

Social reforms in China: 2016-2020

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Abstract:

The need to evolve from an export-based economic model towards a different model where domestic consumption plays a larger role is what has driven the Chinese government to design new social policies to give households greater confidence and boost consumption levels. The 13th Five-Year Plan 2016-2020 includes measures to expand the coverage of the pension system, health insurance, and unemployment insurance, and also provides for a new raise to the minimum wage. However, there are still significant challenges to come and high expectations for how these programs will develop. This paper analyzes the impact of the reforms adopted up until now and examines the scope of the initiatives set forth in the 13th Five-Year Plan.

Key Words: Social policy, pension system, domestic consumption, social spending, rural and urban zones, 13th Five-Year Plan

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INTRODUCTION

The People's Republic of China (PRC) has embarked on an ambitious path of economic and social reforms. The transition to the so-called socialist market model has made the Chinese economy into one of the top economic powers. The measures undertaken since 1979 to attract capital, technology, and knowledge from abroad, foster entrepreneurship and the creation of private enterprise, alter the business fabric, and promote exports have helped the country achieve outstanding growth rates sustained over a long period of time.

However, this export-based growth model seems to be running out of steam, especially since the onset of the 2008 crisis, which is why the government is rolling out new reforms to set the country back on track to more sustainable and inclusive growth.

The benefits of over 30 years of growth have mainly been reflected in a select few population groups, which has exacerbated social inequality. The family registry, or *hukou*, system is one of the keys to this vast disparity, by dividing the population into two groups: on the one hand, rights have been granted and recognized for the population registered in urban zones, while rural area inhabitants have been restricted from or excluded from these same rights, both if they have remained in their regions of origin, as well as

if they have moved towards the industrialized urban zones² (Correa and Núñez, 2013; World Bank, 2008).

Numerous challenges ensue alongside these inequalities, particularly in the circumstances such as those in which China currently finds itself, aiming to compensate for flagging exports by driving up domestic demand. Apparently, the central administration's new initiatives seek to boost welfare and consumption, in the most vulnerable households, too, in various ways: *i*) through more balanced development between coastal and inland zones; *ii*) by reducing the barriers for rural residents to transfer their residence permits to urban zones; and *iii*) by expanding coverage for people reaching retirement age, unemployed workers, the ill, etc.

The 13th Five-Year Plan includes measures to lift 55 million people out of poverty, create over 50 million jobs in urban zones, raise education levels, and expand coverage for pensions, health insurance, and unemployment insurance (Comisión Nacional de Desarrollo y Reforma de China, 2016; Kennedy and Johnson, 2016; *China Daily*, 2015a). The new strategic plan also provides for continued increases to the minimum wage, a process that, pursuant to recent statistics, has already contributed to a notable rise in real wages.

The following sections of this paper will analyze the impact of the reforms already adopted on the living conditions of the Chinese population, and examine the potential scope of the new initiatives laid out in the 13th Five-Year Plan.

DEMOGRAPHIC AGING AND OVERHAULING THE PENSION MODEL

The Chinese pension system faces a dual challenge: rapid demographic aging and an insufficient coverage rate, alongside the fact that the current pension system is inadequate. Although reforms have been enacted over the past two decades, and have indeed made notable progress, the pension model is still extremely fragmented, lacks transparency, and tends to favor inequality.

A few pieces of data clearly illustrate the rapid aging process: in 2014, 9.2% of the population was 65 years or older, but this figure will likely hit 27.6% by 2050.³ Of course, this trend will entail a rising dependency rate and a reduction in the ratio of the working-age population to the population of age to collect a pension. Concretely, if the forecasts hold true, by 2050, there will be a little under two workers per pensioner, as compared to the eight there are currently, a proportion that surpasses even the dependency rate of the most aged societies, such as Japan (see Table 1).

Table 1. Social Security and the Evolution of the Age Structure and Dependency Rates

	<i>Total Population (Millions)</i>	<i>0-14 (%)</i>	<i>15-64 (%)</i>	<i>65 and older (%)</i>	<i>Dependency rate**</i>
1960	667.07	39.96	56.39	3.65	6.47
1970	818.31	40.67	55.66	3.66	6.58

² In 2013, 275 million workers had emigrated from rural zones (more than one third of all workers), and despite being the motor of economic growth, they faced restricted social rights (*China Labour Bulletin*, 2015).

³ Intermediate scenario from the World Bank, 2015 Revision.

1980	981.23	36.20	59.31	4.49	7.57
1990	1 135.18	28.84	65.82	5.34	8.11
2000	1 262.64	25.07	68.28	6.65	9.74
2010	1 337.70	17.41	74.34	8.25	11.10
2014	1 364.27	17.20	73.61	9.18	12.47
2050*	1 348.05	13.50	58.90	27.60	46.86
2100*	1 004.39	1340.00	52.80	33.80	64.02

*Intermediate scenario. **% People older than age 65/people between 15 and 64 years of age.

