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EMBEDDED AUTHORITARIANISM: CHINA'S LABOR POLITICS AND ITS MARKET  
TRANSFORMATION

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To My Parents

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## Abstract

My dissertation tries to address three puzzles in China's reform process. Why does China try to organize a reliable social welfare system, which can shake its critical ground of competitiveness, cheap labor costs? Why do its efforts to set up new social welfare system come to mainly focus on organizing a quite reliable pension system? Finally, how can we understand the efforts to organize social welfare system in terms of China's authoritarian political system?

China needs to set up a reliable social welfare system to address its tough SOE reform process. SOE reform had been dragging for decades without breakthrough, because it was organized with very unique Zhigong labor system. In order to construct socialist industrial system rapidly with the extreme low wage system, the leadership arranged a comprehensive welfare system for SOE Zhigong by organizing SOEs with the Danwei system. SOE Zhigong were the permanent workers and SOEs had to employ much more personnel than they needed to realize full urban employment. With the intensified market competition after the reform, SOEs could not maintain their redundant workers, but they could not dissolve labor relations with their redundant workers. This was a main reason why China's various efforts to reform SOE system could not making meaningful progress for decades. The success of SOE reform depended on if China set up a social condition whereby SOE Zhigong could manage their living after they left their Danwei. Indeed, the Danwei system absorbed all social functions, and there was no social system beyond Danwei in urban society for those urban citizens who did not belong to the Danwei system. In this context, the leadership tried to set up new social welfare system beyond Danwei to make SOEs dissolve labor relations with their redundant Zhigong.

Interestingly, the efforts to set up new social system come to focus mainly on how to organize new socialized pension system independent from Danwei. There was hidden pact in

socialist China that the state guaranteed SOE workers' decent pension after the retirement as a return for their low-waged labor contribution for system construction, and Danwei took the responsibility to grant pension for the retired Zhigong. Yet, the Danwei system could not take the responsibility any more, as increasing numbers of SOEs underwent restructuring process. It also turned out that the very condition that redundant SOE Zhigong could accept to dissolve their labor relations was assurance of their pension entitlement even after they left their Danwei. Hence, SOE restructuring process needed to address the worries of both retired and redundant SOE Zhigong to lose their pension entitlements. Properly working market system is embedded in a certain scheme of supporting social system and China's new reliable pension system for SOE Zhigong turns out to be the main embeddedness scheme to fashion its market transformation process.

The crux of the pension reform is how to handle the Danwei system's IPD, which is Danwei's former pension commitment for their Zhigong. Yet, China does not devise a reliable financial ground and let the new pension system grant pension for retired Zhigong. Hence, many areas' pension systems cannot grant full pension for their retirees. Yet, under the urgent SOE restructuring process, China comes to articulate the system's historical debts, which confirms the Danwei system's pension commitment as the state's eventual liability. Hence, even if there remain many area's pension system that do not have enough resource to grant full pension for their retired Zhigong, China can maintain SOE Zhigong's trust of pension entitlements. This makes China complete long dragging SOE reform process including privatization, and SOEs become pure economic units with the clear ownership system. This is the process of how China realizes its system transformation based on full market system. Hence, confirming SOE

Zhigong's pension entitlement that the Danwei system promised before turns out to be the social contract that the system has to fulfill for the system transformation.

Under Zhigong labor system rural peasants were blocked to enter urban society by setting up Hukou system in order to maintain the urban society's comprehensive welfare system for Zhigong. Now China's urban society is no more bound with Zhigong labor system, and China comes to construct full labor market system where peasant can enter. Those new peasant workers in urban labor market, however, cannot be beneficiaries of the new urban pension system, even if they participate in the system.

This is a result of China's market transformation process under the CCP leadership which formerly tried to organize socialist system. China's market transformation process under the CCP turns out to be based on politics of confirming the state and society's former social pact in terms of socialist accountability. Those new peasant workers, unlike SOE Zhigong, did not have social pact with the system to get pension after the retirement, so they cannot be the pension beneficiaries. China completes its system transformation by dissolving Zhigong labor system, but the process based on socialist accountability under the CCP's authoritarian political rule turns out to be predicated on confirmation of the system and SOE Zhigong's exclusive social pact without dissolving the former social distinction. Accordingly, the nature of socialist accountability politics has nothing to do with growing social capacities to check CCP's authoritarian political system; it rather involves the sustained power of authoritarian CCP ruling political system that can fashion the system transformation process within the social meaning of full recognition of the former socialist system which was predicated on the system and SOE Zhigong's special relations.

## Table of Contents

Acknowledgements .....	iii
Abstract .....	v
List of Tables .....	ix
List of Figures .....	x
Abbreviations .....	xi
1. Introduction .....	1
Part I	
Historical Origin of China's Gradualism and its Dragging SOE Reform	
2. SOE, the Danwei, and Zhigong Labor System .....	22
3. Drifting SOE Reform and the Origin of China's Reform of Gradualism .....	68
4. Xiangang and Embeddedness Politics of SOE Restructuring .....	132
Part II	
China's Pension Reform, the System Transformation, and its Discontents	
5. China's Pension Reform and the Danwei's IPD .....	208
6. Pension and the Politics of the <i>Merging</i> Process .....	284
7. The Historical Debts, Labor Market, and the Market Transformation .....	348
8. The Politics of Socialist Accountability and China's Bounded Embeddedness .....	413
9. Conclusion: Embedded Authoritarianism and China's Market Transformation .....	462
Bibliography .....	491

## List of Tables

Table 2-1. A Case of Zhigong's Total Production and Distribution in the 50s .....	27
Table 3-1. Employment Trend of those Urban Workers in Waiting Jobs .....	73
Table 3-2. Zhigong Welfare Outlay and Wages from 1978 to 1993 .....	79
Table 4-1. Declining the Total Number of SOE Xiagang Zhigong and Increasing the Total Number of Unemployment Insurance Beneficiaries .....	197
Table 5-1. Growing Imbalance between Workers and Pensioners in SOEs and COEs .....	218
Table 5-2. Shanghai's Increasing Dependency Ratio .....	245
Table 5-3. Shenyang's Ratio of Retirees to Working Zhigong .....	254
Table 5-4. Data on Pension Arrears .....	272
Table 5-5. The Central Government's Financial Subsidies to the Zhigong BPI and Xiagang Zhigong Basic Living Support Program, 1998-2004 .....	280
Table 6-1. Various Estimates of the Total Amount of IPD .....	337
Table 8-1. SOEs and Constructing the Socialist System in China before the Reform .....	443

## List of Figures

Figure 3-1. SOE's Total Amounts of Deficits and the State's Total Amounts of Supports for SOEs .....	108
Figure 3-2. The Total Number of SOE Zhigong and the Ratio of SOE Production in the Total Manufacturing Production .....	123
Figure 5-1. Premium Receipts and Pension Granting in Shenyang Pension System .....	257
Figure 6-1. Total Number of SOE Xiagang Zhigong .....	331
Figure 7-1. The Total Number of Zhigong and Urban Congye Renyuan .....	403

## Abbreviations

ACFTU: All China Federation of Trade Unions (中华全国总工会)

AMC: Asset Management Company

BPI: Basic Pension Insurance (基本养老保险)

CASS CSPS: Zhongguo shehui kexueyuan, Shehui zhengce yanjiu zhongxin (中国社会科学院 社会政策研究中心)

CASS IIE SISRT: Zhongguo shehui kexueyuan, Gongye jingji yanjiusuo, Shehui baoxian zhidu yanjiu ketizu (中国社会科学院 工业经济研究所 社会保险制度研究课题组)

CCP: Chinese Communist Party

COE: Collective Owned Enterprise

CRS: Contract Responsibility System

DRC: Development Research Center of the State Council (国务院发展研究中心)

DRC SRRTT: Guowuyuan fazhan yanjiu zhongxin, Shehui baozhang zhidu gaige yanjiu ketizu (国务院发展研究中心 社会保障制度改革研究课题组).

FIE: Foreign Invested Enterprise

FYP: Five Year Plan

GLF: Great Leap Forward

GVIO: Gross Value of Industrial Output

HRS: Household Responsibility System

ILSS: Laodong he Shehui Baozhangbu, Laodong kexue yanjiusuo (劳动和社会保障部 劳动科学研究所)

ILSS RTT: Laodong he Shehui Baozhangbu, Laodong kexue yanjiusuo ketizu (劳动保障部 劳动科学研究所 课题组)

IPD: Implicit Pension Debt

IPO: Initial Public Offering

JIL: Japan Institute of Labor Research (日本労働研究機構)

LSC: Labor Service Company

MOCA: Ministry of Civil Affairs

MOF: Ministry of Finance

MOL: Ministry of Labor

MOLSS: Ministry of Labor and Social Security

MOP: Ministry of Personnel

NDRC: The National Development and Reform Commission (国家发展和改革委员会)

NSSF: National Social Security Funds

PAYG: Pay As You Go

RSC: Reemployment Service Center

SDPC: The State Development Planning Commission (国家发展计划委员会)

SDPC AMR: The State Development Planning Commission Macro Economy Research Institute (国家发展计划委员会 宏观经济研究院)

SETC: The State Economic and Trade Commission (国家经济贸易委员会)

SEZ: Special Economic Zone

SIA: Social Insurance Agency

SLSBK: Shanghai shi laodong he shehui baozhang ju keyansuo (上海市劳动和社会保障局科研院所)

SOE: State Owned Enterprise

SPC: The State Planning Commission (国家计划委员会)

TGB: Guowuyuan jingji tizhi gaige bangongshi (国务院经济体制改革办公室)

TVE: Township and Village Enterprise

## 1. Introduction

In 2004, the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) announced that it would file an appeal with President George W. Bush asking for sanctions against China because of its illegal labor practices. The AFL-CIO cited Section 301 of the Trade Act of 1974 that made it an unfair practice for countries not to uphold internationally recognized workers' rights.<sup>1</sup> Undoubtedly, the announcement was precipitated by the American working class's growing resentment of the Bush Administration's labor policy. Between 2001 and 2004, nearly three million factory jobs had been lost in the United States. The AFL-CIO now linked to China's problematic labor practices: China attracted large numbers of foreign investors due to its cheap labor market that it maintained by neglecting fundamental workers' rights. The 105-page complaint filed by the AFL-CIO detailed the plight of Chinese workers, noting that independent labor unions were prohibited and that labor movement leaders were often arrested. The complaint also provided a sketch of the poor working conditions in many sweat shops; it described how millions of migrant peasants were treated like indentured servants, noting how oftentimes they were forced to work 18-hour days for half the minimum wage; housed in prison-like dormitories; and unable to leave their jobs because their supervisors confiscated their travel papers.

This account of repressive labor practices in China stands in sharp contrast to the Chinese government's expressed desire to establish a sound social welfare system protecting its workers from those shocks associated with the transition from a command economy to a market economy. In fact, since the mid-1990s, the Chinese government has promoted welfare reform as

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<sup>1</sup> Steven Greenhouse and Elizabeth Becker, "AFL-CIO To Press Bush for Penalties against China," *The New York Times*, March 16, 2001.

an integral part of its broader reform agenda.<sup>2</sup> In the new millennium, the post-Jiang leadership has emphasized that its plan for development would encompass both economic growth and the promotion of social progress.<sup>3</sup> Despite such assertions, nevertheless, reports of repressive labor relations in China persist, causing many in the international community to doubt the sincerity of China's commitment to social welfare reform.

This skepticism is also fueled by newly empowered thought on the nature of the globalized economy. Many social scientists believe that the globalized market economy pushes countries in the direction of a flexible labor market. These scholars argue that many advanced nations in the West have begun rethinking their welfare system and making cutbacks in benefits in order to reduce labor costs and increase the global competitiveness of their products and industries. Thus, one buzzword in recent academic debates has been the crisis of the welfare state.<sup>4</sup> Therefore, Chinese welfare policy is puzzling: Why would China endeavor to establish an expansive welfare system at the very moment when other nations are downsizing their welfare systems? Why pursue policies that arguably would undermine China's status as the "workshop of the world" by increasing its labor costs? Why does China introduce social welfare policies that, according to conventional wisdom, impose a check on the free labor market and thereby slowdown China's marketization process? This seeming incongruity between China's economic interests and its stated goal of introducing social welfare reform has led some skeptics to

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<sup>2</sup> Elisabeth J. Croll, "Social Welfare Reform: Trends and Tensions," *The China Quarterly*, Vol. 159 (September 1999): 684-99.

<sup>3</sup> "Hu's Speech on Development Strategies Issued," Xinhua, April 5, 2004, ([http://www1.china.org.cn/archive/2004-04/05/content\\_1092102.htm](http://www1.china.org.cn/archive/2004-04/05/content_1092102.htm), last accessed on April 24, 2016).

<sup>4</sup> For studies on the crisis of the welfare state and its relationship to the global market, see for example, Evelyn Huber and John D. Stevens, *Development and Crisis of the Welfare State: Parties and Policies in Global Markets* (Chicago: University of Chicago Press, 2001); Mark Hallerberg, "Challenges for the German Welfare State Before and After the Global Financial Crisis," *Cato Journal* 33, no. 2 (Spring/Summer 2013).

conclude that China's promise of social welfare reform is simply propaganda aiming at placating the United States and other western nations so as to avoid outside political interference.<sup>5</sup>

The Chinese government clearly has taken steps in the direction of creating a reliable welfare system. For example on July 1, 2011, China's new Social Insurance Law went into effect, establishing the first national social insurance framework. Under the law, all employers are required to enroll each employee in five social insurance programs: basic medical insurance, work-related injury insurance, maternity insurance, and basic pension program.<sup>6</sup> Of these programs, the Chinese government has prioritized building its pension program. In fact, China's level of pension provision is so high that dwarfs the benefits of China's other social insurance programs.

So how can we reconcile these two conflicting scenarios – repressive labor relations, on the one hand, and the government's seeming genuine commitment to social welfare reform, on the other? Accepting the sincerity of the government's commitment requires answering three interlocking puzzles. First, what motives might the Chinese leadership have for pursuing social welfare reform? Second, why focus on costly pension reform rather than adopting a residual approach to social welfare reform more in keeping with China's economic level? Finally, how do we reconcile China's willingness to satisfy demands for social reform with its authoritarian political system? This dissertation will resolve these three puzzles by exploring the implications of social welfare reform for the urgent issue of State Ownership Enterprise (SOE) reform.

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<sup>5</sup> For examples of this skepticism among US politicians, scholars, and pundits, see United States Congressional-Executive Commission on China, 108-1 Annual Report, October 2, 2003; Andrew S. Erickson and Gabriel B. Collins, "Physician, Heal Thyself: Modest Expectations for China's Reforms as Third Plenum Anniversary Approaches," *China Signpost*, no. 81, 23 October 2014; Gillian B. White, "All Your Clothes are Made with Exploited Labor," *Atlantic Monthly*, June 3, 2015; "Why China Matters: Labor Rights in the Era of Globalization," *Global Labor Strategies* (April 2008).

<sup>6</sup> Lesli Ligorner, Gordon Feng, and Mitchell Mosvick, "The New PRC Social Insurance Law and Expatriate Employees," *China Business Review*, 2011.

## **Social Welfare Reform, SOE Reform, and the Paradox of China's Economic Success**

I propose that China has pursued social welfare reform in order to complete the arduous process of SOE reform. For decades, the Chinese government has pursued SOE reform without success. Wave after wave of reform initiatives have encountered unanticipated obstacles, even as its market economy has grown. The Chinese government understands that the country's economic growth is unsustainable unless its lingering issues with SOE reform are resolved.

In fact, China's economic success in the absence of ownership reform has baffled numerous scholars because it contradicts conventional wisdom that the establishment of well-defined property rights guarantees the proper working of the market economy and thus economic growth. A large body of literature has emerged attempting to explain China's remarkable economic success. Some often contrast China's economic success with Russia's lukewarm economic performance, despite Russia having completed fundamental reform of its system of ownership. Peter Nolan, for example, explained China's market success in terms of its gradual reform effort and Russia's lackluster market in terms of its radical ownership reform.<sup>7</sup>

Nolan and other advocates of China's gradualism argued that delaying ownership reform, as well as pursuing economic development, has its advantages in handling the inevitable, painful disruptions, such as unemployment, inflation, and even fiscal deficits that accompany the transition to a market economy. Barry Naughton advanced the notion of a dual-track program to explain the feature of China's economic reforms that differs from European rationalizing reform under socialism (e.g. Hungary's 1969 reform effort) and the "big bang" approach (e.g. Russia and other Eastern European nations in the post-1989). In the dual-track model, part of economic

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<sup>7</sup> See Peter Nolan, *China's Rise and Russia's Fall: Politics, Economics and Planning in the Transformation from Socialism* (St. Martin's Press, 1995).

activity remains planned and acts as a stabilizer, while other economic sectors are exposed to the market and encouraged to grow and ultimately to dominate the economy. Because this approach did not disrupt production in the state sector, China was able to control inflation during the initial stage of transition.<sup>8</sup>

Single factor explanations, such as relative macroeconomic stability, however, do not suffice to explain China's highly dynamic economy. One must also understand the origins of China's market agents. In her study, *Rural China takes Off*, Jean C. Oi advances the notion of local state corporatism to explain how and why Chinese rural-based industry provided the impetus for China's transition. Oi argues that decentralization gave local Party leaders the incentive to act as entrepreneurs and invest in local industry. This corporatism at the local level eventually became effective enough to challenge China's central plan.<sup>9</sup> Thus, in China, the central plan did not play as large a role in organizing the economic system as was the case in Russia.<sup>10</sup> While the central government may not have played as large a role in organizing the economic system, Yasheng Huang's study makes clear that the central government was successful in placing restraints on local government's pursuit of large foreign investments.<sup>11</sup>

Other studies locate the origins of China's dynamic economy in the backwardness of the Chinese economy, rather than in the advantage of gradual reform over shock therapy. For example Jeffrey Sachs and Wing Thye Woo argued that the differing economic performance of

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<sup>8</sup> See Barry Naughton, *Growing Out of the Plan: Chinese Economic Reform, 1978-1993* (New York: Cambridge University Press, 1995).

<sup>9</sup> See Jean Oi, *Rural China Takes Off: Institutional Foundation of Economic Reform* (California University Press, 1999).

<sup>10</sup> The most extreme example was the planned socialist city, where there was a total integration between the lives of the city's inhabitants and the enterprise around which the city was built. A good example is Magnitogorsk.

<sup>11</sup> Yasheng Huang, *Inflation and Investment Control in China: The Political Economy of Central-Local Relations during the Reform Era* (Cambridge University Press, 1996).

China and Russia primarily reflects the two nations' differing economic structures prior to the reform. China was largely a peasant agricultural society, while the former Soviet Union was an urban and industrialized one. A rapid growth was possible because China's large agricultural sector had a vast labor surplus; this surplus could be redirected into new industries.<sup>12</sup> In this context, the Japanese economist Nakagane Katsuji describes China's marketization process as one of adding to the economy, rather than transforming it.<sup>13</sup> In short, China could reform its economy by expanding the non-state sector without having to address SOE ownership reform. The expansion of the non-state sector introduced new market agents such as Township and Village Enterprises (TVEs), foreign investment enterprises (FIEs), and even private enterprises. Thus, the origin of China's success derived from new market agents, not successful SOE reform. In fact, the sluggish and inefficient operations of China's SOEs acted as a major drag on China's economic growth – what the Chinese leadership was well aware and what repeatedly prompted new efforts at its reform. Continuous trial and error attempts usually came to face new unexpected issues.<sup>14</sup>

To date, studies have rarely tackled the question of why SOE reform has proved so difficult in light of SOE's unique organizing scheme. In China, SOEs were not genuine economic units pursuing their profit; however, they are to be reorganized, according to their market performance. Indeed, the efforts to enhance incentives of each SOE for better performance at first allowed more management power for the managers. As an unintended consequences, the more autonomous SOE environment under the reform witnessed managers

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<sup>12</sup> Jeffrey Sachs and Wing Thye Woo, "Structural Factors in the Economic Reforms of China, Eastern Europe and the Former Soviet Union," *Economic Policy* 9, no. 18 (1994): 101-145.

<sup>13</sup> Nakagane Katsuji and Kojima Tomoyuki, *Restructuring China: Party, State and Society after the Open Door* (Tokyo: Toyo Bunko, 2006), p. 221.

<sup>14</sup> Please see Edward S. Steinfield's study, *Forging Reform in China; The Fate of State-Owned Industry* (New York: Cambridge University Press, 2000).

resorting to various measures to boost employees' wages and benefits.<sup>15</sup> But why would SOE managers with newly enhanced abilities to respond to the market economy act against the expectation that they would regulate labor relations in order to create a more efficient production system. Upon closer examination, it becomes clear that these unanticipated consequences are linked to SOE workers' permanent labor relations.

The question of how to handle SOE workers under SOE reform was politically sensitive. In *Dragon in a Three Piece Suit*, Doug Guthrie focused on how Shanghai's medium and large SOEs reorganized their labor relations so as to cope with the unprecedented market uncertainty in the wake of reform. He showed that Chinese firms increasingly imitated foreign firms in response to both their growing contact with international investors and their being cut adrift from state support; they adopted advanced Western management practices and introduced their market-based labor relations.<sup>16</sup>

Introducing such market practices within the SOE system was often volatile. As William Hurst notes in *The Chinese Worker after Socialism*, despite the lack of public quantitative data on workers' protests, we know based on "sporadic media reports, scholars' field observations, and leaked international estimates and reports...that there were at least hundreds, probably thousands laid-off workers' contention in China every year between about 1998 and 2008."<sup>17</sup> Sociologist Ching Kwa Lee also finds much evidence of SOE worker foment, particularly when workplaces were in the process of liquidation.<sup>18</sup>

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<sup>15</sup> I will discuss this in detail in chapter 2 where I examine the reform of the contract responsibility system.

<sup>16</sup> Doug Guthrie, *Dragon in a Three-Piece Suit: The Emergence of Capitalism in China* (Princeton University Press, 1999)

<sup>17</sup> William Hurst, *The Chinese Worker after Socialism* (New York: Cambridge University Press, 2009), 108.

<sup>18</sup> See the following articles by Ching Kwan Lee: "The Labor Politics of Market Socialism: Collective Inaction and Class Experiences Among State Workers in Guangzhou," *Modern China* 24, no. 1 (January

This unrest reflects the fact that SOE system is an integral part of the Danwei system – the organizing principle of urban society in the Chinese socialist system. Under this system, the government assigned every urban resident to a Danwei, a state-owned workplace unit. Each Danwei unit, in turn, functioned as an independent socioeconomic autarky and was expected to provide for the basic needs of its members, including permanent employment, housing, medical care, and pensions. Thus, reforming the SOE system is not simply an issue of enterprise reform; it also affects the fundamental social and structural organizing system of Chinese urban society. To reform SOE means to halt the existing Danwei arrangement that guaranteed the basic needs of its urban citizenry. Failure to introduce a new welfare system in conjunction with SOE reform would impose major hardships on urban workers and thus could jeopardize the success of its new market economic system. In short, China’s efforts at social welfare reform emerge from a socio-political imperative in the SOE reform process – the reorganization of the existing social system monopolized by the Danwei system.

### **Pension Reform’s Significance for SOE Reform**

Why does China make pension reform the centerpiece of its social welfare reform effort? At first glance, this policy choice makes little sense, given China’s economic level and the extensive resources to be deployed for a comprehensive welfare program. It would make more sense that China could keep up with its economic level with a low-cost residual approach to social welfare. The key to understanding the seemingly self-contradictory policy choice lies in China’s institutional legacy of its socialist social system.

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1998): 3-33; "From Organized Dependence to Disorganized Despotism: Changing Labor Relations in Chinese Factories," *The China Quarterly* 157 (1999): 44-71; "The 'Revenge of History': Collective Memories and Labor Protests in North-Eastern China," *Ethnography* 1, no. 2 (2000): 217-237.

The salient feature of the SOE system is its unique permanent worker system that guaranteed employment until retirement; in fact, SOEs could not lay off workers even if they experienced serious financial problems. Thus, the crux of SOE reform involves how to dissolve permanent labor relations and reorganize SOEs as a pure economic system beyond the Danwei system. In short, it entails the political process of determining the conditions under which SOE workers will accept the dissolution of permanent labor relations at their workplace. As this dissertation will show, the guaranteeing of SOE pension entitlements turns out to be the very condition that SOE permanent workers want before they dissolve their existing permanent relationship with their Danwei. Yet, to date, few studies have examined China's focus on pension reform from the perspective of SOE reform. Most studies attempt to account for the pension reform in terms of replacing the existing Danwei-based PAYG in order to handle China's rapidly aging population.<sup>19</sup>

Urban retirees have been the most vocal group in Chinese society when it comes to expressing their resentments about the market reform, particularly when they realize those reforms may jeopardize their pensions. Their anger and resentment is so palpable in China that their grievances take precedence over other groups, such as laid-off workers who have also organized some collective actions. William Hurst and Kevin O'Brien have tried to account for the prominence of pension protests in Chinese society by deploying the concept, "moral economy." Protests among pensioners, they claim, frequently emerge when markets encroach upon "subsistence rights." Retirees perceive failing to deliver their pensions as "reneging on

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<sup>19</sup> A notable exception to this tendency is Edward Gu's study; he focuses on China's welfare reform, including pension reform, from the perspective of SOE reform and the reorganization of the Danwei system. See Edward Gu, "Beyond the Property Rights Approach: Welfare Policy and the Reform of State-Owned Enterprises in China," *Development and Change* Vol. 32, no. 1 (2001): 129-150.

their most materially and symbolically important obligation.”<sup>20</sup> Hurst and O’Brien also suggest that collective nostalgia for the Maoist era accounts for pensioner volatility. As members of a generation that came of age during the heyday of state socialism, they perceive the Maoist era as a better time and see contemporary reforms as undermining socialist values, such as camaraderie and egalitarianism.<sup>21</sup>

Still, an important question remains unanswered. If collective nostalgia and moral economy resistance were in fact the reasons behind pensioner protests, then one would expect those protests to focus on market transformation itself, rather than their pension entitlements. Yet, many Chinese citizens today accept market reform as inevitable.<sup>22</sup> They understand that while some might lose in the transformation, there would be more winners than losers in the long run. Moreover, the issue of subsistence is not unique to pensioners. The subsistence of other social groups, such as peasants, migrant workers, and unemployed workers, has suffered because of market transformation. Thus, the ideas of collective nostalgia and moral economy cannot explain why retirees have been more outspoken than other social groups. In fact, the fact that the Chinese government has provided generous pension benefits as part of its reform package; this suggests that moral economic resistance with its focus on a failed promise to provide for subsistence cannot explain retirees’ motivations for protesting.

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<sup>20</sup> William Hurst and Kevin J. O’Brien, “China’s Contentious Pensioners,” *The China Quarterly*, Vol. 170 (2002): 357.

<sup>21</sup> *Ibid.*, 355-357.

<sup>22</sup> Please see Marc Blecher, “Hegemony and Workers’ Politics in China” *The China Quarterly*, no. 170 (2002).

## **Pension Reform, SOE Reform, and China's Authoritarian Political System**

China's pensioners' salient social position has to do with the fact that the government is more willing to be responsive to their demands rather than repress. In the same vein, ensuring the redundant SOE workers' pension entitlements also turns out to be a critical condition to dissolve the labor relations. Such importance of ensured pension entitlement means that an obvious accountability binds both SOE and their permanent workers in the process of dissolving the permanent labor relations. Then, the accountability comes to extend to the issue of how much the system has to take its liability to ensure SOE workers' pension entitlement, because the Danwei system belongs to the system, after all. Indeed, dissolving SOE workers' labor relations involves a political process to dissolve their relations with the system as well, which is predicated on the system's accountability to ensure their pension entitlement. Then, this politics of reforming SOE labor relations raises an issue of how such accountability can match with authoritarian Chinese political system.

If dissolving SOE labor relations entails political accountability on the part of the government, will the SOE reform process lead to a political check on the government's authoritarian political power? Yet, many reliable evidences hardly confirm that China's authoritarian political system comes to checked with rising power of new social forces out of its market economy. Indeed, China still under the authoritarian rule of CCP. The discussion of the developmental state argues that authoritarian political system can be helpful for economic development.<sup>23</sup> Although there is no necessary connection between the developmental state and authoritarianism, there is an "elective affinity" between the two, since authoritarianism can

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<sup>23</sup> A large body of literature has explained this phenomenon by using the concept of the Developmental State – first articulated by Chalmers Johnson in his book, *MITI and The Japanese Miracle*.

sometimes “inadvertently solve the main political problem of economic development using market forces – namely how to mobilize the overwhelming majority of the population to work and sacrifice for developmental projects.”<sup>24</sup> Put differently, the authoritarian state can contain social welfare demands, thus freeing up all available resources for developmental investments.

Then, why the authoritarian Chinese state does not check the social welfare demands for its economic development? This dissertation proposes that the answer to this lies in the fact that the government’s political accountability with reference to guaranteeing SOE pension entitlements is embedded within the politics of socialist accountability, which tends to reinforce the existing scheme to organize its socialist social relations rather than shake them. Indeed, if the politics of socialist accountability provides the primary political content of SOE reform, then China’s market transformation process predicated on reorganizing SOE system into pure economic units would remain compatible with its existing socialist authoritarian political system. Hence, it would explain why China’s outstanding economic success to date has not been accompanied by increased political demands for more democracy.

### **Embeddedness Politics**

Today few scholars accept laissez-faire economics. Instead, most recognize that the market system requires appropriate regulations and institutions to oversee economic activities.<sup>25</sup> A properly working market system requires coordinating the various activities related to inputs, productions, and distribution. Today many social scientists agree that social actions are

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<sup>24</sup> Meredith Woo-Cumings, “Introduction: Chalmers Johnson and the Politics of Nationalism and Development,” *The Developmental State* (Ithaca, NY: Princeton University Press, 1999), 20.

<sup>25</sup> Douglas C. North, *Institutions, Institutional Change and Economic Performance* (New York: Cambridge University Press, 1990).

embedded in institutions in ways that not only constrain actors but also fashion the nature of agency. These institutions constrain, enable, empower, and constitute agents' social behaviors. Thus, economic activity is socially situated and cannot be explained by economic motives alone; instead, economic activity is embedded in social institutions that shape ongoing interactions between economic agents.<sup>26</sup>

Karl Polanyi first articulated the concept of embeddedness to explain the economy in the pre-industrial society, describing it as “embedded in social, religious, and political institutions. This meant that such phenomena as trade, money, and markets were inspired by motives other than profit making. Economic life in these early societies was instead ruled either by reciprocity or by redistribution.” In contrast, modern society, Polanyi asserted, was ruled by “a new logic that dictated economic life must not be embedded in society.” In short, the industrial revolution had ushered in the “kind of society presupposed in conventional economic wisdom.”<sup>27</sup>

Economic transactions in the market are by no means natural; they are artificial in that anything bought and sold on the market becomes a commodity. Given nothing in the world is created as a commodity, the artificial process of commodification based on institutional arrangements constitutes the first step in creating a market system. The process of commodification extends to human labor. Before human labor became a commodity, however, people belonged to pre-market communities (i.e. feudal or patriarchal systems). The commodification of human labor required that the communal relations of pre-market societies be

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<sup>26</sup> Douglas C. North and Robert Paul Thomas argued that the rapid economic growth of Western Europe was due to its new efficient economic institutions such as property rights that “create an incentive to channel individual economic effort into activities that bring the private rate of return close to the social rate of return.” See North and Thomas, *Rise of the Western World: A New Economic History* (New York: Cambridge University Press, 1973), p. 1.

<sup>27</sup> Richard Swedberg and Mark Granovetter, “Introduction,” *The Sociology of Economic Life*, ed. Swedberg and Granovetter (Boulder, CO: Westview Press, 1992), p. 10.

abolished and new social relations among individuals be established. In sum, people had to be reconstituted as independent entities with exclusive ownership of their labor, so that each individual had the right to buy or sell that labor. This historical development meant that humans were emancipated from various pre-modern constraints on their actions; but it also meant that they entered the labor market without the protection of their former communities. Numerous scholars have detailed this process of modernization and its impact on social and personal interactions. In his classic work, *Gemeinschaft und Gesellschaft*, Ferdinand Tönnies differentiated between communal society (*Gemeinschaft*) and associational society (*Gesellschaft*). Under the former, community members have simple and face-to-face relations with each other that are determined by essential will (*Wesenwille*), meaning natural and spontaneous expression of emotions and sentiments. Under the latter, human interactions become more impersonal, being rationally determined by economic and political interests.<sup>28</sup> Emile Durkheim utilized the term “anomie” to describe this breakdown of social bonds between the individual and community that resulted from industrialization.<sup>29</sup>

Polanyi, in contrast, analyzed the perils of this modernization process in his classic work, *The Great Transformation*, by focusing on the sociopolitical outcomes resulting from the expansion of market relations. He believed that as labor is transformed into a commodity, more and more people are subjected to the dictates of the labor market, resulting in increased social dislocation, poverty, and suffering. As society becomes disembedded, a reactionary countermovement is also unleashed, whereby society attempts to re-embed the economy through the creation of social protections, institutions, and regulations. This dialectical process of

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<sup>28</sup> See Ferdinand Tönnies, *Community & Society* (New Brunswick, NJ: Transaction Books, 1988).

<sup>29</sup> See Émile Durkheim, *Suicide: A Study of Sociology*, trans. John A. Spalding (New York: Free Press, 1979).

marketization and the social backlash against it, he termed a process of “double movement.” According to this theory, a market system can only work properly when it is embedded in some form of relations.<sup>30</sup> Polanyi’s concept of embeddedness does not simply refer to the placing of social checks on the expanding market system; it also represents a constitutive element of society, allowing society to accept new market relations. Indeed, the relation between market system and social embeddedness is no simple zero-sum relation but rather a mutually constitutive one.

The origin of the welfare state can be found in rising social anxieties about the unregulated market economy (cash nexus), which is accompanied with social demands to embed the market in reliable social institutions. Hence, in order to settle various risks involved in market economy, welfare states come into being. The welfare state introduced a series of social policies to provide various benefits in redistributive manner. In this context, welfare state can be understood as the political arrangement by which the state institutionalizes social guarantees that assure a certain level of living standards for its citizens, in order to handle their anxiety about the market system. In other words, the welfare state can be understood as the state taking over the role of social protection which family or local communities (be it the church, voluntary associations, or the guilds) provided before the market economy; it does so in order to manage the social anxieties that accompany the disruption of the existing state of embeddedness, as the market economy system expands.<sup>31</sup> Hence the formation of welfare state stabilizes the market system by containing social anxieties and thus makes it sustainable.

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<sup>30</sup> Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, (Boston: Beacon Press, 2001).

<sup>31</sup> Katherine A. Lynch, *Individuals, Families, and Communities in Europe, 1200-1800: The Urban Foundation of Western Society* (Cambridge University Press, 2003).

The politics of embeddedness, I believe, is useful for analyzing the politics of market transformation. Since a properly working market system is predicated on its social relations, any effort to achieve a positive outcome in market transformation must take into account the social foundation of economic actions, i.e. embeddedness. In Chinese society, this means that any effort at ownership reform must address the unique social relationship that binds SOEs and SOE workers under the Danwei system. Therefore, studies that focus strictly on property rights and China's unclear corporate governance system will not be able to explain why SOE reform has proved so difficult.

The essence of SOE reform in China is to reorganize SOEs into a pure economic system; this requires dissolving the Danwei system – the socialist scheme of embeddedness that organized urban society. So, SOE reform necessitates the creation of a new scheme of social embeddedness in order to manage the intense social anxiety caused by the dissolution of the old social system. This is why China comes to focus on setting up highly costly pension system to handle the social anxiety in the system transformation. It is the very condition that SOE workers want in order to dissolve their permanent labor relations. Indeed, China can complete its long dragging SOE reform by ensuring SOE workers' pension entitlement; hence, its system transformation turns out to be based on the embeddedness scheme which can contain SOE workers' anxiety of losing their pension in the system transformation. Of course, other social groups also face troubled situations in the market system, but China's articulated embeddedness scheme centers primarily on SOE pensioners. With these correlated factors considered, we can understand the very nature of politics of the system transformation by examining the process of how the new pension system fashions the main contents of the embeddedness scheme for China's market system.

In this context, I examine pension reform process in three cities with quite different socio economic backgrounds in China (Shanghai, Shenyang, and Shenzhen) in order to grasp how each city's pension reform has come into being out of its SOE reform process. Shanghai has huge numbers of SOE pensioners but it has not any serious problem to grant full pension for them for its outstanding economic performance after the reform. Shenyang, however, cannot handle its huge numbers of SOE pensioners, as its economy get worse after the reform. Shenzhen is unique case in China that is virtually free from the burden of SOE pensioners, as it is new built city after the reform. Indeed, three cities come to articulate its own way to organize its pension system out of the efforts to handle the permanent workers' labor relations for its SOE reform. The state also engage in the pension reform process by providing supports selectively for some cities, such as Shenyang, that cannot handle the issue. Not only each city's own efforts to handle SOE workers' pension entitlement issue but also the state's selective engagement for the areas that have troubles in managing the new pension system fashions the process of the embeddedness politics in the SOE reform. In short, the politics of embeddedness in China's SOE reform involves the articulation of the contents of the state and society's relations out of the system transformation.

## **Organization**

The dissertation consists of two parts. Part I examines the history of SOEs with a view to explaining why the SOE reform has proved so difficult. The chapter of "SOE, the Danwei and Zhigong Labor System" outlines the salient features of the Danwei system – China's socialist system of urban organization. It focuses particularly on the Zhigong labor system, exploring its

rationale, its social costs, and the challenges it creates for SOE reform. The chapter of “Drifting SOE Reform” details the multiple efforts at SOE reform following the Cultural Revolution up until the mid-1990s. I compare and contrast China’s successful rural reform effort with its unsuccessful SOE reform effort, paying attention to the unintended consequences of successful rural reform for SOEs. Because SOEs could not compete with the new market economy units, such as TVEs, their financial problems worsened. Ironically, attempts at opening the SOEs to market forces did not increase SOE efficiency, but rather empowered SOE workers vis-à-vis SOE management. The final chapter of Part I, “Xiangang and Embeddedness Politics of SOE Restructuring” addresses the radical program of SOE restructuring, *zhuada fangxiao* (“grasping the big, releasing the small”), endorsed at the fifteenth Communist Party Congress in 1997. Under this plan, large-scale SOEs in the main strategic sectors were to remain under state ownership, while small SOEs were to be merged or privatized and those that performed poorly would be allowed to go bankrupt. In the process, SOEs had to reduce their huge amount of redundant labor force; and the leadership decided to introduce a new scheme to layoff them with Xiangang program, which provided a certain living standard and skill retraining for their reemployment for a period of up to three years. The end goal was for these redundant workers to dissolve their permanent labor relationship. But the efforts failed to establish a reliable embeddedness scheme for the process and the government abruptly abandoned the program. This meant that the SOE restructuring push could face really serious social tensions.

Part II delves into how organizing a reliable new pension system beyond the Danwei can lead to a breakthrough in SOE reform, as it turns out to be a critical condition for workers to dissolve their permanent labor relations. The first chapter of Part II, “The Pension Reform and the Danwei’s Implicit Pension Debt” examines the pension reform process that tries to establish

a new pension system for already retired SOE workers, in an effort to settle the Danwei's Implicit Pension Debt (IPD) owed to those workers. The chapter of "Pension and the Politics of the 'Merging' Process" addresses the government's efforts to ensure the pension entitlements of current SOE workers. As the chapter will show, guaranteeing pension entitlements is critical for SOE reform, as it is the condition under which SOE workers will agree to dissolve their permanent labor relations.

The chapter of "Historical Debts, the Labor Market and Market Transformation" analyzes the central government's role in organizing China's new pension system. Politically, the central government wants to avoid the sensitive issue of the Danwei IPD by organizing a regional pension system that provides pensions for SOE workers. But many regional pension systems lack the funds to support pension for those huge numbers of SOE retirees out of the Danwei system. Because the Danwei system belongs to the state system, the workers demand that the central government take a more active role in financing the pension system, so as to honor the Danwei's implicit pension debt. As these demands grow more vocal, the central leadership decides in 2000 to introduce a new National Social Security Fund (NSSF); the principle funding method is the transfer of SOE assets. So even if China still remains under the authoritarian political system, the state cannot but accept the social demands. Indeed, with the state's confirmation of its liability to ensure SOE Zhigong's pension entitlements, China can make breakthrough in its long dragging SOE reform, because it can dissolve the Zhigong labor system eventually. This allows migrants to enter the urban labor market and contribute to the formation of a full labor market system, the very condition whereby China can sustain its outstanding economic growth.

The final chapter, “The Politics of Socialist Accountability and China’s Bounded Embeddedness in the System Transformation” examines the political meaning of China’s system transformation based on its efforts to ensure pension entitlements for SOE workers within the framework of its politics of socialist accountability. Indeed, the system’s confirmation of its eventual liability to ensure SOE Zhigong turns out to be the articulated scheme of social contract for the system transformation, which tries to fulfill the system’s former socialist commitment for SOE workers as the very condition for the system transformation. Hence, China’s system transformation process is embedded in a politics of socialist accountability, which, however, leave new migrant workers, originally excluded from the Danwei system, outside of the new pension system, the very crux of the social contract of the system transformation process. In short, the social distinction between Zhigong and migrant workers survives the system transformation, which ultimately results from the reinforced China’s authoritarian political system.

## Part I

### Historical Origin of China's Gradualism and its Dragging SOE Reform

## 2. SOE, the Danwei, and Zhigong Labor System

Once the industrial production system represented development itself, there were various efforts to figure out what would be the best way to industrialize society. Many leaders in socialist countries thought that a socialist system would result in better economic performance and more rapid industrialization because central planning could achieve the goal of industrialization in much more efficient way than capitalist system. Central planning could mobilize more resources from society which otherwise could be wasted by frivolous consumption in a market system by the rich. Furthermore, a central plan could also invest its available social resources to the most critical sectors for development, avoiding social costs, such as inflation and unemployment caused by reckless investments in a capitalist system. Indeed, for the socialist system leaders, a socialist economy was a rational arrangement of how to best mobilize and invest a society's resources in industry. Most of all, they believed in the virtue of public ownership with the hope that it would guarantee the most efficient development by sparing them from the enormous social contention between capitalists and working class that many capitalist countries had experienced.

