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CHINA: THE IRON RICE-BOWL IS BROKEN

The State's industrial sector has traditionally assured employment and social security cover for a large share of China's salaried employees. But in recent years, its pay-rolls have been cut strongly through the privatisation of small companies and the rationalisation of large ones. However, these reforms have not radically improved the financial situation of State enterprises. The banking system has been weakened by the continued accumulation of bad debts, while the development of collective and private sectors is constrained by limited access to bank financing. Yet, the expansion of this sector is important for job growth to pick up in industry and services, and to halt the rise in unemployment and informal labour.

Up until the end of the 1970s, the Chinese economy was characterised by collectivised agriculture which absorbed about 70% of the active population, at the cost of low labour productivity, and by State-owned enterprises (SOEs) which accounted for 80% of industrial production and employed more than three-quarters of all urban wage-earners for whom it assured the "iron rice-bowl": lifetime employment and social security.

The reforms implemented over the last twenty years have led to profound changes (Table 1). The privatisation of agricultural production led to a fall in the employment in this sector, first in relative terms, and then since the 1990s in absolute terms. The liberalisation of the economy favoured the rise of rural enterprises, collective or private, which absorbed part of the surplus agricultural labour force. Similarly, the emergence of non-state enterprises in the cities reduced the relative importance of the State sector in production and employment. Services, which were marginalised for a long time, started to experience accelerated expansion. These structural changes went hand-in-hand with rapid economic growth. China succeeded in reconciling the transition to a market economy, strong growth and sustained employment. The success of the Chinese strategy of gradual reform could also be contrasted with the costs of so-called shock-therapies applied to Eastern Europe.

But, since the mid-1990s, a new phase has emerged: the political will to accelerate the transition to a market economy has imposed greater efficiency on the State sector. This has led to privatisations and massive labour shedding. However, given the slowing of growth, job creation has failed to absorb labour released by State industries, a problem compounded by rural migration. The restructuring linked to the systemic transition and to economic development have led to a rise in unemployment and informal labour.

Table 1 - The structural evolution of GDP and employment

In %	1978	1985	1990	1995	1999
GDP = 100					
Agriculture	28.1	28.4	27.1	20.5	18.4
Industy and Construction	48.2	43.1	41.6	48.8	48.7
Services	23.7	28.5	31.3	30.7	32.9
Workforce = 100					
Agriculture	70.5	62.4	60,0	52.2	50.1
Industy and Construction	17.4	20.9	21.4	23.0	23.0
Services	12.1	16.7	18.6	24.8	26.9

Source: China Statistical Yearbook.

Unemployment and Informal Labour[1]

The question of employment in China is often analysed from the perspective of WTO entry, which will be a major international event. This research stresses the gains China may realise from a trade specialisation that corresponds more closely to its comparative advantage,

1. Data used come from China's statistical abstract. However, the figures which are grouped together here stem from surveys whose statistical coverage may vary. This grouping nevertheless provides a general idea of the scale of principal phenomena involved.

but also the adjustment costs associated with a sectoral reallocation of labour[2]. This outlook should not however mask the scale of the employment problems faced by the Chinese economy which follow from internal changes: the rise in the population of working age will be about 1% per annum (about 10 million people) over the next ten years; a trend fall in the agricultural labour force given rural underemployment (estimated at between 120-140 million people, or about 35-40% of the agricultural workforce); the continued modernisation of the State sector. In the second half of the 1990s, the search for greater productivity gains in industry has led to the shift of underemployment in the collective and State sectors to open unemployment and informal labour. The organised private sector has only absorbed a small fraction of surplus labour in traditional enterprises.

The privatisation of small enterprises, which account for the very large majority of failing companies, is accelerating. At the same time, rationalisation measures have been taken in large and medium-sized companies leading to substantial job cuts. Twenty million jobs in State industries were thus lost in urban areas, between 1995 and 1999 (Table 2). To these should be added a further 2 million redundancies in other types of urban industrial enterprises[3].

