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Tackling unemployment in China: state capacity and governance issues

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Abstract

This paper considers China's state capacity and changing governance as revealed through its policies to tackle unemployment. Despite high levels of growth, economic restructuring has resulted in rising unemployment over the last decade. The Chinese state has been able to manage job losses from state enterprises, demonstrating some state capacity in relation to this sector and some persistent command economy governance mechanisms. However both design and implementation of policies to compensate and assist particular groups among the unemployed have been shaped by weak state capacity in several other areas. First, capacity to gather accurate employment data is limited, meaning local and central governments do not have a good understanding of the extent and nature of unemployment. Second, the sustainability of supposedly mandatory unemployment insurance schemes is threatened by poor capacity to enforce participation. Third, poor central state capacity to ensure local governments implement policies effectively leads to poor unemployment insurance fund capacity, resulting in provision for only a narrow segment of the unemployed and low quality employment services. Although the adoption of unemployment insurance (and its extension to employers and employees in the private sector), the introduction of a Labour Contract Law in 2007, and the delivery of employment services by private businesses indicate a shift toward the use of new governance mechanisms based on entitlement, contract and private sector delivery of public sector goods, that shift is undermined by poor state capacity in relation to some of these new mechanisms.

Keywords: state capacity, governance, unemployment, China

State capacity is rarely well-defined. Drawing on Lee (2000) and the World Bank (1997) we take it to mean the state's ability to mobilise resources and take actions to achieve chosen public goals. Studies of the Chinese state's capacity have tended to focus mainly on fiscal and extractive capacity (Lee, 2000; Li, 1998; Wang & Hu, 2001), while others have examined coercive capacity (Bakken, 2000). But some—not necessarily framed in terms of 'state capacity'—have looked at the central state's ability to implement policy. These include Maria Edin's study of cadre control (Edin, 2003), and others focusing on particular policies (O'Brien & Li, 1999; Schwartz, 2003).

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State capacity and governance are closely connected. While state capacity refers to the state's ability to mobilise resources, governance relates to the processes through which societies are governed—processes that are largely dependent on the mobilisation of resources by the state. Although 'governance' is often used interchangeably with 'government', in political science theory it has been used more specifically to refer to 'shifting patterns in styles of governing', particularly shifts toward a greater role for non-state actors and 'governing mechanisms which do not rest on recourse to the authority and sanctions of government' (Stoker, 1998, p. 17).

This paper aims to contribute to understanding both the specific issue of state capacity and the wider one of governance in China through a study of policies to tackle the social and political problem of urban unemployment.¹ Such policies are potentially both extractive and redistributive. For example, they are extractive if they involve—as they often do—state-mandated unemployment insurance that requires individuals and employers to make premium contributions. And they are redistributive in using unemployment insurance funds to pay for the benefits and employment services of the unemployed. While they are primarily state-mandated, they may also signal a shift away from highly interventionist state guarantees of full employment to governance mechanisms based on entitlement, contract, and private sector delivery of services. The paper is based on documentary research and fieldwork consisting of interviews with officials in departments implementing unemployment policies in six cities—Shenyang, Benxi, Anshan, Chengdu, Leshan and Mianyang—across Liaoning and Sichuan provinces between 2002 and 2005.²

Policies to tackle unemployment and to assist the unemployed are significant in terms of state capacity and governance because they are an important part of the state's adjustment to the transition to a market economy as well as providing an important source of financial support for rising numbers of people without work. Despite high levels of growth, economic restructuring—central to which are efforts to make state enterprises more efficient—has resulted in growing urban unemployment over the last decade and job losses have become a sensitive issue and the source of much urban unrest. From 1986, but particularly from 1997, central government unemployment policies have focused on assisting the urban registered unemployed and so-called 'laid-off employees' through unemployment insurance, re-employment service centres, and employment (or re-employment) services such as training and job-search assistance. These measures have been supported by ongoing central and local government efforts to control redundancies from state enterprises and create jobs primarily by stimulating economic growth.

We argue that job losses from state enterprises have been highly managed, demonstrating that some capacity remains in relation to this sector of the economy and that some command economy governance mechanisms have been retained. However policies to compensate and assist particular

groups among the unemployed over the last decade, while using new governance mechanisms, have been shaped (in both design and implementation) by weak state capacity in several other areas. First, local capacity to gather accurate employment data is limited (and local governments have incentives to keep the local unemployment rate close to the target set by the central government). As a result, local and central governments do not manage to form an accurate and detailed picture of the extent and nature of unemployment. This undermines policy development and implementation. Second, as the non-state sector share of employment grows the relevance of supposedly mandatory unemployment insurance schemes to many of the working population is undermined by poor capacity to enforce participation in that sector. Third, operated at the city- or sub-city-level, the unemployment insurance scheme is too decentralised to provide sufficient risk-pooling for financial viability and to distribute the financial burden of supporting the unemployed equitably. These problems are recognised and the policy aim has been to make the provinces the operational units, an aim that remains largely unrealised. The consequence of poor capacity in all these areas is provision for only a narrow segment of the unemployed and inadequate re-employment services.