Mao held the belief that the socialist system would bring about faster development without serious social side-effects, such as class struggle, inflation and unemployment and China after the civil war tried to set up the socialist economic system.<sup>1</sup> The primary feature of China's industrialization was an artificial process based on a planned system whereby the state plays a more direct role in organizing its production system. The new state, like other socialist

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<sup>1</sup> "Communist leaders sought to design and implement a strategy of economic development which could transform China into a prosperous and powerful country able to hold up its head proudly in the world of nations. They sought these goals through a strategy of socialist development which would, it was hoped, achieved rapid socio-economic modernization while avoiding the human costs of early capitalist development, and dependence on the advantaged capitalist nations" (White 1993: 1).

countries, tried to set up a new system of compulsory accumulation and took the direct role of investor to stimulate rapid industrialization. Hence China before the reform came to set up the “demiurge” state, which refers to a state that monopolizes the decision-making process regarding its entire investment and production.<sup>2</sup> In this context, China tried to organize SOEs as the key units in which to invest its resources to achieve the goal of rapid socialist industrialization.

The leadership strongly believed that public ownership would not only eliminate contradiction between capitalists and workers, but also guarantee the most efficient development pathway for all of society. They also had the belief that type of ownership itself represented a level of development. As there was no social distinction of employer and employee, state ownership was highest stage of ownership, which was followed by collective or co-operative ownership, and private ownership at lowest level. Thus, the fact that more production units were organized as state ownership system out of collective or private ownership represented development and many socialist countries tried to organize their production system in terms of state owned system.<sup>3</sup> SOE in socialist system was not simply a form of ownership; rather it was ultimate goal of socialist system. For China before the reform, SOE was the primary institution to realize its system to link its compulsory accumulation and efficient investments.

In this context, China, with the end of its civil war, decided to transform various forms of economic entities into state ownership. First, it tried to set up new economy based on SOEs by taking up bureaucratic capital corporations under KMT, which then comprised 70 percent of China’s total fixed assets. In addition, China in 1956 also started to remodel the existing private enterprises into “public-private cooperative system” (*gongsi heyingsi*) under the jurisdiction of

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<sup>2</sup> Regarding the idea of “Demiurge” scheme of development, please see Peter Evans, *Embedded Autonomy: State & Industrial Transformation* (Princeton University Press, 1995) pp. 79-80.

<sup>3</sup> In a sense, the socialist leadership, just like neo-classical economists, had obsession about ownership itself with the belief that ownership meant everything.

regional industrial bureaus.<sup>4</sup> China's private sector after the civil war remained critical to China's economy. The private sectors claimed 51.2 percent of total industrial production in 1952. China at first also planned to allow nationalistic private sector to coexist within the socialist system, according to the China's new democracy program. Yet after China decided on heavy industry as its first developmental strategy, it changed its original ideas to allow private firms. Of total industrial production in 1956, SOE produced 67.5 percent; public-private cooperative system produced 32.5 percent; and private sector virtually produced nothing. Then, China organized more SOEs to its backbone production system to further build its socialist heavy industry. By 1978 the ratio of the state sector's production in total urban industrial production reached to 85.4 percent; while that of non-state sector had shrunken into 14.6 percent.<sup>5</sup>

Obviously, the urban society just before the reform was dominantly organized with SOEs.

China tried to reorganize its economic system into a SOE system with the goal to systematically control society's production outcomes.<sup>6</sup> Yet the idea had a serious problem: heavy industry requires huge amount of capital investments, but China did not have enough capital. In order to handle this problem, China decided to distort factors' price: it not only lowered capital prices such as interests and exchange rate; but it also lowered price of energy, raw materials, labor, and agricultural products. With its highly concentrated plan, China could mobilize its scarce resources to its heavy industry sector.<sup>7</sup>

In order to construct rapidly heavy industry, China as a socialist "demiurge" state tried to reorganize its entire society in terms of building up a more efficient resource mobilization system. China purposely distorted its price system between agricultural and industrial products

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<sup>4</sup> JIL, *Chugoku no rodo shakai hoshu shisutemu no kisoteki kenkyu*, p. 57.

<sup>5</sup> Lin Yifu, Cai Fang, and Li Zhou, *Zhongguo guoyou qiye gaige*, p. 21.

<sup>6</sup> *Ibid.*, p. 19.

<sup>7</sup> *Ibid.*, p. 17.

to systematically channel financial surpluses upward from the agricultural into the industrial sectors. Setting low prices for agricultural products, the state bought peasants' products at a low price and sold them to urban citizens and SOEs at low prices in order to sustain low wages and factor costs.<sup>8</sup> This distorted price system was famous China's "scissors gap" system, which involved the rural areas' systemic sacrifices for the rapid industrialization. Indeed, the scissors gap system "produced surplus industrial profits constantly, which were transferred and concentrated into the state's construction funds for its industrialization."<sup>9</sup> This was the process of how China realized compulsory accumulation from the peasant and the rural society.

China also constructed another way to mobilize social resources to its urban industrial sector. By organizing state owned economic system, the state virtually monopolized the right to control society's production outcomes, and thereby controlled most of urban society's production outcomes. China set up a unique institution to absorb and use financial surplus from its industrial production as much as possible to mobilize more investment resources, believing this would guarantee more rapid industrialization, and prevent wastes of social resources by individual luxurious consumptions. Under this fiscal management system, SOEs funds were managed by a central fiscal system according to the Tiao-Kuai relation in terms of their belonging to which level and which bureaus. If SOEs needed more funds, they could also access state banks' loans. While SOEs could receive their necessary funds, they could not keep what they profits, which had to be transferred to the government.

In fact, SOEs had to pay not only their official taxes but also most of their profits to central or local governments and bureaus to which they belonged and could only keep some

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<sup>8</sup> China could decide the price of agricultural products, after it set up agricultural products 'total buying and total selling system' in 1953.

<sup>9</sup> Liu Yingjie, *Zhongguo Chengxiang Guanxi yu Zhongguo Nongmin Gongren*, p. 61.

portion of planned profits and extra planned profits. According to the regulation of 1952, SOEs in each industrial sector were able to keep 2.5 to 5 percent of planned profits and 12 to 25 percent of extra planned profits as their bonus. China in 1961 lowered the ratio of SOE retaining extra planned profits to 6.9% and in 1962 even eliminated it. Whiting says that in the socialist plan system taxation played only a secondary role in the extraction of revenue and “in China, the state depended on the profits remitted by state-owned enterprises as its main sources of revenue...” (Whiting, 179). Under the central planning system the profits of enterprises were pooled for investments in its precious heavy industry (*Old Age Security*: 15). Under the state’s unified absorbing and investing system, SOEs “resemble branch plants rather than corporations” (Naughton 1997: 182). In this context, SOEs were told to belong to the state’s “big pot rice” system.

The leadership also tried to limit SOE workers’ consumption to redirect more its profits for investment with its famous SOE low wage system.<sup>10</sup> Before the reform, SOE workers’ wage and welfare funds belonged to the state’s so called ‘unified revenue collecting and unified spending’ (*tongshou tongzhi*) system. Accordingly, each SOE’s management could not affect its workers’ treatments level, since SOE workers’ wage funds were arranged within the planned system in advance.<sup>11</sup> Putting SOEs’ bonus funds and welfare funds under serious political control, the leadership did not allow individual SOEs to decide its workers’ treatment.<sup>12</sup> The state held its unique position as the single employer in the industrial sector, so it could set

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<sup>10</sup> Before 1953 the state only controlled the total amount of SOEs’ wage fund and wage ranking standards. Thus, within these boundaries SOEs could decide their workers’ treatments. From 1954, however, the management of wages was gripped by the central government’s labor ministry. The national wage reform conference in 1956 also decided that the central government established unified SOEs’ wage standards, workers’ wage standards, and their ranking and promotion systems, which could not be altered by local governments or SOEs themselves. Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 28.

<sup>11</sup> Ibid., p. 93.

<sup>12</sup> Nakagane Katsuji, *Chugoku keizai hattenron*, p. 146.

workers' wage, the price of SOE labor cost, low. CCP leadership after the civil war initiated severe austerity programs to curb China's super high inflation under the KMT system. The leadership also tried to control workers' demands for increasing wages (Frazier 2002: 94). As China articulated its development strategy with rapid accumulation of investment capital through SOEs, the leadership decided to institutionalize SOEs' low wage system. As Rawski already noted, China tried to set up its economic system which could maximize industrial investments by curbing other social needs such as worker's consumptions, which necessitated tight control of workers' wages (Frazier 2002: 136). In trying to achieve efficient development, China created a financially austere SOE system.<sup>13</sup>

Table 2-1. A Case of Zhigong's Total Production and Distribution in the 50s (Unit: *yuan*)

	1952	1953	1954	1955	1956	%
Total Production	2234	2040	2402	3294	3449	100
Transferred to the State	1526	1046	1369	2135	2258	60.6
Welfare Outlay	180	256	279	303	318	10.4
Wage and Bonus	496	699	708	790	808	27.1
Labor Protecting Cost	32	39	46	66	65	1.9

(Source: Yamamoto, *Gendai Chugoku no rodo keizai 1949-2000*, p.75)

When China organized SOE as the system to absorb more social resources, it had to set up its scheme so that workers would accept the low wage. Otherwise, the system would not be sustainable and SOEs could not play the intended role to transfer more profits to the state. The leadership decided to address this by establishing a compensatory system to supplement the low wages. Various labor-related institutions were created within SOEs to support their workers' standard of living. So unlike the economic units in a market system, SOEs were responsible for providing employees a wide range of social welfare benefits. The SOE's exclusive extensive

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<sup>13</sup> Lin Yifu, Cai Fang, and Li Zhou, *op. cit.*, p. 27.

welfare function made workers totally dependent on their workplaces, the SOEs, for their livelihoods. As SOEs were the backbone of the Chinese socialist system, this labor organizing scheme could be regarded as the main institution that fashioned the very embeddedness of the Chinese socialist system. Thus, to grasp China's socialist system properly, we must analyze the SOE's labor organizing scheme.

China did not use income tax to redistribute social resources to its people. In fact the state's financial system did not cover society's welfare costs and SOEs instead took the direct responsibilities for their workers' welfare needs. In this context, SOEs came to be reorganized as small communities, so called the Danwei, which provided all possible needs for the Zhigong including housing, medical insurance and even education. The Danwei also took full responsibility for its retired workers, as their pensions were granted by their Danwei. As a result, in spite of low wages, SOE workers could sustain a decent standard of living, because most needs were systematically provided for by the Danwei system.<sup>14</sup> In sum, to sustain the low wages system for rapid capital accumulations, the Danwei's welfare system was predicated on the China's labor combination scheme of "low wage and high welfare" system.<sup>15</sup>

One important benefit provided by SOEs was comprehensive labor insurance. In 1951 China established a legal foundation for its urban residents' social security system, by declaring 'People Republic of China's Labor Insurance Ordinance'. It lasted almost 30 years, and demanded that SOEs pay a premium equal to 3 percent of all of their workers' total wages as labor insurance premium. With these premiums, the government constructed 'labor insurance and welfare' fund, which were run by the All China Federation of Trade Union (hereafter ACFTU) and their branches in each SOE. The insurance covered all items covered in developed

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<sup>14</sup> Tang Jun, *Shichang jingji yu shehui baozhang*, p. 30.

<sup>15</sup> JIL, op. cit., p. 59.

countries' social insurance system.<sup>16</sup> Indeed, China before the reform set up 'labor insurance' (*laodong baoxian*) for urban workers, which protected urban workers from those risks of "birth aging sickness and death" as evidence of socialist system's superiority.<sup>17</sup> At first SOE's trade union took the responsibility to manage and grant social insurance funds. Its 70 percent was controlled under lower level trade union and rest 30 percent was transferred to upper level trade union organization to construct the general social insurance fund to play a function of fund adjustment.<sup>18</sup>

This situation radically changed due to the Cultural Revolution.<sup>19</sup> There was no official change in the fact that SOEs under the unified revenue investment system ultimately belonged to the state's budget system. However, due to the political turmoil of the Cultural Revolution, SOEs had to devise their own ways to manage their systems, rendering themselves as virtually independent financial system. The ACFTU and their local branches, which ran the labor insurance system, could not function properly with the start of the Cultural Revolution and the social insurance fund system ceased to operate.<sup>20</sup> So the Ministry of Finance (hereafter MOF) in 1969 issued a "reform opinion regarding some systems in SOE financial affairs," which stipulated that SOEs were not allowed to access the social insurance funds and instead had to cover their workers social insurance through their financial system. This measure transformed

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<sup>16</sup> Li Yingsheng, *Shehui Baozhang yu Shehui Jiegou Zhuanxing: Eryuan Shehui Baozhang Tixi Yanjiu*, p. 61, and 63.

<sup>17</sup> Tang Jun, *op. cit.*, p. 36.

<sup>18</sup> Li Yingsheng, *op. cit.*, p. 63.

<sup>19</sup> Naughton traced the origins of China's urban Danwei system backs to the Great Leap Forward Calamity (Naughton 1997: 171) but many Chinese scholars think that Danwei system emerged with the Cultural Revolution.

<sup>20</sup> Unions in China remain somehow tricky political position in China, especially after the purge of its political leader, Li Lisan. This congenitally weak status of Chinese unions was even checked critically in the Cultural Revolution period. "The All China Federation of Trade Union was formally dissolved and virtually all enterprise unions ceased to function" (Naughton 1997: 177).

China's original social insurance system into an "enterprise insurance system" and starting in 1969 SOEs take full responsibilities for their workers' social security and welfare.<sup>2122</sup> SOEs came to set up everything within themselves that were required to satisfy their workers' various living demands. SOEs provided every benefit, service, and facility such as housing, schools, dining halls, hospitals, fleet of cars, and other basic service facilities within the boundary of walls which physically separated them from outside (Lü and Perry: 5). With all of these necessities provided by the Danwei, workers and their families could manage their whole lives within their work places. This was the process of how SOEs, originally established as a production system under the state, transformed into self-sufficient autarkic units arranging comprehensive welfare benefits for their workers.

This was the historical origin of how China's autarky Danwei welfare system emerged. Even though they were ultimately belonged to the state financial system, the Danwei had to manage its system independently with their own accounts and budgets. In other words, the origins of the Danwei system in terms of exclusive social system to organize SOE workers' living came from the fact that SOE's organizational adaptation under the political turmoil of Cultural Revolution. As the Danwei system become more and more all encompassing socio-economic system, it had to set up every aspect of Zhigong's living requirements within them. Accordingly, the Danwei not only provided their Zhigong with jobs tenures and work related

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<sup>21</sup> Li Yingsheng, op. cit., p. 63; JIL, op. cit., p. 59; Chang Kai, *Laodong guanxi laodongzhe laoquan*, p. 66.

<sup>22</sup> "The abolition of labor unions inevitably meant that the administration of the benefits and social security system was taken over by the enterprise management itself." (Naughton 1997: 177).

benefits but also set up all required social facilities for their Zhigong's livings.<sup>23</sup> In other words, the Danwei system was an extreme insourcing socio-economic system.

China reformulated SOE into a comprehensive welfare system to guarantee SOE workers' decent standard of living in spite of low wages. Thus, SOE as the Danwei took responsibility of the social functions of providing its workers following three main types of benefits. First, as the term 'permanent worker' itself implies, SOE systematically guaranteed its workers' employment with life time job security. Secondly, SOEs provided social insurances benefits such as a pension and free medical care. Finally, SOEs also had their own service facilities such as housing, hospital, nursery, schools, bathhouse, restaurants, recreation facilities, and shopping stores for their workers.<sup>24</sup> All this shows the dynamic of how embeddedness politics were involved in constructing its production system to realize its goal of rapid development with a socialist system and eventually set up a unique labor scheme with the combination of "low wage, permanent employment, and high welfare benefits."<sup>25</sup>

Zhigong was the term to refer to those who employed in the Danwei.<sup>26</sup> In other words, Zhigong were the personnel who held the 'work posts' (*gangwei*) in the Danwei system. Zhigong was predicated on a status meaning, as the Danwei system's labor relations was organized with formal employment positions exclusively. They were all the permanent worker

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<sup>23</sup> Danwei constructed virtually autarchy communities: they were equipped with residential housing, dining hall, health clinic, fleet of cars, and other basic service facilities within the boundary of walls which physically separated them from outside (Lü and Perry: 5).

<sup>24</sup> JIL, *Chūgoku kokuyū kigyō kaikaku no yukue: rōdō shakai hoshō shisutemu no hen yō to kigyō soshiki*, p. 28.

<sup>25</sup> Unlike economic units in market system, its SOEs were responsible to providing their employees with a wide range of social welfare benefits, and Walder's famous Neo-traditionalism shows us SOE's exclusive all-round welfare function, which made their workers totally dependent on their workplaces to manage their livings. Of course, it is a critical aspect of SOE in pre-reform China, but China did not organize its SOEs to mainly provide welfare to its urban workers. Instead, China set up it to organize heavy industry rapidly with low wage system..

<sup>26</sup> "Zhigong refers the formal member of Danwei system" (Interview, 2005, July 16th).

without worries of losing jobs; and entitled to comprehensive welfare benefits, even including reliable pension after the retirement from their Danwei. Zhigong held a status meaning derived out of the Danwei system's formal employment relations without a peril of losing their jobs or entitlements.

Literally Zhigong means both 'staffs and workers', since the term was created by combining the two divided groups of Zhiyuan (management staffs) and Gongren (workers). The administrative lines which dealt with the matters of cadres and worker in China before the reform were clearly divided into two distinct systems: 'personnel management system' for staffs arranged by the Ministry of Personnel and 'labor management system' for workers arranged by the Ministry of Labor.<sup>2728</sup> The Danwei system organized its membership with Zhigong which constituted of two different groups, staffs (managerial and technical) and workers. The boundary between two groups was quite strictly, and once a Zhigong was decided to belong to a group, the decision was permanent and switching groups rarely occurred. "The base of this division was 'grade wage system' (*dengji gongzizhi*) and each stratum had its own scheme of grade wage system. Linked with this wage system, management staff, technical staff, and workers were under different treatment system in food ration, work condition, transportation, health care, housing, and, vacation."<sup>2930</sup>

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<sup>27</sup> "The boundary of personnel relations includes not only the relations of state organizations and their personnel but also that of public and enterprise Danwei and their managers and technicians. ... Personnel relations involve the relations of cadres and their Danwei and labor relations involve the relations of workers and their Danwei." Zhang Yanhua and Wang Dongwei, "Luelun laodong guanxi laowu guanxi renshi guanxi de qubie yu jieding," p. 37.

<sup>28</sup> JIL, *Chugoku no rodo shakai hoshu shisutemu no kisoteki kenkyu*, p. 58.

<sup>29</sup> "The division of different Zhigong rank was quite clear and different Zhigong ranks meant different material rewards and social treatments. According to the data of an industrial sector of Huabei and Dongbei areas, we can identify that 'grade wage system' after the wage system reform of 1956 clearly set up wage differences by each group of Zhigong: management staff's low wage and high wage were 229 *yuan* and 263 *yuan*; technical staff's low wage and high wage were 229 *yuan* and 254 *yuan*; the workers'

Even though staffs and workers belonged to two separate systems, the concept of Zhigong was predicated on the socialist system's egalitarian ideology. China intentionally tried to prevent a sense of differentiation among Zhigong's different strata. For its political leaders, "it is imperative to officially deny the existence of a class division within the urban areas" (Bill Taylor, et al.: 80). In this context, China did not allow the open recognition of Zhigong's internal division. "China for quite long period overemphasized Zhigong's internal integration, and denied Zhigong's internal differences. Thus, many people avoided talking about Zhigong's ranking order."<sup>31</sup> Even though, "Zhigong had clearly divided ranks of staff and workers, but its conscious scheme was more favorable to normal workers. Except for the 'grade wage system', workers were not quite different in social position and production process from management and technical staff."<sup>32</sup> Indeed, the earning differences "between the highest-paid factory officials and lowest-paid workers in China was a multiple of only between two and three, far narrower than the five to one spread found in factories of the former Soviet Union, not to mention capitalist economy" (Frazier 2002: 151).

SOE workers, despite being at a lower strata than their managers or staffs, still became the central focus of the term Zhigong. This is because the term 'worker' incorporates an ideological meaning in the socialist system: the worker was supposed to be the vanguard of revolutionary consciousness for historical development. Hence, the concept of Zhigong was ultimately predicated on the social meaning of workers in socialist system. China's workers before the reform did not simply mean employees of industrial sectors; instead the term

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high wage and low wage were 103 and 134 yuan" Feng Tongqing and Xu Xiaojun, *Zhongguo zhigong zhuangkuang: neibu jiegou ji xianghu guanxi*, p. 46.

<sup>30</sup> Ibid., p.22.

<sup>31</sup> Ibid., p.46.

<sup>32</sup> Zhao Wei, *Qiyè Zhigong jeceng fenhua de yanbian*, p. 43.

“incorporated meaning of social status.”<sup>33</sup> The most salient character of the workers comes from their special position within the workplaces: they were not supposed to be treated as employee as their counterparts in capitalist society; instead, they were recognized as the ‘master’ (*zhurenweng*) of their workplaces. “Under the plan economy, theoretically all workers were the direct owner of entire production factor and workers with their status as the ‘master’ equally used production factor and shared the returns of production.”<sup>34</sup>

Hence, while *Zhigong* was the term that combined both staffs and workers, its internal distinction between the two groups was socially minimized with social recognition of workers’ special position as the ‘master’. Blurring the distinction between the staffs and the workers, the concept of *Zhigong* came to construct the imagined single comprehensive identity that constituted the *Danwei* system.<sup>35</sup> Indeed, many Chinese frequently used the term of *Zhigong* without making distinction between workers.<sup>36</sup> In sum, *Zhigong* labor system constituted the very nature of the *Danwei* as the system to confirm the workers’ special position as the master of society.

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<sup>33</sup> Zheng Hangsheng and Li Lulu, *Dangdai Zhongguo chengshi shehui jiegou: xianzhuang yu qushi*, p. 219.

<sup>34</sup> Chang Kai, op. cit., p. 58.

<sup>35</sup> “The term *Zhigong* was made for very political reason, to emphasize that SOE *Zhigong* were the master of their workplace rather than its employee. In other words, the term incorporates the meaning that there is no employer and employee relation in socialist system and SOE workers are the master of their workplace” (Interview, 2005, January 3rd).

<sup>36</sup> Chang Kai separates the concept of labourer from that of worker: the former refers to only direct producer; the latter refers to broader concept of producer which even includes manager groups. Clearly here the term of worker indicates so called *Zhigong*. He continues “the condition of workers is quite different from that of working class in capitalist society, where worker and labourer’s conceptual boundary are equal.” Chang Kai, op. cit., p. 19. He also mentions various terms to indicate workers in the world as following: “...each country’s labor related laws have quite different terms to mention about workers, such as labourers (*laodongzhe* or *laogong*), *worker* (*gongren* or *zhigong*), personnel (*yuangong*), employee (*guyuan gugong*) or salariat (*gongxin shouruzhe*), employed labour (*guyonggongren*) and so on...” [emphasis added]. Ibid., p. 14

Chinese workers under the socialist system were supposed to be the owners of the means of production and they did not need to sell their labor in labor market. China under the plan economic system tried to accomplish “everyone has his own works” to realize its ideal that “peasants have their own land and workers have their own work.”<sup>37</sup> In this context, China tried to organize the SOE system to mobilize its entire available social labor, which also allowed it to realize the critical goal of full urban employment. The socialist production system claimed its superiority, as it could realize full employment without wasting production factors such as unemployment in market system. In this context, SOE system was supposed to realize rapid socialist industrialization as it could organize production system that could employ entire urban labor forces without wasting them.

The leadership was quite skeptical about the labor market’s ability to realize full employment and decided to initiate the “unified labor allocation system” whereby the state arranged workplaces for all workers. Since the private economic arena had been transformed into public units, the labor market in which individuals could find jobs virtually vanished and only the state sector employed workers. In this context, the state had to devise a new scheme of how to employ labor forces. In 1953, China started a new employment system: the state took full charge of all urban residents’ employment by arranging all their jobs in a state unit. Under the so called ‘unified labor allocation system’ (*tongbao tongpei*), the government decided not only who would be a member of the Danwei, but also who worked in which workplaces.<sup>3839</sup>

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<sup>37</sup> Li Peilin, Zhang Yi, and Zhao Yandong, *Jiuye yu zhidu bianqian: liangge teshu qunti de qiuzhi guocheng*, p.26.

<sup>38</sup> JIL, *Chūgoku kokuyū kigyō kaikaku no yukue: rōdō shakai hoshō shisutemu no hen yō to kigyō soshiki*, p. 127.

<sup>39</sup> In fact local labor bureaus were supposed to arrange work positions for their urban workforces. Local labor bureaus, based to the central plan, assigned new workers to each SOE and rearranged existing

Since every SOE job was arranged by the state, SOEs did not have the power to hire or fire their workers.<sup>40</sup>

Since the state uniformly coordinated SOEs' labor affairs, there was no discrepancy in labor supply and demand. The labor relation between SOE and its workforces became quite stable and there was no labor mobility in Chinese urban society. Once workers were assigned their jobs, they were supposed to keep their position until retirement. Until 1986, SOEs guaranteed a lifetime job for all employees and SOE workers were called 'permanent workers' (*gudinggong*), which constituted the overwhelming majority of the personnel in the Danwei. This life tenure system also guaranteed workers national standard wages and benefits. SOEs were under soft budget constraints with virtually no restructuring or bankruptcy risk, and, consequently, there was no risk of workers losing their jobs. The 'permanent worker' system was a critical part of Zhigong labor system.

The Zhigong's blurring of the distinction between the staffs and the workers came to fashion a distinctive labor organizational scheme. The leadership set up a virtually de-skilled production system that systemically curbed the internal differences between skilled and unskilled workers. Indeed, China set up a limited wage differentiation system for SOE Zhigong (Frazier 2002: 237). It introduced its famous unified "eight grade wage system" for all SOE Zhigong which linked each wage grade with particular jobs and its associated skill sets. However, it was not easy for China from the start to manage its entire SOE Zhigong's wage system, as there were serious tensions in workplaces regarding the issue of how to differentiate each worker's skill

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workforces. They also governed other labor issues such as total wage, average wage, bonus level, and labor insurances affairs. Yamamoto, *Gendai Chugoku no Rodo Keizai 1949-2000*, p. 359.

<sup>40</sup> The central government in 1956 descended the power to hire new workers to local level and realized that year's new hired workers exceeded much more than original plan. So it in 1957 demolished SOEs' power of hiring their workers from society and the state arranged the whole task of urban employments. Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 28.

level to decide their wages. In this context, this original scheme of skill based wage system in practice turned into a simple seniority-based system whereby wages depended on the number of years worked without taking into accounts actual skill levels (Frazier 2002: 149). Usually years of experience and skill are correlated, but in China's de-skilled production system, SOE Zhigong's working years did not necessarily reflect their level of skill. The Danwei system was unique in that it did not have an internal labor market system to systematically promote more skilled workers.

Many socialist countries had a system of incentives to encourage increased production that rewarded skilled workers. Bonuses were awarded to workers who could produce beyond their quotas, causing to work harder (Frazier 2002: 152). This sort of setup of an internal incentive system introduced an internal labor market in many socialist countries that better rewarded skilled workers. The demand for highly skilled workers was also exacerbated by the structural problem in socialist production systems of the uncertain availability of production factors under a bureaucratic allocation system. This made factories hoard available production factors, including labor forces. Skilled workers were particularly valuable because they could manage this uncertain production process. Accordingly, socialist countries also needed to develop their own internal labor market scheme with "differential allocations of rewards targeted to those workers with firm-specific skills and less routinized tasks" (Stark, 1986: 495).

China, however, reflecting the leadership's opposition of any kind of material incentives, abandoned all its output incentive systems including bonuses for surpassing quotas by the late 1950s (Frazier 2002: 155). In the same vein, the SOE system did not incorporate a systemic internal labor market system and their Zhigong were not as eager to produce more than their quotas as other socialist countries' counterparts. Without introducing an internal labor market

scheme, China's SOE system kept reorganizing itself toward a more egalitarian labor system without differentiation between skilled and unskilled workers. "Under the condition of enterprise security system, the distribution principle, rewarding "each according to his work" of socialist system, has changed into the egalitarian practices of mean distribution with limited wage differentiation and enterprise security system."<sup>41</sup>

Obviously, the socialist system dedicated to full employment to organize the "best" economic system for rapid socialist industrialization without wasting social labor forces such as unemployment. Hence, Zhigong labor system tries to absorb as much as work forces from the society which made the Danwei employ the majority of urban labor forces, unskilled workers. This is because there were only a limited numbers of skilled workers in urban China and the Danwei system as a system to realize full employment became a system had to absorb lots of urban unskilled workers with labor scheme that was favorable for them. In sum, Zhigong labor system was established through the combination of following: low wages, full welfare arrangements including job security, and an egalitarian, de-skilled scheme of labor to absorb lots of urban unskilled workers for the goal of full urban employment.

For the Chinese it was so obvious that SOEs' strong commitment of guaranteeing workers' living had to do with their low wage system for its rapid industrialization.<sup>42</sup> In order to maintain SOEs wage low, SOEs, for their employees, took the full responsibility of providing welfare services and job security.<sup>43</sup> Indeed, the embeddedness politics of China to achieve the goal of rapid industrialization came to organize SOEs as the Danwei in terms of autarky welfare system to organize its unique Zhigong labor system. The Danwei welfare system was organized

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<sup>41</sup> Zheng Gongcheng, *Lun Zhongguo tese de shehui baozhang daolu*, p.92.

<sup>42</sup> Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 149.

<sup>43</sup> Feng Tongqing, *Gonghui zai chengbao zulin he gufenzhi zhong mianlin de wenti ji qi duice*, p. 17.

as exclusive program for the Danwei themselves, so its entitlement boundary was limited within the Danwei's Zhigong, and its resources depended on enterprises revenue.<sup>44</sup>

Yet under the 'unified revenue collecting and unified spending' (*tongshou tongzhi*) system each SOE ultimately belonged to the state financial system in terms of "big pot rice" system, so if the Danwei had difficulty providing for Zhigong, then the state would provide the necessary funds to cover Zhigong's living fees. Indeed, the state not only assigned the workers to SOEs, but also decided entire Zhigong's total amounts of wage and level of welfare benefits under the unified state financial system.<sup>45</sup> Indeed, the state set up and decided on SOE Zhigong's wage and welfare funds before the reform as part of its financial system.<sup>46</sup> Since the state arranged and guaranteed welfare benefits for Zhigong, each SOE's performance did not impact nor was linked to the level of benefits its workers received.<sup>47</sup> In this context, Zheng Gongcheng notes that "China's social security system was the state responsible system. Under the unified state financial system, the central financial system became the direct bases for economic investments and the central government became the direct responsible subject of the social security system which provided social constituents with gratuitous material supports."<sup>48</sup>

Under the unified state financial system the state and SOEs were not divided but were organized into virtually single system within the broad state financial system after all. In this context, the Danwei security system whereby each Danwei arranged its Zhigong's

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<sup>44</sup> Zheng Gongcheng, op. cit., p.91.

<sup>45</sup> Indeed, under the unified state financial system, the "number of employees on the payroll and the enterprise's annual wage bill also were fixed and subject to administrative constraints" (Frazier, 2002: 155).

<sup>46</sup> "Zhigong's wage, benefits, and social insurance all together belong to distributional categories of 'social consumption funds' (*shehui xiaofei jijin*)." Dangdai Zhongguo congshu bianjibu, *Dangdai Zhongguo de Zhigong gongzi fuli he shehui baoxian*, p. 1.

<sup>47</sup> Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 93.

<sup>48</sup> Zheng Gongcheng, op. cit., p. 88.

comprehensive living was after all organized within the scheme of the “big pot rice” system in which the state assigned the jobs to the Danwei but it ultimately took the responsibility for proper working of the Danwei level’s security system for their Zhigong.

In this context, the Danwei turned out to be the system to arrange full welfare for Zhigong within the “big pot rice” system. Hence, for the Chinese it was so obvious that the state, institutionally, was responsible for the individual SOE’s performance and its workers’ living as well. It was apparent for the Chinese that the Danwei and its multi-facet welfare functions were ultimately run by the state.<sup>49</sup> So the Danwei’s autarkic welfare system for their Zhigong was not organized as genuinely independent enterprise security system but was supposed to be supported by the state financial system’s eventual engagement.

As the Danwei system ultimately belonged to the state financial system in terms “big pot rice” system, labor relations between Zhigong and the Danwei also extended to the state as well. The Danwei had the power to rights to hire, fire, and arrange, personnel power in terms of rights to hire, fire, and arrange transfers (Lü and Perry: 5).<sup>50</sup> However, the government ultimately decided not only total number of work posts in the Danwei, but also who kept the posts. Zhigong’s “recruitment, allocation, employment permits, transfer and dismissal were (and are) subject to the official approval of the state labour personnel departments at the appropriate level” (Korzec: 30). Furthermore, SOE as social system was a very special form of enterprise: as its owner was the state, it was organized as parts of state administrative organization system.

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<sup>49</sup> He Ping, “Zhongguo shehui baozhang tixi yanjiu baogao (2000),” p. 4; “The Chinese state-sector *danwei* ... operates by its own internal logic. ... Neither the market nor the enterprise but the state, represented by different levels of bureaucratic administrative agents, became the ultimate mediator between the production process and labor, as well as in the allocation of resources and the redistribution of wealth” (Chan: 92-3).

<sup>50</sup> The Danwei kept and controlled the dossier of their employees which were the primary sources of personnel affairs in China.

“China did not have genuine enterprise at all. [Its SOEs] were enterprises on the surface but they were only affiliated factories of administrative system, which lacked enterprise’s function.”<sup>51</sup>

Therefore, SOE’s labor relations with its workers were not based on economic relations. Instead, its labor relations inevitably involved the state’s political engagements. In this context, “the state became the subject of hiring workers and SOE workers became the state’s workers.”<sup>52</sup>

The relation of SOEs and their Zhigong was set up on the basis of mutual consent: SOE Zhigong consented lifetime work, and SOEs consented to provide workers with all living needs.<sup>53</sup> Workers exchanged full labor contributions for institutionalized guarantees of job security and welfare benefits. As the Danwei worked within the state’s “big pot rice” system, its reciprocal contract relations with Zhigong also included a social contract between the state and SOE Zhigong.<sup>54</sup> SOE Zhigong’s dependency on the Danwei was not unilateral or exclusive, as it was derived from the larger reciprocal “social contract” with the state. Capturing the nature of the Danwei system as a socialist version of paternalism, Walder coined the term of Communist Neo-Traditionalism to analyze the dynamics of how the Danwei’s institutionalized paternalistic system brought about authority and power structure in Chinese urban society.<sup>55</sup> As SOE workers’ lives were entirely organized by urban Danwei system, they could not but accept the authority of the existing political order that constructed the Danwei system. But the idea of socialist paternalism did not capture the Danwei system’s contract between the state and

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<sup>51</sup> Weng Zhiyong and Yu Tijun, “Baotuo kunjing chongsu huihuang: Shanghai guoyou qiye de gaige yu fazhan qushi baogao,” p. 16.

<sup>52</sup> Wang Daben, “Chengshi jiuye: Xiangang he zai jiuye,” p.95.

<sup>53</sup> Li Peilin, Zhang Yi, and Zhao Yandong, op. cit., p.63.

<sup>54</sup> “In exchange for obedience to managers and Party officials and curtailing consumer demands, workers were promised a modest income and generous welfare benefits. Such relations were at the heart of a “socialist social contract”...” (Hurst and O’Brien: 357).

<sup>55</sup> Please see Andrew Walder, *Communist Neo-Traditionalism: Work and Authority in Chinese Industry* (University of California Press, 1986).

Zhigong. Zhigong were not simple dependent beneficiaries of socialist paternalism, but rather party to a social contract with the state that contributed full labor for guaranteed benefits.

Zhigong's unique position as state personnel through its social contract with the state was a result of the very unique recognition politics of pre-reform China. China recognized the special status of SOE Zhigong who could enter a social contract with the state. Furthermore, the lack of a labor market system in urban China resulted in a bilateral monopoly in which both SOEs and workers did not have any alternative options. Since the private economic sector had been transformed into public units after the socialist revolution, the labor market virtually vanished and the state became the sole employer for urban society. Accordingly, the state designated work positions for Zhigong to eliminate competition and prevent the development of a labor market. China created the Danwei's full comprehensive welfare system in order to sustain this unique bilateral monopoly between the state and SOE Zhigong. The system ultimately placed SOE Zhigong in a unique position as the sole politically recognized social group in pre-reform China that could provide labor for the state to construct its socialist system.

China set up the Danwei system as the institution to organize relations between the state and Zhigong, and so Zhigong took a very special position within their Danwei. In order to grasp the nature of Zhigong's special position, we must focus on how society constructed Zhigong's key component: the workers. There was a broadly shared consensus that "workers hold the position in plan economy system as the 'master' (*zhurenweng*)."<sup>56</sup> Therefore, SOE workers were not SOE employees, but rather the 'master' of their Danwei. China tried to set up its labor system as a system where SOE Zhigong were the 'master' who constructed the socialist system.

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<sup>56</sup> Feng Tongqing, *Zhongguo gon ren de mingyun : gai ge yi lai gong ren de she hui xing dong*, p. 12.

“Historical evidences prove that the issue of how to realize social security as well as the principle of distribution according to labor contribution have always been the primary issues in the socialist society. After properly arranging Zhigong’s wage, benefits, and social insurance affairs, we can activate Zhigong group’s maximum enthusiasm, energy, and creativity, which will accelerate the construction of socialist system”<sup>57</sup>

In order to activate Zhigong as the recognized constructors of the socialist system, they were entitled to gratuitous social welfare benefits.<sup>58</sup> The free benefits provided and guaranteed by the state was a way to represent and recognize the Zhigong’s status as ‘master’ in the establishment of a socialist system, with the state tending to the workers’ needs. Hence, in the pre-reform public ownership economy system, “the state took total responsibility and duties for its workers. The features of its labor relations were workers’ dependency on the state and the state’s protection and recognition of its workers.”<sup>59</sup> In sum, Zhigong held a very unique social position in pre-reform China: they were the state workers under the “big pot rice” system; a contracting party of social contract conditioned by bilateral monopoly relations recognized as the single social group to provide their labor for the system; and finally the ‘master’ of the Danwei system which built up genuine social value for constructing the socialist system.

Because the Danwei incorporated comprehensive welfare functions, China’s urban areas did not develop alternative institutions that provided social services. “...in those days, labor issue did not emerged as a prominent social issue, since the state adopted unified labor arranging system with the schemes of high employment and egalitarian distribution, which allowed everybody to have jobs to work and food to eat.”<sup>60</sup> Hence, the Danwei as an autarkic welfare system came to be the exclusive social system that organized all aspects of its own workers lives

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<sup>57</sup> Dangdai Zhongguo congshu bianjibu, op. cit., p. 1.

<sup>58</sup> Zheng Gongcheng, op. cit., p. 87.

<sup>59</sup> Chang Kai, op. cit., pp. 127-8.

<sup>60</sup> Ibid., p. 57.

in exchange for low wages. As the Danwei performed all the social functions that urban society needed, the urban society before the reform virtually had no other independent social system, and all urban residents had to belong to a Danwei, as life was unimaginable without one.

As Zhigong referred to the Danwei personnel, and the Danwei was the central organizing system of urban society, so Zhigong was essentially synonymous with urban citizen. In fact, a critical condition of urban residency was dependent on the Zhigong status. As the Danwei organized urban society, Zhigong, as the Danwei personnel, had social meanings beyond the simple economic meaning of employees, and encompassed a broader social meaning of urban citizen.<sup>61</sup> And thus, Zhigong was the most salient concept in constructing China's urban citizenship before the reform. Indeed, China anchored the nature of its urban citizenship around its constructed notion of Zhigong, which was ultimately predicated on the special position of workers in the socialist China who were the recognized the 'master' of the Danwei system, rather than employee, with the status of the state workers, and the contracting party of social contract with the state.

Indeed, workers were the most salient concept in constructing the meaning of Zhigong and the term of worker itself had very salient connotation in China, so workers could represent entire urban citizens incorporating various social groups.<sup>62</sup> Obviously, workers was not a minor position in making the concept of Zhigong, instead, it as the 'master' stood in the central position in constructing its social meaning. Indeed Zhigong turned out to be the central scheme in constructing China's socialist citizenship, so the workers who constituted the majority of

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<sup>61</sup> Indeed, Zhigong in China before the reform "are not so much contractors with the Danwei as they are citizens of it" (Naughton 1997: 170).

<sup>62</sup> "[T]he main body of the working class was industrial workers, but it also included commercial and agricultural workers who were registered as permanent residents in urban localities (chengshi hukou). In this broad sense, the working class included other staff and intellectuals engaged in educational, scientific and health work units" (Taylor, Kai, and Li: 78).

Zhigong virtually primary component of the citizenship. Here we can identify the China's unique meaning of workers in construct its citizenship: the workers in China were not a part of its concept of citizen; instead, Zhigong predicated on workers special position as the 'master' were the only recognized social position in constituting its concept of socialist version of citizenship before the reform. In this context, the very nature of China's socialist citizenship was predicated on Zhigong labor system that organized the Danwei with the feature of de-skilled labor based system to arrange full employment for the urban society. So the primary attribute of China's socialist citizenship derived from egalitarian scheme of Zhigong labor system to organize the society with full welfare community that could cover its majority of unskilled workers. Indeed, the very concept of China's citizenship was derived from Zhigong labor system which was based on the combination of low wages, full welfare provisions, and de-skilled labor based labor relations to employ its majority of unskilled workers for full employment.

