temporary but the recovery of the labour market after the late 2008 downturn has shown that unofficial migrants are a permanent feature of the urban labour market and that they quickly adapt their wage demands in order to secure employment. Nonetheless, the economic crisis caused social disruption in the short term, exposing the inadequacy of existing provisions of the social safety net for this group of employees; but it also demonstrated the potential advantages of a flexible labour market that can respond rapidly to new economic conditions.

3. This paper first considers the major developments in the labour market over the past decade, before looking in more detail at migration from rural to urban areas, highlighting a number of factors that impede it. It then assesses the extent of government intervention in the labour market and the changes brought about by the new labour laws introduced in 2008.

1. Richard Herd heads the China/India Desk in the Economics Department of the OECD, Vincent Koen heads the Division this Desk belongs to and Anders Reutersward worked in the OECD's Directorate for Employment, Labour and Social Affairs. A shorter version of this paper appeared as a chapter in the *OECD Economic Survey of China* published in February 2010 on the responsibility of the Secretary-General of the OECD. Useful feedback on earlier drafts was received in Beijing from Chinese experts in the context of two seminars organised by the State Information Centre in July and October 2009, and at the OECD from Andrew Dean, Robert Ford, Sam Hill and Yu-Wei Hu. Thomas Chalaux provided technical assistance and Nadine Dufour and Lillie Kee editorial assistance.

Labour market developments: job creation, migration and persistent segmentation

Employment, unemployment and activity rates

4. Over the past decade, China has been faced with the need to increase employment sufficiently rapidly to cope with a growing labour force. Each year on average, the working-age population has increased by over 10 million people. Around the turn of the millennium, policy makers worried whether the economy would be able to create enough jobs to employ both the growing labour force and those laid off during the restructuring of state-owned enterprises (SOEs), which involved the loss of 4 million jobs per year. In the event, employment in manufacturing contracted substantially between 1998 and 2002 (Table 1), only returning to its 1998 level in 2004. Tertiary employment grew, however, especially in distribution and construction. Nonetheless, the unemployment rate rose, peaking in 2000 at nearly 10% of the urban working population, excluding those working in agriculture (Box 1), and then declined as the laid-off workers became self-employed.

5. By 2003, GDP growth started to pick up under the influence of the global upturn and stimulatory monetary policy. As a result, employment expanded strongly, particularly in the secondary sector, where it expanded by nearly 6.5% annually between 2003 and 2007, adding an average of over 11 million jobs per year. Tertiary employment increased less rapidly, partly reflecting slower growth in the broad government sector, at only 2% annually (Box 2).

Box 1. Measuring unemployment

The Chinese government does not publish an internationally comparable unemployment rate. However, the annual labour force surveys yield data for total employment and the number economically active. The difference between the two equals unemployment. The questions in the survey correspond to the normal job-search categories used internationally. In rural areas, by convention, no agricultural worker can be classified as unemployed because they all own land which requires to be tended. This is the case even if their main activity is outside agriculture. Following this convention, the unemployment rate should be computed as the number of unemployed divided by the urban working population not engaged in agriculture.

6. The decade to 2008 also saw a marked increase in youth enrolment in education, both at senior high (16 to 18 year olds) and tertiary levels. Enrolment in post-compulsory education started to grow in the late 1990s and by 2004 approached 5 million per annum, though the pace of the expansion subsequently slackened somewhat. The number of university graduates rose six-fold between 2000 and 2008, substantially boosting human capital (Figure 1). The average new entrant into the labour market now has 11 years of schooling, while the average person leaving it has less than six years of education, implying an increase in human capital of around 2% annually. The decline in the participation rate in recent years has mainly been caused by this increase in the number of students. Hence, it should not be interpreted as a withdrawal from the labour force but as investment in human capital.

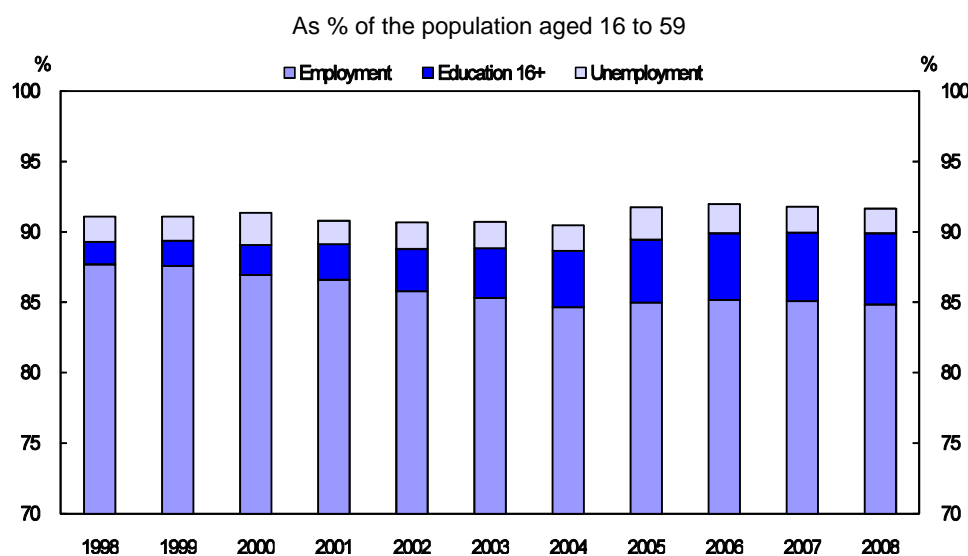
Table 1. Employment and unemployment

End-year	Total	Urban	Rural	Primary	Secondary	Tertiary	Unemployment	Unemployment rate ¹
1998	706.4	216.2	490.2	351.8	166.0	188.6	14.5	7.1
1999	713.9	224.1	489.8	357.7	164.2	192.1	14.0	6.7
2000	720.9	231.5	489.3	360.4	162.2	198.2	19.1	8.7
2001	730.3	239.4	490.9	365.1	162.8	202.3	14.1	6.6
2002	737.4	247.8	489.6	368.7	157.8	210.9	16.2	7.5
2003	744.3	256.4	487.9	365.5	160.8	218.1	16.4	7.5
2004	752.0	264.8	487.2	352.7	169.2	230.1	16.2	6.9
2005	758.3	273.3	484.9	339.7	180.8	237.7	20.5	8.1
2006	764.0	283.1	480.9	325.6	192.3	246.1	18.4	7.0
2007	769.9	293.5	476.4	314.4	206.3	249.2	16.6	6.1
2008	774.8	302.1	472.7	306.5	211.1	257.2	16.0	5.7

1. The unemployment rate is measured as a percentage of the estimated urban non-agricultural labour force, see Table 2 for the employment data. If the labour force were taken as the total urban labour force, then the unemployment rate would be 0.7 percentage points lower.

Source: China Statistical Yearbook and CEIC.

7. Labour markets developments in China cannot be fully understood, however, without distinguishing between its rural and urban components and further dividing the urban market into sub-sectors. Indeed, people wanting to move from the rural to the urban market face major obstacles and the conditions enjoyed by employees in the relatively protected SOE and government sectors differ from those elsewhere. Quantification of these movements, however, raises substantial problems. The main difficulties stem from the failure of the aggregate employment data for rural and urban areas to distinguish between employment in the primary, secondary and tertiary sector. Given that a substantial, but unknown, proportion of urban workers are in agriculture, this complicates analysis of the urban labour market. In addition, the number of informal self-employed workers is difficult to measure.

Figure 1. Distribution of the population between work, studies and unemployment

Source: China Statistical Yearbook.

Box 2. Measuring employment

The nature of the Chinese economy has evolved greatly over the past three decades and this had implications for the way in which employment data are collected and presented.

Data collection and presentation

For years prior to 1990, the data are based on the Comprehensive Labour Statistics Reporting System (CLSRS) and the official registry of self-employed workers. The CLSRS data comes from all units in urban areas that maintained independent accounting records, together with information for the rural sector.

From 1990, a second presentation is based on an annual labour force sample survey. This data is presented for the nation, split down between rural and urban geographic areas and between three sectors of the economy (primary – agriculture, forestry and fishing; secondary – mining, manufacturing, utilities; and tertiary, including construction and other services). The level data are reported in the NBS *Statistical Yearbook*.

A third presentation of the labour force data is given in the *Population and Labour Yearbook*, but only in terms of the distribution of the labour force according to various criteria. Moreover for some of the tables, only data for the urban sector of the economy is presented.

The fourth presentation focuses on the number of employees in the urban sector and uses the above CLSRS which comes from all employers that maintain independent accounting records. This reporting system was fundamentally changed in 1998, when local authorities started to pay benefits to laid-off employees. Prior to that year, all people paid by a company were counted as employees, even when they had been laid off. Henceforth, the primary series for employees excluded laid-off workers. As a result, the reported number of employees dropped by some 20 million in 1998.

This data is split into quarterly and annual, and by type of company registration and economic sector. The split by company registration separates all state units (including the following categories: enterprises – *i.e.* units not in company form; companies; public service units and state management units) from other companies (which are broken down into large and small companies – measured by capitalisation at registration), officially registered private enterprises, foreign-owned companies; companies owned by Hong Kong, Macau and Taiwan capital – to use the official Chinese nomenclature – and finally joint ventures.

It should be noted that the quarterly employment data does not include registered private companies, whereas the annual data does (this category is not the only form of private enterprise since, in this presentation at least, all non-state units are privately controlled). Registered private companies have been the most rapidly growing part of employment recently and accounted for 51 million jobs at end-2008. Thus the annual urban data for employees shows 171 million employees, whereas the quarterly data for December 2008 shows just 121 million people. This latter sample is used to calculate average wages. Since 2006, the NBS has been experimenting with a new system for measuring quarterly employment and wages that includes registered private enterprises and individually-owned businesses. Figures for 2008 are now available but have not yet been published because changing the measurement basis for average earnings by locality will affect future pension benefits and all parties have to agree on the changes (Feng, 2009).

A fifth presentation comes from the Ministry of Agriculture and reports the number of employees in the primary sector in rural areas (Table 3). This source also gives data for secondary and tertiary employment in the rural sector. For 2005, the most recent year for which data is available (from the 2006 *Rural Statistical Yearbook*), the sum of the three sectors no longer agrees with the revised number for total rural employment published in the 2008 *Statistical Yearbook*: the sum of the components is 3.9% (19 million) lower than the revised total figure.

Interpretation of the data

China is not alone in having two basic sources for urban employment data. The United States has a similar structure of household and employer-based data. There, as well as in China, considerable effort is put into explaining why the two sources sometimes show different movements. In the case of China, the difference between the labour force survey and employer-based estimates amounted to 57 million in 1998 (26% of survey-based employment) and rose to a peak of 102 million in 2004. Since then the difference has stabilised and by 2008 it had dropped to 95 million, but this still represented 31% of total employment. It has sometimes been suggested that this gap indicates a growing informalisation of employment in urban areas (OECD, 2007, Cai *et al.*, 2009).

One reason for the size of the gap, if not its growth, is that the Chinese urban economy still has a substantial agricultural sector and estimates of the agricultural labour force in urban areas vary considerably across sources. Urban development has tended to sprawl and includes areas that are predominately rural. As a result, the areas considered as urban are large, even with the more realistic definitions of the urban geographic sector adopted by the NBS in 2006. The size of the agricultural sector in urban areas varies across the country, but amongst the 53 metropolitan areas identified by the OECD, only two have an agricultural share of below 10% and a further 13 have agricultural shares of between 10% and 30%.

Table 2. Estimates of urban employment by sector
Millions

	Total	Agriculture	Other workers	Registered self employment	Employees					
					Total	Private sector	State units			
							Total	Industrial	Services	Government
1998	216.2	25.5	31.5	22.6	136.6	46.0	90.6	34.3	24.1	32.2
1999	224.1	28.6	39.8	24.1	131.6	45.9	85.7	30.4	23.1	32.3
2000	231.5	32.4	49.2	21.4	128.5	47.5	81.0	26.7	22.0	32.4
2001	239.4	40.6	51.0	21.3	126.5	50.1	76.4	23.7	20.4	32.3
2002	247.8	48.8	47.6	22.7	128.7	57.1	71.6	21.6	18.2	31.8
2003	256.4	52.9	46.2	23.8	133.5	64.8	68.8	19.5	17.4	31.9
2004	264.8	46.7	53.5	25.2	139.3	72.2	67.1	18.0	17.0	32.2
2005	273.3	39.9	58.8	27.8	146.8	82.0	64.9	17.1	15.1	32.7
2006	283.1	38.3	60.3	30.1	154.4	90.1	64.3	16.4	14.7	33.1
2007	293.5	37.0	59.6	33.1	163.8	99.6	64.2	16.0	13.7	34.6
2008	302.1	36.0	59.0	36.1	171.0	106.5	64.5	15.5	13.1	35.8

Source: Rural Statistical Yearbook, China Statistical Yearbook and CEIC.