The next two sections set out the extent of the unemployment problem in China and the key policies designed to deal with it. The following two sections then assess what the problems implementing those policies show about state capacity. In the concluding section we discuss the implications of weak state capacity in relation to unemployment policies particularly for our understanding of governance in China today.

Rising urban unemployment in China

In the pre-market reform (state planning, ‘command economy’) period (roughly the 1950s-1980s), unemployment was limited as urban workers were allocated jobs for life (through state labour departments or specially-designated officers in schools) under the so-called ‘iron rice bowl’ and rural-urban migration was strictly controlled. By the mid-1960s most urban dwellers worked in state enterprises or other public sector employment and the private sector had been virtually eliminated. The term ‘unemployment’ (*shiyè*) was seen as a phenomenon of capitalism and the aim was therefore to eliminate it. Those without work tended to be young (secondary or tertiary) graduates who were waiting to be allocated a post and were labelled as ‘waiting for work’ (*daiyè*), and the number of people actually losing jobs was very small (Jefferson & Rawski, 1992). Through the 1960s-1980s, however, there were periods in which significant numbers of young people were without work. There was, for example, a peak in the 1978-1980 period, when they returned from periods of compulsory work in rural areas (Jefferson & Rawski, 1992).³

But from the late 1980s, state enterprise reforms gave managers greater flexibility in hiring and firing employees, and unemployment began to grow. Since then there has been a slow but steady rise in the

official unemployment rate, from 2.5 per cent in 1990 to 4.2 per cent in 2004 (see Figure 1). The official figure, however, presents only a partial picture of unemployment in urban areas because of its restricted coverage. It includes only the registered unemployed (*dengji shiye ren yuan*) and excludes two categories of persons who, by the usual internationally-accepted criteria, would be counted as unemployed. These are: first, those not eligible for registration as unemployed and, second, and those who are eligible but lack an incentive to register.

[Insert Figure 1 about here]

Focusing only on the long-term residents of urban districts of Chinese cities (*shiqu*), the following were until recently by regulation not eligible to register as unemployed:

- ‘Laid-off employees’ (*xiagang zhigong*, literally ‘standing down employees’), who are formally still attached to their work units.
- Unemployed rural migrants resident in urban districts for six months or more (the definition of migrants in Chinese statistics).

Since the last two or so years, migrant workers are in principle allowed to register as unemployed but this makes little difference, if any.

As is usual in any registration count, the category ‘registered unemployed’ excludes urban residents who are unemployed but have no incentive to register. Possible reasons include not qualifying for unemployment benefit or not wanting to make use of additional benefits that come with registration such as subsidised participation in retraining programmes or job-search assistance. Such unemployed workers may include school leavers and those re-entering the labour force after a period of withdrawal because of, for example, childbirth and rearing or illness. With the shift in urban employment towards sectors where participation in unemployment insurance is low (something we discuss below), the percentage of the unemployed lacking an incentive to register has risen.⁴

In addition, unemployment statistics are distorted by government-set targets because sub-national governments alter their figures to ensure that they hit the target unemployment rate. As Dorothy Solinger (2001) has detailed, the real unemployment rate is difficult to determine. Giles, Park and Zhang (2005) estimate, based on a survey of five cities and using international definitions of unemployment, that it increased among urban residents from 6.1 per cent in January 1996 to 11.1 per cent in September 2002. Xue and Zhong (2006) put the real unemployment rate at 11.6 per cent in 1999 and 11.5 per cent in 2002.

Policies to tackle unemployment

State policies to deal with urban unemployment have evolved since 1986 when labour markets first began to be encouraged. They include policies to offset the insecurities of unemployment through unemployment insurance and ‘re-employment service centres’ for ‘laid-off employees’. There also have been policies aimed at helping unemployed and laid-off employees get back into work through the development of employment (or ‘re-employment’) services. Finally, there have been initiatives to generate new jobs by promoting economic development, create incentives for employers to hire laid-off employees, and to help the unemployed set up in business.

Unemployment insurance

Before the mid-1980s China did not have an unemployment insurance (UI) scheme. Under the command economy the focus instead had been on job creation and allocation—contributing to ‘hidden unemployment’ in an overstaffed urban state sector where economic efficiency and profit-seeking were not the drivers of enterprise activity. Beginning in 1986, state enterprise reforms began to encourage labour mobility, permit managers to dismiss workers and enterprises to become bankrupt, and introduce contracts for workers that signalled the end of job tenure (Leung, 1995).

In 1986, too, UI was introduced. But it at first provided for only two categories of urban state sector employees, those whose enterprises had been declared bankrupt and those yet to find a new job following the expiry of a fixed-term employment contract. Benefits were paid to workers from a fund into which state enterprises contributed one per cent of their wage bill.⁵ However from the early 1990s state enterprise employees declined as a share of the urban employed. They were around 70 per cent in 1991, down to 55 per cent in 1999, and fell further to 41 per cent in 2004.⁶ This made UI of declining relevance and perhaps in response in January 1999 national Unemployment Insurance Rules (hereafter, the 1999 Rules) extended participation beyond the state enterprise sector and made it (in principle) mandatory for all urban employers (*chengzhen qiye shiye danwei*) and their employees (State Council, 1999).⁷

Under the 1999 Rules, employer contributions were raised to two per cent of their total pre-tax wage bill and individual employees now made premiums contributions of one per cent of their wage. If they lost their jobs involuntarily, wished to work and were registered unemployed, individuals who had paid contributions for at least a year were then eligible to receive unemployment benefit (UB) for a maximum period of 24 months (the actual length of the period depending on for how long they had paid premiums). UI funds were also to be used to subsidise UB recipients’ medical treatment and funeral expenses. And it could also be used to provide re-employment training and job introductions services (State Council, 1999).