Source: World Development Indicators. World Bank. World Population Prospects. 2015 Revision. World Bank.

Up until about a decade ago, only a very small number of families were able to have a second child without suffering severe penalties. The one-child policy, originally designed to prevent overpopulation in the country, ⁴ was termed calamitous by Pei (2015), alluding to population aging, the 336 million abortions performed between 1971 and 2012, and the gender imbalance (in 2013, the number of males between the ages of 0 and 24 exceeded the number of women by more than 23 million).

However, the complicated future viability of the pension system has spurred a policy shift, as the government hopes to boost the birth rate. The penultimate reform, from November 2013, changed the rule to allow a second child as long as one of the parents was an only child, a condition which the majority of households in urban areas could meet, although additional requirements were also put into place that in practice restricted the right.⁵ Finally, on the occasion of the 13th Five-year Plan, in October 2015, the right was made universal, such that currently, all Chinese couples are allowed to have a second child (*China Daily*, 2015b and 2015c). According to some estimates, thanks to this reform, by 2050, there should be 30 million additional workers (*China Daily*, 2016), although other experts are more cautious in their calculations, signaling that couples have grown accustomed to the one-child policy and are very aware of the increased expenses that would come along with having a second child (Moody, 2015).

As has been noted, in China, aging entails additional complications because the pension system is already underdeveloped and overburdened. Up until around the mid-1990s, the public pension system encompassed two essential programs that provided coverage to a small proportion of the population: *i*) Labor Insurance for employees at state-owned companies, financed individually by the companies, and *ii*) Governmental Insurance, for employees of the government and public institutions (like public universities or research institutes), funded by the various levels of government.

This system, frequently called the “iron rice bowl” system (job, housing, healthcare, and social security) endowed workers at state enterprises with generous pensions of up to 80% of wages when they retired at the age of 60 years (men), or 50 or 55 years with 15 years of service (women). Although true that in urban areas, few workers were left out of the system, those who were, not to mention the enormous population living in rural zones, lacked any type of coverage at all (Giles *et al.*, 2013).

The reforms to the essential elements of the system began in 1991 and were solidified in 1997 (Zheng, 2007; Alonso *et al.*, 2011), when, in adherence to World Bank recommendations (1997), the State Council published Document No. 26 "Establishment of a Unified Basic Pension System for Company

⁴ It is estimated that the one-child policy has made the current population 400 million people smaller than what it would have been without the policy (*China Daily*, 2015b).

⁵ An OECD study estimated that the number of births would only rise by around 20% as a result of this measure (OCDE, 2015).

Employees." This new regulation set forth the basis for a unified pension system at the province-level for companies and organizations officially registered in urban zones.⁶

In these regulations, the new terms of the pension system rest on three pillars: the first consists of two components, 1A and 1B. Pillar 1A is based on tax withholdings, such that the company contribution is determined by the local government, and is usually around 20% of total wages. These contributions are allocated to a solidarity regional fund which allows workers, after retirement, to receive a pension equivalent to 20% of the annual average wage.⁷ Pillar 1B was set up as a sort of private fund funded by employee contributions of 8% of the salary. Early on, this second component only existed theoretically, as serious errors came about in its management, which made it harder to expand its development. However, since 2001, it has become widespread.⁸

The second pillar is voluntary, quite similar to private pension plans in Western countries. It is meant for companies that have covered the requirements of Pillar 1, and is designed to collect contributions from employers and employees. However, in the absence of tax deductions, initially, only a few companies (the most profitable) chose to implement this type of initiative (Williamson and Zheng, 2003). Nor did subsequent modifications reap much success.⁹ The same has happened with the third pillar, a supplementary individual savings account for workers who can and want to save a portion of their income throughout their professional careers, as the lack of tax incentives has meant that this instrument is hardly used.

Logically, the implementation of these reforms has given rise to new needs when it comes to managing and overseeing the funds (Zheng *et al.*, 2009; Zheng, 2015). With that in mind, in the year 2000, the National Social Security Fund¹⁰ (NSSF) was created, and the National Social Security Fund Council was established as the oversight and management body for the NSSF. Two types of agents play a role in managing the NSSF: internal specialists and external managers. The internal experts may only invest in bank deposits, State bonds, and other highly liquid and secure financial instruments. However, the

⁶ This system did not provide coverage to major groups of the urban population, including freelance workers, workers at private unregistered enterprises, and companies with less than eight employees, as well as unemployed urban residents.

⁷ Initially, the plan called for a minimum pay-in period of 15 years to access a full basic pension. However, the new Social Security Act, in effect since July 1, 2011, stipulates that if the payment period is under 15 years, participants may collect the basic monthly pension as long as they continue to pay the premium until the time period reaches 15 years, or may transfer their rights to a new rural or urban social security pension plan to receive the appropriate benefits.

⁸ In the early years, the low amount of funds accumulated was used to pay the pensions of workers who were retiring, in other words, to cover the deficit generated in Pillar 1A. As such, in 2001, the government commenced a pilot test in the province of Liaoning, which was later expanded to other provinces (Zheng, 2006), and which pointed to the need to separate the accounts of Pillars 1A and 1B, and began to prohibit transfers between them.