Perry argues that China tried to organize the Danwei system mainly emulating the ideal scheme of the artisan's guild system in terms of a full welfare system for workers (Perry: 44). However, it is risky to grasp the nature of the Danwei simply in terms of the guild system, since its internal labor relations were not organized with skill-based artisan production system. Conversely, China's Danwei system was organized as a de-skilled mass production system, which depends on unskilled or semi-skilled workers. In an artisan production system, artisans hold exclusive controlling power over their apprentices' labor. By contrast, in a mass production system, labor relations are more horizontal, as the system depends on more numerous unskilled workers that have only limited skill variations. Due to these differences, despite the similarities of a full welfare system, the Zhigong labor system was systemically different from the artisan

guild production system. even with its full welfare provision, had systemic affinities with artisan's guild production system. This horizontal, egalitarian scheme was central to the Zhigong labor system.

China's SOE system was a unique combination of an egalitarian, de-skilled production system and an autarky welfare community for its vast unskilled workforces providing lifetime job security and full welfare benefits. Historically, welfare based labor systems were organized for skill-based production systems which required stable labor relations with many benefits to support the long training periods required for workers to develop their skills. Interestingly, SOEs provided full welfare benefits for workers even though their workforces was largely unskilled and was not based on developing skills. In doing so, the Danwei system combined two systems that could conflict: a de-skilled production system that tried to curb internal labor differentiation, and an autarky welfare community like an artisan production system that provides full welfare benefits. Hence, a critical feature of Zhigong labor system lies in the fact that it came to organize a de-skilled labor system with an exclusive formal employment system, as a result of its efforts to organize all labor relations with formal employment regardless of an individual worker's skill level.

A country's labor regime (Burawoy's term) depends on how it formulates its two critical dimensions of organizing labor relations: the horizontal openness for new labor forces, and the hierarchical stratification in terms of skill density. While unskilled labor-based production systems are apt to be more flexible with limited welfare benefits and opens to new external labor forces, skilled labor-based production systems tend to organize more fixed labor relations with strong organized welfare programs that tend to restricts entrance from external labor forces. How a country organizes its division of labor in terms of it hierarchically stratification by labor

skill tends to be correlated with specific labor welfare schemes and also shapes how the state views external labor forces. So choosing the labor division scheme involves a broader social decision of how to constitute its social welfare system including the degree of openness to the newcomers from outside. In this context, the contents of each country's labor regime in terms of horizontal openness and hierarchical stratification in skill density are formulated according to the society's decisions out of its embeddedness politics in organizing its scheme of division of labor for the industrial production.

The Danwei became a de-skilled, egalitarian labor system with a strong autarky welfare system by combining the two seemingly incompatible labor schemes. Under this unique scheme, unskilled SOE workers who constituted the majority of the SOE system, received the same level of welfare benefits as the more limited skilled workers. This was the critical feature of the Zhigong labor system - formal employment exclusive system for unskilled workers. Thus, the sustainability of the system depended on whether it could create enough jobs for those vast unskilled urban labor forces. This proved to be difficult and the Zhigong labor system faced serious challenges in providing enough of these guaranteed work positions.

Socialist countries largely boasted their achievement of realizing full employment. This was possible because they were generally faced with labor shortage conditions caused by the widespread practice of labor hoarding. Due to uncertain factor availability, factory managers in socialist countries tried to hoard production factors, including labor. Soviet Union and other former socialist countries systemically faced labor shortages and did not worry about unemployment.<sup>63</sup> However, China was under quite different conditions. Even with labor hoarding, the country never faced labor shortage situations due to its huge population. Instead,

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<sup>63</sup> According to Frazier, factory managers of socialist countries were troubled by labor shortages and frequent turnover (Frazier 2002: 155).

the fundamental problem of the Danwei system faced was the lack of urban employment opportunities. To make matters worse, its industrial policy focused primarily on heavy industry which turned out to be a capital intensive system with limited jobs creating effects.<sup>64</sup> Due to these factors, China was unable to reach its goal of full employment. Unable to incorporate all of urban society, some residual segments of society were left.

To deal with this issue, China organized these residual segments into Collective Owned Enterprises (hereafter COEs) as independent accounting units from the state's unified financial system. COEs were not under direct control of the central governments, though they were not entirely free from state's control; instead, they were under the jurisdiction of various levels of local governments.<sup>65</sup> The original scheme of collective ownership had the following meanings: on the one hand, a collective ownership (*jiti suoyouzhi*) co-existing with whole people's ownership (*quanmin suoyouzhi*) as a part of a socialist public ownership (*gongyouzhi*) system; but, on the other hand, it was a just transitional and low level ownership to be elevated to people ownership system.<sup>66</sup>

China initiated its collective economic system in the 50s when it set up cooperatives mainly to reorganize its existing handicraft units, which were simply regarded as a pre-modern

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<sup>64</sup> According to Hu Angang and Yang Yunxin, if China had taken more labor intensive development scheme, then China's industrial sectors would have created 186 millions more work positions between 1952 and 1987. Hu Angang and Yang Yunxin, "21-shiji de zui da tiaozhan: Zhongguo jiuye zhuangkuang fenxi," p. 127.

<sup>65</sup> According to Qian Yingyi, the main difference between SOE and COE can be captured terms of ownership: "the central government reserves the ultimate rights of reallocation of residual cash flow and assets" in SOEs, "even if the control rights have been delegated and residual income has been assigned to local governments. But the central government (and any government except those of the townships and villages) has no such rights over the assets of collectively owned enterprises" (Qian: 216).

<sup>66</sup> The original idea came from Stalin. In his work, "Economic Problems of Socialism in the USSR," published in 1952, Stalin not only separated collective ownership from people's ownership but also suggested the idea that collective ownership should be enhanced to the people's ownership system. Gu Baofu and Xiong Guohe, *Zhongguo chengzhen jiti suoyouzhi jingji lilun yanjiu*, p. 13.

production system. China thought that it needed to transform its numerous small artisan production units into a more organized large-scale mass production system. However, as the two production systems had very different organizational schemes, China could not directly reorganize its handcraft production units into large-scale mass production system. So, it devised the cooperatives as an institutional stepping-stone to reorganizing its artisan production system. Then, China, during the Great Leap Forward (GLF), initiated a new push for COE system mainly by mobilizing housewives through “street collectives” administered by neighborhood committees. As China tried all possible types of investments in the GLF period, it allowed lower level local governments to invest independently from the central government’s financial system. Then, from the early 1970s, China had another round of expanding the COE system, in which many large SOEs started to set up their own affiliated COEs and many local bureaus established their COE to procure their required input factors (Walder: 46-7).

As independent accounting units, these collective undertakings were responsible for their own profits and losses, and outside the protection of the state. As self-supporting accounting systems, COEs could not expect bail-outs from the state, and thus, had to be sensitive about their economic performance. However, as China eliminated its market system, COEs could not become rational economic actors. Most COEs were gradually incorporated into the business networks of state agencies or enterprises, rendering them as part of SOEs’ interlocked subsystem (Walder: 44). Under China’s socialist system without market system, COEs were unable to be SOEs’ competitors, and instead became minor or marginal sub-systems within China’s unified state financial system.

From the beginning, the distinction between COEs and SOEs was not supposed to be eternally fixed. The two urban systems were organized with a clear division as premature and

developed systems, respectfully, but there was a possibility for the premature COEs to be transformed into developed SOEs. Between 1966 and 1976, China not only combined independently managed small scale COEs into unified large COEs, but also elevated large COEs into SOEs.<sup>67</sup> China in those years believed that social development could be best attained by making more SOEs out of other minor forms of enterprises, because SOEs represented the most advanced form of ownership.<sup>68</sup> Thus COEs were never fully recognized as independent production system, but rather just a makeshift system to eventually be reorganized into mature SOEs. In other words, even though China set up an independent production system outside of the unified state's "big pot rice" system, it by no means recognized this intrinsic autonomous economic actor.

The leadership also did not make serious efforts to formulate a single integrated labor system for COE workers independent from the SOE Zhigong system and as a consequence COE labor relations remained as highly ambiguous system. China from the start did not politically recognize COE workers' full labor relations. Indeed, China did not acknowledge the labor relations based on the traditional scheme of artisan and apprentice as a constructive force for its socialist system. Furthermore, because COEs did not directly belong to the central government's plan system, the state did not arrange their internal labor relations. While the state decided total number of SOE Zhigong and local governments according to the central decision decided their SOE's Zhigong numbers, the number of COE workers was under the direct control of the local governments. When a local government decided to change the number of its COE workers, then

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<sup>67</sup> Lin Yifu, Cai Fang, and Li Zhou, *op. cit.*, p. 21.

<sup>68</sup> Especially, China in the era of Cultural Revolution admitted only 'big' and 'public' ownership as the proper socialistic production form. In this context China from 1967 started to transform radically its COEs into SOEs (Chen Gang: *Zhongguo laodong fuwu gongsi*, p. 29).

it just reported it to the center for records.<sup>69</sup> Not belonging to the state “big pot rice” system, COE workers, unlike SOE Zhigong, did not hold the position of state’s personnel.

Due to its ambiguous and unrecognized nature, COE workers’ treatments lower than that of SOE Zhigong.<sup>70</sup> COE’s positions were not stable like SOE permanent workers. They were frequently hired on a contractual basis and could let go during business downturns (Steinfeld: 12). Plus, COE workers’ wages were lower than that of SOE workers. COE workers’ annual average wage in 1980 was 604 *yuan*, versus 803 *yuan* for SOE workers. The gap in pay is even wider if welfare benefits are accounted for.<sup>71</sup> Since China’s urban society was organized by the Danwei-based autarky welfare community system, most urban COEs also had to run their own autarky welfare system for workers (Hu: 288). However, the state did not arrange special funds for COE workers’ benefits. Hence, COE workers’ benefits depended only on the financial conditions of their own workplace and many were not provided with full welfare benefits like SOE Zhigong.

Even with the rise of COEs, citizenship was only for SOE workers. The designation of COE workers as a marginal social position clearly demonstrates China’s philosophy of “SOE as the single paragon system”. COEs were its marginal sub-systems, created purely to handle the predicament of limited work positions in the Zhigong labor system. Indeed, a critical feature of China’s labor organizing scheme in urban society before the reform had to do with an exclusive

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<sup>69</sup> Cai Fang and Lin Yifu, *Zhongguo Jingji*, p. 50.

<sup>70</sup> According Frazier, the division of SOE and COE from the start was critical, not only in their relations with the state but also in the ratio of permanent workers to temporary workers in both systems. “The social transformation of industry thus created important divisions among workers, primarily between relatively prosperous full-time workers in state-owned enterprises and disaffected temporary and contract workers in underfunded collective enterprises. ... The largest state enterprises employed virtually all full-time workers, while the collective sector contained the largest portions of contract and temporary workers” (Frazier 2002: 142).

<sup>71</sup> Yamamoto, op. cit., p. 280.

public production that included the superior SOEs and the marginal COEs, but excluded labor relation of non-public production system.<sup>72</sup> In sum, despite the numerous number of urban COEs, SOE based Danwei Zhigong remained as the single scheme to construct the very contents of socialist China's citizenship before the reform.

However, even with the marginal urban system China could not resolve the fundamental problem of the SOE Zhigong labor system's limited capacity to provide enough work posts. An autarky welfare community with only formal employment could only produce limited work posts, so it was not compatible with the goal of full employment for the urban unskilled labor forces. Instead of trying to handle this fundamental problem, China politically decided to stick to the Danwei full welfare system combined with egalitarian de-skilled production system based on urban unskilled workforces. As the COE system revealed, China could afford only limited numbers work posts if it stuck to Zhigong labor system's formal employment exclusive system. Hence, in order to manage the Zhigong labor system, China needed to maintain and limit the total numbers of Zhigong and set up an effective system to check new unskilled workforces. To achieve this, China set up a social barrier to exclude new unskilled workforces, which led to completely separated dual social systems between urban and rural populations.

China at first did not try to control migration of rural populations into urban society. In fact, the Ministry of Public Security's "temporary ordinance for urban Hukou management" of 1951 clearly stated that the purpose of the ordinance was "guaranteeing people's freedom of moving". As China tried to reorganize its entire economic system to create state industrial sectors by focusing on heavy industry, state employment between 1949 and 1957 grew from 4.94

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<sup>72</sup> In 1978, total urban labor forces was 95.1 million, which was consisted of SOE Zhigong 74.5 million (76.3%) and urban COE Zhigong 20.4 million (23.7%). By contrast, total number of 'urban individual workers' (*chengzhen geti laodongzhe*) was only about 150 thousand, which was only 0.16 percent of total social labor forces. Tang Jun, "Zhongguo de renkou yu shequ," p. 15.

million to 21 million. As opportunities for urban employment increased, and newly organized state sectors expanded, millions of rural residents were allowed to enter urban society (Davis: 225). Especially after 1953, peasants' immigration into urban society became more intensified. Between 1949 and 1956 China's urban population increased from 10.6 percent to 14.6 percent of the country's total population, with a net gain of 34.6 million people (Cheng and Selden: 653). Of the total increased urban population between 1949 and 1957, the portion of peasants who moved from rural areas reached to 70-80 percent.<sup>73</sup>

This was a normal mobility pattern that also could be found in many other developing countries under industrialization. However, the leadership in China started to worry about the expanding numbers of migrating peasants due to urban society's limited capacity to create employments. Urban society had a significant surplus workforces. Indeed, urban China's unemployment rate in 1952 was 13.2 percent (total number of unemployed was 3.7 million) and the rate in 1957 still remained as high as 5.9 percent. Yet, China could only create limited numbers of work posts, since it tried to reorganize its economy with the Danwei as autarky welfare community combined with de-skilled mass production system. In this context, peasants from rural areas were not welcomed in most cities, since they hurt the chances of urban citizens' employment.

But peasants' desire to move into urban society was high and they kept pouring into urban society,<sup>74</sup> especially after China tried to push radically rural collectivization starting in

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<sup>73</sup> Cai Fang and Lin Yifu, *op cit.*, p. 51.

<sup>74</sup> According to Cheng and Selden, this was the outcome of both pulling and pushing effect. "In the first half of the 1950s, the most powerful stimulus for migration lay in the "pull" of the cities, above all the attraction of urban employment that offered workers security, a range of benefits and prestige. Yet there were also "push" factors. These included flight from poorer regions, discontent with co-operatives, and the loss of income-earning opportunities associated with the market as the state curtailed private commerce, set low purchasing prices for agricultural commodities..." (Cheng and Selden: 653).

1956.<sup>75</sup> China called these migrants from the countryside as “blind drifting” (*mangliu*), which with the GLF became more serious at a nation-wide scale. “During the Leap, millions left agricultural work and crowded into existing factories as well as hurriedly erected new plants, including the well-known “backyard steel mills.” This sudden human flood into the factories was churned up by the bizarre political utopianism of the Leap, but also corresponded with the interests and aspirations of individual migrants” (Naughton 1997: 172). In this context, CCP on December 18, 1957, issued the “ordinance regarding checking rural population blind outflow” which demanded strict management of the urban household registration system and the People’s Congress on January 9, 1958 passed “PRC’s household registration ordinance” which only allowed peasants to move into urban society only with the permission of urban labor bureaus.<sup>76</sup>

Provisions have always been China’s primary concern in ‘people’s livelihood’ (*minsheng*), because the country not only had a huge population and agricultural productivity was not high enough to feed the huge population. In order to secure provisions for urban Zhigong, China in the October of 1953 determined ‘unified buying and spending’ (*tonggou tongxiao*) of grains (which lasted until 1985), which established compulsory sales to the state of specified amounts of grain at low state prices (Cheng and Selden: 657). In the June of 1955, state council passed, “The Directive Concerning Establishment of a Permanent System of Household Registration” known as the Hukou system (Cheng and Selden: 655). Then, two months after establishing the Hukou system, China introduced a ration system, which covered grains and most other foods (Cheng and Selden: 657). Rationing made it more difficult for illegal migrants to obtain food in urban society and this was a critical feature of the Hukou

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<sup>75</sup> Liu Yingjie, op. cit., p. 57.

<sup>76</sup> Li Yingsheng, op. cit., p. 71.

system in separating urban society from the rural areas.<sup>77</sup> Hukou system was a critical institution to organize Zhigong's life, especially because it was the institutional base to run a grain rationing system in urban society. In this context, China's 1958 "PRC Hukou registration regulation" gradually divided its people into two social groups: the people with rural Hukou and the people with urban Hukou.

For all these measures, China initiated GLP in the 1958 to accelerate development, which was initiated as a new venture to reassign SOEs under the central government to local governments.<sup>78</sup> This resulted in unexpected social consequences - the abrupt expansion of SOE workers.<sup>79</sup> A socialist country's production system was never free from the problem of unguaranteed production factors, which caused managers to hoard production factors. China's local government also felt it had to hoard as many workers as possible for their newly assigned SOEs.<sup>80</sup> Therefore, regardless of the newly established Hukou system, SOEs under local governments recruited millions of new labor forces from the countryside. Between 1958 and

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<sup>77</sup> China issued a series of notices and instructions in 1957 which demanded that urban areas take measures to check peasants' moving in. The documents emphasize especially that police bureaus should supervise Hukou system strictly and foodstuffs bureaus should not provide grains with the people who did not have urban Hukou. Liu Yingjie, *op. cit.*, p. 57.

<sup>78</sup> According to Frazier, the 9,300 SOEs under central government in 1957 were reduced to 1,200 by the end of 1958 (Frazier 2002: 201).

<sup>79</sup> "Decentralization in 1957 was followed quickly by a massive increase in China's industrial labor force. Enterprises, now under less stringent control of local authorities, haphazardly "recruited from society" to fulfill utopian production targets set by local officials who had little knowledge of industry, much less macroeconomic administrative capabilities. Between late 1958 and early 1959, an estimated three million peasants migrated to urban areas, but the increase in the industrial labor force was put at twenty million new workers in 1958 alone. This amounted to more than twice the number of new entrants into the ranks of industrial employment in the previous eight years. In 1960, state plans called for 2 million new workforce entrants, but in just the first eight months of the year, enterprises had added 3.4 million new workers" (Frazier 2002: 205).

<sup>80</sup> "China had really serious problem of wasting its labor forces and there emerged fictitious phenomenon of insufficient labor forces, which could not be satisfied even with its annually increased new urban labor forces, one million" (Chen Gang: 16).

1960, China experienced a total increase of 28.68 million SOE Zhigong, of which about 20 million came from its rural areas.<sup>81</sup>

China's urban society could not feed and accommodate the rapidly expanding number of people. The state had limited resources to cover Zhigong's livings and political leaders worried about the influx of rural migrants whose living the state could not cover.<sup>82</sup> The political leaders realized that too many migrants from rural areas would disrupt the well-organized urban system which guaranteed Zhigong's social status.<sup>83</sup> Especially, with the social frustrations of GLF, China, in the early 60s, decided to layoff recently recruited rural workforces and started to strictly check peasant mobility by executing a program combining Hukou system and urban rationing system.<sup>84</sup> The leadership also thought the great famine had to do with the fact that too many peasants left rural areas for the urban manufacturing sectors causing a shortage of agricultural workers. To produce enough food, the state had to secure enough labor forces in rural areas.<sup>8586</sup> Between 1961 and 1964 more than 30 million urban residents, mainly peasant emigrants in the 1950s, were dispatched back to the countryside (Davis: 225).

The leadership clearly realized the urban population should be controlled, since the state had limited financial capacity to arrange the Danwei's autarky welfare community. The state had to provide the Danwei Zhigong with not only low priced agricultural products but also

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<sup>81</sup> Chen Gang, op. cit., p. 16.

<sup>82</sup> "For example, the 27 November 1957 People's Daily bemoaned the practice of workers bringing their families to the cities, thus driving up costs to the state in the form of housing, health care, food subsidies and urban infrastructure" (Cheng and Selden, 661).

<sup>83</sup> The State Construction Commission estimated that a total of 558-695 *yuan* in construction costs was required for each additional person in the urban society (Banister: 328).

<sup>84</sup> Liu Yingjie, op. cit., p. 58.

<sup>85</sup> Li Yingsheng, op. cit., p. 72.

<sup>86</sup> Yet, this was not be an accurate reason for the origin of great famine involved with Great Leap Forward. Regarding the institutional origin of the great famine, please see Dali Yang, *Calamity and Reform in China* (Stanford University Press, 1996)

various forms of welfare benefits.<sup>87</sup> In order to secure its urban welfare system with its limited financial capacity, China could not but separate its urban society from rural areas with Hukou system. For many Chinese it was obvious that the primary goal of the Hukou system was to exclude its huge peasant from urban society, meanings that peasants were not allowed to access the urban social system that constituted urban citizens' secure life such as urban employment system and social security system.<sup>88</sup> Obviously, China's Danwei based egalitarian de-skilled production system could not arrange enough work posts for its urban citizens, which was a critical reason for the leadership to check new migrant workforces from rural areas by setting up social boundary between its urban and rural society.<sup>89</sup> With the separation of urban society from rural areas, China could maintain the Danwei's autarky welfare community. The Danwei and Hukou system were not two independent different systems before the reform; rather they were two closely related supporting systems organized to the Danwei's autarky welfare community for Zhigong.

Hence, Hukou system was not a simple residence registration system in terms of where people lived; rather it became a unique scheme to organize Chinese society into two completely separated systems. Urban Hukou, under the coverage of urban employment and a living provision system, meant that urban citizens were supposed to be assigned work positions and to be provided with food and other living necessities. This is because they were state's Zhigong and the state took care of their living directly. In contrast, rural Hukou, bounded by land, meant that peasants engaged in agricultural productions.<sup>90</sup> Peasants were not regarded as state

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<sup>87</sup> Cai Fang and Lin Yifu, *op. cit.*, p. 51.

<sup>88</sup> Liu Yingjie, *op. cit.*, p. 64.

<sup>89</sup> *Ibid.*, p. 60.

<sup>90</sup> *Ibid.*, p. 64.

personnel and the state did not take care of their livings directly.<sup>91</sup> In sum, Hukou system was the primary institution to divide society into two entirely different worlds – urban/rural dual systems.

China before the reform achieved its industrialization quite rapidly especially in its heavy industry sector. Rapid industrialization was made possible by the clear separation of urban society from rural areas. Thus, China’s industrialization before the reform missed one important social outcome: the transformation of rural labor forces into industrial workforces, and its urbanization before the reform lagged far behind its industrial transition.<sup>92</sup> China before 1970, except for between 1958 and 1961, 80 percent of the total population worked in the agricultural sector and in 1978, 70.5 percent of the total population lived in rural areas.<sup>93</sup> As a result, rapid industrialization was limited as urban affairs and the vast majority of the population in rural areas were excluded from urban industrialization. Thus, China faced a unique contradiction: it in a sense realized its goal of setting up industrial production system, but the majority of people were still bound to engage in agricultural production.

At the same time, the leadership decided to set up the People’s Commune in 1958, which tried to reorganize rural areas as a collective economy through the collective rural land ownership.<sup>94</sup> Through this system, the leadership tried to organize rural areas as a socio-economic autarky system in which peasants depended on their collective system for production

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<sup>91</sup> “In rural areas, however, the collective or family economy is responsible for supplying these needs, and the government rarely concerns itself with budgeting for the basic needs of rural residents” (Banister: 328).

<sup>92</sup> Cai Fang and Lin Yifu, *op. cit.*, p. 54.

<sup>93</sup> Zheng Gongcheng, *op. cit.*, p. 175; Cai Fang and Lin Yifu, *op. cit.*, p. 54.

<sup>94</sup> Indeed, while China organized the urban society with Zhigong labor system based on low wage, full welfare provision, and de-skilled labor relations, it tried to organize rural areas in terms of peasant collectivization. Hu Rong, “Woguo shehui baoxian gaige de moshi xuanze,” p. 111.

and distribution.<sup>95</sup> Indeed, China needed a more systematic scheme in its rural areas beyond the traditional family economy to extract rural resources for rapid urban industrialization and organized rural areas under the economy system to handle all production functions and peasants' living with a scheme of rural collective security system.<sup>96</sup> Yet, the rural self-governing collective living security system in practice was did not hold up to promise, and rural society did not have a reliable social security system - as the state, unlike the urban Danwei system, did not directly engage in rural area's collective security system.<sup>97</sup> The rural collective security system remained as a nominal system and the living of most Chinese peasants still virtually depended on their family.<sup>98</sup> Indeed, China's social security system before the reform enlarged disparities between urban and rural areas' living conditions. China's rural society was organized by the People's Commune which could arrange only nominal welfare system, whereas China's urban society was organized with the Danwei system which was based on a series of urban institutions such as the urban Hukou system, the state's unified labor arranging system, a grain rationing system, and many other welfare entitlements.<sup>99</sup>

Under the clearly separated dual social systems, the living of the peasants was not improved. Instead, the number of peasants in rural areas kept increasing to the point where there were too many agricultural workers and lowered overall agricultural productivity. The total number of Chinese peasants in 1952 was 173 million, which increased to 294 million by 1979,

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<sup>95</sup> Li Yingsheng, op. cit., p. 72.

<sup>96</sup> The basic scheme of rural collective economy was "organizing collective production system with their members who had normal labor capabilities and providing collective protection for the handicapped members." Li Yingsheng, op. .cit., p. 64.

<sup>97</sup> It only had occasional relief programs to handle natural disaster and the "five guaranteed households" program under the Ministry of Civic Affairs (hereafter MOCA) which arranged minimum living for the fatherless family and childless old peasants. JIL, *Chugoku no rodo shakai hoshu shisutemu no kisoteki kenkyu*, p. 34.

<sup>98</sup> Li Yingsheng, op. cit., 65.

<sup>99</sup> Liu Yingjie, op. cit., p. 59.

reducing the average cultivating acreage per peasant from the 8 *mu* in the early 50s to 5.1 *mu* in 1979. Consequently, China's total agricultural production for the same period increased 2.3 times but its labor productivity only increased 0.19 times.<sup>100</sup> Yet, the scale of state absorption of rural resources kept increasing. The state transferred 7.4 billion *yuan* of rural production to urban areas with the "scissors gap" in 1952; in 1956 the amount was 12.7 billion; and in 1978, the amount reached 36.4 billion *yuan*.<sup>101</sup> Furthermore, the relative price of agricultural products remained extremely low despite the increasing rural population. Indeed, "the state just propped up its industrialization through the "scissors gap" of agricultural products price, levying agricultural tax, and the unified grain control program. Under this condition, it is impossible to establish same level of urban workers' social security (insurance) system for peasants."<sup>102</sup> The rural peasant population accounted for 70.5 percent of the total population in 1978, but total agricultural production was accounted for just 28 percent of GDP.<sup>103</sup> China tried to set up an urban/rural social division not only for the purpose of setting up an exclusive urban *Danwei* system but also create a systemic mechanism to transfer social resources from rural areas to the urban industrial sector.

Hence, the dual systems turned out be a system not just to block the labor mobility from the rural areas but to transfer more rural agricultural production cheaply into the urban society to supports its low wages system for rapid socialist industrialization. Under the dual system China systemically transferred cheap agricultural products for the urban society, which allowed the

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<sup>100</sup> Li Yingsheng, op. cit., p. 75.

<sup>101</sup> Ibid., p. 76.

<sup>102</sup> Ibid., p. 65.

<sup>103</sup> Cai Fang and Lin Yifu, op. cit., p. 54.

urban society maintain Zhigong's low wage system, so China's unique dual systems was critical institutional foundation to organize the Danwei based de-skilled production system.<sup>104</sup>

With the clearly separated urban/rural systems, the entire Chinese population was also divided into two social groups: Zhigong who were urban citizens that belonged to the Danwei system and peasants, the majority of the population, that belonged to the rural commune system and were not allowed to access the urban Danwei system.<sup>105</sup> In this context, Zhigong and peasant in China are not simple terms that refer to different occupations; rather they represent China's two different social groups that bound individuals to two completely different and unequal social systems. "Workers and urban citizens are brought into state's labor employment system and its social welfare and security system. Hence, they can enjoy the advantage of the socialist system, which covers their all round living issues, from the issues of birth, aging, sick, and death to the issue of wearing, eating, housing, and traveling. By contrast, excluded from this social security system, peasants and countrymen are brought into rural People's Commune system. Belonging to this collective unit virtually means that peasants have to arrange their own life and take care of themselves."<sup>106</sup>

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<sup>104</sup> "Under the former plan economic system, our country, primarily based on urban/rural household registration system, carried out a comprehensive urban/rural separated system including employment, welfare, and social security system, which constituted dual structure of labor system. Under the condition of economic backwardness and limited resources, it was an inevitable choice for the state to concentrate its limited resources to realize industrialization through public ownership. Not to interrupt urban welfare system which made low living costs possible and to realize urban citizen's full employment, the state, with the bounds of Hukou, employment system, and ownership system, blocked peasant from moving into urban areas." Chang Kai, op. cit., p. 128.

<sup>105</sup> "In China's Hukou system, peasant, workers, and cadres are the most critical social categories in terms of both occupational and status sense. In fact intellectuals also are included into category of "cadres". Theoretically speaking, cadres also belong to category of workers, therefore, the division of peasant and workers has become two biggest social categories which constituted its society." Liu Yingjie, op. cit., p. 27.

<sup>106</sup> Liu Yingjie, op. cit., p. 96.

Urban society was protected from inflows of rural migrants making urban residence “an even more privileged status” (Naughton 1997: 172). Hence, Zhigong as urban citizen came to incorporate the social meaning of a privileged social status. They were not only permanent workers in their Danwei, but also lifetime urban citizens with privileged entitlements to comprehensive welfare benefits that were not available to peasants. In this context, Chinese peasants were also a social status as well as an occupational concept.<sup>107</sup> China separated its urban/rural societies and developed a unique meaning of citizenship based on a different combination of entitlements and liabilities for each group.

“This division leads workers and peasants, or urban citizens and countrymen, possess essentially different positions and treatments, which, consequently, make them two groups with different and unswitchable social status. This dual system does not only set up the division of workers and peasants but also solidify social discrimination in their social status, in terms of workers as ‘first citizens’ (*yideng gongmin*) and peasants as the ‘second citizens’ (*erdeng gongmin*).”<sup>108</sup>

China tried to organize the SOE system as the backbone its socialist system to construct its heavy industry rapid in socialist way to based on low wage system for its workers. In order to maintain the low wage system China set up SOE under the Danwei system which arranged comprehensive welfare benefits for Zhigong to let them manage their living even with low wage. Hence, the Danwei system was dependent on the very unique Zhigong labor system which was a combination of low-wages and formal employment exclusive labor system, which guaranteed Zhigong’s employment until retirement. At the same time, the leadership also tried to realize full employment, so the Danwei system came to employ urban workforces as much as possible under the state’s ‘unified labor allocation’ system. In this context, the Danwei system was full of those

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<sup>107</sup> Ibid., p. 27.

<sup>108</sup> Ibid., p. 96.

urban unskilled workers, which fashioned its Zhigong labor system based on egalitarian de-skilled labor division scheme depending on unskilled work forces.

However, the Danwei's formal employment exclusive labor system could bring about only limited numbers of work posts, so it was contradictory with its commitment to realize full employment. The situation got even worse with China's heavy industry first policy which depended more on capital than on labor. Hence, the Danwei system for the goal of full urban employment came to employ much more assigned unskilled workforces even when they did not need them. As it was turned out to be impractical to employ entire urban workforces with SOEs' formal employment, China allowed COEs as minor urban system; and finally even decided to block new labor forces from countryside to enter the urban society to limit total scale of the urban work forces.

This vast separation of society into two discrete social groups was interestingly enough caused by the leadership's efforts to create the Danwei system. The more the state tried to build the Danwei system, the more society fell into the institutional trap social segmentation in terms of those who belonged to the urban Danwei and who did not. This ironical outcome had to do with internal tension within the Zhigong labor system. This labor system depending on unskilled urban work-forces with the commitment to arrange full urban employment with comprehensive welfare could inevitably only create a limited numbers of work posts. Hence, Zhigong labor system's fundamental problem in terms of combining two incompatible labor systems, a labor system based on unskilled workers with an autarky full welfare provision system caused China to

formulate this unique segmentation system, which eventually took the form of unique urban/rural dual social systems with completely different rights and responsibilities for each group.<sup>109</sup>

The dual social system turned out to be quite compatible with the rigid Zhigong labor system. SOEs could not employ their new workers by themselves, even when they faced a labor shortage, since the state decided the total number of permanent SOE workers tried to construct system without economic cycles, but the Danwei's de-skilled production system was not completely free from the needs of occasional labor adjustments. So the leadership allowed SOEs facing labor shortages to hire contract or temporary workers independently from the state plan, who could be laid off without the state permission. Virtually no urban citizens would take these temporary work positions, since they could expect formal work positions. So peasants who were supposed to remain in rural areas came to take these temporary positions. As the social division between urban and rural areas became more systematically entrenched, peasants could only participate in urban sectors as temporary, seasonal, or contract workers.<sup>110</sup>

Although these informal laborers worked in the urban Danwei system, they were not recognized as Zhigong with full entitlements. Temporary workers from rural areas “were paid not from the wage fund, but from general administrative expense or from petty cash [presumably as the firm in question saw fit] and were simply not eligible for benefits. Indeed, they were not even listed on the books of the enterprises” (Solinger 1997: 208). They were systematically

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<sup>109</sup> The guild system in Europe based on the clear division of master and apprentice organized their small workshops in terms of autarchy welfare communities. China also organized its Danwei in terms of autarchy welfare communities which however were mainly based on unskilled labor forces.

<sup>110</sup> Indeed, the Cultural Revolution was the period in which China's social tension between formal Zhigong and temporary workers turned into really serious political tensions. Politically mobilized social discontents of temporary workers could shake and destabilize existing socio-political boundary, but it could not succeed as the leadership worried about hardly predictable socio-political consequences when it totally deny existing Zhigong based urban social orders. Please see Lü and Perry; Yamamoto, op. cit., pp. 133-143.

neglected social groups, who, as simple employees, did not belong to formal Zhigong. Even though these informal labor relations remained as unrecognized labor, they played a critical role to maintain China's extremely rigid Zhigong labor system. Due to these informal labor relations, SOEs could adjust its labor forces according to their actual labor demands without the state's permission. The informal labor relations were also critical because SOEs could adjust their total number of workers without changing the number of Zhigong as decided by the state. Thus, this informal labor system was an indispensable part of the rigid formal labor system that allowed some flexibility for SOEs under an economic system with no labor market.<sup>111</sup>

The formation of China's unique dual social systems was also the result of the bilateral monopoly relations created between SOEs and the state while establishing the Danwei system. Bilateral monopoly refers the condition of single seller and single buyer. The state and SOE Zhigong before the reform were in the condition of bilateral monopoly as without a labor market, neither party could find any alternative partners. Indeed, the SOE paragon system and the dual social systems that blocked new labor forces from rural areas positioned both the state and SOE Zhigong in a condition without alternative partners. The primary foundation of bilateral monopolies involve a reciprocal commitment to recognize the other party as the exclusive partner. The state and SOE Zhigong also were bound with mutual recognition under special relations: SOE Zhigong exclusively provided their full labor and transferred most of what they produced to the state, while the state recognized Zhigong's exclusive 'master' position within the Danwei with comprehensive welfare entitlements.

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<sup>111</sup> According to White, the number of this contract and temporary workers was "impossible to estimate accurately, but without [them] the 'official economy' would have been in far worse trouble" (White 1993: 124).

China's egalitarian politics organized SOEs in terms of de-skilled scheme of division of labor which limited differentiation in treatment of its skilled and unskilled workers. Hence, the Danwei's unskilled workers were arranged full welfare provision without serious distinction with its skilled workers. What this virtually meant was that SOE was organized with highly favorable system for the urban unskilled workers.<sup>112</sup> Indeed, China after the reform also came to realize that SOE was highly favorable system for its unskilled workers, as it rewarded the unskilled labor much more than enterprises in market system; by contrast, it was unfavorable for skilled workers who were rewarded much less than their counterparts in market system.<sup>113</sup> Most of all, it was absolutely unfair system for unskilled labor forces who did not belong to the urban society, huge numbers of peasant in rural areas. So it was quite ironic that the efforts to organize egalitarian de-skilled Zhigong labor system to construct socialist industrial system turned out to be only favorable system for urban unskilled workers.

Accordingly, the bilateral monopoly involves the fact that China came to organize a system that recognized the urban unskilled workforces as the primary group to construct socialist labor relations. China's social construction out of its efforts to realize rapid socialist industrialization turned out to be predicated on the very concept of Zhigong in terms of politically recognized its urban unskilled workers. Obviously, Zhigong was the very concept of constructed China's socialist citizenship. As the primary feature of Zhigong labor system was empowered SOE unskilled workers, those urban unskilled workers were the major social forces

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<sup>112</sup> There were potential tensions between skilled and unskilled workers' position in China's political process. Of course, this potential tension usually was not so patent in its political process, but skilled workers' political position was from time to time vulnerable to the political momentum which demanded more egalitarian social system. Indeed, there was some hidden political process in China before the reform which empowered unskilled workers' positions and checked skilled workers' political positions. Political figures representing skill workers' positions were not only in defensive position such as Chen Yun, but also purged as suddenly as Li Lisan and even as tragically as Liu Shaoqi.

<sup>113</sup> ILSS, *Zhongguo Laodong Kexue Yanjiu Baogaoji 2000-2001*, p. 218.

that constructed the central scheme of socialist China's citizenship. Indeed, the bilateral monopoly relations in China involve the political condition in which both the state and SOE Zhigong were bound to the reciprocal commitment to recognize each other as the exclusive partner, while neglecting other social positions. So the embeddedness politics involved with Zhigong labor system derived from their exclusive and protected position made skilled workers remain silent, and even blocked numerous rural peasants from entering urban society.

In this context, it is clear that SOE reform cannot be free from Zhigong labor system reform, which then extends to the politics of how to handle properly the state and Zhigong's special relations. So SOE reform without proper efforts to handle Zhigong labor system cannot make a significant result. And as the following chapters show, this was the main reason why China's series of efforts to reform the SOE system could not make a meaningful breakthrough for decades. This was difficult because reforming the Zhigong labor system naturally extends to dealing with delicate politics that involve the underlying scheme that constitutes the unique socialist citizenship concept based on bilateral monopoly relations between on the state and SOE Zhigong.

### 3. Drifting SOE Reform and the Origin of China's Reform of Gradualism

Since China before the reform tried to organize plan economy system without market prices, it was hard to estimate economic performance of each economic actor. Indeed, the plan economic system distorted the price system, so it did not have any reliable mechanism to reveal individual SOE's real performance. Especially, the 'endogenous' nature of SOE's governance system did not set up any examining and checking system from outside, nor did SOEs did not have any reliable information index which could reflect their genuine economic performance.<sup>1</sup> SOEs were not organized as economic actors but rather as social units; they were not evaluated according to their economic performance. There was no even an idea of bankruptcy. Then, why did China initiate its reform? More precisely, even without a reliable scheme to evaluate SOE performance, what made China decide to alter its existing SOE to the single paragon system?

The problem of SOEs became clear, as they were not good at handling the urban employment issue. China for the goal of rapid industrialization tried to mobilize all available social resources to expand scale of heavy industries vigorously, which, however, for its limited employment elasticity could not create enough jobs for this most populous country. At first, many people expected that urban manufacturing sectors, especially heavy industry with the form of SOE, would provide enough work posts for urban citizens. They believed in SOE system which, as the highest level of production mode, would provide enough work positions in urban area. Yet, as discussed before, the Danwei system's formal employment system with full welfare benefits could creat only limited numbers of work posts. "Between 1952 and 1978, annual increase rate of China's heavy industry was 13.6 percent and that of its light industry was 9.1 percent. Yet, in the same period, annual increase rate of industrial workers (including SOE

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<sup>1</sup> Lin Yifu, Cai Fang, and Li Zhou, *Zhongguo guoyou qiye gaige*, p. 15.

Zhigong, urban COE Zhigong, and rural industry's workers) was only 5.5 percent, which was the number with even large numbers of SOE redundant personnels."<sup>2</sup>

The limited capacity of China's industrial investment scheme could not even provide enough employments for the urban societies, especially for those young urban workforces. "Between 1965 and 1975 the labor force grew from 49-65 million to 81-91 million, with more than 27 million new position created in the state alone. Yet even this massive expansion of state employment could not satisfy the demand of urban secondary school graduates for "good jobs." Children of low ranking cadres scrambled for positions on the factory floor, children of higher level cadres looked to the military for a bright future, and children of ordinary blue color workers and children of the much maligned intelligentsia accepted even temporary work or jobs in the street committee factories..." (Davis: 226). Indeed, China's urban youth unemployment was the most volatile political issue in China before the reform, and Mao handled the issue by rustivating them in the period of the Cultural Revolution.

However, the urban society came to face much more serious employment crisis by the end of 70s. With the Cultural Revolution ceased, the urban employment pressures mounted to an alarming level. First of all, many local governments could no longer relieve urban employment problems by rustivating their young workforce. Furthermore, China had to arrange new work positions for total 17 million returning intellectual youths from countryside. It was extremely tough tasks for China's urban society, because throughout the Cultural Revolution, its most work posts had already been taken by 13 million labor forces from rural areas.<sup>3</sup> Obviously, it was impossible to arrange their work posts in SOEs, and urban area's 'waiting work posts' (*daiye*) rate expanded abruptly. Political leaders could not simply neglect the employment issue of these

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<sup>2</sup> Chen Gang, *Zhongguo laodong fuwu gongsi*, p. 29.