The 1999 Rules stipulated that UB payment rates should be set locally and be lower than the local minimum wage but higher than the local minimum living security (*zuidi shenghuo baozhang*) benefits paid to the urban poor so as to provide an economic incentive to take up a job. In the six Liaoning and Sichuan cities where we conducted fieldwork UB ranged between 60 and 80 per cent of the minimum wage (authors' interviews, 2002, 2005). The minimum wage, and so level of UB, differed within cities between urban districts (where they were higher) and suburban districts and counties. In some localities, higher UB was paid (at 80 per cent of the minimum wage) for workers who had been employed for more than 10 years. On this basis, in 2002 the monthly payments across the six cities we studied ranged from 163 yuan to 233 yuan (authors' interviews, 2002). By 2004 they ranged between 189 and 238 yuan (Mo & Ge, 2004). In addition, the unemployed also often received a subsidy to assist with costs of any outpatient medical treatment, and sometimes, if they did not participate in the local state social health insurance scheme, 70 per cent of their inpatient medical costs—but usually up to a specified limit (authors' interviews, 2002).⁸ They also received certain free re-employment services, including job-search advice, introductions and training. The variation in UB across cities or city districts reflected not only differences in living costs but also the state of local public finances. Localities with strained finances set UB lower.

Re-employment service centres for laid-off employees

Before the 1999 Rules appeared the central government had approved the adoption nationally of another scheme for 'laid-off employees' in the state sector. Pioneered in Shanghai, Re-employment Service Centres (*zai jiuye fuwu zhongxin*, RSCs) were supposed to provide a 'basic living allowance' (*jiben shenghuo fei*, BLA) for three years to people who no longer worked in their state enterprise but who had not severed links with it and so could not register as unemployed.⁹ This initiative was introduced in the late 1990s, with the first RSCs set up in Shanghai in 1996 and the central government endorsing their creation nationally from 1997.¹⁰ They were a temporary measure, however, and from around 2001 have been phased out in a so-called 'merger' with the UI system through which those in RSCs who do not find work are transferred onto the unemployment register and are entitled to unemployment insurance (Wong & Ngok, 2006). While some localities may still have RSCs, they have now been closed down in most cities.¹¹

RSC organisation and provision varied from locality to locality and between enterprises in the same locality. In Liaoning and Sichuan, we found that RSCs attached to individual enterprises provided laid-off employees with a BLA that was usually very similar to the local monthly UB rate. But reflecting the fiction that laid-off employees were off-work but not unemployed, the BLA was usually set slightly higher than the UI cash benefit. Both BLA and UB varied across cities, reflecting, as with UB, not only local price differences but also the state of local public finances. BLA ranged in 2002

from 163 yuan to 240 yuan per month (authors' interviews, 2002). In addition, laid-off employees were also said to have social insurance contributions paid for them (for old-age, health and work injury) if such social insurance schemes were established in the locality, often adding up to a further 200 yuan in benefits. Finally, these laid-off employees, like those receiving UB, were provided with certain free re-employment services, including training and job-search assistance.

As noted above, laid-off employees, because they retained links with their enterprises through the RSCs, were not registered as unemployed and therefore not included in official unemployment statistics. Moreover, the real number of laid-off worker numbers was not known—many laid-off employees did not actually join RSCs and receive benefits from them. For example, although by the late 1990s most state enterprises had RSCs, with a few exceptions urban collective enterprises did not. As a result most urban collective laid-off employees did not receive a BLA. Despite this, estimates indicate that laid-off worker employee numbers rose much more quickly than those of the officially unemployed in the 1990s: the number of registered unemployed (which excludes laid-off employees) was 4.2 million in 1993, 5.75 million in 1999, and had risen to 8 million in 2003. Meanwhile it has been estimated that the number of laid-off employees rose from about three million in 1993 to a peak of 9.3 million in 1999, before falling again to 7.41 million in 2001 (Wong & Ngok, 2006).¹² The RSC initiative appears therefore to have been an attempt to keep the unemployment figures down and reduce unrest and opposition to state enterprise restructuring. As an enterprise-based solution it enabled the state to make enterprises responsible for provision, but permitted some state financing for particularly problematic cases. Although the RSC regulations indicate that funding for laid-off employee allowances, retraining and insurance payments should be shared three ways by enterprises, state and 'society', with 'society' referring to UI funds that consist in part of contributions by employees (Party Central Committee & State Council, 1999), in fact our fieldwork indicates that they were mainly financed by enterprises and unemployment insurance funds, with funding from state budgets made only when the enterprises and UI funds were unable to cope. The amount of municipal government budgetary support depended heavily on the state of local public finances.