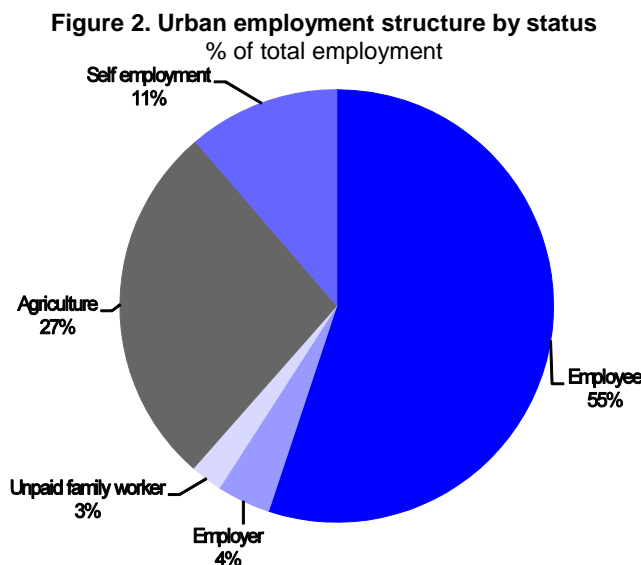
Two separate sources give different results for agricultural employment in urban areas. The labour force survey shows it at 27% of urban employment (Figure 2). However, if the figure for the amount of primary sector employment in rural areas is taken as correct, then the difference between rural and national agricultural employment represents the urban agricultural workforce. This would suggest that only 13% of the urban workforce is in agriculture – a difference of 38 million workers.

Table 3. Rural employment
Millions

	Total	Agriculture	Non-state enterprises	Government	State enterprises	Self-employment
1998	490.2	326.3	117.7	5.1	2.6	38.6
1999	489.8	329.1	115.1	5.1	2.3	38.3
2000	489.3	328.0	124.9	5.1	2.0	29.3
2001	490.9	324.5	133.2	5.1	1.8	26.3
2002	489.6	319.9	138.3	5.0	1.6	24.7
2003	487.9	312.6	146.2	5.0	1.5	22.6
2004	487.2	306.0	154.2	5.1	1.3	20.7
2005	484.9	299.8	157.5	5.2	1.3	21.2
2006	480.9	287.3	165.6	5.2	1.2	21.5
2007	476.4	277.5	170.4	5.5	1.2	21.9
2008	472.7	270.5	173.1	5.7	1.2	22.3

Source: Rural Statistical Yearbook, China Statistical Yearbook and CEIC and OECD estimates.

Another reason for the big gap may be an under-estimate of the self-employed in the official figures. The latter showed only 30 million as registered self-employed in 2006. The labour force survey showed the total of self-employed employers and unpaid family workers at 50 million – a difference of 20 million.



Source: Population and Labour Statistical Yearbook (2007).

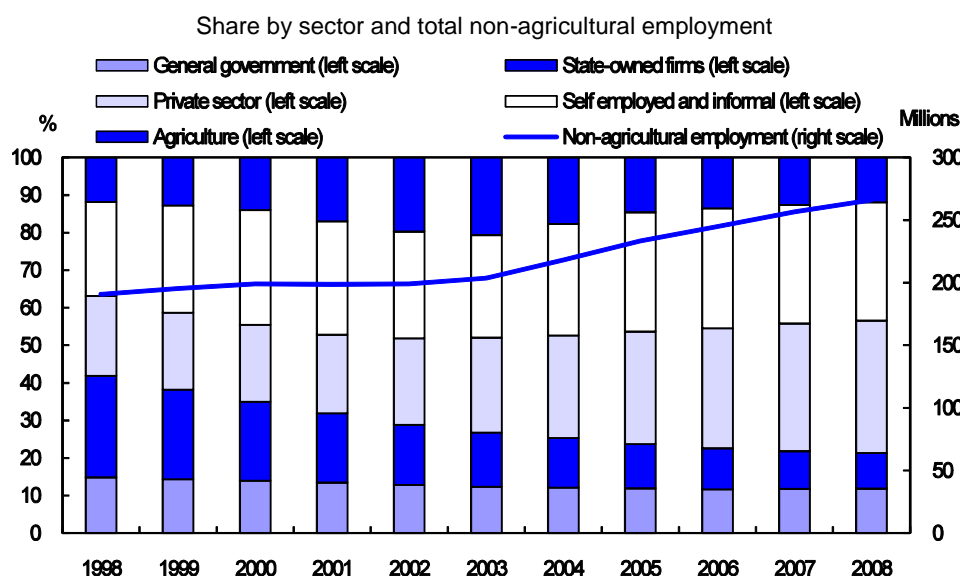
By contrast, the estimates of employees in the employer and labour force surveys are in close agreement. The employer survey gives a total of 154 million employees in 2006, as against 156 million for the labour force survey – a difference of only 2 million. Thus, unmeasured employment in small businesses could account for only a tiny portion of the gap.

In sum, the main explanation of the missing employment would appear to lie in an undercount of agriculture in urban areas and a much smaller undercount of the self-employed, rather than in a large informal economy. In any event, the size of the difference between the employer and household survey based measures of employment in urban areas as been constant over the past four years and should not be taken as a measure of the evolution of the informal economy.

8. The stress in the labour market as a result of SOE restructuring was clearly evident in the availability of urban jobs. The number of employees in state-controlled work units fell by over 14 million between 1998 and 2003 – a 25% downsizing of state-controlled commercial enterprises (*i.e.* excluding government employment, which remained stable). Some of those who lost their job may have returned to local agriculture (which expanded) or joined the growing number of unregistered self-employed (Table 2). Private enterprise employment did not increase much and, insofar as it did, this may have partly reflected companies moving from the state to the private sector. As a result non-agricultural employment stagnated in this period. In the next four years, the downsizing of urban SOEs continued, but far more slowly, with less than one million jobs lost per year. Private sector employment rose markedly, by nearly 9 million jobs per year (Figure 3). Only 2 million of these were in the export area dominated by companies owned by foreigners or residents of Hong Kong, Macau and Taiwan. The remainder were created by domestic privately-controlled companies – either privately registered companies or various forms of shareholding companies.

9. In rural areas, employment remains predominantly agricultural but enterprise employment has been growing rapidly (in this paper, rural and agricultural refer to the actual employment or geographic status of the people concerned and not to their status under the population registration system). In the first half of the decade, total rural employment remained stable, with some movement out of agriculture into

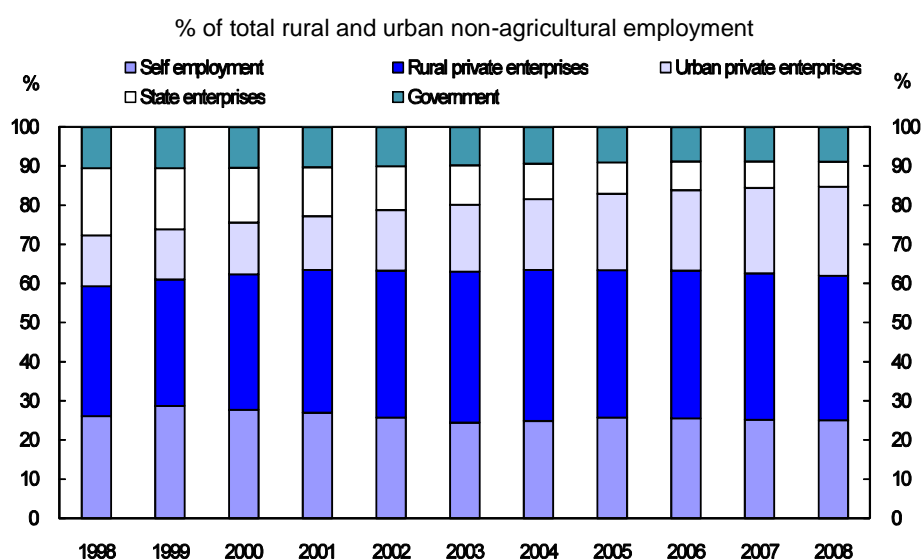
Figure 3. Urban employment



Source: OECD estimates.

rural enterprises, which by 2003 were essentially all privately owned (except for a small state enterprise sector). These enterprises continue to be registered with township governments and village collectives and are hence sometimes referred to as “township and village enterprises”, a label that referred to a completely different structure in the 1980s. During 1998-2003, nascent enterprises in the rural private sector created 30 million jobs, as against 18 million for their urban counterparts. Since then, the latter have moved ahead but they still provide a smaller portion of overall employment.

Figure 4. Composition of non-agricultural employment



Source: China Statistical Yearbook and CEIC.

10. Overall, the share of the private sector in total non-agricultural employment has increased over the decade to 2008 (Figure 4). The state-enterprise sector now accounts for less than 7% of total non-agricultural employment, down by nearly 10 percentage points. At the same time, the share of employment in the government sector has declined and by 2008 the public sector accounted for only 15% of total non-agricultural employment, against 27% a decade earlier. Most of this transformation occurred in urban areas, where public sector employment fell from half of total non agricultural employment to one quarter.

The impact of the business cycle on the labour market

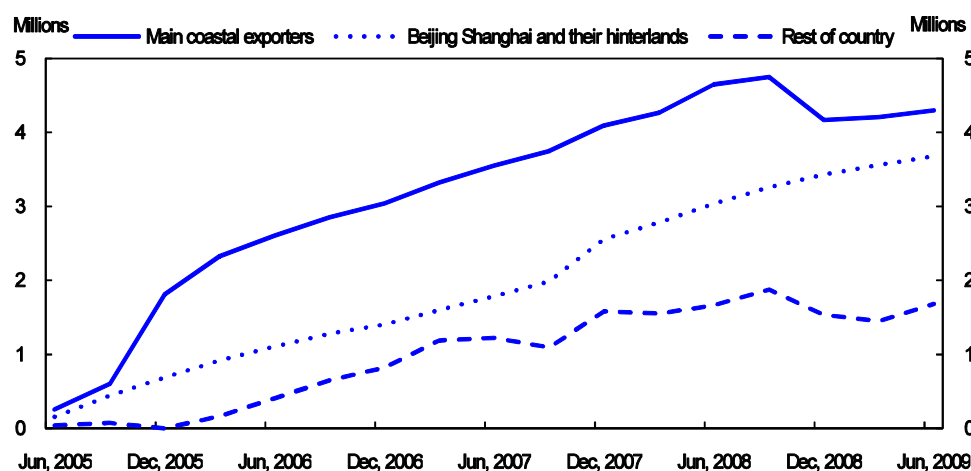
11. The impact on employment of the recent economic cycle varied considerably across the country. At least three different areas can be distinguished: the major coastal areas, most exposed to foreign trade and where exports generally exceed half of provincial GDP; the areas including and surrounding Beijing and Shanghai, which encompass the provinces of Hebei and Zhenjiang, as well as the provincial city of Tianjin; and finally the rest of the country – which could be split further into areas that are major suppliers of migrants to the rest of the country and the remainder. The exporting regions offer easier access to migrants even if becoming an official migrant is difficult, whereas in the three provincial cities (Beijing, Tianjin and Shanghai) there are very strict restrictions on obtaining official migrant status (see below). In the rest of the country, there are effective barriers to leaving officially (in that land rights are lost), while unofficial migrants are often forced to leave families behind while they seek work, given the discrimination they face in obtaining basic public services in the areas to which they move.

12. During the upswing, employment grew most rapidly in the coastal areas (Figure 5), rising by nearly 5 million between 2005 and 2008 (excluding private-sector employees). It also grew rapidly in the main metropolis areas and their hinterlands. By contrast, employment in the rest of the country expanded very slowly, by less than 1% annually for a cumulative increase of under 2 million.

