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The role of monetary and fiscal policies in promoting more and better jobs in China: Issues, evidence and policy options

Cai Fang
Du Yang
Wang Meiyan

Employment
and Labour
Market Policies
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Preface

The primary goal of the ILO is to work with member States towards achieving full and productive employment and decent work for all. This goal is elaborated in the ILO Declaration 2008 on *Social Justice for a Fair Globalization*,¹ which has been widely adopted by the international community. Comprehensive and integrated perspectives to achieve this goal are embedded in the Employment Policy Convention of 1964 (No. 122), the *Global Employment Agenda* (2003) and – in response to the 2008 global economic crisis – the *Global Jobs Pact* (2009) and the conclusions of the *Recurrent Discussion Reports on Employment* (2010 and 2014).

The Employment Policy Department (EMPLOYMENT) is engaged in global advocacy and in supporting member States in placing more and better jobs at the center of economic and social policies and growth and development strategies. Policy research and knowledge generation and dissemination are essential components of the Employment Policy Department's activities. The resulting publications include books, country policy reviews, policy and research briefs, and working papers.²

The *Employment Policy Working Paper* series is designed to disseminate the main findings of research on a broad range of topics undertaken by the branches of the Department. The working papers are intended to encourage the exchange of ideas and to stimulate debate. The views expressed within them are the responsibility of the authors and do not necessarily represent those of the ILO.

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¹ See http://www.ilo.org/global/about-the-ilo/mission-and-objectives/WCMS_099766/lang--en/index.htm

² See <http://www.ilo.org/employment>

Foreword

The slow and uneven pace of economic and employment recovery since the 2008 global financial crisis highlights the need to reconsider macroeconomic policy thinking. There is a need for policy to be more pro-employment to ensure a fast, inclusive and sustainable recovery. Lessons from emerging and developing economies that have successfully coped can be of particular help for effective policy-making.

The International Labour Organization (ILO) has been working on pro-employment macroeconomic policies for a number of years, assisting member States' efforts towards decent work and productive employment for all. Constituents asked the ILO to identify promising macroeconomic policy frameworks, notably in the 2003 *Global Employment Agenda*, the 2008 *Declaration on Social Justice for a Fair Globalization* and the 2009 Global Jobs Pact. The 2014 International Labour Conference resolution in assistance to macroeconomic recovery specifically calls for policies that “support aggregate demand, productive investment and structural transformation, promote sustainable enterprises, support business confidence, and address growing inequalities” (ILO, 2014: 7(a)).

Since the 1978 Economic Reforms, China has made impressive strides in the creation of productive jobs, poverty reduction and social development. This study showcases China's experience with fiscal and monetary policy to support inclusive growth and job-creation. As underlined by the authors, China's experience holds important lessons for other emerging and developing economies, but also potentially for developed countries seeking to improve policy coherence and coordination. This study complements the ILO's growing body of research on China, including corresponding study on *The role of labour market and sectoral policies in promoting more and better jobs in China: Issues, evidence and policy options* (Cai et al., 2016). The insights from this and other studies feed into the advice that the ILO provides member States in drawing up their national employment and development strategies.

This paper was authored by Professor Cai Fang, Vice President of the Chinese Academy of Social Sciences (CASS) in Beijing, along with his colleagues, Professor Du Yang, Chief of Division of Labor and Human Capital and Deputy Director of Research Center for Human Resources, and Professor Wang Meiyan, Professor at Institute of Population and Labor Economics. The preparation of the paper was supervised by Wang Yadong, as part of a project called “The role of macroeconomic, sectoral and labour market policies to promote more and better jobs in selected middle income G20 countries” under the ILO-Korean Government Partnership Programme. The support of the Government of the Republic of Korea is gratefully acknowledged.

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Abstract

This paper outlines the evolution of fiscal and monetary policies in China in conjunction with of labour market developments. It examines employment trends in China since the 1978 Economic Reforms – or “Reform and Opening Up” policies – along with the reorientation of macroeconomic policies in line with the transition from a planned to market economy. The authors argue that the increasing openness of China’s economy has resulted in a shift away from solely focusing on macroeconomic stability to supporting employment objectives as well. The study underlines the role of Government institutions, such as the Communist Party of China (CPC) organs, the Ministry of Finance, the People’s Bank of China (PBOC) and the “Inter-Ministerial Meeting on Employment” coordination mechanism, in designing and implementing coherent macroeconomic policies. The paper presents the Chinese response to the 2008 global financial crisis as an example of effective policy response and implementation, before discussing future challenges.

Key words: China, economic growth, employment, fiscal policy, exchange rate policy, macroeconomic policy, labour market analysis, monetary policy, policy coordination and implementation, rural-urban migration, 1978 Chinese Economic Reforms, 2008 global financial crisis

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Abbreviations

CCCPC	Central Committee of the Communist Party of China
CNY	Chinese Yuan/Renminbi
CPC	Communist Party of China
COE	collectively-owned enterprise
EPL	Employment Promotion Law of 2008 (China)
FDI	foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
HRS	Household Responsibility System (China)
ILO	International Labour Organization
IMF	International Monetary Fund
MOF	Ministry of Finance (China)
MOHRSS	Ministry of Human Resources and Social Security (China) (MOLSS prior 2008)
MOLSS	Ministry of Labor and Social Security (China) (succeeded by MOHRSS in 2008)
NBS	National Bureau of Statistics (China)
NDRC	National Development and Reform Commission (China)
NPC	National People's Congress (China)
PBOC	People's Bank of China
RCAI	revealed comparative advantage indices
SAFE	State Administration of Foreign Exchange (China)
SAT	State Administration of Taxation (China)
SME	small- and medium-sized enterprise
SOE	state-owned enterprise
TVE	township and village enterprise
VAT/BT	value-added tax/business tax
WTO	World Trade Organization

1. Introduction

1.1 Overview

Promoting employment is one of the responsibilities of government and thus an important starting point for making economic and social policies. One of the key targets of macroeconomic policies – which basically comprise monetary and fiscal policy – is to promote employment, although the priority, and therefore the weighting, of employment in making macroeconomic policy may differ across countries and the different stages of development within a country. Indeed, for developing countries, the tasks of monetary and fiscal policies should not only be to ensure short-term macroeconomic stability, but also to create an environment for long-term growth and structural transformation by supporting the creation of productive employment.

An indicative angle to assess the performance of economic and social development in a country is to examine whether the country can choose appropriate macroeconomic policies to achieve employment promotion targets. In the last 36 years of implementing the “Reform and Opening-Up” (*Gǎigé kāifàng*) policies – or Economic Reforms – in 1978¹, China has made impressive progress in economic growth and employment expansion at the same time; experiences worth sharing with other developing countries.

This paper focuses on the design and implementation of fiscal and monetary policy in China. It is organized as follows: Section 1 presents a brief overview of the trends in China. Section 2 describes the evolution of macroeconomic policies in China. Section 3 discusses the interaction between macroeconomic policies and employment promotion targets. Section 4 explains how China takes advantage of macroeconomic policies to deal with cyclical fluctuations so as to maintain stable employment levels. Section 5 concludes the paper by examining challenges in the near future.

1.2 Employment trends in China from 1980-2015

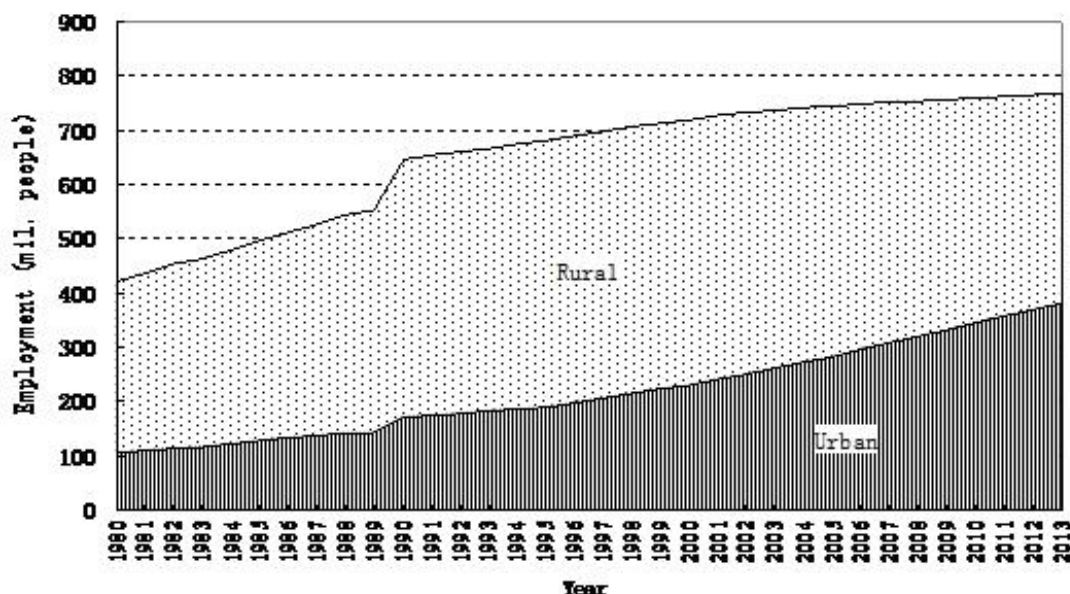
The key factors impacting on employment in China can be characterized by the following: (i) developmental stage upgrading from low- to middle- and high-income stages, similar to other developing countries; (ii) a demographic transition from high to low fertility experienced by many emerging economies; and (iii) an institutional transition from a planned to a market economy shared with other former planned economies. During these transition periods, the role of China’s macroeconomic policies in promoting employment also altered over time. In what follows we generalize some facts regarding labour market developments by narrating the employment expansion in China’s transitional period.

First, employment expansion is closely linked with economic growth and structural change. Since China initiated its Reform and Opening-Up policies in 1978, the achievements of economic and social development have created wide employment opportunities for the rural and urban labour force, which can be seen from the expansion of non-agricultural employment and the change in sectoral composition. From 1980 to 2013, the annual growth rate of GDP was 9.7 per cent while total employment grew by 1.8 per cent annually, urban employment 4.0 per cent, and rural employment 0.6 per cent (Figure 1). The slow growth of

¹ Following the accession of Deng Xiaoping as Paramount Leader of the Communist Party of China (CPC) in 1978, China embarked on a series of economic reforms to shift from the Mao Zedong era planned economy to a semi-market system called “Socialism with Chinese characteristics”.

rural employment was due to the substantial shrinkage in the number of workers engaged in agriculture. More specifically, rural employment has declined since 1997: the share of agricultural labour in the total employment declined from 68.7 per cent in 1980 to 33.6 per cent (NBS, 2014) or 22.7 per cent (Cai, et. al, 2012) in 2012, depending on the measurement methodology used.