Re-employment services

Employment, or 're-employment' (*zai jiuye*), services refers to a range of provision to help the unemployed find work. These include provision of information about jobs, placement into available vacancies and retraining, usually short. Some services are provided by the private sector, but partly or wholly financed by the government, and some by enterprise RSCs. Some services are also organised by local governments, usually through Employment Service Departments beneath city Bureaux of Labour and Social Security (LSS). Whether using other state or private sector agencies to actually provide them, local governments finance the free one-off services for both the registered unemployed

and laid-off employees in RSCs, usually on a per capita basis (Ministry of Labour and Social Security, 2000).

In Liaoning and Sichuan employment services were available to anyone seeking work and were delivered on a fee-charging basis to many. Free services for registered unemployed and RSC laid-off employees were funded from unemployment insurance funds and subsidised by the local government. But others, including migrants, for example, had to pay for them themselves. But this has changed. Since 2005, migrant workers, after a period of employment, are entitled to the same services on the same terms as those provided to their urban counterparts. The government work report approved by the Fifth Session of the 8th National People's Congress in March 1997 required that re-employment funds to help laid-off employees be established with contributions from local government budgets, enterprises and 'social security funds' (*shehui baozhang jijin*).¹³ In practice, we found in Liaoning and Sichuan in 2002 and 2005 that re-employment services for both the unemployed and laid-off employees were funded mainly from unemployment insurance funds. There was, however, great variation in the amounts that were invested in this work and the share of UI funds used for re-employment services. Most localities invested relatively little in re-employment services and they were usually of poor quality, with little regard for the specific needs of people on the programmes (authors' interviews, 2002, 2004).

Job creation

There have been calls from China's top leaders—including Jiang Zemin, Zhu Rongji and Hu Jintao—since 2000 for employment expansion (Hu & Sheng, 2006). And the central government has set targets for job-creation—in 2004 it was 9 million new jobs, for example.¹⁴ Specific initiatives include financial incentives to employers to take on laid-off employees, support for business start-ups and the creation of public sector posts (*gongyixing gangwei*) for the unemployed. And in late 2002 the 16th Chinese Communist Party National Congress called for the promotion of labour-intensive industries (Hu & Sheng, 2006).

In Liaoning and Sichuan we found that local government Employment Service Departments often argued that a key strategy for reducing unemployment in urban China was developing the economy and thereby creating jobs (authors' interviews, 2002, 2005). This type of job creation may often be emphasised locally in part because economic growth is a key performance indicator for local leaders. While local governments were also encouraging businesses to employ laid-off employees and creating some low-grade, low-paid public works-type employment, these were not a key focus and not considered significant in reducing unemployment. In Liaoning there was greater interest in and emphasis on business start-ups for the unemployed because the city of Anshan was a pilot city for a 'Start Your Business' initiative run jointly by the International Labour Organisation and the Ministry

of Labour and Social Security. Under this project the unemployed were given advice on tax, preferential policies, and all aspects of running a business as well as sometimes being provided with micro-credit (authors' interviews, 2005).

Residual central and local state capacity

Controlling state enterprise restructuring and bankruptcies

There has been evidence of some state capacity in relation to the state sector, which comprises state enterprises (hereafter also SOEs). SOEs under the pre-reform state planning system had little autonomy from the state: planners allocated inputs, and determined what and how much they produced and how many people they employed. In the absence of markets, these enterprises did not respond to market prices or have to worry about efficiency and making a profit. But this was to change from the late 1980s as policy makers sought to improve SOE performance. Now, as markets began to emerge, SOE 'overstaffing' and low productivity was seen as a problem. But rather than privatising SOEs, reforms were initially aimed at improving managers' powers to respond to market incentives and raise efficiency, in part by cutting back their workforce.

But SOE restructuring was highly controlled, and phased over time from the 1990s. Although many SOEs were struggling to compete in a marketising economy, even those that were effectively insolvent were not permitted simply to declare bankruptcy. SOE bankruptcies had to be officially approved, or rather, officially decided and mandated. And they were particularly controlled in the early 1990s, with the numbers very limited. Although from 1997 onwards the central state pushed SOE reform and real unemployment began to rise, RSC policy helped keep official unemployment rates relatively low, with the national figure rising from 2.9 per cent in 1995 to just over four per cent in 2004 (see Figure 1). But in retrospect it seems that government policies only managed to slow down the speed rather than the magnitude of labour redundancies. In ten years from 1995 to 2005 the number of state sector employees fell by a massive 43 per cent from 113 million in 1995 to 65 million in 2005.

Establishing RSCs in state enterprises

The policy of establishing RSCs in state enterprises is another indicator of some retained state capacity at central and local levels in relation to this sector. The state was able to create RSCs in state enterprises, provide for at least some of their laid-off employees and reduce official unemployment while at the same time preventing unrest and minimising the financial burden on UI funds and local governments. It was able to do this because through state agencies—notably labour departments that had in the planning period directed labour use in enterprises—it had systems place to monitor compliance. These long-standing systems were also supplemented by state controls over senior SOE appointments as well as enterprise access to key resources such as water, electricity and finance. However, enterprises, particularly those in difficulty, often found it difficult to set up fully-funded

RSCs to provide for laid-off employees, and with local governments unable or unwilling to subsidise RSCs, the policy was not fully implemented and many redundant workers were left unprovided for. In the six cities we studied SOEs usually did set up RSCs but did not transfer all laid-off employees to them (Mo & Ge, 2004).

