

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 health care and education.

- In July 2014, authorities issued an opinion that called for relaxing the burdensome restraints on individuals who wished to move and change their residency (the household registration or *hukou* system). This policy eased controls for those wishing to move to smaller cities while leaving in place more restrictive measures for 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 the basic foundation for 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.

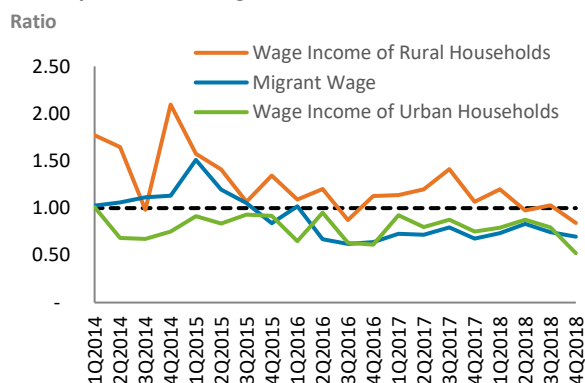
METHODOLOGY

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



Source: National Bureau of Statistics, Rhodium Group.

- Since migrant and urban wage growth weakened substantially compared to GDP this quarter, we further downgrade our assessment of labor and shared welfare reform progress. This occurred despite labor shortages across the country and a decline in government social spending, both of which are reasons to expect wages to rise.
- Much of the weakness in our indicator is likely due to a weaker economy, but the government is not responding by pushing through needed reform to labor markets.
- Leaders announced an "employment-first" policy for 2019 including measures to reduce employee-related expenses for companies. This might drive up wages later this year, but broad structural reform to labor markets is more important than a short-term stimulus campaign.

THIS QUARTER'S NUMBERS

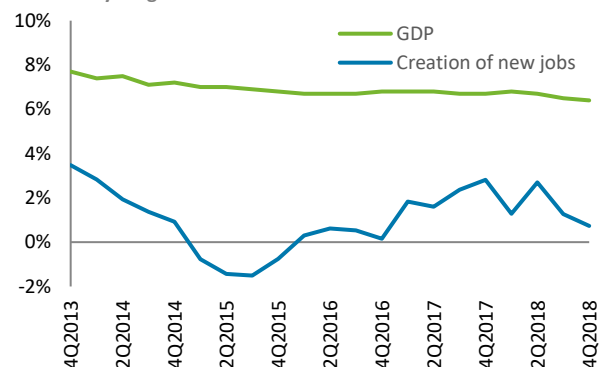
Our indicators show wage growth lagging economic growth in all categories in 4Q2018: the 2013 Third Plenum goal of lifting the “labor share of income” cannot be attained under these conditions. Real growth in migrant workers’ wages, our primary indicator of Beijing’s success in encouraging labor mobility and creating new employment opportunities, declined: growth was 30% lower than the rate of GDP growth in 4Q2018. While the urban-rural income gap narrowed, this reflected weakness in urban wage growth, which dropped from 80% to 52% of the rate of headline GDP growth – the lowest in our five-year window. Rural wage growth also fell. The economic downturn and its effect on employment are more serious than smoothed headline GDP numbers would indicate.

Supplemental data also show the effect of the economic downturn on employment. New job creation continued to fall (well below GDP now, at a mere 0.7% year-on-year growth rate; see **New Job Creation**). At the same time, the growth of available positions continued to outpace the number of people applying for them, implying that jobs created were not aligned to what local workers were willing or able to do (see **Labor Demand-Supply Ratio**). Reasons for the continued inflexibility of the labor market include the *hukou* system, which still prevents qualified applicants from relocating to fill new jobs, while local candidates often lack the skills that positions require. Low-skilled jobs are eliminated by technological change, and high-skilled jobs require new talents.

The government is not spending enough on worker training and unemployment benefits to address these challenges. Fiscal expenditures on social welfare are decelerating (see **Social Spending**). Government social spending as a percentage of GDP declined in the first half of 2018; while this stabilized toward the end of the year, it was still 11% of GDP lower in 4Q2018 than in 4Q2017. This is partly a side effect of the deleveraging campaign to cut local government and corporate debt, which causes companies to reduce wages and fire employees and reduces local government tax income for covering social welfare (see **Fiscal Affairs**). In other words, the squeeze on credit growth pared back government assistance precisely as the need for it grew.