Figure 1 Employment expansion in rural and urban China (1980-2013)



Source: NBS (2014).

Second, employment expansion reflects demographic changes. Corresponding to the demographic transition, the natural growth rate of the Chinese population remained over 10 per cent before 1997, then decreased to below 10 per cent; recently it has been lower than 5 per cent. During the period when the population – especially the working age population – grew fast, there was great pressure for China to create the necessary amount of jobs through economic growth. When population growth at first slowed – particularly as the growth of the working age population aged between 15 and 59 slowed – and then after 2010 grew negatively, employment pressure eased and the employment rate has grown at a relatively slower rate in recent years.

Thirdly, a higher labour force participation rate and fuller employment were realized primarily by the increase in the labour share of the non-agricultural sectors. As predicted by the Lewisian theory of dual economy², what happened in the early history of industrialized countries is now happening in many developing countries. China experienced massive migration of labour from the agricultural to the industrial and services sectors, from rural to urban areas, and from the poorer central and western regions to the wealthier coastal ones, a phenomenon recognized by scholars as the largest peace time migration ever in human history (see, e.g., Connelly et al., 2004).

² Lewis' (1954) framework analyzes a developing economy as comprising two sectors: (i) a labour-intensive rural sector dependent on traditional technology, and (ii) a capital-intensive industrial – usually urban – sector dependent on modern technology. The separation results in a large supply of labour – often characterized as “unlimited” – in the rural economy. Migration from the rural to the industrial sector is an important component in Lewis' development model, as the excess rural labour seeks better opportunities in the industrial sector.

The Chinese experience is also unique because of the *hukou* – or household registration – system, a special institutional arrangement that divided the Chinese population into rural (agricultural) and urban (non-agricultural) residents based on birthplace. Serving as a status marker, the *hukou* system was used to deter labour mobility in the planned economy period and is currently being reformed to better integrate rural and urban development. Those rural workers who have migrated to urban areas seeking non-agricultural jobs, but have no urban *hukou*, are called “migrant workers”.

In 2014, 269 million migrant workers had left their agricultural work, of which 103 million found jobs in non-agricultural sectors within their home town, while the other 166 million left their home town and moved into urban areas to work for more than six months. As a result, around 38 per cent of total urban employment consists of migrant workers. However, as the population age structure changes and the share of agricultural labour declines, the speed of labour mobility has slowed down significantly. The annual growth rate of migrant workers across township decreased from 4 per cent in 2005-2010 to 1.3 per cent in 2014.

Lastly, employment expansion has been influenced by the transformation of the labour force allocation mechanism from government planned to labour market driven, which has diversified the structure of employment significantly. This transformation is in line with the wider reforms carried out as part of the transition from planned to market economy, and from unitary public ownership to the coexistence of multiple (including private) ownerships – described as a “socialist market economy” by the Communist Party of China (CPC). As the labour market has developed and matured, the change of labour force allocation mechanism also conforms to such a transition. In 1980, state-owned enterprises (SOEs) and collectively-owned enterprises (COEs) employed 99.2 per cent urban workers, whereas this share had fallen to only 18.1 per cent in 2013. Accordingly, 58.0 per cent of urban workers worked in corporate enterprises, private enterprises, and individual business in 2013.

In sum, during the past 36 years the Chinese economy was a typical dual economy characterized by widespread underemployment (especially in SOEs), surplus labour in agriculture, and massive informal employment in cities. This dual economy was caused by the “unlimited” labour supply and (explicit and implicit) high unemployment arising from economic restructuring.

At different stages of development, the employment policies and implementation mechanisms varied. Since the economy arrived at the Lewis turning point³ in 2004 (Cai, 2010), which is characterized by labour shortages and wage inflation, China has undergone a transition from labour-intensive to capital-intensive growth⁴, with the changes of employment profile and labour market trends posing new challenges for government policies to create decent jobs. The target of macroeconomic policies in China has shifted from economic growth that indirectly spurs employment creation, to more direct measures to support employment expansion. At the same time, the focus on employment promotion in China has moved from employment quantity to employment quality, and consequently from employment protection to social protection for workers.

³ The Lewis turning point is the point at which the excess labour supply from rural areas reaches zero, suggesting a transition from the previous dual economy structure to a single economy, for which the neoclassical growth model is more appropriate for analysis. Cai (2010) argues that China reached its Lewis turning point in 2004.

⁴ Similarly, the analytical framework will shift from the Lewisian dual economy growth model to the neoclassical growth model.

For developing countries, the tasks of monetary and fiscal policies are not only to ensure short-term macroeconomic stability, but also to create an environment for long-term growth and structural transformation, and in this process, to create more and better jobs. The practice in China has been to incorporate economic growth and employment expansion in the national development strategy, as illustrated in the following section on the evolution of macroeconomic policies.

2. The changing orientation of macroeconomic policies

The most significant change in China's pro-employment macroeconomic policies have been happening since the early 1980s, when the Economic Reforms took place in the countryside and in SOEs, while urban unemployment emerged as a problem for the first time. Increasing openness due to exchange rate reform and 2001 accession to the World Trade Organization (WTO) also exposed the labour market to external shocks. The Government responded by reorienting macroeconomic policies towards employment objectives. In this section, we narrate how this evolution of policy took place.

2.1 Growth-centered macroeconomic policies in the 1980s and 1990s

From the 1950s to the late 1970s, China was a typical planned economy and developing country. Despite the People's Republic's rapid recovery from the Second World War and Chinese Civil War in its early years, economic growth and living standards performed poorly in the entire period of the planned economy. In 1978, on the eve of the Economic Reforms, GDP per capita was only 380 Chinese Yuan (CNY), or 150 US dollars even at the then undervalued foreign currency exchange rate. Massive surplus labour had accumulated in the inefficient agricultural sector, 250 million farmers lived below the absolute poverty line, and the income ratio of urban to rural households was as large as 2.57.

At the time, although the Chinese economy had already entered the dual economy stage of development, the labour surplus was concealed by a series of institutional arrangements. The labour force allocation was segregated by the *hukou* system between rural and urban areas, so surplus labour in agriculture sector was not allowed to move to any non-agricultural sectors, but engaged in inefficient agricultural production. The share of agricultural labour was consequently as high as 80.3 per cent of the total labour force in 1978. Meanwhile, almost all jobs in urban areas were guaranteed by government economic planning, particularly in SOEs and COEs, where unemployment did not exist by definition but underemployment was rife. Correspondingly, there were hardly any macroeconomic policies as defined by market economic theory, since all production, marketing, and distribution were conducted according to central planning. Therefore, while the State Planning Commission implemented the national economic plan, the Ministry of Finance served as an accounting department and the People's Bank of China (PBOC) as both a central and commercial bank – in fact it was the only bank in the People's Republic of China.

2.1.1 *The initial economic reforms and macroeconomic policies*

China's Economic Reforms were initiated in rural areas in the early 1980s, which were marked by the household responsibility system (HRS)⁵. Prior to this, the people's commune system severely dampened labour incentives because the connection between earnings and actual contribution made by an agriculture worker was extremely weak and workers are

⁵ Previously, the agricultural sector had been collectivized as part of the 1958 Great Leap Forward (*Dà yuè jìn*).

reluctant to contribute, which led to very low labour productivity as a consequence. In this context, all the agricultural surplus labour were hidden. Only after the establishment of HRS that stimulated work effort, the work time needed for agriculture declined significantly, and the issue of labour surplus emerged. Under the HRS, collectively-owned arable land was contracted to individual households, and farmers were allowed to claim the residual farm production after the payment of obligatory taxes and the sale of a quota to the State at the planned prices. Since the HRS substantially improved farmers' incentives to improve agricultural production and management, underemployed labourers were released from farming and encouraged to move first to local township and village enterprises (TVEs), then to nearby small towns, and eventually migrate to cities in the whole country.

At about the same time, economic reforms began in the urban sector. In their early stages, urban reforms aimed to give more freedom to SOEs while constraining their budget allocation, and allowing the entry of non-public enterprises into the market to compete with them. Meanwhile, the market mechanism was gradually strengthened and played a greater role as an allocator of the labour force and other resources, co-existing with the planned economy system in a transitional arrangement commonly called the "dual-track system". Correspondingly, monetary and fiscal policies started to play a role in stabilizing macroeconomic outcomes, and partially substituted for the planning system.

For some years, however, employment was not explicitly recognized as an objective of macroeconomic policy in China. On the one hand, in the early period of the Reform and Opening-Up policies, planning played a large role in allocating the labour force and other factors of production, as typical macroeconomic policies using policy levers to influence market signals in order to smooth macroeconomic cycles had not yet been formulated. On the other hand, in the early stage of the dual economy, because labour supply was characterized as essentially unlimited, the absolute shortage of employment opportunities was mainly caused by insufficient growth of the non-agricultural sectors. Therefore, it was commonly believed among decision makers that it was not employment *per se*, but overall economic growth that should be the priority of macroeconomic policies.

In several developed market economies – notably the USA – the central bank commits to maintaining a high and stable employment rate as an announced objective of monetary policy. Mishkin (1998) summarizes six principal policy objectives of the US Federal Reserve in order of priority: (1) high employment, (2) economic growth, (3) price stability, (4) interest rate stability, (5) financial market stability, and (6) exchange market stability. Despite the adoption of inflating targeting frameworks, high employment has remained a *de facto* consideration in several developed market economies, especially in response to the 2008 global financial crisis (see, e.g. Islam and Hengge, 2015; Miles, 2014). Besides, despite disagreement with regard to the implementation of fiscal and monetary policies among economists and practitioners in western countries, fiscal policies are still utilized to promote employment from time to time.

In 1980s and 1990s, however, employment was not included in the officially announced objectives of macroeconomic policies. For example, Article 3 of the 1995 *Law of the People's Bank of China* asserts that "the aim of monetary policies shall be to maintain the stability of the currency value and thereby promote economic growth" (The Legal Affairs Office of the State Council, 2014). Moreover, at the time, fiscal policy objectives were phrased such that the Government implemented national economic and social development plans, industrial policies, and regional development strategies by means of taxation, public expenditure, fiscal subsidies, and infrastructure investment. These would help achieve the goals of curbing inflation, reducing regional disparities, while maintaining stable, sustainable, and fast economic growth (Cai, 2003).