This has led to two major phenomena:

- Industry as a whole has ceased to be a job-creating sector since 1995. As the dynamism of rural industries has weakened, the slower increase in their labour force (up by between 2 and 3 million between 1995 and 1999) is far from compensating for the losses experienced in urban areas. Overall, the industrial labour force is estimated to have fallen from 110 to 91 million between 1995 and 1999 (Table 2).

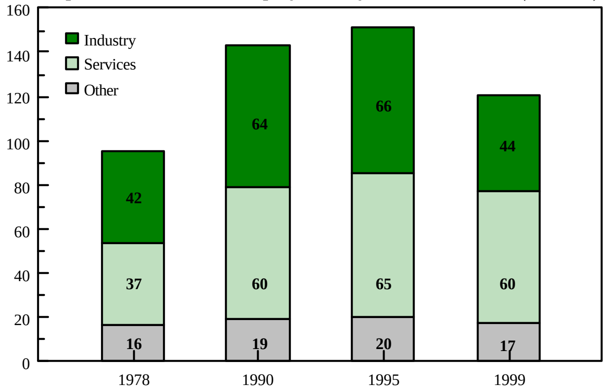
Table 2 - Industrial employment

In millions	1978	1990	1995	1999
All industry*	**61**	**97**	**110**	**91**
Rural industry		33	44	46
Urban industry		64	66	44
State enterprises		44	44	24
Collective enterprises**		19	15	7
Other enterprises**		1	7	13

* excludes village enterprises.
** in 1999, companies with more than Yuan 5 million in turnover.
Source: China Statistical Yearbook.

- The contraction of industrial employment has led to a cut in salaried employment in towns, and other sectors (services and construction) have also experienced job cuts. In total, salaried, urban employment retrenched by 20% between 1995 and 1999 (Graph).

Graph - Urban, salaried employment by sector (*in millions*)



Note : In 1999, employment in non-State industrial enterprises with a turnover of less than Yuan 5 million is not included.
Source: China Statistical Yearbook.

The distribution of urban employment by type of company (Table 3) shows a considerable rise in the number of workers who do not belong to any category of identified companies (State, collective or private enterprises or other). This number has risen from 18 to 54 million between 1995 and 1999, and henceforth accounts for more than a quarter of urban employment. It indicates the scale of the population unemployed or working in the informal economy. Indeed, a comparison of the figures in the Graph and in Table 3 illustrates the apparent decline of salaried labour in urban areas, which fell from 100% in 1978 to a mere 57% in 1999.

Table 3 - Urban employment by type of enterprises

In millions	1978	1990	1995	1999
All urban employment	**95**	**166**	**191**	**210**
State employment	75	104	113	86
Collective, private and other enterprises	21	44	61	70
Unallocated	0	19	18	54

Source: China Statistical Yearbook.

Given that the industries in which the number of firms has fallen the most are also those in which profits are still weakest, such restructuring is likely to continue. Furthermore, official indicators suggest that the State sector still has excess labour in the order of 30%, so that the adjustments which have so far essentially taken place in industry are likely to spread to other areas, in particular into the tertiary sector.

The Radicalisation of Reforms

Having been put off for long, the restructuring of industry has greatly accelerated in recent years. From 1978 through to the early 1990s, reforms strove to affect the distribution of income in State enterprises. In November 1993, a programme to establish a "modern

2. See F. Lemoine, "Why China Wants to Join the WTO?", ***La Lettre du CEPII***, n°189, April 2000, available in English on Internet (www.cepii.fr); Development Research Center, "The Global and Domestic Impact of China Joining the World Trade Organisation", Beijing, December 1998.
3. The fall in industrial employment in the non-State may be due to a change in the coverage of statistics: since 1998, the data relating to employment cover enterprises above a certain size, whereas previously they related to autonomous accounting units.