13. The downturn hit the exporting areas first. Employment in the coastal exporting provinces fell by at least 2% (the quarterly data do not cover registered private companies, which may react most vigorously to changes in output, although they do cover foreign-owned firms, which are major employers of unofficial migrant labour). In these regions, employers showed some reluctance to hire from late 2007, notably in Guangdong – well before the downturn in world markets. Possibly, this reflected the anticipated costs of the new labour laws, whose content was then well-known (see below). The abruptness of the downturn caused the departure of 70 million unofficial migrant workers (about one third of the total, including those working within their township's own geographical area but not in their own village). Most of these left in November and December, ahead of the usual Chinese New Year movement (National Bureau of Statistics, 2009). At the time it was estimated that 20 million migrant workers were unemployed. While employment dropped outside the main metropolises, they themselves were largely unaffected by the crisis. The fall was short-lived, however, and employment has been rising since the beginning of 2009 in all three types of regions. As far as migrant workers were concerned, government reports suggest that by August 2009, 67 million of those who returned home in late 2008 had gone back to cities and the total number of unofficial migrants in cities had risen to 147 million by June 2009. Their unemployment rate was estimated at only 3%, well below the 4.3% for local residents (Wang, 2009).

Figure 5. Absolute growth in employment by regions

Millions (excludes employees of registered private enterprises), from June 2005



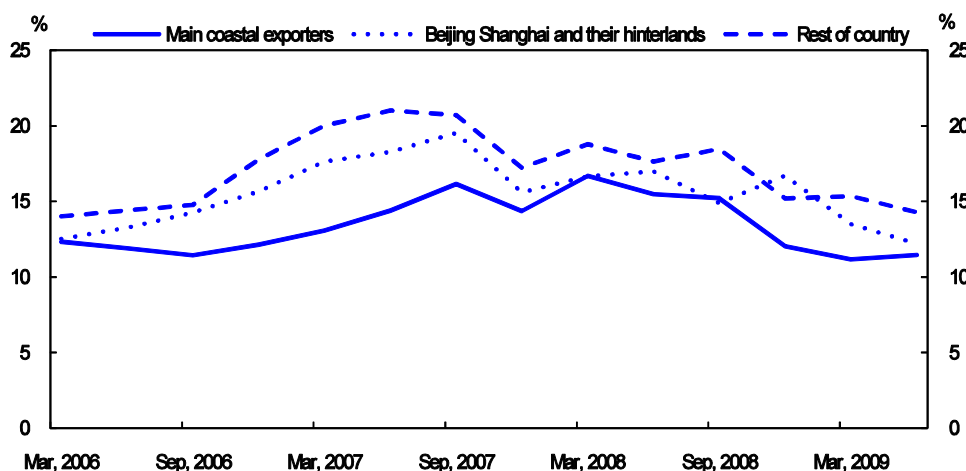
Source: CEIC.

14. Regional labour market differences are also reflected in earnings (Figure 6). The rapidly growing coastal area, with the most open labour markets, saw the least rapid growth in earnings throughout the business cycle. Labour inflows kept down wage growth during the upswing and, when employment fell, the coastal regions experienced the sharpest slowdown in earnings. Earnings growth in the major metropolises, with the strictest controls over labour, was faster. However, earnings grew most in the interior of the country. There employment growth was limited, and labour outflows ensured that wages grew rapidly. Indeed, in the five years to June 2009, the wage differential (excluding domestic private sector employees) between the urban coastal and interior areas fell from 45% to 27%. This supports the view that migration is creating a much wider labour market and helps narrow wage dispersion (Cai *et al.*, 2007).

15. The government has taken measures to deal with the rise in unemployment amongst migrants. It announced a special programme to increase vocational training for migrant workers, college graduates and laid-off workers in 2009-10 with the objective of providing unemployed migrants with new skills to help them find better jobs or open businesses in their hometowns. Unemployed migrants will also receive central government subsidies to encourage them to take training. This programme will come in addition to those in force in 2008, when about 4 million laid-off workers attended vocational training.

Figure 6. Growth of average earnings by region

(Excludes employees in registered private firms)



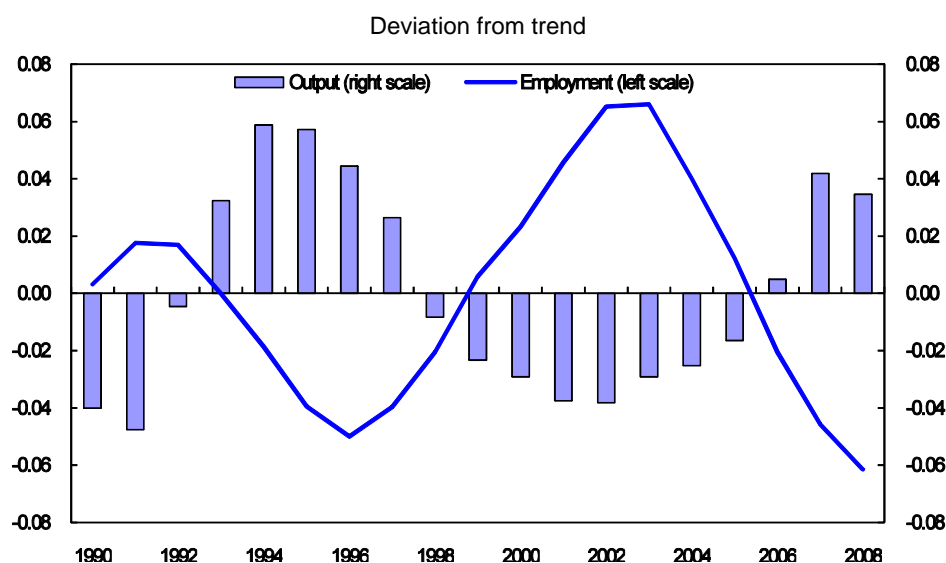
1. The main coastal exports areas are Fujian, Guangdong, Jiangsu and Shandong. The hinterlands of Beijing and Shanghai are Hebei, Tianjin and Zhejiang.

Source: CEIC.

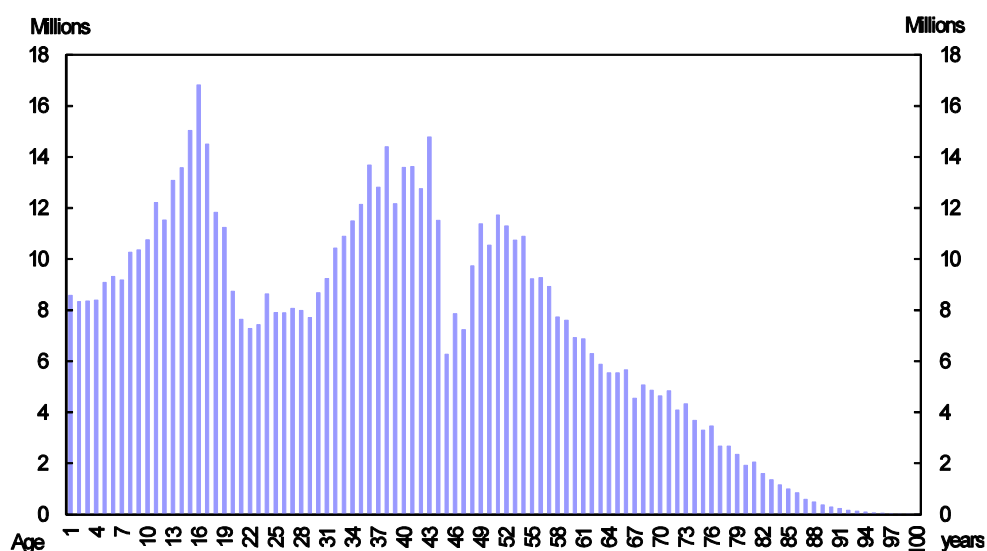
Prospects for continued migration

16. The agricultural sector is still very large, at about 40% of employment, down from 50% two decades ago. The fall in agricultural employment has been modest, with a trend decline of less than 1.5% per year. In years of high demand in the non-agricultural sectors more labour was drawn out of agriculture and the reverse happened when the rest of the economy was more depressed (Figure 7). This suggests that it may take another decade for the share of labour in agriculture to fall to 25%. In Japan, it was only when farming employment fell to this level that the wages of people moving from farms to cities started to take off rather than remaining at a subsistence level (Minami, 1968).

17. However, the availability of labour to move to new employment is determined not only by the exodus from agriculture but also by the natural increase of the rural population. Indeed, the shortage of migrant labour during the upswing, appearing first in 2004, may have been driven by short-term demographic developments, reflecting the very small size of the 18-22 age cohort (Figure 8). The cohort born between 1958 and 1961, visible in Figure 8 as those aged around age 45 in 2005, was particularly small due the rural famines during the “Great Leap Forward”. Thus the number of children born 20 years later, in the early 1980s, was small relative to surrounding cohorts. Family planning regulations also eased in the early 1980s, causing a wedding boom that explains the relatively large size of the cohorts entering the labour market in the period to 2015 (Figure 8). This 18-25 age-group is most in demand by exporting companies in coastal areas. This demographic factor, coupled with the reduction in the agricultural labour force, suggests that, contrary to what Cai *et al.* (2009) argue, the Chinese economy has not yet reached a Lewisian turning point when the demand for rural labour would exceed supply, ending the elastic supply of rural workers at the subsistence wage (Lewis, 1958). The key for further urbanisation would seem to lie in migration continuing to contribute to the growth of urban areas and raising incomes in rural areas.

Figure 7. Deviation of agricultural employment and non-agricultural GDP from trend

Source: OECD estimates.

Figure 8. Rural population in 2005 by single year age groups

Source: Tabulations of the 2005 Sample Census, China Data Online.

18. Internal migration in China does appear to offer such a “win-win”. Individuals generally see a three-fold increase in their average income when they move. And when employment in agriculture (or the primary sector) falls, the productivity, and hence incomes, of those who remain rises. A number of reasons may explain this: higher incomes may increase rural saving and investment and so boost agricultural productivity; land holdings may be consolidated, generating economies of scale; and the fall in employment may be concentrated amongst the elderly, whose continued activity had a mainly social aspect in three-generation households.

19. The gap between the level of productivity in the primary sector and the rest of the economy is still large, at almost six times. In most of the OECD countries, average productivity in the primary sector is

similar to that in the rest of the economy. Only in some (Austria, Greece, Ireland, Japan, Korea, Poland, Portugal and Switzerland) does agricultural productivity remain much lower. A further marked fall in agricultural employment and re-organisation of the agricultural sector would be needed to narrow the productivity differential in China. By implication, the flow of labour out of agriculture, and the movement to urban areas, still has a long way to go, provided that policies to improve living standards in rural areas do not result in protection and subsidies for farmers and the agricultural sector.

Unofficial migrants in the urban labour market

20. The estimates of the number of migrants vary considerably (Box 3) and many focus on the totality rather than the subset of most concern to policy makers: rural migrants who have moved to urban areas without obtaining official residential status there. The 2005 Census allows for a more accurate estimate of this category because it distinguishes the geographic origin of the people living in a given area without a local *hukou* (registration, see Box 4). However, even the 2005 Census data may be inaccurate because migrants are probably more difficult to count than the general population and hence the factors used to scale up the sample numbers to the national level may be incorrect. Bearing in mind this possible source of error, the total number of rural-to-urban migrants without a local *hukou* is estimated at just below 74 million, of which 62 million are active in the labour market using the 2000 activity rates of unofficial migrants (Table 4). People who move from one city to another may also be unofficial migrants. In fact, there are almost as many of this type of unofficial migrants (53 million) as unofficial rural migrants. In urban areas, unofficial migrants represented 80% of workers in construction and 68% in manufacturing (Research Office Project Team, 2006). By 2005, unofficial migrants in urban areas represented 39% of the urban labour force and nearly 46% of non-agricultural employment.

21. New arrivals in the urban labour market appear to face some discrimination. People born in rural areas but living in urban areas are much less likely to work in public sector jobs. Over half of locally-born residents work in either the government or SOEs (Table 7, top panel). Nearly all unofficial migrants work in the private sector and are over-represented in services and manufacturing, whereas the locally-born workers are mainly in professional or technical jobs (Table 7, bottom panel). This contrast may partly reflect differences in education: less than 2% of migrants have tertiary education qualifications against 22% for local inhabitants.

Table 4. Origin and destination of unofficial migrants: population and employment
2005

	Coming from urban areas	Coming from rural areas	Total
Absolute number (millions)			
Population			
Living in urban areas	52.6	73.6	126.3
Living in rural areas	5.2	18.1	23.4
Total	57.9	91.8	149.6
Employment			
Living in urban areas	45.2	61.7	106.9
Living in rural areas	4.9	15.0	19.9
Total	50.1	76.7	126.8
As % of population or employment living in an area			
Population			
Living in urban areas	13.1	22.5	9.4
Living in rural areas	2.4	3.1	0.7
Total	7.0	11.4	4.4
Employment			
Living in urban areas	16.5	22.6	39.1
Living in rural areas	1.0	3.1	4.1
Total	6.6	10.1	16.7

Source: Tabulations of 1% sample census Chinadataonline, employment rate from 2000 Census, as quoted in Fan (2008).