The policy to end RSCs and transfer laid-off employees to unemployment insurance from 2001 also indicates some state capacity to push through closures. But in Sichuan, central government SOEs resisted the move because their ministries would not fund it—here we see provincial and city governments finding it difficult to enforce compliance among ‘high-ranking central government SOEs, particularly when reforms require central government finance that is not forthcoming. Elsewhere, poor capacity is due to shortage of finance. In Liaoning at least one poor city implemented it more slowly than others because it found it hard to find the financing for it (Mo & Ge, 2004). RSCs and re-employment services often needed local government finance, but this was limited particularly in cities with high unemployment because a key cause of unemployment—problems in state sector enterprises—was also the cause of decline in an important source of government revenues, SOE tax payments.

But the failure of even those losing their jobs in the state sector to be assured of state assistance through UI or RSCs can be due not only to poor capacity but also to local governments being unwilling—whether for economic or political reasons—to subsidise programmes.¹⁵ One urban labour official in Sichuan argued that the closure of RSCs was putting pressure on UI funds and if it became serious enough:

‘government finance might have to subsidise. But this would show that the economy is in a bad condition and that there is a big risk of instability and so is only a last resort. The main thing is for people to find work. We are doing this by developing the tertiary sector and small and middle-sized enterprises’ (authors’ interview, 2002).

Job creation

It is difficult to assess overall state capacity in relation to job creation, particularly as pursued through the promotion of economic growth. Certainly, jobs have been created and the number of new jobs in the economy appears to have been significant. It is officially estimated that between 1990 and 2003 the employed population (*congye renkou*) increased by nearly 97 million and that in 2006 alone 12 million urban jobs were created.¹⁶ The high economic growth rates that have been sustained over the last two decades may mean that, other things being equal, real unemployment has been lower than it would have been without government investment geared to economic growth. But job creation may not have been ideal. A different growth strategy—one focused more on labour-intensive industries, for

example—might have produced growth with lower unemployment rates. Hu Angang and Sheng Xin have certainly argued that there needs to be a significant shift in overall economic strategy to make employment growth more central (Hu & Sheng, 2006).

Poor central and local state capacity

Employment data

There is weak capacity in relation to labour statistics and information-sharing among LSS and other government departments. Labour statistics are gathered both by statistical bureaux and LSS departments, but neither does so well and they produce different figures (authors' interviews, 2002). Moreover, there are several levels of government (city, district, neighbourhood office) involved and poor information systems connecting them, which add to the problems. The result is that not only are real *unemployment* rates not known, but also departments have little idea of how many people are *in* work. This is because they tend to have only information on people in work if they have labour contracts. People in informal work, without contracts, are more difficult for the authorities to identify. Informal work, however, has risen dramatically since the early 1990s as employment in the state and traditional collective sectors, where contracts are more common, has declined (see Figure 2).

[Insert Figure 2 about here]

The informalisation of employment and poor capacity to ensure compliance in UI schemes

Not knowing the real extent of employment and unemployment makes it difficult to design employment promotion policies and target benefits accurately: many who are unemployed are not getting benefits, and many with work are. And it is particularly problematic that local governments have difficulties extending UI schemes to the non-state sector of the economy where labour contracts are uncommon and informal employment is widespread. This helps explain the poor results in extending UI participation beyond the state sector since 1999. Despite the fact that UI Rules issued that year stipulate that all urban enterprises and their employees should join the schemes, participation has been dominated by workers with contracts in the formal, mainly state sector. The recent Labour Contract Law (National People's Congress, 2007) indicates central government interest in tackling the problem by increasing the use of contracts. Though capacity for monitoring compliance with the law remains rudimentary, it could be a step toward extending participation in UI.

At present, however, the paucity of labour contracts is compounded by weak LSS department links to the non-state sector. These departments historically have had strong relationships with state and urban collective enterprises and so there are norms, established practices and channels for obtaining information, monitoring activities, and ensuring compliance.¹⁷ However many urban collectives have been privatised or broken up. And the expanding non-state sector consists of both many very small

private firms and many self-employed. Labour departments may not even know of the existence of many firms since they appear and disappear rapidly. And high staff turnover and rapidly growing non-state sector informal employment means they find it difficult to determine employee numbers and the wages they pay—information that is essential for collecting contributions. Enforcing social insurance system compliance in relation to such firms and individuals is difficult even in advanced industrialised nations, but in China the usual problems of firm evasion and high staff turnover and are compounded by lack of legal and normative institutions to support business registration and social insurance contributions. Even when state agencies do know of enterprises' existence, however, they may tolerate partial (private enterprises, especially smaller ones, tend to contribute for their 'core' white collar employees rather than for their entire labour force) or non-compliance because they think it important that those businesses operate and thereby contribute to local economic and employment growth. Such thinking may be compounded by a lack of staff and other resources needed to pursue large numbers of small businesses and by the lower priority that extending unemployment insurance has within local governments in comparison with economic growth (authors' interviews).