Supplemental 1: New Job Creation

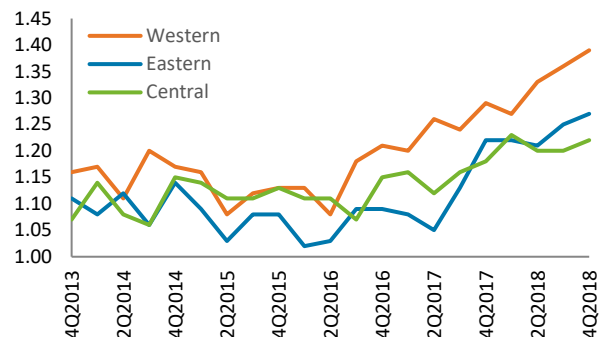
Year-over-year growth



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

Supplemental 2: Labor Demand-Supply Ratio

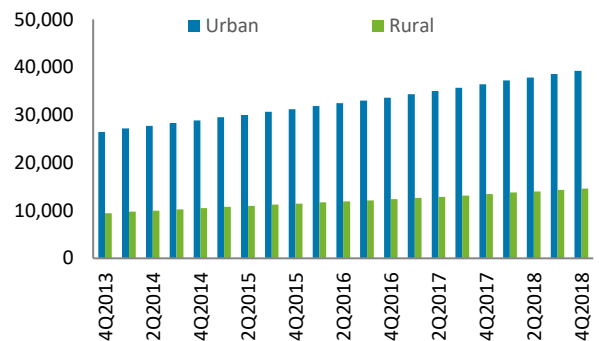
Job openings per applicant



Source: Ministry of Human Resources and Social Security.

Supplemental 3: Rural-Urban Household Income

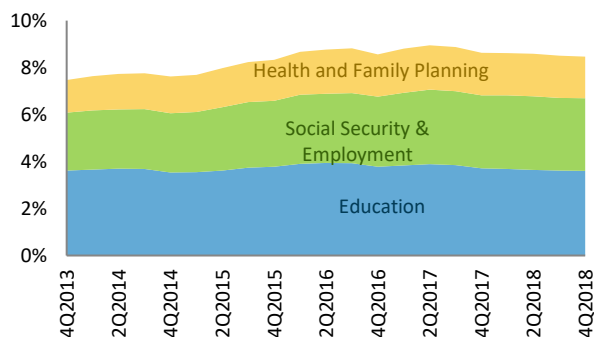
Annualized RMB



Source: National Bureau of Statistics.

Supplemental 4: Government Social Expenditures

4qma, percent



Source: National Bureau of Statistics, Ministry of Finance.

enforcement (see **Winter 2019** edition). In 4Q2018, there were no clear measures to put the social security fund on a sustainable footing.

POLICY ANALYSIS

At the March National People’s Congress (NPC), Premier Li Keqiang introduced an “employment first” strategy as part of his annual work report on the government, including a target of 13 million new urban jobs this year. These aspirations echo a December 2018 Politburo statement announcing stabilization of employment growth as a 2019 priority. Li’s work report offers these solutions: more money for infrastructure projects, reduced corporate taxes and fees, more vocational training support, and an end to labor market discrimination. Measures like increased infrastructure spending are already helping support employment early in 2019, but promised improvements to the structure of the labor market will take years to implement. Relieving cost pressures on businesses, meanwhile, has important trade-offs. Larger than expected tax cuts in the context of limited central-local fiscal reform (see **Fiscal Affairs**) mean less funding for local governments to spend on social welfare, continuing the trend of falling social welfare allocation described in our data review for this period.

At the NPC, Premier Li also announced that mandatory corporate pension contributions would be reduced to 16% of employees’ salaries from the current 19%–20%. The reduction was meant to reduce employee-related expenses, but it was also in part a recognition that companies were already paying below statutory rates, a gap that local governments have struggled to fill. Indeed, the government pension fund suffered a 10% shortfall in 2017. A central government pension coordination fund was set up in 2018 to help bridge the deficit, but the RMB 61 billion (\$9 billion) dedicated so far is insufficient.

Authorities have made a similar trade-off with regard to China’s social security fund, which is supposed to provision not only pensions but also old age, medical, and unemployment insurance. Beijing has backed off a planned merger of the social security and tax administrations, which would have made contribution collection from companies more efficient, in response to corporate concerns about the higher employment costs that would result from stricter