Box 3. Alternative measures of rural migration

Some estimates suggest that the number of unofficial rural migrants is larger than indicated by the Census. In 2005, the Rural Migrant Survey showed the total number of rural migrants at almost 126 million (Table 5). The Census showed nearly 74 million unofficial rural migrants in urban areas and a further 16 million in rural areas (a total of 92 million). The Census and the Survey only count a person as a migrant if he or she has moved from his village and also outside the administrative area of his township. A large number of short-distance migrants are not counted in this figure, with some estimates putting this figure at 70 million. One factor behind the difference is that the Census only counts people as migrants after a six-month stay in an urban area, whereas the Survey counts people as migrants after one month's absence and relies on third-party replies as to whether a person is a migrant. The Census gives the best picture of migration in urban areas. The Survey, however, is the only source for the year-to-year movement in the number of unofficial rural migrants.

In comparing the two series and trying to determine the number of migrant workers, it is first necessary to subtract those family members who are not workers, then to focus on those who move to urban areas (80% of the total) and finally to make an assumption about the proportion of workers who are in urban areas for less than six months. After such calculations, the difference in the number of migrant workers largely disappears. The Census and Survey both show a number of unofficial rural migrant workers in urban areas of between 60 and 65 million in 2005, around 23% of total urban employment in 2005. Between 2005 and 2008, the number of migrant workers in urban areas appears to have increased by 2.5 million per year.

Table 5. Unofficial migrants: reconciliation of Census and Rural Survey data

	Based on Rural Survey					Based on 2005 Census			
	Actual Rural migrants includes family members	Estimates				Share of urban employment	Estimates		Actual Urban employment
		Migrant family members	Migrant workers	to urban areas ¹	Over six months ²		Working in urban areas ³	Share of urban employment	
		Millions				%	Millions	%	Millions
2000	101.2	22.7	78.5	63.1	50.5	23.7	48.7	22.9	212.7
2001	108.3	24.3	84.0	67.5	54.0	22.6	52.1	21.8	239.4
2002	104.7	23.5	81.2	65.3	52.2	21.1	50.3	20.3	247.8
2003	113.9	24.3	89.6	72.0	57.6	22.5	55.6	21.7	256.4
2004	118.2	24.7	93.5	75.2	60.2	22.7	58.0	21.9	264.8
2005	125.8	26.3	99.5	80.0	64.0	23.4	61.7	22.6	273.3
2006	132.1	27.6	104.5	84.0	67.2	23.7	64.8	22.9	283.1
2007	136.5	28.5	108.0	86.8	69.4	23.7	66.9	22.8	293.5
2008	140.4	29.3	111.1	89.3	71.4	23.6	68.9	22.8	302.1

1. Assumes 80% of migrants go to urban areas, in line with data from 2005 Census.
2. Assumes that 85.8% of migrants are in urban areas for more than six months (Cai *et al.*, 2009).
3. Moves in line with the series based on the Rural Survey.

Source: Rural Migrant Survey, National Bureau of Statistics; Sample tables of 1% Census 2005, from Chinadataonline.

Box 4. The *hukou* system

The *hukou* registration system was introduced in the 1950s as a part of centrally-planned labour allocation. Policy was aimed at keeping as many people in farming as possible, in order to maximise food production for the towns. Movement from rural areas to towns was almost impossible. Central government authorisation was necessary and limited to about 0.2% of the population per year. If a person did move despite these barriers, he or she would be unable to obtain a local ration card to buy food. By 1984, migration to cities was allowed provided the individual brought his own food from the countryside. Since then, the *hukou* system has gradually evolved.

The *hukou* system involves a twofold categorisation of a person. First, the person is classified as having an agricultural or non-agricultural status, and then according to location. Thus, in any city a person may carry one of at least four types of *hukou*: local agricultural or non-agricultural (even urban cities can have residents with agricultural status) and non-local agricultural or non-agricultural. Sometimes the agricultural and non-agricultural *hukous* are referred to as urban and rural *hukous*. Such classifications are misleading because the words urban and rural are attributes of a locality. Thus, a person in city with an urban *hukou* from another urban locality would be treated differently from a local urban *hukou* holder.

In the 1990s, a number of provinces started to abolish the distinction between the agricultural and non-agricultural *hukous* within individual jurisdictions. Moreover, they abolished the annual quota for changing from agricultural to non-agricultural *hukou*. By 2005, the Ministry of Public Security announced that 11 provinces had been chosen to act as trial areas in this process; subsequently the number of provinces was raised to 13. No official figures are available on the extent to which this has happened. Press reports suggest that the merging of the two *hukous* has occurred mainly in areas that are heavily urbanised such as the Shijingshan district of Beijing or in urbanised areas of the Pearl River Delta where there has been some resistance to losing a non-agricultural *hukou* because it would entail losing one's share of the income from the developed and urbanised land belonging to the inhabitants of the village.

In smaller towns, the barriers to obtaining a local urban *hukou* were greatly eased starting in 1998 (Reutersward, 2005). The principal conditions for obtaining a local *hukou* in these areas are that the individual has a stable source of income and adequate housing. The interpretation of these conditions varies according to localities. Typically, they require one or two years contractual employment. Sometimes only contracts from SOEs are accepted, together with evidence of a fixed and legal residence. Even in small cities, these conditions are not easy to meet for migrant workers. Few of them have a long-term labour contract (see above) and even fewer work for SOEs. As to the accommodation condition, most do not live in normal housing (see above). Perhaps as a result of these limitations, only 1.4 million new *hukous* were granted in the first five years of the policy (Chan and Buckingham, 2008). The relaxation, moreover, took place nearly entirely in inland and western areas (Table 6). In Guangdong, the government has only recently announced that conversion of migrant to local *hukous* may be undertaken in the next few years. On top of these conditions, non-local *hukou* holders are required to surrender all land-use rights in their village of origin (Chan and Zhang, 1999).

Table 6. Severity of restrictions for obtaining a local *hukou*

	Population in areas (millions), 2004		
	Whole country	Eastern and Coastal	Rest of country
Tightest	13.7	13.0	0.7
Very tight	36.2	25.5	10.7
Tight	19.6	16.5	3.1
Medium	29.5	29.5	0.0
Controlled	95.1	95.1	0.0
Minimal	206.9	0.0	206.9
Urban population	401.0	179.6	221.4

Source: Wang (2005).

In larger towns the possibility for a migrant to obtain a local *hukou* still remains practically nil. In 20 years, 30 million migrants have worked in Shenzhen and yet until 2004 only one had obtained a local *hukou* (IHLO, 2004). The city has given 70 000 urban *hukous* per year between 2000 and 2007, mainly on the basis of education, skills and capital, for an annual inflow of 875 000 rural migrant workers. The average rural migrant thus has little chance of gaining a local *hukou* from the city. It imposes the requirement of a high level of education and a reasonable quality local residence, qualifications that rural migrants would have difficulty in meeting. Many other cities offer local *hukous* on the basis of the investment that the newcomer will make in the local economy. Shenzhen is now considering relaxing these criteria but would still require a five-year residency, ownership of property and an employment contract.

Table 7. Sector and occupational status of urban workers

2005

Sectoral status	Total			With contract			No contract		
	Local	Unofficial rural migrant	Unofficial urban migrant	Local	Unofficial rural migrant	Unofficial urban migrant	Local	Unofficial rural migrant	Unofficial urban migrant
Public sector	0.52	0.05	0.15	0.67	0.06	0.23	0.47	0.05	0.11
Government	0.26	0.01	0.05	0.28	0.01	0.07	0.34	0.01	0.04
State-owned enterprise	0.26	0.04	0.1	0.39	0.05	0.16	0.13	0.04	0.07
Private sector	0.47	0.94	0.86	0.33	0.94	0.78	0.54	0.95	0.90
Collective enterprise	0.05	0.03	0.04	0.06	0.05	0.05	0.06	0.03	0.05
Family business	0.19	0.35	0.35	0.07	0.22	0.21	0.15	0.28	0.27
Private enterprise	0.12	0.34	0.32	0.10	0.36	0.33	0.23	0.47	0.45
Other work unit	0.04	0.13	0.1	0.04	0.26	0.16	0.04	0.10	0.08
Others	0.07	0.09	0.05	0.06	0.05	0.03	0.06	0.07	0.05

Occupation status	Total			With contract			No contract		
	Local	Unofficial rural migrant	Unofficial urban migrant	Local	Unofficial rural migrant	Unofficial urban migrant	Local	Unofficial rural migrant	Unofficial urban migrant
White collar	0.42	0.07	0.30	0.49	0.11	0.41	0.44	0.06	0.23
Manager or official	0.04	0.02	0.06	0.05	0.03	0.1	0.04	0.01	0.02
Professional or technical	0.23	0.02	0.15	0.28	0.03	0.19	0.23	0.02	0.13
Administrative	0.15	0.03	0.09	0.16	0.05	0.12	0.17	0.03	0.08
Blue collar	0.57	0.92	0.71	0.51	0.89	0.59	0.57	0.93	0.76
Servicea	0.26	0.34	0.45	0.18	0.25	0.33	0.27	0.29	0.47
Farming	0.04	0.02	0.01	0.06	0.04	0.01	0.02	0.01	0.00
Manufacturing, transport, etc.	0.27	0.56	0.25	0.27	0.60	0.25	0.28	0.63	0.29

Source: 5% random drawing of the 2005 1% Census in Gagnon *et al.* (2009).

22. Most migrants work in the flexible sector of the labour market. A significant portion of them are self-employed. Moreover, when they work in factories or services they are likely not to have signed labour contracts. Overall, nearly half of all migrants do not have a wage contract and this proportion rises to three-quarters for those who are employees (Table 8). Hardly any have a long-term contract. Overall in 2005, the share of rural migrants in self-employment, with short contracts or no employment contract, at 91%, is 30 percentage points higher than that for local inhabitants. Even migrants with higher levels of education are still much more likely to have short-term contracts than their official resident counterparts.

23. Using a slightly different definition of the flexible labour force that is restricted to the self-employed and those with no labour contract, Cai *et al.* (2009) find that the extent of flexible employment increases with age for unofficial rural migrants but follows a U-shaped curve for other groups (Table 9). Not surprisingly, informality decreases as the education level of an individual increases.

Table 8. Employment status and earnings of urban workers

2005

	Contract status			Monthly earnings			Hourly earnings		
	Local	Unofficial rural migrant	Unofficial urban migrant	Local	Unofficial rural migrant	Unofficial urban migrant	Local	Unofficial rural migrant	Unofficial urban migrant
	Share of total			CNY per month			CNY per hour		
Employer	0.03	0.05	0.09	-	-	-	-	-	-
Household worker	0.02	0.03	0.03	-	-	-	-	-	-
All below	0.95	0.92	0.88	1 058	973	1 527	6.12	4.61	8.25
Self-employed	0.13	0.19	0.17	848	982	1 231	4.23	4.57	6.11
All employees with contract	0.51	0.26	0.38	1 188	1 100	1 905	7.04	5.38	10.62
All employees	0.82	0.73	0.71	1 079	958	1 542	6.24	4.80	8.87
Long-term contract	0.34	0.01	0.07	-	-	-	-	-	-
Flexible	0.48	0.72	0.64	-	-	-	-	-	-
Short-term contract	0.17	0.25	0.31	-	-	-	-	-	-
No contract	0.31	0.47	0.33	902	878	1 133	5.19	4.07	5.92

Source: 5% random drawing of the 2005 1% Census in Gagnon *et al.* (2009).

Table 9. The extent of flexibility in the employment of urban workers

2005, non-agricultural sector, self-employed and employees without contracts

	Rural migrants	Urban migrants	Locally registered people
All	65.4	52.5	52.6
20 and below	59.6	79.8	68.8
21-30	60.2	53.6	51.9
31-40	69.8	51.3	52.5
41-50	74.2	47.5	48.2
51-60	76.6	51.2	51.5
61 and above	78.3	71.3	70.3
Primary	80.0	82.9	81.7
Junior high	65.5	69.2	67.4
Senior high	50.4	35.4	36.8
College	26.0	7.1	8.2
Male	66.5	52.9	53.1
Female	64.0	51.9	51.9

Source: Cai *et al.* (2009) using the 2005 sample census.

