

# **Labour Market Insecurities in China**

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## **Contents**

List of abbreviations .....	v
Glossary of terms in Chinese .....	v
Abstract.....	vii
1. Introduction .....	1
2. From hidden unemployment to massive lay-offs in urban China.....	2
2.1 Low open unemployment and high lay-offs in urban China.....	2
2.2 The scale and scope of lay-offs .....	3
2.3 Composition of laid-off workers .....	5
3. Why lay-offs? Why not open unemployment?.....	7
3.1 Origins of massive lay-offs .....	8
3.2 The state-ownership complex of laid-off workers.....	9
3.3 The problem of “hidden employment” .....	10
3.4 Chinese lay-offs as transitional unemployment .....	11
4. State actions to cope with massive lay-offs.....	12
4.1 The launching of the Reemployment Project: Active Labour Market Policies.....	12
4.2 The establishment of Reemployment Service Centers: transitional arrangements .....	14
4.3 The merge of lay-offs into unemployment: local innovations .....	17
5. Conclusions .....	18
References.....	21
Other papers in the SES Paper Series .....	25

## **List of tables**

Table 1. Unemployment and unemployment rates in urban China .....	3
Table 2. Unemployment, lay-offs and unemployment rates in urban China .....	4
Table 3. Composition of laid-off workers by ownership form of their original employment units .....	5
Table 4. The top five provinces suffering severe lay-off problems in 1998.....	6
Table 5. State-owned industrial enterprises running in deficit .....	6
Table 6. Composition of laid-off workers by gender, age and education in 1998.....	7
Table 7. Redundant workers in 142 state-owned enterprises, first quarter of 1994 .....	8



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## List of abbreviations

COE	Collectively-owned enterprises
LCS	Labour Contract System
RSCs	Reemployment Service Centres
SOE	State-owned enterprises

## Glossary of terms in Chinese

<i>Danwei</i>	Workplace units
<i>Er guoying</i>	Quasi-state-owned enterprises
<i>Er guoyou</i>	Semi-state-owned enterprises
<i>Youhua laodong zuhe</i>	Optimization of labour allocation



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## Abstract

China is suffering from mass unemployment. Millions of former lifetime employees have been laid-off since 1993. Although being *de facto* unemployed, laid-off workers still maintain nominal employment relations with their original workplace units. Most of them refuse to register themselves as unemployed as they worry about losing entitlements to welfare benefits (e.g. old-age pensions). Many central government's unemployment policies have confronted failure in local implementation because they don't take in account the embeddedness of lay-offs within the welfare arrangements. Local governments are playing a crucial role in creating transitional arrangements for laid-off workers to deal with welfare issues.



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## 1. Introduction

Since the late 1970s, China has experienced a dramatic transition from a planned to a market economy. The market-oriented transformation of labour institutions,<sup>1</sup> particularly those governing employment and unemployment, has been a central challenge in China's market transition. During the pre-reform era from 1949 to 1978, the Chinese government adopted a state labour allocation system in urban areas. Under the system, Chinese workers enjoyed lifetime employment (known as the "iron rice bowl" in China), social security (pension and free health care), and a fairly broad range of fringe welfare benefits once they were recruited into publicly owned organizations or workplace units (*danwei*). As a result, there was virtually no unemployment in its strict sense (i.e. people moving from employment to unemployment), but only youth unemployment (i.e. jobless young people waiting for job assignment by government) in urban China at that time.

The dramatic market transition since late 1978 has brought many changes to this state socialist labour regime, one of which was the contractualization of the employment relationship. Beginning in the mid-1980s, the Chinese government imposed a so-called "Labour Contract System" (LCS), which has been institutionalized in the Labour Law of the People's Republic of China (hereafter the Labour Law) that took effect in January 1995, to replace the old system of lifetime employment. By the end of the 1990s, the majority of urban employment had been covered by the LCS (see Gu, 2001).

With the contractualization of the employment relationship, unemployment (in its strict sense) has gradually become a normal socio-economic phenomenon. All contractual employees would become unemployed if their expired labour contracts fail to be renewed. Nevertheless, the implementation of the LCS had little substantial impact upon workers who had been recruited into the *danwei* under the old labour institutions until the mid-1990s. They still enjoyed the status and privileges of permanent employees (called "fixed employees" in China), and had no need to worry about their employment security.

As enterprise restructuring mainly triggered by privatization has accelerated from 1993 onwards, millions of former "fixed employees" have been laid off by SOEs as well as collectively-owned enterprises (COEs). Although they have since become *de facto* unemployed, Chinese laid-off workers still maintain nominal employment relations with their original work-units. Actually, most so-called "laid-off workers" are highly unlikely to reinstate employment at their original work-units. Therefore, unlike in market economies and other transitional economies, lay-offs operate in China as a transitional institutional arrangement in the change from hidden to open unemployment (Gu, 1999). The manifestation of massive unemployment in the form of lay-offs rather than in the form of open unemployment indicates that in China the institutionalization of unemployment has only been partly accomplished despite the breakdown of the "iron rice bowl."

Unemployment, no matter what form it takes, is always an extremely sensitive issue to the Chinese government. Actually, an extensive system of the rules governing this new socio-economic game (or simply unemployment institutions) had already started to take shape in the mid-1980s. Given the new surge of lay-offs, a series of new employment and unemployment policies have been imposed by the Chinese government from 1993 onward.

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<sup>1</sup> The term "institutions," "institutional," and "institutionalization" are used throughout this paper in a new institutionalist sense, in which "institutions" are defined as the "rules of the game" (North, 1990, p. 3.). Along the light of the new institutionalism, a crucial distinction between institutions and organizations is made (North, 1990, p. 4).

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These new policies not only include active and passive labour market policies attempting to reduce the number of laid-off workers and ensuring their basic living, but also involve institutional changes in labour and welfare systems. More recently, the Chinese government is taking steps to merge lay-off into the formal institutional structure of open unemployment, so as to comply with the institutionalization of unemployment in the near future.

## **2. From hidden unemployment to massive lay-offs in urban China**

The planned economy was characterized by high hidden unemployment (or “disguised unemployment,” in the sense of unemployment on the job) (see Porket, 1995, pp. 38-42; Commander and Coricelli, 1995; Mickiewicz, 1998, p. 48). The process of the market transition, theoretically speaking, would give rise to a rapid shift from hidden to open unemployment (in the sense of the occurrence of jobless persons in the labour market) at least during the early stage (for more details, see Commander and Coricelli 1995). The reality of the market transition in Central and Eastern Europe and in Russia tallied with the theoretical view. In fact, high open unemployment occurred in almost all transition countries in most years of the 1990s, especially during the early stage of the transition (for more details, see Boeri, 1996, pp. 41-70; Jackson *et al.*, 1995). To some extent, only Czechoslovakia (and later the Czech Republic) was exceptional due to certain employment policies (i.e. work-sharing measures) carried out during the early stage of the transition.