enterprise system" created the conditions necessary for a transformation of the private property regime. A precondition to possible privatisation was that State enterprises be transformed into companies: small State enterprises may be privatised under the initiative of local authorities. The programme, which was first set out in an experimental manner, was progressively generalised after 1997 (at the 15th Congress of the CGP). The State must henceforth withdraw from industry, save in a limited number of strategic sectors[4]. Lastly, from September 1999 onwards (4th Plenary session of the 15th Congress), the privatisation methods which had applied only to small enterprises were extended to medium-sized ones. Between 1995 and 1999, the number of State enterprises fell from 88000 to 61000, in the wake of privatisations, mergers and bankruptcies which mainly affected small enterprises. This "small" privatisation progressed rapidly under pressure from local authorities which saw it as a way of reducing their charges and increasing their revenues, as they control the privatisation process completely, right through from evaluating the value of assets to their final distribution[5]. These enterprises have often been sold to their employees, but they have also been ceded directly to foreign investors and to local managers. Since 1995, the pressure to exit the State sector has been all the stronger given that these industries have been recording mediocre financial results.

In large companies, rationalisation through job cutbacks has preceded privatisation. At the end of 1999, only 7000 large and medium-sized State enterprises (about half the total) had been transformed into companies[6]. This change in status has so far not been accompanied by the sale of shares. The State industrial sector is still made up of a majority of enterprises and companies which are entirely or largely state-owned. The State still even holds a dominant share in the thousand companies quoted on the stock exchange[7]. Since 1999, however, shareholding is being opened up. The authorities have re-launched the development of the stockmarket, which had been interrupted as of 1996 by a macroeconomic slowdown, and then by the Asian financial crisis. From 1999-2000, 240 new companies were quoted on the Shanghai and Shenzhen markets and discussions are now underway about whether or not to float some of the quoted-companies non-tradable shares on the market. The capital raised on the markets more than doubled between 1998 and 2000 (rising from Yuan 44-98 billion). The fall in interest rates and the taxation of interest on savings deposits have favoured a shift of savings by private investors to the financial markets. The same also holds for the permission given to Chinese investors to buy shares on the foreign exchange market. At the same time, capital raised by Chinese companies on the Hong Kong stock exchange recorded $7 billion last year.

Pruned of thousands of small companies and lightened by a reduced payrolls, China's State industry chalked up strong productivity gains between 1995 and 1999, and improved profit rates[9]. The rate of return on capital has improved, but still remains far below that on non-State enterprises, especially those operating in "competitive" sectors (in which non-State enterprises account for more than half of production). Recent reforms have reduced plus labour but have not radically improved either management or corporate governance in the State sector.

A Weakened Banking System

The reduction in the weight of the State sector has not been accompanied by a reallocation of financial resources to other types of enterprise. In 1999, the State sector still received nearly two-thirds of bank credit destined to finance fixed capital investment, or a little more than in 1995 (61%). The development of the collective and private sector is largely based on self-financing, which limits its capacity to create jobs and improve capital productivity[10]. Furthermore, high levels of indebtedness by State enterprises is weakening the whole banking system, at a time when it is being called upon to adopt international prudential rules.

To rid State banks of the weight of their bad debts, the authorities re-capitalised them in 1997, and in 1999 created financial asset management companies that took on bad debts accumulated before 1996, in exchange for a share in capital. This transfer of assets was equivalent to 15% of GDP and should reduce the weight of bad debts by about half, according to official estimates, which were equal to between 20-25% of outstanding loans. Yet, according to the authorities, non-performing loans still accounted for 25% of outstanding loans, at the beginning of 2001. This reveals both the under-estimation of their initial levels and the continued emergence of bad debt: enterprises are still late on their payments and new loans are not accorded on the basis of risk evaluation. The banking system thus continues to carry a large number of insolvent or badly-managed companies, which will ultimately end up creating serious risks for public finances. Indeed, while the level of public