24. Sometimes analysis of the Chinese labour market focuses on informality rather than flexibility as defined here. The notion of informality is, however, extremely difficult to circumscribe. The UN/OECD national accounts system focuses on the differences in accounting systems and whether or not more than one person is employed, defining enterprises with independent accounting systems as formal enterprises and the self-employed as informal (ILO, 1993). An additional category of informal workers are those employed by informal enterprises defined either as being below a minimum size or by the absence of registration. Thus by these criteria most Chinese enterprises registered as private or as family firms would be classified as formal. However, the definition of informal employment is even less clear following an amendment to this definition which specified that employees are considered to have informal jobs if their employment relationship is, in law or in practice, not subject to national labour legislation, income

taxation, social protection or entitlement to certain employment benefits or jobs for which labour regulations are not applied, not enforced, or not complied with for any other reason (ILO, 2003). This definition is much wider, and would be difficult to apply to China because it depends on attributes linked to the employee rather than the enterprise. It would include, for example, workers in the urban sector not covered by social security or not covered by minimum wage legislation or without a labour contract (as national law specifies they should have a labour contract). While it might be possible to calculate such a number from census data, it seems better not to amalgamate different categories but to look for a definition that fits the analysis under consideration. Thus non-payment of social security contributions does not make the worker part of the flexible economy; instead, this criterion should be looked at separately.

25. The difference in the choice of employment sectors might be expected to lead to much lower income for unofficial rural migrants but this is not the case, at least for monthly cash earnings. Overall, rural migrants earn only slightly less than local inhabitants (Table 6, second block). Hourly earnings are significantly lower, but migrants work on average six days a week against five for local staff. Unofficial urban migrants, however, earn considerably more than unofficial rural migrants. There is some controversy about whether this difference in hourly earnings reflects discrimination or individual endowments. One view, based on small-scale survey data, is that there is an unexplained negative difference between earnings of rural migrants and local official residents (Cai *et al.*, 2009; Frijters *et al.*, 2009). However, data from the 2005 Census point to similar earnings within a given industry and occupation and for observed personal characteristics (Gagnon *et al.*, 2009). Segmentation does not explain much of the difference in earnings either, though, of course, it does result in differences in social benefits. The same authors, however, find a large unexplainable difference between the earnings of unofficial urban and unofficial rural migrants. It remains to be established whether these differences are the result of deliberate policies. Local government policies may play a role because the extent to which rural migrants are paid less than an efficiency wage varies considerably across cities. In Wuxi, for example, migrants seem to earn what corresponds to their efficiency wage (Frijters *et al.*, 2009).

26. It is not just rural migrants who suffer from differential treatment in urban areas. The barriers to migration mean that even people who live in smaller cities with lower earning opportunities are unable to move to take advantage of higher wages elsewhere. Wage differences across cities in the same province are much higher than in OECD countries (OECD, 2010). These differences cannot be explained by the employees' endowments (Frijters *et al.*, 2009). This suggests that the restrictions on migration associated with the registration system result in significant losses of economic efficiency not just for rural migrants, the usual focus for policy interest, but also for city dwellers who face barriers to moving to other cities (or even across districts within a large city) where their skills would be better rewarded.

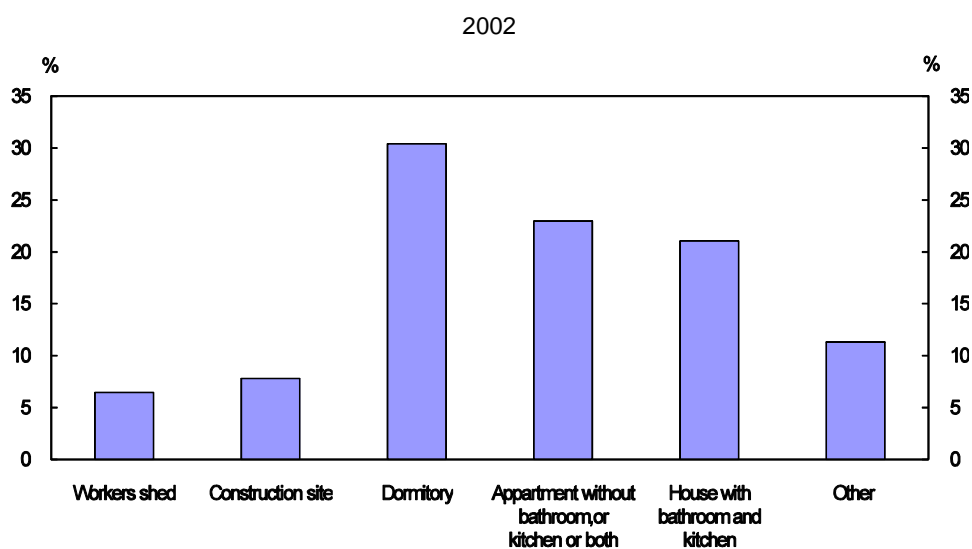
27. Turning to the evolution over time of migrant worker real wages, the Rural Household Survey data suggest that for most of the 2000s, they have risen by around 6% per year. This is markedly less than the growth of wages of all urban workers (Table 8), with migrants' earnings dropping from 71% to 49% of salaried urban workers between 2001 and 2007. The growth of migrant earnings has been almost in line with the growth of rural per capita incomes, at 7% per year in the same period, suggesting that the opportunity cost of migration is important in determining wage levels. On the other hand, factory-level data from Guangdong suggest that much of the real wage gains stems from the improving endowment of migrant workers: for the very lowest skill levels, real wages hardly changed between 2000 and 2004 (Meng and Bai, 2007). This view was supported by the Research Office Project Team (2006). Even then, unofficial rural migrants' earnings in urban areas average over three times the average per capita household income in rural areas (Table 10). This ratio has declined somewhat since 2007, possibly reflecting government efforts to ensure that employers comply with social security obligations, ahead of new labour legislation (see below). Evidence from Shanghai suggests that a one percent increase in the compliance rate induces a fall in wages of 0.3% (Nielsen and Smyth, 2008).

Table 10. Wages of unofficial rural migrants and urban workers

	Migrant worker wages from rural household survey			Rural real household per capita income	Migrants relative to rural inhabitants	All urban workers		
	Nominal wage	Real wage				Nominal wage	Real wage	
	Yuan per month	% change				Yuan per month	% change	
2001	644	644			327	903	903	
2002	659	666	3.4	5.0	319	1 031	1 041	15.3
2003	702	703	5.6	4.3	321	1 164	1 154	10.8
2004	780	756	7.6	6.9	319	1 327	1 285	11.4
2005	861	821	8.7	8.5	317	1 517	1 493	16.2
2006	946	889	8.2	8.6	316	1 738	1 712	14.7
2007	1 060	950	6.9	8.6	294	2 078	1 989	16.1
2008	1 205	1 020	6.7	8.5	297	2 429	2 195	10.7

Source: China Statistical Yearbook and Rural Survey (various years).

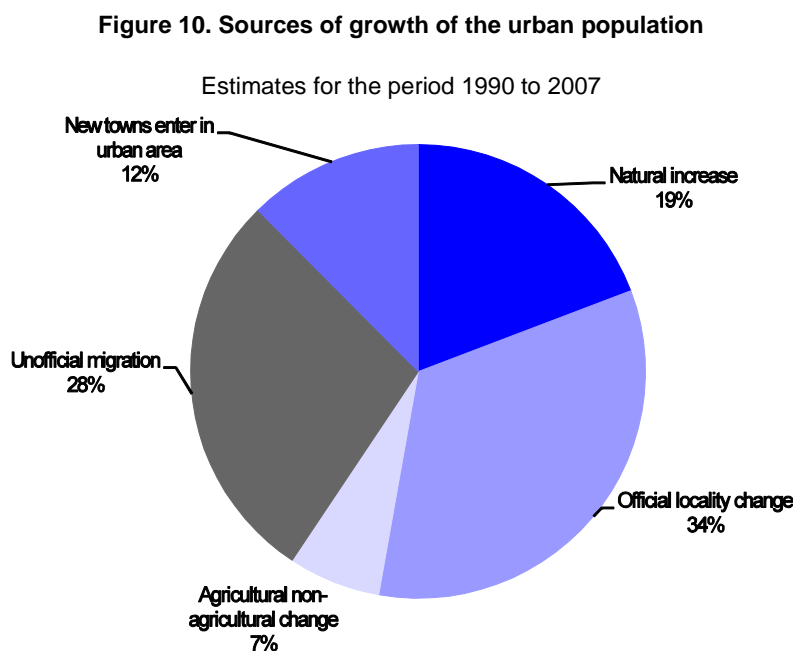
28. A major argument in the official justification of the *hukou* system is the need to avoid the growth of slums, but in reality unofficial migrants already endure poor living conditions. Usually, the reason given for tight restrictions in major cities (such as Beijing, Shanghai, Tianjin, Guangzhou and Wuhan) is that they face tremendous demand for new permits and if they were fulfilled slums would appear (Sun, 2008). But in reality unofficial migrants live in accommodation they can afford. Given their low incomes, this accommodation is of low quality: often they do not even have separate access to their housing, living on work sites or in dormitories (Li, 2008) (Figure 9). Moreover, the median migrant has less than 8 square metres at his disposal.

Figure 9. Living conditions of unofficial rural migrants in urban areas

Source: China Urban Labour Survey in Li (2008).

Official rural migrants in the urban labour market

29. Nearly all discussion of rural-to-urban migration focuses on unofficial migration, but over time official migration from rural to urban areas has been larger. Official conversion from rural to urban status is granted by various government departments and concerns mainly university students, communist party cadres and people leaving the military. The number that obtains such official permission to move is low each year, at 0.7% of the rural population. Over several decades, though, the stock accumulates and had grown to more than 100 million by 2002 (Quheng and Gustafson, 2006). It has been the largest source of increase in the urban population since 1990 (Figure 10).



Source: Urban population 2000 and after, *China Statistical Yearbook* (2008); urban population pre-2000, Shen (2006); official conversion of rural to urban *hukou*, Wu and Treiman (2003); conversion from agricultural to non-agricultural *hukou*, Chan and Hu (2003).

30. Official rural-to-urban migrants are markedly different from unofficial migrants. They are well integrated into the local economy and earn more than the average local resident, provided that they receive their urban *hukou* before the age of five. Later converts have more difficulty integrating. The people who received their *hukou* through a career route integrate better. Those who receive it through other routes (such as spouses who are granted a local *hukou*, rural people who receive a *hukou* in exchange for land or people who buy a *hukou*) fare less well. Given personal characteristics, official rural migrants earn 50% more than unofficial migrants, suggesting that an urban *hukou* is worth about 6.5 years of the average urban earnings. Indeed, in larger cities where *hukous* were sold in the 1990s, their price approached that level, though with a discount reflecting the uncertainty of future income streams.

Barriers facing unofficial migrants

31. Overall, the *hukou* system is still very much in force, acting as a major constraint on migration and hence on urbanisation. The continued use of *hukous* does not mean that there are legal barriers to movement any more. Migrants can now freely register as temporary urban residents and the right of the police to expel unofficial migrants was abolished in 2003. However, the main problem remains: migrants do not have the same social rights as local permanent residents, raising equity as well as efficiency issues.

32. Indeed, household surveys show that the decision to migrate is heavily influenced by social rights. Migrants settling in a nearby county-town can generally access social services. Accordingly, a person living close to a county-town where social services are available is much more likely to migrate there (Lee and Meng, 2009). Equally, the factors that generally inhibit migration (such as the absence of grandparents, the presence of a young child in the absence of a grandparent, higher age, poor health and the presence of an elderly parent) all cease to be significant when the probability of migrating to a nearby county-town with social services is considered. The removal of social service barriers has a much larger impact on female than male migration, presumably because of child care.

Migration as a key to urbanisation

33. China's migration policies restrict the growth of cities. Larger cities generate economies of scale thanks to specialisation, information spillover and clusters. Restricting city size through limiting social services to their inhabitants entails large costs in terms of forgone productivity. Au and Henderson (2006) for instance estimate that a decade ago, more than half of China's prefectural cities were considerably undersized and county-level cities even more so. They estimated that each doubling of city size can add an extra 3–14% to city GDP over and above its proportional increase, through economies of scale and scope, a broadening of the labour market and the clustering of firms. The extent of the loss of productivity in Chinese cities was put in the range of 10 to 35% by Yusuf and Nabeshima (2006), depending on whether the cities were 30% or 50% of the optimum size. Such differences are appreciably greater than the scale differences found in Europe (Combes *et al.*, 2009). Metropolitan areas in China, as defined by Kamal-Chaoui *et al.* (2009), could also increase productivity levels by allowing a quicker reduction in the share of population engaged in agriculture, as these shares are particularly high for the lower-income areas.

