Labor

The Story So Far

From the birth of the People’s Republic of China in 1949 to 2015, China’s working-age population grew by 600 million people: it is little wonder economic output expanded. Today, the size of the workforce is shrinking, so improving both its quality and mobility is critical for longer-term competitiveness. The share of Chinese people living in cities is also slated to rise to 60% by 2020, adding huge growth potential but also increasing fiscal pressure on local governments to deliver social services. China’s 2013 Third Plenum called for labor policy reforms to boost job creation and entrepreneurship, discourage discrimination and labor abuse, improve income distribution, fund social security and pensions, and enhance healthcare and education.

- In July 2014, authorities issued an Opinion that called for relaxing the burdensome restraints on individuals who wished to change their residency (the household registration or hukou system). This new policy eased controls for those wishing to move to smaller cities while leaving in place more restrictive measures for those wishing to move to bigger cities. Policymakers also planned to set up a nationwide residency permit system that would ease and standardize the process of relocating.

- In December 2015, the central government established that anyone living in one locality for six months could apply for a residency permit and therefore gain access to basic social services. The measure softened the division between rural and urban hukou, and it laid a basic foundation for the abolishment of the hukou system over the longer term.

- A notice issued in August 2016 recommended fiscal support to incentivize and facilitate urbanization and provide social services based on the newly established residency permit system. The extent and effectiveness of this support are still unclear.

- In February 2018, China’s State Council indicated that it would share more social expenditures with localities. Local governments have long shouldered a disproportionate share of overall government spending while suffering from weak sources of revenue; more revenue from the center would help bridge this gap.

Methodology

To assess progress in China’s labor policy reforms, we chart wage growth for the segment of the labor force most likely to present a bottleneck to the country’s productivity: migrant workers. Working away from home in temporary and low-skilled jobs and with little access to urban social services, migrant workers have supported China’s growth miracle, but they are increasingly vulnerable to structural changes. Our primary indicator charts the growth rate of migrant worker wages relative to the GDP growth rate. If wage growth trails GDP growth, it suggests falling productivity or inadequate policy support for the workforce, or both. The wage/GDP growth trend for other segments of the workforce is also included. Divergence in income gains between segments can lead to social unrest, as can downward trends impacting all segments simultaneously. Our supplementary indicators look at job creation, labor market demand and supply conditions, urban-rural income gaps, and social spending relevant to labor outcomes.

Quarterly Assessment and Outlook

Primary Indicator: Wage Growth Relative to GDP

![Wage Growth Graph]

- We upgrade our assessment based on a modest and likely temporary improvement of migrant and rural worker wage growth and positive policies such as hukou relaxation, worker training, and measures to reign in healthcare costs.

- Progress on wages is likely driven by improvement of overall economic conditions and thus is temporary. Employer demand remains mismatched with worker supply, and government social spending and job creation are stagnant.
• Policymakers have yet to address structural impediments in the labor market. Measures to curb healthcare costs are a step in the right direction but still inadequate. Hukou relaxation and reemployment training may help with labor mobility and job matching, but the emphasis on rural revitalization undermines the effectiveness of policies supporting labor mobility.

**This Quarter’s Numbers**

The labor market showed signs of improvement in 1Q2019, largely as a result of better economic conditions rather than structural reform. Lending, investment, and industrial production all slowed at the end of 2018, forcing businesses to cut back on labor costs. In 1Q2019, government stimulus and cheaper credit started to reverse these trends to the benefit of workers. Though wage growth was better than the dismal rate seen in 4Q2018, it still lagged GDP growth, implying that China did not make meaningful progress toward the 2013 Third Plenum goal of lifting the labor share of income. Moreover, the fact that employment remained stagnant even as the economy improved points to enduring problems in matching labor supply with labor demand.