⁹ In 2004, the Ministry of Labor and Social Security published the Provisional Regulations for Employment Pensions (Decree 23), which allowed companies to deduct up to 4% of the total wage burden from their gross revenue to make the company contributions.

¹⁰ Four income sources were used to endow the NSSF with resources: *i*) tax transfers through budgets from the central government, the highest in amount; *ii*) 10% of the income coming from the sales of State-Owned Enterprises in national and foreign stock markets, the second-highest in amount; *iii*) revenue from the national lottery; and *iv*) revenue earned on investments.

external managers have greater freedom, although they too face various constraints (maximum limit of 40% in investment shares and bonds, minimum limit of 50% in bank deposits and state bonds, etc.).

It is important to note that in spite of the advances made, there is still significant inequality in pension coverage depending on the type of company involved (state-owned, private, foreign, etc.), as well as variance between provinces and between rural and urban zones. Successive reforms are aiming to achieve convergence and consolidate the pension system to move towards universal coverage, but this is still a far-off reality.

Up until a few years ago, most of the residents of rural zones lacked any type of pension system coverage.¹¹ The situation began to improve in June 2009, when the government launched the national pension pilot plan in rural zones (consolidated in 2011), which was aligned with the pension system described earlier for workers in urban areas.¹² Likewise, it was only recently, when the new Social Security Act of 2011 was passed, that coverage was extended to urban workers at companies not officially recognized and unemployed urban residents.

Some studies have made very positive assessments of the rapid expansion of the pension program and its target of universality by 2020 (OIT, 2015a). By the end of 2014, the pension program for urban workers had achieved coverage of 255.31 million workers, or approximately 64% of urban employees. Similarly, the official figures signal that the pension plan in rural zones¹³ took off between 2009 and 2011, attaining a figure of some 237 million people paying in, or around 57% of the workers registered in the rural system (Chen and Turner, 2013; HelpAge Internacional, 2015), although other authors have found much lower rates, even below 20%¹⁴ (Zuo, 2015).

Table 2. Pension Program Coverage for Urban Workers (Millions of People)

	1997	2004	2010	2014
Contributing workers	86.71	122.5	194.02	255.31
Beneficiaries	25.33	37.75	58.12	80.14

Source: National Statistics Office of China. 2015 Yearbook. Created by the authors.

Altogether, the data analyzed reveal how significant improvements have been made to the Chinese pension system, but there are still major reforms pending if the goal is to achieve the universality set forth in the new Five-Year Plan (*China Daily*, 2015a). In spite of the progress made, approximately 50% of people in rural areas and around one-third of those living in urban areas are still excluded from the pension system.

The current model has multiple failings and problems that need to be corrected (Zheng, 2012 and 2015). Contributions are overly high for low-earning population groups, who are consequently left out of the system. Along these lines, some authors have proposed launching a non-contributory pension program, a

¹¹ A high percentage of rural workers were not paying in to the system and had no right to obtain benefits from any pension plan, although many workers had made contributions in urban areas did not have the right to a pension (Yang *et al.*, 2009).

¹² The convergence between the two systems happened in 2014. In January 2015, aiming to advance towards unification, the State Council approved the State Employee Pension System Reform, which entailed equating the state-owned enterprise and private enterprise pension systems.

¹³ The expansion of coverage to rural areas is vitally important, because rural areas are home to triple the number of elderly poor than urban zones. Concretely, it is estimated that in 2011, there were 18 million elderly poor people in China, and more than 75% lived in rural areas (Quan, 2012).

¹⁴ This rate would be even lower (15.7%) in the case of the 166 million rural workers who have emigrated outside of their regions (*China Labour Bulletin*, 2015a).

sort of Pillar 0, to provide true universal coverage to all people over the age of 65 (Zuo, 2015; Dorfman *et al.*, 2013).

Moreover, the excessive local/regional fragmentation of the first pillar makes it difficult for people to transfer their right to a pension when they move, which discourages workers who are more mobile from taking part. As such, the recommendation is to merge the province-level funds in Pillar 1 at the nationwide level. Likewise, there is an enormous quantity of individual savings accounts without funds (Pillar 2), and just like what has happened with Pillar 3,¹⁵ up until now, government attempts to encourage people to use them have proved unsuccessful (Zuo, 2015).

Another of the major problems when it comes to the viability of the current system is the early age at which some swaths of the population are able to retire, which is between age 50 and 60 years for some workers at public enterprises or institutions. These thresholds, set back in the 1950s, are not at all realistic for a country with a current life expectancy of 75 years (*China Labour Bulletin*, 2015a). The 13th Five-Year Plan already reflects the idea of gradually pushing back the retirement age (*China Daily*, 2015a), although other additional measures may be necessary as incentives to foster labor participation among older workers and policies to push companies to hire these workers (Zuo, 2013 and 2015; Zhang and Zhao, 2012).