New labour laws

34. New labour laws were introduced in 2008 to create a more equal basis for co-operation between employers and employees in a market now dominated by private-sector employers. A minority of workers have been subjected to unjust practices by employers, notably by their refusal to pay wages on time. Long working hours are the norm in many industries, with very limited payments for overtime. Finally, only half of employees hold a written employment contract. The new labour laws are meant to address these problems. Some of them might ease when eventually the excess supply of rural labour dwindles, but this is a longer-term prospect.

General labour legislation and employment protection

35. The 1995 Labour Law covered all employers and employees and required the use of written labour contracts, adherence to social security, payment of wages on time and redundancy payments. In practice, this legislation was not enforced. Only slightly more than half of urban employees had labour contracts in 2005 (Table 11). The situation was much worse in some groups: nine out of ten migrant workers in domestic private companies did not have written contracts and according to Census tabulations, even a large number of government employees did not have written contracts.

36. The work to replace the 1995 Labour Law started just over a year after it was promulgated, when it was clear that it was inadequate in many respects. Work on the law was put to one side during the period of economic restructuring (Karindi, 2008). It came to the fore again with the 2002 White Paper on Labour and Social Security and was given extra emphasis by the new Prime Minister in 2003. An initial draft was proposed in 2004 by the All China Federation of Trade Unions and was the subject of much debate, in which some felt the draft was too extreme and while others thought that the new law should be correct to protect the rights of labour. This debate mirrored the internal debate on the Bankruptcy Law where there was concern by some that creditors were being given precedence over workers. The debate was unusual in

the extent to which foreign opinion was allowed to participate. The debate was real and did result in some toning down of procedures for restructuring of firms, notably replacing the need for agreement with the employees by the need to consult.

Table 11. Employees without contract by type of enterprise

2005

	Total employees			No contract						
	Official urban residents	Un-official rural migrants	Un-official urban migrants	Official urban residents	Un-official rural migrants	Un-official urban migrants	Official urban residents	Un-official rural migrants	Un-official urban migrants	All urban residents
	Millions	Millions	Millions	Per cent						
Public sector	53.9	2.3	4.8	18.4	1.4	1.6	34.2	64.4	34.1	35.3
Government	27.0	0.5	1.6	13.3	0.3	0.6	49.4	64.4	37.2	49.0
State-held enterprise	27.0	1.8	3.2	5.1	1.2	1.0	18.9	64.4	32.5	22.8
Private sector	48.8	42.3	27.6	21.2	27.5	13.4	43.4	65.1	48.6	52.4
Collective enterprise	5.2	1.4	1.3	2.4	0.9	0.7	45.4	64.4	58.1	50.7
Family business	19.7	15.8	11.2	5.9	8.1	4.0	29.8	51.5	35.9	38.6
Private enterprise	12.4	15.3	10.3	9.0	13.6	6.7	72.5	89.0	65.4	77.2
Other work unit	4.1	5.9	3.2	1.6	2.9	1.2	37.8	49.5	37.2	42.8
Others	7.3	4.1	1.6	2.4	2.0	0.7	32.4	50.1	46.5	39.7
Total	102.7	44.6	32.4	39.6	29.0	15.1	38.6	65.0	46.5	46.6

Source: 2005 Sample Census as tabulated by Gagnon *et al.* (2009) and OECD calculations.

37. Three new laws came into force in January 2008:

- The Labour Contract Law makes it mandatory to use written contracts, which can be fixed-term, open-ended or for a specified project. The law instructs the Labour Inspectorate (under labour bureaus at county level and above) to oversee labour contracts and to respond to complaints from workers and trade unions. It also lays down a revised, sharpened and much more detailed version of the employment protection rules that had been briefly outlined in the 1995 Labour Law. In particular, it lays out rules for the payment of wages, sets out payments for terminating a labour contract unilaterally and specifies the conditions under which the contract can be terminated.
- The Law on Arbitration and Mediation in Labour Disputes specifies the procedures workers and trade unions can use to file complaints against employers in the arbitration tribunals or the courts.
- The Employment Promotion Law makes the government responsible for employment and for providing employment services, unemployment insurance, vocational training and active labour market programmes. It also rules out discrimination in employment, notably when it is based on gender, ethnicity, or disability, or on rural versus urban residence.

38. A chief aim of the new laws, and especially the first one, was to promote a formalisation of individual labour relations. Consequently, there might be less need for implementing regulations to ensure that the laws are consistently applied. Nonetheless, implementing regulations have been issued at country, province and city levels.

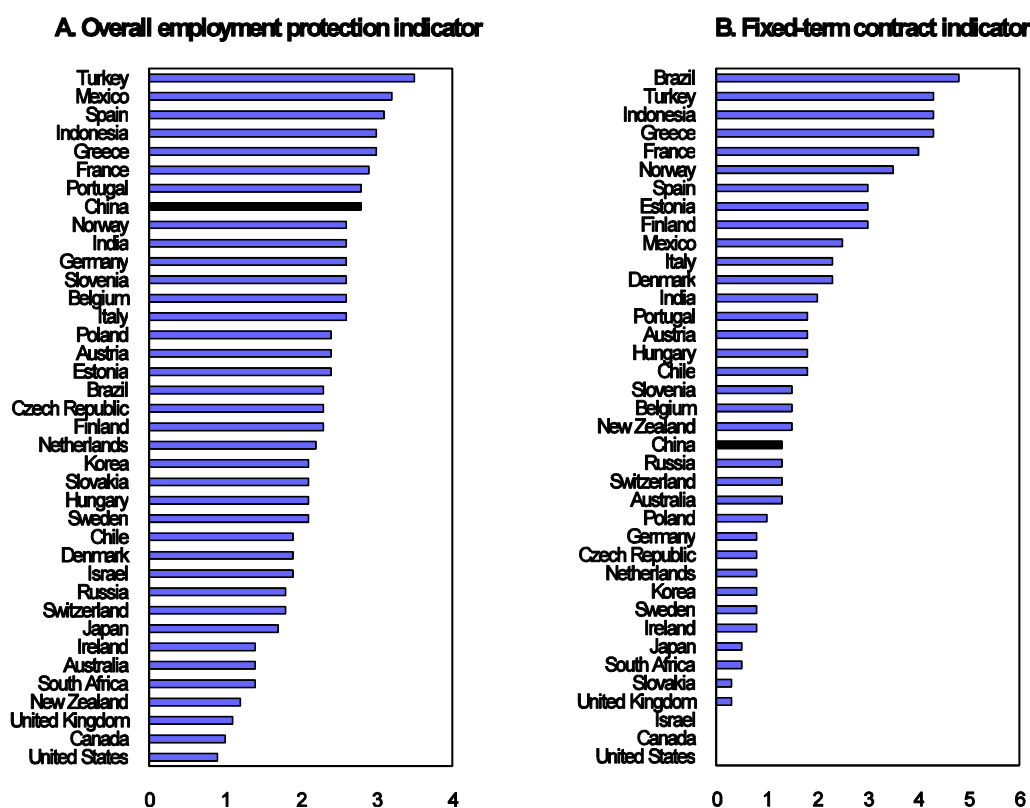
39. The Labour Contract Law makes major steps in improving the ability of workers to ensure that they are actually paid for work that has been undertaken. One of the most important improvements concerns underpayment of wages, which is addressed in two ways. First, broad obligations are imposed on employers to pay employees their remuneration on time, in full and in accordance with their contracts and employment law. Second, the new law prohibits specific strategies that employers have used to reduce their wage bill, such as forced overtime. Penalty rates for overtime must now be paid in accordance with the Labour Law. The new law prohibits bonded labour: an employer may not retain an employee's property or money as security. It also prevents an employer including penalty clauses in employment contracts (Cooney *et al*,2008). If no contract has been signed (as is the case for most private sector employees), the law specifies that after working for one month the person is deemed to have been employed on an indefinite contract.

40. The new law is particularly strict with procedural requirements to consult employees in the event of changes to work conditions and prescribes relatively high severance pay (one monthly wage per year of service, with some limitation for high wages, paid even at the end of fixed-term contracts). Translating this into the overall OECD indicator measuring the strictness of employment protection, China appears in the upper quintile of countries for which the indicator is compiled, along with Mexico, Turkey, Spain, France and Indonesia and only slightly above India (Figure 11, left panel). In the four above emerging economies, employment protection laws have until now been applicable mainly to large enterprises and those in state ownership, as in China until 1998. The Chinese government has emphasised that the current legislation does not represent a return to the pre-1998 regime when employment in SOEs was for life. It has stressed that there are 14 grounds on which an employee's contract can be terminated.

41. The rules governing fixed-term contracts are more liberal by comparison with other countries (Figure 11, right panel). Cumulated job durations for fixed contracts of up to ten years are allowed, though not with more than two consecutive contracts. However, the change in law grandfathered previous employment with companies, requiring some to quickly move their staff to indefinite contracts. The ten-year rule was also in the previous labour law, but not the provision on the number of contracts. The possibility to use fixed-term contracts has facilitated the recruitment of migrants under formal conditions – a result that must be welcomed, although it cannot be excluded that their continued use will maintain the unequal treatment of local residents and unofficial rural migrants.

42. The private sector in China has little experience of indefinite labour contracts, which are almost exclusively found in government employment and SOEs. Nearly all private-sector labour contracts, where they exist, are for fixed terms. In OECD countries, the use of fixed-term contracts tends to be most common where employment protection laws are rigid – *e.g.* in Spain and Portugal, where it has also been associated with an undesirable segmentation of the labour market. Based on this experience, the OECD Reassessed Jobs Strategy recommended that future employment protection law reforms should aim primarily to make open-ended contracts more flexible. China has done the reverse, but without tightening the rules too much for fixed-term contracts. This suggests a desire to avoid placing too much of a burden on the private sector. Overall, the new Contract Law may turn out to be less restrictive than suggested by the overall indicator. Even so, the new law will certainly increase firms' administrative costs. They will need to be much more careful than in the past in documenting the treatment of workers and in separating the contents of labour contracts from the content of workplace regulations that are not covered by the law.

Figure 11. Strictness of employment protection laws
Synthetic OECD indicator, range 0 to 6



Source: Venn (2009).

Enforcement of the new labour laws

43. As in many other countries, the key to the impact of the new law will be enforcement. This has been a weak spot in many areas of legal regulation of the economy, witness social security and the environment. The problems of enforcing law are systemic in China (Box 5) but are aggravated by the fact that there is no freedom of association for workers and all unions are under the All-China Federation of Trade Unions which is, effectively, controlled by the Communist Party.

Box 5. Enforcement of labour laws

The legal architecture

The major laws passed by China's supreme legislative organ, the National People's Congress, are replete with general statements of obligation, the detail of which is usually filled out by national and local administrative regulations and pronouncements. Many agencies have law-making power and legal norms are generated by the State Council, various ministries, provincial congresses, provincial governments as well as municipalities. Although the central government has taken important steps to clarify the relative authority of these legal instruments – notably through the passage of the Legislation Law – in many instances the law remains confusing and contains major gaps (Peerenboom, 2002).

Administrative agencies, such as the Ministry of Human Resources and Social Security (MOHRSS), and the Supreme People's Court have tried to fill some of these gaps by promulgating various rules. In contrast to laws or national regulations imposing an obligation, creating a right or setting out a process to be followed, such documents take the form of a letter issued from the MOHRSS and other agencies to local labour bureaus clarifying aspects of the law. It is unclear to what extent such documents create enforceable obligations.

Furthermore, the clarifying provisions are scattered through a range of legislative instruments, the status of which is not always apparent, meaning they are not readily accessible by the employers who are supposed to comply with them. In short, this legal material reflects a mindset from a period in which most enterprises were related to the state, rather than the current reality where the majority of employees and the overwhelming numbers of enterprises are outside the state-owned sector.

Enforcement

Where they do seek to enforce the law, labour inspectors have fairly weak powers. The penalties that may be imposed by administrative agencies are regulated by the Administrative Punishments Law. It provides for penalties including warnings, correction notices, fines, compensation orders, confiscation, cancellation of business licence, administrative detention and orders directing a firm to cease operations. As these provisions are of growing importance to firms, it should be possible to devise an effective enforcement strategy (Ayres and Braithwaite, 1992). In practice, however, labour departments can only impose the less serious penalties, such as warnings, correction notices, fines and compensation orders. Generally, labour departments cannot order a business to close, confiscate earnings, or detain its proprietor. They must seek the assistance of other state bodies to do so, such as the police. These are more likely to intervene if there is a public disturbance created as a result of a labour violation, rather than to simply enforce labour law.