2.1.2 Employment challenges in the 1980s and 1990s

In the period, the biggest employment challenges are the following. First, surplus labour in agriculture was released in 1980s. Prior to the reform, the planning system prevented surplus labour from moving out of agriculture sector. In the mid-1980s, most scholars and policy researchers believed that the size of the surplus labour force ranged from 100 million to 150 million, accounting for 30–40 per cent of the total labour force in rural China (Taylor, 1993). Carter et al. (1996) estimated that, in 1990, there were still 172 million surplus labourers, making up 31.5 per cent of total rural labour. The underemployed labourers eagerly needed to move to the non-agricultural sector to find productive jobs at the time.

Secondly, the young people who had been sent to rural areas returned to the cities in the late 1970s, which created a huge unemployment challenge. From 1966 to 1977, a period called the Cultural Revolution (*Wénhuà dàgémìng*), some 20 million middle school graduates were sent to state-run farms and people's communes (*rénmín gōngshè*) in rural areas, for re-education and to relieve employment pressure in cities. However, in the late 1970s, as the Cultural Revolution ended, the Government revised its policies and allowed the youth to come back to their home cities. These newly-returned youth, together with the mass of new entrants in the urban labour market, placed huge pressure on the job market in urban areas, and brought about significant official unemployment, pushing up the unemployment rate for the first time since unemployment statistics were available in China. In 1979, the urban registered unemployment rate reached 5.38 per cent, 80 per cent of which were youth.

Thirdly, the problem of underemployed workers in urban SOEs and COEs had to be resolved. In the planned economy system, the government gave jobs to workers by making annual work assignment plans, no matter whether the SOEs and COEs needed these workers or not. Workers were not worried about being fired after they were hired, regardless of how they performed at work, how the enterprise was managed, or the impact of the economic cycle. As a legacy of the planned economy, underemployed workers amounted to 30–40 per cent of total employees in urban enterprises (Zhang, 2008: p.101).

Above all, in the early stage of market economy development, employment had not been set as a priority target of macroeconomic policies, but the implementation of the Reform and Opening-Up policies had a positive impact on employment expansion in rural and urban China. Generally speaking, the expansion of productive employment was mainly manifested in absorbing rural surplus labour and urban unemployed youth as a result of economic growth, as well as by the transition to the market economy. The reforms gave impetus to the fast economic growth which expanded the manufacturing and services sectors. Moreover, policy liberalization encouraged the movement of migrant workers from traditional cultivation to “larger agriculture” (including farming, forestry, animal husbandry, sideline production, and fisheries), then to TVEs, and eventually to all non-agricultural sectors in the various cities. Another thing worth mentioning is the development of a variety of privately owned enterprises which started breaking the “iron rice bowl” (*tiě fàn wǎn*) – the system which guaranteed income and job security under the planned economy. The development of privately ownership enterprises strengthened the capacity of the labour market to absorb the massive surplus labour in agriculture, underemployed workers in SOEs, and the unemployed in urban areas. In supporting these developments, the Chinese Government created a new employment policy framework in the early 1980s, which included three “Open Doors”: (i) giving the Government a role to play, (ii) establishing COEs, and (iii) promoting self-employment.

2.2 The reorientation of macroeconomic policies since the late 1990s

Until the mid-1990s, impressive achievements were made in employment expansion thanks to rapid economic growth. Numerous surplus labourers from agriculture and new entrants in the urban labour market found jobs. However, the employment challenge was still

daunting. The speed of the labour transfer from agriculture was not rapid enough to keep pace with the decline in the share of agricultural value added to GDP. For example, in 1995, when the share of agricultural output declined to 19.7 per cent of total GDP, the share of agricultural labour was still as high as 52.2 per cent of total employment according to official statistics, or 36.4 per cent, as estimated by scholars (Cai, 2015). Although SOEs were granted autonomy with respect to employee recruitment and dismissal, they were still not encouraged by the Government to fire workers even though there was severe overmanning.

Such a situation continued until the second half of the 1990s, when China entered a new stage of development. The new features of the Chinese economy at this stage suggested that macroeconomic policies had to be reoriented. First, the Economic Reforms, particularly the development of commodities and factor markets, exposed the labour market to macroeconomic cyclical fluctuations, which caused rising urban unemployment, especially among migrant workers. Secondly, China applied to resume its membership of the General Agreement on Tariffs and Trade (GATT) in 1986⁶, became an observer of the World Trade Organization (WTO) in 1995 and joined as a full member in 2001. In order to be integrated into the world market, China reformed its foreign exchange system in 1994; the Chinese economy therefore significantly improved its degree of openness, but also became exposed to external shocks such as financial crises.

In the second half of the 1990s, SOEs suffered widespread losses due to the macroeconomic downturn, the acceleration of industrial restructuring and the shock of the 1998 Asian financial crisis. Many SOEs lost their comparative advantage and competitiveness, and fell into decline or closed down. Managers had no choice but to use their autonomy to fire underemployed workers. As a result, the issue of long-standing overmanning in SOEs was turned into explicit lay-offs. In response to the massive lay-offs (*xiàgǎng zhígōng*) and high unemployment in urban areas, the Chinese Government implemented in 2002 a series of countermeasures to relieve the pressure on the labour market. These included: exemption from taxes and administrative fees, micro-credit, subsidies for social insurance, employment assistance, increased public expenditure, building a social protection net, limiting enterprises' lay-offs, and building community platforms for employment assistance. Taking these as a starting point, the Chinese Government has deliberately formulated proactive employment policies since then as part of its fiscal policy and its permanent national employment policy framework.

2.2.1 *The adoption of a Government pro-employment mandate*

This subsection outlines the Chinese Government's gradual adoption of a pro-employment mandate for framing macroeconomic and other policies.

First of all, the highest CPC organs formulate the national employment policy and set guidelines, giving the different Government agencies their mandate to tackle employment. In the case of China, these are the National Congress of the CPC and, when the former is not in session, the Central Committee of the Communist Party of China (CCCCP). The *Report of the 16th National Congress of the CPC* in 2002 announced the implementation of an employment strategy and set employment expansion as one of the key objectives of macroeconomic policies together with other objectives, including economic growth, price stabilization, and maintaining a balance international payments equilibrium. In the report, the CCCCPC determined to put employment expansion as a high priority for economic and social

⁶ While China had originally ratified the GATT Agreement in 1947, its membership had been suspended due to the Civil War in 1949.

development, which then became a guideline for the Government at all levels, as well as the policy objective of monetary and fiscal policies.

Second, the above mandate and guidelines were embedded in laws, so as to enshrine the Government's responsibility towards national employment policy. The *Employment Promotion Law* (EPL) issued in 2008 requires the Government at all levels to pay great attention to employment generation and make it an important goal in its endeavours for economic and social development. The legal provisions related to macroeconomic policies in the EPL include:

- (1) Article 13 – The Government develops both domestic and foreign trade as well as international economic cooperation to explore more channels for employment opportunities;
- (2) Article 15 – The Government implements the fiscal policies which are favorable for the promotion of employment, increases employment budget and improves employment environment in order to create more employment;
- (3) Article 19 – The Government adopts financial policies favorable for employment promotion, open up more channels to finance small and medium-sized enterprises (SMEs), and encourages financial institutions to improve financial services, by giving such enterprises increased support in loans and providing, within a given period of time, micro-credit, etc. to support persons who start their own business.

This law also makes provisions for the Government's responsibility, financial guarantees, and assistance measures for public employment services.

Thirdly, to follow the guiding principles of “rule by law” and “administration by law” promoted by CCCPC, the Government has gradually improved its proactive employment policies. In response to the 2008 global financial crisis, the Government put forward “a more active employment policy framework”. Since then, employment expansion has gained the priority position among all the objectives of macroeconomic policies. Between the 1980s and the mid-1990s, the employment challenge was tackled mainly by spurring overall economic growth and eliminating institutional barriers, but since the late 1990s, macroeconomic policies have increasingly played a more direct role in coping with employment shocks caused by fluctuations in the economic cycle.

Last but not least, after successfully tackling the global financial crisis in 2008- 2009, the Chinese Government gave employment a higher priority. In 2010, the 5th Plenum of 17th National Congress of CPC passed the resolution on *Suggestions on Formulating the 12th Five-Year Plan of National Economic and Social Development*. Some basic requirements for economic and social development were listed in the *12th Five-Year Plan* (2011-2015), which included the objective “to put employment expansion as a first priority of economic and social development”. The *Report of 18th National Congress of CPC* in 2012 further proposed to “implement an employment-led development strategy and a more active employment policy”.

The above political and legal commitments illustrate the importance which the Chinese Government attaches to employment in the formulation and implementation of its economic and social development strategies and policies.

3. How macroeconomic policies are implemented to promote employment

3.1 Coordination mechanism for pro-employment macroeconomic policies

3.1.1 The Inter-Ministerial Meeting on Employment

Since employment promotion was established as a top priority, it has become the State Council⁷'s routine work to discuss employment issue. Each department of the State Council performs its own functions according to the overall arrangements by the State Council. To highlight the importance of employment promotion and the obligations of the relevant departments, particularly in coping with the massive unemployment during the late 1990s and early 2000s, in 2003 the State Council set up an institutional mechanism – the Inter-Ministerial Meeting on Reemployment. In 2005, the State Council decided to rename the Inter-Ministerial Meeting as the “Inter-Ministerial Meeting on Employment”; it is coordinated by the Ministry of Labor and Social Security (MOLSS)⁸ and comprises key departments⁹. The EPL institutionalizes this mechanism, whose main tasks are to deliberate on vital issues relating to employment and coordinate work on employment promotion. The EPL also designates the MOLSS to lead employment work and requests local governments to follow the similar institutional arrangements.

Among the member Departments of the Inter-Ministerial Meeting, the People's Bank of China (PBOC), Ministry of Finance, National Development and Reform Commission (NDRC), and State Administration of Taxation (SAT) are responsible for the implementation of macroeconomic policy. The PBOC facilitates employment promotion through monetary and exchange rate policies, guiding the financial activities of the “policy banks”¹⁰ and commercial banks. The Ministry of Finance is responsible for implementing fiscal policies and funding government programs aimed at employment promotion. The NDRC, coordinating with the Ministry of Finance, plays a role in employment promotion through large investments, sectoral policies and infrastructure projects. The NAT coordinates with the Ministry of Finance to enforce the relevant fiscal policies relating to taxation.

⁷ The State Council is the highest administrative authority in the Government of China, chaired by the Premier and including each Government department and agency head.

⁸ Became the Ministry of Human Resources and Social Security (MOHRSS) upon merger with the Ministry of Personnel in 2008.