<sup>3</sup> Chen Gang, op. cit., p. 28; Yamamoto, *Gendai Chugoku no Rodo Keizai 1949-2000*, p. 359.

returned youths, since their resentment could be turned into serious social agitation at any time.<sup>4</sup>

Indeed, the leadership seriously worried about the social consequences of urban unemployment.<sup>5</sup>

In this context, the state also allowed the “replacement” (*dingti*) program, which arranged Zhigong’s child to replace their parents’ workposts with their parents’ early retirement. Thus, the program encouraged elder Zhigong’s early retirement to provide more employment opportunities for young workers. Yet, it was an only makeshift program and could not resolve the urban employment issue fundamentally. Indeed, there were critical voices about *dingti* practice; but even many *dingti* critics tempered their tone by admitting the necessity of the mass retirements for solving the immediate crisis of urban unemployment (Davis 1988: 230).<sup>6</sup>

China adopted new policies to expand urban employment. On one hand, it tried to mitigate the exiting SOE centered urban economy system by allowing urban society to expand the commercial, service sectors, and collectives. On the other hand, it also set up more job channels, such as developing the role of labor service companies (LSC) and encouraging individuals and groups to create their own business (White 1987: 370). In the same vein, the state allowed the Danwei to initiate their own business in tertiary sectors to arrange jobs for their Zhigong’s children.<sup>7</sup> Realizing that its scheme of rapid development defied the expectation of

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<sup>4</sup> A lot of young people who had been sent to rural areas thought that they were the victim of the Cultural Revolution and the political leadership after the Cultural Revolution could not overlook their resentments. “Chinese youth who had grown up during the late 1960s and early 1970s resented (particularly in the cities) the personal restrictions imposed by the ‘correct proletarian line’, particularly the lack of educational and job opportunities and the policy of sending urban youth ‘down to the countryside and up to the mountain’ which condemned them to an ignominious life on the farm and made access to scarce opportunities for advancement (particularly college entrance) vastly more difficult” (White 1993: 41). In this context, the leadership thought that they had to arrange work positions for these returned people.

<sup>5</sup> There were occasional explosions of impatient job seekers’ collective actions and in Shanghai even “the army had to be called out in early 1981 to restrain a demonstration of 1000 unemployed youths outside the municipal labor bureau” (White 1987: 372).

<sup>6</sup> China officially prohibited the practice of *dingti* in 1983 but the practice continued, in one guise or another, until China introduced a new contract recruiting system in 1986 (Davis: 230).

<sup>7</sup> Feng Tongqing and Xu Xiaojun, *Zhongguo zhigong zhuangkuang: neibu jiegou ji xianghu guanxi*, p. 150.

engendering enough work posts for urban citizens, China reconsidered its existing employment scheme centered on SOE as single paragon system. “The outcome of compulsory bringing its economy into plan system was the economic imbalance of single ownership structure. Its economic development was slow and unstable, which eventually manifest itself as employment crisis.”<sup>8</sup> China started to review its scheme of SOE as the single paragon system, which tried to transform COE into SOE following its own scheme of development, as it became so clear that SOE single system could not provide enough work posts. “While ownership structure day by day has been converged into single form [of SOE], the state economy’s development has been slow, so its capacity to absorb labor force is getting more and more languid.”<sup>9</sup> In this context, the “upgrading” (*shengji*) and “transition” (*guodu*) of COE into SOE structure had serious problem in making urban work posts in China, since they suffocate various forms of employment routes.<sup>10</sup>

In the same vein, the state reviewed many predicaments of existing ‘unifying labor arranging system’ and initiated its labor system reform. After the 11<sup>th</sup> CCP 3<sup>rd</sup> central plenum, the leadership “corrected its improper understanding of ownership, such as the bigger and the more public are the superior” and it recognized the co-existence of various economic forms, which opened a space for the development of COEs and individual economic units.<sup>11</sup> For the first time, the leadership admitted that COEs, the urban minor sector, could play a critical role, and many urban COEs in the 80s become the important system to absorb the critical part of

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<sup>8</sup> Chen Gang, op. cit., p. 43.

<sup>9</sup> Ibid., p. 29.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid., p. 56.

urban unemployed workforces.<sup>12</sup> Suddenly, the minor position of COEs was spotlighted as a source for its new potential employment advantages.<sup>13</sup> Mainly engaged in light industries and commercial service business, COEs comprised the labor intensive system which could create jobs than SOEs. The increasing urban demands for service and consumption goods also led to the higher expectation of the potential of COEs.<sup>14</sup>

This change gradually modified China's former employment scheme primarily based on SOEs and large COEs. After the national labor employment conference held in Beijing in August of 1980, China decided to allow the so called 'three combined' (*sanjiejie*) employment program with three modes of employment: first, employment arranged by labor department, according to the state's employment plan, for SOEs and large COEs; secondly, voluntary combined employment, which refers to voluntary groups organizing themselves to run various forms of COEs; finally, self arranging employment, which refers to individuals engaging in individual trade and services.<sup>15</sup> This represents that China, to handle its tough employment issue, came to recognize its non-state economic sector for the first time.<sup>16</sup> As illustrated the following table, COEs played more active roles in providing new jobs for urban workers, while SOEs did limitedly.

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<sup>12</sup> Deng Xiaoping "broke away the misconception about collective ownership in terms of "transitional" or "half socialist" economic form and reaffirmed that collective ownership was a part of socialist public ownership. He also broke away the existing conception that collective ownership was inferior system, which needed to be elevated to state ownership... ." Gu Baofu and Xiong Guohe, *Zhongguo chengzhen jiti suoyou zhi jingji lilun yanjiu*, p. 34.

<sup>13</sup> "COEs as economic units take the whole responsibility for the outcome of their management and they are full of momentum for their development. Especially, COEs do not belong to the the state's 'big pot rice' system and their Zhigong do not eat 'big pot rice'." Chen Gang, op. cit., p. 56.

<sup>14</sup> Yamamoto, op. cit., p. 282.

<sup>15</sup> Chen Gang, op. cit., p. 31.

<sup>16</sup> It was based on the proposition that "China should be attentive to how to increase employment capacity of non state economic unit (especially, civilian running COEs and private companies) and change its urban employment scheme primarily depending on the state economic units." Chen Gang, op. cit., p. 129.

Table 3-1. Employment Trend of those Urban Workers in Waiting Jobs (Unit: 10 Thousand)

		Types of Economic Form							
		SOEs		COEs		Individual Labor		Temporary Work	
		Numbers	%	Numbers	%	Numbers	%	Numbers	%
1979	707	76	10.8	422	59.7			209	29.5
1980	651	241	37	279	42.9	40	6.1	91	14
1981	603	175	29	296	49.1	33	5.4	100	16.5
1982	475	99	20.9	240	50.4	26	5.6	110	23.1
1983	415	114	27.6	212	51.2	42	10.1	46	11.1
1984	423	117	27.6	219	51.7	41	9.6	47	11.1
1985	402	129	32	203	50.4	42	10.4	29	7.2
1986	417	156	37.4	188	45.1	30	7.2	43	10.3
1987	414	135	32.7	186	45	37	9	55	13.3
1988	428	136	31.8	187	43.7	40	9.3	65	15.2
Total	4935	1378	27.9	2432	49.3	331	6.7	795	16.1

(Source: Xia Jizhi and Dang Xiaojie, *Zhongguo de jiuye yu shiye*, p. 59)

“For the last 10 years, the ‘three combined’ employment program, which allows the coexistence of multiple ownership with public economy as our primary economic bases, not only has widened the route for collective economy and individual economy to enlarge employment opportunities; but also has provided critical bases for the function of labor service market system to realize its potential to coordinate increasing laborforces.”<sup>17</sup> This statement represents the fact that China could not push its previous developmental scheme depending on SOE single paragon system anymore, because heavy industry-based SOEs failed to create enough employment opportunities. In the urban sector, the previous stress on large-scale, capital-intensive forms of production in state enterprises was replaced by the drive to more labor-intensive collective industry outside the state sector. In short, China decided to modify its employment system: the previous single employment route through SOEs changed to multi-route employment including COEs and ‘individual economic units’.<sup>18</sup>

<sup>17</sup> Xia Jizhi and Dang Xiaojie, *Zhongguo de jiuye yu shiye*, p. 274.

<sup>18</sup> Xia Jizhi and Dang Xiaojie, *op. cit.*, p. 27.

Against the backdrop of intense urban employment pressure, China also tried to reform SOE system. New employment relations related to COE and other minor units did not mean that China give up SOE as the prime system to organize the urban society. Examining the origin of SOE problem, the leadership agreed on the deficiency in management autonomy and limited incentives system, both of which had been neglected under the tight central plan system. Therefore, SOE reform originated from the scheme of “expansion of enterprise autonomy” and “increase in retained profits” to set up incentive structure within SOEs. In the same vein, China reform its financial system to carry out sub-contract financial system by transforming the state unified finance system into multi-level financial system among the center, province, city and county governments. Consequently, the central government could not control its entire revenues as it used to, while local governments’ revenue expanded rapidly. As an extension of experiments of financial sub-contract system, China also initiated SOE sub-contract systems to improve its economic performances through more incentives.

This scheme of reform critically permitted some SOE resources that had not been under state’s direct control. Before the reform the state totally controlled SOEs’ financial resources, which not only supplied all SOE required expenditures but also siphoned off their net revenues. Under this condition, it was really hard to measure a SOE’s real performance. There was no incentive for managers and workers to improve their performance. Most parts of SOE’s productions transferred to the state, and SOE could hold only small part of what they had produced. The system had problems in driving its manager and Zhigong’s enthusiasm out.<sup>19</sup> China’s reform entitled SOEs to control more financial resources: it gradually introduced “profit-

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<sup>19</sup> China’s political leaders reached the consensus that the problem of SOE involved its lacking incentive structure. Lin Yifu, Cai Fang, and Li Zhou, *op. cit.*, p. 4.

retention system” whereby SOEs could hold a certain proportion of its net revenue for their own purpose, be it production investments, wage, or welfare benefits.

The program was first experimented in Sichuan province in 1978 and then became national program. The central government’s capacity to secure its budgetary resources for its macro-economic policies critically declined, as it dispersed more financial resources to SOEs and their supervisory department as ‘extra-budgetary funds.’ This side-effect caused great concern about whether or not the central government could lose its capacity to lead and control many local governments and its society (see Oksenberg and Tong; and Wong). In this context, China devised a ‘tax for profit’ system, which aimed to clarify the relationship between the state and SOEs. The new system allowed to retain after-tax-profits and take had full responsibility for their own financial conditions. The real effect of ‘tax for profit’ reform to emplyfy state finance was marginal<sup>20</sup> without reorganizing SOE’s incentives structure enough to drive out the enthusiasm of its manager and Zhigong.

To enhance SOE’s management autonomy, China between 1987 and 1993 tried to put Contract Responsibility System (hereafter CRS) into practice which featured the contrat between the state and SOEs (usually for a period of three to five years).<sup>21</sup> At first, a SOE signed the contract with its bureaucratic superiors, considering the enterprise’s specific financial conditions, which spelled out clearly “deliveries of profits and taxes as well as other financial targets” (Lardy: 23). Then, the SOE was to hand over the contract amount of its revenues to the state, retaining the rest of its revenues. The form of management system was based on contract clarified right and responsibility relations between the state and SOEs. On one hand, CRS was

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<sup>20</sup> Nitchu Keizai Kyokai, *Chugoku no kigyo kaikaku*, p. 28.

<sup>21</sup> In the early 1980s, Shandong province first in the early 1980 initiated the measure of profit subcontract system, which virtually become national program since 1987. Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 45.

expected to make SOEs financially detached further from the state's revenue system, which would resolve the problem of "big pot rice" system. On the other hand, it was also expected to increase SOE autonomy: because the state and SOE's relation depend on the contract, the state would not intervene arbitrarily SOE's management. In fact, if a SOE could hand over its contracted profits, the state was supposed to allow SOE management autonomy on how to invest and how to use their retaining profits.<sup>22</sup> Most of all, CRS was expected to resolve the SOE's deficient incentive structure problem. Since the contract stipulated how much SOE had to transfer to the state, SOE and its Zhigong could expect more rewards from the increased production. if they could produce more.

Yet, CRS had an issue of institutionalization, as it ultimately depended on individual contracts between the state and each SOE. Each SOE's contract not only differs from that of other SOEs, but also not necessarily reflected the enterprise's financial conditions which could be influenced by its relations with the bureaucratic superiors. Most of all, CRS did not touch SOE's ownership issue, which still rendered ownership and management relationship unclear. Even if CRS divided the SOE funds from state revenue, but the state still remained as the owner of SOEs.<sup>23</sup> Consequently, the system was vulnerable for the administrative intervention which made its management autonomy quite shaky.<sup>24</sup> Many authorized management rights from the

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<sup>22</sup> "Contracts were designed to provide better incentives for improving the financial performance of enterprises by limiting the ability of higher bureaucratic levels to ratchet up, on an annual basis, the requirement to remit profits" (Lardy: 23).

<sup>23</sup> From the corporate governance perspectives, CRS was a compromising system, since it tried to realize the principle of dividing of ownership and management, without touching SOE's ownership issue. Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 5.

<sup>24</sup> "The goal of the reform was realizing 'releasing rights and allowing interest' and CRS based on administrative contract. But in this stage of reform, administrative influence still took a critical position in SOE." Zhao Wei, *Qiyе Zhigong jeceng fenhua de yanbian*, p. 6.

center also frequently was checked and distorted by local or other administrative authorities.<sup>25</sup>

For all its big expectations, many discussions after the practice of CRS program have concluded that the program was not successful in improving SOE's management autonomy and incentive structure significantly.

In this context, China promulgated "company law" in 1988 to clarify "SOE's status of legal person, which, as an independent economic organization, should not only manage by itself, but also take responsibility for its profits and losses."<sup>26</sup> According to "CCP Notice on Carrying Out Enforcing Company Law," of April 28<sup>th</sup> of 1988 "nowadays, unclear division of government and enterprise still remains as a critical obstacle in boosting up enterprise vitality." It continued, "based on the principle of government and enterprise separation, [we should] transform [existing system's] functions; slim down organization and personnel; and overcoming bureaucratism..."<sup>27</sup> Yet it remained unclear if promulgation of company law would solve SOE's limited autonomy and distorted incentive issue. These issues might not be genuine origin of SOE problems, as they could be just symptoms of the real underlying cause. SOE reform cannot avoid the reform of Zhigong labor system that organize the Danwei system with the combination of low wage, full employment, and formal employment exclusive system regardless of workers' skill level. SOE reform did not devised measures to handle Zhigong labor system. So we need to understand the upshot of reform that tried to only enlarge SOE management autonomy without altering Zhigong labor system.

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<sup>25</sup> "Most industrial managers in the mid-1980s owed their jobs to their bureaucratic superiors ... Furthermore, in the partly-reformed economy of the mid-1980s, managers faced serious economic problems which required the support of their superiors. Industrial departments were useful not only in bailing 'their' enterprises out of financial trouble, but also in procuring raw materials and energy supplies and finding outlets for products" (White 1993: 135).

<sup>26</sup> Zhao Wei, op cit., p. 6.

<sup>27</sup> Feng Tongqing, *Gonghui zai chengbao zulin he gufenzhi zhong mianlin de wenti ji qi duice*, p. 52.

Before the reform, the state decided the standard of entire Zhigong wage system, since all SOE Zhigong were supposed to share the state's "big pot rice" system. Moreover, there were no serious wage differences among Zhigong, since SOE's wage equalism represented a critical virtue of socialist system which would foster sense of solidarity among urban working class. Therefore, the reform in 1978, inevitably lessened its egalitarian scheme of Zhigong wage and rehabilitated its incentive and bonus system.<sup>28</sup> With the reform in progress, equal wage system began to be regarded as harmful in providing enough incentives for Zhigong. In order to handle this 'vicious equalism', China widened Zhigong wage inequality in line with SOE's performance.<sup>29</sup> Especially, with the series of reform such as profits retention system, 'tax for profit', and CRS, SOEs were no more under the strict regulation of "big pot rice" system and gradually gaining their autonomy in arranging level of their Zhigong's wage.<sup>30</sup> The reform, altering equalism and enhancing autonomy, entailed Zhigong's wage rapid increase.

Yet, out of worries about the risks of abrupt increase of Zhigong's wage, China tried to set up state's control of SOE's total wage system. At first, China thought the state should not loose its control of Zhigong's wage system, as China, without low wage system, could not provide the more employment chances.<sup>31</sup> As a part of CRS system, China tried to introduce the "linking SOE annual total wage and its performance system."<sup>32</sup> However, China could not successfully curb the momentum of increasing Zhigong wage, and the trend continued to exacerbate in the 90s. Since the state practically decided to discard the center's monopolized

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<sup>28</sup> Yamamoto, *op. cit.*, pp. 264-5.

<sup>29</sup> *Ibid.*, p. 376.

<sup>30</sup> "But early reforms did significantly increase the volume of resources under the control of the enterprise. Decentralization and increased autonomy to the enterprise implied expanded resources for the enterprise" (Naughton 1997: 183).

<sup>31</sup> Xia Jizhi and Dang Xiaojie, *op. cit.*, p. 52.

<sup>32</sup> Nitchu Keizai Kyokai, *op. cit.*, p. 87.

role in arranging social resources for its rapid development, it did not need to execute Zhigong's low wage system any more. Consequently, Zhigong's nominal wage growth rate from 1990 to 1996 was 175 percent, outstripping the 110 percent increase in the general consumer price index in urban areas. Thus, the real wage increased 30 percent. SOEs Zhigong's average standard wage became 6747 *yuan*, which was 1047.7 percent expansion of 1978s'.<sup>33</sup> Obviously, Zhigong labor system's low wage system could not persist as before.

At the same time, the Danwei's welfare outlays for their Zhigong also expanded rapidly after the reform. SOEs' labour insurance and welfare outlays remained the bulk of the aggregate social security expenditures in China, with the sharing rising from 70 percent in 1978 to 80 percent in 1993, which accounted for 1.9 percent and 4.4 percent of GDP, respectively (Hu: 286). The aggregate expenditures on labour insurance and welfare as a ratio of the total wage bill for urban formal sectors were rising over the reform period. In 1978, this ratio was 14 percent. By 1993, however, labour insurance and welfare costs climbed to 34 percent of the total wage bill. This ratio could be considerably higher for SOEs because the levels of labour insurance and welfare benefits are generally higher in the state sector (Hu: 288).

Table 3-2. Zhigong Welfare Outlay and Wages from 1978 to 1993

	Total Outlay of Zhigong Welfare (billion <i>yuan</i> )	Welfare Outlay per single Zhigong ( <i>yuan</i> )	Average Wage per single Zhigong ( <i>yuan</i> )
1978	7.8	82.22	615
1985	33.2	268.33	1138
1990	93.8	667.33	2140
1993	167.0	1124.79	3371

(Source: Hu: 289; Li Yingsheng, *Shehui Baozhang yu Shehui Jiegou Zhuanxing*, p. 78)

<sup>33</sup> Li Yingsheng, *Shehui Baozhang yu Shehui Jiegou Zhuanxing: Eryuan Shehui Baozhang Tixi Yanjiu*, p. 137; Especially, since SOE Zhigong's wages were artificially curbed in low level for long time, its increasing rate higher than the wage of other forms of companies. Throughout the all reform period, SOE workers' wage increasing rate has exceeded non-state sector's wage increasing rate. Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 55.

SOEs spent huge amount of money for their Zhigong welfare: the increase rate of SOE Zhigong's welfare outlay between 1980 and 1994 was 26.4 percent and its total amount in 1994 reached to 164.6 billion *yuan*.<sup>34</sup> The expansion of Zhigong's welfare outlay even outpaced increasing Zhigong's wages in the reform period.<sup>35</sup>

China's political leaders expected that the reform of increased SOE autonomy would improve SOE's performance.<sup>36</sup> However, as the unintended consequence, many SOEs did not invest increasing resources for their future productivities but rapidly upgraded their Zhigong's treatments. "Zhigong's wage and bonus increased vigorously, which was no more based on the former scheme of 'living expenses' (*shenghuofei*). At the same time, social consumptions under the name of labor welfare were also inflated briskly. Between 1978 and 1990, total Zhigong earnings increased 419 percent."<sup>37</sup> Despite the increase SOE autonomy, therefore, SOEs' performance did not improve significantly. "China's many studies have indicated that one primary reason for this disappointing outcome is their total wages' erosion of surplus and their too heavy burdens for labor insurances and welfare. In fact, SOEs' strong inner interest structure and their increasing functions for the social insurance already have become huge impediments for the reform. According to a survey of China's ten large cities' 508 enterprises, SOEs and state controlling stock enterprises' the ratio of social insurance and welfare costs to the total wages reached 57.66 percent and 50.33 percent respectively..."<sup>38</sup>

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<sup>34</sup> Lin Yifu, Cai Fang, and Li Zhou, op cit., p. 94.

<sup>35</sup> Li Yingsheng, op cit., p. 78.

<sup>36</sup> "As reform broadened and deepened, enterprises were allowed to retain progressively larger shares of the surplus they generated. The primary objective was to provide enterprises with incentives to cut costs and improve productivity" (Naughton 1997: 183).

<sup>37</sup> Tang Jun, *Shichang jingji yu shehui baozhang*, p. 31.

<sup>38</sup> Li Peilin and Zhang Yi, "Guoyou qiye shehui chengben fenxi: dui Zhongguo 10 ge da chengshi 508 jia qiye de diaocha," p. 49.

Both Zhigong's wages and welfare benefits expanded, which broke down Zhigong labor systems's internal trade-off between low wages and affluent welfare provisions. Zhigong labor system did not retain its original format. "In China enterprise managers too often are able to ignore the interests of the state in favor of the interests of managers and workers. In particular, they are likely to maximize wages, bonuses, benefits in kind for workers, managerial emoluments, and retained funds, including depreciation and social welfare funds, rather than maximizing profits" (Lardy: 53). Obviously, there was rampant practice of moral hazard in SOE reform process, and the crux of CRS reform was to set up SOE's internal system which could make its management focus on the long term interests such as technological innovation and fixed assets growth.<sup>39</sup> Yet, under the CRS, it turned out that SOEs use only 20 percents of their profit allotment for production; instead they use about 80 percents of its profit allotment for Zhigong's bonus and other welfare outlays.<sup>40</sup> In this context, the leadership worried about SOE's future, since SOEs accumulate only small portions as enterprise funds. At the same time, it did not look rational to expect those SOE reforms could bring about new more jobs for the urban society.

The state, although owning SOEs in principle, could not manage them and assigned their management to the managers. With the division of ownership and management rights, SOEs incorporated the issues of principle and agent derived out of information asymetrics.<sup>41</sup> In this context, a claim emerged that the origion of problem came from information asymetry between the state as SOE's owner and SOE managers. Because of information asymetrics, SOEs could

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<sup>39</sup> Nitchu Keizai Kyokai, op. cit., p. 29.

<sup>40</sup> Ibid., p. 43.

<sup>41</sup> Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 22.

make much favorable contract with the state which could neglect the state's interests.<sup>42</sup> China's reform process resulted in many institutional loopholes for rent seeking, such as dual price system and unclear division of SOE's rights and responsibilities. Under this condition, SOEs, based on its superior information on itself, could make much favorable contract by negotiating with its administrative departments, and came to compete with each other in increasing their Zhigong's bonus, which consequently raised such issues as "wage encroaching profit".<sup>43</sup> "Since SOE system has the structural problems such as unmatching incentives, asymmetrical information, and unbalanced responsibilities system, it, through inflating outlay, tends to increase its share of profit allotment and its share for Zhigong's wage and welfare. Of course, SOE's this practice is harmful for the state interest, since it encroaches the state assets by decreasing the returns of State assets management."<sup>44</sup>

Obviously, this was insider dominated firms that were free from any serious checking mechanism, which frequently emerged in the system transformation process of many post socialist countries with the problems such as "asset stripping, poor investment decisions, decapitalization through excessive wage increases, and increases in other private benefits" (Lardy: 55). Aoki captured the "insider control" issue in terms of information asymmetric between enterprises' owners and the managers.<sup>45</sup> He indicates a unique nature of corporate governance issue in system transformation as "insider control", which refers to "the capture of substantial control rights by the manager or the workers of formerly state-owned enterprise (SOE) in the process of its corporatization" (Aoki: 3). The central theme in the discussion is

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<sup>42</sup> "Since the state could not have enough information about SOEs, contract between the state and SOEs could easily neglect the interests of state but reflect asymmetrically the interests of SOEs and their Zhigong." Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 6.

<sup>43</sup> Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 46.

<sup>44</sup> Ibid., p. 55.

<sup>45</sup> Ibid., p. 8.

how to institutionalize outsider control system in the reform of SOE system for modern enterprise system.<sup>46</sup>

Under the condition of information asymmetry both SOE managers and Zhigong could collaborate to take more pies by deceiving the state, which can explain the structural origin of SOE's moral hazard in the reform process.<sup>47</sup> Nevertheless, it cannot explain why SOE managers with their increased managerial power could not discipline Zhigong's excessive demands. Indeed, SOE managers could get much more with their increased management power if they had limited Zhigong's wage and welfare benefits. The principle-agent issue in SOE reform can explain only some parts of SOE's moral hazard practices of expanding welfare outlay. While the principal-agent issue focuses on the relation between the enterprise owner and its manager, expanding welfare involves the issue between the managers and their Zhigong in terms of how their positions could get lined up. Hence, the crux of the issue in SOE reform process is how increased managers' power could not contain the insider control issue but rather came to get along with it. It is essential to understand the underlying reason that made the managers follow their Zhigong's position in SOE reform process.

The discussion of information asymmetry has been constructed with the issue of corporate governance system, as modern big enterprises' numerous shareholders face the monitoring issue of whether their managers really run the business to maximize the owners' interests. SOE system, however, was organized with unique contents of corporate governance system, Zhigong labor system. Zhigong labor system in SOE was not just way to organize its

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<sup>46</sup> There are two reasons why outsider control is critical: on the one hand, it can radically expand enterprise scale by offering much broader finance opportunities to enterprises; on the other hand, it puts quite rigorous market surveillance system on enterprise's performance, so it will resolve the issue of soft budget constraints.

<sup>47</sup> In this context, Lin, Cai, and Li argue that the main beneficiaries of SOE reform were its manager and Zhigong. Lin Yifu, Cai Fang, and Li Zhou, *op. cit.*, p. 46.

labor relations but also a scheme to decide its primary stakeholders.<sup>48</sup> In other words, Zhigong were not just SOE employees but the ‘master’ of the Danwei system. Hence, the internal meaning of CRS reform to improve SOE performance was constituted mainly around the issue of its impact on Zhigong position within the Danwei. Zhigong could not be free from worried about their possible deteriorating social position following the CRS reform, as it could not but affect the existing Danwei system that was supposed to secure their very positions as the ‘master’.<sup>49</sup> Indeed, some Zhigong under CRS program began to feel that their relations with their workplace was no more based on the Danwei’s system’s “labor relations,” but rather on de facto “hiring relations” (*guyong guanxi*).<sup>50</sup>

While SOE Zhigong felt insecurity in SOE reform, there were not many SOE managers who could carry out the reform against Zhigong oppositions. Obviously, SOE system was embedded in Zhigong labor relations, which was to secure the very position of Zhigong as SOE’s primary stakeholders, so SOE managers were very sensitive about Zhigong’s opinion about them. Of course, “SOE managers are the beneficiaries of SOE reform, such as, increased management autonomy or CRS, but their increased interests cannot be guaranteed, if they cannot fashion ‘interest community’ with Zhigong.” Plus, “only with Zhigong’s cooperation, SOE managers can achieve the contract’s production goal and share the following earnings. Hence,

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<sup>48</sup> “Corporate governance is a set of institutional arrangements governing the relationship among several groups of stakeholder (investors, both shareholder and creditors; managers; and workers) in order to realize economic gains from such coalition” (Qian: 235).

<sup>49</sup> “In order to enhance efficiency, enterprises under CRS should not only improve their ways of management but also reform Zhigong’s labor insurance and welfare treatments successfully. In practice, however, not small numbers of managers not only neglect improving their ways of management; but also devise various forms of countermoves for Zhigong’s labor insurance and welfare treatments, which critically infringe Zhigong’s proper rights and interests.” Feng Tongqing, op. cit., p. 29.

<sup>50</sup> In the SOEs which executed CRS, “the relations of managers and workers by no means change into “hiring relations” (*guyong guanxi*). Yet not small numbers of managers assume themselves as ‘hirers’ (*guzhu*) and not small numbers of workers assume themselves as ‘hired laborers’ (*gugong*).” Feng Tongqing, op. cit., p. 6.

distribution relation within SOE following increased management autonomy tends to become favorable for Zhigong.”<sup>51</sup> All these conditions of the Danwei system made SOE managers very sensitive about Zhigong’s wages and welfare, which fashioned their accommodating attitudes toward their Zhigong.<sup>52</sup> At the same time, the state and SOE Zhigong’s bilateral monopoly relations fashioned social frame whereby SOE managers could not treat Zhigong as simple employees. Zhigong remain as the permanent workers within the Danwei, which under the condition without labor market made them exclusive labor suppliers, so SOE managers to garner their compliance could not but appease the demands for higher wages and more welfares in terms of welfarism.<sup>53</sup> Consequently, both SOE managers and Zhigong cooperated for their mutual interests rather than conflict.

SOEs and COEs, unlike private enterprises, tried to maximize income per employee rather than firms’ profits (Meng and Perkins 1996). China’s own survey also identified the same fact that SOEs and COEs focus more on how to increase Zhigong’s incomes rather than profits or market shares.<sup>54</sup> Obviously, the Danwei practice to maximize Zhigong’s whole earning does not fit well with Walder’s depiction of the Danwei system in terms of Chinese workers’ unilateral dependency on their beneficial workplace paternalism. Instead, the Danwei system in the reform era turned out to be welfare community for Zhigong who held the position not of

<sup>51</sup> Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 51.

<sup>52</sup> “There was a high degree of congruence of interests between managers and workers ...” (Taylor, et al: 80).

<sup>53</sup> “Yet the “organized dependence” of workers on the firm was matched by the management’s own dependence on workers due to the fact that workers enjoyed permanent job security” (Gallagher: 68).

<sup>54</sup> The Management Goal of Enterprise Managers (%)

	SOE	Urban COE	TVE	Foreign Invested	Joint Venture	Private Enterprise	Joint Stock Enterprise
Enhance Zhigong’s Income	73.6	73.1	58.5	47	57.3	53.3	58.4
Increasing Market Share	19.8	26.1	24.8	23.6	29.7	39.9	26.3
Maximizing Profits	59.8	60.1	55.8	70.6	67.1	53.4	71.5

(Source: *Guanli shijie*, 1997, Issue 4, p. 126.)

simple employees but of the ‘master’ of their workplace. The relation between the Danwei and Zhigong thus was organized in terms of welfare community of Zhigong as the primary stakeholders.

Even many SOEs in the red attempted to bargain with the supervising ministries and tax authorities for budgetary subsidies or tax exemptions on the grounds that they were unable to meet their labour insurance and welfare obligations. The Chinese leaders seemed to be politically unacceptable if SOEs could not arrange proper living for their personnel or could not grant their retirees’ pension. Thus, the government arranged a series of subsidies for loss-making SOEs to cover their welfare outlays. In 1989, such subsidies already reached to 60 billion *yuan*, accounting for 20 percent of total government expenditure (Hu: 293). Then, why the government provide substantial subsidies to its loss-making SOEs instead of pushing them to slim down welfare expenditures, while it tried to reform SOEs to be efficient market actors? Asymmetric information did not suffice to explain was not the Danwei’s welfarism in the reform era, but it had more to do with Zhigong’s unique social position within their Danwei, so that the system itself could not overlook Zhigong’s troubles in attaining their supposed living and welfare. Under this condition, SOE managers could not overlook Zhigong’s very interests within the Danwei.<sup>55</sup>

As the origin of SOE’s excessive welfarism was its insider control issue, how to handle the issue was the crux of SOE reform process. The issue was rooted in the scheme of the Danwei embeddedness in the system’s commitment to arrange SOE Zhigong’s living and welfare to maintain their low wage system for the construction of socialist industry system.

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<sup>55</sup> Indeed, “the authority of managers rests on their ability to please both the government and the firm’s employees. Although managers’ control right may be strong, they are not backed by any ownership rights and this creates a sense of insecurity” (Garnaut, et al. 2005: 34).

Indeed, with the scheme of bilateral monopoly, the system entitled SOE Zhigong to the Danwei's comprehensive welfare benefits. Most SOE managers were appointed from above, so they were supposed to follow the Danwei system's commitment to arrange Zhigong's welfare. A country's corporate governance system is a constructed social institution out of the political process to configure the contents of the relations among those who engage in its corporate system. Hence, the emerging welfarism out of SOE reform process also had to do with the very contents of bilateral monopoly that virtually confirms Zhigong's 'master' position within the Danwei system. SOE reform did not extend to reshuffle its social bases of SOE corporate governance system beyond Zhigong labor system. CRS measure did not allow SOE managers to hold power to reorganize the labor relations, while they tried to maximize the Zhigong's position, which ended up with the welfarism. In sum, the institutional origin of insider control issue in SOE reform was not asymmetric information between principal and agent but underlying power relations of the Danwei system embedded in Zhigong labor system.<sup>56</sup>

SOEs in the reform era could not maintain its low wage system, which had constituted a critical part of Zhigong labor system. Enhanced management autonomy led to welfarism for SOE Zhigong, which broke down the combination of Zhigong labor system's low wage and high welfare provisions. Hence, there emerged voices which indicated many problems accompanied with the change of Zhigong labor system. Zhigong labor system shared those defects of state socialist economies, overemployment and low labor morale, and "this deficiency means that the Chinese workers mainly identify their enterprise as "a social 'unit' and much less (compared to

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<sup>56</sup> Even privatization process in many transition countries frequently faces deeply rooted insider control issue, as the process did not necessarily fashion the corporate governance system that would align with the broader shareholders' positions beyond the insiders. "Privatization of SOEs is ex ante constrained by the legacy of socialism, and in most it is cases ex post constrained by the weakness of the privatization agency in relation to the inside interest groups" (Aoki: 12).

Japanese or South Korean labour relations) as a productive ‘unit’” (Korzec: 26). Especially, as the situation of underemployed Zhigong within the Danwei go worse under competitive market condition, Zhigong’s work discipline was deteriorating.<sup>57</sup> Since formal Zhigong’s labor eagerness was not high, many SOEs could not help hiring many informal laborforces from outside such as temporary workers, subcontract workers, and retired Zhigong.<sup>58</sup> The report continued that formal Zhigong, as aristocratic cohort, did not take hard works, so SOEs increased laborforces from outside, whose increasing rate was 9 percent and whose scale already reached to 3 percent of total Zhigong number.<sup>59</sup>

SOE Zhigong as the permanent workers held their job tenure in their Danwei. As late as 1983, 96.8 percent of the state workers were permanent workers (White 1987: 366). SOE’s poor performance had to do with its extremely “rigid” lifetime employment system. “Under permanent employ system, workers are free from unemployment risks and any other forms of pressure. Lacking any systemic stimulation, the permanent employ system fosters Zhigong’s inertia.”<sup>60</sup> The issue came to be articulated as ‘iron rice bowl.’<sup>61</sup> “In order to pursue maximum job security program with the static full employment system, China did not hesitate to sacrifice SOE’s economic efficiency. This is because all covering employment scheme based on the “iron rice bowl” system excludes employment and work post competition, which allows SOE workers

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<sup>57</sup> “There were shocking reports of workers playing cards and sleeping on the job because they had nothing to do” (White 1993: 140).

<sup>58</sup> A survey about 200 Shanghai SOEs and their 1000 Zhigong, by the Economic Development Institute of Huadong Chemical Industry Academy.

<sup>59</sup> Nitchu Keizai Kyokai, op cit., p. 58.

<sup>60</sup> Wang Daben, “Chengshi jiuye: Xiagang he zai jiuye,” p. 95.

<sup>61</sup> Indeed “iron rice bowls” represented SOE’s three kinds of iron labor system. “The so-called “three irons”: (i) ‘iron rice bowls’ (guaranteed job assignment, pay, housing, pensions, medical care, and a host of other benefits; (ii) ‘iron chairs’ (permanent job positions in permanent state enterprises); and (iii) ‘iron wages’ (uniformly distributed, fixed wage payments that are unconnected to job performance and productivity). Although this system was effective in social protection in the pre-reform era, its rigidities and limitations have become important barriers to enterprises restructuring” (Hu: 291).

to enjoy SOE system's current wealth, but, at the same time, has entailed low skill level, resources wasting, rapid expansion of total wage, redundant personnel, and declining work efficiency."<sup>62</sup> Then, for the first time China came to admit the possibility that (under the condition of "iron rice bowl" system) Zhigong and the state's interest could be conflict.

"A single term that will capture the former interest relations among the state, SOEs, and workers is "two big pot rice systems," which refers to the condition that Zhigong eat SOE's "big pot rice" and SOE eat the state's "big pot rice." Regarding this term, people have the habit of interpreting it intuitively as Zhigong infringe on SOE's interests and SOEs infringe the state's interests."<sup>63</sup>

The tough condition of urban employment fashioned the social discourse of blaming of "iron-rice bowl," and the reformers saw the contract labor system as the potent way of tackling its serious urban employment issue (White 1987: 371). In this context, the State Council in 1986 issued four sets of temporary regulations concerning the labor contract system: employment procedures, labor insurance, and labor discipline, and the right to lay off employees. With these regulations the labor contract system became the official policy to be applied nationwide to the hiring of all new employees included in state labor and wages plans (Howard: 99). Since enterprise could lay off its workers with the expiration of labor contract, the labor contract system was the first critical program to reform SOE's "iron rice bowl," the Zhigong's permanent employment system.<sup>64</sup> The leadership expected contract labour as a general solution to the problem of SOEs' overstaffing Zhigong. Alongside this experiment of labor contract system evolved media campaign against the "iron-rice bowl." The introduction of labor contract system is one of the most critical reform in SOE labor relations. The new employment system would

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<sup>62</sup> Feng Tongqing and Xu Xiaojun, op. cit., p. 131.

<sup>63</sup> Feng Tongqing, op. cit., p. 16.

<sup>64</sup> Cai Fang and Lin Yifu, *Zhongguo Jingji*, p. 61.

demolish the existing permanent employment system, as enterprises, when the contract expires, would review the workers performance and decide to extend contract or not.

Though the problem of permanent worker system broadly perceived, the introduction of labor contract system was politically very sensitive, because it represented the end of Zhigong's permanent worker position and their virtually guaranteed lifetime livings such as their job tenure and pension benefits after their retirement. Indeed, labor contract system did not guarantee such rights and benefits by articulating work period, positions, and treatments. Their welfare benefits such as pension – pension, medical care – were to be lower than those of permanent workers, and they even had to pay a certain amount of their premium for those benefits.”<sup>65</sup> Most of the SOE Zhigong regarded this change as the direct threat to their social position, the shift from the ‘masters’ of their workplace to simple hired labourer.<sup>66</sup> “... the position of contract workers in their workshop are full of character of commodity exchange; indeed, the labor contract between they and their workshops is an agreement of commodity exchange.”<sup>67</sup> This new social position of contract workers made urban Zhigong worry about their future social position very seriously. Zhigong's excessive job security was harmful for both SOE's performance and economic efficiency, but “it no doubt represented Zhigong's social status.”<sup>68</sup>

SOE was organized as de-skilled production system without incentives system to encourage its workers to attain more labor skills. The majorities of SOE Zhigong were consisted of unskilled workers. Accordingly, China's urban society in the reform era faced serious labor imbalance, the shortage of skilled labor and the surplus of unskilled labor (Howard: 102). Under

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<sup>65</sup> Feng Tongqing and Xu Xiaojun, op. cit., p. 168.

<sup>66</sup> “...adoption of the labour contract system to counter the ‘iron rice-bowl’ would intensify an already significant shift of power within the enterprises in favour of managers, with the consequence that workers would become ‘hired labourers’ rather than ‘masters’ of the enterprise” (White 1993: 139).

<sup>67</sup> Feng Tongqing and Xu Xiaojun, op. cit., p. 138.

<sup>68</sup> Ibid., p. 131.

this condition, China's reform of labor contract system could cause really serious social tensions. Those surplus urban unskilled Zhigong, losing former systematic guarantee of job tenure and social status, had to enter labor market; then, they would be treated only as unskilled workers in labor market. In addition, the labor contract system did not clarify the relations between the new urban contract workers and existing contract workers (*hetong gong*) mainly from rural areas as temporary bases. Many urban Zhigong worried about that labor contract system would condition them in an inevitably competing situation with those minor migrant workers. They would hardly accept the change of their status because contract workers previously had been part of those temporary workers from rural areas, who they had despised.

Unskilled urban Zhigong would be the main losers with the abolishment of the 'iron rice bowl' system.<sup>69</sup> Labor contract system impaired the existing social relations constructed in the Danwei, an egalitarian de-skilled production system. The problem is that these losers constituted the majority of Zhigong in the urban society: they were not just majority of the urban society, but also the social cohort who constituted the central scheme of its citizenship in the CCP political system. Thus, the leadership was always politically very sensitive to Zhigong, and, in other words, those unskilled SOE workers' collective responses to new labor contract system. In reality, Zhigong tried to resist by mobilizing socialist ideology, justifying the permanent workers system.<sup>70</sup> Consequently, the labor contract system was unpopular in the urban society, and its

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<sup>69</sup> Since China's urban society faced serious shortage of skilled labor, their market demand were quite high. Accordingly, it was quite certain that they would be better off with the abolishing the 'iron rice bowl' system (Howard: 102).

<sup>70</sup> "The issue of unemployment has been seized upon by opponents of thoroughgoing labour reform who have argued that full employment and job security are fundamental characteristics of 'socialism' and must be maintained. ... job security was part of the 'superiority of socialism', and attempts to undermine it would be lead to a system of capitalist wage-labour" (White 1993: 139).

implementation was lingering in many areas for a long time.<sup>71</sup> Neither did it have solid social bases in its urban society, nor urban group supported it. New contract workers also did not support the change, because they could not understand why they could not have job tenure, early recruited Zhigong's privilege of 'iron rice-bowl.' Concerned about the trouble caused by that change, many managers did not implement the new contract system enthusiastically. They were quite reluctant to incur the resentments of laid-off workers (White 1993: 141).