### **2.1 Low open unemployment and high lay-offs in urban China**

At first glance, China was another exception in terms of its low unemployment rates. From officially released figures (see Table 1), it seems that China never confronted any serious problem of unemployment as its unemployment rates throughout the reform era were very low. This observation is basically true before 1993. Although labour reforms were placed on reform agenda from the very beginning of the reform era, the actual change in unemployment institutions - especially dismantling of the “iron rice bowl” - proceeded at a much slower pace than did other aspects of China’s economic reform from 1978 to 1992 (for more details, see Hu and Li, 1993).

The officially released low (formal) unemployment figures, however, do not reflect the severity of the actual high unemployment from 1993 onward. The actual high unemployment, quite distinctively, takes place in urban China not in the form of open unemployment, but rather in the form of lay-offs. Laid-off workers, according to an official definition, are those who loose their jobs as their employing units encounter economic difficulties, while still maintaining their nominal employment relationship with the enterprises (DRC Institute, 1997, p. 37). Since official unemployment rates are calculated on the basis of number of registered unemployed people and all laid-off workers do not register themselves as unemployed at the employment service agents, low official unemployment rates since 1993 conceal the severity of mass unemployment in urban China.

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**Table 1. Unemployment and unemployment rates in urban China**

Year	Employment (million persons)	Unemployment (million persons)	Unemployment rate (percentage) *
1979	99.99	5.68	5.37
1980	105.25	5.42	4.90
1981	110.53	4.40	3.83
1982	114.28	3.79	3.21
1983	117.46	2.71	2.26
1984	122.29	2.36	1.89
1985	128.08	2.39	1.83
1986	132.93	2.64	1.95
1987	137.83	2.77	1.97
1988	142.67	2.96	2.03
1989	143.90	3.78	2.56
1990	166.16	3.83	2.25
1991	169.77	3.52	2.03
1992	172.41	3.64	2.07
1993	175.89	4.20	2.33
1994	184.13	4.76	2.52
1995	190.93	5.20	2.65
1996	198.15	5.53	2.72
1997	202.07	5.70	2.74
1998	206.78	5.71	2.69
1999	210.14	5.75	2.66

Source: China Labour Statistical Yearbook, 1998, pp. 8-9; 1999, pp. 7-8; 2000, pp. 7-8.

Lay-off is not a new economic phenomenon nor is it unique to China. In market economies, the term “lay-off” usually connotes an ending of the employment relationship with the prospect of re-hiring if the employer’s financial situation improves. Lay-offs, together with short-time working (which means that employees work less than normal hours or the working hours specified in their labour contracts), are administratively categorized as “partial unemployment.” Economic boom and depression accompanying the development of industrialized countries - and thereby the cyclicity of employment - always gives rise to such a problem. Furthermore, partial unemployment may arise at any time as a result of natural disasters, mechanical failure or other accidental events that cause temporary stoppages of work. Due to its different nature from normal unemployment, specific regulatory systems on partial unemployment are also yet to be developed in advanced market economies (see Szyszczak, 1990).

In China, however, lay-off is a specific form of informal unemployment. Within the Chinese institutional context, lay-off cannot be identical with formal unemployment. It stands out as an institutional arrangement between formal employment and formal unemployment, and as elaborated below applied only to certain groups of employees. In China, lay-off also manifests itself in different form from lay-off in advanced market economies. Some special regulations have been developed to govern lay-offs, and accordingly some special organizations have been set up to deal with the problem. Basically, lay-off as an institutional arrangement and the regulations governing lay-offs in China are products of market transition, and they themselves are transitional in nature.

## **2.2 The scale and scope of lay-offs**

Although massive lay-offs began in 1993, there was no official data on its scale until 1995. There are also some inconsistencies in the data on lay-offs available from China

Labour Statistical Yearbook. Nevertheless, rough estimates on the scale of lay-offs can be drawn from available data. Table 2 shows the numbers of laid-off workers at the end of the years 1993 to 1999, and actual unemployment rates (i.e. revised unemployment rate) after the numbers of laid-off workers are taken into calculation. We can see that the figures of actual unemployment rates are high in the late 1990s, especially in 1997, according to the international criterion.

Table 2. Unemployment, lay-offs and unemployment rates in urban China

Year	Number of unemployed (million persons)	Official unemployment rate (%)	Number of laid-off workers (million persons)	Revised unemployment rate (%)***
1993	4.20	2.33	3.00*	3.99
1994	4.76	2.52	4.00*	4.64
1995	5.20	2.65	5.64	5.52
1996	5.53	2.72	8.15	6.73
1997	5.70	2.74	12.74**	8.86
1998	5.71	2.69	8.77	6.81
1999	5.75	2.66	9.37	6.99

Sources: China Labour Statistical Yearbook 1996, pp. 91, 409; 1997, pp. 89, 406; 1998, pp. 8, 431; 1999, pp. 83, 441-442; 2000, pp. 3, 409-410.

Note: \* No official statistics for the numbers of laid-off workers in 1993 and 1994 were available, and the two figures are based on rough estimation.

\*\* Here, the officially released figure (by *Yearbook*) for the number of laid-off workers in 1997 is only for those from SOEs, and is therefore an underestimate.

\*\*\*Figures in the column include the number of laid-off workers.

While the scale of lay-offs is massive, the scope is rather limited. Lay-off as a transitional institutional arrangement is applied only to two categories of employees in urban enterprises:

- ✍ formal employees who were recruited before the implementation of the LCS, and were categorized as “fixed employees”;
- ✍ and formal contractual employees who loose their jobs before their labour contracts expire.<sup>2</sup>

Basically, massive lay-offs take place mainly in the SOE sector. In 1998, laid-off workers flowed out from SOEs accounted for 67.84 per cent of the total (see Table 3).

Massive lay-offs also appear in some COEs and even in private enterprises in urban China. In those enterprises there are some employees who held the “status” of lifetime employment similar to that of “fixed employees” in SOEs. Many large COEs that were established during the pre-reform era have become “semi-SOEs” (*er guoyou*) or “quasi-SOEs” (*er guoying*) as many governmental regulations imposed upon SOEs also take effect in this sector (Walder, 1986, pp. 43-48). In most medium-sized and small COEs and in most COEs established during the reform-era, there are also some employees who enjoy the status of lifetime employment. A small number of laid-off workers came from private enterprises. In fact, some employees in private enterprises including Sino-foreign joint ventures were formerly employees in SOEs and COEs. Some of them still maintained their original status as SOE or COE employees after job-hopping to the private sector. Employees of this sort in the private sector are categorized as “laid-off workers” rather than “unemployed persons” when they become jobless (see Table 3).

<sup>2</sup> The text of the regulations is available in *China Labour*, September 1998, pp. 35-37.