Poor state capacity to ensure participation in unemployment insurance due to the informalisation of employment has an impact on the relevance of UI and perhaps its sustainability. As the numbers and share of urban employees working in the state sector has fallen, so has the percentage of the urban labour force participating in unemployment insurance. Around the turn of the century, in many cities the number of UI participants fell—at a time when unemployment from the state sector was rising. At that time, particularly in cities with high unemployment, UI funds ran into deficit or were insufficient to both pay UB and adequately fund local re-employment services. To reduce pressure on UI, cities made one-off compensation payments to laid-off employees rather than transferring them onto UI in line with national policy. Re-employment services were widely perceived to be low quality by both officials and the unemployed (authors' interviews 2002, 2003).

In recognition of the difficulties LSS departments have collecting contributions, some localities have contracted out this work to tax departments –nationally about half of localities collect through tax bureaux (Dong, 2005). Since paying taxes, unlike contributing to unemployment (and other social) insurance, is a legal obligation for enterprises, it may be easier to collect contributions alongside them. Certainly in localities where LSS departments collected insurance contributions themselves, officials talked of the benefits of having tax departments do the work (authors' interviews, 2002). However in localities where tax departments did this work the LSS departments were not always satisfied, with officials complaining that tax bureaux tended to collect tax first and insurance contributions only thereafter. Moreover labour officials said they were left not knowing which enterprises had and had not contributed as tax departments did not report this information to them. Overall, LSS officials in

Liaoning and Sichuan seemed to feel they had poor capacity to collect premiums whichever system was in place (authors' interviews 2002, 2005).

Poor central redistributive capacity

Poor central state capacity to redistribute in relation to unemployment relates to the inability to deliver sufficient risk-pooling across China or even across a single province. Nationally, there has been a surplus in UI funds—that is, funds into which UI contributions are paid and from which UB and re-employment services are financed (it was 30 billion RMB in 2003). However, these funds are held at city and county-level, or even at the level of city districts as for example in Chengdu. The implication is that any redistribution is only within these small areas. This can mean UI fund finance for re-employment services is in greatest shortage precisely where it is most needed: cities with high unemployment are likely to have fewer contributors to UI schemes but more people in need of services that are financed by UI contributions.

Higher-level pooling, for example at provincial level, would distribute risk more widely and provide localities with higher unemployment more finance for UB and other services but has so far been prevented by weak central and provincial state capacity. Due to regional inequalities (in terms of economy, local government revenues and expenditures, and people's incomes) there is considerable opposition from richer cities to national pooling for unemployment insurance that would result in them 'subsidising' poorer cities. Central and provincial government capacity to raise pooling even at provincial level is limited because both central and provincial governments fear that if they raised pooling to provincial level, cities, particularly the wealthier ones, would not conscientiously pursue payment arrears and ensure compliance in the UI schemes. This is in turn because those cities would see their own efforts merely subsidising poorer cities and of little benefit to themselves—in the context of a decentralised fiscal system local (city) leaders and the officials in their government agencies have strong incentives to think in such terms. And fiscal decentralisation combined with a system of decentralised government appointments means that higher level governments have little leverage to counter those incentives: finance for labour departments' operations (salaries and running costs) comes from local government and local leaders appoint the labour department officials who implement policy. With local governments on the receiving end of numerous (sometimes competing or contradictory) central policy initiatives that they must finance themselves, they can successfully argue that they are struggling to enforce some, particularly those that are not given the highest priority by central leaders.

Poor central and provincial government capacity to raise the level of pooling has resulted in a compromise arrangement, 'adjustment funds' (*tiaojijin*), under which a small proportion of the unemployment insurance funds is submitted upwards to the provincial level and used to assist city UI

funds that are running deficits. The 1999 Rules stipulate that the proportion of city UI funds submitted to provincial adjustment funds shall be decided by the provinces themselves. In 2002, it was eight per cent in Sichuan and four per cent in Liaoning (authors' interviews, 2002). Thus there is some redistribution within provinces, but it is capped at a low level.

Other systemic factors can add to the pressures on UI funds due to limited redistribution. The phasing out of the RSC system from around 2001 put pressures on UI funds because it increased the numbers of registered unemployed (as they were transferred out of RSCs) and because all their costs were now paid from the UI funds rather than being shared with the enterprise or government. These pressures have been alleviated since 2005, when unemployment insurance funds shifted from generally being in deficit to instead predominantly being in surplus. (This was due to a marked slowdown in labour lay-offs from the state sector and the disappearance of the bulge in the number of unemployment insurance benefit recipients caused by the absorption of laid-off employees into UI.) Even before the pressures increased in 2001, however, governments preferred to accrue surpluses in funds rather than invest in re-employment services. This was perhaps because in high unemployment areas officials thought that the most vulnerable groups were unlikely to be able to find work even with training and assistance. If such views persist, and if there is further pressure on UI funds in the future, the unemployed are likely to continue to receive low-grade training and job-search assistance that is not tailored to their needs.