The objective of the 13th Five-Year Plan is to expand pension coverage to 90% of urban residents. It also mentions other relevant challenges related to managing the pension funds in Pillar 1, primarily, the need to diversify investment channels and obtain higher profitability. What is certain is that there is a wide range of complex challenges of significant magnitude, which raises doubts about the capacity of the Chinese authorities to maneuver through them, although their recent track record invites an optimistic outlook.

WAGE LEVELS AND UNEMPLOYMENT INSURANCE COVERAGE

The transition from an economic model dependent on the exportation of unsophisticated manufactured goods to a new model grounded in internal consumption and manufacturing higher technology-intensive products demands significant changes in many realms of Chinese society and, in particular, labor market reforms. In order for household spending to become the new motor of economic growth, the country needs to maintain employment levels and boost wages. At the same time, it is essential that labor reforms be implemented with an element of social calm (Lam *et al.*, 2015).

The statistics on wages reflect a notable and sustained upward trend. In real terms, wages have risen between 10% and 15% annually, which means that in 25 years, wages have practically been multiplied by a factor of five. In fact, given that wages in China have risen much more sharply than in the rest of Southeast Asian countries, in 2013, the 613-dollar annual monthly wage in China was more than triple the average wage in Pakistan and Indonesia, and even more so with respect to Vietnam and the Philippines¹⁶ (OIT, 2015b).

Evidently, the average Chinese wage obscures enormous disparities between different activity sectors, provinces, rural and urban zones, as well as positions of responsibility as compared to unskilled laborers. In spite of the increases the country has seen, in 2014, the average monthly wage of migrant workers

¹⁵ In 2013, only 8.5% of workers who participated in an urban pension program made contributions to Pillar 3.

¹⁶ Even so, the average wage in China is still approximately one-third of that earned in Hong Kong and less than one-fifth of wages in Japan.

was something less than 2,900 renminbis (*China Labour Bulletin*, 2013), or approximately 50% of the average monthly wage of workers living in urban zones (some 4,700 renminbis).

Moreover, the minimum wage represents just over 50% of the average wage of urban workers. Minimum wage regulations have made significant strides forward.¹⁷ The new regulations stipulates concrete criteria to ensure that the minimum wage is a decent living wage¹⁸ and, in particular, determines that it shall be set at between 40% and 60% of the regional average wage.¹⁹ However, on more than a few occasions, this 40% minimum is not reached (*China Labour Bulletin*, 2015b), which frequently means that real wages earned are not enough to attain a decent standard of living and obliges workers to piece together various jobs and deal with an extremely exhausting workday (Yao and Rosettani, 2015). And, despite it all, the statistics reflect that the 250 dollars of the average minimum wage in China in 2015 neatly exceeds the 100-150 dollars a month earned in various countries nearby, such as Pakistan, Cambodia, Indonesia, or the Philippines²⁰ (*China Labour Bulletin*, 2015b).

Widespread non-compliance with some labor regulations is one of the principal impediments to improving working conditions in China. It is illustrative that six years after the adoption of the Employment Contract Law, only 38% of migrant workers have signed an employment contract as is required by said law (*China Labour Bulletin*, 2013). Moreover, private agreements have proved to be an ineffective instrument in improving worker rights, which should hardly be surprising in light of the fact that independent unions are not legally authorized (Chan, 2013).

It must be noted that in spite of the risks, workers at various factories around the country have engaged in forceful protests against precarious, and in some cases nearly inhuman, working conditions,²¹ and poor management practices (Chan and Nadvi, 2014). Of note is the strike declared at the Honda car factory in Guangzhou (Chan and Hui, 2012; Hui and Chan, 2014), and the savage strikes of April 2014 at the company Yue Yuen²² due to the company's failure to make pension payments and social security contributions. In fact, it seems likely that these strikes may finally give local governments the push they need to increase minimum wages (Chan and Nadvi, 2014).

¹⁷ .Article 48 of the Labor Law establishes that the minimum wage shall be sufficiently high so as to guarantee the daily needs to workers. However, it was not until 2004 when the Ministry of Labor and Social Security approved the Minimum Wage Regulations that a comprehensive regulatory framework was established to calculate and update the minimum wage.

¹⁸ Regional governments must calculate and adjust the monthly minimum wage pursuant to the cost of living, the consumer price index, social security contributions, average wages, and the level of local economic development, as well as pursuant to the local labor supply and demand.

¹⁹ The amount of the minimum wage varies significantly among the various regions throughout China: 2,000 renminbis in major financial centers, such as Shanghai or Shenzhen, as compared to less than 1,000 renminbis in towns such as Heilongjian, Guanxi, Guizhou, etc.

²⁰ Wages for unskilled workers in the textile industry are below 70 dollars a month in Sri Lanka and Bangladesh, between 85 and 125 dollars in Cambodia, Pakistan, and Vietnam, and over 150 dollars in China (OIT, 2015b).