Table 3. Composition of laid-off workers by ownership form of their original employment units

Years	State-owned		Collectively-owned		Private	
	Millions	%	Millions	%	Millions	%
1998	5.95	67.84	2.51	28.62	0.31	3.54
1999	6.53	69.69	2.59	27.64	0.26	2.77

Sources: China Labour Statistical Yearbook, 1999, pp. 442-443; 2000, pp. 410-411

## 2.3 Composition of laid-off workers

The severity of lay-offs varied across sectors, regions, and enterprises. Massive lay-offs, initially occurred mainly in the so-called “sunset sectors,” such as mining and quarrying, textile, train transportation, and some manufacturing industries. In 1996 and 1997, after lay-offs were endorsed by the central government as a major reform measure for restructuring enterprises, some industrial departments of the government set forth the stunning targets for labour retrenchment - one million employment cut in the mining sector, 1.2 million in the textile industry, 0.6 million in the shipbuilding, 0.7 million in steel and iron, and two million from the engineering industry (Gao, 1998, p. 179). At the end of 1998, there were 5.95 million employees laid off from SOEs. Their proportions in different sectors were as follows: 12.62 per cent from the mining and quarrying sectors; 47.73 per cent from the manufacturing sector; 1.04 per cent from the utilities sector; 6.77 per cent from the construction sector; 4.54 percent from the transportation and telecommunication sectors; 18.15 per cent from the trade and catering service sector; and 9.08 per cent from other sectors (see China Labour Statistical Yearbook, 1998, p. 442).

Second, while lay-offs take place across the country, massive lay-offs are a regional phenomenon. Massive lay-offs concentrate only in areas where SOEs in “sunset” industries are concentrated and local economic growth is relatively slow. If the proportion of lay-offs to the total employment is used as an indicator (which is termed as “lay-off rate”) to measure the severity of lay-offs, we can find from Table 4 that China’s northeast area is such an (lay-off) area. In 1998, the three provinces (Liaoning, Heilongjiang, and Jilin Provinces) in this area suffered from massive lay-offs most seriously as their lay-off rates were recorded as the top three among 31 provinces (and provincially ranked cities) in China. According to an estimate by some local scholars, by the end of 1997, nearly 13.7 per cent of laid-off workers who had not yet found new jobs were living in Liaoning (Xu *et al.*, 1998, pp. 242-256). The three provinces in the northeast area are China’s most strategically significant industrial bases, in particular for heavy industries and military industries. As a matter of fact, these areas were consistently severely afflicted with massive lay-offs since 1993 (Gao, 1998, p. 181), and their GDP growth rates were also below the national average level during most of the 1990s (see China Statistical Yearbook, 1999, p. 62). Generally speaking, the problem of lay-offs is not severe in South China’s coastal areas, the areas where economy is prosperous in general and the private sector is relatively more developed.

**Table 4. The top five provinces suffering severe lay-off problems in 1998**

Provinces	Total employment (100 thousand)	Lay-offs (100 thousand)	Lay-off rate (%)
Liaoning	88.49	10.35	11.70
Heilongjiang	81.86	8.31	10.15
Jilin	51.10	4.98	9.75
Hunan	71.16	6.87	9.65
Shaanxi	44.63	4.16	9.32

Source: China Labour Statistical Yearbook, 1998, pp. 13, 446.

Third, most laid-off workers were from SOEs, especially the SOEs running at a loss. In 1998, laid-off workers from SOEs accounted for 67.83 per cent of the total number, and those from loss-making SOEs accounted for 69.59 per cent of the lay-offs in the SOE sector. In fact, throughout the 1990s, the already poor performance of SOEs, particularly in the industrial sector, rapidly worsened. Both the number of industrial SOEs running at loss and the amount of the losses soared. By the end of 1998, almost half the SOEs in the industrial sector ran at a loss, and the amount of the total losses was more than double of their net profit (Table 5). A large number of such enterprises were even in arrears with salary payment to their employees. In some localities the problem of salary arrears triggered workers' unrest. Clearly, the financial difficulties facing these industrial SOEs became a major factor driving labour restructuring, including lay-offs, in China's manufacturing sector.

**Table 5. State-owned industrial enterprises running in deficit**

Year	Amount of losses (billion Yuan)	SOEs at loss / SOE Total number (%)	Total losses / Total pre-tax profits (%)	Total losses / Total net profits (%)
1979	3.69	23.4	4.62	7.19
1980	3.19	22.4	3.72	5.79
1981	4.24	27.7	4.99	8.14
1982	4.27	25.1	4.91	8.22
1983	2.86	14.6	3.05	5.01
1984	2.29	10.5	2.23	3.73
1985	3.71	9.6	2.29	4.36
1986	4.71	13.4	3.96	8.24
1987	5.07	12.8	3.95	8.33
1988	7.13	10.7	4.70	10.16
1989	12.80	15.9	8.29	22.33
1990	27.88	30.3	23.23	110.24
1991	30.02	28.0	22.87	126.61
1992	30.01	22.7	19.96	96.43
1993	28.17	29.8	13.36	42.67
1994	27.38	32.6	10.85	38.80
1995	36.48	33.3	14.09	57.86
1996	50.14	37.5	20.60	136.07
1997	60.72	43.9	24.74	205.34
1998	85.02	47.4	31.52	248.23

Source: China Finance Yearbook, 1999, pp. 483, 486.

The most vulnerable group during the process of labour restructuring consisted clearly of employees of old age, low education, and low skills. From the 1998 national statistics, we can ascertain that 66.71 per cent of laid-off workers were above 35 years of

age, and nearly a quarter were above 46 years, and 57.01 per cent had received education only to the level of junior middle school or below (Table 6). Most of these laid-off workers had already been recruited for some time before the reform era started in late 1978. During the pre-reform era and the early stage of the reform era, they received little labour retraining. For many reasons, this group of employees displayed the least adaptability to the dramatically changing institutional environment during the market transition, thus becoming the most disadvantageous group in China's transitional society.

The gender composition of laid-off workers is a controversial issue. It appears that middle-aged female employees would bear the full brunt of lay-offs. The Female Employees Section of the All-China Trade Unions Federation (ACTUF) conducted a series of sample surveys on the situation of female laid-off workers in some localities in the mid-1990s, which show that in 1993 and 1995 the proportions of female laid-off workers to the total were about 60.0 and 55.6 per cent, respectively (see Gao, 1998, p. 180). It seems that the national figures available in 1997 and 1998 indicate an opposite situation. The 1997 figure shows that in the SOE sector there were 2.84 million female laid-off workers who had no new jobs at the end of this year, accounting for 44.80 per cent of the total (see China Labour Statistical Yearbook, 1998, pp. 432, 445). The 1998 figure shows the same proportion of female laid-off workers to the total number from all kinds of enterprises (see Table 6). If we calculate unemployment (including lay-offs) rate only among the female, the picture would be quite different. In 1998, there were 46.78 female employees, 3.00 million female registered unemployed persons and 3.93 million female laid-off workers in urban China (see China Labour Statistical Yearbook, 1999, pp. 3, 88, 442). Therefore, the revised female unemployment rate of this year is 12.91 per cent, much higher than the overall revised unemployment rate (6.81 per cent) in the same year (see Table 2). Generally speaking, most of female laid-off workers had been less educated during their educational ages and after recruitment they received less occupational training due to heavy family responsibilities. Therefore, they had less opportunity to be reemployed than their male counterparts (see Gao, 1998, pp. 180-181).