⁹ The members of the Inter-Ministerial Meeting include representatives of key Government ministries as well as social partners: the Ministry of Labour and Social Security (MOLSS), the National Development and Reform Commission, the Ministry of Education, the Ministry of Supervision, the Ministry of Civil Affairs, the Ministry of Finance, the Ministry of Construction, the State-Owned Assets Supervision and Administration Commission, the People's Banks of China (PBOC), the State Administration of Industry and Commerce, the State Administration of Taxation (SAT), the State Commission Office of Public Sectors Reform, the Central Committee of the Communist Youth League, the All-China Federation of Women, and the All-China Federation of Trade Union

¹⁰ These are government banks set up in 1994 to replace the government spending functions formerly provided by state-owned commercial banks: the Agricultural Development Bank of China (ADBC), China Development Bank (CDB), and the Export-Import Bank of China.

3.1.2 Example: The 2002 Government response to unemployment

Taking the decision-making process in 2002 – when the Chinese Government coped with the massive unemployment and laid-off workers from SOEs – as an example, we illustrate how the responsibilities are divided and policies implemented among the various departments of the Central Government. The whole process follows a top-down procedure and responsive pattern. It consists of three steps of policymaking and implementation: (1) CCCPC and State Council, (2) the Inter-Ministerial Meeting, and (3) the relevant Ministries. Such decision-making and policy implementation guarantees consistency of policy targets and enforcement of Central Government decisions.

- 1) On September 30th 2002, the CCCPC and the State Council issued a *Notice on the Work of Reemployment of the Unemployed and Laid-off*, which can be summarized as follows:
 - a) It required integration of the stabilization of the unemployment rate and job creation in the targets of macroeconomic policy, economic and social development plans.
 - b) It designated employment promotion as one of the key components of government performance appraisal, which included indicators such as net increase in jobs, the reemployment rate, public service of reemployment performance, special fund contributions for reemployment, and assistance to the vulnerable in the labour market. These tasks are divided between and enforced at the various levels of Government.
 - c) It proposed maintaining a minimum necessary economic growth rate; speeding up the process of structural adjustment; encouraging private and foreign investment to develop the non-public sector; developing labour-intensive industries, the services sector and flexible employment; and separating supporting jobs from the major business in SOEs (Office of the Inter-Ministerial Meeting on Employment of the State Council, 2008: pp. 57-62).
- 2) On 25 November 2002, all the Government departments who later became members of the Inter-Ministerial Meeting jointly issued the resolution *Suggestions on Implementing the Notice on the Work of Reemployment of the Unemployed and Laid-offs*. The *Suggestions* specify which groups to target for reemployment, and the policy tools for implementation. In addition, the *Suggestions* determine the division of responsibilities among the departments and local governments at all levels (ibid: pp. 84-90).
- 3) The relevant departments at the central level issued their own documents on how to concretely implement those policies. For instance, on 3 December 2002, the Ministry of Finance and MOLSS issued documents to commit funds in support of reemployment. On 27 December 2002, the Ministry of Finance and the SAT issued documents on tax reductions and exemptions to support reemployment. On 14 December 2002, the PBOC issued documents on micro finance supporting reemployment (ibid: pp. 91-116).

Regarding the orientation and effects of the monetary policies, the PBOC increased open market operations in the first quarter of 2003, which significantly increased the velocity the money supply and provided sufficient liquidity. By the end of March 2003, the broad money supply M2 had increased by 18.5 per cent year on year. The loans from financial institutions increased substantially, especially loans to SMEs, while consumption loans expanded in order to bolster domestic demand. The PBOC also made efforts to stabilize the CNY exchange rate by means of open market operations. In the last quarter of the year, GDP growth rate rose to 9.9 per cent, 2.3 percentage points higher than the same period last year (PBOC, 2003).

3.2.2 Labour market information systems

In addition, the Ministry of Human Resources and Social Security (MOHRSS) and the National Bureau of Statistics (NBS) jointly collect labour statistics to provide labour market information for decision-making. The officially used labour market statistics include the following sources.

First, the employment reporting system in urban areas is conducted by the NBS, which collects employment information from all work units (*dān wèi*) with independent accounting. Combined with the labour statistics on private enterprises and individual business collected by the State Administration of Industry and Commerce, the aggregate data reflects employment dynamics by sector, province and ownership. Usually, this information is publicized annually. Based on these sources, total employment in urban units was 322 million in 2013.

Second, the NBS has set up a nationwide labour force survey at the household level using the ILO definition¹¹, which provides basic information on employment and unemployment. Using the collected data, the employment rate, unemployment rate, labour force participation rate, and other internationally comparable indicators can be calculated. Based on the NBS, the urban employment totaled 383 million in 2013. The difference between this number and total employment in urban work units (322 million) can be deemed as a proxy for urban informal employment (Cai, 2004). In recent years, the NBS has begun to conduct urban labour force surveys in 31 large Chinese cities. The results are only used for internal reference among Government departments and are not publicized. Nevertheless, according to Premier Li Keqiang's speeches in some occasions, the urban unemployment rate was about 5.1 per cent in 2014 and 2015.

Third, official urban unemployment status, as registered with the public employment services agency run by the MOHRSS, is the basis for unemployment insurance benefit payments. Since migrant workers have limited access to unemployment insurance programs, registered unemployment mainly covers workers with local urban *hukou* status. In recent years, the registered unemployment rate has been very stable, around 4.1 per cent.

Fourth, the Labor Market Monitoring Center affiliated to the MOHRSS collects quarterly data on labour demand and supply from the public employment service scattered in more than 100 cities. The Center publishes the ratio of job vacancies to job seekers by region, education level, and occupation every quarter, which reflects the short-term situation of the job market. In general, the trend of this indicator has been consistent with macroeconomic and other labour market indicators. Since 2009, this ratio has been greater than one, which indicates a tight labour market, i.e. there are more vacancies than job seekers on average.

Fifth, the NBS established a nationwide migrant worker monitoring survey in 2008, which collects information on migrant workers based on the household survey in target areas. This survey provides information on migrant workers such as total number, regional and sectoral distribution, their wage rate, social security status, and demographic features. The aggregated information is published in a monitoring report annually. According to the latest update, migrant workers totaled 168 million - 1.3 per cent more than the previous year.

Additionally, some other complementary information is used as a basis of decision-making. For instance, the PBOC includes indicators such as employment expectations and employment perception in its urban household savings survey. These indicators are used as

¹¹ See ILO (1982) for details at http://laborsta.ilo.org/definition_E.html.

warning signals of unemployment risks. The NBS includes an employment index in the survey that collects data for the Purchasing Manager's Index¹² in manufacturing and non-manufacturing sectors; this serves as leading index of labour market outcomes.

Labour market data also help determine the progression of CPC cadres and civil servants: they are assessed by their superiors on the basis of progress in achieving local employment objectives on the basis of indicators such as the urban registered unemployment rate, employment rate, and new job creation in urban areas. The 2008 *EPL* states that:

Article 58 – The People's Government at all levels and all the relevant departments shall establish a target-based responsibility system for the promotion of employment. The People's Government at or above the county level shall, on the basis of the requirements of such a system, assess and supervise the work of its subordinate departments and the People's Government at the next lower level.

Once the central documents and related laws set employment as a priority and specify the targets, expansion and stabilization of local employment naturally become a key criterion of such an evaluation system within the government hierarchy. The data used for such evaluations also helps assess the efforts and impact of the Government at each level in coping with local employment challenges

It is worth noting that no single department is authorized to decide the specific direction and strength of macroeconomic policies. All departments are required to hold the same policy orientation and carry out the decisions of the CCCPC and the State Council. The CCCPC convenes the Central Economic Conference at the end of every year to set the general tone and policy direction of economic work in the coming year. After collecting all relevant information, including that on the labour market situation, the State Council requires the relevant departments to propose concrete policy measures and implementation plans.

The following subsection examines the work of the PBOC and the Ministry of Finance, the two major institutions responsible for macroeconomic policy, as examples of how to promote employment through monetary and fiscal policy.

3.2 The People's Bank of China, the financial system and organizations

3.2.1 Monetary policy

The People's Bank of China (PBOC) is the central bank of China. According to the *Law of the People's Bank of China*, the PBOC is under the leadership of the State Council and consequently lacks policy independence. It is responsible for making and implementing monetary policy, preventing and relieving financial risks, and maintaining financial stability. The PBOC summarizes its policy instruments as the following five categories: (1) open market operations, (2) deposit reserve requirements, (3) direct loans from the central bank, (4) interest rates, and (5) "standing lending facilities"¹³. All these policy instruments are similar to the ones used in other market economies. Although employment promotion is not

¹² The Purchasing Managers Index (PMI) is compiled from data on production, new orders, main raw materials inventory, number of employees and supplier delivery time. It is used to help monitor and forecast macroeconomic trends (NBS, 2016).

¹³ An instrument peculiar to the PBOC where the policy and commercial lenders can ask the central bank for one to three month loans and the interest rate is determined case by case. Standing lending facilities allow the PBOC to target banks that need liquidity support and withhold loans if necessary, without affecting the others.

explicitly written in the *Law of People's Bank of China* as an independent monetary policy target, the 16th CPC National Congress set employment expansion as one of the four targets of macroeconomic policies, separate from the economic growth target. This implies that, under the unified decision of the State Council, the PBOC has the obligation to increase and stabilize employment by implementing monetary policy to this end.

However, it is hard to understand the Central Bank's policy stance simply based on PBOC statements, let alone how the monetary policy responds to employment pressures: since 1998, the official pronouncements on monetary policy have been worded as "prudent" and never altered. In fact, prudence is a guiding principle aimed at preventing financial risks when making monetary policy. Rather, in practice one has to recognize the implemented monetary policy as "loose", "neutral", or "tight" based on the declarations of the State Council and the PBOC with regard to economic growth. In other words, policy-makers, by and large, adjust economic growth rate in response to employment pressure. Typically, in each of the Five-Year and annual plans the Government sets up a GDP growth rate target to ensure full employment. When actual economic growth rate is lower than the target and the unemployment rate rises, the Central Government proposes maintaining a certain growth rate and requires the PBOC to adjust monetary policy accordingly.

Due to the high proportion of indirect financing in China, the PBOC uses other policy tools in parallel with conventional monetary policy to maintain the necessary amount of credit to financial institutions, direct loans to target areas and monitor performance. Among these policy tools, "window guidance" is the most distinctive one, where the Central Bank takes advantage of its authority and influence in the financial system to "advise" the lending behavior of commercial banks and guide financial institutions to respond to the Central Government's policies actively. This administrative policy instrument does not represent pure market approach, but is necessary and works under the conditions of an immature financial market. More generally, monetary policy tools are not just confined to changes in the benchmark interest rate or deposit reserve ratio, but also include social interactions such as face to face meetings, dialogue, or decisions by the Inter-Ministerial Meeting in order to achieve the goal of stabilizing the job market and reducing unemployment rate. Only in such a way can macroeconomic regulation be strictly enforced and have immediate effects.