In the event of non compliance with an order, the powers of enforcement are also weak. The Labour Inspection Regulations empower a labour inspector to order a firm to pay double the amount owed to employees, in the case of arrears or to impose a fine of up to CNY 20 000 (around \$2 500), in case of excessive working hours. These penalties are not particularly severe, but in any case, if the employer continues to refuse to pay, the labour department cannot further increase pressure on him. Furthermore, an employer can attempt to resist the imposition of penalties through litigation under the Administrative Litigation Law.

Dispute resolution

The labour dispute resolution system seems workable on paper but has serious structural flaws (Gallagher, 2005). Labour disputes are treated differently from most other forms of legal disputes in that complainants only have direct access to courts in the case of wage arrears (and only since the new labour law became effective). When a labour dispute occurs, parties may initially invoke intra-firm mediation. However, either party can bypass this process and refer the matter to labour arbitration, which is conducted by labour disputes arbitration committees (LDACs).

The peculiar structure of the labour dispute resolution process advantages wealthier litigants since proceedings can be drawn out (Zheng, 2003). Most complainants face in effect at least two hearings: an initial hearing by the LDAC and then a complete rehearing (not an appeal) by the courts. Further rehearsals by higher-level courts are also possible. The arbitration committee cannot grant an interim order safeguarding an employee's position for example. These provisions contrast with commercial arbitration where the law states that interim orders are available and appeals to the courts against arbitration decisions are permissible only on procedural grounds. It is difficult to enforce arbitration awards, especially outside major cities (Chen, 2002). The courts have divisions responsible for executing judgments, but these are frequently under-resourced and reluctant to use coercive methods.

Another major problem with the labour dispute resolution procedures concerns the institutional arrangements for LDACs. These are notionally tripartite autonomous bodies but in fact they operate as bureaucratic divisions within labour departments, reflecting their establishment when the Chinese economy was much more state-centred and bureaucratic than today (Zheng, 2003).

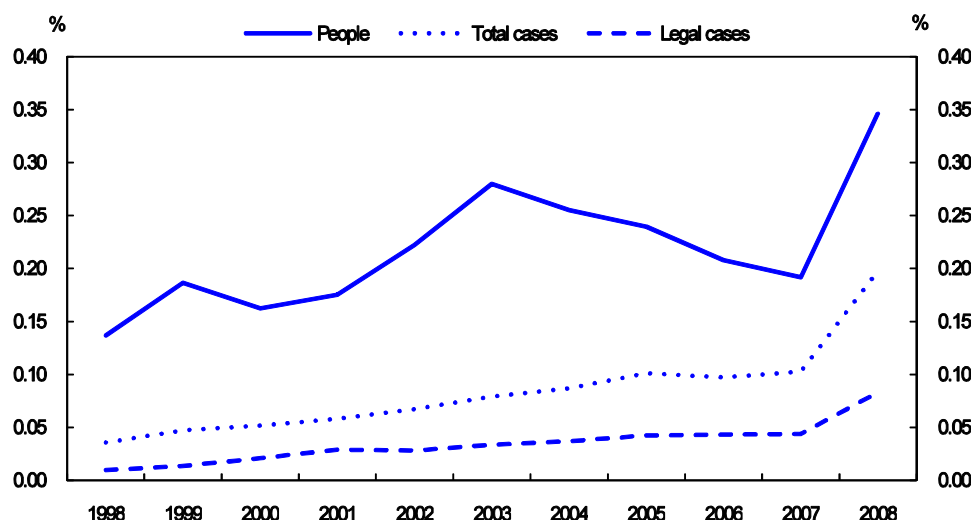
LDACs do not have their own assets or administrative staff, and are usually dominated by government (*i.e.* labour department) representatives. The employer and employee representatives often do not participate in proceedings and are in any case nominees from SOEs or from the state-controlled union. Thus, the distinction between state-initiated enforcement of Labour Law (through the labour inspectorate) and worker-initiated enforcement (through independent dispute resolution) is blurred in practice. One consequence of this lack of institutional autonomy is that LDACs are subject to the same local government and business pressures as labour departments, and there is some evidence to suggest that certain LDACs do indeed favour government and business interests over workers' (Gallagher, 2005).

Source: This box draws extensively on Cooney (2007), with permission.

44. Workers have always been able to demand redress for infringements of labour law through arbitration tribunals. After the enactment of the 1995 Labour Law, the number of cases brought for arbitration tripled between 1996 and 2001. Following the new labour laws, the number of cases almost doubled in 2008 (Figure 12). In 2007, about two-thirds of the cases were linked to pay and social security questions (mainly wage arrears, overtime and failure to enrol an employee in social security). The remaining disputes were mainly about the terms, or non-existence, of a labour contract. Disputes about the employer ending a contact accounted for only 4% of cases. While the number of cases has continued to increase, by 2008 only two cases could be expected annually for each thousand employees. Moreover, most of the cases are settled in mediation although the proportion going to arbitration has increased since few private firms have mediation committees. The majority of cases now concern private-sector firms. On average over the decade to 2007, employees were successful in more than 85% of cases. However, while workers were successful in claims for wages amounting to CNY 6 billion in 2007, only a small portion of the total due was actually repaid to workers in 2007. Overall, enforcement to date has thus been very limited.

Figure 12. The extent of arbitration and mediation claims

Total employees involved, new cases accepted and cases before courts, as percentage of number of employees



Source: Labour Statistical Yearbook (2008).

45. It is still too early to evaluate the impact of the new labour laws. The use of fixed-term contracts still seems the norm. In the first five months of 2009, in Nanjing only 17% of newly recruited workers signed open-ended labour contracts, while 70% signed contracts exceeding one year. In the past, labour contracts of one year or less accounted for 90% of all contracts (Diao, 2009). In the area of social security, the number of participants in the basic pension scheme rose by 11% in the 18 months ending June 2009, a substantial increase in coverage due in part to the signing of new labour contracts that clearly indicate that an individual must be enrolled in social security. A survey of 300 workers in Shenzhen suggested that large employers with over 1000 workers were signing contracts with nearly all of their employees, but only half of the employees of smaller domestically-owned companies had contracts and these employers used many devices to lessen the impact of the contracts when they were signed (Dagongzhe Migrant Worker Centre, 2009).

46. The new law was meant to lessen the incidence of wage arrears, where employers await the end of a contract before paying outstanding wages. At end 2008, 5.8% of migrant workers were owed wages, ranging from 4.4% of those who were returning to the same job to 13% for those whose firms had closed.

This appears to be markedly lower than in 2005 when the same report showed the proportion was around 10% (Rural Migrant Survey, 2006 and 2009).

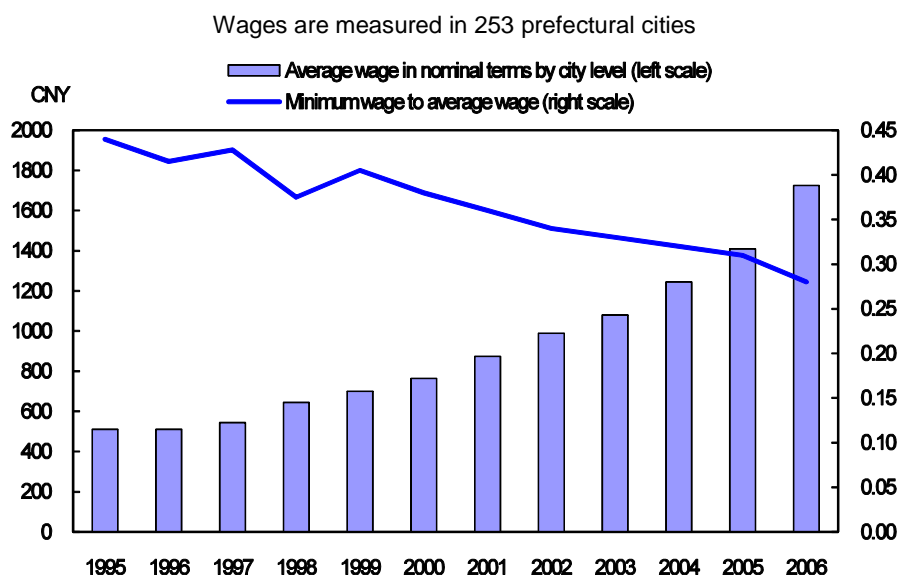
Wage setting

47. Minimum wages were first introduced in 1993, but new regulations were put in place in 2004 to cover part-time workers via a minimum hourly rate, and to increase the penalties for non-compliance (Baker & McKenzie, 2004). The minimum monthly wage is set on the assumption that the employee works a standard 40-hour week and the labour law specifies that extra hours should be paid at 150% of the normal hourly rate. Decisions to introduce a minimum wage and to determine its level are usually taken at prefecture level, with effect in all prefectural-level cities but not in county-level cities.

48. The regulation specifies that the minimum wage should be changed at least every two years, if necessary, and should take into account a range of local economic factors. It offers three methods that the local authorities can adopt. The first two are based on determining the basic living needs of an individual. The first takes a sample of local households and adjusts the income of the lowest group upwards by the amount needed to support elderly relatives and sets the minimum wage at a proportion of this level. The second sets the minimum wage at the point where food expenditure exceeds a certain proportion of income. The final method takes a fixed proportion of local wages of between 40% and 60% of local average wages, said to be the international norm. Most local authorities use the first two methods. Once the level is set, the adjustment methods also vary. In Shenzhen, for example, the increase was taken as the average of the price increase, the wage increase and the productivity increase (Liu and Wu, 1999). Once adopted, the minimum wage covers all workers in urban areas.

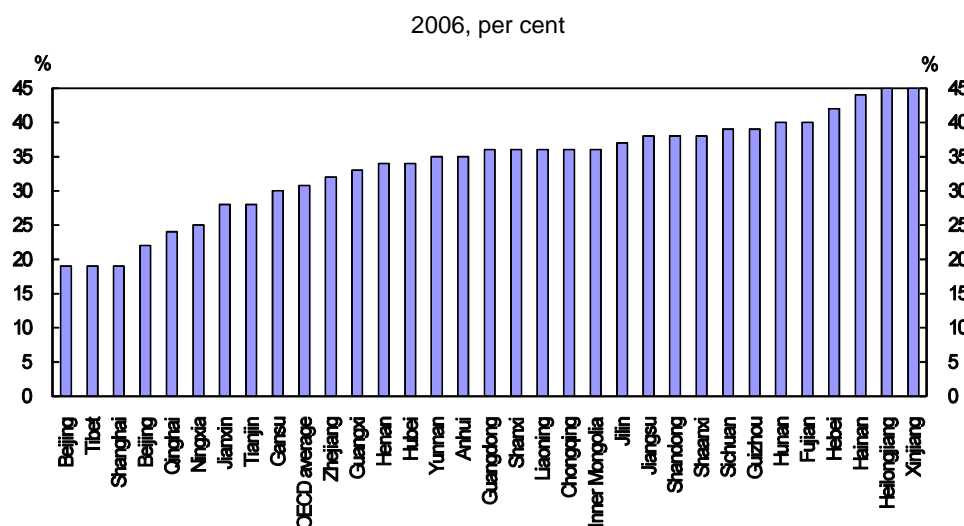
49. No national data are available on the level of minimum wages, but for 253 prefectural cities, the minimum wage increased by only 6.5% per year between 1995 and 2006, about 4 percentage points less than the growth of average wages in these cities. As a result the minimum wage fell from 44% of average local wages in 1995 to 28% (Figure 13), a low level by international standards. Also, the ratio of the minimum wage to the average wage varied considerably across provinces (Figure 14). Typically, it was lowest in the higher-wage provinces.

Figure 13. Minimum wages in cities relative to local average wages



Source: Du and Pan (2009).

Figure 14. Minimum wages as proportion of average earnings across provinces



Source: NBS.

50. While the minimum wage exists on paper, there is little evidence that it is effectively enforced on the ground. While only one tenth of employees earned less than the monthly minimum wage in 2005 in five major cities, only just over a fifth of unofficial migrants were paid the minimum hourly wage (Table 12). Even about half of local workers were paid less than the hourly minimum wage.