**Table 6. Composition of laid-off workers by gender, age and education in 1998**

	Number (million persons)	%
Total	8.77	100.0
Gender:		
Female	3.93	44.81
Age group:		
< 35 years	2.92	33.29
36-46 years	3.72	42.42
>46 years	2.13	24.29
Education:		
Junior middle school and below	5.00	57.01
Senior middle school and equivalent	3.15	35.92
University and college and above	0.62	7.07

Source: China Labour Statistical Yearbook, 1999, pp. 442-443.

### **3. Why lay-offs? Why not open unemployment?**

Unlike frictional, cyclical, and structural unemployment, massive lay-offs take place in urban China mainly due to certain institutional changes accompanying the market transition. As a specific economic phenomenon, lay-offs are structured by the transitional institutional context, and especially shaped by yet underdeveloped unemployment

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institutions. Lay-offs in China thus constitute an institutional arrangement between formal employment and formal unemployment.

### 3.1 Origins of massive lay-offs

Basically, the institutional changes in two economic realms triggered the massive lay-offs. One was the so-called “optimization of labour allocation” (*youhua laodong zuhe*) or labour restructuring carried out in SOEs and COEs from the late 1980s onward, which aimed at laying some low-skilled, redundant employees off from their posts (for more details about this reform, see below). The other was the restructuring of enterprises through administrative closing or legal bankruptcy, which got accelerated during the mid-1990s (Gao, 1998, pp. 166-172). In fact, the number of enterprise bankruptcies rapidly grew in the mid-1990s. Of course, the factor of economic fluctuation also contributed to the massive lay-offs. The Asian financial crisis in 1997 and 1998 exacerbated the downturn of Chinese economic development in the late 1990s, thus aggravating the severity of the lay-offs.

Like the surge of open unemployment in European transitional countries (see Porket, 1995; Mickiewicz, 1998), the problem of massive lay-offs in China was also rooted in the “full employment” policy carried out under the centrally planned economy and during the early stages of the reform. This policy legacy of the past put a heavy burden on the vast majority of SOEs, and on huge numbers of redundant workers. Until the early 1990s, the superficial phenomenon of “full employment” was actually concealed by the massive “hidden unemployment” in the state sector. According to a survey of 142 SOEs conducted by the World Bank in 1994, the majority of the interviewed managers acknowledged that there were considerable numbers of redundant workers in the enterprises under their management (Table 7). Through some fragmentary surveys, some Chinese economists also estimated that, in the mid-1990s, there were at least 15 million redundant workers in SOEs, about one-third of their employment (see Lin *et al.*, 1997, p. 102; and Yang *et al.* 1998, p. 123).

Table 7. Redundant workers in 142 state-owned enterprises, first quarter of 1994

Actual employment relative to optimal employment level	Enterprises (%)
More than 30 %	17.0
20 to 30 %	16.2
10 to 20 %	26.8
5 to 10 %	24.6
About right	12.0
Too low	3.4

Source: World Bank (1996), p. 14.

Despite similar roots, the outcomes were different. In European transitional countries, the problem of high unemployment during market transition erupted directly in the form of open unemployment, while in China it did in the form of lay-offs. The basic reason for this difference is that the two regions inherited quite different institutional legacies from their labour systems in the past. In eastern European countries and the Soviet Union, labour systems had already been market-oriented during the pre-transition periods after Stalinism (see Barr, 1994, pp. 121-122). In China, by contrast, lifetime employment as an institutional arrangement was very rigid.

During the reform era, the progress of building institutional arrangements coping with unemployment lagged far behind other institutional changes in the field of labour system. In 1986, the contractualization of the employment relationship was introduced in the SOE

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sector, and it was applied only to newly recruited employees until it was extended to all employees from 1992 onward. From 1986 to 1992, a dual-track labour management system operated in SOEs and COEs. All employees who had been already recruited before 1986 were still categorized as so-called “fixed employees,” while most employees who were recruited after 1986 as “contractual employees”. “Fixed employees” enjoying lifetime employment could not be dismissed unless they had committed criminal offences. Even during economic downturns, enterprises facing financial difficulties were not allowed to terminate the employment relationship with “fixed employees.” Only contractual employees could be hit by the misfortune of unemployment during the late 1980s and the early 1990s.

Throughout the 1990s, labour reforms and enterprise restructuring speeded up. The right of dismissal as part of a belated package of managerial autonomy was legally granted to enterprise managers in 1992 (Naughton, 1995, p. 294). The retrenchment of labour forces by enterprises became legal in November 1994, when the Ministry of Labour promulgated the related regulations. According to these regulations, all enterprises falling into economic straits were allowed to retrench labour if all retrenched employees were offered income compensation. The proposal for labour retrenchment had to be reported to the trade union or the employee’s congress of the enterprise and to the local labour bureaus.<sup>3</sup>

Although these measures signalled steps towards the institutionalization of unemployment, the move of “fixed employees” into formal unemployment was still unusual and rare in the 1990s. During the process of the “optimization of labour allocation” or during enterprise restructuring, employees with different status encountered different fates. Those employees who were recruited after the implementation of the labour contract system would become unemployed if their contracts expired and were not renewed. In contrast, fixed employees had no need to be concerned with unemployment, but they had to worry about lay-offs. Lay-off became a favourite option for enterprises to carry out labour retrenchment involving “fixed employees.”

### **3.2 The state-ownership complex of laid-off workers**

Lay-offs in China were institutionally different from those in Western countries in that Chinese laid-off workers still maintain an employment relationship with their employers while their counterparts in the West end such relationship. In fact, few Chinese laid-off workers would like to terminate their employment relationship with their employing work-units, although this relationship is just nominal.

Laid-off workers also showed certain specific preferences for reemployment. One such preference was that they strongly preferred to be reemployed in the state sector rather than in the non-state sector. On many occasions, laid-off workers have been unwilling to take jobs available from the non-state sector even if the salary was higher than that from their employment in state-owned work-units (Gu, 1999, pp. 287-288). According to a nation-wide sample survey conducted in 1997, those who chose self-employment accounted for only 11.5 per cent of total laid-off workers, and those who sought jobs repeatedly, 25.0 per cent. The other 63.5 per cent of laid-off workers only waited at home, pinning their hopes on job assignments by government or reemployment at their own work-units. They strongly believed that “the state will never let them go hungry” (Chen, 1997, p. 44).

<sup>3</sup> The text of the provisions (Chinese version) is available in *Zhongguo Laodong Nianjian* (China Labour Yearbook), 1992-1994, pp. 634-635.

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However, the shrinking state sector no longer creates more jobs for the unemployed and laid-off workers. The employment growth rate in the non-state sector has been much higher than that in the state sector (plus the collective sector, the second-class state sector). In urban China, the non-state sector consists of foreign enterprises, joint ventures, shareholding companies, private businesses, and other kinds of enterprises that are set up by various non-state funds. In the tertiary industry, private businesses are dominant. Few laid-off workers are willing to make a precarious living in the non-state sector.

