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A LABOUR SHORTAGE IN CHINA IS NOT IMMINENT

At a time when China's foreign exchange reserves are at record level, are its labour reserves drying up with a risk of threatening its export led growth? Several symptoms – local shortages of workers, wage rises – might make you believe it. In reality, although the demand for labour has become stronger in the last few years, China still has considerable labour reserves. It is only around 2015 that demographic changes will have an influence toward a reversal of the situation in the labour market.

An overabundant labour supply, a segmented market

When China opened up, more than 100 million industrial workers (twice as many as in the G7) became integrated into the world economy. Until recently, the growth in the active population and the rural underemployment seemed to guarantee China's modern and exporting sector an unlimited pool of cheap labour. But, since 2003, the labour shortages that have occurred in certain provinces (Guangdong) have raised the question: has the labour market in China reached a turning point where businesses have to increase wages in order to recruit workers? It is difficult to answer this question. As several recent studies have pointed out, the available statistics on employment and wages are extremely confusing[1]. The various public authorities use disparate concepts and cover fields that overlap but leave out important areas of activity. The time periods are not consistent and the data, particularly concerning wages, is very incomplete. According to government sources, the number of jobs in urban areas varied between 157 million to 256 million in 2002, in urban industry from 39 million to 57 million.

In spite of these difficulties, the analyses agree on the first observation: there is a global labour surplus. Chinese growth has failed to create enough jobs. From 1995 to 2002, the GDP increased on average by 8.5% per year but employment by only 1%. The phenomenon is even clearer in industry where production doubled but employment stagnated. Manufacturing industry has in fact become a very competitive sector in which improving productivity has become a condition for the survival of firms, including in the state sector which was massively overstaffed. Considerable investment, the adoption of new technologies and mass redundancies since the end of the 1990s have resulted in very fast increases in labour productivity, which has started to catch up with the level of the developed countries[2]. Faced with the increase in the active population (the population of 15-64 year olds increased by more than 100 million between 1995 and 2005), the low demand for labour has created a situation of a global surplus of labour. At the same time, the labour market has remained very segmented. This is the second fact on which the analyses all agree. They point out that one of the

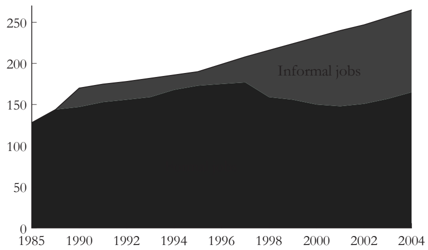
1. J. Bannister (2005), "Manufacturing employment in China", *Monthly Labour Review*, July, "Manufacturing earnings and compensation in China", Monthly Labour Review, August; A.K. Ghose (2005), "Employment in China: recent trends and future challenges", *ILO Employment Strategy Papers* 2005/14; Fang Cai *et al.* (2005), "China's Labor Market on Crossroad", *China and World Economy*, vol.. 13, n° 1.
2. The productivity of labour in China is particularly difficult to analyse due to the lack of statistical data. Using the ICOP method, R. Ren & H. Zheng estimate that the productivity of labour in manufacturing industry in China has increased from 7% to 25 % of that of the United States between 1995 and 2004; see R. Ren & H. Zheng (2006), "Chinese Manufacturing Performance from Multilateral Perspective: 1980-2004", Hitotsubashi University Research Unit for Statistical Analysis in Social Sciences, *Discussion Paper Series* n° 170, June.

most important dividing lines is the one that separates the labour market in the cities from that in the countryside.