Our indicators show all categories of wages improving in 1Q2019 compared to the previous quarter, but income for most earners continued to grow at a slower pace than GDP (see **Wage Growth**). Our primary indicator, migrant wages, shows that Beijing is failing to encourage labor mobility and create new employment opportunities. Real migrant wage growth remains the weakest of the three demographics we track, increasing from 70% of the rate of GDP growth in 4Q2018 to 79% in 1Q2019. Real urban income growth saw the strongest upturn from the previous quarter, from 52% to 91% of GDP. Rural income performed best this quarter, growing 11% faster than GDP and helping narrow the rural-urban income gap.

While better economic conditions supported wage growth in 1Q2019, our employment indicators show there are still structural impediments to labor mobility and the development of human capital. **New Job Creation** fell for the third consecutive quarter (well below GDP now, at a mere 0.6% year-on-year (yoy) growth rate). At the same time, available positions continued to outnumber people applying for them, indicating that jobs created in most areas were not aligned with local worker availability (see **Labor Demand-Supply Ratio**). Conditions did improve slightly in Eastern China, where wages and human capital are higher, but the gap is still historically wide. The hukou system is still preventing qualified applicants from relocating to fill new jobs, while local candidates lack the skills that open positions require.

The government is still not spending enough on education, training, and social benefits to address these challenges (see **Social Spending**). Government expenditures improved or were stable as a percentage of GDP in 1Q2019 from 4Q2018. Education spending rose slightly from 3.6% to 3.65% of GDP. However, the three types of spending measured together declined by 0.1% of GDP yoy. This is partly a side effect of the deleveraging campaign to slow expansion of local government and corporate debt, which caused companies to reduce wages and fire employees and reduced local government tax income for social spending. In other words, the squeeze on credit growth pared back government assistance precisely as the need for it grew.

**Supplemental 1: New Job Creation**

Yoy, percent

![Graph showing new job creation and GDP growth](image)

Source: Ministry of Human Resources and Social Security, National Bureau of Statistics.
**Policy Analysis**

Beijing adopted policies this year to improve labor mobility and education, broaden access to social services, and reduce medical costs. However, without fundamental fiscal reforms and more support from the center, these policies will have only a limited impact on labor productivity and shared welfare. The most important change so far has been an acceleration of reforms to the *hukou* system. On April 8, the National Development and Reform Commission announced plans to relax all *hukou* restrictions in cities with urban populations of 1–3 million this year, and for cities with 3–5 million residents, to ease *hukou* restrictions on migrant workers who have lived in them for more than five years.

On May 5, the State Council followed up with a measure that aims to gradually eliminate all *hukou* restrictions by 2022, except for those in the four mega-cities. Formally, these reforms are meant to channel human and financial capital to and increase social spending in rural areas in line with President Xi Jinping’s “rural revitalization plan,” as discussed in the *Spring 2018 Land* assessment.

In reality, these changes are likely meant to boost flagging demand for property and thus government revenues in smaller cities, which may help social spending in the short term. However, it will be difficult for central authorities to force local governments to grant benefits to migrant citizens, and to the extent that they succeed, it is not clear how localities will afford greater migrant-related expenditures in the long term. The State Council intends to only slightly adjust the ability of localities to manage land resources and generate independent sources of revenue, leaving them poorly prepared to finance the greater spending that Beijing expects of them.

Since *hukou* reform will likely take years to improve the labor market, Beijing has implemented more immediate measures to train workers in specialized fields. On April 30, the State Council decided to set aside 100 billion yuan from the unemployment insurance fund to give 50 million workers vocational training over the next three years, with 15 million workers to be trained in 2019. Furthermore, the Ministry of Education published an action plan in May to admit 1 million more students to vocational colleges.

Authorities are also trying to build on the limited successes over the past year in making healthcare more affordable and accessible. Household spending on healthcare since 2017 has grown on average by 15% yoy,
almost twice as fast as other expenditures. On June 5, the State Council published a 2019 plan for healthcare reforms that aims to reduce the cost of medicines and medical devices, expand the coverage of healthcare insurance, improve the efficiency and quality of public hospitals, and encourage non-governmental investment in the healthcare industry. These policies have worked to some extent – the central government has successfully lowered the cost of basic medicines for urban residents in several major cities. In light of mounting medical costs, however, these limited measures are unlikely to meet planners’ reform ambitions.