At first glance, the “preference of laid-off workers to be reemployed in the state sector,” which can be called “laid-off workers’ state-ownership-complex,” is irrational (Gu, 1999, p. 288). A variety of “irrational” choices that laid-off workers make for their reemployment, are attributed in the Chinese media to the so-called “outworn mentality of laid-off workers concerning employment.” Laid-off workers are often appealed to and even required to shift their mentality by Chinese officials (including Premier Zhu Rongji, for example, see editorial of *People Daily*, June 4 1998). Chinese policy makers believe that a major obstacle to resolving the problem of massive lay-offs lies in the so-called “aristocratic mentality” of laid-off workers (Yang *et al.*, 1998, p. 235).

### 3.3 The problem of “hidden employment”

Accompanying the eruption of lay-offs is the emergence of “hidden employment.” Many laid-off workers engage in a variety of “temporary jobs,” but few would like to register these jobs as their new occupations (Ge and Fan, 1996, p. 52). As a socio-economic phenomenon, hidden employment exists in many countries, in particular in those countries where the underground economy is relatively developed. In advanced market economies, people engage in hidden employment mainly to evade tax or due to illegal immigration. In urban China, laid-off workers engage in hidden employment for a totally different reason: they prefer maintaining their present status of “laid-off workers” to becoming new employees on their new posts.

No hard data (especially national data) are available about the scope of hidden employment because of its illicit nature, and hidden employment rates also vary from place to place depending upon the extent of economic prosperity. Most laid-off workers are inclined to deny their engagement in hidden employment when facing interviews (Li *et al.*, 2001, p. 86). In February 1998, a group of scholars from the Statistical Bureau of Shanghai municipal government conducted a survey among 3,000 laid-off workers in the city. The finding shows that during the period of the survey 971 were engaged in income-earning work, and among them 672 could be categorized as “hidden employees” (Shanghai Urban Investigation Team, 1999, pp. 20-22). A 1998 survey of 635 laid-off workers in Beijing shows that only 182 (29.1 per cent) admitted their engagement in hidden employment (Li *et al.*, 2001, p. 82). Many Chinese scholars and policy researchers believe that at least two-thirds of laid-off workers earn income through hidden employment. Basically, in metropolitan areas it is not difficult for laid-off workers to find jobs.

The Shanghai survey mentioned above shows that majority of these “hidden employees” found jobs through personal relations rather than through job-replacement offered by official employment service agents. On average, the income earned from “hidden employment” was about 6.3 per cent below their previous income before lay-off. The vast majority had jobs in the service sector, which required almost no specific skills. Among these, 55.5 per cent had engaged in hidden employment for less than half a year, 23.8 per cent for half a year to one year, 21.2 per cent for one to two years, and 10.5 per cent for more than two years. Therefore, hidden employment was basically precarious (Shanghai Urban Investigation Team, 1999, pp. 20-22).

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The above-mentioned Beijing survey indicates that among 182 laid-off workers who admitted engagement in hidden employment 98 (54.2 per cent) could earn 290 to 799 Yuan and 60 (or 33.2 per cent) could earn more than 800 Yuan. Only 23 workers earned below the local poverty line (290 Yuan). As far as employment security is concerned, however, only nine people interviewed showed satisfaction (Li *et al.*, 2001, pp. 83-84).

Hidden employment is an outcome of rational choice made by both laid-off workers and their new employers. For laid-off workers, engaging in hidden employment has twofold benefits: on the one hand, they can receive basic-living subsistence for laid-off workers while also supplementing income from their new jobs; on the other, they can continue to be covered under the pension and health-care insurance offered by their original employers. For new employers, hidden employment means that no labour contracts are signed between the two sides. This brings about flexibility of hiring and firing and reduction of social insurance burdens (Shanghai Urban Investigation Team, 1999, p. 23).

### 3.4 Chinese lay-offs as transitional unemployment

As noted, the occurrence of a high number of lay-offs rather than high formal unemployment in urban China resulted from interactions concerning the game of institutionalizing unemployment involving the state, enterprise managers, and employees. The motivation of the state to incorporate unemployment institutions into the labour administration system in the state and semi-state sectors was to upgrade labour productivity and, in the final analysis, consolidate the economic foundation of its rule. All “*de facto* permanent employees,” however, had internalized the old rules of the game for decades, and thus would not see any unemployment institutions as operating in their interests. Within the institutional context of market transition, enterprise managers are not the exact Chinese counterparts of employers in Western market economies. The genuine owner of all SOEs and the *de facto* owner of many COEs is the state, and Chinese enterprise managers serve merely as the agents of the state. From a principle-agency perspective, enterprise managers have their own interests that often do not coincide with the interests of the state. To maximize their own interests, or minimize harm to them, Chinese enterprise managers sometimes play a role in mediating a possible clash of interests between employees and the state. Lay-off, a form of *de facto* unemployment but not identical to formal unemployment, thus appeared to be a suitable transient institutional arrangement for all sides when they faced the situation in which labour retrenchment seemed inevitable.

For most employees who could not avoid labour retrenchment, being laid off was a better arrangement than becoming unemployed with income compensation. The employment relationships that they unswervingly want to maintain with their original work-units are not nominal, but vested with substantial interests, due to the distinctive Chinese social security and welfare system.

Within the pre-existing state labour allocation system, as mentioned earlier, a wide range of social security and welfare benefits were given to all formal employees on the basis of their employment in publicly-owned work-units. Unlike other former state socialist countries, however, the social security and welfare benefits were delivered in China not through state agents, but through workplace units. Under such institutional conditions, the livelihood of employees and their families was largely dependent upon their workplace units. Labour reform scarcely altered this aspect of the old institutional structure until the late 1990s. In the newly emergent private sector, by contrast, there was until very recently no social security system, and the provision of occupational welfare was subject to corporate policy.

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The dependency of laid-off workers upon their original workplace units was particularly notable. In fact, the majority of laid-off workers, according to many Chinese sources, were formal “*de facto* permanent employees” who were older, and who had little education and low skills (see Table 6). By the time they were laid off, they had contributed a great deal to their enterprises despite receiving low pay for a long time. The most significant vested interest they had in their employment was the provision of social security and welfare benefits, especially old-age pensions and health care benefits.<sup>4</sup> Therefore, most laid-off workers rejected the termination of the employment relationship with their original work-units because they worried about losing their social security and welfare entitlements.

Under these circumstances, all seemingly irrational laid-off workers’ preferences and choices become comprehensible. To maintain their entitlement to social security benefits (pension and health care) that they were entitled to under the old labour regime, the majority of laid-off workers reject to terminate their employment relationship with their original workplace units, although this relationship looks nominal. To maintain this relationship, they are reluctant to accept job offers from private enterprises, and even though they accept job offers they do not register their new jobs as their formal employment.

## **4. State actions to cope with massive lay-offs**

Fearful of potential social and political instability, the Chinese government has always hesitated to take radical steps in abolishing the lifetime employment system and institutionalizing unemployment over the reform era until recently. Given the eruption of massive lay-offs and consequently the growth of financial and political burdens, the Chinese government has had no choice but to facilitate transition into a genuine market-oriented labour regime and to reduce unemployment.

From 1993 onward, the Chinese government introduced a series of new employment policies to deal with the problem of massive lay-offs, and to promote transition of the labour market. Like those employment policies successfully implemented in market economies, these new employment policies comprised a variety of active and passive labour market policies attempting to reduce unemployment and provide income support for laid-off workers and unemployed people. Uniquely, they also involved institutional changes in labour and social security systems, aiming to increase the incentives to laid-off workers to seek jobs in the growing non-state sector.