Overall, during the past decade, investment in these job-creating sectors substantially increased. For example, in the 2002 *Government Work Report*, the Chinese Government proposed giving priority to the development of pro-employment industries including labour-intensive sectors, services, and SMEs (Zhu, 2002). As a result, fixed asset investment grew faster in services and manufacturing than in other sectors during 2003-2013, and faster in the private sector than in other sector during 2006-2013. However, faster growth in prioritized sectors cannot be simply attributed to monetary or industrial policies, but should be deemed the result of investment allocation in accordance with the comparative advantage of labour. This is because in the same period, total fixed asset investment, the proportion of budgetary funds, domestic loans, and foreign investment declined, while the proportion of self-financed funds/loans from other sources made up 82.5 per cent of the current total.

3.2.2 *Exchange rate policy*

The State Administration of Foreign Exchange (SAFE) is both the national level agency managing foreign exchange and part of the PBOC. Exchange rate policy and capital account management are component of monetary policy, also following the prudence principle. Though the SAFE does not declare policy targets on employment promotion explicitly, it is assumed that boosting economic growth and preventing financial risks serve the overall goal of promoting and stabilizing employment. Since 1994, China has steadily pursued foreign

exchange reforms and established a unitary¹⁴, managed floating exchange rate regime based on the supply and demand of foreign currency, i.e. increasingly allocated on the basis of market forces. The Renminbi (CNY) is convertible in the current account, and its convertibility in the capital account has been gradually pushed forward. As part of the macro prudential framework, management system of foreign debt and capital flows has been established. Under the principle of deepening reforms, the exchange rate policy and administration of the capital account have helped expand foreign trade, attract FDI flows and encourage domestic enterprises to develop overseas.

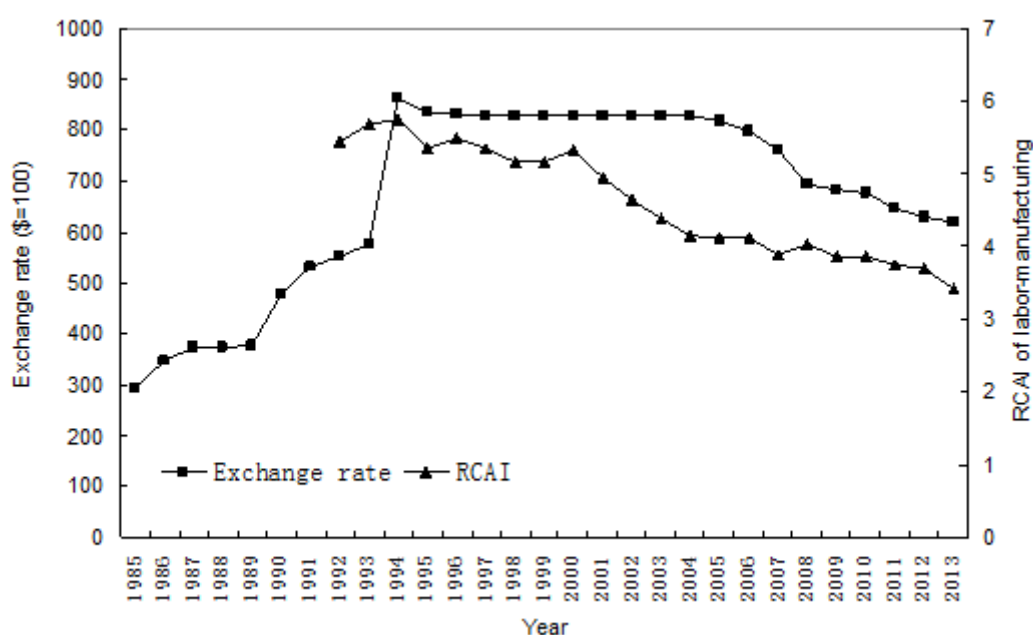
Prior to the reforms, the exchange rate of the CNY had been depressed and seriously distorted. Since the early 1980s, a dual track system where the official exchange rate and swap price of foreign exchange coexisted. Exporting firms were able to make a profit by selling foreign exchange on the swap market, which helped exporting industries develop. In 1994, the official exchange rate and swap exchange rate of the CNY were merged, while the system of foreign exchange retention and submission¹⁵ was replaced by a system of exchange settlement and sales. China kicked off this unitary, managed floating exchange rate regime, which is based on supply and demand in the foreign exchange market. At the same time, the CNY depreciated substantially at one blow, and the exchange rate drew near to the market equilibrium level. Then, in the period 1994 to 2004, the exchange rate level of the CNY remained relatively stable, with a slight appreciation. In 2005, the PBOC announced it would end the practice of pegging the CNY to the US dollar, replacing it with a managed floating exchange rate regime, based on a basket of foreign currencies. The CNY has appreciated substantially since then.

After the 2008 global world financial crisis triggered by the subprime crisis in the United States, the deceleration of exports and fall in trade surplus substantially decreased; the contribution of net exports to economic growth was often nil recently. In 2012, the International Monetary Fund (IMF) admitted that China had undergone a significant reduction in its current account surplus since peaking in 2007 and, as a result, the CNY is now only moderately undervalued. In May 2015, the IMF declared that China's currency is "no longer undervalued" (Mitchell and Donnan, 2015). Figure 2 depicts the exchange rate of the CNY against the US dollar since 1985 and revealed comparative advantage indices (RCAI – the ratio of the Chinese share of exports to the total share of exports in the world trade) of 11 selected labour-intensive products. Despite the limited numbers of years reporting the RCAI, the overall trend in the figures indicates a logical relationship and the changes in the two time series.

¹⁴ Previously, the People's Republic of China had a dual currency system with locals using the Renminbi (CNY) while foreigners in China had to use foreign exchange certificates, which were convertible at a fixed exchange rate. This was abolished in the 1990s in favour of a unitary currency – the Renminbi (CNY).

¹⁵ From 1979 to 1994, exporters were allowed to retain a share of their foreign earnings in foreign currency for their import needs ("retention"), while they excess foreign currency through the State Administration of Exchange Control ("submission").

Figure 2 The exchange rate and revealed comparative advantage indices (RCAI) of selected labour-intensive products in China (1985-2013)



Source: NBS (2014) and UN (2014).

According to the theory of comparative advantage, the Chinese economy, which had experienced a dual economy development with unlimited labour supply, would hold comparative advantage in labour-intensive manufacturing once it kicked off the opening-up and started fast growth – for example, the revealed index of comparative advantage of 11 products in Figure 2 are all greater than 1. This process has driven massive employment growth. In 2004, exports accounted for 23.9 per cent of total sales in manufactured goods, while the share of employment in export-oriented firms was 26.4 per cent of total employment in manufacturing. In 2008, the two shares were 18.9 and 22.3 per cent, respectively. Not only that, export-oriented firms in coastal areas, for example in the Pearl River Delta region, hired massive numbers of migrant workers and/or agency workers, who are often not included in the official employment statistics, so actual employment in export-oriented sectors tends to be underestimated to a great extent. Consequently, the dependence of Chinese economy on exports would be higher than it seems if measured by employment rather than export value.

3.3 The Ministry of Finance and fiscal policy

The functions of the Ministry of Finance in implementing macroeconomic policies designated by the Central Government include: (1) analyzing and predicting the macroeconomic situation, (2) involvement in making macroeconomic policies – namely, proposing fiscal policies to regulate the macro economy – and (3) achieving the principal macroeconomic policy objectives set by the 16th National Congress of CPC in 2002, of which employment expansion is one. Policies are implemented by means of the state budget, taxation, public investment, fiscal subsidies, and fiscal credit allocation in accordance with the macroeconomic policies decided by the State Council. In addition, tax reform is a component of fiscal policies as broadly defined. In practice, the implementation of pro-employment fiscal policies is embodied in two areas: (i) the Ministry of Finance directly implements fiscal policies under the guidance of the budgetary plan, while (ii) the National Development and Reform Commission (NDRC) and other Government departments implement industrial and regional policies. We outline some of these practices below.

First, the targeted economic growth rate is incorporated in the budgeting and allocation approval process. The targeted rate is set to ensure the expansion and stabilization of employment, and to balance economic and social development. In general, the annual budget is required to respond to the general tone of the macro economy proposed by the Central Economic Conference held at the end of each year, and is discussed and approved by the National People's Congress (NPC)¹⁶ session held in March of the following year. Proactive employment policies and employment-oriented principles are discussed and evaluated as part of the proposed budget during the NPC session. As a routine, the annual budget determines the appropriate level of budget deficit given the policy response to the economic cycle, ensures funds are allocated to support national employment policies, sets up target growth rates for pro-employment public investments, and allocates expenditure to social protection programmes.

Second, according to the macroeconomic situation and overall directives of the State Council, the relevant departments implement cyclical policies aimed at smoothing the economic cycle. For example, in different years, the official macroeconomic policy stance has been “fiscal policies aiming to promote the adjustment of the national economy” (1979), “tight fiscal policies” (1988), “moderately tight fiscal policies” (1993), “active fiscal policies” (1998), “prudent fiscal policies” (2004), and “active fiscal policies” (since 2008) respectively. As for active fiscal policies, stimulus measures include: issuing national or local bonds on behalf of local government, supporting public investment in infrastructure construction and other projects, relieving or exempting taxes on small, medium, and micro enterprises and start-ups, and implementing financial discount policies for micro finance and social security funds.

Third, reforms of the taxation system aim to foster and develop targeted sectors and industries in order to expand employment. One such reform is the value-added tax reform through a pilot programme, which will replace the business tax with a value-added tax (or, VAT/BT reform) on transportation and other selected modern services sector. The reform aims to remove double taxation on goods and services, thereby supporting business development and employment creation. For a long time, Chinese policy-makers and researchers believed that, due to its low share of GDP compared to that of the secondary sector (particularly manufacturing), the services sector was not conducive to employment expansion. Since the arrival at the Lewis turning point in 2004, the comparative advantage of manufacturing has weakened as a result of rising labour costs. This has created the necessary policy environment for services sector development, particularly for the modern services sector, and therefore provided new growth possibilities for employment. Moreover, since a large proportion of the new entrants in the labour market hold college degrees, expansion of modern services is more likely to create productive jobs that match their skills.