Broad social hostility toward the new labor contract system has to do with the perception that it was virtually same as those disadvantaged position of existing temporary workers from rural areas, so there emerged numerous articles which have sought to reassure that "contract workers of the new type are not temporary workers but are 'hired for permanent position' and are 'regular, official employees' (*zhengshi gong*) just like workers employed under the old system" (Howard: 102). The leadership decided to initiate its labor contract system by applying it only to newly recruited young workers. However, there still remained broad Zhigong's worries that they would be eventually covered by the labor contract system. Political leaders repeatedly emphasized the catch phrase "new system for new men and old system for old men"<sup>72</sup> and they did not implement labor contract system beyond newly recruited workers. Consequently, only newly recruited workers, usually made five-year contracts, were able to be laid off when their contracts expire. Even for the newly recruited workers, in practice, China did not try to enforce labor contract system in a very strict sense.<sup>73</sup> Contract labor system came to apply for only those

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<sup>71</sup> "Policy-makers seem to have been caught in a "catch 22" situation: if they invested the policy with full and forceful authority and tried to hurry it along, they ran the risk of disruption, or defiance; if they tried incremental "salami tactics" they gave scope for local government and enterprises to avoid (on the grounds of "special conditions"), downplay or subvert the policy should they so wish" (White 1987: 377).

<sup>72</sup> Nitchu Keizai Kyokai, op. cit., p. 90.

<sup>73</sup> JIL, *Chūgoku kokuyū kigyō kaikaku no yukue: rōdō shakai hoshō shisutemu no hen yō to kigyō soshiki*, p. 160.

newly employed young workers, and the Danwei's existing Zhigong could hold their permanent worker position. In effect, even with broadly shared consensus about labor reform for SOE reform, Zhigong labor system remained untouched.

Enlarged management autonomy for SOE reform did not include manager's power to reform Zhigong labor system. The Danwei's highly organized welfare system was to maintain Zhigong's low wage system to mobilize more social resources for rapid socialist industrialization. Yet the low wage system was not maintained after the reform, which, however, was not accompanied with the measure to contain welfare provisions. Instead, the Danwei's welfare provisions also expanded rapidly, which means that the previous Zhigong's labor system's trade off between low wage and high welfare broke up. Zhigong came to be in even more favorable condition than before. The reform to introduce labor contract system also circumvented the existing Danwei Zhigong. Untouched within the Danwei, Zhigong labor system along with enlarged management autonomy ended up with the Danwei welfarism centered on Zhigong's welfare community. In short, it did not contain but rather enhance the Danwei's insider control issue.

Since the main focus of China's reform since 1978 was SOE reform, many expected that the reform gradually reduced and then transformed the Danwei's comprehensive social functions. However, this scheme of reform did not reduce the Danwei's social functions; instead, "the initial effects of reform often strengthened the danwei system" (Naughton 1997: 183). In fact, as SOE increasing upgraded its Zhigong's living standard, the Danwei system after the reform engaged in more dynamic social functions connected with more broad practices of the Danwei-based "welfarism".

“The legacy of plan economy system survived a series of SOE reform in the 80s; and Zhigong’s personal affiliation to his Danwei was untouched; the band binding these relations transformed from pure “political allegiance” (*zhengzhi xiaozhong*) to “welfarism” (*fulizhuyi*). In this context, the Danwei tried to set up every required system not only from restaurant, nursery, infirmary, and club to canteen and school for children, but also housing, transportation, water, electricity, and gas system. Consequently, “welfarism” made the Danwei system a “small society”.<sup>74</sup>

Unlike its initial expectation, SOE’s increasing autonomy strengthened the existing Danwei system, increasingly empowering the practices of the Danwei-based autarky welfarism in urban society.

The main problem in SOE reform involved not only its limited management autonomy but also the Danwei’s unique scheme of embeddedness, the untouchable Zhigong labor system. Here the issue was how to handle the embeddedness in terms of the system’s commitment to arrange living and welfare for Zhigong. The reform involved the realignment of the relations among Zhigong, SOE managers, and the state in terms of reorganizing existing Zhigong labor system. The puzzle of SOE reform was why the state and SOE managers could not contain Zhigong’s excessive welfarism, which even defied the very efforts to improve the Danwei’s performance. As discussed above, untouchable Zhigong labor system, made the efforts to enhance SOE management autonomy unable to handle the Danwei’s insider control issue. Hence, SOEs used frequently their increased retained resources for their Zhigong’s treatment rather than investment to improve productivity. This was the main reason why many SOEs’ performance did not improve even under the enlarged management autonomy. It is not reasonable to expect that SOE reform could improve its efficiency to offer much more employment opportunities for the urban society. Indeed, the urban society faced really serious

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<sup>74</sup> Tang Jun, “Zhongguo de renkou yu shequ,” p. 19.

shortage of employment chances, as Zhigong labor system allowed the *inner system*'s formal employment exclusively.

Historically China's reform process reflects the change of its scheme of development. It involved the political process of discarding its former linear and teleological scheme of development based on the belief of public ownership organized with equal and deskilled labor system. After three decades of its institutional obstinacy, China could not but admit that its original scheme of development had an undeniable problem, its limited capacity to provide employment opportunities. In this context, China tolerated new economic actors which could organize a production system and create new employment chances without depending on the state financial system. The leadership could accept new economic units after the reform as long as they could offer new jobs. As Hukou system strictly prohibited rural population from entering the urban society, the rural areas contained a huge number of underemployed populations. Ironically, the situation became even exacerbated with successful reform in rural areas, which entailed more numbers of underemployed rural population. The rural areas, as the case of SOEs, had huge numbers of underemployed peasants who needed to leave the agricultural sectors eventually. The state embraced a new production system that could offer jobs for rural areas' underemployed peasants. In particular, new Township and Village Enterprises (hereafter TVEs) emerged in rural areas. TVEs were organized independently beyond the state budgets, and called the *outer system (tizhiwai)* units, in contrast to the *inner system (tizhinei)* Danwei which belonged to the state financial system.

China's reform at first initiated in its rural areas by substituting its former People's Commune system with Household Responsibility System (hereafter HRS). In 1984, the state decided to change the existing People's Commune system and allowed peasant and lower level

collective organizations to have more production autonomy. The state in 1985 abolished its 30 year-old unified farming byproducts control system and introduced new state's planned contract purchasing policy.<sup>75</sup> All these measures increased peasants' autonomy in production followed by the rapid increase of its rural productivity and a new ground for manufacturing system beyond agricultural production.<sup>76</sup> In this context, there emerged lots of new dynamic TVEs, which engaged in industrial production in rural China. Obviously, TVEs became a critical source of China's economic momentum in the reform era, as they were from the start market-responsive production system. TVEs institutional uniqueness could attain this unique nature, as they belong to China's rural areas which under Hukou system were systemically separated from the urban society. While the urban society was organized with the scheme of the *inner system* as the state's direct system, the rural areas were supposed to arrange their living by themselves as the *outer system*. The *outer system* of the rural area aloof from the state contributed to organizing market-oriented production system independent of the state plan system.

Many TVEs started their business with their local communities' available resources, and their major investors were in practice many local governments. The condition of TVEs depending on local-level independent financial system induced them to engage in primarily market oriented production. To survive as an independent financial system, TVEs needed to be

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<sup>75</sup> Li Yingsheng, op. cit., p. 82.

<sup>76</sup> In rural China, there were also small scale collective owned industrial enterprises operated by communes and brigades, which with its some 20 million labor forces produced roughly 10 percent of the nation's GVIO in 1980. Obviously, this small scale rural collective industrial system turned into vigorous TVE system afterwards. Many employers in the production system were not fully engaged in manufacturing production; instead they were half peasant and half workers. But some of them did reside in small town and engaged in manufacturing production exclusively. In either case, however, they were not treated as formal workers: they still had rural Hukou and did not receive urban grain rations, let alone welfare benefits (Walder: 56). Obviously, they were not workers socially, even though they engaged in industrial production. Indeed, their life was not decided by works which they were doing; but by their Hukou types. Obviously, Hukou did not just represent where a Chinese live; rather it decided the basic condition of how they could live.

sensitive to their economic performance, which made them responsive to market demands.

TVEs had more from for management autonomy than the *inner system*, since they could be free from the *inner system*'s various administrative interventions from higher authority. Embedded in local communities, many TVEs were substantially influence by local governments. In many cases, their de facto owners were local governments. This very condition enabled them to be free from the center's direct interventions and enjoy much more autonomy in their management.

Contrary to the *inner system*'s dense labor regulations in terms of state arranging social embeddedness, rural areas was left as the niches. Indeed, the Hukou system divided the society into two separate dual systems, urban society and rural area. The division provided TVEs with a critical institutional advantage: TVEs could be free from the *inner system*. As a result, the institutional protection of the *inner system* did not cover TVE's labor relations, which allowed them to organize its labor relations according to the dynamic of supply-demand in market.<sup>77</sup>

TVEs organized themselves as market-oriented production system which was predicated on their own funds, management autonomy, and socially unregulated labor system.

In sum, TVEs developed out of niches of China's dual social systems. The distinctive character of China's rural areas formulated TVEs' market-oriented production units. They could enjoy political negligence, granted a new social space in which its rural areas could organize new industrial production system intertwined with flexible labor relations. At first, China's political leaders did not take this new production mode as any serious new socio-political system, since TVE remained in rural areas and did not affect Zhigong's urban life directly. In fact, the state did not intervene in TVEs' management, as far as they remained in rural areas, with the scheme of "leaving soil but not leaving hometown, entering factory but not entering cities." Importantly,

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<sup>77</sup> Chang Kai, *Laodong guanxi laodongzhe laoquan*, p. 128.

the origin of TVE as market-oriented production system comes from China's strict dual system, which left its rural areas a free space from the *inner system's* dense embeddedness.<sup>78</sup> Outside the dense social embeddedness arranged by the state grew the new production system of TVEs.

TVEs could performance than the *inner system* Danwei. "Even though TVEs did not use a penny of the state's funds, they, only in eight years, accomplished total production value of 100 billion *yuan*."<sup>79</sup> By the end of 1995, the total number of TVEs reached to 22 million and their total production reached to 1.4 trillion *yuan*, which claimed 56 percent of total rural productions. Furthermore, total number of TVE employers in 1978 was 28.2 million and it increased to 128 million in 1995, which claimed total 28 percent of rural labor forces.<sup>80</sup> This rapid development of TVEs constituted a new stream of China's industrialization in its rural areas. From the early 80s, China's grand rural areas with their TVEs stepped into industrialization, speeded up entire China's rapid industrialization. Totally 20 million TVEs now spread out to China's broad rural areas, not only to create vast amounts of social wealth but also to transform rural areas' surplus labor forces into non-agricultural sectors. Between 1979 and 1994, the annual growth rate of TVEs' productivities reached to 32 percent, and their production ratio of total industrial production expanded from 9.1 percent to 42 percent.<sup>81</sup> The political leaders gradually acknowledged TVEs' social position and regarded them as China's critical part of its economic system.

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<sup>78</sup> "The lesson from the great famine in the early 60s was really grave. Therefore, even when China produced great agricultural products in 1984 and it was for the first time hard to sell the grains, the government did not change its Hukou system, which had strictly restricted its agricultural population to become non-agricultural population. China's agricultural production system could not absorb its numerous labor forces in its rural areas and the government did not allow them to enter urban areas. Under this condition, the peasants to make their fortune unavoidably establish and run TVEs locally and voluntarily try to transform their living base into industrial or service sector" (Liu Kaiming: introduction).

<sup>79</sup> Chang Kai, op. cit., p. 127.

<sup>80</sup> *Naodong neican*, 1996 Issue 10, p. 7.

<sup>81</sup> Zheng Gongcheng, *Lun Zhongguo tese de shehui baozhang daolu*, p. 176.

This acknowledgment of TVEs had another critical implication in China: it means that the leadership virtually tolerated the practice of TVEs' own labor relations different from the *inner system* Danwei's Zhigong labor system. Therefore, the tolerance represented China's political decision to acknowledge new labor organizing practices. This meant that China recognized de facto labor market where labor supply and demand functioned without the restrictions of dense labor regulations of the *inner system*. Since China's de facto labor market developed out of its *outer system*, the major social groups who constituted the de facto labor market were its people of the *outer system*, the peasants. TVEs were COEs in rural areas, and they were not covered by social security system, as the rural areas were not supposed to be organized to arrange social security programs for their peasants.<sup>82</sup> The rural peasants, unlike the urban workers, were not regarded as a group who need social security protections.

In this context, there emerged a debate about the social position of TVE workers, who were not supposed to work in industrial sector within the dual social systems. TVE workers raised a socially sensitive question of "whether TVE workers belong to workers or peasants."<sup>83</sup> With the scheme of "entering factory but not entering city, and leaving soil but not leaving hometown," China from the start places TVE workers beyond the social boundary of the *inner system*. This means that China's institutionalized social division of rural and urban system still framed China's reform process and socially demarcated the social status of TVE workers as peasant instead of worker. A plausible reason adds that they "still do not really detach their relations with their soil, and, consequently, selling their labor is not their single available measure to make their living..."<sup>84</sup> Interestingly, the dual social systems survived the reform

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<sup>82</sup> Interview, 2005 July 1st.

<sup>83</sup> Chang Kai, op. cit., p. 138.

<sup>84</sup> Ibid., p. 146.

process and those new rural workers of the *outer system* were recognized as “socially” as peasant workers.

Because of the serious underemployment in rural areas, China’s peasant had strong propensities to move out of their original rural areas. A survey in 1986 indicated that 37.2 percent of peasants who not engaged in their rural area’s agricultural production. Of these new peasants, 61.6 percent engaged in non-agricultural sectors in their original area, but the rest of them (38.4 percent) moved out for their new jobs. The survey clearly showed that the mobility of the peasant was quite high from the early period and China’s Rural Development Institute declared that China’s rural labor already went beyond the scheme of “leaving soil but not leaving hometown.”<sup>85</sup> So it did not take very long before the peasant workers came to enter urban society. The the scheme of “entering factory but not entering city” finally turned out to be unsustainable.

Hukou system under the dual social system previously prevented peasants from moving into urban society and becoming industrial workers. A serious tension rose between the dual social systems and the increasing numbers of rural population who enter the urban society. The dual systems compromised by binding rural population to the *outer system* and systemically excluding them from social benefits granted by the dense labor programs of the *inner system*. Hence, the urban society came to be free from the obligation to rearrange social benefits for them. Indeed, the peasant workers were allowed to enter the urban society under the condition of staying out of the formal labor relations of the *inner system*. Those new peasant workers in the urban society constituted a new emerging labor market, still remaining socially minor compared to urban Zhigong. The incorporated a unique social character into China’s dual social systems.

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<sup>85</sup> Yamamoto, op. cit., pp. 349-50.

The emerging new de facto labor market has really critical meaning in China's reform processes, as it allowed China to formulate new pure economic units, such as private or foreign invested enterprises.<sup>86</sup> In fact, China's increasing ratio of labor from de facto labor market mean its growing ratio of market-based new production system. These new economic units based on de facto labor market could organize efficiency oriented pure economic systems, that were free from the social burdens to arrange their workers' employment, job tenure, or comprehensive welfare benefits. That shift signaled a new economic momentum in China. In particular, the potential scale of China's de facto labor market would become almost unlimited, considering the great number of underemployed peasant, so China was conditioned with steadfast social foundations for the development of its new vigorous efficient production systems. Unlike other former socialist countries, China, instead of privatizing its existing SOEs, allowed new independent social space for de facto labor market in which new market oriented production systems could emerge. In this vein, the political tolerance of de facto labor market was one of the most critical decisions in the China's reform processes.

Workers of different types of enterprises were treated in quite different ways.<sup>87</sup> In terms of incomes, TVEs were ranked first, followed by Foreign Invested Enterprises (hereafter FIEs), SOEs, and urban COEs. In employment security and benefits, however, SOEs came first and then urban COEs, followed by TVEs and FIEs.<sup>88</sup> The *inner system* enterprises, such as SOEs and COEs, with their public ownership nature tried to guarantee their Zhigong's positions to a

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<sup>86</sup> According to surveys of migrant workers in the mid-90s, two-thirds of them went into private sector and only less than 15 percent obtained their jobs in SOEs (*Sharing Rising Incomes*: 28).

<sup>87</sup> Unger and Chan observed the bifurcation of industrial system the *inner system* in China based on SOEs and large COEs on the one side, and the *outer system* with private units, foreign invested firms, and TVEs, on the other side, which divided Chinese industrial workers into two completely different relations in terms of work conditions, benefits, and job security (Unger and Chan: 119).

<sup>88</sup> Feng Tongqing and Xu Xiaojun, op. cit., p. 36.

considerable level. Their employment security was better than that of the *outer system* counterparts; their wages and bonus, regardless of their performance, did not change in any situations. By contrast, the *outer system* units, TVEs and FIEs, tried to improve their employees' position with the measure of improving their economic performance.<sup>89</sup> With the different ways to organize the internal labor relations, the performance of the *inner system* and the *outer system* enterprises turned out to be very different. Between 1980 and 1993, while SOE's GVIO (Gross Value of Industrial Output) increasing rate was only 8 percent, private and FIEs' GVIO increasing rates reached to 48 percent.<sup>90</sup> Obviously, the *outer system* units could outperform the *inner system* enterprises.

As non-state economy developed vehemently, its higher demand of laborforce absorbed a large amount of new urban workers, including migrant workers. Unlike the *inner system*, the *outer system* units could play much more active roles in creating jobs.<sup>91</sup> Between 1978 and 1990, the *inner system's* urban employee ratio somewhat declined from its initial 99 percent but still remained around 95 percent. In the wake of socialist market economy in 1992, the situation started to change radically. The great development of the *outer system* led to development one-fourth of the total urban employees in 1995. By the end of the last century, the employees ratio of the *inner system* and the *outer system* eventually had reached to half and half.<sup>92</sup> In the period between 1978 and 2001, SOE's ratio in the total urban employment declined from 78.3 percent

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<sup>89</sup> Ibid., p. 37.

<sup>90</sup> *Nanfang zhoumo*, 1995, October 20th

<sup>91</sup> "Since the reform and open door policy, unlike the *inner system* economy which has undergone losing and shrinking, the *outer system* economy has been prosperous and has developed rapidly. As a result, the *outer system* economy's momentum and labor absorbing capacity highly exceed that of *inner system* economy" (Li Peilin, Zhang Yi, and Zhao Yandong, *Jiuye yu zhidu bianqian: liangge teshu qunti de qiuzhi guocheng*, p. 63).

<sup>92</sup> Tang Jun, op cit., p. 17.

to 31.9 percent; COE's ratio in the same period also declined from 21.5 percent to 5.4 percent. In contrast, non-state sector's ratio expanded from nothing to 62.7 percent.<sup>93</sup>

Realizing clear defects of the *inner system* based on the formal employment for the urban society, the leadership could not stick to the *inner system* as the exclusive scheme to organize its urban society. At the same time, the leadership understood the evident momentum of the new *outer system* units unbound with Zhigong labor system. The new economic momentum accompanied by a huge number of new jobs made the leadership not to protect its *inner system* from new *outer system* in market competition. Hence, the urban society began to involve the newly emerging de facto labor market relations. Since the central government virtually did not block the new *outer system* entering the urban society, the *outer system* units had rapidly developed in urban society to create and expand de facto labor market relations. Consequently, the critical portion of labor market system was incorporated into the urban society. Cai and Lin argue thus that "in the process of declining SOE and urban COE ratio of China's total amount of urban employment, China's urban labor market starts to emerge."<sup>94</sup>

The leadership's tolerance and virtual recognition of the *outer system* units became the social origin of China's competitive market system. This aspect revealed the unique feature of China's reform process. First, instead of privatizing its SOEs, China acknowledged its new social space (at first in rural areas) originated from the *outer system* such as TVEs, private companies or FIEs; then, it allowed the new *outer system* units to compete with the *inner system* enterprises. Inevitable was an unprecedented competitive market between the *inner system* and the *outer system* enterprises. At first, the dualism substantialized the distinction of the *inner system* and the *outer system*, each of which depended on completely different labor organizing

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<sup>93</sup> Cai Fang and Lin Yifu, op. cit., p. 62.

<sup>94</sup> Cai Fang and Lin Yifu, op. cit., p. 62.

scheme without any interactions. Then, the changing ratio of production and employment in the two systems were not the result of simple expansion of the *outer system* but rather the dynamic process of expanding the *outer system* and contracting the *inner system* at the same time. The emerging competitive market condition in the urban society necessarily shocked the *inner system* enterprises, as it brought new competitive scheme into urban society which had been systemically checked to maintain the Zhigong embeddedness exclusively.

At first, urban COEs were exposed to market competition, and their personnels began to decline radically from the late 80s. Since urban COEs were the marginal system, China did not try to protect them from the competition of the *outer system* units.<sup>95</sup> COE's personnel in the first half of 1988 already declined total 260 thousand from the number of a year before (Nichu: 91). In this context, the leadership realized that COEs could not create enough jobs for urban citizens and that urban COEs "have become a less important alternative to the state as a source of jobs" (*Sharing Rising Incomes*: 29). In the first half 90s, while the total number of Zhigong including SOE Zhigong kept increasing, the number of urban COE Zhigong was declining.<sup>96</sup> The main cause of such a significant decline could be found in COE Zhigong's transformation into other economic forms.<sup>97</sup> With more intensified market competition, many urban COEs not only were in shutdown or in half operation but also went to even bankruptcy - and its degree was captured

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<sup>95</sup> An estimation of World Bank clearly shows that COEs were exposed to the market competition much earlier than SOEs. In order to identify the correlations between China's ownership types and their worker's income overtime, it constructed a simple regression equation with data between 1989 and 1995. What it found out was that COEs "face strong competition from the private sector, so they offer wages in line with labor productivity and the market. State-owned units are still largely sheltered from market competition and continue to operate under a soft budget constraint" (*Sharing Rising Incomes*: 29).

<sup>96</sup> The number of total Zhigong in 1994 was 147.4 million, which had increased 1 million from 1993. The number of SOE Zhigong in 1994 was 108.5 million, which had increased 0.5 million from 1993. By contrast, the number of urban COE Zhigong 33.9 million, which had decreased 1.5 million from 1993.

*Laodong neican*, 1994, Issue 5, p. 5.

<sup>97</sup> *Ibid.*

as “went beyond serious conditions.”<sup>98</sup> The impact of COE restructuring for the urban society remained limited, as COE was the marginal urban system. Yet, market competition could not remain as the exclusive for COEs.

SOEs could not evade the impact of intensified market competition. By the mid and late 1980s, there had been visible signs of unprecedented market competitions with the financial performance of SOE deteriorated. First of all, the rate of SOE’s profit kept declining: at the outset of reform, the profitability was 25 percent, which dropped to 17 percent by the end of 1980s (Naughton, *Growing*, pp. 36-40). China’s enterprises in the early 90s were divided into three groups by performance. “As well known term such as three a third, one third of enterprise is in deficit; one third of them is in hidden deficit; and the other one third of them is in profit making.”<sup>99</sup> The deficits made by state owned industrial enterprises kept exploding: 3.2 billion *yuan* in 1985, 18 billion *yuan* in 1989, 34.8 billion *yuan* in 1990, and 45.3 billion *yuan* in 1993. Ten years’ total deficits reached to 240 billion *yuan*. Importantly was that these numbers of deficits were only formal. With informal deficits added, the ratio of state owned industrial enterprises in the red in 1994 was 39.1 percent.<sup>100</sup>

Interestingly, according to survey data covering the period from 1980 to 1994, 80 percent of those profit-losing SOEs issued extra bonuses for their Zhigong.<sup>101</sup> Despite the deterioration of SOE performance, the practice of welfarism out of Zhigong labor system had remained intact. It means that hard budget constraint was not yet applied to them. Therefore, SOEs’ insider

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<sup>98</sup> By the end of 1996 the total number of urban COEs reached to about 22 thousand (*Laodong neican*, 1997, Issue 3, p. 27).

<sup>99</sup> *Naodong neican*, 1994, Issue 2, p. 23.

<sup>100</sup> For example, in 1991, total formal deficits of SOE under state’s budget system were 100 billion *yuan* and informal deficits were 80 billion *yuan*. *Nanfang zhoumo*, 1995, October 20th.

<sup>101</sup> And the extra bonus expenditure could account for 38 percent of those profit losing SOEs’ financial loss (Li: 372).

control issue turned out to be rampant, as the previous SOE reform efforts had not undertaken any serious reform of Zhigong labor system. When China initiated a series of reform efforts to make SOE system invigorated, SOEs could not bring about more jobs for the urban society because they stick to formal-employment exclusive labor relations with full welfare benefits. Hence, SOE welfarism, widely conducted, regardless of their deteriorating performance, meant encroaching the interests of SOE owner, the state. Evidently, China could not put off a fundamental SOE reform.

The leadership decided to initiate the corporatization reform of SOE as it could not tolerate the practice of welfarism and the encroachment of state interests.<sup>102</sup> The new scheme of SOEs reform started in 1993 with the Third Plenum of the Fourteenth CCP Congress, which endorsed the creation of “modern enterprise system.” The new reform drive interestingly focused on SOE’s ownership reform, and China issued the Company Law in the same year to set up legal base to transform SOEs into corporations with modern enterprise system in the market system (Lin and Zhu: 309). Many discussions on the issue of interest discrepancy between the state and SOEs reached wide consensus that its origin had to do with SOE’s unclear ownership issue. Indeed, China came to accept that SOEs’ unclear ownership had been a comprehensive reason for making state-SOE relations unseparated and managers neglectful of the ownership interests.<sup>103</sup> In this regard, the leadership adopted the ownership restructuring strategy with hopes that “it could help “clarify” the ambiguities in SOEs’ property rights, further increase managerial autonomy, strengthen managerial incentives and improve the effectiveness of monitoring” (Lin and Zhu: 310). The main process of corporatization involves reorganizing

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<sup>102</sup> According to Qian Yingyi, reforming governance of SOEs in China underwent three different stages: corporatization, rearrangements of corporate control, and privatization” (Qian: 234).

<sup>103</sup> Lin Yifu, Cai Fang, and Li Zhou, *op. cit.*, p. 7.

SOEs into limited liability companies or limited shareholding companies.<sup>104</sup> In essence, the SOE reform to reorganize as “modern enterprise system” had nothing to do with SOE privatization; it focused mainly on clarifying state’s ownership so as to strengthen the state’s monitoring system to protect its interests.

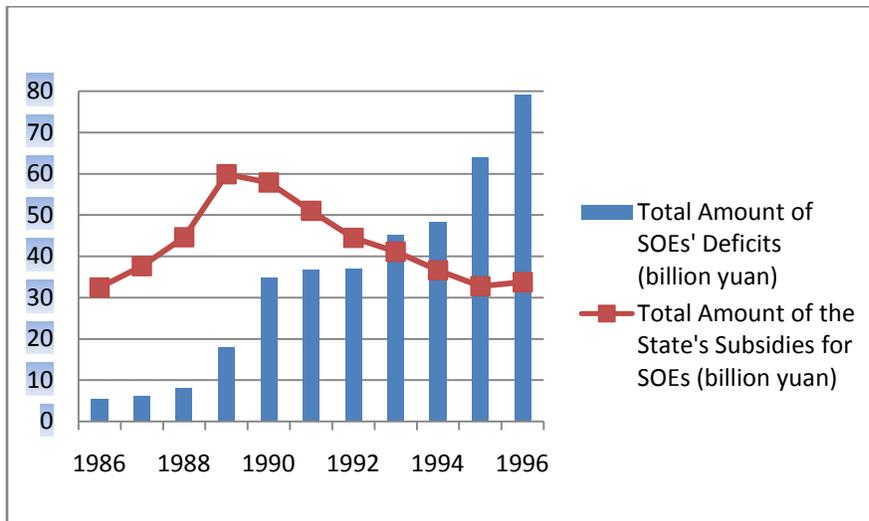
At the same time, the leadership also tried to separate SOEs from the state in line with corporatization reform which would entitled SOE legal person with its own property rights (Tenev, et al.:16; Qian: 236). SOE corporatization was associated with defining rights of corporation as legal entities, which were to operate independently of the state’s ownership and rights. Obviously, the process aimed at clearly separating SOEs from the Danwei’s insider control issue. Indeed, the 1993 decision clarified its goal to encourage development of diversified forms of enterprise ownership, including private-owned, individual-owned, and foreign-invested enterprises. It means that those vigorous *outer system* enterprises could compete on equal terms in the marketplace. Market competition inevitably became even more intensified, and more SOEs underwent financial difficulties. The question then became whether China’s central revenue should engage and support them or not. The central government, however, was no more the ultimate hub of China’s entire financial system, since the reform had allowed local governments and SOEs to retain more financial autonomy. That autonomy affected the existing ‘unified revenue collecting and unified spending system.’ Hence, the leadership realized that the state could not keep supporting SOEs’ increasing financial demands. As the following table clearly shows, even though the deficits of China’s SOEs expanded rapidly, the state decided to reduce its financial supports for those deficits making SOEs from 1990. Clearly the leadership decided not to support poorly performing SOEs unconditionally. In

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<sup>104</sup> Ibid., p. 49.

short, to resolve the Danwei system's issue of welfarism under the "big pot rice" system, China initiated corporatize SOEs with modern enterprise system, thereby trying to clarify the state ownership and set up enterprise's own legal personality clearly separated from the state.

Figure 3-1. SOE's Total Amounts of Deficits and the State's Total Amounts of Supports for SOEs



(Source: Hong Dayong, "Gaige yilai Zhongguo chengshi fupin gongzuo de fazhan lichen," p. 72)

The new efforts of SOE reform since 1993 did not look successful. As the market competition became tougher, and unsubsidized by the state, many SOEs could not but decide half-operation or even shutdown. "Especially, after SOEs are exposed to market competitions, the efficiency of some SOEs started to decline, since their management system was not compatible with the demand of market economy. Indeed, some SOEs could not fulfil their production responsibilities; some of them stopped production or produced only half; and some even could not grant Zhigong's wage."<sup>105</sup> According to MOL's rough estimation, the total number of SOEs in shutdown or half-operation by the end of 1996 reached to nineteen

<sup>105</sup> *Laodong neican*, 1997 Issue 6, p. 17.

thousand.<sup>106</sup> The situations were even more serious in some areas.<sup>107</sup> By September of 1994, 3.1 million Zhigong had not been fully paid their wages.<sup>108</sup> By the end of 1995 there were totally about fourty one thousand SOEs and urban COEs which stopped or half stopped their production. The total number of Zhigong who belonged to these troubled enterprises was 6.6 million. Among them, the total number of Zhigong who were not fully paid their wages was 4.8 million, and the total amount of these unpaid wages was 10.5 billion *yuan*.<sup>109</sup> According to an estimate, 1.1 million workers engaged labor related collective actions in more than 30 cities in 1995 (Chen: 41).

Even if more SOEs were increasingly under the serious financial conditions, China tried to stick to its reform to separate SOEs from the state's "big pot rice" system. The leadership decided to shift the way of financing SOE's financial demands, by arranging public-sector borrowing from the state banking system. In other words, the loans of state banks substitute the state's direct financial engagement for SOE capital flow, and the loans to SOEs started to expand rapidly.<sup>110</sup> By the end of 1995, outstanding loans to state industry amounted to 83 percent of all outstanding bank loans of that year (Steinfeld: 20). As SOEs became ever more dependent on banks, the liabilities of SOEs rose precipitously. The liabilities of industrial SOEs in 1993 were estimated to be the equivalent of two-thirds of the value of their assets, which reached to four-

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<sup>106</sup> *Laodong neican*, 1997 Issue 3, p. 28.

<sup>107</sup> In 1995 "some 60 to 70 percent of the firms in China's industrial Northeast simply ceased production..." (Steinfeld: 20).

<sup>108</sup> Yamamoto, op. cit., p. 372.

<sup>109</sup> *Laodong neican*, 1996, Issue 8, p. 6.

<sup>110</sup> Indeed, there emerged criticism about the state bank's increasing loans, because this was only substitution of former state revenue's "big pot rice system" with new state bank's "big pot rice system." Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 150.

fifths in 1994 and rose again to 85 percent in 1995 (Lardy: 40; 52).<sup>111</sup> More serious problem was that a large portion of this capital was used as SOEs' working capital to cover their current production costs rather than long-term productive investment to improve their future productivity (Steinfeld: 20). Since their asset and liability ratio condition had been worsening rapidly, many firms simply could not pay workers or maintain basic production without infusion of short-term loans.<sup>112</sup> So even with huge amount of state banks' loans, the future of many SOEs was not promising at all.

Yet, even with the fact that SOE's financial performance deteriorated radically, China did not try to restrict the *outer system* units to protect many poorly performing SOEs. All this meant that the then SOE reform leading to increasing bank loans could not be sustainable and needed to undertake full-scale reform. Those poorly performing SOEs could not expect supports from state revenue any longer, because China tried to transform SOEs into modern enterprises by introducing self-supporting account system. Their survival ultimately depended on their market performance. Therefore, the issue of welfarism in SOEs saturated by Zhigong labor system could not be sustained. Obviously, a critical reason of SOEs' deteriorating performance had to do with their heavy social burdens to maintain Zhigong labor system.<sup>113</sup> Compared with the *outer system* units based on market based labor relation, SOEs based on Zhigong labor system

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<sup>111</sup> However, Lardy assumed that the real situation might be even worse, since many official data about SOEs might have problems such as the underestimation of liabilities and the overestimation of assets (Lardy: 42).

<sup>112</sup> Lardy argued that SOEs in the mid-90s had virtually no working capital other than funds they had borrowed from banks (Lardy: 42).

<sup>113</sup> "When we take the state sector's contribution to tax revenue and employment into account, the difference in performance levels between state enterprises and other enterprises becomes narrower. ... When we look at the ratio of the sum of total wages, pension and pre-tax profits to equity, the difference would basically disappear" (Zhu: 351).

shouldered too heavy social burdens.<sup>114</sup> Under the competitive market condition Zhigong labor system had turned out to be the primary source of SOE system defects.

Especially, SOE's serious underemployment had turned into a salient problem. China, as a socialist country, recognized full employment as its critical political commitment. To carry out the commitment, it tried to assign as much as urban laborforce to SOEs without consideration of their labor demands, which entailed much more personnel than SOEs needed. Indeed, providing work posts to China's urban citizens was a critical part of the Danwei's social functions, and the Danwei system, in this context, came to be organized as extreme insourcing system which employed lots of personnel who did not engage in production process.<sup>115</sup> SOE's underemployed Zhigong could remain as manageable issue, as long as the Danwei system under the state's "big pot rice" system could stay away from serious market competition. Yet, as the market competition got tougher with increasing *outer system* units, the leadership realized that SOEs were not competitive enough with their huge amount underemployed personnel who did not engage in production.

Many people in the late 80s believed that, of 130 million total urban workers, there were redundant workers between 15 and 30 million.<sup>116</sup> In this context, trying to reorganize SOE Zhigong and upgrade their labor productivity, China from the late 80s devised a new program, so-called "labor optimizing combination" (*youthua laodong jiehe*) (hereafter LOC), which aimed at introducing a new flexible labor scheme to achieve the best combination of labor and production factors. To implement the program successfully, China needed to establish SOE manager's

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<sup>114</sup> "Since SOEs are under those of unequal competition conditions, they make excuses for their needs of soft budget constraints." Lin Yifu, Cai Fang, and Li Zhou, *op. cit.*, p. 150.

<sup>115</sup> "Only about two-thirds of the industrial SOE work force consists of actual industrial workers" (Naughton 1997: 178).

<sup>116</sup> JIL, *Chugoku no rodo shakai hoshu shisutemu no kisoteki kenkyu*, p. 68.

power to push the program. The whole country entrenched SOE manager's responsibility system in the late 80s, in which SOE managers were entitled to have the rights to decide the number of their required workforce and to select who would remain and leave based on competition principle.<sup>117</sup> Therefore, LOC was supposed to modify existing permanent employment system, since it would eventually allow SOE managers to discharge their underemployed Zhigong.

China, however, could not discharge SOE's underemployed Zhigong. The government at first could not but decide to re-arrange new work posts for these underemployed Zhigong within their workplace rather than discharge them.<sup>118</sup> Therefore, many underemployed SOE Zhigong could remain in their workplace with the form of 'waiting jobs within workplace' (*changnei daiye*), which provided them with skill trainings and basic living fees.<sup>119</sup> Some SOEs also set up new affiliated COEs to place their redundant Zhigong as well. There were also other measures which included waiting posts within workplace, or 'keeping position without wages' (*tingxinliuzhi*), 'early retirement' (*tiqiantuixiu*), and 'long-term vacation' (*changjia*).<sup>120</sup> Of course, these measures could not resolve the issue of underemployed SOE Zhigong directly. Instead, as many SOEs had to internally arrange work posts for their underemployed Zhigong, their social burdens increased.<sup>121</sup> SOE managers could not modify Zhigong labor system's permanent employment system. In sum, LOC program clearly represented China's growing

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<sup>117</sup> Ibid.

<sup>118</sup> In fact, China at first tried to experiment the program in total 36.5 thousand SOEs in sectors such as construction, post service, communication, commerce, which had total 13.3 million Zhigong and separated total 847 thousand Zhigong (6.4 percent of experimented SOEs' total Zhigong) from their workplace. However, China could not push the program in its full scale and it re-assigned total 667 thousand Zhigong (78.8 percent) as waiting Zhigong within workplaces. Yamamoto, *op. cit.*, p. 353.

<sup>119</sup> Ibid., p. 420.

<sup>120</sup> JIL, *op. cit.*, pp. 68-9; Nitchu Keizai Kyokai, *op. cit.*, p. 97.

<sup>121</sup> JIL, *op. cit.*, p. 51.

consensus that the reform of SOE's underemployed Zhigong was inevitable, but it turned out to be extremely hard to carry out.

The scale of underemployed Zhigong in SOEs did not get better in the 90s; rather it seemed even worse with more SOEs' deteriorating performance. Then, those underemployed Zhigong were socially refashioned as redundant Zhigong. The estimation of SOE redundant labor in the 90s varied, but the consensus was that it reached to more than 20 percent of total laborforces. The World Bank surveyed 142 enterprises in 1994 and found that 60 percent of the firms had redundant workers exceeding 10 percent of their laborforces and that one-third of them reported labor redundancy exceeding 20 percent (Lardy: 50). Both ILO and MOL in 1995 estimated 18.8% of total SOEs workers were redundant workers. Both the State Plan Committee and the System Transform Committee estimated the size as the 25% of the total personnel in SOE.<sup>122</sup> By and large, its amounts were supposed to be around one-third of total workforce.<sup>123124</sup>

The efforts to estimate the scale of the *inner system* redundant workers involves social process to construct the *inner system's* redundant workers who are supposed to be leave their work place eventually. The social constructing of redundant Zhigong under the competitive market condition meant that China reached a social consensus that many SOEs' poor performance had to do with Zhigong labor system. In fact, there emerged many discussions which blamed SOE's labor system for its poor performance: "under the plan economic system, our country formerly undertook institutional arrangement to realize the goal that "everyone has jobs," which, however, entailed overstaffed personnels, declining efficiency, interrupting

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<sup>122</sup> Yamamoto, op. cit., p. 419.

<sup>123</sup> Nakagane, *Chugoku keizai hattenron*., p. 181.

<sup>124</sup> Each industrial sector had different scale of surplus personnel: coal industry had surplus personnel 1 million of its total 3.1 million Zhigong; timber industry had 390 thousand surplus personnel of its total 1.1 million Zhigong; and textile industry had 900 thousand surplus personnel of its total 4.8 million Zhigong. He Ping, *Guoyou qiye gaige zhong de shehui baoxian*, p. 191.

development, insufficient work posts, and a large number of underemployed workers.”<sup>125</sup> China also realized that the Danwei system could maintain redundant Zhigong, as it was organized with the “big pot rice” system.

“Our country executed plan economy system for a long time, and the state put into practice unified labor arrangement; SOE eat the state’s “big pot rice” and Zhigong eat SOE’s “big pot rice”; employment system enforced low wage, more employment program, so “five persons shared three persons’ meals,” which sacrificed efficiency to guarantee employment. Even though SOE’s personnels were overflowing, SOEs did not worry about this. Since our country’s commodities in those days were not enough, the contradiction of redundant personnels was not serious issue, just as emperor’s daughters did not worry about marriage. Yet, along with transforming SOE management system, executing self management and self responsibility for profits and losses, the issue of SOE’s redundant personnel has been gradually uncovered.”<sup>126</sup>

It had become clear that SOEs’ declining performance with the intensified market condition had to do with their redundant personnel, which under the condition of the Danwei system’s “big pot rice” system hindered SOEs from being reorganized into efficient economic system.<sup>127</sup>

Obviously, SOEs could not maintain their redundant Zhigong under the competitive market condition, so SOE reform required urgent measures to dismantle the “big pot rice” system. Compared with previous situation to carry out LOC, SOEs condition became much more serious, so the reform of the “big pot rice” could not be lingering. In this context, SOE corporatization efforts came to focus on how to handle the Danwei’s “big pot rice” system, which involved the decision that the state would not support those poorly performing SOEs “naturally” to let them maintain their redundant workforces.

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<sup>125</sup> Li Peilin, Zhang Yi, and Zhao Yandong, op. cit., p. 26.

<sup>126</sup> *Laodong neican*, 1997, Issue 6, p. 17.

<sup>127</sup> “Under the past plan economy system, primary feature of China’s labor relation was the absolute equalism in the “big pot rice” system. Even though this system was established to handle the [problem of capitalist] system in which men repress other men, but its upshot was costs of institutionalized laziness and general poverty.” Li Peilin, Zhang Yi, and Zhao Yandong, op. cit., p. 31.

“SOEs should go to market, and take independent management, routes of assume sole responsibility for its profit and losses. The bottom line is [that we have to] separate politics from enterprises. In this context, we should not allow SOEs to eat the state’s “big pot rice”, and not allow Zhigong to eat SOE’s “big pot rice” any more.”<sup>128</sup>

Obviously, as the market competition became really serious, China tried to corporatize SOE system that would be financially independent from the state financial system. Then, SOEs would be no more a social system to fulfill urban society’s full employment, and their inherited redundant Zhigong would be discharged eventually.