²¹ A total of 13 migrant workers committed suicide in 2012 in a Foxconn factory (Taiwanese electronics and IT company, the main supplier to Apple and also a supplier to Samsung), which some authors considered as an act of passive resistance against inhuman management practices and extremely hard working conditions (Ngai and Chan, 2010).

²² This Taiwanese company is the top manufacturer of sports shoes and the main supplier for brands like Nike and Adidas.

As has been noted, salary increases and growing discontent with indecent working conditions have, in recent years, driven numerous cheap labor-intensive companies (textile, toy, etc.) to transfer production to other neighboring countries where they can replicate the labor and wage conditions of China a decade ago²³ (*China Labour Bulletin*, 2015b). Movements have also been detected from coastal industrial zones towards the interior of the republic, in search of the surplus labor in those regions (Roberts, 2006).

A priori, it could be expected that the upward trend in wages would be reflected to a certain degree in family spending, although it would also be necessary to consider the evolution of the unemployment rate,²⁴ as well as the level of guarantees afforded by the coverage system in case of potential unemployment, as families in unstable circumstances may choose to allocate their additional income to saving.

The terms of the unemployment insurance model are similar to those in other countries. Under the current system,²⁵ employees contribute with 1% of their wages and companies with an additional 2%, and the duration of the right depends on how long the person has been paying in to the insurance plan, with a maximum of 24 months of benefits for people who have paid in for 10 years or more (*China Labour Bulletin*, 2015a). The main problem resides in the fact that the amount of the benefit is fairly low, which in the case of minimum wage workers may prove to be insufficient as a living wage²⁶ (even in the case that they have really paid in to the insurance). Moreover, just as is the case with pensions, it is very difficult to transfer benefits between provinces, which once again is especially harmful to migrant workers. Accordingly, when it comes to unemployment benefits, there is a clear need for novel reforms to both increase the amount of the benefit and guarantee transferability from region to region.

Some authors have pointed out that falling labor surpluses in rural areas and the consequent rise in costs of the labor factor are sufficient proof that China has reached the Lewis²⁷ inflection point (Das and

²³ As shown in a comment in the *New York Times* about how labor in China is becoming more expensive, in the past, migrant workers in rural zones were thankful just to not go hungry, while now they enjoy sufficient levels of security so as to start demanding higher wages, elemental social benefits, etc. (Dammon, 2012).

²⁴ Statistics on unemployment provided by the National Statistics Office of China are not very reliable. However, according to these data, in urban areas, the unemployment rate has remained fairly steady at 4.1% between 2010 and 2014, despite an economic slowdown (*China Labour Bulletin*, 2015b). One study signaled that minimum wage regulations could be engendering asymmetrical effects on welfare, because on the one hand, they would have benefitted workers earning the minimum regulated, but on the other, they would encourage companies to move less-skilled tasks to other countries in the region, leading to an increase in unemployment rates for in the less professional categories of employment (Huang *et al.*, 2014).

²⁵ The initial unemployment insurance framework was established by the 1999 Unemployment Insurance Regulation, which was later reworked into the Social Security Act of 2011.

²⁶ The benefit should be between 40% and 60% of the wage earned and should in all cases be lower than the local minimum wage. Pursuant to China's Statistical Yearbook 2011, in 2010, the average unemployment benefit was 2,076 renminbis, with an annual growth rate of 13.9% in real terms since 1994.

²⁷ In 1954, the economist Arthur Lewis established the inflection point theory, according to which, in agricultural economies with a large surplus of labor that rapidly enter industrialization, a temporary wage ceiling will emerge. The growth of manufacturing activities will be profitable until the labor surplus has been absorbed, at which point labor will become scarce and the price of the labor factor will rise.

N'Diaye, 2013; Zhang *et al.*, 2011; Wildau, 2015). However, other authors reject this idea. These authors point out that the labor force in rural zones is still quite ample (nearly 400 million, of whom approximately 250 million work in agriculture), which is also reflected in the fact that in China, the average arable land surface per capita (0.57 hectares/inhabitant) is still 10 times lower than that of middle and high income countries (Wang and Wan, 2014).

According to this vision, the *hukou* acts as a bottleneck and artificially prevents the labor surplus from the rural areas from moving to urban zones (Wang and Weaver, 2013), such that in practice, the government uses these permits to regulate the flows of a labor supply reserve at low cost to attract investment projects designed for exportation (Correa and Núñez, 2013; Qi, 2014). Despite this, gambling on a model that lends greater weight to domestic consumption entails moving away from the low-cost export-based strategy, relaxing the restrictions imposed by the *hukou* and increasing labor mobility,²⁸ and, ultimately, opting for better welfare for the population with the tradeoff of becoming less competitive in costs (Correa and Núñez, 2013).