For this reason, the Central Government has gradually extended the VAT/BT reform to a wider range of sectors and regions. On 1 August 2013, a VAT/BT pilot was carried out nationwide. On 1 January 2014, railway transportation and the post services were incorporated, which represented full coverage of the transport sector in the pilot program; since 1 June 2014, the telecommunications sector was incorporated in the reform as well. Such progress with tax reform has accelerated the faster growth of output value and employment generation in the services sector, increasing significantly the share of services sector in the total economy.

In the period from 2000 to 2010, the share of the services sector in terms of value added increased from 39.8 to 44.2 per cent, an average annual increase of 0.44 percentage points. This share further increased to 48.2 per cent in 2014, an average annual increase of 1 percentage point since 2010. The modern services sector can roughly be categorized as the

¹⁶ The national legislative body of China.

following: water management and conservation, environment, and public facilities, information transmission, computer services and software, financial intermediation, real estate, leasing and business services, scientific research, technical service and geological prospecting, education, health, social security and social welfare, culture, sports and entertainment, and public management and social organization. The contribution of these subsectors to total employment in the whole services sector stranded at 58.6 per cent during the period of 2004 to 2013, when the first and third rounds of Economic Survey were conducted, respectively. Expansion of services has no doubt improved the employment situation for college graduates given that those sectors are major creators of employment.

3.3 Challenges to policy implementation

China has also experienced challenges in implementing pro-employment macroeconomic policies, including adapting previously successful policies to changed circumstances. We summarize some these below.

One of the lessons is that macroeconomic policies have not always been implemented through altering macroeconomic signals which allow markets to react towards recover economic boom, but often by dint of administrative means, which, while solving temporary, immediate problems, generates future risks. For example, in implementing the stimulus package to tackle the 2008 global financial crisis, some construction projects that previously had been rejected in accordance with industrial policies were approved in order to quickly stimulate economic recovery, which resulted in the duplication of project construction, overcapacity, a real estate bubble, and large local government liabilities. Despite the fact that these projects absorbed large amounts of labour, should the potential risks become a real crisis, many of these new jobs will be destroyed and the resulting employment shock may be more severe than otherwise.

Another lesson lies in the conflict between policy objectives. There are potential conflicts among the four major objectives of macroeconomic policy: economic growth, employment expansion, price stability, and a balance of international of payments equilibrium. Which objectives should a government pursue as a priority when designing macroeconomic policy and economic development plans? If a conflict does occur, there would be no guarantee that employment is always prioritized. Local governments tend to focus on GDP growth and tax revenue, which are not necessarily compatible with employment expansion. For example, while heavy industry and infrastructure projects that require large scale capital investment are more likely to meet the desire of governments for local economy and fiscal revenue growth, they generate a limited number of temporary, low-productivity jobs.

In addition, although the PBOC has not officially adopted an inflation targeting framework, it intends to give price stability a high priority in determining monetary policy. For example, Governor Zhou Xiaochuan of the PBOC once pointed out that “compared to other economies, the Chinese economy has the nature of being in ‘transition’, therefore, [we] should pay more attention to the problems caused by economic overheating and inflation, and give priority to the guard against the risk of inflation” (Zhou, 2012). Putting price stability above the other considerations tends to overlook the dual nature of China’s economy, leading to rigid uniformity when implementing monetary policy. For example, when implementing tight monetary policies, non-public SMEs, which have disproportionately larger employment elasticities and concentration of informal employment, suffer the most from the tightening, while large-scale projects and less labour-intensive SOEs may still retain privileged access to financing.

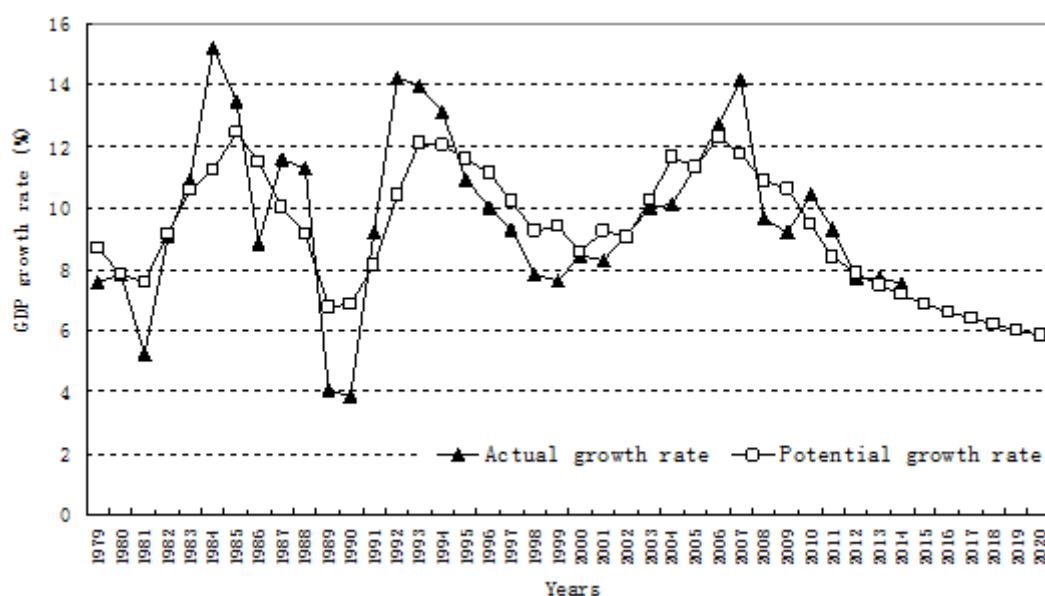
4. The experience of coping with the economic cycle and crises

In the course of its unprecedented economic growth since the Reform and Opening Up policies were initiated in the late 1970s, the Chinese economy has experienced dramatic macroeconomic fluctuations – namely, macroeconomic downturns and international financial crises – which impacted on employment negatively. To understand how macroeconomic policies responded to the evolution of employment policies, and how Government departments implemented policies to promote employment and stabilized the labour market, we review some significant employment shocks in recent Chinese history, and summarize the policy response in each case.

4.1 Economic growth and urban unemployment trends

The negative impacts of macroeconomic fluctuations on employment are usually caused by the fact that aggregate demand embodied in exports, consumption, and investment falls short and thus actual growth rate is lower than the potential growth rate. Therefore, a negative gap between the actual and potential growth rates occurs together with cyclical unemployment. Since there are no consistent and systematic statistics on unemployment rate in China, in order to accurately narrate the economic and employment fluctuations since the Reform and Opening Up policies began, we first compare the actual growth rate with the potential growth rate (Figure 3), and then compare the estimated growth gap with the available unemployment rates (Figure 4).

Figure 3 The potential and actual growth rates in China (1979-2020)

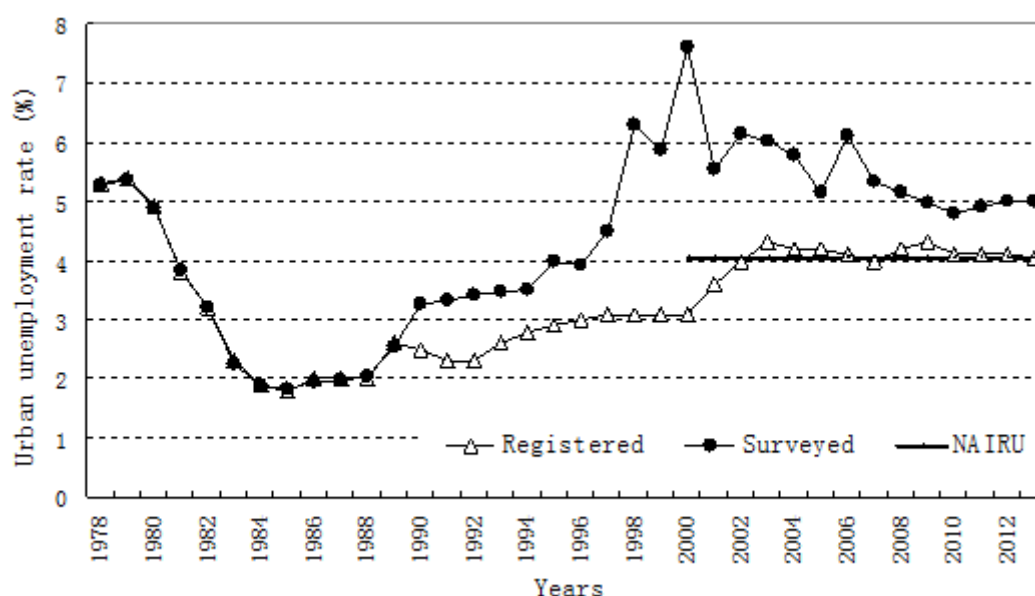


Source: Cai and Lu (2013).

From Figure 3, one can see that the potential and actual growth rates were roughly similar – about 10 per cent – in the period from the late 1970s to 2010. Meanwhile, there were economic fluctuations during this period, though the amplitude of fluctuations tended to narrow over time. Besides, the economic fluctuations were mainly caused by domestic factors before the late 1990s; they have been more affected by international financial crises since then. As Figure 3 shows, there have been four significant cycles during the entire period based on the negative gap between actual and potential growth: (i) in the early 1980s, (ii) in the late 1980s and early 1990s, (iii) in the late 1990s to the early 2000s, and (iv) in 2008 and 2009.

In order to examine the relationship between economic fluctuations and the labour market, we need to show the changes in the urban unemployment rate during the period. The Government has been publishing urban registered unemployment rate per annum, but has never published the urban surveyed unemployment rate up to now, even though such a survey began being conducted as early as in 1996 and has been technically improved since then. However, by using data on the economically active population and employed population from the labour force survey conducted and published by the NBS, and based on some reasonable assumptions, we can estimate the urban surveyed unemployment rate since the mid-1990s. Before the mid-1990s, the number of urban unemployed was equal to that of the registered unemployed, because those registered rarely had re-employment opportunities. Therefore, the urban registered unemployment rate can serve as a reasonable proxy of the urban surveyed unemployment rate which was not available at that time. Combining the estimated results with the data calculated from population censuses and piecemeal figures collected from media reports in recent years, we can build a time series data set of the urban surveyed unemployment rate and find it consistent with the trend (Figure 4).

Figure 4 Selected urban unemployment measures in China (1978-2012)



Source: Du and Lu (2011); NBS (2014).

4.2 Macroeconomic policy reforms in the 1990s

The two macroeconomic downturns – the one that happened in the early 1980s, and the other at the end of the 1980s and in the early 1990s – were both caused by domestic factors and characterized by high levels of unemployment. As mentioned in the previous section, the unemployment problem that accompanied the first macroeconomic fluctuation in the early 1980s was solved by the economic reforms and reform-driven economic growth. The second macroeconomic downturn during the late 1980s and early 1990s, was caused by policies aiming to tackle inflation in 1988-1989, and by the subsequent retrenchment policies to achieve macroeconomic stability. During this period, economic growth recovered and then accelerated to an even higher level than the potential growth rate, which generated great job opportunities. This significant economic growth was further promoted by deeper economic reforms launched by the famous 1992 speech of Deng Xiaoping made during his tour of South China.