Conclusions

State capacity

It is difficult to assess the state's record in job creation and thereby unemployment reduction. Much job creation may be a side-effect of central and local government prioritisation of economic growth. This local government focus on economic growth is generally understood to be the result of incentives created by fiscal decentralisation in tandem with local leader performance indicators and promotion chances tied to local economic performance (Edin, 2003; Whiting, 2001). In this sense, job creation may be seen as an indirect outcome of the central state's capacity to mobilise local governments to encourage economic growth. However, the economic growth-focused strategy may not have been optimal in terms of creating jobs.

Where the state retains an 'ability to mobilise resources and take actions to achieve public goals' it seems to be particularly in relation to SOEs. Unemployment policies involving this sector—for example controlling bankruptcies and redundancies, and setting up RSCs—are implemented relatively well. Others, however, especially where they relate to new sectors of the economy and market-induced social change are less successful and reveal a state apparently struggling to adapt. Poor capacity to gather employment data and enforce compliance in mandatory social insurance schemes reveals

extractive weaknesses, particularly vis-à-vis new economic actors such as non-state businesses and the self-employed. Meanwhile principal-agent problems within the state itself undermine central capacity to implement more redistributive provincial or national risk-pooling in entitlement-based unemployment insurance.

The consequences of these weaknesses are poorly-targeted benefits, provision for only a narrow segment of the unemployed, and under-funded re-employment services. With poor employment data, it is difficult to ensure that benefits and services are reaching those who need them. So long as the informal sector of the economy continues to grow and those working in it are not covered by UI, this benefit is likely to become increasingly irrelevant for the urban employed population. Until the problems contributing to weak state capacity in this policy area are tackled many urban dwellers will face impoverishment due to unemployment and will receive low quality assistance with retraining and job searches.

Governance mechanisms and weak capacity

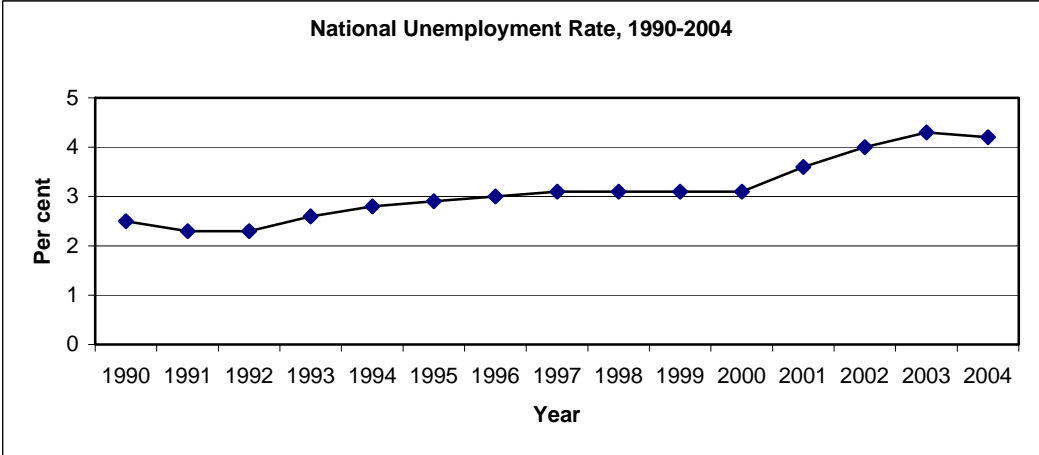
With the introduction of labour markets since the late 1980s there has been a shift from command economy guarantees of (almost) full employment to entitlement-based unemployment insurance and services to assist some segments of the working population with the contingency of unemployment. Although the state has controlled the pace of enterprise restructuring and unemployment in ways reminiscent of the command economy, there has nevertheless been some use of new governance mechanisms, such as entitlement and contracts as well as the private sector delivery of re-employment services.

There are, however, problems with these and other new governance mechanisms, particularly the use and enforcement of contracts. For example, new information systems that underpin contract-based governance in a market economy need to be backed by the effective gathering of employment data from enterprises. Similarly, use of the courts and media to help improve enterprise compliance in UI and reduce arrears will work only as a supplement to the formalisation of labour (authors' interviews, 2002, 2005). While the promulgation in 2007 of the Labour Contract Law is a move in this direction, it will not overcome some of the more fundamental causes of weak state capacity in this area. These include most notably a lack of incentives and resources for LSS officials to pursue non-compliant employers.