SOE corporatization process could not maintain the Danwei’s Zhigong labor system, the source of SOEs’ serious redundant workers. The leadership had to introduce a flexible labor scheme into the Danwei’s Zhigong labor system, as SOE corporatization process could not avoid transforming the existing Zhigong labor system predicated on the permanent worker system. However, it turned out that dissolving the labor relations with the permanent worker system was the very sensitive issue, and the permanent worker system, as we observed before, survived the efforts to introduce labor contract system. Indeed, the labor contract system was introduced only to the newly employed workers, who could not hold the same job security as older permanent workers with less welfare benefits than that of permanent workers.<sup>129</sup> Yet, with the deteriorating SOE performance those existing Zhigong from the early 90s started to worry about if they could maintain their permanent worker position.<sup>130</sup> Observing increasing numbers of vigorous new

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<sup>128</sup> *Laodong neican*, 1997, Issue 6, p. 17.

<sup>129</sup> Obviously, “these young Zhigong’s social status has declined from that of older Zhigong who are mostly permanent workers.” Feng Tongqing and Xu Xiaojun, *op. cit.*, p. 168.

<sup>130</sup> “Today SOEs still manage their labor organizing system primarily based on permanent workers, and they also guarantee to a large degree Zhigong’s full employment, but since SOEs are under reform process toward market, they will gradually internalize competition and risk elements within their system, which makes Zhigong more sensitive to their work posts.” Feng Tongqing and Xu Xiaojun, *op. cit.*, p. 138.

*outer system* companies, more and more Zhigong came to feel insecure about their permanent worker position within their Danwei.<sup>131</sup>

Indeed, China for the first time used the term of labor market officially in the Third Plenum of the Fourteenth Chinese Communist Party Congress, which presented labor market as a critical part of urgent task to formulate its market system. Based on the decision, there followed “MOL’s general scheme on labor system reform in the era of setting up socialist market economy system” which planned that in the ninth FYP period [1996-2000], China basically abolish its ‘unified labor arranging’ system and accomplish the task of formulating primary scheme of modern labor market system.<sup>132</sup> Obviously, this was a measure to handle increasing numbers of SOE redundant Zhigong, as Zhu Jiazhen, deputy-minister of MOL, stated that the crux of China’s labor issue was not if SOE managers held right to hire new workforces, but if they could lay off their redundant workforces.<sup>133</sup> In this context, China set up the Labor Law in 1994 as an institutional foundation for its emerging labor market system, introducing a scheme to discharge redundant employees in SOE’s Zhigong labor system.<sup>134</sup>

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<sup>131</sup> “Especially, foreign invested and private enterprises have newly emerged vigorously and gradually take more dynamic position in the competition with SOEs, which renders SOE productivities and profiticiencies decline more radically. Thus, lots of workers start to feel insecure their positions.” Feng Tongqing and Xu Xiaojun, op. cit., p. 93.

<sup>132</sup> *Fuyin baokan ziliao, Laodong jingji yu renliziyuan guanli*, 1994, April, p. 5.

<sup>133</sup> He said “since our policy has always emphasized handling SOE redundant personnels within SOE as the primary scheme and social arrangement as a supplementary one, SOEs practically cannot put into effect their autonomy in managing their employments. In fact, the program of “allowing entering solely without discharging” itself has problem.” *Fuyin baokan ziliao, Laodong jingji yu renliziyuan guanli*, 1994, May, p. 11.

<sup>134</sup> “China’s Labor Law clarifies the market orientation of China’s labor system reform. Especially, Chapter 3’s regulation on “labor contract and collective contract” which constructs both the positon of enterprise’s hiring subject and that of worker’s employment subject. Enterprise hires workers independently and worker selects jobs by himself. Accordingly the establishment of labor relations and clarifying rights and responsibilities of two independent parts totally depend on voluntary agreement after negotiation of two equal parts.” *Laodong neican*, 1994, Issue 9, p. 1.

SOE Zhigong clearly realized that they could not expect their vested rights within the Danwei system that had allowed them to maintain secure life. The very essence of SOE corporatization reform was to transform the Danwei system into pure economic system after stripping their onerous social functions of Zhigong labor system. That transformation entailed a fundamental reorganization of the existing relations among all stakeholders in terms of corporate governance transformation. Especially, reorganizing SOEs into the shareholding companies would strengthen shareholders' position and shake the very ground to organize Zhigong's existing special position within the Danwei system.<sup>135</sup> The change meant that SOE Zhigong would lose their vested interests and special work position consisted of the trinity of "employment, security, and welfare."<sup>136</sup>

Corporatized SOEs separated from the state would be no more a social system to organize socialist labor relations with Zhigong labor system. Hence, its related labor reform involved "the transformation of SOE Zhigong labor system to introduce basically market based labor system."<sup>137</sup> Of course, this was a very sensitive process, as SOE Zhigong held the special position of the state workers. Indeed, out of the scheme that the state represented SOEs and SOEs represented Zhigong, the Danwei system with the "big pot rice system" fashioned closely connected relations between SOE Zhigong and the state in terms of bilateral monopoly, which virtually acknowledged their state workers status.

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<sup>135</sup> "The transformed shareholding companies, according to the demand of modern enterprise system, generally establish shareholder's meeting, board of directors, and supervisory board (so called new three bodies). These new bodies can cause a series of conflicts with the labor union, employee representative council, and CCP branch committee (so called old three bodies) in former enterprise system. From the functional perspectives speaking, 'new three bodies' which generally take investor's interests as primary their tenet become enterprise's decision maker..." He Ping, *op. cit.*, pp. 2-3.

<sup>136</sup> JIL, *op. cit.*, p. 67.

<sup>137</sup> Li Peilin, Zhang Yi, and, Zhao Yandong, *op. cit.*, p. 63.

SOE corporatization reform inevitably altered the unique state and Zhigong's bilateral monopoly relations, and the status of Zhigong in corporatized SOEs could not remain as the state workers as before.<sup>138</sup> Losing the state worker status and becoming employees with labor contracts held a serious political meaning in China. Within a socialist system based on public ownership system, workers, the owner and users of production factors, hold the position of the 'master' who worked for both themselves and society.<sup>139</sup> But the reform to introduce flexible labor scheme "causes trepidation among broad Zhigong and workers, who suppose that the reform will transform workers as the 'masters' of the enterprises and the state into commodities; it will also transform the nature of labor, from the labor for worker himself and society into the *hired labor (guyong laodong)* for others. Emotionally, this change [for Zhigong] is hard to accept, and, therefore, it will easily cause social crisis."<sup>140</sup> This was a serious political issue in China, since the political leaders, though trying to construct market economy, could not be free from socialist ideology.<sup>141</sup>

Obviously, the very condition of Zhigong within the Danwei could not remain as before. China constructed its concept of Zhigong by combining both staffs and workers, which constituted the very concept of China's socialist urban citizenship intertwined with the Danwei's egalitarian de-skilled labor system. Yet the Zhigong's internal relations were not sustainable as China decided to introduce flexible labor system which came to apply differently to different

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<sup>138</sup> "Zhigong of sharholding companies are no more Zhigong of the state; instead they have become genuine Zhigong of enterprises, who set up labor relations with their workplace by signing up "labor contract"" He Ping, op. cit., pp. 2-3.

<sup>139</sup> Xia Jizhi and Dang Xiaojie, op. cit., p. 271.

<sup>140</sup> Ibid., p. 269.

<sup>141</sup> "Labour reforms have been the subject of acute disagreement and heated debate ever since their inception. Though much of this debate has remained hidden... .. While central Party leaders have apparently agreed on the need for reform in the state labor system, they have disagreed over its pace and extent" (White 1993: 138).

Zhigong cohorts. In the efforts to introduce labor contract system, China tried to apply the program mainly to the workers, while cadres' permanent personnel status remained untouched.<sup>142</sup> The ratio of permanent workers declined more rapidly than that of permanent technician staffs.<sup>143</sup> In the same vein, LOC program applied mainly to production workers, so it did not disrupt the status of technicians.<sup>144</sup> Indeed, SOE reform inevitably involves the gradual transformation of SOE's internal status scheme. As social respect for information increase, technicians' social position also began to rise,<sup>145</sup> which, however, was accompanied with deteriorating position of unskilled production workers, the majority of Zhigong.<sup>146</sup> The declining position of those unskilled production workers became a salient social issue, and of the Zhigong ranks in terms of managing staffs, technicians and workers, unskilled production workers' positive attitudes about the reform declined most radically.<sup>147</sup>

Zhigong's internal cohesion was the primary scheme to organize China's socialist system, so any attempt to alter it could entail a really explosive social response. Indeed, the process to lay off redundant SOE Zhigong meant to remove the existing formal employment relations from the majority of Zhigong and push them to labor market system. Disbanding the internal integrity of Zhigong and forcing the majority of them, those unskilled SOE workers, into marginal positions, could entail politically explosive social responses. A series of China's labor reform programs

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<sup>142</sup> Zhao Wei, op. cit., p. 9.

<sup>143</sup> Portion of Permanent and Non-Permanent Position by Different Zhigong Stratum

	Permanent Position	Non-Permanent Position
Management Staffs	89.8%	10.2%
Technician Staffs	95.5%	4.5%
Workers	77.3%	22.7%

(Source: Feng Tongqing and Xu Xiaojun: 52)

<sup>144</sup> Zhao Wei, op. cit., p. 43.

<sup>145</sup> Ibid., p. 6.

<sup>146</sup> Obviously, "workers were the first cohort who entered "market" and lost their "organizational" reliance scheme." Zhao Wei, op. cit., p. 8.

<sup>147</sup> Feng Tongqing and Xu Xiaojun, op. cit., p. 23.

brought about unprecedentedly growing Zhigong's discontents. Especially, Zhigong thought that, having lost a lot in the reform process, they were under an unfair social blame driven out of "iron rice bowl" discourse.

"The society and public opinions are somewhat unfair, since they blame too much about Zhigong's practice of pursuing and protecting their short-term interests. Of course, these practices do exist, but at the same time we want to indicate the corresponding phenomena that the interests of Zhigong are also frequently infringed."<sup>148</sup>

In this context, China realized the political urgency to slow down the process of dissolving Zhigong's internal cohesion to the level the society could accept.

"Nowadays quite many SOEs face lots of problems. Some of these enterprises for the reason of their poor performances and long term deficits, just stop running or only produce half and cannot pay their Zhigong's wages; some of them after their bankruptcy do not arrange their Zhigong's settlement and render those Zhigong to lose living securities. We should accomplish ... the stabilizing project for SOEs and for Zhigong ranks (*duiwu*)."<sup>149</sup>

The society was not yet fully ready to accept SOE's right to lay off its redundant workforces. So many SOEs actually had to keep their redundant Zhigong, and labor mobility in the urban society remained quite low.<sup>150</sup>

As discussed before, SOE's poor performance resulted from its high cost of Zhigong labor system: full employment, permanent worker system, and welfarism. SOE corporatization reform, therefore, could not make a meaningful outcome, without measures to remove Zhigong labor system's onerous burdens from the Danwei. It was politically sensitive issue, as it needed to tackle the primary scheme to organize the urban society. In a sense, the efforts to corporatize SOE have to reform Zhigong labor system, which could not but extend to the reform of the very

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<sup>148</sup> Feng Tongqing, op. cit., p. 22.

<sup>149</sup> *Laodong neican*, 1994, Issue 5, p. 1.

<sup>150</sup> Yamamoto, op. cit., p. 388.

scheme of its citizenship. This was why the labor reform following SOE corporatization efforts came to take the form of how to handle Zhigong's status and how to soothe their misgiving of dissolution of Zhigong's ranks (*duiwu*). Especially, the leadership could not be free from political sensitivity of dissolving Zhigong labor relations, as Zhigong was socialist China's primary scheme of citizenship. Hence, the reform of Zhigong labor relations could extended to the fundamental change of existing scheme of organizing social relations, and China's SOE corporatization reform could not make meaningful progress.

China's outstanding economic performance after the reform did not come from its successful SOE reform; rather, its economic momentum came from mainly new vigorous *outer system* units, such as TVEs, private companies, or FIEs.<sup>151</sup> Those dynamic non-state sectors, bringing the vigorous economic drives to Chinese economy, took more market share and pushed the existing unproductive SOEs out of market. Hence, SOEs' poor performance did not mean that China failed SOE reform; ironically, it showed that the reform itself was in the right track. Indeed, the declining profitability of SOEs was a result of the expansion of the *outer system* firms eroding the SOEs' monopoly positions (Naughton 1996: 236-40). Hence, the reduction of SOEs profits ascribed to increasing market competition did not necessarily mean their declining efficiencies.<sup>152</sup> Jefferson and Singh explained how China's SOEs had lost their superior position as non-state actors joined the market competition, perceiving the process as "creative reduction" drawn from Schumpeter's idea of creative destruction (Jefferson and Singh: 195-9). In this regards, the dominant process driving Chinese economic reforms forward had been the creation

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<sup>151</sup> Indeed, two cities represent China's vigorous economic momentum: Wenzhou and Shenzhen. The former is famous for its strong private sector and the latter is famous for its huge foreign investment.

<sup>152</sup> This is a reason why some indicators about SOE performance are conflicting with each other: SOE's poor financial performance and its stagnating or even rising total factor productivity (Lardy 47).

of competitive pressures by the entry of new *outer system* units: initially TVEs, then after the 1990 those private and FIEs (Naughton 1997: 186).

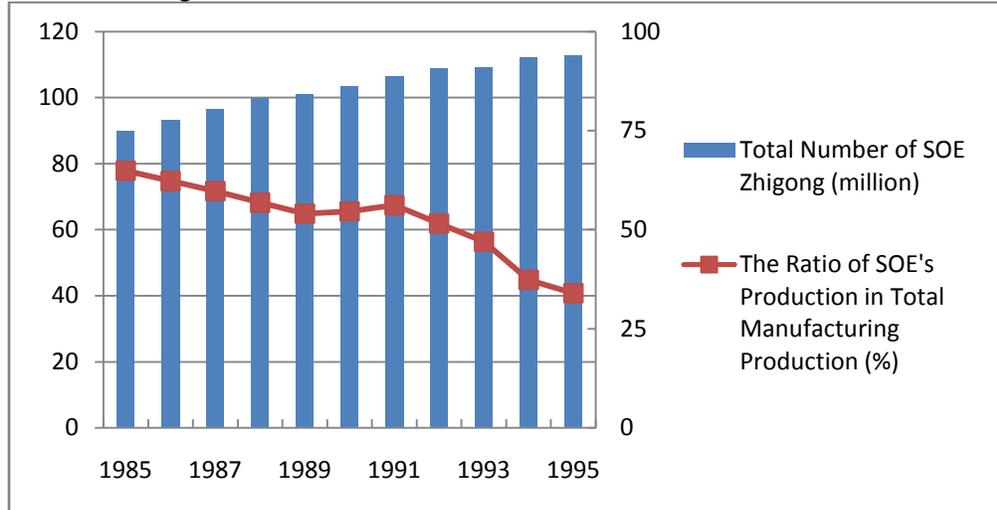
China's reform successfully stretched to the reduction of SOEs' position in economy. More troubled SOEs meant the more success in China's economic reform. While the very process of SOE reform was passive and reactive against the new competitive market condition, which, unlike the dynamic units of *outer system* gained competitiveness from their market-based labor relations without the burden of formal employment with comprehensive welfare provision including job tenure. Then, the intensified market competition with the new vigorous *outer system* units uncovered SOEs' serious numbers of redundant workers inherited from Zhigong labor system which was committed to arrange formal employment for the urban society. Yet, the leadership had not clarified a guideline of how to handle those SOE redundant Zhigong, as Zhigong labor system was the primary scheme to organize the socialist system in the urban society. Considering the significance of SOE's social functions, China's political leaders were clearly aware of political risks that a full scale SOE reform without properly treatment of its social embeddedness would bring to Chinese society.<sup>153</sup> A survey illustrated the total number of SOE Zhigong kept increasing by the first half of 90s, even if more and more SOEs came to be in the reds with increasing market competition. Importantly, the ratio of SOE's production in China's manufacturing production shrunk drastically.<sup>154</sup>

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<sup>153</sup> "But SOEs command 70 percent of the state's net value of industrial fixed assets and produce about half of industrial outputs. SOEs not only contribute critical parts of tax revenues for each level government, but also resolve total 68 percent of urban workers' employment issue. In addition, SOEs assume heavy social burdens to provide their personnel and their family with broad social services and securities." SETC, MOF, and World Bank, *Zhongguo guoyou qiye gaige zhengce xuanze*, p. 27.

<sup>154</sup> Hong Dayong, "Gaige yilai Zhongguo chengshi fupin gongzuo de fazhan lichen," p. 72.

Figure 3-2. The Total Number of SOE Zhigong and the Ratio of SOE Production in the Total Manufacturing Production



(Source: Hong Dayong, “Gaige yilai Zhongguo chengshi fupin gongzuo de fazhan lichen.” p. 72)

The situation could not continue and China had to reform its increasing numbers of troubled SOEs with heavy burdens to maintain their redundant Zhigong. Interestingly, the degree of SOEs’ exposure to market competition varied depending on their sizes. They were situated in different reform pressures. Large SOEs usually were not in a tough competitive condition as much as small SOEs, so they were in better financial conditions than their small counterparts. Indeed, large SOEs almost doubled their share of gross output value from 32% in 1980 to 60 % in 1994 and in the mid-1990s; the 500 largest SOEs accounted for 37% of total assets, 46% sales value, and 63% of total profits (Nolan and Wang: 184). Large SOEs rarely made losses (in 1992 just 42 of the top 500 SOEs reported losses), creating two or three times larger profit rate than small SOEs. The main reason of the results was that large SOEs engaged in large-scale upper stream sectors which could be free from serious competition by new small

scale *outer system* units (Nolan and Wang: 185). Obviously, large SOEs were in less competitive market pressure, so their financial condition remained relatively stable.<sup>155</sup>

Nevertheless, this does not mean that large SOEs were free from the burden of redundant Zhigong. “Large and middium-size SOEs generally have ten to twenty percent of redundant employees and some cases even have thrity to fifty percent of redundant employees. The problem of ‘enterprise running the society’ inherited from the plan economy system is not really settled.”<sup>156</sup> The huge size of redundant Zhigong in those SOEs could turn into volatile collective actions, so the leadership did not initiate its reform to discharge redundant Zhigong in large SOEs, let alone restructuring or liquidating. Instead, the leadership tried to support them in various ways.<sup>157</sup> The Danwei system’s “iron rice bowl” remained without serious change in cases of most large SOEs. In this context, the state’s financial supports for them had a political meaning of social management costs by allowing them to retain their underemployed Zhigong.

China came to limit large SOE reform in terms of clarifying ownership by transforming the system into limited liability or shareholding companies under the Company Law. The main objective of this ownership reforms was “to separate government and business functions and to create incentive structures that ensure that firm managers act in a manner consistent with the interests of the firm’s owners. The Company Law allowed for the establishment of corporations as distinct legal entities, separate from their owners (shareholders), “with a clear definition of and accounting for its own assets and liabilities”” (Lardy: 24). But the conversion of medium and large SOEs into limited liability shareholding companies remained somewhat slower.

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<sup>155</sup> Large SOEs under the center had been in better condition: while 72.5 percent of local firms were in the red in 1995, only 24.3 percent of central SOEs were unprofitable (Garnaut, et al 2005: 3).

<sup>156</sup> Chang Kai, op. cit., p. 87.

<sup>157</sup> Indeed, when large scale SOEs were in a financial crisis, “central authorities not only provide bailout subsidies, but also elect to provide those subsidies in the form of “policy loans” from commercial banks” (Steinfeld: 70).

Indeed, the practice of corporatization of many large SOEs was not a clear separation of them from the state but consolidation of the state's ownership. There were no significant changes in the governance of the medium and large SOEs converted to limited liability shareholding ownership. Indeed, many of "corporatized" SOEs chose to become wholly state-owned companies, whose decisions to make or approve mergers, break-ups, dissolutions, increases or decreases in a firm's capital, or the issuance of bonds were all reserved for "an organization authorized by the state" (Lardy: 54-5).

Unlike those large SOEs, small SOEs could not avoid shock out of serious market competitions with vigorous *outer system* companies. The output share of small and medium SOEs which usually engaged in light manufacturing started to reduce. It was so apparent that they were edged out by the new rural non-state enterprises. Indeed, the relation between TVEs and urban small SOEs was competitive, and the rise of TVEs came at the expense of the small urban SOEs (Steinfeld: 15). Most of those troubled small SOEs were under local government, and local governments could seldom arrange financial supports for their troubled small SOEs.<sup>158</sup> Especially, after the reform of dividing the central and local tax, local governments had to run their own budgets system independently. With the hardened budget constraints, local governments had to pay increasing costs to maintain their inefficient SOEs (Cao, Qian, and Weingast: 121). While 72 percent of small SOEs under local governments were in the red in 1995, many local governments decided to push ownership diversification by withdrawing state ownership rather than bailing out them (Tenev, et al.: 30). There were three types in withdrawing state ownership from those troubled small SOEs: filing for bankruptcy; selling or

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<sup>158</sup> There were around 300 hundred thousands SOEs in the early 90s and majority of them were medium and small SOEs which belonged to county or city governments. Yu Faming and Guo Yue, "Guanyu guoyou qiye zhuanzhi guocheng zhong laodong guanxi chuli de jidian sikao," p. 42.

merger to the outsiders; and reorganizing into stock cooperatives which granted Zhigong ownership.<sup>159</sup> Here the practice of withdrawing state ownership from those small SOEs, inevitably involved a politically really sensitive issue, reducing the number of Zhigong who were in the state payroll. Hence, deciding a withdrawing type among the three was based on sincere consideration of each option's potential social impacts, and three types were not evenly distributed.

Bankruptcy was the last resort due to its serious social impact. After the bankruptcy law for SOEs was enacted in 1986, there were only a small numbers of bankrupt SOE cases, and the average number of annual bankrupt SOEs between 1988 and 1993 remained only 277 (Tenev, et al.: 15). A critical reason for this limitation was that it remained unclear how to handle those Zhigong in bankrupt Danwei. The regulation of bankruptcy law - how to mobilize and use settlement funds for Zhigong in bankrupt enterprises - was not practice. Many related programs were also not even compatible with each others: while MOL's related documents stipulated that bankrupt enterprise's Zhigong should be handled by their enterprise's supervising bureaus, some areas' stipulated that bankrupt SOE Zhigong be transferred to the labor and social insurance bureaus.<sup>160</sup> Obviously, China was not ready to use bankruptcy measure for SOE reform, as it did not articulate a clear social scheme to deal with the newly unemployed.<sup>161</sup>

Moreover, for political reasons, China was also quite reluctant to proceeding diversification of small SOE ownership to the extent of full privatization. Selling and merger to outsiders were not broadly conducted practice to diversify the ownership of many troubled

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<sup>159</sup> Ibid.

<sup>160</sup> *Laodong neican*, 1994, Issue 10, p. 27.

<sup>161</sup> In fact the bankruptcy law article 4 just vaguely stipulates that "the state, with various measures, should properly arrange bankrupt enterprise Zhigong's re-employment and guarantee their basic living demands before their re-employment." *Laodong neican*, 1994, Issue 12, p. 6.

SOEs. In contrast, leasing was the most extensively used restructuring method, followed by auction and managerial contract with collateral (Lin and Zhu: 321). The reluctance to privatization critically had to do with uncertainty of how the changed ownership would affect Zhigong's labor relations.

Many troubled small SOEs tried to diversify their ownership in the form of stock cooperative companies to reorganize the Danwei system into economic units based on their internal ownership through a distribution of the shares to their Zhigong. Compared with small SOEs under local governments authorities, stock cooperative companies were economic units with enlarged management autonomy and clear ownership, as they attained critical features of modern enterprise system, such as legal person status and limited liability system.<sup>162</sup> The Stock cooperative companies had two critical features. On the one hand, unifying workers and workers' capital, its Zhigong were not only the company's workers but also investors. Hence, labor did not control capital and vice versa. On the other hand, its Zhigong based on their equal status attained similar amounts of its shares so as to collectively own, produce, and manage the socialized production resources. Hence, any shareholders did not take a dominant position, and all workers maintained equal rights. Neither were outsiders usually allowed to access to shares, nor the shares were allowed to be transferred to outside investors. Stock cooperatives at its enterprise organization level were claimed to amalgamate both stock system as workers' capital coalition and cooperative as workers' labor association. They crystallized into tight combination of stock and labor cooperative.<sup>163</sup>

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<sup>162</sup> He Runyu, Wang Ying, and Lü Youchen, "Lun gufen huozuo zhi zai guoyou xiaoqiye gaizhi zhong de shiyongxing," p. 36.

<sup>163</sup> Chen Lijuan, "Gufen hezuozhi shi jiti suoyou zhi xin de shixian xingshi," p. 30.

Zhucheng in Shandong province and Shunde in Guangdong province, two financially troubled cities, initiated the experiment of SOE reorganization with the scheme of stock cooperative.<sup>164</sup> The leadership was quite satisfied with the measure of stock cooperative companies in treating many troubled small SOEs. Above all, it avoided big-scale of Zhigong's layoffs by combining Zhigong and shareholders position.<sup>165</sup> "Considering SOEs' burdens to arrange Zhigong employment, stock cooperative companies out of many small SOEs allow their Zhigong to hold shares, making them not only workers but also owners with direct interests, which stabilizes Zhigong's employment, guarantees their interests, and lowers the reform costs."<sup>166</sup> By the end of 1996, more than half of all small SOEs at the county level had been transformed mostly to stock cooperative companies, after their shares were sold mostly to employees.<sup>167</sup> Specifically, in Shandong, 50 percent of reorganized small SOEs were stock cooperatives; in Henan, about one-third; and in Jiangsu, more than 80 percent (Cao, Qian, and Weingast: 110).

The size of SOEs was critical for different levels of competition, causing the diversity of corporatization path. After extensive discussing that phenomenon, the central government in 1995 decided on the policy of *grasping the big and releasing the small (zhuada fangxiao)*, which planned to keep key large SOEs directly under the state and release lots of small ones.<sup>168</sup> As the term implies, the leadership came to confirm the conducted practice of different SOE

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<sup>164</sup> 103 of the 150 Zhucheng SOEs were in the red at the end of 1992 and Shunde also faced serious debt problem before it started restructuring its SOEs (Garnaut, et al. 2006: 37).

<sup>165</sup> He Runyu, Wang Ying, and Lü Youchen, op. cit., p. 37.

<sup>166</sup> Jiang Hao and Wang Xuelei, "Gufen hezuozhi shi fangxiao de shixian xuanze," p. 34.

<sup>167</sup> Some of these firms, in turn, have been transformed into limited liability companies, often after managers bought a controlling number of shares (Lardy: 54).

<sup>168</sup> In 1994 the State Economic and Trade Commission (SETC) sent a report entitled "suggestions on revitalizing small SOEs" to Vice Premier Wu Bangguo, who was in charge of enterprise reform, and the policy in September 1995 was formally announced by the CCP Central Committee in one of its plenaries (Garnaut, et al. 2006: 37).

corporatization by their size: while the state reinforced its direct relations with large SOEs (with its clarified ownership), it rather decided to separate itself clearly from lots of troubled small SOEs in terms of ownership diversification. Then, the issue was not simply the scale of SOEs, as it was also closely related to the degree of SOEs' exposure to the market competition.<sup>169</sup> At the same time, the decision was made with the consideration of its potential social impact under the condition of China's dearth of reliable measures to resolve the redundant SOE Zhigong. In fact, large SOEs became under the tighter control of the state with the measure of corporatization focused on clarifying the state's ownership. That measure was not accompanied by serious downsizing process such as laying off their redundant Zhigong. Many troubled small SOEs also underwent ownership diversification which mainly took the form of stock cooperative units. This path organized its own ownership separated from the state by distributing the shares to the inside Zhigong. So those Zhigong could remain their companies with the position of shareholders without worries of leaving their workplaces even in the cases of bankruptcy or privatization. Obviously, China's SOE corporatization reform since 1993 ended up with *grasping the big and releasing the small* according to different SOE size; however, it was based on shared the internal drive that proceeded only to the extent that the urban Zhigong society could accept.<sup>170</sup>

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<sup>169</sup> As China's reform allowed new *outer system* units to enter market competition, its impact at first focused on the parts of the *inner system* which were in the competitive relations with this new economic actors, such as numerous urban COEs and small SOEs under the local governments, while many large SOEs for their monopoly position could be free from the impact of competition.

<sup>170</sup> "Carrying out 'grasping the big and releasing the small' program, large SOEs are still under the government's special caring and their workers can still retain a certain degree of so called former "negotiable position." Previously in the Bohai Shipyard I had a chance to observe worker's these kinds of capacities. In the cases of released small enterprises, a half of them have choose stock cooperative system in which workers also retain some influential positions. In Anhui and Hebei I also had chances to observe this." Feng Tongqing, *Zhongguo gonren de mingyun*, p. 85.

SOE corporatization was turned out to be embedded in the very process to handle the Danwei's Zhigong labor relations. Originally, SOE reform efforts including CRS did not devise required measures to handle the Danwei's Zhigong labor relations.<sup>171</sup> SOE managers were not free from Zhigong's position within the Danwei, as enlarged their management autonomy combined with insider control issue driven out of Zhigong labor system ended up with welfarism for Zhigong. Of course, with the competitive market condition SOE's welfarism could not persist because the state could not arrange unlimited supports for them under the "big pot rice" system. In this context, China initiated SOE corporatization efforts to separate them clearly from the state, only to implement to the extent that the urban Zhigong society could accept. In so doing, the labor contract system was introduced partially only to those new employed young workers, and the SOE corporatization reform ended up with *grasping the big and releasing the small* so as not to entail huge layoffs of numerous redundant Zhigong in troubled SOEs. Hence, SOE reform efforts, either CRS or corporatization, were not the reform of reorganizing the state and SOE relations to check the principal agent issue between the state and SOE managers, but rather involved the reform of the Danwei's Zhigong labor system that organized the urban society.<sup>172</sup>

I emphasize the social meaning of Zhigong labor system, as its reform inevitably involves the change of its primary scheme of urban social relations in which SOEs were embedded. The urban society was organized with the Danwei system that was based on Zhigong labor system, so SOE reform inevitably involved with the reconfiguration of existing Zhigong labor system.

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<sup>171</sup> "But CRS theoretically had a critical defect: it only regulated the relations between SOEs and the state and neglected to regulate the relations between SOEs and immense group of Zhigong. It did not recognize group of workers as a subject of SOE reform." Feng Tongqing and Xu Xiaojun, *op. cit.*, p. 95.

<sup>172</sup> As SOE had not been a simple production organization, its reform could not remain as a reform of corporate governance system, but rather extended to interest adjustment of entire social relations. Weng Zhiyong and Yu Tijun, "Baotuo kunjing chongsu huihuang," p. 7.

Nevertheless, China did not devise measures to reform Zhigong labor system, which was the main reason why SOE corporatization reform came to be confined with the form of *grasping the big and releasing the small* to the extent that the urban Zhigong society could accept. The reform was a reactive response within the limits that urban Zhigong society could accept. Obviously, the reform of Zhigong labor system was highly sensitive political in that such reform would shake Zhigong ranks (*duiwu*), the socialist China's primary scheme of citizenship. Hence, the leadership postponed its reform as long as it could. This was the main reason why a series of SOE reform did not make any breakthrough for decades, which involved the structural origin of China's very unique reform of gradualism.

#### 4. Xiagang and Embeddedness Politics of SOE Restructuring

China, as we observed before, could carry out SOE reform only to the extent the urban society could accept. Yet, more and more SOEs' economic conditions got worse. Apparently, there were many SOEs that lost their competitiveness and could only be merged with other enterprises or go bankrupt. In this context, the state council selected 18 experimental cities for merger or bankruptcy as early as 1994, which increased to 50 cities in 1996, and 100 cities by 1997.<sup>1</sup> The situation, however, became even more urgent, as almost half of China's 118,000 industrial SOEs losing money in 1996 (up from about one-third in 1994), and SOE total losses that the year's total loss of entire industrial SOEs shockingly exceeded their total profits (Baum: 143; Lin and Zhu: 335). Obviously, the leadership knew that SOE reform could not remain with the scheme of existing gradualism any more that carried out SOE reform only to the extent that the *inner system* Zhigong could accept. In this context, the general secretary Jiang Zemin in the 15<sup>th</sup> Party Congress in 1997 demanded "bold experimentation" with new forms of economic ownership, organization and management (Baum: 143). He said:

"We shall convert large and medium-sized state-owned enterprises into standard corporations according to the requirements of "clearly established ownership," well defined power and responsibility, [and] separation of enterprise from administration ... so that they will become corporate entities and competitors adaptable to the market. ... [In these enterprises] the state will enjoy owner's equity according to the amount of capital it has put into the enterprise and bear limited responsibility for the debts of the enterprise, [which] will operate independently according to law, responsible for their own profits and losses. ... We shall also quicken the pace in relaxing control over small state-owned enterprises and invigorating them by way of reorganization, association, merger, leasing, contract operation, joint stock partnership or sell-off. ... We should encourage merger of enterprises, standardize bankruptcy procedures, divert laid-off workers, increase efficiency by

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<sup>1</sup> By the end of 1995 those experimental 18 cities witnessed total 103 bankrupted enterprises and 336 merged enterprises; by the first half of 1996 those 50 cities witnessed total 131 bankrupted enterprises with another 154 enterprises in the process of bankruptcy, and 215 merged enterprises. Chen Hongjuan, "Guoyou ziben jiegou tiaozheng de jinzhan qingkuang he cunzai de wenti," p. 30.

downsizing staff and encourage re-employment projects so as to form a competitive mechanism selecting the superior and eliminating the inferior” (Baum: 145).

As we observed, China since 1993 made efforts to corporatize SOEs which did not make meaningful progress, and the leadership came to realize that it could not be patient about protracted SOE reform any longer. The leadership decided on a full scale SOE restructuring process which extended to even ownership reform by focusing on corporatization with more explicit and legally defined ownership out of vaguely defined public ownership (Naughton 2007: 105). Hence, a primary feature of the 1997 decision was to carry out full SOE restructuring which was predicated on the political resolution to carry out SOE ownership reform beyond ideological constraints. Yet, as China’s SOEs were embedded in completely different social conditions depending on their size, the social impact of this restructuring process was not the same. So following the existing SOE corporatization practice of *grasping the big and releasing the small*, the leadership decided to take different restructuring schemes for SOEs by size. While the restructuring process for large SOEs focused on corporatization in terms of clearly defined state ownership, the restructuring process of small SOEs pursued ownership diversification including privatization.

Trying to figure out the measure to reorganize SOEs into an efficient corporate system, the State Council in 1996 selected 300 key large industrial SOEs to carry out restructuring experiments. Even if they were only 0.4 percent of all industrial SOEs, their assets accounted for 40 percent of total industrial SOE assets and thus China decided to carry out this experiment to figure out how to best reorganize the very crux of SOEs into an efficient corporate system.<sup>2</sup> The

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<sup>2</sup> The State Council in the no. 11 document of 1996 explicitly announced that in order to invigorate crucial large and medium SOEs needed establishing modern enterprise system in terms of “self managing,

state continued to increase the number of SOEs involved in this experiment and the number increased to 500 in 1997 and again expanded to 1000 by the end of the 9<sup>th</sup> FYP period. These 1000 large SOEs comprised 1.25 percent of the total number of industrial SOEs, but their asset accounted for an astounding 66.7 percent of total industrial SOE assets. They were the essence of the state's industrial system, so the efforts involved the leadership's plan to make them constitute the backbone of the *inner system* economy with pure economic units in the market economy system.<sup>3</sup> In this context, the primary focus of big and medium SOE restructuring was came on how to establish clear state ownership with the corporatization process going beyond the "big pot rice" system, with the expectation that this could settle the financial troubles of big and medium SOEs.<sup>4</sup>

There were also a huge number of small SOEs that already lost their competitiveness and the leadership assigned management of these SOEs to many lowe local governments. The center relegated this task to local government because they did not want the burdens of overseeing the numerous troubled small SOEs. Small industrial SOEs made up 80 percent of all industrial SOEs, but their total assets accounted for only 20 percent of total industrial SOE assets.<sup>5</sup> However, these small SOEs played a critical role in providing Zhigong's employment for urban society, so the efforts to reform small SOEs before 1997, as we observed before, ended up as a strategy to introduce the stock cooperative company scheme.<sup>6</sup> The main practice of introducing the stock cooperative company scheme was selling the small SOEs to insiders, i.e., SOE

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financially independent, self developing, and self constraining substantial legal person and competing subject in market." *Laodong neican*, 1996, Issue 5, p. 27.

<sup>3</sup> Chen Hongjuan, op. cit., p. 29.

<sup>4</sup> The leadership in 1997 declared that "by the end of 2000 most large and medium SOEs must be brought out of their financial plight through organizational restructuring" (Lin and Zhu: 336).

<sup>5</sup> Chen Hongjuan, op cit., p. 29.

<sup>6</sup> Ibid.; Dou Qingshen, "Gufen hezuozhi zhuyao caozuo nanti sikao," p. 75.

Zhigong, as direct sales to new investors from outside frequently caused serious resentments from insiders. Indeed, the scheme's key feature involved institutionalization of the insider's control by recognizing the Zhigong's position of ownership of the existing Danwei system.

It did not take very long before realizing some defects of the stock cooperative system in handling numerous troubled small SOEs. A critical feature of recognized Zhigong's ownership is equalism, as most stock cooperative companies uphold the principle of "one person one vote" rather than "one share one vote," turned out to be a critical barrier to running them efficiently.<sup>7</sup> In this context, the leadership decided in 1997 to undergo a full scale SOE restructuring and unbounded *releasing the small* out of stock cooperative company scheme to push ownership reform to the extent of privatization.<sup>8</sup> Indeed, the proportion of private shares increased radically in the late 90s, which included shares controlled not only by managers and employees but also by outsiders. In addition to forming joint ventures and mergers with domestic or foreign firms, open sales to outsiders became a more popular form of small SOE restructuring.<sup>9</sup> The decision of full scale SOE restructuring in 1997 opened the gate for lots of troubled small SOEs to be reorganized into privatized companies with the measures of leasing, sales, or mergers and acquisitions.

The full scale SOE restructuring push of 1997 handled large and small SOEs differently. While retaining tight control over the limited number of large SOEs which constituted a critical portion of China's economy based on clarified state ownership system, the state completely separated small SOEs from the state by selling them to outsiders to the extent of full

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<sup>7</sup> Wang Hailin, "Guoyou zhongxiao qiye gaige jinzhan qingkuang cunzai wenti he xia yibu gongzuo anpai," p.22.

<sup>8</sup> Indeed, Zhucheng and Shunde, two pioneer cities of stock cooperative companies, in 1997 moved to full scale restructuring toward share concentration with management buyout (Garnaut, et al. 2006: 38).

<sup>9</sup> Obviously, SOE restructuring has become more radical in terms of privatization and the outsiders have been playing an increasingly more active role in the privatization process (Garnaut, et al. 2006: 45-6).

privatization. In this context, under the full SOE restructuring push, lots of troubled small SOEs underwent radical restructuring process beyond the stock cooperative system and even the bankruptcy mechanism came to apply to many of them. After the NPC passed Bankruptcy Law in late 1986, the numbers of bankrupt SOEs remained low for long time, but with serious market competition the number of bankrupt SOE increased rapidly in the mid 90s.<sup>10</sup> Of course, most of the bankrupted enterprises were small SOEs<sup>11</sup> and the bankrupted SOEs Zhigong could not remain with their Danwei. Thus, the increasing numbers of bankrupted SOEs represented the fact that the SOE restructuring push went beyond the level that Zhigong society could accept.

Indeed, the decision of the 15<sup>th</sup> Congress was not a simple endorsement of the existing practice of *grasping the big and releasing the small* at the local level. Rather, its overhaul as the central scheme to carry out full scale SOE restructuring went beyond the existing reform boundary to the extent that the *inner system* Zhigong could accept.<sup>12</sup> The State Statistical Bureau's survey data of industrial SOE restructuring in 1998 identifies that the overwhelming majority completed ownership restructuring during 1997-98. Hence, even if the efforts of SOE corporatization started in 1993, a major push of SOE ownership reorganization was carried out from the decision of the 15<sup>th</sup> Party Congress in 1997 (Lin and Zhu: 321). China's lingering SOE reform for decades finally made a breakthrough, as it decided to push full scale SOE restructuring for corporatization beyond the "big pot rice system." Indeed, the 15<sup>th</sup> Party

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<sup>10</sup> The Numbers of Bankruptcy Cases Adjudicated by People's Courts.

Year	1989	1990	1991	1992	1993	1994	1995	1996
Cases	98	32	117	428	710	1625	no data	6232

(Source: Rawski: 146)

<sup>11</sup> JIL, *Chugoku no rodo shakai hoshu shisutemu no kisoteki kenkyu*, p. 69.

<sup>12</sup> "By 1997 the "diversification of ownership," which meant large-scale privatization in practice, was actively promoted by the central leadership. The change was contained in the "Hold the Large, Let Go the Small" policy that was announced at the Fifteenth Party Congress in 1997 but had been in various stages of implementation at the provincial level since at least 1994. The policy approved the sale, merger, acquisition, or bankruptcy of tens of thousands of small-to-medium state firms" (Gallagher: 140).

Congress adapted the meaning of state ownership in its economy from the existing absolute one to more a strategic one, which represented the fundamental turning points for the socialist system.<sup>13</sup>

This was a complete abolition of China's unique reform scheme of gradualism, as the efforts to reform the SOE system over decades did not make significant progress. The primary reason for the drawn-out SOE reform had to do with the fact that the Danwei system did not have a scheme to dissolve labor relations with their Zhigong. Indeed, with new *outer system* units and serious market competition, SOEs suddenly became entities full of redundant workers, due to their their underemployment practice to arrange full urban employment. Hence, the Danwei system's inherited contradictions with the competitive market condition exploded with redundant workforces as increasing numbers of troubled SOEs could not dissolve labor relations with their Zhigong. Yet, China did not devise measures to handle the redundant SOE Zhigong, which was a critical precondition to carry out full scale SOE restructuring.<sup>14</sup> Hence, even if the leadership declared its determination of full SOE restructuring, it still remained unclear how to make those redundant Zhigong accept the restructuring process.