At the time, there were neither market-oriented macroeconomic policies, nor announced macroeconomic policy goals for employment expansion. Policy-makers, however, understood the fact that economic growth could create more jobs, that the economic system reform could help expand employment channels, and that, as long as the economy could

return to its normal growth track, the problem of cyclical unemployment would finally be solved. This was because the main task of employment policy during this period was to help surplus labourers find jobs, rather than to dealing with cyclical unemployment.

In the late 1990s, the macroeconomic downturn and the Asian financial crisis successively caused a serious wane in demand, leading to underutilization of production capacity and mass unemployment. The urban surveyed unemployment rate in 2000 had reached the highest level in the history of the People's Republic of China. However, China's accession to the WTO facilitated access to strong external demand for Chinese manufacturing, and economic growth rebounded to its potential and unemployment rate fell after 2000. In the process of coping with the economic cycle, the Chinese government gradually formulated employment policies and strategies, and in particular, monetary and fiscal policies to tackle the severe unemployment challenge for the first time.

In order to restore economic growth, the Central Government shifted the orientation of both fiscal policies and monetary policies from "moderately tight" to "proactive fiscal policies" and a "prudent" (but then read as robust) monetary policy. The then Premier Zhu Rongji set a strict target growth rate of no less than 8 per cent in 1998, which was long accepted as the bottom line of GDP growth rate by the Central Government. Later, the documents of the CCCPC explicitly proposed "promoting sustainable, rapid and healthy development of national economy" (see, e.g., CCCPC, 2000), which further supported the growth target.

In 1998, the Central Government proposed implementing proactive fiscal policy and to issue long-term government construction bonds in order to stimulate domestic demand. About CNY 910 billion of such bonds were issued from 1998 to 2003. The PBOC removed loan limit controls on commercial banks on 1 January 1998, cut the required reserve ratio from 13 to 8 per cent in March 1998, and cut it once more to 6 per cent in 1999. In addition, the PBOC widened the floating range of the lending rate three times in 1998 and 1999, and lowered benchmark interest rates of both deposits and loans five times from 1998 to 2002. In September 1999, a tax on interest was levied, which indicates a transition from restraining to stimulating consumption (Zhong, 2010).

Under the overall guidance of the Central Government, the Ministry of Finance, the PBOC and other departments made the following fund and credit arrangements to promote employment and reemployment, which are largely still in effect:

- 1) Firstly, the Central Government channels funds into the budget plan to support the expenditure of the local government in assisting employment. The funds are mainly spent on the following: social insurance subsidies, guarantee funds for micro-credit, interest subsidies of micro-credit loans for low-profit projects, as well as subsidies for skills training, for public employment services, and for public works. For those enterprises that recruit recently laid-off workers, the Government grants exemption from sales tax, urban maintenance and construction taxes, education fees, and corporate income tax for a certain number of years. In addition, fiscal subsidies are arranged to deal with enterprise bankruptcies and support the reemployment of laid-off workers. A variety of administrative fees were also abolished in order to reduce the burdens on enterprise.
- 2) Secondly, micro-credit is provided to help recently laid-off workers start their own business. While local governments guarantee financial funds, banks provide subsidized loans at a discounted rate – 50 per cent of the benchmark interest rate – to those enterprises that are willing to recruit the recently laid-off workers.
- 3) Lastly, the 1994 exchange rate regime reforms discussed earlier in this paper helped the rapid development of the export-oriented economy and with employment creation, although not intentionally part of the policies tackling unemployment. China's exports

benefited immediately from these reforms and the balance of trade swung from deficit to surplus that very year.

The proactive employment policies, including macroeconomic policies, have been well implemented. Particularly, with China's entry into the WTO, export-oriented labour-intensive industries in coastal areas expanded rapidly. Since 2002, the economic growth rate has risen to the level of the potential growth rate, urban surveyed unemployment rate has gradually declined and urban registered unemployment rate has remained at the level of a little bit higher than 4 per cent over the 14 years since then.

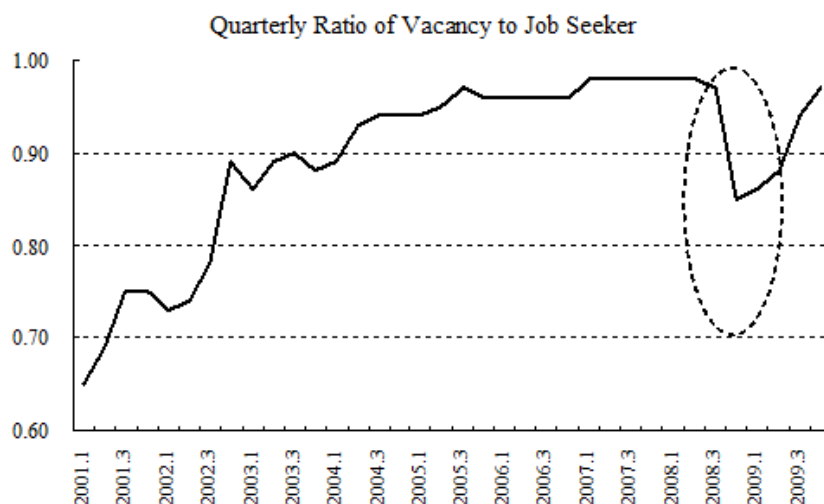
4.3 The policy response to the 2008 global financial crisis

The 2008 global financial crisis resulted in an external shock to export-oriented manufacturing in coastal areas, which temporarily brought actual economic growth below the potential rate. A cyclical phenomenon, this economic downturn only lasted for a short period of time before economic growth recovered. It seems that this downturn did not cause severe unemployment: the urban registered unemployment rate only rose slightly for a short period, and the urban surveyed unemployment rate did not show any increase at all. One can understand this in following ways.

4.3.1 *The impact of the 2008 employment shock on migrant workers*

As shown in Figure 3, we find that the estimated non-accelerating inflation rate of unemployment and registered unemployment rate in urban China have been almost the same in recent years (Du and Lu, 2011), which is no coincidence. In China, only urban residents with local *hukou* are entitled to registered unemployment status and to claim benefits from the MOHRSS; most migrant workers are ineligible to do so. Typically, workers with urban *hukou* status only suffer natural (structural and frictional) unemployment and are generally free from cyclical unemployment: migrant workers tend to be more affected by cyclical unemployment. Specifically, in the face of the labour market shock caused by the global financial crisis, masses of migrant workers temporarily lost their jobs in cities and had to return to their home villages in late 2008 and early 2009. Because the official urban labour survey could only cover a fraction of the migrant workers, it was not representative of their total numbers. As migrant workers left cities, they completely withdraw from the survey sample population, so the impact of the global financial crisis on employment was not manifested in a rise of the urban unemployment rate. On the other hand, an employment shock did exist and was still reflected by the "ratio of vacancy to job seeker" indicator, which is calculated based on data collected from public employment services and published by MOHRSS (Figure 5): the ratio abruptly decreased in 2008, indicating a rise in the number of job-seekers per vacancy.

Figure 5 Quarterly ratio of vacancy to job seeker (2001-2009)



Source: China Labor Market Information Center (2014).

4.3.2 *The role of the fiscal stimulus package as a policy response*

The macroeconomic policy response to the employment shock was characterized by a large stimulus package. In the face of the shock, the Chinese Government rapidly renounced the implementation of “moderately tight” macroeconomic policies in the second half of 2008 and instead announced a stimulus package totaling CNY 4 trillion at the end of that year to ensure an economic growth target of 8 per cent. The Central Government allocated CNY 1.18 trillion to public investments, expecting contributions of CNY 2.82 trillion from local governments and other sectors. The Central Government’s investments were financed by budgetary and Central Government funds, while the local contributions were raised from their own budgets and bonds issued by the Central Government on their behalf, policy-related loans, medium-term debenture stock, bank loans, and private investments. The composition of this CNY4 trillion stimulus package addressed both long-standing bottlenecks in the economy and priority areas¹⁷ to stimulate economic growth.

In the course of implementing this stimulus package, fiscal, monetary, industrial and regional policies were combined and coordinated. After the NDRC approved specific investment projects, the Ministry of Finance arranged the necessary fiscal funds, the PBOC accordingly loosened monetary policy, and the commercial and policy banks cooperated actively to carry out those projects practically. In addition, local governments actively responded to the projects conducted by the Central Government and built various investment platforms. In the end, the stimulus package was enlarged to investments totaling about CNY 30 trillion. Given the speed with which the various departments responded and the final scale of the package, its effect on recovery of economic growth was tremendous. While economic growth rate rebounded to 8.7 per cent in 2009, the employment situation soon stabilized.

For example, employment expansion in construction largely made up for the loss of migrant worker employment in manufacturing. According to a survey conducted by the NBS, the proportion of migrant workers employed in manufacturing decreased from 42.0 per cent in 2008 to 39.1 per cent in 2009, whereas the proportion of migrant workers employed in construction increased from 16.3 per cent in 2008 to 17.3 per cent in 2009 (Sheng et al.,

¹⁷ The exact allocation was: construction of key infrastructure (38 per cent); recovery of earthquake-impacted areas (25 per cent); subsidized housing (10 per cent); and rural infrastructure construction (9 per cent); investments in innovation and economic restructuring (9 per cent); greenhouse gas emissions reduction and environmental protection (5 per cent); and social development (4 per cent).

2009). Together with the services sector that absorbed some displaced migrant workers, most of them returned to the cities and found jobs soon. Since the second half of 2009, the issue of labour shortage has reemerged.

4.3.3 Other complementary measures

The proactive employment policies formulated in the early 2000s and the *Employment Promotion Law*, and *Employment Contract Law* that came into effect since 2008 all played a role in tackling the employment shock in terms of providing employment assistance and promoting business start-ups while protecting labour rights. The Government also issued a series of measures to ease the burden on enterprises by allowing those with financial difficulties to postpone the payment of social insurance contributions. It is estimated that the postponed payment amounted to over CNY 100 billion, allowing around 10 million jobs to be maintained (Cai et al., 2009).

5. Challenges facing China's employment in near future

While fast economic growth helped resolve underemployment in rural and urban areas, China's demographic transition entered a new phase signaled by the deceleration of the working age population growth rate. Since the shortage of migrant workers appeared in coastal areas for the first time in 2004, labour shortages have become widespread and the wages of unskilled workers have increased at an unprecedented rate. More generally speaking, the profiles of the labour supply and demand have dramatically changed since then.