### **4.1 The launching of the Reemployment Project: Active Labour Market Policies**

The first significant employment policy implemented was a so-called “Reemployment Project,” aiming to speed up the shift from unemployment to reemployment through various job-replacement, job training and job-creation programmes. It was first introduced

<sup>4</sup> According to a national survey of 53,561 employees conducted by the All-China Federation of Trade Unions (ACFTU) in September-October 1997, 70.9 per cent of respondents, when asked to choose the most important of five labor insurance items, chose old-age pensions and 22.1 per cent chose health care insurance as their most important. Furthermore, 61.6 per cent chose health care insurance and 13.6 per cent chose old-age pensions as their second most important insurance items (see Policy Research Office of the ACFTU, 1999, p. 35).

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1994 in 30 cities. In 1995, the Ministry of Labour issued a new policy, extending the Project to all cities across the country (Gao, 1998, pp. 182-185).

The Reemployment Project was basically a combination of various active labour market policies. Under job-replacement programmes, local governments subsidized the employment of laid-off workers and unemployed people. Employers were also allowed to employ laid-off workers for a three-to-six month probationary period without signing labour contracts with them. Laid-off workers and other kinds of unemployed persons who wanted to pursue self-employment could receive subsidies from local governments or their original work-units to assist in starting up their own businesses. All enterprises and other kinds of organizations (such as trade unions) were encouraged to run a variety of job-training programmes. They were also encouraged to set up a variety of labour-intensive spin-offs to absorb laid-off workers and unemployed people. Funds for the setup of these spin-offs were made available either through local labour bureaus or other governmental channels.<sup>5</sup>

The fundamental characteristics of the Reemployment Project remained similar to the employment policies previously carried out by the Chinese government to cope with the problem of youth unemployment during the early stages of the reform era. These policies overwhelmingly focused on the active rather than passive aspects of the labour market policy by sharing a common solution namely state subsidization of job-placement, job-training, job-creation, and all other available employment-enhancing activities initiated by both state and non-state organizations. The subsidies came directly from the governmental budget. But this time, the Reemployment Project was financed mainly by unemployment insurance funds in which a large amount of money had accumulated since their launch in 1986. By the end of 1996, the balance of unemployment insurance funds across the country was 8.6 billion Yuan (see *China Labour Statistical Yearbook*, 1997, p. 423). Such a large accumulation of funds was the outcome of low formal unemployment rates on the one hand, and the strict limitations imposed on eligibility for receiving unemployment benefits, on the other.

The launching of the Reemployment Project was largely an autonomous action taken by the central government. The Ministry of Labour, however, could only formulate the framework of the policy, and local governments played an independent role in realizing the specifics since all unemployment insurance funds were administered at the municipal level. Under this institutional condition, some local governments had an incentive to create transitional institutional arrangements to reduce the number and duration of lay-offs and instances of unemployment so as to prevent the depletion of accumulated unemployment insurance funds. One such arrangement was the so-called “trusteeship of laid-off workers,” first initiated by Shanghai’s municipal government.

SOEs are largely concentrated in the Shanghai area in China. Throughout the 1990s, Shanghai carried out dramatic structural adjustment for industrial upgrading. As a result, large number of employees were laid off from the “sunset” industries. From 1992 through 1996, 1.09 million employees were laid off from their posts, but 81.65 per cent of these people (or 0.89 million) had been reemployed by the end of 1996. In 1997, the total number of laid-off workers, who had failed to become reemployed was less than 0.20 million (see Sun *et al.*, 1998, pp. 65-66). In 1998, the figure further declined to 0.16 million (see *China Labour Statistical Yearbook*, 1999, p. 446). This achievement, which is called the “Shanghai miracle” in China, occurred due to various employment-enhancing reform measures implemented by the municipal government, one of which was the

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<sup>5</sup> The text of the Chinese version of the policy document is available in *China Labour Yearbook*, 1995-1996, pp. 409-410.

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creation of an arrangement for the trusteeship of laid-off workers through Reemployment Service Centers (RSCs).

In July 1996, two sectoral-based RSCs were established in the textile and electric instruments industries in which many laid-off workers had been formerly employed. The RSCs served not only as the employment service agents specifically targeting laid-off workers as their clients, but also as the trustees of laid-off workers for their original enterprises. Later on, this experiment was extended to other sectors such as the chemical, metallurgical, and engineering industries. Community-based RSCs were also established in almost all districts of the city (Sun *et al.*, 1998, pp. 8-10, 240). These steps signalled a slight but significant institutional change regarding the transition from lay-off to unemployment.

RSCs operated as follows:

- ✍ enterprises presented their applications for lay-off trusteeship to the RSC in the sector to which these enterprises belonged;
- ✍ the RSC signed the agreements for trusteeship with the enterprises upon the approval of their applications;
- ✍ laid-off workers who agreed to accept the trusteeship were “peeled off” from their original enterprises by suspending their original labour contracts and signing new trusteeship contracts with both the enterprise and the RSC; and
- ✍ the RSC took charge of social security for all laid-off workers under trusteeship, and provided them with job-placement and job-training services. The duration of the trusteeship was three years, and after that laid-off workers who failed to leave the centres would become unemployed (Sun *et al.*, 1998, pp. 81-84).

This experiment achieved preliminary success within a very short period. By the end of 1996, 84,210 laid-off workers from 131 enterprises in the textile industry and 31,740 laid-off workers from 114 enterprises in the electric instruments industry entered the two RSCs. In the textile industry RSC, 44,850 (53.26 per cent of) laid-off workers under trusteeship had left the RSC, and 31,700 of these had ended their trusteeship with the center. In the electric instruments industry, 18,190 thousand (57.31 per cent) had left the RSC. Most of the laid-off workers processed through the RSCs found new jobs either in enterprises outside the industry or in their original enterprises after restructuring, while some of them left the centers to pursue self-employment or engage in temporary employment arranged by the centers, mostly in the community service sector. A minority made arrangements for early retirement (Sun *et al.*, 1998, p. 84).

## **4.2 The establishment of Reemployment Service Centers: transitional arrangements**

Shanghai’s initial success with the “trusteeship of lay-offs” prompted the central government to disseminate this local initiative across the country. In June 1998, the Chinese Communist Party’s Central Committee and the State Council jointly issued new policies concerning the basic-living security and reemployment of laid-off workers, an unusual action by the Party-State in the late 1990s.<sup>6</sup> Two months later, five state departments (including the Ministry of Labour and Social Security, the State Economy and

<sup>6</sup> During the second decade of the reform era, separation between the Party and the government was partially put into effect in China. Under this separation of powers, the party and the Government jointly issue policies only when they regard these policies as extremely significant to politics, the economy, or social development.

