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

- We further downgrade our labor reform assessment in 2Q2020. Although China's economy rebounded statistically, job opportunities and social benefits declined.

- Wages for migrant workers continued to fall sharply, while citizens with permanent urban and rural residency status were less affected, increasing the gap.

- Beijing is trying to support workers by promoting new digitally enabled economic activities and more flexible employment; however, fiscal constraints continue to limit the effective implementation of these and other labor reform policies.

This Quarter's Numbers

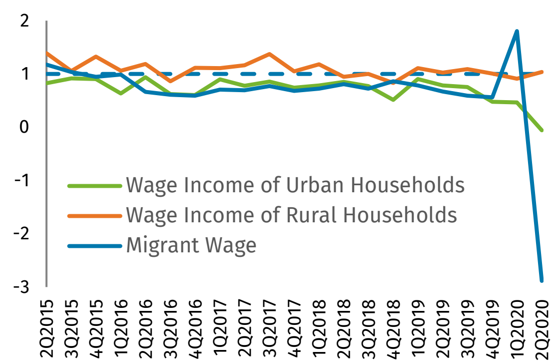
Labor reform indicators worsened in 2Q2020 despite China's economic recovery, meaning workers have not been sharing in the growth rebound. Price-adjusted wages for migrant workers continued to fall, contracting by 9.2% year-on-year (yoy). Urban households saw wages fall by 0.2% yoy. Only rural households experienced wage growth that was faster than that of the economy, as demand for agricultural products remained high as the pandemic subsided. Altogether, price-adjusted wage growth was 60% lower than GDP growth, the largest gap since data became available in 2014.

Wages lagged GDP growth because job creation was weak, not because GDP growth was strong. China created only 3.3 million jobs in 2Q2020, an improvement from 2.3 million in 1Q2020 but still 19% below 2019 levels (see **New Job Creation**). The number of job openings per applicant fell across the country as companies delayed hiring due to the uncertain economic outlook (see **Labor Demand-Supply Ratio**). This is a vicious cycle: domestic demand is unlikely to recover until household incomes and consumer confidence rebound.

The Chinese government has been constrained from doing more to help. Social security and employment spending increased by 5% yoy, but that spending represented only 3.2% of GDP in the quarter, down from 4.8% in 1Q2020 (see **Social Spending**). Authorities even spent 8% less on education and 5% less on healthcare, compared with 2Q2019. As a result, overall social welfare expenditure declined by 3%, just as households needed it most. This was a hard reality of the lockdown to control the virus: a closed system had fewer opportunities to put money to work.

Primary Indicator: Wage Growth Relative to GDP

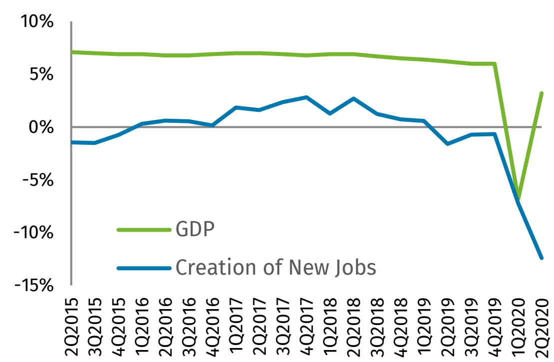
Ratio



Source: National Bureau of Statistics, Rhodium Group.