4. Chinese studies indicate that strategic sectors only represent 20% of the capital of State enterprises.
5. J.F. Huchet, "La face cachée des réformes du secteur d'Etat en Chine", ***Perspectives chinoises***, n°61 October 2000.
6. "Reforming China's Enterprises", OEDC, 2000.
7. The law obliges the State to retain at least 35% of shares in quoted, State enterprises. In fact, more than two-thirds of quoted companies still belong to the State, or have public institutional shareholders and are not freely negotiable.
8. Respectively $5.3-11.8 billion.
9. The profit rate rose from 3.7% of value added in 1997 to 8.3% in 1999, and to 17% in 2000, but it should be noted, that the rise in the price of petroleum and, to a lesser extent, the fall in interest rates contributed largely to the improved results of industrial State enterprises.
10. Yi Chen & Lshac Diwan, "When the Bureaucrats Move out of Business. A Cost-Benefit Analysis of Labour Retrenchment in China", ***World Bank Policy Research Working Paper***, n°2354, May 2000.

debt is still low (15% of GDP), its rapid growth, the weakness of public revenues (12% of GDP) and the accumulation of bad debts risk making it unsustainable in the long term. The situation of China's financial system would therefore appear to be comparable to that of the Asian countries that have reformed their systems the least (Indonesia and Thailand).

One of the factors blocking change lies in the lack of legislation on bankruptcies, so that administrative decisions prevail and limit the influence of creditors in the decision-making process is limited. A recent report by the World Bank stresses the urgency of introducing a new law on bankruptcy as a condition for the needed restructuring of the State sector[11]. A government Bill on this, going back to 1995-1996, is still blocked because of the expected consequences for employment at a time when no social security system exists.

The Iron Rice-Bowl is Broken

The medium term outlook holds out little improvement in the employment situation. Officially, the unemployment rate will rise to 5% in 2005, as opposed to 3.1% presently, but the figures are notoriously under-stated. The service sector, which is still under-developed as it employs only 27% of the workforce, should be the major source of new jobs. Net job creation in industry would require a reversal of trends witnessed over the last years, and would necessitate an expansion of a new private sector to take up the slack left by the State sector. This requires that the financial system will be able to mobilise the resources accordingly. Indeed, the liberalisation of trade following China's entry into the WTO should help reduce the weight of the State sector in industry.

The presence of State enterprises (Table 4) is relatively greater in sectors with a high capital intensity (transport equipment), sectors in which China is at a comparative disadvantage. In contrast, non-State enterprises appear to be well-positioned: more than 60% of their output and 70% of their employment are found in potentially "winning" sectors (especially textiles and clothing).

Table 4 - the structure of industrial output, 1999

In %	All entreprises	State	Non-State*
All sectors	100	100	100
Of which (13 primary sectors)			
Electronic material and telecommunications	8.0	7.1	8.9
Chemicals	6.8	7.3	6.2
Transport equipment	6.4	8.9	4,0
Textile industry	6.2	4.4	8,0
Ferrous metals	5.6	8.5	2.9
Electrical machinery	5.5	2.6	8.4
Food industry	4.8	4.2	5.5
Construction materials	4.7	3.3	6,0
Petroleum refining	3.7	6.7	0.8
Machines	3.7	3.2	4.2
Metal products	3,0	0.9	5.1
Mining (extraction of oil and gas)	2.9	5.9	0,0
Clothing	2.8	0.4	5.1

* Entreprises with a turnover of less than Yuan 5 million.
Source: China Statistical Yearbook, 2000.

Unemployment and informal labour appear to be durable phenomena, linked to the transition to a market economy and to the modernisation programme. The State is withdrawing from direct intervention in the economy, and has new tasks to complete, including the most urgent need to create a system of social transfers to reduce tensions brought about by the mutations of the economic and social system. Though China resisted the external shock of the Asian crisis well, it now appears vulnerable to rising social tensions, born out of domestic economic transformations.

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11. "Bankruptcy of State Enterprises in China: a Case for Reforming the Insolvency System", www.worldbank.org.

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