

Forthcoming in Asian Economic Papers.

Comment on Hu Angang's Paper "Macroeconomic policy and employment promotion in China"

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The main theme of the paper is about employment in China, which is one of the most important issues for China and global development. The paper presents rich facts and proposes some innovative approaches to look at present employment conditions in China. It explores the relationships between wage policy and employment, between informal and formal employment, between job-creation and job-destruction growth, etc. The author tries to arrive at some policy recommendations on employment creation by balancing different interests and objectives of the society.

I have a few comments and suggestions on the revision of the paper. First, it would be useful to develop a more explicit conceptual framework that could link the macro and micro aspects of employment creation/destruction. Second, it is useful to include more explicit discussion about the links and related mechanisms that go from analysis to policy recommendations. Finally, I would like to give an alternative thinking framework on the subject to stimulate discussion and future research. We may call this an institutional-Keynesian-Lewis type analytic framework on China's employment and growth.

If we assume the natural rate of employment for China's primary sector is 30% of the total labour force. The difference between the actual rate and the natural rate of employment in the primary sector could be regarded as some sort of effective rate of unemployment arising from the surplus farm labour. Let's assume the actual rate of employment for the primary sector in China has declined from roughly 70% to 50%, the effective unemployment then would also fall from 40% to 20%. The numbers here are only suggestive but would reflect at least qualitatively the employment conditions in China's countryside.

The reduction of rural effective unemployment in China from 40% to 20% is indeed a great achievement but the existing 20% effective unemployment is still a high unemployment rate and would easily qualify China as a Keynesian depressed economy or a Lewis under-developed economy with unlimited supply of labour from the traditional rural sector.

Table 1. China in the world of Lewis and Keynes

	1978	2001
Actual employment rate in primary sector	70%	50%
Natural rate of employment in primary sector	30%	30%
Effective unemployment rate arising from rural surplus labour	40%	20%

To some extent, we can regard the last two decades as a period when China was recovering from a great depression under the centrally planned economy! This recovery has been driven by two forces at both the micro and macro level.

At the micro level, the institutional reform leads to a long process of privatization which destroys employment in the state-owned enterprises but creates jobs in the private sector. Using the paper's statistics, during 1996-2001, China's total employment growth rate is 1.2% but the state sector employment growth rate is -6.3%. This change in the structure of employment driven by privatization is efficient for the society as a whole but painful for some groups of people.

At the micro level, another force driving employment creation is globalization and the opening of China. China now is not short of capital due to high savings and large inflows of FDI. It is hard to blame the lack of capital for unemployment at the macro level but it is true that at the micro level there is a big problem in how to channel the available funds to the most productive projects.

The paper raises a question on whether the capital-intensive projects usually associated with FDI could destroy jobs or create less employment. This is a valid concern, especially within the traditional world of capital immobility. But today capital is mobile across the borders on a large scale as is demonstrated by China's becoming the World's largest FDI destination, ahead of the US in 2002. Under the new environment of capital mobility, China can develop both capital-intensive and labour-intensive industries at the same time!

The globalization and FDI are also closely related to China's structural changes: the employment of unskilled rural labour in the manufacturing and service sector. In this process of employment creation, wages are largely market-determined. At the low end, wages for unskilled labour have stayed at around US dollar 50 cents an hour for almost two decades. This is the subsistence wage as described in the Lewis dual sector model. Wages at the high end are rising but in my opinion are likely to be stabilized as the supply of high skill labour grows rapidly due to a rapid expansion of high education in China. It seems to me that the employment growth and wage setting in the private sector are doing well without much wage policy guidance from the Chinese government. On the other hand, there could be a danger of discouraging employment if the government is to impose some kinds of minimum wage regulation.

There is also an important macro story behind China's structural transformation and employment creation. Investment plays a key role in the Lewis and Keynesian World. Lewis emphasizes role of high savings in accumulating capital for the development of the modern sector. Keynes focuses on the co-ordination of credit creation and allocation to increase effective demand and employment. The key point of the macro story is that the costs of co-ordination failures are much larger than the temporary inefficiency relating to the non-performing loans. We can compare China today with China before 1978.

As pointed out above, before 1978, China's effective unemployment rate was about 40%. That was largely due to a lack of market-oriented macro coordination, including the poor financial system as well as due to inefficiency of the state-owned enterprises.

By 2001, China's effective unemployment rate was reduced to about 20%. This was partly due to improved micro efficiency of the growing private sector and partly due to rapid improvement in macro economic coordination. In particular, the credit creation has been unprecedented. Money supply increased from about 30% to 180% of GDP during last two decades. China also maintained a stable exchange rate since 1994. Banking reforms and the development of stock markets have improved the macro coordination significantly.

Compared to the problem of non-performing loans, the privatization generated micro efficiency and the success in macro credit coordination are the first order issues, at least for the time-being. Let me use a simple numerical example to highlight my point that the losses from non-performing loans or asset bubbles are secondary compared with potential collapse of macro coordination, which is the root of the Great Depression. Assume the losses from non-performing loans are \$100 billion. It is likely that \$80 billion of the losses are actually transfers from the state to private sector in the form of asset-stripping, corruption, commercial crime, etc. These transfers are unfair but the wealth involved are not destroyed and has real purchasing power. The rest would then be pure waste at \$20 billion. However, because of the credit creation, the private sector could grow and could actually create \$50 billion additional value in a growing economy. Hence, for the society as a whole, there are no net losses at all. The society actually gain \$30 billion net value added due to better macro coordination and micro efficiency but in spite of the \$20 billion losses in non-performing loans.

This is not arguing that we should not deal with the non-performing loan problem seriously. We should but the timing is important and we need to have a historical perspective. In the near future, the non-performing loan problem will become the first order issue as the Chinese economy is moving towards a full employment economy.