There was growing consensus in China that the state had to come up with a system to discharge the numerous redundant SOE Zhigong and the leadership knew very well that it could

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<sup>13</sup> Then, private enterprises got full political recognition in 1999 with a constitutional amendment which redefined private sector's nature from previous "supplementary" one to an "important integral part" of the economy.

<sup>14</sup> According to survey on the restructuring of industrial SOEs conducted by the State Statistical Bureau in the summer of 1998, about 17.1 percent of SOEs completed restructuring, but about 52.1 percent did not take any concrete action for restructuring, even if over half of them were inclined to do so (Lin and Zhu: 318).

not continue to procrastinate.<sup>15</sup> However it was not a simple reform, as China's former efforts such as the "labor contract system" and the 'labor optimizing combination' (LOC) did not produce meaningful results. There had been various makeshift schemes to handle redundant Zhigong's labor relations in the SOE corporatization process before 1997, whereby redundant Zhigong were separated from the production process without clearly dissolving the labor relations, such as 'keeping positions without wages' (*tingxinliuzhi*), 'long-term vacation' (*changjia*), 'internal retirement before formal retirement' (*neitui*), and even 'mutual negligence' (*liaongbuzhao*). Then, how could the push of full scale SOE restructuring after 1997 extend to radical privatization, unlike many previous efforts, by handling the sensitive issue of dissolving the labor relations with the numerous redundant Zhigong?

Without a socially accepted unemployment system, an economic unit cannot discharge its redundant workers for restructuring. The socialist system claimed its superiority in its lacking of the condition of unemployment, as it was regarded as a social problem only in market economies.<sup>16</sup> The socialist system tried to co-optate its society with the belief that a good political community could be constructed by organizing society in terms of protecting the system from shocks that market economies experience through political commitment of full employment for all citizens. So China before the reform did not have an unemployment system and only its unique 'waiting post' (*daiye*) system, which refers to some citizens' temporarily unemployed condition under exceptional circumstances. Since the state had the political commitment to arrange work posts for all its urban citizens, the urban citizens were supposed to be

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<sup>15</sup> The State Commission for Economic Restructuring in May 1997 predicted that 15 to 20 million redundant workers in SOE lose their jobs by 2000 with estimation of total SOE redundant workers at 54 million (Sheehan, et al.,: 488).

<sup>16</sup> "Xiagang refers to the interruption of employment in the plan economy; unemployment refers to the interruption of employment in market economy." *Nanfang zhoumo*, 1998, Jan. 16th.

administratively assigned their work posts that they would keep them until their retirement. Hence, there was no reason for urban society to have an unemployment system. This was the exact dilemma for China to reform SOEs it had to convert their redundant Zhigong into unemployed workers even though they did not have a socially approved unemployment system. In this context, China's SOE restructuring process involves the politics of how to construct an unemployment system that urban society could accept from scratch.

A critical precondition for a society to accept unemployment system depends on whether the system can reliably support the unemployed. Yet, urban society before the reform was organized with the Danwei system as the exclusive social system to arrange full urban employment. As China organized the Danwei system to absorb social resources to construct its heavy industry hastily, it gave only small wages to SOE Zhigong with the system's guarantee of their living as permanent workers who were entitled to comprehensive welfare benefits. Indeed, the Danwei system was organized not as simple workplace but as a living community that guaranteed the entire living of its personnel.<sup>17</sup> A critical feature of the Danwei system before the reform was the SOE's exclusive "enterprise insurance system" without any further social coordination scheme outside of the Danwei. Indeed, the Danwei system did not need social system beyond itself, because there were no citizens who did not belong to the Danwei.<sup>18</sup> Hence, the Danwei as a small society organized urban society by managing all social functions of its workers – urban citizens – and thus there was no independent social system beyond the Danwei.<sup>19</sup>

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<sup>17</sup> SOE Zhigong, once employed, was not only provided with wages but also naturally guaranteed their tenure, housing, medical service, and pension. JIL, op. cit., p. 39.

<sup>18</sup> Indeed, the urban society was equal to the "sum of Danwei" and its all citizens were without exception supposed to belong to any Danwei. JIL, op. cit., p. 38.

<sup>19</sup> "Danwei's social function expanded and became a quite closed and independent social system; and its 'social community' (Shequ) that was placed under the Danwei framework retrograded into marginal position and played really limited functions in actual everyday life." Sun Liping, *Duanlie*, p. 112.

In this context, without the Danwei affiliation, there was no social ground upon which the urban citizens could depend to manage their living. This was a critical reason why urban society still could not accept this unprecedented unemployment condition. As unemployment meant unreserved termination of Zhigong's labor relation with their Danwei, the newly unemployed would come to lose the exclusive organizational protection scheme in urban society. This would cause rising discontents among Zhigong due to the anxieties related to their living after dissolving the labor relations with their Danwei. This was a critical reason why the previous push of LOC to introduce a new flexible labor scheme did not successfully devise a scheme to dissolve labor relations with redundant Zhigong. Hence, the crux of China's SOE reform is how to construct a new socially acceptable unemployment system by organizing new reliable social system beyond the parochial Danwei based enterprise insurance system.

Officially, China tried to introduce an unemployment system with its reform of the labor contract system, since employers could resolve labor relations with their workers at the end of a labor contract. The reform, however, as we observed, could apply only to newly- employed young workers, so it was not a system that could apply to existing workers. Yet, those new contract workers could dissolve the labor relations with the expiration of labor contract, and China promulgated new labor system to handle those new released Zhigong from the Danwei. The "rule of SOE Zhigong 'waiting post' (*daiye*) insurance" in 1993, which targeted mainly for two unprecedented social groups who could not belong to existing the Danwei system: discharged contract workers and bankrupted SOEs' Zhigong, as SOEs were no more exempt from bankruptcy. With a new social system to support these new social groups who could be released from the Danwei system, the leadership tried to organize its new social system as a

complementary system to deepen SOE reform.<sup>20</sup> Here, the leadership devised the scheme of a ‘waiting post’, instead of unemployment, which provided supports for a limited period until Zhigong that were let go were reemployed in another Danwei system.<sup>21</sup>

With the new supporting systems for those who did not belong to the Danwei system, the leadership wanted to apply the labor contract system to everyone, not just the newly employed young employees. Indeed, the corporatization efforts and the LOC were supposed apply to all the existing Zhigong. However, Guthrie’s 1995 study found that the labor contract system was in reality applied to only part of Shanghai SOEs employees. SOEs with more financial troubles and SOEs that belonged to higher level of governing systems tended to apply the labor contract system more widely. Most managers did not want to apply the full labor contract system due to the socialist value of patron-client relationship.<sup>22</sup> Urban society was not ready to apply the labor contract system to SOE Zhigong and fully replace their permanent worker status. Even those Zhigong who were turned into contract workers were not actually laid off for the restructuring process.<sup>23</sup> Hence, under the condition of the ‘waiting post’ insurance system, the efforts to apply the labor contract system to all SOE Zhigong did not end up as a scheme whereby SOEs could truly dissolve labor relations with redundant Zhigong.

In contrast, many small SOEs and COEs were placed under serious market competition with the new *outer system* units and they could not maintain their redundant personnel as

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<sup>20</sup> He Ping, *Guoyou qiye gaige zhong de shehui baoxian*, p. 194.

<sup>21</sup> Tang Jun, *Shichang jingji yu shehui baozhang*, p. 65.

<sup>22</sup> “Where firms can afford to do so, they reward past loyalty and honor these past relationships” (Guthrie: 97).

<sup>23</sup> “The use of labor contracts was often just a formality and not a real threat to employment until SOE reform was accelerated in the mid-to-late 1990s” (Gallagher: 66).

before.<sup>24</sup> For small SOEs and COEs, China's *inner system* was already under industrial restructuring and resulted in many Zhigong who found without any system to arrange supports for them. The *inner system* could not accept the redundant Zhigong released from their Danwei and the 'waiting post' could not provide enough support for them. In this context, the Labor Law of 1994 officially recognized the new unemployment system, which unlike the 'waiting post' system created a new social group who did not belong to the *inner system* and provided clear termination of Zhigong labor relations with their Danwei. As a result, the unemployed could not expect that the state would arrange their jobs within the *inner system* had to find jobs in the labor market by themselves. This required a new social system that the unemployed could depend on until they found new jobs in the labor market. Yet the effort to introduce a new unemployment system was not followed by related efforts to set up a new social system to support the newly unemployed that could replace the unorganized existing 'waiting post' insurance system.<sup>25</sup>

However, it became increasingly clear that a more robust unemployment system had to be established as the number of SOEs in financial trouble grows with intensified market competition. China estimated that the total number of unemployed Zhigong from 1995 to 2000 would reach to 18 million out of full restructuring process with SOE bankruptcies, economic layoffs, and the ending of labor contracts.<sup>26</sup> In this context, the country clearly realized that it needed a reliable social system that could support unemployed Zhigong until they found new jobs. Unlike *waiting post* insurance, the new unemployment insurance system was not linked to

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<sup>24</sup> MOL revealed at the end of 1996 that the number of SOE redundant workers who stood by at home without wages, those virtually on the verge of unemployment, already reached to 22 million. JIL, op. cit., p. 69.

<sup>25</sup> He Ping, op. cit., p. 213.

<sup>26</sup> Ibid., p. 199.

the government's commitment to arrange their new work posts. Thus, the government was relieved from the burdens to place urban citizens within the already full the *inner system* and thereby virtually ended the state's 'unified labor placement' system. Furthermore, it enabled troubled SOEs to release redundant Zhigong, because the Zhigong could now depend on unemployment insurance system. In this context, the leadership in 1995 expressed the urgent need to establish unemployment insurance system to handle redundant SOE Zhigong for the urgent SOE restructuring. Wang Jianlun, the deputy minister of MOL, stated that

“the reform of unemployment insurance system is one of the hottest issues of entire society regarding the establishment modern enterprise system. Now it is hard for SOE to absorb redundant personnel; it is hard to settle bankrupted SOE Zhigong; and these tough issues not only disturb SOE but also affect SOE reform. To handle these issues, from the labor departments' perspectives, it is required to perfect unemployment insurance system and speed up the reform of unemployment insurance system.”<sup>27</sup>

The key challenge in setting up an organized unemployment insurance system is whether it can successfully incorporate a sustainable revenue source to support the program funded by premiums. China planned to set up its socialized unemployment insurance system in the 9<sup>th</sup> FYP which would cover the entire Zhigong class with the burden shared among the state, the Danwei, and individuals.<sup>28</sup> The plan, however, was difficult to execute, as more and more SOEs could not pay their premium due to poor performance. According to Liaoning province labor department, the province's unemployment insurance had a serious problem in collecting the funds. In addition to the many poorly performing industrial enterprises that could not pay their premium in the province, some enterprises that had the capacities to pay also rejected with various reasons. The government's enforcement of paying premium was weak during the initial

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<sup>27</sup> *Laodong neican*, 1995 Issue 5, p. 9.

<sup>28</sup> *Laodong neican*, 1996 Issue 7, p. 6.

stage.<sup>29</sup> Unable to collect sustainable funds, the emerging unemployment insurance system could not provide enough supports to the newly released Zhigong. Hence, not all unemployed personnel were able to receive to the unemployment insurance: the numbers of unemployment insurances beneficiaries in 1998 were 1.6 million, only 27.7 percent of total registered unemployed personnel, 5.7 million.<sup>30</sup>

Despite the efforts to set up an unemployment insurance system, it did not become a reliable social system on which those discharged SOE Zhigong could depend and urban society was not ready to accept full scale SOE restructuring. In this context, MOL's no. 7 Document of 1996 confirmed that in order for China to deepen SOE reform, it needed to guarantee the basic living of troubled SOE Zhigong. "Handling the issue of troubled SOE Zhigong, we should stick to the direction for industrial restructuring and deepening SOE reform... For the troubled SOEs which are temporarily hard to merge, bankrupt, closing down, and dissolution, we should take various measures to sincerely guarantee the basic living of troubled SOE Zhigong..."<sup>31</sup> Indeed, the leadership now came to focus on the issue of how to handle Zhigong's 'relieving hardship' (*jiekun*) in SOE transformation. President Jiang Zemin at the end of 1996 consoled Beijing's troubled SOEs and their Zhigong, and Premier Li Peng also went to Anshan to examine the condition of the area's troubled SOEs and their Zhigong. Deputy-Pemier Wu Bangguo, on the other hand, held national vedio conference on how to push project of relieving Zhigong's hardships. In fact CCP issued its no. 29 Document of 1996, which provided a systematic

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<sup>29</sup> *Laodong neican*, 1996 Issue 9, p. 37.

<sup>30</sup> ILSS, *Zhongguo Laodong Kexue Yanjiu Baogaoji 2000-2001*, p. 139.

<sup>31</sup> *Laodong neican*, 1996 Issue 2, p. 20.

foundation for program to relieve Zhigong hardship by establishing a hardship relief responsibility system and hardship relief funds, and deciding how to collect the funds.<sup>32</sup>

In addition to hardship reliving programs, China also realized that it was critical to set up a new re-employment system for the discharged Zhigong, since the most reliable living guarantee is employment.<sup>33</sup> Indeed, (with the State Council's 100 enterprise testing program for modern enterprise system in 1994), MOL started to think over how to arrange new re-employment for those redundant Zhigong after they were discharged from the Danwei.<sup>34</sup> Then, national joint-meeting for 'relieving hardship' task issued "opinion regarding how to handle well the task of guaranteeing Zhigong in their living troubles in 1997", which demanded that "each area set up its re-employment program for Zhigong in hardships."<sup>35</sup> Li Boyong, the Minister of Labor, also demanded that in arranging basic livings for Zhigong of troubled SOEs, the fundamental solution was re-employment, as "relieves are only temporary measures and it is only after realizing re-employment that the issue is essentially resolved."<sup>36</sup> In this context, China tried to devise a new reliable re-employment system and MOL articulated "reemployment project" which included tax breaks for enterprises that employ redundant Zhigong, financial support for redundant Zhigong who try to set up their own new business, and relieving and skill retraining programs.<sup>37</sup>

The emphasis on re-employment meant that those troubled SOE workers had to find out their new jobs in labor market. Li Boyong, the Minister of MOL, argued that "we should bring

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<sup>32</sup> *Laodong neican*, 1997 Issue 4, p. 4.

<sup>33</sup> "In order to guarantee the living of released Zhigong, the bottom line is how to find out their new employment route and settle their work post." *Laodong neican*, 1996 Issue 3, p. 1.

<sup>34</sup> *Laodong neican*, 1996, Issue 3, p. 6.

<sup>35</sup> *Laodong neican*, 1997, Issue 4, p. 12.

<sup>36</sup> *Laodong neican*, 1997, Issue 6, p. 3.

<sup>37</sup> JIL, op. cit., p. 70.

troubled SOE Zhigong into re-employment project in which the government's responsibility is to assist workers to realize their re-employment with their own endeavors through diverse routes and diverse forms of employments. Here it is critical to transform Zhigong's consciousness: Zhigong in hardship should realize that the track now China is on is restructuring, which means there will be no more state's arrangement of their employment depending on extensive enlargement of production system like former days."<sup>38</sup> From the statements we can identify the fact that the reform under the CCP leadership reached full recognition of the labor market system where discharged SOE Zhigong could realize their re-employment. What this means is the fact that the labor relations would be fashioned mainly through labor market system, and the state came to be relieved from the burdens to arrange employment for the urban society.

At the same time, from the early 90s there started to emerge Zhigong who did not have work to do in their Danwei, and their Danwei could not maintain their work posts. Without any reliable social system for those discharged Zhigong, there emerged some ad hoc measures to discharge their redundant Zhigong. Indeed, some small SOEs and COEs underwent restructuring process based on Xiang practice which arranged redundant Zhigong to leave their workpost temporarily.<sup>39</sup> "Xiang personnel refer to those who, for various reasons, temporarily leave their working posts, receiving the original Danwei's allowances and relieves, and wait for their

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<sup>38</sup> *Laodong neican*, 1997, Issue 6, p. 3.

<sup>39</sup> Before Xiang, China only had Fenliu program which refers to the arranged labor transferring practices within plan economy system by separating Zhigong from original Danwei and reassigning them into new one. Even though labor mobility in the plan economy system was rare, but there were limited cases of labor transfer, such as for newly created Danwei. Thus, Fenliu system arranged administratively labor transfer within the *inner system* units, in which Zhigong could sustain their position of the state personnel. By contrast, Xiang from the start implied that projected termination of the labor relations between Zhigong and Danwei in the future, but it at least allowed temporarily preservation of labor relations between them (Lee: 914).

re-employment.”<sup>40</sup> The concept at first was ambiguous and it did imply the possibilities that Xiagang Zhigong could return to their former work posts someday when their Danwei got better. Hence, Xiagang at first remained mainly as local-level experimental practices as provisional suspension scheme of Zhigong’s relations with their Danwei with a chance to come back to their old Danwei. Its main feature was not how to provide reliable supports for discharged workers but how to make redundant Zhigong accept the very sensitive condition that they could leave their Danwei.

China could not lay off lots of SOE redundant Zhigong all at once, as its urban society was not ready to accept this unprecedented reform. The leadership also knew that without reliable social safety nets China could not directly lay off lots of SOE redundant Zhigong. Yet, China had to push full scale SOE restructuring process, even if its social system was not organized enough. In this context, the leadership came to think over organizing quite reliable Xiagang program to introduce a systematic transitional phase in discharging redundant Zhigong.<sup>41</sup> Indeed, the primary feature of emerging Xiagang program was Xiagang Zhigong still held their labor relations with their Danwei, even after they lost their work posts in their problematic Danwei, as the term Xiagang meant literally “step down from work posts.” Then, the leadership also decided to set up quite organized Xiagang system as a reliable system for those Zhigong in discharging phase by encompassing those roles of ‘hardship relieving’ and re-employment supports. In this context, Xiagang emerged as a unique status between employment and unemployment: on the one hand, Zhigong left their work posts, but they still held labor

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<sup>40</sup> Chang Kai, *Laodong guanxi laodongzhe laoquan*, p. 60.

<sup>41</sup> Obviously, Xiagang system “represents the facts that our social security system and SOE Zhigong consciousness of employment are not ready for the radical diminution of SOE workforces according to fluctuating economic cycle and restructuring industrial system.” Li Peilin, Zhang Yi, and Zhao Yandong, *Jiuye yu zhidu bianqian*, p. 20.

relations with their Danwei, which made their Danwei keep taking the burdens of arranging their welfare and basic safety nets.<sup>4243</sup> Then, with supporting for re-employment for Xiagang Zhigong, the leadership expected that redundant SOE Zhigong could realize re-employment and leave their Danwei smoothly. In this context, Xiagang became a focal system for the restructuring process which absorbed the roles of hardship relieving and re-employment support.

The leadership's expectation of Xiagang was propped up with the successful experience of Shanghai's Xiagang program. Shanghai was the most industrialized city in modern China's history. After the revolution the CCP leadership tried to reorganize Shanghai's industrial systems into the socialist industrial system through SOE form, without losing its leading industrial position.<sup>44</sup> In a sense, Shanghai's socialist industrial systems were systemically protected, because there was not market competition. But with intensified market competition after the reform, it also became the first city in China which underwent serious the *inner system* restructuring. It had a big textile industry, which in its nature had lower entry barrier for new business starters. Seeing this success, many other local governments after the reform tried to start their own textile industry and refused to send their textile inputs that they had previously sent to Shanghai. This caused a critical shock for Shanghai, as its textile industry had come to depend greatly on input from other areas.<sup>45</sup> If the center decided to curb other areas' ventures, Shanghai could have avoided restructuring its textile industry, but the center did not and Shanghai became the first experimental case to figure out how to restructure the old industry

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<sup>42</sup> Cai Fang and Lin Yifu, *Zhongguo Jingji*, p. 67.

<sup>43</sup> Xiagang Zhigong were given basic living subsidies (*shenghuofei*), instead of unemployment benefits, and are not included in the registered unemployment-rate (Lee and Warner: 177).

<sup>44</sup> Its industrial production of its total GDP in 1952 was already 53.6%, which kept increasing to 77.4 percent by 1978. The ratio of labor forces belonged to industrial sector in 1952 was 29.6 percent, which increased to 44.1 percent in 1978. Wang Daben, "Chengshi jiuye," p. 89.

<sup>45</sup> Interview, October 25th, 2003.

system in China.<sup>46</sup> As China did not have an unemployment system, the city did not have a social system to support the unemployed. Thus, Shanghai became the first city to devise unprecedented measures on how to handle the laid off Zhigong.

Restructuring industry is a very sensitive political issue, as it involves laying off large portion of the labor forces. Industrial restructuring in China particularly entailed much more serious social shocks than in any other country. First of all, China under the plan economy system never before experienced such a thing as industrial restructuring or layoff workforce. Secondly, the scale of the affected work force would be much bigger than that of market economy system, as China's *inner system* retained a huge number of underemployed personnel to achieve full employment for urban society. Finally, the social impact of its discharging underemployed Zhigong could be really explosive, as China did not have any social institutions to deal the newly laid off Zhigong.<sup>47</sup>

In this context, Shanghai from 1993 tried to organize workers in restructuring industrial sectors through of Xiangang without clearly dissolving their labor relations.<sup>48</sup> However, the issue of how to place those Xiangang Zhigong to find their new work posts remained unclear. The Xiangang Zhigong were not competitive in the labor market due to their low skill levels as part of the SOEs' deskilled production mode. Plus, China did not have a mature labor market and only a minor labor service (*laowu*) market in which most Zhigong neglected. Very few Xiangang

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<sup>46</sup> Chen Xueming, op. cit., p. 26.

<sup>47</sup> "...in the middle of 90s, Shanghai leadership faced a really serious dilemma to handle: if Shanghai does not undergo remolding its traditional industry to optimize industrial structure to develop its economy, it will suffer from its loss of good chance to develop its economy; but, on the other hand, if it discharges its personnel issues improperly, then this will cause social unstabilty..." Chen Xueming, op. cit., p. 26.

<sup>48</sup> Shanghai City Trade Union before 1994 conducts a survey for total 137 enterprises in four sectors (electrical machinery, textile, instrumental and light industries) belonging to *Hongkou* and *Zhabei* districts. Of the total 271.8 thousands Zhigong in those enterprises, the number of Xiangang Zhigong was 21.8 thousands, which account for 8.1 percent. *Laodong neican*, 1994, Issue 1, p. 29.

Zhigong, and the majority remained in a passive scheme of placement including early retirement, waiting for retirement, keeping positions without wages, and long term break. There were also a considerable number of Xiangang Zhigong that just waited for job placement at home.<sup>49</sup> In this context, Shanghai government realized that it needed a new scheme to arrange reemployment for the newly discharged Zhigong.<sup>50</sup> In 1993, the city tried to construct a new social system of reemployment and launched its “reemployment project” (Lee and Warner: 177) with the policy goal to offer jobs to the discharged Zhigong or help them obtain reemployment by using various administrative means.

Shanghai’s textile industry made various efforts to handle its redundant Zhigong and shifted 170,000 workers to other jobs since 1986, but was still running a loss of 350 million *yuan* in June 1996. In this context, “the Shanghai Textile Holding (Group) Company (*Shanghai fangzhi konggu gongsi*) decided to cut their activities further, and 80,000 textile workers were said to have lost their jobs then” (Lee and Warner: 178). In this context, the enlarged meeting of the Shanghai CCP standing committee convened in July 1996, and there emerged a new scheme to handle the labor issue in its two serious industrial sectors’ (textiles and electrical machinery) restructuring process with re-employment program for Xiangang Zhigong based on “Reemployment Service Center (hereafter RSC).”<sup>51</sup> Then, the government issued the notice of

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<sup>49</sup> Ibid., p. 30.

<sup>50</sup> China soon realized that SOEs could discharge their underemployed Zhigong only after it set up a new social scheme of re-employment. “To handle SOE’s surplus personnel, we have to encourage SOEs to actively develop their tertiary industry to arrange their employment. Regarding the ‘socially unemployed personnel’, we have to focus on its knotty points in employment, based on the survey to the bottom and well organized analysis, and help their employment as soon as possible, with such supports as free skill training and other subsidies to help them establish their production self-help base.” He Ping, op. cit., p. 244.

<sup>51</sup> Chen Xueming, op. cit., p. 27.

idea on enforcing the experiment of Shanghai textile holding company and Shanghai electrical machinery holding company's reemployment project.<sup>52</sup>

Indeed, Shanghai made efforts to set up a reliable reemployment program with the expectation that it would help troubled SOEs unload their redundant labor forces, and increase their market competitiveness by allowing them to reduce their heavy social burdens to maintain the labor system for Zhigong.<sup>53</sup> So trying to articulate its scheme of RSC system in the textile and electrical machinery sectors, Shanghai made up the following principles: "establishing one center, constructing two systems, and pioneering three funds sources."<sup>54</sup> Establishing one center referred to setting up the RSC system as a social intermediating agency that arranged required support for redundant Zhigong's re-employment. As the system to organize Xiangang just released from their work posts, a critical feature of the RSC system was that even after Zhigong left their work posts, their labor relations with their industrial sector were not yet completely dissolved. RSC was designed to play a role to guarantee these Xiangang Zhigong's living: it not only granted basic living fees but also arranged them to sustain their entitlement to pension and medical insurance. With this intermediate agency, when Zhigong were separated from SOEs, they did not enter into society directly but were entrusted to RSCs.<sup>55</sup>

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<sup>52</sup> Then, five other industries' holding companies (group) also followed suit and established their own RSCs in the March of 1997. Chen Xueming, *op. cit.*, p. 34.

<sup>53</sup> "Excessive redundant workforces and excessive social burdens are the SOE's chronic diseases, which for long time obstruct SOE's reform and development. The condition that Zhigong can enter and can leave is a critical mechanism, which fashion modern enterprise's competitiveness. From long term perspectives, SOE system lacks its competitiveness, since it did not establish this mechanism. With the re-employment program, shedding off SOE surplus personnels and bankrupt or merged SOE's Zhigong will help SOE lay down its social burdens and increase their competitiveness." Chen Xueming, *op. cit.*, p. 38.

<sup>54</sup> *Laodong neican*, 1997 Issue 5, p. 33.

<sup>55</sup> *Laodong neican*, 1997 Issue 4, p. 26.

Two systems referred to Shanghai's plan to fashion two unprecedented systems for the reform of problematic SOEs: the formation of SOE restructuring system such as mergers or bankruptcy and a new reemployment system for Xiang Zhigong. The two systems were closely linked, as the efforts of SOE restructuring could not succeed without a properly arranged new reemployment system for those discharged Zhigong.<sup>56</sup> Without a strong institutional system of reemployment, Shanghai's huge number of redundant Zhigong could not accept the city's decision to lay them off. Thus, Shanghai tried to set up its new RSC as an institutional bridge that could smoothly link enterprise restructuring and reemployment of discharged Zhigong. Troubled SOEs entrusted the RSC to support their discharged Zhigong in finding new employment.<sup>57</sup> RSC system came to play dual roles, not only arranging Xiang Zhigong's basic living but also supporting their reemployment, the two most sensitive issues in discharging redundant SOE Zhigong.<sup>58</sup>

RSC came to play a critical role for Shanghai's restructuring process, as it could handle SOE's redundant personnel with the Xiang scheme. Yet, Shanghai's RSC system was organized under a holding company, so its Xiang scheme was also called the 'entrusting' (*tuoguan*) system, as it entrusts each SOE's redundant personnels' reemployment issue to a

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<sup>56</sup> RSC to cushion the Xiang Zhigong against the pain of being laid off "acts as a buffer for them to enter the market gradually by providing a temporary safety-net to solve their immediate financial problems. ... The goal of this program is prima facie to guarantee a basic living for the entrusted Xiang workers and help them to get reemployment as soon as possible" (Lee and Warner, 179).

<sup>57</sup> Indeed, a SOE had to submit a formal request to the RSC of their holding company before it could lay off its surplus workers. Then, RSC screened it following the conditions set by the municipality. If approval was granted, the enterprise would then transfer its Xiang Zhigong to RSC (Lee and Warner: 179).

<sup>58</sup> Huang Ju at the 1996 meeting already said that RSC would not only "be entrusted with the task of caring of Xiang and waiting position personnel, but it also open reemployment channel with the scale of whole Shanghai society and carry out the unified scheme of adjusting structure of laborforce." Chen Xueming, *op. cit.*, p. 27.

higher holding company.<sup>59</sup><sup>60</sup> Hence, ‘entrusting’ system was holding company managed Xiagang system, which virtually organized SOE restructuring process at the industry’s holding company level beyond each SOE.<sup>61</sup> Indeed, the ‘entrusting’ system could successfully set up its Xiagang program, as it could handle the troubled SOEs’ redundant Zhigong with the scheme of coordinated restructuring system at industrial level.<sup>62</sup> Yet, the holding companies themselves could not cover all the required financial resources for RSC, so the city decided on three fund sources - the city government, SOE’s holding companies, and “society.” This was based on the principle that not troubled SOEs themselves but the society had to collectively share the burdens “by establishing collective scheme of responsibility between troubled SOEs and their administering bureaus with the supports of society and the government’s funds.”<sup>63</sup><sup>64</sup>

Before setting up the RSC system, Shanghai could not start restructuring its troubled SOEs. The city had serious problems in its textile and electrical machinery sectors, but there was not a single case of completed bankruptcy by 1995. Only after it set up RSC system could the city initiate its new drive for SOE reform including bankruptcy. “The establishment of RSC and implementation of reemployment project created preconditions for handling of bankrupt SOE’s

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<sup>59</sup> Yamamoto, *Gendai Chugoku no rodo keizai 1949-2000*, p. 425.

<sup>60</sup> “The immediate purpose is to reduce the financial burden of the enterprises by transferring much of their responsibility for the redundant workers to the state holding corporations (SHCs) (*guojia konggu jituan gongsi*) that have their own budgets” (Lee and Warner: 179).

<sup>61</sup> “This entrusting system to some degree reduced each SOE’s burdens, but, it is not partition from industry, rather, it is only partition from the factory, after all. ... In the stage of ‘entrusting’ system, the burden of unemployed Xiagang workers is divided by all enterprises of same industrial sector.” *Nanfang Zhoumo*, 1998, January 16th.

<sup>62</sup> “The bottom line is Xiagang Zhigong have to leave their SOEs that need restructuring; but they, instead of being directly plunged into society, are entrusted to RSC, which, under the commission of the holding company, will train new skills, introduce new occupations... grant them living fees, pay their social insurance fees, and support their reemployment.” *Laodong Neican*, 1997, Issue 5, p. 33.

<sup>63</sup> *Laodong neican*, 1997, Issue 5, p. 33.

<sup>64</sup> Specifically, the municipal treasury paid its portion from its poverty relieving funds; holding companies paid its funds which included their bankrupt SOE’s Zhigong placement fees; finally, the “society” contributed its portions by collecting fees from enterprises employing migrant workers. *Laodong neican*, 1997, Issue 5, p. 34.

personnel arrangement issue and SOE's 'reducing personnel to increase efficiency' (*jianyuan zengxiao*)."<sup>65</sup> In 1996, the textile and electrical machinery experienced 17 bankruptcies which affected a total of ten thousand Zhigong and thirteen thousand retired Zhigong.<sup>66</sup> The textile industry, under the RSC system reduced its number of Zhigong from 556 thousand in the early 90s to 229 thousand in 1998 (Wang Daben: 88). This RSC-based Xiangang system was also applied to Shanghai's *inner system* in general and its number of Xiangang Zhigong expanded rapidly. In the early 1996, Shanghai had more than two hundred thousand Zhigong waiting for their work posts.<sup>67</sup> By the early 1997 eight hundred and sixty thousand Xiangang Zhigong, of which six hundred and sixty thousand Xiangang Zhigong were already re-employed.<sup>68</sup> After Shanghai set up its Xiangang system based on RSC with a commitment for reemployment, many redundant Zhigong could accept the city's decision to release them, and Shanghai SOE Zhigong number declined radically from 1.35 million in 1995 to eight hundred and fifty thousand in 1998.<sup>69</sup>

The RSC system not only allowed SOE restructuring, but also instigated labor mobility in the city. Then, the city tried to use its momentum of *inner system* restructuring and labor mobility to upgrade its economic structure by transforming its economic system toward a tertiary industry based one.<sup>70</sup> Its production in 1990 consisted of 4.6 percent of primary industry, 56.2 percent secondary industry, and 39.4 percent tertiary industry, which in 1998 changed into 1.6,

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<sup>65</sup> Chen Xueming, op. cit., p. 37.

<sup>66</sup> *Laodong neican*, 1997, Issue 4, p. 27.

<sup>67</sup> *Laodong neican*, 1997, Issue 5, p. 33.

<sup>68</sup> *Laodong neican*, 1997, Issue 4, p. 26.

<sup>69</sup> Wang Daben, op. cit., p. 88.

<sup>70</sup> Indeed, the leadership from the early period of time planned to develop Shanghai's tertiary industry. The center as early as 1992 decided to initiate Shanghai's 'one forefront and three centers' (*yige longtou sange zhongxin*) project, which with the momentum of Pudong area's development planned to reshape Shanghai as the nation's center of economy, finance, and trade. Wang Daben, op. cit., p. 89.

46.5, and 51.9 percent, respectively. At the same time, its total workforces in secondary industry were 4.13 million in 1990, which decreased to 3.09 million in 2001. By contrast, its total workforces in tertiary industry were 2.18 million, which increased to 3.55 million (Wang Daben: 90). Shanghai became the first city in China to successfully restructure its many problematic SOEs and also transformed its industrial structure with rapidly growing tertiary industry. The city was able to achieve this outcome because it successfully carried out its experiment of the Xiangang program based on the RSC system.<sup>71</sup>

With Shanghai's successful Xiangang push, many areas also tried to devise their own Xiangang program. Hence, urban society since the 90s has undergone unprecedented experiences, such as workers losing their work posts without increasing the registered formal unemployment rate.<sup>72</sup> What this means is that with many areas' efforts to organize their Xiangang programs, urban society could carry out *inner system* restructuring without affecting the official unemployment rate. Indeed, whereas the number of China's urban registered unemployed personnel increased only slightly in the mid 90s, the number of Xiangang Zhigong started to expand rapidly. The total number of urban registered unemployed personnel in 1995 was 5.2 million, which increased to 5.5 million in 1996; but the total number of urban Xiangang personnel was 5.6 million in 1995, which increased to 8.1 million in 1996.<sup>73</sup> Obviously, with an immature unemployment system, more and more areas tried to carry out SOE restructuring process depending on their Xiangang program.

In this context, with the decision to push full scale SOE restructuring in 1997, the leadership decided to adopt Shanghai's successful RSC based Xiangang system as the national

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<sup>71</sup> Chen Xueming, *op. cit.*, p. 28.

<sup>72</sup> Cai Fang and Lin Yifu, *op. cit.*, p. 67.

<sup>73</sup> Yang Yiyong, *Shiye chongji bo*, pp. 218-220.

program. The State Council issued the no. 10 document of 1997, which not only emphasized basic living guarantee for destitute Zhigong, but also encouraged other cities to follow Shanghai's reemployment program based on RSC.<sup>74</sup> For the leadership, Shanghai reemployment program had its virtue in the fact that it could ensure social stability for radical restructuring of the *inner system*. The State Council admitted that this organizing practice for re-employment is a creative and plausible measure to promulgate under the condition of China's imperfect social security system and immature labor market.<sup>75</sup> In this context, the leadership decided on the full scale SOE restructuring scheme of *grasping the big and releasing the small* in the 15<sup>th</sup> Congress of the CCP in 1997 depending on Xiagang as the primary scheme to push the urgent task of "reducing personnel for efficiency, which was invented from Shanghai's reform experience."<sup>7677</sup>

The leadership expected that under the immature condition of its social security system, Shanghai's RSC scheme was the only plausible measure to achieve Xiagang Zhigong's reemployment.<sup>78</sup> The CCP Central Committee and the State Council in May of 1998 summoned the "national working conference on SOE Xiagang Zhigong basic living security and re-employment" in which the leadership, clarifying the unified national Xiagang scheme based on Shanghai's program, demanded that every SOE with Xiagang Zhigong should establish a RSC or

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<sup>74</sup> The document, entitled "the State Council's supplementary notice regarding the related issues of some cities' enforcing SOE merger, bankruptcy, and Zhigong re-employment," demanded that each experimental city's government, following the experiences of Shanghai's re-employment program, should establish RSC eagerly, which, based on each area's concrete condition, combined employment and reform of social security system. *Laodong neican*, 1997, Issue 10, p. 20.

<sup>75</sup> Yamamoto, op. cit., p. 425.

<sup>76</sup> *Laodong neican*, 1997, Issue 5, p. 1.

<sup>77</sup> Jiang Zemin stated in the 15<sup>th</sup> Party Congress that with the deepening of enterprise reforms and economic restructuring, it would be hard to avoid personnel flow and Zhigong's Xiagang, which could cause troubles for some Zhigong temporarily; but would be compatible with working class long term interests with its effect of economic development.

<sup>78</sup> "This organizing measure to realize re-employment is plausible measure, which is created under the condition of imperfect social security system and immature labor market. RSC work energies should be focused on re-employment." *Laodong neican*, 1997, Issue 7, p. 5.

a similar system to provides supports for Xiagang Zhigong.<sup>79</sup> The State Council also issued the “notice regarding sincerely arranging SOE Xiagang Zhigong’s basic living security and reemployment” in 1998 to urge each area to establish RSCs hastily.<sup>80</sup> Most of all, to ensure a financially sustainable RSC system, the leadership, following Shanghai’s fund organizing scheme, decided on the so called “three-three system,” which would be constructed by equal contributions from the government, SOEs, and social funds (mainly from unemployment insurance funds).<sup>81</sup>

The RSC system, however, could not guarantee every Xiagang Zhigong’s re-employment, and thus some inevitably had to leave their RSCs after their three year Xiagang program expired. So there was also a need to set up a social supporting system for those who did not successfully find new jobs through the RSC system. In this context, China also tried to set up two other related social programs to construct more organized support systems for Xiagang Zhigong - the “three security lines.” The first line was the Xiagang Zhigong basic living security line; the second line was an unemployment relief security line; and the final one was a minimum living security line. Xiagang Zhigong were entitled to the basic living expenses in RSC, for a maximum of 3 years to find new jobs without a guarantee of reemployment. If they were unsuccessful at finding a new position, they had to leave RSC and fully dissolve labor relations with their workplaces. Obviously, the leadership clearly formalized the fact that Xiagang

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<sup>79</sup> DRC SRRTT, “Zhongguo chengzhen shiye baoxian zhidu gaige de huigu yu qianzhan,” p. 78.

<sup>80</sup> Hong Dayong, “Gaige yilai Zhongguo chengshi fupin gongzuo de fazhan lichen,” p. 81.

<sup>81</sup> For the part of government’s contribution, the central government covered the central SOEs and local governments covered their SOEs. DRC SRRTT, op. cit., p. 78.

Zhigong had to dissolve their labor relations with their Danwei since they were entitled to only three years of RSC supporting programs.<sup>82</sup>

Without a reliable institution for the unemployed, Xiagang Zhigong could not leave their RSC, which forced the leadership to set up reliable unemployment insurance system to arrange a smooth transition for Xiagang Zhigong into unemployment. Zhigong had to leave RSC could be transferred the unemployment insurance system which would take care of them for a maximum of 24 months. Now, Xiagang Zhigong could leave their RSC even when they could not achieve their reemployment. And thus the unemployment insurance system became a part of the Xiagang program. Again, for those who could not find new jobs even after the 24 months of unemployed insurance program, the leadership decided to set up a new urban minimum living security program.<sup>83</sup> This final supporting system would enable the newly unemployed to keep searching for new jobs even after their two years' unemployment insurance entitlement was over. With the "three security lines" China's Xiagang program was supposed to smoothly transfer redundant Zhigong into the unemployed.

With the organized supporting systems for Xiagang Zhigong, the leadership hoped that Xiagang could play an institutionalized cushioning role to absorb the shock of discharged redundant Zhigong from their Danwei even without realizing re-employment. Indeed, Xiagang program was not a system for genuine unemployment, but a stepping stone for real unemployment. It was an initial arrangement for SOEs to release their Zhigong without leaving them completely empty-handed. Thus, China needed to devise other supplementary measures to

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<sup>82</sup> Shanghai at first decided that Xiagang Zhigong could stay in RSC only two years. "If Zhigong could not find out their new jobs within these two years, they had to leave RSC to enter 'labor market.'" *Laodong neican*, 1997, Issue 4, p. 26. However, when Xiagang became national program, China decided that Xiagang Zhigong could stay in RSC for three years.

<sup>83</sup> Zhang Minjie, "Xiagang baozhang xiang shiye baozhang "binggui": Zhejiang sheng de jincheng," p. 689.

make this half unemployment system into genuine one.<sup>84</sup> In this context, China forged the scheme that Xiangang Zhigong had to leave RSC after their limited period of benefits with the entitlement to unemployment insurance system. In the same vein, the urban minimum living security program supported those unemployed workers after two years of unemployment insurance benefits to provide another supported period where the unemployed workers could find new jobs. Thus, the scheme of “three security lines” could make those Xiangang Zhigong who could not realize re-employment accept the process to dissolve the labor relations. With the scheme of “three security lines” Xiangang system could become the very scheme to dissolve redundant SOE Zhigong’s labor relations, which virtually meant introducing unemployment system in the urban society.

Obviously, China came to set up Xiangang system that could transfer redundant SOE Zhigong into the unemployed, which made the decision of 1997 to carry out full SOE restructuring possible by dissolving redundant Zhigong’s labor relations. With organized Xiangang programs the urban society came to accept the very condition whereby those redundant SOE Zhigong could leave their Danwei to search for new jobs in labor market as the unemployed. Hence, the very scheme of *grasping the big and releasing the small* did not remain as former scheme of SOE corporatization efforts which proceeded only to the extent that could preserve Zhigong labor relations, but became the very scheme to realize full SOE restructuring. Indeed, Xiangang program based on RSC was expected to induce acceptable scheme to dissolve redundant Zhigong’s labor relations for the urban society which could lead to full scale SOE restructuring beyond the constraints of preserving Zhigong labor relations in the urban society.