Considering the evolution of labor conditions, and in particular, of wages, and the trend towards higher technology-intensive production, one might daresay that the Chinese labor force is making progress. Even so, it would be foolhardy to posit a direct and positive relationship between the two variables, because as can be derived from the analysis conducted by Butollo (2014), there seems to exist no positive "predestined" correlation between the evolution and industrial modernization of a company and the social progress of its employees.²⁹ Similarly, nor is there a unanimous diagnosis as to the consequences of the growing role of the Chinese economy in labor conditions in other countries.³⁰

The analysis of wealth distribution among labor income and capital also points to rising social imbalances. As recognized by Dollar and Jones (2013), in China, labor factor revenue represented 43% of the Gross Domestic Product (GDP) in 2007, a percentage far lower than the 50% in 1993, making China among the top 10% of countries with the lowest share of labor in wealth generated. This increasingly downward trend in the share of labor in GDP means that company benefits and government revenue have risen notably, which implies that economic growth, which was more extensive at the start of the reforms, is now more intensive, and points to rising inequality in China (Whitfield, 2016).

According to this thesis, the segmentation of the labor market is the cause behind rising wages; the relative scarcity of qualified labor prompts wages to rise in these professions, while the evolution of wages that lower-skilled workers earn responds in large part to the tensions and fluctuations of the global demand for labor-intensive goods and services, as well as the management of the surplus through

²⁸ According to Bosker *et al.* (2012), the relaxing of restrictions on labor mobility would lead to greater division between the center and periphery, and even sharper predominance of the four large Chinese urban hubs, Beijing, Shanghai, Guangzhou, and Chongqing.

²⁹ Rather to the contrary, using the database for various textile and clothing companies and LED technology sector companies in the Peral River delta region, Butollo demonstrated that technological progress tends to lead to the expansion of cheap labor, loss of employment, and longer working hours.

³⁰ Some authors, perhaps more optimistic, believe that the global economy progresses in terms of income and labor conditions such that the most advanced economies become increasingly specialized in value added and the rest of the economies absorb the production that the latter group discards (Friedman, 2006). Others, on the contrary, believe that China's productive capacity will be enough to capture all of the value-added segments, spurring economic stagnation and eroding working conditions, in the most advanced countries, too (Freeman, 2010).

the *hukou*.³¹ Some authors believe it very unlikely that *hukou* will be relaxed in the near future (Correa and Núñez, 2013), which would mean the maintenance of a fragmented labor market and little possibility that hundreds of millions of families would be able to improve their living conditions and go out and start spending.

HEALTH INSURANCE AND OCCUPATIONAL INSURANCE

The terms of health insurance for workers were established in 1998 when the State Council's Decision for the Establishment of Basic Health Insurance for Urban Workers (*China Labour Bulletin*, 2015a) was approved. The health insurance system, like the pension system, combines shared funds and individual accounts. Although the amounts vary from region to region, employees tend to allocate 2% of their salaries (entirely to the individual account), and companies between 6% and 12% of wages (of which 30% is allocated to the worker's account).

The individual worker account covers the cost of medical treatment whose cost is less than 10% of the local annual average wage. The shared fund covers costs above that limit, but up to a maximum of five times the annual average wage. As such, if workers does not have sufficient funds in their individual accounts to cover the aforementioned 10%,³² they must pay the remaining amount with their savings. Similarly, in case of severe or long-term illness, if the cost exceeds the five years of average wages, it is workers themselves who must take on the extra cost, at least if they are able to do so. Moreover, the health insurance regulations have other problems, which result in a situation in which many workers are unable to access care³³ (*China Labour Bulletin*, 2015a).

On the positive side, it should be noted that the system is growing rapidly: the number of workers and retired people covered by health insurance in urban zones has doubled over the past decade, reaching 210 million workers and 72 million retirees. Furthermore, the development of the system has been even more vertiginous in the case of unemployed urban residents, as in merely eight years, the model has managed to extend coverage to 314 million people (see Table 3).³⁴

Table 3. Health Insurance Coverage in Urban Areas (millions of people)

	1995	2000	2005	2010	2014
Workers	7.0	28.6	100.2	177.9	210.4

³¹ In 1990, the wages for some labor-intensive jobs (like construction) were 14% higher than the banking and insurance sectors; however, in less than two decades, the situation has changed completely, such that in 2007, bank wages were 260% higher (Yang *et al.*, 2010).

³² Lower-wage workers may need many more years to reach that 10% limit, which in practice means that many workers must assume part of the cost of treatment.

³³ Although theoretically the health insurance fund should pay the costs, frequently, workers must advance the amount of their treatments themselves. Moreover, in order to be covered by the public funds, the treatment must be performed at one of the hospitals on the government-approved list. There are also lots of obstacles in using the insurance coverage for treatments and medicines that do not require hospital admission.

³⁴ Initially, the system only covered employed workers, but in 2007, the Basic Health Insurance System for Urban Residents was approved to provide coverage to other urban residents, including spouses and children.

Pensioners	0.4	9.2	37.6	59.4	72.5
Unemployed Residents	-	-	-	182.1	314.5

Source: National Statistics Office of China. Created by the authors.