Urban job insecurity and unemployment

In the last 10 years, mass unemployment, an increase of jobs in the informal sector and the rapid rise in wages in the organised (formal) sector have all been features of the urban labour market. According to the surveys, the urban unemployment level exceeded 11% in 2000[3] whereas the official level, which only takes into account the unemployed receiving compensation from the social protection system, was only 3% at that date (and 4.3% in 2004). The informal sector now has a major role in the creation of urban jobs. The number of informal jobs reached 100 million in 2004, estimated from official statistics as the difference between the figure of total employment (based on the census of the population) and the number of jobs declared by the registered businesses (state, collectives, private and foreign businesses). These informal jobs represent almost 40% of urban jobs. They include not only jobs in unregistered businesses but also the "informal" workers in registered businesses ("moonlighting" workers in urban businesses who are often migrants) and other insecure jobs (street sellers, domestics, *etc.*). As for "formal" employment, which covers workers officially recorded in registered businesses, it has declined in absolute terms since 1996[4] (graph 1). The last survey of economic activities (2004) confirmed the important role of the informal sector in the Chinese economy in the last few years: by highlighting the number of informal activities not previously recorded, it resulted in a re-evaluation of the GDP by 17%.

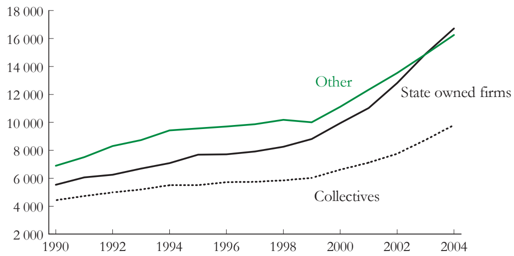
Graph 1 – Urban jobs: the rise of the informal sector (in millions)



Source: according to the China Statistical Yearbook, 2005.

Whilst unemployment and insecure jobs indicate a surplus labour supply, wages have increased rapidly in the organised urban sector: -9% on average per year (in real terms) between 1995 and 2004. This progress can be attributed to the rapid technological modernisation of Chinese industry[5], which needs a more qualified workforce. In manufacturing industry, the number of state owned firms has been cut by half and their workforce dropped from 55 million to 29 millions between 1992 and 2002; the trimmed down state sector has thus been able to pay its workforce average wages that have caught up with those in the private and foreign sectors (graph 2).

Graph 2 – Changes in wages in urban businesses
(annual wages in yuan 2004)



Source: China Statistical Yearbook, 2005.

Naturally, the observed increases in wages are only true for the organised sector. There are no statistics for the informal sector, which probably encompasses a great variety of situations. But, both the levels of and changes in wages are certainly, on average, much less favourable there than in the organised sector.

The hidden face of industrial employment

Although the majority of the Chinese population (58%) still lives in rural areas, agriculture now only employs 60% of the active population in the countryside (300 million out of 504 million in 2005). Non agricultural activities provide peasants with more than half their net incomes and two thirds of their net monetary incomes[6]. At first (until the middle of the 1990s), the development of non agricultural activities (industry, transport, trade) in the small towns and villages enabled peasants to leave agriculture without leaving the countryside. But, in the last few years, these rural businesses have run out of steam or have been integrated into the peri-urban areas; increasing numbers of peasants find that temporary immigration is the way to remedy the low level of agricultural incomes[7]. In 2005, there were 120 million peasants working away from their official home (official figure), amounting to almost a quarter of the active rural population.

3. OECD (2005), *Economic survey*, China; He Ping (2006), "Developing Labour Market and Improving Social Security", www.cdrf.org.cn/2006cdf/report3__en.pdf.
4. Hu Angang (2004), "Economic Growth and Employment Growth in China (1978-2001)", *Asian Economic Papers*, Spring-Summer; J. Bannister (2005), *op. cit.*.
5. A.K. Ghose (2005), *op. cit.*.
6. C. Aubert (2005), "Le devenir de l'économie paysanne en Chine", *Revue Tiers-Monde*, n° 183, July-September; C. Aubert (2006), "Modernizing China's Agriculture, A survey report from Wenxian county, Henan province", 8th European Conference on Agriculture and Rural Development in China, 31st August - 2nd September.
7. C. Aubert (2005), "Politiques agricoles chinoises : la porte étroite", *in* CEPII *L'économie mondiale 2006*; C. Cindy Fan (2005), "Migration in China: A Review of Recent Findings and Policy Recommendations", Backgroundpaper prepared for the World Bank's input into the 11th Five-Year Plan, January.

Migrants form more than 20% of the working population of Beijing and more than 25% of those of Shanghai and Guangdong province[8].