The working age population (aged between 15 and 59) peaked in 2010 and shrank afterwards, which further exacerbated labour shortages, increased the wage costs of manufacturing, and weakening the comparative advantage of labour-intensive industries. More specifically, all factors that drove China's growth in the past decades have actually weakened, which is manifested in several aspects: inadequate labour supply and higher labour costs caused by labour shortages; diminished returns to capital inputs led by a rapid increase of the capital-labour ratio; and slow growth of total factor productivity because of slow growth of rural-urban labour migration.

As a result, both the potential growth rate, which is determined by changes in the supply of production factors and in productivity, and the actual growth rate have declined substantially since the beginning of the 2010s. According to the estimations of Lu and Cai (2014) and officially published data, while the potential growth rate declined from 10.1 per cent in 2010 to 7.4 per cent in 2014, the actual growth rate declined from 10.4 to 7.4 per cent correspondingly. That is to say, the demographic dividend that has been driving China's growth in the last decades, is disappearing speedily, and the labour market is therefore facing two new challenges.

First, the nature of the employment problem has substantially changed. As the labour surplus in agriculture and underemployment in the urban sector have been reduced, employment problems are no longer manifested as underemployment, but more and more as symptoms of natural unemployment (structural or frictional) caused by labour market mismatches. For example, new entrants in the job market now consist of graduates of all school levels, who often face difficulties in finding suitable jobs, the reason is largely the skills mismatch between what they have and what employers demand for. According to our calculations based on the data of the 2010 population census, the urban surveyed unemployment rate was 5.4 per cent on average, whereas each age group below 22 years old had a two digit unemployment rate, and the new entrants aged 16 had the highest unemployment rate a 17.8 per cent of the cohort. This implies that creating jobs through economic growth as a single way will no longer work to solve employment problem. On the other hand, macroeconomic policies need to be strengthened to play a role in monitoring and

alerting the labour market when cyclical unemployment caused by economic fluctuations becomes a more frequently occurring phenomenon.

Second, after China passed its Lewis turning point in 2004, labour shortages have become the norm in the labour market and a constraint on economic growth. Following the peaking of the working age population aged between 15 and 59, the economically active population, whether calculated from the ages of 15 to 59 or of 16 and above, will peak in 2017, amounting to 801 million and 784 million, respectively. Afterwards, the total number of economically active individuals (a better proxy of labour supply than working age population) will decrease in absolute terms. It is a new challenge for macroeconomic policies concerning how to address this altered labour market situation. The conventional tools of macroeconomic policies aim to increase labour demand by stimulating economic boom during the period when cyclical unemployment dominated the labour market, however, macroeconomic policies have to be applied in the future to increase the labour supply through eliminating institutional obstacles.

Finally, it is the right time to strengthen labour market institutions. In the above discussed context of the labour market, workers have started to demand higher compensation, better working conditions, and equal treatment in terms of social security benefits. This implies that China has entered into a new stage of development, where workers are claiming more powers and rights in collective bargaining, minimum wages, coverage of social security, labour contracts, and even urban *hukou* status, to which labour market institutions and the social protection system have to respond. For example, labour disputes represent their willingness to have “voice”. The average number of reported cases of labour disputes each year increased from 390,000 in 2003-2007 to 840,000 in 2008-2012. If macroeconomic policies in the past have played its role in creating more jobs, in the future, the role will be to provide better jobs.

6. Conclusion and discussion

6.1 The Chinese experience and lessons

China’s fast economic growth triggered by the Reform and Opening-Up policies in the late 1970s has been widely recognized as a miracle in economic development history. In implementing proactive employment policy, Government policy has successively paid attention to SOE workers, residents with urban *hukou* status, migrant workers, and surplus labour in agriculture. Ultimately, the Chinese people in rural and urban areas have all benefited from the miraculous economic growth which maximized employment. After the Lewis turning point was reached in 2004, the shortage of unskilled labour resulted in wage increases and convergence, in turn leading to a reduction in income inequality. The ratio of rural to urban income and the Gini coefficient among all residents peaked in 2009 and then began to decrease.

The experience of how such economic growth helped with poverty alleviation has also received high praise from the international community, and is set as an example for many developing countries. Recognizing China’s achievements in employment promotion and analyzing the underlying reasons helps draw lessons, separating the unique characteristics of the Chinese experience from the similarities with other developing countries. Consequently, we review below the Chinese experience in designing and implementing macroeconomic policies to promote more and better jobs.

6.1.1 *Prioritizing employment at the highest leadership level*

First, the hierarchy of policy priorities is a signal of how much a government focuses on certain areas of economic and social development – such as employment – and indicates whether the government is willing to allocate the necessary public resources to these areas. While at a certain stage of development, economic growth directly results in the expansion of employment, expansion of employment in itself should eventually become an independent objective of government. That is to say, apart from the rate of economic growth, policy should also focus on other areas that will impact on the quantity and quality of jobs, such as industrial policies, the quality of government services to promote employment, and the level of development of labour market institutions.

Chinese policy-makers have constantly made employment a policy priority, eventually raising it to the highest among the policy goals of economic and social development. Based on the core idea that employment is fundamental to the people's livelihood, pro-employment policies have been drawn up and endorsed by the highest levels of the Chinese Leadership and Government. Being put as one of the principle objectives of macroeconomic policy, employment issues are no longer solely taken care of by the MOHRSS but are the responsibility of all Government departments at all levels. Moreover, the Inter-Ministerial Meeting on Employment coordinates the formulation and implementation of employment policy across Government departments. Other countries seeking to prioritize pro-employment policies would similarly benefit from (i) policy endorsement at the highest levels of government and (ii) a coordination mechanism between the relevant government agencies to ensure policy coherence.

6.1.2 *Policy compatibility with labour market reforms*

The implementation of pro-employment macroeconomic policies also needs to be compatible with wider labour market reforms. One of the common tasks facing developing countries is fostering and developing labour markets while balancing the relationship between security and flexibility of employment, and thus between equity and efficiency. This trade-off requires the elimination of institutional barriers that prevent the expansion of employment quantity and quality. Since the late 1970s, along with fast economic growth, China has experienced thorough reforms aiming to establish a market economic system, on which the evolution of the objectives and instruments of macroeconomic policy arose.

Easing the transition to the market economy and facilitating structural transformation are important elements of CPC policy, as in the case of the combined policy package of breaking the “iron rice bowl” of the planned economy system, actively creating jobs, developing the labour market, and building the social protection net. In the late 1990s and early 2000s, in addressing the massive lay-offs in urban areas, the Chinese Government did not attempt to rescue the old jobs characterized by the “iron rice bowl”; these not only suppressed work incentives but had also lost competitiveness. Instead, the Government made efforts to create new jobs through economic recovery and structural adjustment, diversifying the channels of employment creation through labour market development, while protecting vulnerable groups by building a social security system. Such practices have been used in coping with the volatility of the macro economy since then. On 15 April 2013, the meeting of Standing Committee of Political Bureau of CCCPC made this practice official, urging the Government departments to “implement macro policies for stability, micro policies for activation, and social policies for safety net” (Xinhua Daily Telegraph, 2013). Other countries pursuing labour market reforms and facilitating structural transformation may adopt a similar set of complementary policies to ensure that workers in declining sectors or facing increased precariousness can easily transition to jobs in new sectors or benefit from social protection floors.

6.2 Trends in pro-employment macroeconomic policies and suggestions

First, there is an urgent need for macroeconomic policies to focus more on addressing structural unemployment. Though natural unemployment in urban areas is only 4.1 per cent, structural and frictional unemployment for young people and elderly workers are serious problems: the distribution of the urban unemployment rate by age shows a U-shaped curve. That is, youth and the people close to retirement age are the groups most vulnerable to unemployment in the job market. Macroeconomic policies focusing on structural issues can effectively target these groups and produce good results.

Second, macroeconomic policies are required to support newly emerging industries and business models since the Central Government of China committed to implementing the “Strategy of Entrepreneurship and Innovation Country” (Li, 2015). Studies found that the development of internet technology has provided employers and potential employees with more opportunities by facilitating information flows to better match enterprise and labour market needs (Cai et al., 2014). China’s macroeconomic policies have been actively responding to the “Strategy of Entrepreneurship and Innovation Country” and the “Internet Plus Action Plan” promoted by Premier Li Keqiang in his *Government Work Report* in March 2015. Two projects have been deployed:

- 1) One is to develop inclusive finance. In addition to micro-credit that has already been in place for a long time, the new financing tools include equity crowd-funding and regional equity trading markets. Policy support has been given to encourage domestic listing with a special equity structure and the development of mutual insurance.
- 2) The other is to provide fiscal support. The government has established venture capital funds, but also assists state and foreign capital in operating venture capital businesses, provides preferential support to hackerspaces¹⁸ in establishing office accommodation and internet facilities, and gives preferential tax arrangements to small and micro enterprises and incubation institutions. The Government also provides direct investment towards innovation activities (Xinhuanet, 2015).

Third, the Government should make institutional arrangements for the pro-employment objectives of macroeconomic policies, and improve the employment statistics system. Since the established macroeconomic objectives usually conflict with one another in practice, only when the first priority is given to employment can a national employment-led strategy be reasonably guaranteed successful implementation. The current employment statistics system is incomplete and non-transparent, while the labour market information system is discontinuous and inconsistent: for instance, to this day, the NBS has not yet publicized such statistics as the surveyed unemployment rate, labour force participation rate, and employment adequacy ratio. Consequently, the PBOC and other Government departments are not able to make informed decisions and conduct accurate forecasts with regard to the economic cycle, external and internal shocks.

Finally, the target of macroeconomic policies should shift from the protection of employment to the protection of workers. For a long time, the Government implemented expansionary macroeconomic policies focusing on employment security and a large fraction of public resources was allocated for the purpose of preventing workers from losing their existing jobs. In the context of China’s “new normal” of economic development, the demographic dividend will be exhausted and will no longer drive economic growth: the new mode of growth needs to rely on structural adjustment and transformation of the growth

¹⁸ Spaces where people with an interest in computing or technology can meet to share ideas and work on projects together.

pattern. Protecting existing jobs on the pretext of preventing unemployment is the same as to preserve the old industrial structure and conventional growth pattern, which impedes the Chinese economy from gaining a new growth engine. On the contrary, letting these old jobs be destroyed in an environment of competition, while protecting workers through the social safety net and assisting them in obtaining new skills and finding new jobs, is more compatible with both market principles and government responsibilities.

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