When it comes to rural areas, the transition to market socialism entailed the practical disappearance of the old health insurance system:³⁵ the proportion of the rural population covered fell from 90% in the 1970s to less than 5% at the end of the 1990s (Yang, 2013). Illnesses exacerbated poverty in rural China, the cost of treatment for hospitalized patients rose, and the percentage of the population that ignored recommendations to seek medical care rose (Yang, 2013).

In light of this scenario, in 2003, the New Cooperative Medical System was created, and to try to guarantee widespread coverage, the individual contributions required were set at very low levels. This New System, still modest and developing, represented an important step forward, although in 2009, it still had not shown a significant effect on household healthcare spending or the perception of risk for potentially having to face an unaffordable expense (You and Kobayashi, 2009).

One particularly concerning piece of data is that the budget for this New System is too small (only 20% of healthcare spending per capita in rural areas) so as to significantly reduce the portion of healthcare spending that families must pay out of pocket (You and Kobayashi, 2009). It is telling that in case of severe illness, the vast majority of rural residents must travel to cities for care due to the lack of sufficiently equipped hospitals in their regions of residence.

In addition, the high rate of occupational accidents and illnesses is reason for concern. It is estimated that annually, more than one million occupational accidents are recorded, as well as nearly 70,000 work-related deaths³⁶ (*China Labour Bulletin*, 2012 and 2013). The occupational mortality rate in China is 20 times higher than that of the United Kingdom (Bardsley, 2011) and 16 times higher than that of the United States (Hosier, 2010).

The accident rate remains high due to scarce oversight in compliance with occupational safety regulations by local government civil servants, as well as the subordination of safety to productivity (*China Labour Bulletin*, 2013). It will be necessary to build and develop a safety culture, which entails training civil servants and executives about the need to put health-related criteria before productivity and profitability indicators (Zhu *et al.*, 2014).

When it comes to professional accident insurance, the Social Security Act of 2011 stipulates that in case of a professional accident or illness, the expenses shall be covered by the company through the professional accident insurance fund; moreover, they must continue to pay the worker's wage during medical treatment, as well as supplementary amounts pursuant to the disability the worker is facing. For those cases in which the company has not been contributing to the accident fund, the regulation establishes that local governments shall cover the expenses and, subsequently, may sue the company. However, there are still many local governments that do not accept this obligation, and workers sometimes only have coverage if companies have really paid in to the fund.

Even in those cases where a worker dies due to an occupational accident, there is no guarantee that the family will receive any payment from the accident fund. In 2012, the state administration for occupational safety reported 72,00 work-related deaths, but only 22,313 of those deaths were officially

³⁵ Under the communist system, town doctors provided primary care for free to rural populations, although in some cases, families had to pay small amounts for medicines.

³⁶ The Occupational Accidents Map published by the organization *China Labour Bulletin* reflects that the majority of accidents take place in construction and primarily migrant workers (see <<http://maps.clb.org.hk/accidents/en>>).

declared as occupational accidents and were therefore eligible to receive compensation from the accident fund³⁷ (*China Labour Bulletin*, 2015).

INEQUALITY AND CONSUMPTION

In 2010, the central government set a target of doubling real GDP and real per capita income by 2020. It is an achievable objective, considering that per capita GDP in China still accounts for only one-fourth of the figure in the United States, but it will not be easy, because it requires annual GDP growth of approximately 6.5%, and the current economic conditions in China do not seem conducive to attaining these levels (Feldstein, 2015).

However, the main challenge consists of achieving this growth in a way that reduces the enormous social inequalities in the country. According to the data available, in 2014, per capita income in urban households was practically triple that of rural households (28,843 and 10,488 renminbis, respectively), a proportion similar to that recorded 20 years ago, but now with a much wide gap in absolute terms.³⁸ Consequently, consumption differences have also diverged; although over the past two decades, this variable has grown relatively on par in proportional terms, in absolute values, the gap in spending on consumer goods has widened so much that it hit 16,700 renminbis in 2014.

Table 4. Average Spending per Household on Consumption in Rural and Urban Zones (renminbis)

	1995	2000	2005	2010	2014
Rural Zones	1.344	1.917	2.784	4.941	8.744
Urban Zones	4.769	6.999	9.832	17.104	25.449
Rural-Urban Gap	-3.425	-5.082	-7.048	-12.163	-16.705

Source: National Statistics Office of China. Created by the authors.

Rising per capita income levels and household spending on consumer goods would seem to indicate that, just as the Chinese government desires, domestic demand could be taking over for exports as the motor of economic growth. However, it still remains true that consumption is far from becoming the new backbone of growth. On the contrary, as is evident by analyzing the composition of GDP, the relevance of household consumption has been falling for two decades now (37.9% in 2014 as compared to 45.8% in 1995).