In the east of the country, manufacturing industry has experienced rapid expansion, transforming the countryside of some provinces (Jiangsu, Zhejiang) into industrialised rural areas, integrated with the economy of large urban centres and the international markets. Rural industries employed about 60 million people in 2005, according to the official statistics, but many more according to certain estimates because many businesses located outside the administrative boundaries of cities are not included in the statistical surveys. In the first years of the 21st century, the number of rural workers may therefore have exceeded 70 million and represented 60% of total manufacturing employment[9]. Many businesses that give work to rural migrants are foreign-financed firms producing for export.

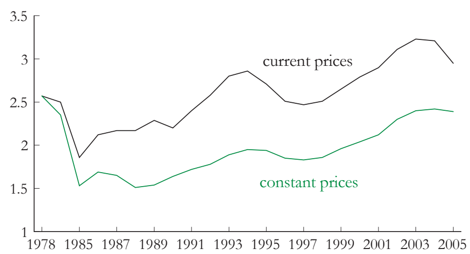
There are no official statistics on the wages of rural workers or on those of migrants. However, the surveys indicate that, in the early years of this century, they were around half of urban wages (if social benefits are included in the latter)[10] and that they had not increased much, if at all, between the middle of the 1990s and 2002[11]. A recent survey by the Chinese People's Bank on migrant workers in the Pearl river and Yangtse river deltas indicated that two thirds of them did not have employment contracts.

China's competitiveness in world markets is largely based on this hidden part of Chinese industry, ignored by the official statistics, but which has benefited for the last 10 years from the traditional sector's (agriculture) reserve of labour. As Claude Aubert points out, the peasant economy has nourished the capitalist economy of the coastal areas.

A turning point around 2015

Since 2003, the symptoms of a change in the situation of the labour market have been multiplying: growth is creating more jobs and wages have increased, including those of unqualified workers. Official figures (subject to their limitations) indicate that the loss of jobs observed in the organised urban sector between 1995 and 2002 has been stemmed: the number of people employed has increased slightly since 2003. In industry (urban and rural), the growth of activity has been accompanied by a significant increase in the jobs registered (+13 million amounting to +25% between the end of 2001 and June 2006), undoubtedly because most of the over manning was eliminated during the previous years. This increase in the demand for labour in the organised sector explains why the pressure to increase wages has intensified, especially for qualified workers which have always been in relative shortage. In some southern coastal provinces, the local labour shortages that have appeared since 2003 have also resulted in the improvement of the living standards of peasants (due to the increase in agricultural prices in 2003) which has discouraged migration, given the high costs associated with it (living conditions and lodgings). In 2005, these shortages resulted in significant increases in the pay of rural workers and migrants. Various surveys indicate that the hourly wages of migrants rose from 3 to 4 yuan between 2001 and 2005 (order of magnitude) and that added to this rise, in some cases, there was an increase in benefits in kind (lodging, canteen). In September 2006, five provinces[12] increased minimum wages. Thus, income differentials between urban and rural workers, which had considerably increased since the middle of the 1990s, stabilised in 2004 and reduced slightly 2005[13] (graph 3).

Graph 3 – Income differential per head between cities and the countryside (towns = 1)



Source: National Bureau of Statistics, Beijing.

And yet, this does not imply that the Chinese economy has entered into a phase of continuous rises in wages for all workers. There is still a large pool of labour on which the modern business sectors, and particularly manufacturing industry, can draw. Chinese agriculture still experiences massive underemployment which can be measured by the difference that exists between the workforce currently employed in agriculture (300 million people, undoubtedly including peasant-workers and temporary migrants) and that