State capacity in relation to unemployment is often weak precisely where new governance mechanisms are involved. And it should be remembered that these new mechanisms are being introduced where governance is still overwhelmingly based on longer-standing ones and dominated by the state. In this sense there has been little overall shift toward the use of governance mechanisms in

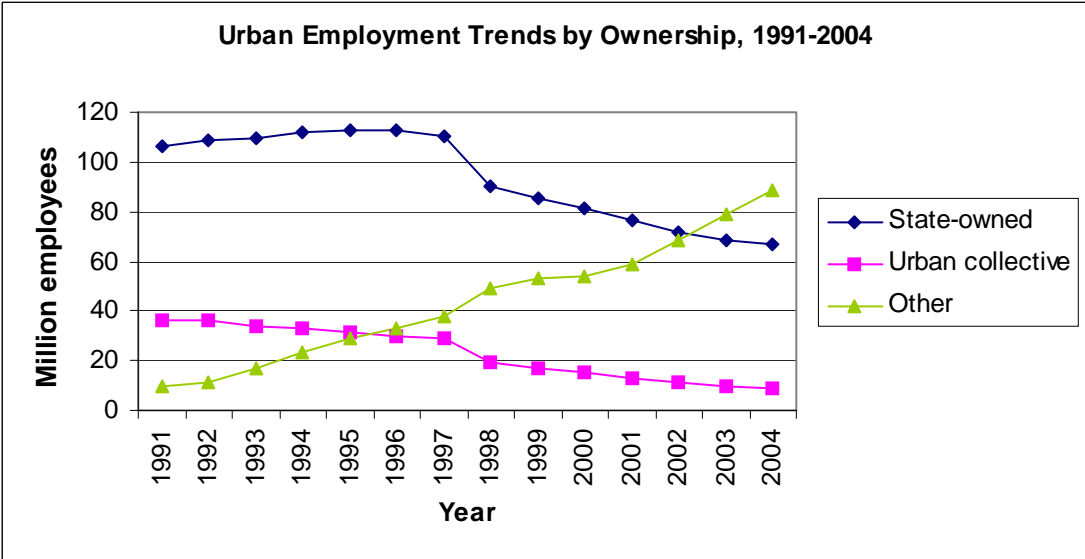
Stoker's sense—those that do not rely on government authority and sanctions. On the contrary, while consulting much more on public policy initiatives (for example it solicited views on the Labour Contract Law), the state still tightly controls the policy agenda and prevents any significant organisation of labour. As Ng and Ip (2006) have argued, the official All-China Federation of Trade Unions has done little to protect workers' rights, instead functioning more as a welfare agency in providing re-employment services and support for the unemployed. While all this enables the state to maintain a veneer of control over unemployment, particularly official unemployment rates, it reduces the political pressure to tackle the sources of weak capacity and to deliver more comprehensive support and assistance to the unemployed.

Figure 1: Controlled Official Unemployment



Source: MOLSS, Labour and Social Security Yearbook, various years. From www.molss.gov.cn. Accessed 28 November 2006.

Figure 2: The Informalisation of Employment



Source: National Bureau of Statistics at www.stats.gov.cn, accessed 12 December 2006.

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Notes

¹ We do not deal with the issue of ‘rural unemployment’, usually referred to by the Chinese authorities as ‘surplus labour’ or ‘hidden unemployment’ and, as argued by Murphy and Tao (2006), the subject of only fragmented policy responses.

² These interviews were conducted under the aegis of the Unemployment Insurance Project (2002-2005) carried out in the People’s Republic of China and funded by the UK government’s Department for International Development.

³ Young people were ‘sent down to the countryside’ in the first place, not only during the Cultural Revolution (1966-76), but also in the early 1960s, in order to reduce urban unemployment (Leung, 1995).

⁴ In line with international convention, official unemployment in China measures joblessness among those of working age only, which in China means males aged 16-50 years and females aged 16-45.

⁵ State Council, Provisional Regulations on Unemployment Insurance for State Enterprise Employees, promulgated in July 1986, cited in Pi (1995).

⁶ National Bureau of Statistics, employment data by sector, various years. From www.stats.gov.cn.

⁷ In April 1993, the State Council had also promulgated the ‘Regulations on Unemployment Insurance for State Enterprise Employees’, which expanded the scope of insurance to state sector employees ‘waiting for work’ because their enterprises had been dissolved or had stopped production (Pi, 1995).

⁸ Limits were set in different ways. In one example, it was set at the equivalent of the total amount of UB a person was eligible for, around 7000 yuan.

⁹ The Shanghai RSCs differed in some respects from those established nationally. Notably, the Shanghai RSCs were established by particular industries, through state agencies responsible for those industries (former industrial bureaux), but under the national scheme they were established in each enterprise.

¹⁰ See for example the Party Central Committee and State Council ‘Notice concerning realistically doing well state enterprise laid-off employee basic living security and re-employment work’ issued in June 1998 (Party Central Committee & State Council, 1999).

¹¹ Note also that the ‘merger’ is supposed to transfer laid-off employees to UI for up to two years, but in practice they are often given a one-off compensation payment.

¹² See also Xue and Zhong (2006).

¹³ See account in a Ministry of Labour-led Notice published in 1997 (Ministry of Labour et al., 1999).

¹⁴ Xinhua, 26 April 2004, at People’s Daily online, www.people.com.cn, accessed 15 March 2007.

¹⁵ Note also that RSCs (with their attendant benefits) have generally not been established in collective enterprises, even though they have many laid-off employees. And until they actually make their employees formally redundant, they are not able to register as unemployed.

¹⁶ South China Morning Post, 13 March 2007, from www.scmp.com, accessed 15 March 2007.

¹⁷ The precise agencies handling unemployment insurance vary from locality to locality, but they are usually a section of the local Bureau of Labour and Social Security that is part of the Ministry of Labour and Social Security’s hierarchy.