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Trade Commission, the Ministry of Finance, the Ministry of Education, and the State Statistical Bureau) and the All-China Federation of Trade Unions, jointly issued a notice regarding regulations concerning lay-offs and RSCs.<sup>7</sup>

According to these policies, enterprises are now required to set up RSCs serving their own laid-off workers. All laid-off workers are required to join the RSCs under an institutional arrangement of trusteeship. The duration of trusteeship is two or three years, depending upon a local decision. After that, laid-off workers have to terminate employment relations with their original enterprises and become unemployed if they are still unable to find new jobs, or if they twice decline jobs offered to them by the RSCs. Then, they become eligible to receive unemployment benefits (Gao, 1998, pp. 204-205).

In these reforms, the Chinese government still carried on its conventional practice of relying upon SOEs to deal with socio-economic problems with which the state rather than the enterprise should in fact cope. But this time, the Chinese state shifted its policy focus from overwhelmingly placing emphasis on active aspects of labour market policies to laying equal stress on both active and passive labour market policy measures. Besides job-placement and job-training programmes, a basic task that RSCs undertake is delivering basic-living subsistence to laid-off workers and paying social security contributions for them.

In financing the RSCs, the central government proposed a so-called “three-three principle” in which local governments, enterprises, and other social sources each provide about one-third of the total operational funds. Local governments suffering fiscal difficulties in financing the RSCs under their jurisdictions can apply for subsidies from the central government. The central government has promised to allocate specific fiscal appropriations through inter-governmental transfers to those areas where state-owned heavy industries are concentrated and where local governments face difficulties in dealing with the problem of massive lay-offs unaided. Unemployment insurance funds are regarded as one of the so-called “social sources” (Gao, 1998, pp. 181-189). The 1998 national statistics show that the contribution from state subsidies accounted for more than half (52.16 per cent) of the total funds raised for running these centers, while enterprises contributed 30.15 per cent, and social sources 17.69 per cent, of which 10.95 per cent came from unemployment insurance funds (see China Labour Statistical Yearbook, 1999, pp. 491-492).

Few successful local reform initiatives, however, can be easily duplicated across the country. Shanghai, a major locomotive of China’s economic development, is one of the most prosperous Chinese cities. It is relatively easy for laid-off workers in Shanghai to find new jobs in the booming service and/or private sectors. By contrast, their counterparts in many other Chinese cities suffering sluggish economic growth, may find that joining RSCs and accepting trusteeship means taking the risk of permanently losing their status as formal employees of the establishments of publicly-owned organizations, after the end of the period of trusteeship. Hence, some laid-off workers have been reluctant to enter the RSCs and accept the arrangement of trusteeship largely because they are uneasy about terminating the employment relationship with their original work-units after the duration of trusteeship. Some laid-off workers even sued their employers for breaking the provision of

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<sup>7</sup> The Chinese texts of these two policy documents are available in *Zhongguo Laodong (China Labour)* (July 1998), pp. 41-44; and *China Labour* (September 1998), pp. 35-37. *China Labour* is a monthly publication by the Ministry of Labour and Social Security, which replaced the Ministry of Labour in March 1998. As a policy-oriented magazine concerning labour and social security issues, *China Labour* publishes official policies documents, statements, policy implementation surveys and discussions (by officials and policy consultants), and interviews with officials and managers.

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indefinite employment in their signed labour contracts (see Research Group of the CCP Central School, 1998).

However, according to the regulations promulgated by the central government, joining RSCs is mandatory. All laid-off workers who decline to enter RSCs without proper reasons are ineligible for basic-living subsistence as well as other benefits and services delivered by RSCs.<sup>8</sup> The intention of the state in imposing this harsh stipulation was clearly to make RSCs operate as “transfer stations” from lay-off to formal unemployment. According to an unfinalized plan concerning labour market institution-building unveiled by Zhang Zuoji (the Minister of Labour and Social Security) in early August 1999, all RSCs will gradually close from 2004 onwards, and thus by that time there will be no lay-offs; all employees leaving enterprises after that time will have to enter the labour market directly (*Jingji Xinxu Shibao*, 2000, p. 1).

Only in a small number of areas where local labour markets are tightening, can local governments implement the central government’s unemployment policy to the letter. For example, the Guangdong provincial government made a decision in November 1999 to start to merge lay-offs and unemployment. From that time on, all discharged employees from SOEs now go directly in to the labour market rather than being laid off. They must terminate labour relations with their original work-units and are offered severance payments. All existing RSCs will close by 2003 (*The Southern Daily*, 1999, p. 1). The municipal government of Dalian, the most prosperous city in northeastern China, has increased job-replacement programmes while strictly imposing the existing regulations upon laid-off workers under trusteeship by, for example, reducing or terminating the payment of basic-living subsistence if laid-off workers decline new job-offers without proper reason (*Economic Reference Newspaper*, 1999, p. 1). However, most local governments and SOEs have not fully implemented (and may not wish to fully implement) this stipulation. The national 1998 figures show that the non-compliance rate was 22.1 per cent across the country for the year (see China Labour Statistical Yearbook, 1999, pp. 446-447). In order to assure that no laid-off workers stayed at the RSCs longer than the set duration of trusteeship, some enterprises introduced “rotating lay-offs,” allowing all laid-off workers to be on-post and arranging the same number of on-post employees to be laid off by dates close to the expiration of their trusteeship (see Information Centre of the Ministry of Labour and Social Security, 1999).

All in all, the problem of how to terminate the labour relationship of laid-off workers with their original work-units is a bottleneck in the institutionalization of unemployment in China. This is not only the case with laid-off workers who are engaging in “hidden employment,” but also with those laid-off workers who have already found new jobs through job-replacement programmes organized by RSCs. After RSCs were established, about 50-60 per cent of laid-off workers were replaced through RSCs, but most of these replaced laid-off workers did not terminate their labour contracts with their original work-units (Luo, 1999). Some of them earned income from their new employers while simultaneously enjoying social security and welfare benefits (e.g., free health care and pension insurance) from their old employers. The reason for this phenomenon was two-fold. On the one hand, most laid-off workers firmly opposed the termination of their labour relationship; on the other hand, many new employers took advantage of loopholes in labour regulations, not signing labour contracts with newly-employed formerly laid-off workers and/or not providing them with social security insurance. One concrete measure often used, was to exploit the provisions concerning probation in the policies related to the Reemployment Project, employing employees laid-off, only for three to six months (Shi, 1998; Li, 1999; He, 1999).

<sup>8</sup> The text of the Chinese version of this policy document is available in *Zhongguo Laodong (China Labour)* (September 1998), pp. 35-37.

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### 4.3 The merge of lay-offs into unemployment: local innovations

The problems with the operation of RSCs indicate that the Chinese government's efforts to sharply reduce the number of lay-offs through trusteeship and to merge lay-offs and unemployment over the last two years have suffered serious setbacks. Enterprises that have numerous laid-off workers find that lay-off trusteeship as a transitional arrangement fails to help them to get rid of labour redundancy. Even though the majority of their laid-off workers find new jobs in other places, these enterprises still have to bear heavy financial burdens of meeting their social security and welfare payments and running the RSCs. Few laid-off workers are satisfied with the current institutions as arranged by the government. Compared to their previous earnings as formal employees (salaries, bonuses, and welfare benefits), the actual income of most laid-off workers has decreased considerably. Even though many of them can gain income from "hidden employment," their new "jobs" are often precarious. Clearly, lay-off as a transitional arrangement is in a state of disequilibrium, and the Chinese state has to take more autonomous actions to solve the situation of institutional embeddedness in order to take the institutionalization of unemployment further.