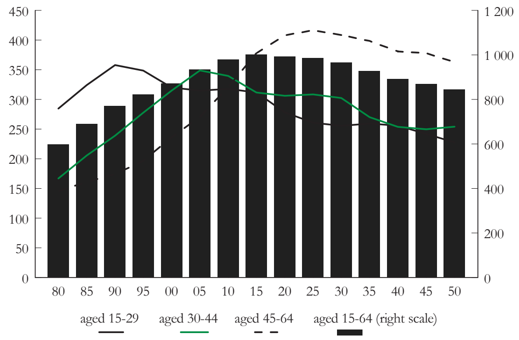
8. "Maligned and misunderstood: China's migrant labour", *China Economic Quarterly* 2005, Q3.
9. J. Bannister (2005) *op.cit.* He Ping (2006) *op. cit.*.
10. According to Judith Bannister, in 2002 the monthly wage in rural industrial businesses was 623 yuan, or about 3.4 yuan an hour (0.4 dollar), as against 7.9 yuan (0.95 dollar) in the urban businesses.
11. J. Bannister (2005) *op.cit. ;* He Ping (2006) *op. cit.*.
12. Zhejiang, Shanghai, Gansu, Liaoning, Guangdong. In the latter province, the wage levels were increased by 18% on average; they are between 450 and 810 yuan per month depending on locality (source: *South China Morning Post*, 5th of September 2006).
13. Some analyses point out that this difference in incomes almost reached a critical threshold in 2002, close to that which triggered a radical change in economic policy in agriculture in 1978, (end of collectivism and increase in prices); see Cai Fang (2003), "Rural Urban Income Gap and Critical Point of Institutional Change", *Working Paper series* n° 37. The multiplication of peasant revolts supports this point of view; see C. Froissart (2005), "Travailleurs migrants : l'émergence de mouvements sociaux", *Perspectives chinoises*, n° 90, July-August.

estimated to be sufficient to guarantee current production levels with unchanged techniques (about 150 million). This shows that there are at least 100 million "surplus" people. In spite of the measures taken by the government to improve the living standards in the countryside (tax exemptions and extension of the social security system), it is difficult to see how the rural population's income could continue to improve to the point where the migratory flows would dry up.

In these conditions, one of the keys to the development of the labour market will be the government's policy towards the migrations. The system of official registration that assigns a place of residence (hukou) to each rural inhabitant has gradually been made more flexible during the last 20 years and countryside people have received residence permits for small towns. It is the provincial and municipal authorities that decide on the conditions for receiving an urban residence permit. Some provinces have abolished the institutional barriers to migration, but the large towns and a fortiori conurbations like Beijing and Shanghai have a selective policy that strictly limits legal "immigration". So temporary migrants (legal or illegal) are the most frequently subject to segregation: some jobs (state owned firms and public services) are closed to them, they do the hard and badly paid jobs refused by the city dwellers (construction); they have no access to social services and in particular schools and social security. This segregation affects the level of their wages but protects that of the town dwellers. This is why the authorities intend to continue controlling the exodus, especially into the large cities where integrating migrants would cost a great deal if the infrastructure for receiving them (housing, schools) had to be built and the system of social services, reserved for the city dwellers up to now, were to be extended to the newcomers. Therefore, it is probable that segregation will be gradually made more flexible but continue to bear down on the wages of rural workers and migrants, after the adjustment that occurred in 2003-2005.

Finally, until 2010, the population of working age (15-64 years) will continue to grow rapidly (+44 million), which should increase the migratory pressure, especially as there will be a lot of people in the 15-29 year age group which contributes a geat number of migrants (graph 4). A turning point will occur after 2015, when the workforce of 15-29 year olds will shrink (-33 million between 2010 and 2020). The total active population will reduce, which, along with its ageing, will cause upward pressure on wages. The context will then be more favourable for a liberalisation of migration and the elimination of the dualism in the labour market.

Graph 4 – Population of working age, by age bracket, 1980-2050
(in millions)



Source: UNO.

For the time being, the pursuit of strong growth to absorb urban unemployment and the surplus agricultural labour force remains a necessity. The 11th five-year plan (2006-2010) sets the creation of 45 million urban jobs and the same number of non-agricultural jobs for country dwellers as an objective; this means creating twice as many jobs as were created from 2000 to 2005. The workforce surplus will continue to exert downward pressure on the wages of poorly qualified workers and favour growth led by the competitiveness of labour intensive manufacturing industries. It is unlikely that this growth strategy will be revised in the near future even though it is a subject of debate in China[14].

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14. See "China: the price of compertitiveness", *La Lettre du CEPII*, n° 254, March 2006.

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