Supplemental 1: New Job Creation

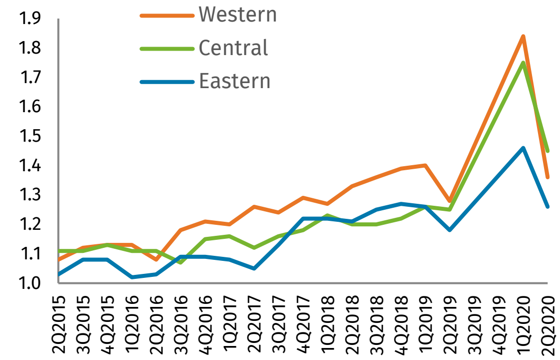
Yoy, percent



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

Supplemental 2: Labor Demand-Supply Ratio

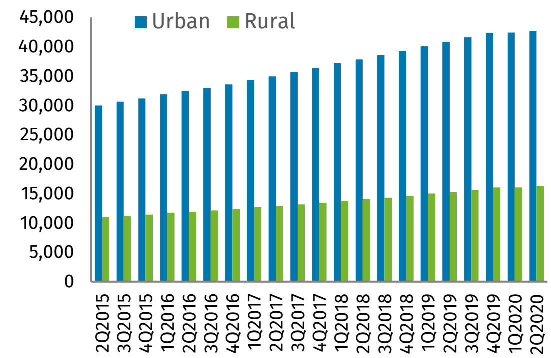
Job openings per applicant



Source: Ministry of Human Resources and Social Security.

Supplemental 3: Rural-Urban Household Income

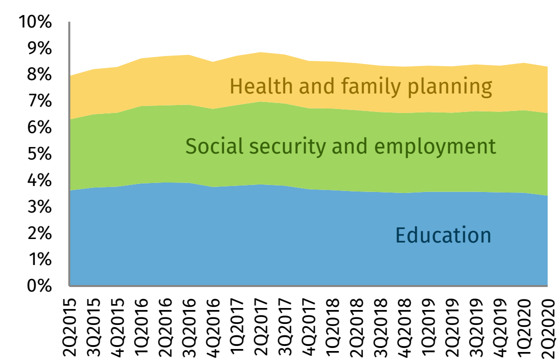
Annualized RMB



Source: National Bureau of Statistics.

Supplemental 4: Government Social Expenditures

4qma, percent



Source: National Bureau of Statistics, Ministry of Finance.

Policy Analysis

Beijing is proposing digital solutions to support employment and consumption. On July 14, the State Council issued an opinion promoting online education, remote work, digital trade, e-commerce, social media, and live streaming. It encouraged self-employed, part-term work and entrepreneurship to support these internet-based activities. On July 31, the Council published another opinion supporting flexible employment and encouraging workers to find sources of income beyond their formal jobs. These policies aim to create new opportunities for China's workforce, but doing so is easier said than done.

Final Dashboard Assessment

Among the ten reform areas tracked in the China Dashboard, labor reform has regressed the most. The 2013 Third Plenum covered a wide range of labor issues with a focus on letting workers share in China's economic growth, but the gap between wage and GDP growth is larger than ever. The government promised to end job discrimination and improve social welfare. And yet, migrant workers still experience slower wage growth, and government spending on social welfare as a percentage of GDP has declined from 2015 levels. Beijing has come up short of the ambitions set out at the start of the Xi years.

This was not for a lack of effort. The past five years saw important changes. For example, the government removed household registration (hukou) restrictions in cities with fewer than 3 million residents and lowered requirements for cities with 3–5 million residents (see **Summer 2019 Edition**). Beijing is making progress on pension fund centralization (see **Fall 2018 Edition**), expanding health insurance coverage and extracting social security funds dividends from state-owned enterprises (see **Fall 2019 Edition**). Beijing assumed some welfare spending obligations from local governments and restructured the bureaucracy to spend money more efficiently (see **Summer 2018 Edition**). But all these efforts have failed to increase worker compensation, job security and protections, and shared welfare.

Fiscal imbalances remain the biggest constraint on implementing bolder labor reforms. Local governments still bear most of the responsibility for social welfare but lack the wherewithal. Tax revenue comes not so much from incomes or consumption but from local businesses and land sales. Therefore, authorities are less focused on services for lower-income groups and more on support for businesses.

The 14th Five Year Plan, previewed in October and to be released in early 2021, will lay the groundwork for future labor policies. These will include easing more household registration restrictions in larger cities, widening health insurance coverage, and better coordinating social services across cities. But unless Beijing makes progress on fiscal reform and resolves the central-local fiscal imbalance problem, labor reform is unlikely to deliver meaningful outcomes. A failure to bolster household incomes and worker welfare at a time when the traditional drivers of China's economy—credit expansion and property construction—are fading will lead to weaker consumption and declining productivity. That would undermine recovery and erode long-term prospects.