The preference of laid-off workers in urban China to maintain labour relations with their original work-units is shaped by the social security and welfare arrangements embedded in the pre-existing state labour allocation system. In a survey of 812 laid-off workers in 20 cities in the second half of 1988, showed that 74 per cent of those who explicitly expressed their reluctance to separate from their original work-units chose "worry about losing pension and health care insurances" as the most important reason for their opinion.<sup>9</sup> Hence, appropriate policies aiming to cope with lay-offs have to be found in the institutional realm of social security. This is unique to China, since the situation of institutional embeddedness varies from country to country. In most other transitional countries, state agents mostly administer social security, and therefore the paths of social security transformation are not so closely related to the institutionalization of unemployment as is the case in China (Elster *et al.*, 1998, pp. 203-246).

However, social security and welfare arrangements in urban China are not immutable and frozen. In fact, social security reform is underway, but largely due to its tremendous complexity the pace of this reform has always lagged behind that of other labour reforms. During the early stage of the reform era, the Chinese state paid little attention to social security reform because there was then little demand for it. Since the late 1980s, however, the problem of soaring social security and welfare spending in the SOE sector has become evident, enough to make the Chinese government aware that the existing welfare system had not only impeded further SOE reforms, but also eroded the base of state revenues. The malfunction of the workplace-based social security and welfare system also led to a collapse of welfare provisions in many financially precarious SOEs, and the problem sparked sporadic protests.

These problems pushed the Chinese government to carry out a wide range of social security or welfare reforms, aiming to shift the responsibilities for welfare provision from individual workplace units to a combination of governments, enterprises, and individuals, a practice commonly called "socialization" in China. One of the common characteristics of pension and health care reforms was the replacement of existing "workplace-based labour insurance" with "social insurance." By the late 1990s, most Chinese cities had set up social insurance schemes, to which both employers (enterprises) and employees were required to contribute certain proportion of their payrolls. However, the delivery of pensions and health care benefits was until very recently still largely in the hands of individual work-

<sup>9</sup> This survey was conducted by a team of labour specialists affiliated to the Ministry of Labour and Social Security.

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units. At the same time, the coverage of social insurance schemes was limited to SOEs, and some COEs for most of the 1990s. In the late 1990s, the Chinese government began to take further steps to speed up the “socialization” of social security benefits delivery and broaden its coverage to the private sector.

Given the facts that a genuinely “socialized” social insurance system is yet to be established, the anxiety of employees (especially laid-off workers) about social security cannot be eased and, thus, their dependency upon the work-units cannot vanish. Some transitional arrangements must be devised to bridge the old and the new institutions. In this regard, local governments are playing a significant role. One commonly imposed measure is subsidizing the termination of labour relations. All laid-off workers who choose this option receive a lump sum employment-termination benefit in addition to the severance payments to which they are entitled. The benefit equals the amount of the basic-living subsistence they would be granted if they chose to move to an RSC. This option is normally offered to, and accepted by, relatively young laid-off workers who are more competitive in the labour market. For older laid-off workers, the municipal governments of Shanghai and Qingdao have invented a transitional arrangement, which is called the “social insurance reservation agreement” (Research Group of the Institute of Labour Science of the Ministry of Labour and Social Security, 1999). Under such an agreement, laid-off workers are required to terminate employment relations with their original work-units, but all or part of their social insurance payments (depending upon the outcome of bargaining) continue to be met by the latter (Yu and Yue, 1999).

The “social insurance reservation agreement” is an arrangement that can result in a win-win situation for both laid-off workers and employers over the transitional period. Through this institutional arrangement, laid-off workers can enter into the labour market without worrying about their social security, and employers (both local governments and enterprises) can reduce the huge amount of severance and compensation payments that would arise if radical approaches to transforming lay-offs into unemployment were adopted. However, such an institutional innovation is transitional in nature. The ultimate outcome of the transition, in the final analysis, still depends upon the Chinese government’s capability to take over from individual work-units, basic duties of social security and welfare provision within a short period.<sup>10</sup>

## 5. Conclusions

The transformation of labour institutions, including those governing unemployment, is critical to the market transition in all transitional countries, and state actors serve as the major agent of institutional change in this arena. The Chinese experience, however, suggests that autonomous state actions in institutionalizing unemployment are structured by the institutional arrangements concerning labour administration and welfare provisions embedded in the pre-existing labour regime, and as a result their outcomes often deviate from the track of institutional change that the government initially designed. To put

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<sup>10</sup> The Chinese government has failed so far to do so largely because of financial constraints. Most currently operating social insurance funds administered by municipal governments are in financial trouble. In order to restructure the existing workplace-based social security regime into a new contribution-based, fully funded system, the Chinese government has to seek alternative financial sources besides contributions and fiscal appropriations to capitalize these funds. One such source discussed for a long time by Chinese economists and policy consultants exists state assets. According to a news report by Xinhua News Agency on 13 June 2000, the Chinese government is considering selling its own SOE assets to ensure the normal operation of its social security system reform (People’s Daily, 14 June 2000). A detailed examination of social security reforms is, however, beyond the scope of this article.

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institutional change back on track, certain transitional arrangements have to be invented by state actors to bridge old and new institutions.

Before market transition, the Chinese labour regime was characterized by a state labour allocation system in which all formal employees in publicly owned enterprises in urban areas were offered lifetime employment. The institutional arrangement for lifetime employment, very uniquely, were interrelated with workplace-based social security arrangement, in which all-formal employees under the state labour allocation system enjoyed social security. Basically, the problem of unemployment (except for youth unemployment) was non-existent.

During the reform era, the Chinese state, mainly for the purpose of consolidating its rule, found it in its own interest to abolish the institutional arrangement of lifetime employment and to build a market-oriented labour system as replacement. State-imposed institutional changes in this direction, however, were largely past-dependent rather than path dependent. Institutional choices made to push through the abolition of lifetime employment and the institutionalization of unemployment was delayed by the existence of a workplace-based social security system. As a result of this institutional embeddedness, massive lay-offs rather than high open unemployment occurred in urban China in the mid- and late 1990s. Millions of previously permanent employees were laid off from SOEs and COEs, but they still maintained employment relations with their original work-units.

Because of institutional embeddedness, many employment and unemployment policies promulgated by the central government to cope with massive lay-offs have confronted failure in implementation. At the core of this policy, implementation failure has been the reality that most laid-off workers have refused to terminate employment relations with their original work-units because of fear of losing social security entitlements. As massive lay-offs are rooted in social security arrangements embedded in the pre-existing labour system, no unemployment policy purporting to transform lay-offs into formal unemployment can succeed without thoroughgoing social security reform. Given the fact that the comprehensive social security reform is still pending, local governments now play a crucial role in breaking the hindrance which institutional embeddedness causes to market transition by creating transitional arrangements for laid-off workers to deal with social security issues.



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