In spite of rising income levels, Chinese populations in urban areas hesitate to consume and are allocating increasingly large proportions of their income to savings (30% in 2014 as compared to 24% in 2004), which reflects a persistent lack of confidence in the social security safety net and makes clear the need to deepen the reforms that have been undertaken (Roach, 2015). A high propensity to save is also related to the one-child policy, which has reduced families' consumption needs because they have fewer members (food, clothing, education, etc.), while simultaneously encouraging saving for retirement

³⁷ The majority of the rest of the cases were closed through private agreements and aid from the charity system.

³⁸ Likewise, in urban and rural zones, there are significant differences by migrant status, activity sector, type of labor performed, nature of the company, etc. In urban zones, practically 20% of households have per capita income below 15,000 renminbis annually (where 10% earn less than 10,000 renminbis). In rural households, a little over 20% earn per capita income of below 4,000 renminbis (where 5.6% earn less than 2,000 renminbis).

in light of the fact that families foresee receiving less support from their sole progeny (Modigliani and Cao, 2004) (see Table 5).

Table 5. Structure of GDP from the Point of View of Spending (%)

	1995	2000	2005	2010	2014
Household Consumption	45.8	47.0	40.1	36.6	37.9
Public Spending	13.3	16.7	14.0	13.4	13.5
Gross Fixed Capital Formation	39.3	33.9	40.5	45.7	45.9
Net Exports	1.6	2.4	5.4	4.3	2.7

Source: National Statistics Office of China. Created by the authors.

In an age marked by the falling weight of family consumption and a lower contribution by exports, China's economic boom of the past decade has been based on growth in gross capital formation, whose share in the GDP rose from 40.5% in 2005 to 45.9% in 2014, a percentage already considered too high in 2005 (Juijs, 2005).

The expanding role of gross capital formation could be a reflection of excessive reliance on building infrastructure and other types of buildings. Already in 2010, suspecting that a real-estate bubble could be forming, Chinese authorities began to adopt various financial regulation measures to try to slow rapidly rising housing prices (Ahuja *et al.*, 2010; Barth *et al.*, 2012). However, the new spike in residential prices would seem to indicate that in effect, an extremely large bubble has already emerged³⁹ (Chen and Wen, 2014; Sheen *et al.*, 2016).

Ultimately, dependence on construction, low levels of consumption, and a high propensity to save make clear that Chinese families do not put much stock in the social protection system, and therefore prefer to do without certain goods that would improve their quality of living to have more peace of mind and security in case of potential adversity in the form of an illness or job loss. It would be fitting to conclude that the significant reforms undertaken to date in the social security system have yet to provide enough guarantees to the population.

As has been observed, many of these measures are imperfect, both in form and, especially, in application. The 13th Five-Year Plan 2016-2020 sets forth ambitious objectives, such as a universal pension system and improved access to education and health services. However, it is likely that it will take longer than five years to bring about these profound changes in such a fragmented society.

CONCLUSIONS

The changing labor market might lead an observer to believe that the end of the age of cheap labor is nigh and the future augurs relatively optimistic for Chinese workers. Rising real wages, enhanced social

³⁹ The construction boom has also been reflected in employment data, such that in 2014, the proportion of migrant workers employed in construction had risen to 22.3% from a mere 16.1% in 2010, while the proportion in industry fell from 36.7% to 31.3% in the same time period (*China Labour Bulletin*, 2013). According to some studies, the decision to build large international infrastructure projects tied to strategic and multinational initiatives, like the Asian Infrastructure Investment Bank, the BRICS Bank, or the Silk Road, is associated with the need to find an adequate replacement for the already oversized domestic construction industry (EY, 2015; Kun, 2014).

protections and pension coverage, stronger labor rights, and wider health insurance coverage all undoubtedly constitute relevant progress.

However, the reality is less clear-cut, and big challenges loom ahead for the Chinese authorities. The rise in wages has driven some factories to move to neighboring countries with lower labor costs and has coincided with a global crisis that has reduced the growth of Chinese manufacturing exports. As such, the government is now embarking on a transition to a new and more sustainable and inclusive economic growth model where family spending will play a bigger role.

Reducing the inequality derived from the wall between rural and urban zones is one of the top challenges, as it affects the living conditions of some 275 million migrant workers. The development of rural areas in inland China is already producing certain benefits, while the relaxation of administrative barriers to migrating to small and medium-sized cities has facilitated worker mobility and reduced migratory pressure on large urban hubs.

In an increasingly aged society, due to the effects of the one-child policy, an underdeveloped social security system is another one of the main reasons why rising wages do not really represent improved living conditions. Without an adequate pension or health insurance, workers prefer to save to face their futures with greater peace of mind. Declining desire to spend means that families are not buying the goods that would help them improve their standard of living and, in macroeconomic terms, makes it difficult for consumption to become a lever for economic growth.

The 13th Five-Year Plan 2016-2020 contains a few large-scale initiatives, among them the end of the one-child policy, measures to expand coverage and unify the urban and rural pension plan systems, better healthcare services, and more flexibility to transfer resident permits and the social benefits associated with them. In principle, all of these measures seem to be beneficial, although it is likely that more than five years will be needed for their effects to be truly felt.

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