Table 12. Coverage of minimum wage rate in five major cities

	Monthly earnings		Coverage		Hourly earnings		Coverage	
	Unofficial migrants	Local hukou	Unofficial migrants	Local hukou	Unofficial migrants	Local hukou	Unofficial migrants	Local hukou
	CNY		Per cent		CNY		Per cent	
Men	1 140	1 282	88.6	88.9	4.4	7.0	26.3	52.0
Women	879	963	79.1	80.0	3.3	5.4	14.4	34.9
Total	1 022	1 144	84.4	85.0	3.9	6.3	21.1	44.6

Source: Du et al. (2009).

Wage guidelines

51. In parallel to minimum wages, the state has also established a system of wage guidelines. These were originally designed to regulate the pay of employees in SOEs, before public sector enterprise reform (Rawski, 2002). Despite the growing role of the market economy, the guidelines have continued to exist. They serve to give indicative guidance to firms about current wage levels in their districts for many occupations. These pay levels are determined through surveys. The system is meant to provide an external reference standard for the employers and employees. It was expected that this might improve the success rate of applying for jobs for labourers and so promote overall labour market efficiency. In 2006, 167 cities had established such systems (People's Republic of China, 2006). The mission statement of the Ministry of Human Resources and Social Security (MOHRSS) indicates it should draft the measures concerning the

wages of enterprise employees; work out enterprise wage guidelines and wage income regulatory policies for industrial sectors and the income distribution policies for managers of the SOEs (MOLSS, 2004). This role was confirmed by the first session of 11th Party Congress in 2008 (Central Translation Bureau, 2008).

52. It is difficult to assess the impact of the guideline system but official statements suggest that in some cities it is more than purely indicative. For example, the 2007 guidelines in Guangzhou had a fairly interventionist tone (China Law and Practice, 2007). In contrast, the Guangdong provincial labour and social security office publicized the 2009 baseline for wage growth as 7%, but specified that enterprises experiencing zero or negative growth, or enterprises with normal production and operation but poor cost-effectiveness, or enterprises experiencing instability in production and operation because of the financial crisis, could stop increasing wages temporarily. Likewise, when Shenzhen issued its 2009 guidelines in June, suggesting a pay cut of 3.8% for the average worker, the Municipal Office indicated that the guidelines were not mandatory (CSC staff, 2009).

The tax burden on formal employment

53. In China's urban labour markets, the "tax wedge" for an average-wage earner is estimated at around 32% of the total labour cost, or 41% of the wage (Box 6). It consists almost entirely of employer and employee contributions to social insurance. This figure, however, represents an approximate average for workers in China's urban formal enterprises and is not fully comparable with the tax wedges calculated for OECD countries, which refer to the entire labour market. Keeping this caveat in mind, the national average tax wedge in Chinese cities appears similar to those in Canada, Japan, the United Kingdom and the United States, and lower than in most of Continental Europe (Figure 15).

54. In China, the effective tax wedge varies substantially between regions. First, the use of a national income-tax scale with a standard tax-free allowance makes the effective taxation highly dependent on the local wage level. Local average wages are hardly taxed at all except in rich cities such as Shanghai and Shenzhen, where they can be expected to face a marginal income-tax rate of 15% and a total tax of about 5% of the wage. Second, social contribution rates are determined by provinces or cities, whose financing needs vary greatly, in particular with respect to their first-tier pension funds. Contribution rates tend to be higher than average in old industrial regions such as the Northeast and in old big cities, including Beijing, Shanghai and Guangzhou, where many old citizens are entitled to pensions. By contrast, the recently-emerging big cities of Dongguan Shenzhen and Zhuhai (all in Guangdong's Pearl River delta) charge social insurance contributions at total rates that averaged 18%, far below the national norm of 40% (Singapore Manufacturers Federation, 2006). In relatively poor cities that were not heavily industrialised before the reforms, the effective rates can be expected to be moderate for both income tax and social contributions.

55. All told, the tax wedge can represent a substantial burden for business in the formal sector. However, the high taxation found in some of the economically most successful cities suggests that other advantages, such as a well-educated workforce, can compensate for the additional cost. This does not exclude that high taxation could have more negative effects on job creation in cities that do not share this comparative advantage.

Box 6. Income tax and social insurance contributions

Income tax mainly concerns workers with above-average urban incomes. It is charged at progressive rates from 5 to 45%, which are applied to taxable income after deduction of a basic allowance of CNY 2 000 per month. For a person with an average income in 2008 (CNY 2 408), the marginal tax rate was thus 5% of CNY 408, corresponding to nearly 1% of total income.

Contribution rates to social insurance vary across provinces and cities. The national reference rate (and approximate average) is 40% of earnings, of which 29 percentage points are to be paid by the employer and 11 by the employee – and 21% for the self-employed who choose to participate. Contributions are charged on incomes of at least 60% of the average urban wage, but not for amounts in excess of 300% of this wage. The total rate is decomposed as follows:

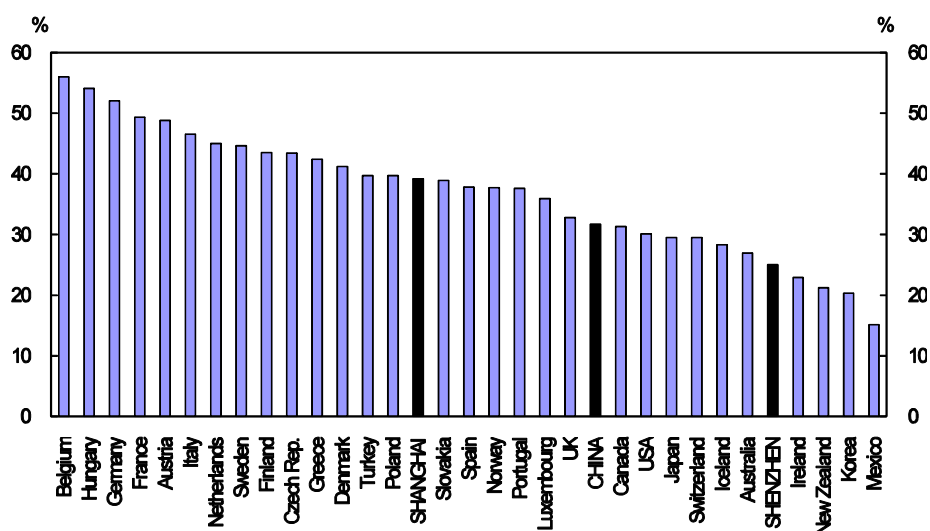
- Basic pensions: 20% for employers; 12% for the self-employed.
- Mandatory individual pension accounts: 8% for employees and the self-employed.
- Sickness and maternity: 6% for employers; 2% for employees.
- Work injuries: 1% for employers and the self-employed.
- Unemployment: 2% for employers; 1% for the employee.

In addition employers must pay contributions to a housing provident fund.

Following national recommendations, many localities use reduced contribution rates for rural migrants, and sometimes also for other groups such as the self-employed and SMEs. For example, the basic pension contribution may be suspended or substantially reduced, and migrants may be offered a cheaper sickness insurance covering only some basic treatments. Many localities do not allow migrants to participate in unemployment insurance.

Figure 15. The estimated tax wedge in 2007

Income tax plus employer and employee contributions as percent of the labour cost, based on the local average wage



Source: OECD (2008) and OECD estimates for China and Chinese towns.

Conclusions and recommendations

A resilient labour market...

56. The labour market has proved exceptionally resilient in the face of three shocks: the policy-induced slowdown in early 2008, the new labour laws and, in late 2008, the fall in export demand. There was much initial concern about the fall in employment, especially for unofficial rural migrants in urban areas. However, the labour market appears to have cleared relatively quickly. By mid-2009, all but 4% of the migrants who returned home had come back to the cities according to official sources, and an extra 7 million migrants moved to cities in the first half of 2009. The unemployment rate amongst migrants was only 3% by June 2009, not least owing to a readiness to trade lower wage awards for employment. The government reacted swiftly to the crisis: the minimum wage rate was frozen in nearly all cities and training and vocational education programmes were introduced in the areas from which migrants originate. By Spring 2009, employment had started to increase anew, though not at the pace of earlier years.

... but which is still very segmented

57. The downturn has highlighted the problems faced by unofficial migrants, who are the first to lose their jobs. It will be impossible for China's economy to advance without continued urbanisation, which requires further rural-to-urban migration. Currently, China first separates its citizens in a given city into two groups: those with local registration and those registered elsewhere. Each of them is then split into people with agricultural or non-agricultural status. While within some areas, the agricultural and non-agricultural permits have been merged, in the major migrant zones, the essential regulations restricting most social services to those holding local non-agricultural registration permits remain in force. The inability to fully benefit from such services (despite central government policies that encourage integration) remains a major barrier to population movement. So does the inability to sell rural land-use rights (as documented in OECD, 2010) and their loss in case of official migration. These restrictions apply equally to urban residents who wish to change the city (or even the district in a city) in which they live and work. Increased migration would markedly improve the distribution of wages across the country and improve the efficiency with which labour resources are used.

Integration is needed to support urbanisation

58. Continued urbanisation requires to completely integrate the rural and urban labour markets and to remove all barriers to the free flow of labour within the country. The government has already taken initiatives in this direction. There are now few restrictions on obtaining local non-agricultural status in many inland small towns, though there are still cases of people purchasing urban *hukous* in cities at the county level in order to attend senior secondary schools. In larger towns, migrants can now register as temporary residents but this does not give the same rights as a permanent residence permit. The government has also recognised that migrants are workers and not peasants and has insisted on the need to provide education for migrant children. But current educational regulations still require university admission examinations to be taken in the locality of the student's *hukou* and follow the local syllabus. This results in families being split with adverse consequences for the next generation. It adds to the discrimination caused by requiring a higher test score for rural applicants to university.

59. In this light, the government now needs to institute pilot programmes in major Eastern cities making local registration available to all comers, education available to all without any restrictions (such as quotas) on the children of migrants and allowing migrant access to subsidised rental housing and local medical insurance (maternal death rate remain much higher for migrant mothers in urban areas). Extra grants from central or provincial governments may be needed to that effect, and such measures would have to be introduced in conjunction with other policy changes. Notably, land use rights in rural areas need to be

made similar to those in urban areas, while ownership rights of rural land might need to be modified (see OECD, 2010).

60. Such reforms would make it possible over time to reach an urbanisation rate of 60 to 75%. The demographics of rural areas suggest the recent past represented a low point in the supply of migrant labour that will not be seen again for the next 20 years. Throughout the country, less than one-quarter of the rural population has migrated, suggesting room for considerable population movement.

Labour market laws

61. The labour market in China is still in its infancy. Less than 20 years ago the human relations function in major enterprises still rested on rigid Communist Party-established rules, and returns to education and skills were low. This type of set-up is now only found in parts of government and public service units. But while the labour market has expanded, the habits of contract and law-based economic relations are not yet well established. Only half of all workers have written contracts and the new private entrepreneurs largely ignore labour market legislation, often not respecting minimum wage legislation, not paying wages on time or not contributing to the social security system.

62. The 2008 labour laws provide the basis for giving the employee more recourse to law in order to rectify some of the more egregious faults committed by the employer. Such a development is welcome. However, there remains some doubt about the laws' effectiveness. The power of labour inspectors is constrained by the legal framework for administrative penalties: the possible punishments are very limited and the fines involved so small that they do not represent a deterrent to illegal labour market activity. Moreover, there is a proliferation of official regulations and guidance notices, whose legal standing is often unclear. The powers of the labour inspectors need to be enhanced and a complete codification of all regulations ought to be available.

63. While the new labour contract law may seem very strict by the standards of the OECD indicator, this is somewhat misleading. The most severe conditions are for the termination of indefinite contracts, but only 20% of urban employees hold this type of contract and most of these work for the civil service or SOEs. The proportion of indefinite contracts does not appear to have risen since the enactment of the law. Fixed-term contracts come with relatively few restrictions in China, though only two such consecutive contracts are allowed. This restriction could usefully be eased without increasing the cumulated allowable length of the total of such contracts. Furthermore, the new law's additional regulations for collective dismissals are mostly procedural. The indicator for a collective dismissal is slightly higher than in other countries but the new law imposes no additional delays on the employer in the event of a mass layoff.

64. Given existing labour practices in China, the new labour laws do not appear to be unduly onerous, given that they do not impose indefinite contracts and that most private sector employees currently have fixed-term contracts (if any). The new laws will certainly entail a heavier burden of record-keeping for human resource departments, which will need to have documented evidence to terminate employment contracts. They may also increase costs if they result in an increase in compliance with minimum wage, hours worked and social security legislation. The new laws do mean that individual employees will find it easier to try to obtain recognition of their rights, even if enforcing any resulting judgement may be difficult.

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