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<sup>84</sup> “Xiangang Zhigong basic living guarantee and reemployment program are not a standard security system for the unemployed, after all.” DRC SRRTT, op. cit., p. 79.

China could reach broad consensus about the urgency of full SOE restructuring by observing the Asian economic crisis in neighboring countries, which discredited the developmental state scheme based on strong state's deep economic engagement. In this context, successful economic reform came to mean full corporatization of the SOE system and clearly dissolving relation with the state. With the belief in the market system for development, China also decided to participate in WTO, which meant that it had to push full SOE reform more quickly, as it would surely need competitive enterprises both domestically and internationally. The leadership in the fourth Plenum of the 15<sup>th</sup> Central Committee in 1999 issued "the CCP Center's decision of some critical issues regarding SOE reform and development" which reconfirmed its decision of full SOE restructuring with the reduction of redundant Zhigong based on Xiagang system's basic living and re-employment supports. As the central leadership decided to make Shanghai's experiment of RSC based Xiagang system into a national program, Xiagang was no longer a makeshift measure at the local level, a systemic program with the political drive from the center to restructure the *inner system* economy itself. In this context, the number of Xiagang Zhigong exploded, especially after 1997, and then the number remained high in the following years. Between 1997 and 2002, total number of SOE Xiagang Zhigong reached to 27 million.<sup>85</sup>

Indeed, the sharp increase of Xiagang personnel is the "consequence of China's reform of its prolonged hidden unemployment and of appearance of those redundant personnel on the surface" (Li, Zhang, and Zhao: 26). But at the same time, transforming those hidden unemployment into Xiagang personnel also meant that China was already equipped with not only RSC based basic living and re-employment supports but also related social security systems

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<sup>85</sup> *Zhongguo laodong he shehui baozhang nianjian*, 2002, p. 544.

for those who do not realize re-employment. Indeed, those expanding numbers of Xiagang Zhigong meant radical SOE restructuring, as they left their Danwei and entered labor market for their new jobs. Obviously, with the efforts to set up RSC based Xiagang program and related “three security lines,” China could dissolve redundant Zhigong’s labor relations, which allowed the urban society push full scale SOE restructuring to the extent of full ownership reform including privatization.

However, it did not take very long before the Xiagang system exposed its own defects. China decided to organize financially sustainable RSC system with the so called “three-three” scheme to follow Shanghai’s successful Xiagang program, which was predicated on its ‘entrusting’ scheme depending on holding company, i.e., industry-level RSC system. However, the “three-three” scheme was not organized as planned and many areas came to face troubles in setting up their Xiagang program based on the industry level ‘entrusting’ system. Shanghai could organize RSC system run by a holding company which involved coordination of the social costs of restructuring problematic SOEs at its industrial level. However, many other cities could not mobilize such resources to set up an industry level coordination scheme.<sup>86</sup>

In this context, many SOEs themselves could not but open and run their own RSCs to arrange Xiagang personnel’s basic living and support their re-employment efforts.<sup>87</sup> Hence, what really happened was that Xiagang programs silently reassigned the burden of restructuring the *inner system* to financially troubled SOEs themselves, and consequently, did not significantly

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<sup>86</sup> “But Shanghai’s Xiagang program was also quite costly measure. It was not practical measure for the areas which did not have material resources. Especially, it was almost impossible for place such as Xian city or Northeastern Area, where SOE’s surplus personnels reached more than half of total personnel.” Yamamoto, op. cit., p. 425.

<sup>87</sup> Cai Fang and Lin Yifu, op. cit., p. 67.

reduce those troubled SOEs' financial burdens.<sup>88</sup> Even with the "three-three scheme," SOEs had to finance to organize and manage their RSCs, while the central and local governments were to support their affiliated SOEs, and social resources mainly depended on the small amount of transfer from the unemployment insurance funds.<sup>89</sup> Thus, despite China's attempt to organize RSC based Xiagang program following the Shanghai model, many areas' programs remained financially unstable. Thus, in reality, not every Xiagang Zhigong who entered RSC were granted their entitled basic living supports. Of the total 6.5 million SOE Xiagang Zhigong in 1999, it was estimated that around 10 percent of them in RSC were not granted their full basic living expenses.<sup>90</sup> Especially, in areas such as China's rust-belt Northeast, lots of SOEs were on the brink of bankruptcy, and it was hard to believe that they could properly arrange basic living and re-employment supports for their Xiagang Zhigong.

Under this condition, many local governments were naturally saddled with more burdens to manage the "three-three system". Xiagang was concentrated in areas with poor economic performances such as old industrial areas, where SOEs and the areas' urban unemployment insurance funds frequently could not contribute their portions of the "three-three system", making the local government naturally cover the fund shortages. However, these areas' local governments were also usually under serious financial pressures to the point where they could not even contribute their assigned financial portion of the "three-three system" and came to depend on the central government's support.<sup>91</sup> The last resort to the RSC system was the central

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<sup>88</sup> "Under the scheme of Xiagang, SOEs were assigned the role of providing social security; or, in other words, SOEs, by internalizing unemployment issue and maintaining the hidden unemployment, took the burden of arranging Xiagang personnels' welfare and supports as before." Cai Fangt and Lin Yifu, *op. cit.*, p. 67.

<sup>89</sup> Hong Dayong, *op. cit.*, p. 76.

<sup>90</sup> Tang Jun, "Zhongguo de chengshi pinkun wenti yu shehui jiuzhu zhidu," pp. 468-9.

<sup>91</sup> DRC SRRTT, *op. cit.*, p. 78.

government and the center came to arrange much more supports for many areas' RSC system than its share of the original "three-three" scheme. Indeed, of the total amount of 29.5 billion *yuan* for Xiagang Zhigong's living support in 2000, the government contributed 57.6 percent of which the center's contribution reached to 45 percent.<sup>92</sup> The original "three-three" scheme did not work in many areas, which required new coordination among the three different financial sources to run RSC system. But this meant the center had to provide much greater share, making the leadership start to be skeptical about the program.

Furthermore, Xiagang program could not play a meaningful role in helping Xiagang Zhigong find new jobs in labor market. Re-employment cannot be easily achieved through supporting programs, as it mainly depends on economic conditions. Shanghai was able to arrange many new jobs for its Xiagang Zhigong, as the city, instead of an uncompetitive old industrial sector, could develop a its new vigorous business sector by transforming itself into successfully new hub of financial industry in China. But many other areas faced troubles in establishing new businesses and industry, and thus could offer no new jobs. Without new thriving businesses, Xiagang program's re-employment efforts are limited. There were also other issues that limit Xiagang program's re-employment prospects. One critical issue was Xiagang Zhigong's generally low human capital, which rendered them uncompetitive in finding new jobs in the market system. As China constructed SOE system mainly as a de-skilled production system under equalism, SOE Zhigong generally were low or unskilled workers. SOE Zhigong's educational background in general was quite low and SOE could not make its workers more skilled labor with their workyears. Moreover, the major social groups who lost their workposts were middle aged Zhigong, who could not easy to attain new skills for new jobs in

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<sup>92</sup> Zhang Zhibin, "Guoyou qiye xiagang Zhigong jiben shenghuo baozhang yu shiye baoxian zhidu bingui dui woguo jiuye xingshi de yingxiang," p. 15.

labor market.<sup>93</sup> Indeed, SOE Zhigong were older with lower education levels than their *outer system* counterparts.<sup>94</sup>

In addition, RSCs were not organized as a reliable system and they could not play the supposed role in managing a well-organized skill retraining program for their Xiangang Zhigong. Therefore, many Xiangang Zhigong could not easily find new jobs in China's emerging labor market<sup>95</sup> and most of them would become officially unemployed at the end of their three-year Xiangang program. Another issue with re-employment involves the nature of emerging new jobs that became available for Xiangang Zhigong. As the majority of Zhigong were unskilled workers, they were mainly qualified for new labor jobs in non-state sector.<sup>96</sup> However, they did not want to take these jobs of the *outer system*, since they were considered "inferior" jobs for them, Zhigong as the Danwei workers, to take.<sup>97</sup> According to MOLSS survey of 10 cities in 2000, the main reason why many Xiangang Zhigong did not actively try to find their new jobs was because

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<sup>93</sup> Plus, these middle age Zhigong had more handicaps in their labor skill, since they were the generation who lost their skill training opportunities for the political turmoil of the Cultural Revolution. "Of those laid off personnel, low educated and unskilled Zhigong are the first exposed to the shock but those conditions [of poor human capital] are caused by the historical reasons: such as "going and working in countryside" (shangshan xiexiang) stripped them from the chance to be educated. ..." *Nafang zhoumo*, 1998 Jan. 16th. In fact, a survey compares human capital of China's labor forces by dividing its labor forces into two, a group from 15 to 39 and a group above 40. It finds out older generation's ratio who had education under junior high school is higher 13 percent than that of younger generation. Cai Fang and Lin Yifu, op. cit., p. 66.

<sup>94</sup> The average age of SOE Zhigong in 1997 was 37.3, while the age of private enterprise was 30.6 and that of foreign invested enterprise was 32.8. Zhao Wei, *Qiyeh Zhigong jeceng fenhua de yanbian*, p. 63.

<sup>95</sup> "It has become really hard for elderly Zhigong who do not have any specialized skills to find out new jobs and it is virtually impossible for quite old Xiangang Zhigong (men above 50 and women above 45) find out new jobs in labor market." Yang Yiyong, *Zhongguo Zhuangui Shiqu de Jiuye Wenti*, p. 123.

<sup>96</sup> According to a survey, 71.4 percents of Xiangang Zhigong believe that proper occupations for them are salesman, serviceman, general clerk, janitor, and driver. Li Peilin, Zhang Yi, and Zhao Yandong, op. cit., p. 24.

<sup>97</sup> More specifically, "since Xiangang Zhigong lose their jobs, they have to find out new workplaces. But the problem is Xiangang Zhigong who originally belonged to SOEs or urban COEs, have to find out their jobs in economic units of the *outer system*. Accordingly, some people are transformed into owners or employers but others cannot but being transformed into employed workers..." Li Peilin, Zhang Yi, and Zhao Yandong, op. cit., p. 63.

the new available jobs provided unstable employment and no social security benefits.<sup>98</sup> In this context, many of them simply waited with the expectation that their original SOEs, after finishing their reform, would give them a new work post again.<sup>99</sup> Indeed, China's RSC system to arrange reemployment for Xiagang Zhigong was from the start not a quite practical program.<sup>100</sup>

In order to address sensitive issue to dissolve the labor relations with redundant SOE Zhigong for the restructuring, the leadership expected that RSC based Xiagang program, following Shanghai's successful case, could play a social scheme which could make redundant SOE Zhigong leave their Danwei. However, many areas' Xiagang program were not organized on financially sound bases and RSC turned out as an immature system that could not provide Xiagang Zhigong with sufficient social safety nets. Not all Xiagang Zhigong were arranged their supposed benefits such as basic living and re-employment supports. Xiagang was not enough to achieve its supposed role to provide a social scheme that could make urban society accept full scale SOE restructuring. As a result, many areas' Xiagang programs did not allow their SOEs to push for discharging their redundant Zhigong. In this context, there were many Xiagang Zhigong who did not enter RSC: according to a survey, actual scale of Xiagang Zhigong, including those who did not entering RSCs, was more than about 20 percent of the official

<sup>98</sup> "10 chengshi qiye Xiagang Zhigong he li tuixiu renyuan jiben zhuangkuang de chouyang diaocha," p. 52.

<sup>99</sup> What Zhigong Were Doing after They Lost Their Workposts

Temporay Worker in SOEs or COEs	Guyuan in Private Companies	Foreing Invested Enterprises	TVEs	Individual Business Units	Extra	Do Nothing
4.8	8.9	1.0	0.2	19.6	2.4	63.2.

(Source: Li Peilin, Zhang Yi, and Zhao Yandong, *Jiuye yu zhidu bianqian*, p. 65)

<sup>100</sup> Yamamoto, op. cit., p. 423.

number of Xiangang Zhigong.<sup>101</sup> This is because they have to dissolve labor relations with their Danwei when the three-year program expires if they enter RSCs. Even with the leadership's big expectation, Xiangang, except for Shanghai case, was not organized as a reliable system to play a social role that could manage the sensitive process of full scale SOE restructuring.

Thus, this raises an issue of how China could keep carrying out the decision of 1997 without a reliable scheme to dissolve the redundant Zhigong's labor relations. Large SOEs were not completely exempt from market competition; and by the end of 1997, 16874 large and medium state-owned or state controlling enterprises 6599 enterprises were in the red. In this context, the leadership in the first plenum of 15th CCP congress decided to set up the goal of breaking away from the hardship conditions of most large SOEs within three years.<sup>102</sup> Nearly 50 percent of the large and medium SOEs in Jiangsu province in the first half of 1999 completed organizational restructuring and a report in the summer of 2000 claimed that 60 percent of large and medium SOEs in Liaoning province completed restructuring (Lin and Zhu: 340). The crux of the restructuring process was how to handle those large SOEs' numerous numbers of Xiangang Zhigong in terms of 'reducing manpower for efficiency' (*jianyuan zengxiao*), which turned out to be a tricky issue with non-functioning Xiangang programs in many areas. Hence, China tried to figure out new approach to handle large SOE Xiangang Zhigong's labor relations without depending on Xiangang program.<sup>103</sup>

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<sup>101</sup> Jiang Min, "Jiuye youxian wenti yanjiu," p. 39.

<sup>102</sup> Lü Zheng and Huang Sujian, *Zhongguo guoyou qiye gaige 30 nian*, pp. 139-140.

<sup>103</sup> "We have already achieved total 80 percent of 2470 experimental enterprises to transform into modern enterprise system since 1994; but there still remain total 6500 large and medium sized troubled enterprises, which are waiting not only urgent reforming, restructuring, but even merger and bankruptcy. Indeed, except for the some areas which have only small portion of SOEs such as Shenzhen, Wenzhou, Shunde, or Zhucheng, most areas' SOE reform are facing serious challenges. On the surface some areas' reform process look quite speedy; but in reality the fundamental issue, i.e., the personnel issue, still

The leadership was very sensitive about handling the large SOE Zhigong labor issue, as there was a linkage between SOE size and their Zhigong's social status.<sup>104</sup> Many large SOEs tried to limit downsizing their redundant Zhigong to a minimum level (Sheehan, et al.: 491), as they could increase their chances to get state resources including the state banks as a large SOE to minimize the potential of social unrest caused by large-scale layoffs (Sheehan, et al.: 495). In the restructuring process, those limited numbers of large monopolistic SOEs were also provided with many favorable arrangements. Transformed into a shareholding companies, some of them were also allowed to turn their old bank debts into equity, i.e., debt-equity swap, which would be held by four newly organized asset management companies (AMCs) through the state banks from which the loans were originally borrowed.<sup>105</sup> Indeed, 580 large SOEs, which accounted for about 40 percent of the state sector's assets and sales, were selected for debt-equity swaps (Garnaut et al. 2005: 6). Many cases of large SOE corporatization reform did not entail radical layoffs in their reform process because it was too sensitive an issue to take any radical measure.<sup>106</sup>

In this context, the very process to restructure large SOEs did not depend on simple transformation into limited liability (shareholding) companies, but rather into modern enterprise systems with the measure of separating various social functions from main business functions to

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remains to resolve... and most areas' SOE labor reduction tasks are still very tough." ILSS, *Zhongguo Laodong Kexue Yanjiu Baogaoji 2000-2001*, p. 259.

<sup>104</sup> "Originally, there should be no direct relations between the scale of enterprise and the status of its Zhigong. Yet under our former administratively managed economy system, enterprise scale and Zhigong's status were closely related. The government before the reform paid more attentions to bigger enterprises with priorities in placement of capital, facilities, cadres, and technicians." Feng Tongqing and Xu Xiaojun, *Zhongguo zhigong zhuangkuang*, p. 31.

<sup>105</sup> Indeed, China's four specialized banks have their own AMC created by the State Council and underwritten by the Ministry of Finance (Oi: 130).

<sup>106</sup> "For large SOEs since their large numbers of personnel and their broad social effects the bankruptcy process should take prudent approaches... ." ILSS, op. cit., p. 279.

divide subsidiary part from the primary part. Then, the separated subsidiary service sectors were organized as independent companies that usually engaged in service business often with a graduated period to become responsible for their own profits and losses (Oi 2005: 129), which were to absorb large SOEs' huge numbers of redundant Zhigong (Sheehan, et al.,: 488). Indeed, the separated side-business parts were organized as independent companies and transferred workers to the new subsidiary companies would dissolve their labor relations with their original workplace, which would change their SOE Zhigong status. So the measure not only handled the issue of enterprise managing society, but also separated and repositioned the redundant Zhigong successfully.<sup>107</sup> Without depending on the Xiagang program, large SOEs could reduce their redundant Zhigong by transferring them to newly organized spinoff companies out of their subsidiary part.

After separating the subsidiary part from the primary part and transferring a critical amount of redundant Zhigong, the remaining part could be reorganized as a very efficient economic system. Stripping off the heavy social burdens, many large SOEs came to take the best portion of their state assets to become new, efficient, and purely economic firms that were free from the inherited socialist burdens of debts, outdated facilities, and less skilled redundant workers (Oi 2005: 130). With the best parts of former large SOEs, China reorganized new modern limited liability joint-stock companies, and the shares were to be listed in the stock market. Yet, this does not mean they underwent full privatization, as the state held most of the shares, directly or indirectly by investment companies and allowed only a small portion of the shares to be traded. This scheme had nothing to do with reduction of state ownership for privatization but involved reconfirming state ownership as shareholders for the newly organized

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<sup>107</sup> ILSS, op. cit, p. 279.

joint-stock companies created out of the very best parts of large SOEs. Some biggest SOEs were parent companies of many privatized firms listed on the stockmarkets and the state turned out to be the dominant shareholder in many restructured enterprises.<sup>108</sup> This involved the very contents of *grasping the big* in full SOE restructuring process, which tried to clarify state ownership for the very best part of the *inner system* economy after reorganizing them into modern corporation systems without the former socialist burdens of arranging employment and extensive welfare programs for their Zhigong.

By contrast, those huge numbers of small SOEs were in very serious competitive market conditions, and most of them were under the authority of local governments that usually had only limited financial capacities. As their social position remained marginalized, they could not expect any meaningful supports. Obviously, they could not remain within scheme of stock cooperatives any more or followed those large SOE's practice of separating the primary and the minor parts. In this context, lots of small SOEs under district or county levels underwent serious restructuring in the second half of 90s.<sup>109</sup> By the end of 1998, more than 80 percent of SOEs and COEs at the level of county or below underwent restructuring process with the form of direct privatization (Garnaut et al. 2005: 4). Most of all, it became clear that putting off restructuring those troubled small SOEs could pay more social costs, since many of them could lose the right timing to be merged or sold. Then, they had no other option but bankruptcy, which meant not

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<sup>108</sup> In this context, Oi states, "political constraints in China have resulted in significant restructuring but relatively little genuine privatization" (Oi: 117).

<sup>109</sup> "51698 small SOEs of the China's total 63490 small SOEs (81.4 percent) already reduced their personnels with their own restructuring programs. According to the 'national small group of enterprise merging and bankruptcy', China from the 9<sup>th</sup> FYP recognized total 5765 cases of SOE merging and bankruptcy, which affected total 4.3 million of their Zhigong." Qiao Jian, *Xin yi lun jigou tiaozheng xia de Zhongguo laodong guanxi ji gonghui de yinying duice*, p. 2.

only losing state property but also rendering their Zhigong even worse off.<sup>110</sup> As Zhigong could remain employed within new privatized firms, selling or merger was seen as a better alternative than bankruptcy.

In this context, many local governments tried to restructuring their troubled small and medium-sized SOEs to new owners, and foreign investors suddenly appeared as key actors for the process.<sup>111</sup> Indeed, “foreign investors are now allowed to merge, lease, or buy out medium-sized and small SOEs with the hope that foreign capital, technology, and management experience will put the ailing firms back into the black” (Gallagher: 47). Chinese local governments by the end of 1990s became very eager to sell off state enterprises, which was even called as “Big Bang, Chinese-style” (Yang 2004: 33) and this was the reason why great number of small SOEs disappeared radically. For example, rust-belt Liaoning Province by the November 1998 was estimated to have sold off 60 percent of its small and medium-sized enterprises.<sup>112</sup> China preferred selling or mergers to bankruptcy as restructuring measures for lots of troubled small SOEs, for it could maintain their workers’ jobs. Likewise, local governments tried to arrange favorable conditions such as discounts on the price of assets (including land use rights) to those outside buyers if they agree to employ more workers (Garnaut et al. 2006: 49). Indeed, survey data found that restructuring and privatization of many small

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<sup>110</sup> “We know that, no matter how much we have to pay as [reform] costs, we should stick to the principle to cut down the relations completely as soon as possible. This is because... from Xiagang Zhigong and Zhigong of bankrupt enterprises’ perspectives, putting off the issue will only make them pay more costs; from the transforming SOE’s perspectives, putting off the issue will diminish more SOE assets, which will make Zhigong more negative in settling their labor relations issue, and increase reform costs unlimitedly.” ILSS, op. cit., p. 229.

<sup>111</sup> “Foreign investment has figured significantly in the state’s “letting go” of its small and medium enterprises through a rapid increase in the number of “grafted” joint venture, the foreign acquisition of state firms, and the renting of factories to foreigners on long-term leases” (Gallagher: 46).

<sup>112</sup> “The mayor of Shenyang toured Europe to find buyers for 18 Shenyang SOEs with a total workforce of 309,436. In total, 3,000 SOEs in Shenyang were put up for sale. In 1998 the deputy mayor of Shenyang stated that of its 232 large SOEs only 16 were to remain state-owed...” (Gallagher: 145).

SOEs did not necessarily entail discharging their many Zhigong except for the year when restructuring took place (Garnaut et al. 2005: 103). Obviously, this was the way how China carried out urgent restructuring huge numbers of small SOEs even to the extent of privatization under the condition of immature Xiagang system.

Yet, the nature of jobs in those restructured companies could not remain the same as before because a critical part of restructuring process had to do with replacing the existing Zhigong labor relations with market based ones. However, it remained unclear how to deal with Zhigong labor relations in the privatization process, as China tried to maintain as many workers as possible in the restructuring process under the immature condition of its labor dissolving scheme. In fact, some areas in SOE restructuring process did not put the issue of how to handle Zhigong's labor relations in their primary agenda, and transformed only their ownership. Then, these enterprises after the reorganization, in their laying off, firing, and ending labor contract with Zhigong, faced various forms of issues and troubles, which trapped the enterprise in complicated personnel disputes once again, and many restructured enterprises could not but initiate another round of restructuring.<sup>113</sup> This was a critical reason why SOE restructuring was “not a one-off event, but rather a continuous process” (Garnaut et al. 2005: 57). In this context, China realized that no investor would dimwittedly merge or buy any SOEs which did not resolve their personnel issues.<sup>114</sup> Hence, it became clear that full restructuring of many small SOEs for privatization could not avoid fundamental transforming the nature of labor relations bound to Zhigong.

Indeed, the process of restructuring many small SOEs involved the political process which articulated the very condition of dissolving the existing Zhigong's the *Danwei personnel*

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<sup>113</sup> ILSS, op. cit., p. 228.

<sup>114</sup> ILSS, op. cit., p. 227.

position without depending on Xiagang. Even before China clarified Xiagang program, many small SOEs that could not but undergo restructuring with their own measures to dissolve the labor relations with their redundant Zhigong. From those experiences, it became clear that SOE Zhigong's labor relations could not be dissolved with simple severance payments, because they held special status as the *inner system* personnel based on the permanent worker system.<sup>115</sup>

Between Zhigong and the Danwei lied various contents of debt and credit relations that had been fashioned with the presumption of the permanent labor relations. That special relation needed to be settled clearly before the dissolving of Zhigong's labor relations. In this context, there suddenly emerged SOEs' various liabilities owed to their Zhigong, which under the permanent worker system had not been an issue as SOEs gradually settled the liabilities within the Danwei welfare system in the long run. But dissolving the labor relations, SOE Zhigong could not expect the Danwei system's returning benefits for their credits that they had earned within the system. Indeed, paying off SOEs' various liabilities to their Zhigong was the first measure that SOEs had to take when they tried to dissolve redundant Zhigong's labor relations.

Many poorly performing SOEs had problems in granting wage or paying social insurance premiums for their Zhigong, which was the obvious liabilities that those Danwei had to pay off. In addition, the Danwei as the autarky social system also collected various 'funds for their common purpose' (*jizikuan*) from Zhigong, and they should be returned to Zhigong when they left the Danwei.<sup>116</sup> According to the survey conducted by MOLSS in July 2000, about 57

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<sup>115</sup> China has realized that a prominent issue emerging in the SOE restructuring process is "how to handle Zhigong's labor relations, in other words, the issue of how to transform Zhigongs' status, which has already become crux issue that restricts not only SOE reform but also the strategic adjustment of entire state economy's arrangements." Yu Faming and Guo Yue, "Guanyu guoyou qiye zhuanzhi guocheng zhong laodong guanxi chuli de jidian sikao," p. 42.

<sup>116</sup> Jiang Min, *op. cit.*, p. 40.

percent of total personnel replied that their Danwei owed them various forms of liabilities (wage arrears was 33 percent; raised funds (*jizikuan*) from Zhigong, 15 percent; unpaid medical fees, 27 percent; unpaid social insurance premium, 21 percent; and other forms of debts 4 percent). The survey also estimated that SOEs' liabilities per individual worker reached 3624 *yuan*.<sup>118</sup> As more and more SOEs had difficulties in handling their liabilities issue appropriately, their efforts to dissolve the relation with Zhigong became even more difficult. "Those SOEs in long term deficit have little hope to offset these liabilities and those SOEs in long term stop production have no capacities to payoff these liabilities, so the Zhigong and their Danwei cannot dissolving the relations."<sup>119</sup>

Interestingly, SOEs under restructuring were concerned more about their debts owed to Zhigong than about their overdue bank loans (Garnaut et al. 2005: 78). Hence, China gradually articulated its principle about how to handle SOE liabilities to Xiang Zhigong, which SOE should pay off. If SOE had not had capabilities to pay off, then it should have gone into bankruptcy and pay off the debts with the measure of asset liquidation.<sup>120</sup> In case an SOE could not go into bankruptcy, it still had to pay off its liabilities. To handle SOE liabilities which hardly expected to be paid off by the enterprise, China tried to devise some measures, including one that allowed the enterprise to 'issue temporary voucher' (*da baitiao*) guaranteed by the

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<sup>117</sup> The so called collected funds (*jizikuan*) refer to SOE's many collected funds from their Zhigong for the some special purposes. As increasing number of SOEs were under financial pressure, many SOEs tried to raise required funds from their Zhigong. Plus, some local governments also tried to constitute their basic construction funds depending on SOE's fund raising from their Zhigong. Yu Faming, *Xiang Zhigong laodong guanxi wenti toudi*, p. 42. Accordingly, the raised collected funds (*jizikuan*) were the debts the SOEs had to settle before dissolving the labor relations with Xiang Zhigong.

<sup>118</sup> ILSS, op. cit., p. 264.

<sup>119</sup> Jiang Min, op. cit., p. 40.

<sup>120</sup> "When a SOE does not have enough capability to cover all its debts, then it, in principle, should undergo bankrupt process. In this case, its Zhigong should be provided with settlement fees, according to the Bankruptcy Law, and their credits should be paid off at first." ILSS, op. cit., p. 281.

government.<sup>121</sup> It was the political decision to guarantee SOE's liabilities to be paid off eventually even with the measure of government's, implicit or explicit, guarantee.<sup>122</sup> Indeed, the leadership clearly made a principle that the government would guarantee the Danwei's fulfillment of their financial obligations, as it was critical condition to dissolve Xiangang Zhigong's labor relations.

At the same time, there also gradually emerged social consciousness about economic compensation for Zhigong who would leave RSC after clearly dissolving their labor relations. An idea of compensation for discharged Zhigong came up in China quite early. When China tried to introduce bankruptcy system in the early 90s, it suggested 'settlement grants' (*anzhifei*) for those Zhigong of bankrupted SOEs.<sup>123</sup> Then, out of the process to dissolve redundant SOE Zhigong's labor relations for the restructuring, the society came to articulate various reasons of compensation to dissolve the labor relations. Indeed, in the actual practice in carrying out compensations, "each place has different standards depending on different regulations, which ends up a series of confusing situations, such as some grant compensations but some do not; some grant more and some grant less."<sup>124</sup> Though the very nature of economic compensation remained unclear, there emerged broad consensus about the requirement of compensation for

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<sup>121</sup> ILSS, op. cit., p. 266.

<sup>122</sup> Total SOEs debts owed to Xiangang Zhigong could be estimated as 22.6 billion *yuan* based on the survey outcome that SOEs had debts relations with total 57 percent of their Xiangang Zhigong with average debts owed to individual Xiangang Zhigong 3600 *yuan*. The estimation led to the idea that "even when parts of SOE's debts are transferred to the government, its total amount cannot be very big." ILSS, op. cit., p. 266.

<sup>123</sup> "For these Zhigong, the government, based on the area's condition, can pay one time 'placement fees' (*anzhifei*) and they will no more hold SOE Zhigong's status. In principle, this one time placement fees will be paid to the amount of three times of local Zhigong's annual average wages, but its actual standard will be decided by local government's regulations." *Laodong neican*, 1994, Issue 12, p. 7.

<sup>124</sup> Indeed, some areas granted living supports depending on the "temporary regulations to carry out SOE labor contract system"; some areas granted economic compensation referring to the State Council's "economic compensation method for breaching and dissolving labor contract"; and other areas granted onetime "settlement grants" (*anzhifei*) depending on the State Council's regulations of bankrupt enterprise of some experimental cities." Jiang Min, op. cit., p. 40.

those redundant Zhigong to dissolve their labor relations. According to a survey in 1999, to the question about “what kind of demand do you have, when you dissolve the labor relations with SOEs,” 53 percent of the total reply selected the answer “granting economic compensation.”<sup>125</sup>

In this context, China came to involve the social process to articulate the very reason for the compensation for dissolving Zhigong’s unique status as the *Danwei*’s permanent personnel. Indeed, even if those Zhigong could remain within restructured firms, their position was not based on former Zhigong labor system, and “many argue that workers deserve to be compensated for the loss of job security and lifetime benefits” (Garnaut et al. 2005: 103). So the liabilities that SOEs had to settle came to include compensation to dissolve Xiangang Zhigong’s the *Danwei personnel* status. Yet, it still remained unclear how to compensate to for changing *Danwei personne* status, and those efforts to restructure SOEs without clear compensation scheme were followed by serious collective actions in the forms of petitions, silent sitting in public space, and even blocking roads or railways.<sup>126</sup> In order to capture the nature of compensation with which those redundant Zhigong really want to dissolve their *Danwei personnel*, we need examine how they respond to the very restructuring process.

In the restructuring process, Zhigong opposed SOE privatization decided exclusively by the managers: “Workers think that managers alone without their consent do not have right to make any decision related with SOE’s ownership change. Since SOE belongs to public property,

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<sup>125</sup> ILSS, op. cit., p. 264; “Nowadays, the primary reason why many areas are in a predicament in switching their policy focus from “public assistance” to “making [Xiangang Zhigong] leave RSC and resolving [labor] relations” ... is their limited capacities in granting economic compensation and paying off various SOEs’ liabilities owed to their Xiangang Zhigong.” ILSS, op. cit., p. 265.

<sup>126</sup> According to Hong Kong Center for Human Rights and Democracy, China witnessed as many as 6000 labor related collective actions in 1998 mostly made by former SOE Zhigong with “such grievances as delayed wages and pensions and unfulfilled compensation for the loss of work posts” (Solinger 2003: 947).

SOE workers have parts of right to the property.”<sup>127</sup> SOE Zhigong’s serious opposition to the privatization depended on the concept of SOE ownership which derived from the old socialist theory. In the earlier past, they had been educated for a long time that “SOEs belong to public property” and “workers are the ‘master’ of SOE,” so they still strongly believed that they should have voices about any reform of transforming SOE ownership.<sup>128</sup> In other words, SOE Zhigong were claiming their stakes within SOE properties derived from their *Danwei personnel* status. Their claim of the stakes was not simply rhetorical, but had a substantial ground. Having contributed to the SOE’s wealth for their work year under the low wage system, Zhigong perceived that “the factory is not only their (managers) but also ours (workers).” For instance, when Taiyuan Metal Component Company was sold off to Shanxi Aviation Corporation, the workers got very angry because Shanxi Aviation Corporation had interests only in profitable part of the company. The Zhigong were obviously excluded in the decision which could not only let them lose work posts but also evaporize a critical part of their workplace properties that they had had a stake.<sup>129</sup> Therefore, the crux of the issue involved how to attain confirmation for those Zhigong’s inherited rights within SOE properties in the restructuring process.

In this context, Zhigong’s primary discontents in SOE reorganizing were articulated as the objection against manager’s state asset stripping. There were broadly shared worries about the illegal asset stripping in the process of SOE ownership reform. Indeed, some SOE managers moved SOE assets into new nonstate enterprises, leaving the original SOE only as the holder of liabilities (Lardy: 51). Of course, many SOEs’ performance got worse in the competitive market, but many Zhigong came to suspect their managers out of their increased sensitivity about

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<sup>127</sup> Chen Feng, “Zhongguo de gongye gaizhi yu gongren kangzheng,” p. 6.

<sup>128</sup> Ibid., p. 5.

<sup>129</sup> Ibid., p. 6.

their stakes in SOE assets as the *Danwei personnel*. Some SOE Zhigong illustrated their eager opposition to the restructuring process by occupying the factory under the slogan of “protecting the factory” (*huchang*).<sup>130</sup>

SOE Zhigong, after all, regarded the restructuring without confirming their stakes as infringement of their right as the *Danwei personnel*. So SOE Zhigong came to take their status issue in the SOE restructuring process as stakeholders who had rights to a certain amount of SOE assets. Accordingly, even if Xiagang Zhigong maintained labor relations with new owners after the restructuring, they thought their rights were infringed without confirming their stakeholder positions. In this context, the very nature of broad anxiety of the asset stripping and collective action for “protecting the factory” involved the social process to confirm Xiagang Zhigong’s stakes in SOEs assets in the context of dissolving their *Danwei personnel* status.

The primary feature of Zhigong’s the *Danwei personnel* status was complete integration with their Danwei under the permanent worker system, so their relations with SOE properties were tightly combined. Dissolving their labor relations, therefore, required a scheme that could split them from SOE properties in the context of dissolving their *Danwei personnel* status. In this context, there emerged a scheme of *separating personnel from the assets (renzifenli)*, which virtually recognized their right to certain amount of SOE assets. Liquidating parts of the assets, many SOEs tried settled their liabilities owed to their Zhigong (including unpaid wages, social insurance premiums, and *jizikuan*) and arranged economic compensations as well. As Zhigong’s the *Danwei personnel* status was based on their tight integration with their Danwei, the restructuring process came to articulate the scheme of *separating personnel from the assets*

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<sup>130</sup> They closed the factory’s gate, so that new owners could not enter the factory, or they occupied whole factory to check the reorganizing process “for the purpose of protecting public property and they have legal right for the public property.” Chen Feng, op. cit., pp. 6-7.

which splited a portion of the assets to settled the Danwei liabilities owed to them and arrange compensation.

Here, the *separating personnel from the assets* clarifies the nature of compensation that those Zhigong really want in order to dissolve their permanent Zhigong status. As China had had a compensation scheme to dissolve SOE Zhigong's labor relations before, SOE restructuring process, obliged to downsize redundant Zhigong, gradually converged into a compensation scheme that could be acceptable in the context of dissolving their status as the *Danwei personnel*. Obviously, it was the political outcome of articulating the primary scheme to transform Zhigong's status in terms of economic compensation that could make Xiagang Zhigong leave RSC. It also socially confirmed Zhigong's stake within SOE properties. Hence, the very contents of compensation that could be acceptable to dissolve SOE Zhigong's labor relations which were originally organized as permanent one turned out to be recognition of their stakes within SOE assets that they had constructed with the premise of the permanent labor relations.

China, however, did not institutionalize compensation system for dissolving SOE Zhigong's labor relations. The center did not set up general rules of how to apply the scheme of *separating personnel from the assets*, and each SOE carried out the scheme as its own program by liquidating their assets. Such individual applications ended up with various forms of compensation to dissolve redundant SOE Zhigong's labor relations. This turned out to be a critical issue many SOEs' restructuring process. Especially, many troubled small SOEs under local governments, even with asset liquidation, could not arrange enough compensation for their redundant Zhigong. To make matters worse, with lingering settlement of SOE debts and economic compensation by SOE themselves, many SOEs lost their best restructuring timing only to become bankrupt. The urban society thus had to intervene the lingering compensation issue.

Mianyang city in Sichuan province, for example, devised its own scheme of *separating personnel from the assets* with the city government's deep financial engagement. The government mobilized 40 million *yuan* from its budget as the exclusive funds for economic compensation and placement supports for Zhigong who dissolved their labor relations. With the measure of dissolving labor relations clearly, the SOEs in process of selling, ownership transfer, and merge were able to be evaluated in terms of their assets without considering their redundant personnel. Hence, "after removing personnel issue which has been the most headache one, many private and foreign investors initiate investments to buy and merge these SOEs."<sup>131</sup>

The efforts of separating labor forces from the state assets could attract new investments, private or foreign, for restructuring its SOE system as SOEs were relieved from the burdens of redundant personnel.<sup>132</sup> Indeed, Mianyang city set up 'revolving funds' (*zhouzhuanjin*) out of its financial system and trimmed down smoothly the number of Zhigong with its total mobilized 350 million *yuan* since 1996.<sup>133</sup> The city by 2000 finished its *separating personnel from the assets* program which not only could entice new investment capital from outside but also created numerous job opportunities to allowed many Xiagang Zhigong to realize re-employment. The program could induce a virtuous circle for the reform by playing critical functions in adjusting total number of SOE Zhigong and revitalizing its capital which after the restructuring offered new job opportunities for the society. From the second half of 1996 to the first half of 2000, the city had total 38.2 thousand Xiagang Zhigong and its 'placement' (*anzhi*) rate accounted for 77.8

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<sup>131</sup> Yu Faming and Guo Yue, *op. cit.*, p. 44.

<sup>132</sup> ILSS, *op. cit.*, p. 259; ILSS RTT, "Shichang daoxiang jiuye jizhi de jianli: bixu jiehe qiye gaizhi tongbu shixian," p. 9.

<sup>133</sup> "Laodong kexue yanjiusuo fu suozhang Yu Faming tan jianli shichang daoxiang jiuye jizhi de ruogan wenti," p. 9.

percent.<sup>134</sup> Mianyang city identified a critical fact that local governments could play active roles in the compensation arrangement for the *separating personnel from the assets*.<sup>135</sup> Indeed, as the local level strategy for development has articulated into “the large-scale privatization of small and medium failing state firms and a renewed drive to attract FDI to buy out state assets” (Gallagher: 135), many local governments came to engage actively in their SOEs’ *separating personnel from the assets* process with their available resources so as to let them attract more investors from outside to buy or merge them.

After the settlement of SOE Zhigong’s status issue, the normal labor relations as those in labor market could be organized. Then, foreign investors and private units from outside bought and merged small SOEs one after another.<sup>136</sup> In this context, SOE restructuring process based on compensation for dissolving SOE Zhigong status with the *separating personnel from the assets* scheme led to SOE ownership reorganization including many small SOEs’ full privatization.<sup>137</sup> SOE restructuring process, after all, had to handle the issue of how to compensate SOE redundant Zhigong who were to lose their Danwei system’s permanent worker status, and *separating personnel from the assets* scheme which settled SOE Zhigong’s status issues with compensation that recognized their stakes within SOE assets. Here we can identify the fact that transforming SOE Zhigong’s *Danwei personnel* status with recognition of their stake of SOE assets and SOE ownership reform were closely related. Indeed, settlement of Zhigong status

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<sup>134</sup> ILSS RTT, op. cit., p. 8.

<sup>135</sup> ILSS, op. cit., p. 228.

<sup>136</sup> Ibid.

<sup>137</sup> Indeed, restructuring process of many medium and small SOEs could not but end up full privatization, which based on ‘separating personnel from the assets’ scheme resolved the issue of required financial resources to dissolve Zhigong’s Danwei personnel status. Zhu Ling, “Lun guoyouqiye Xiagang Zhigong jiben shenghuo baozhang zhidu xiang shiye baoxian zhidu binggui: yi Hubei sheng wei zhongxin,” p. 132.

issue with the *separating personnel from the assets* scheme allowed many small SOEs to realize privatization.

The crux of sensitive SOE restructuring process was how to handle redundant SOE Zhigong, and different restructuring process by SOE size also had to do with the different practice in handling the redundant Zhigong's labor relations by the Danwei size. It turned out that Xiangang program did not play its intended role as the unifying scheme to dissolve redundant SOE Zhigong's labor relations for the full-scale SOE restructuring push. According to the survey conducted by ILSS RTT in four cities in 2000, the actual scheme of personnel adjustment was diverse according to SOE scale: large SOEs in general relocated their Zhigong within their sub-enterprises after separating subsidiary part; medium SOEs mainly depended on Xiangang programs; and small SOEs predominantly followed the full privatization and dissolved Zhigong labor relations clearly in the process of full SOE ownership transformation.<sup>138</sup> Hence, Xiangang just played a limited role in dissolving SOE Zhigong's labor relations for the urgent restructuring SOEs process.

Interestingly, those large SOE corporatization process which transferred their redundant Zhigong to the newly organized sub-firms out of their subsidiary part was also turned out to be framed with the scheme of handling their status as the *Danwei personnel*. China issued SETC no. 859 document in 2002 out of discussion of eight related authorities regarding the measure to handle large SOEs' redundant Zhigong based on separation of the primary and the subsidiary part. It articulated a scheme of 'separating with the assets' (*daizi fenliu*) which necessitated compensation for those transferred redundant workers to the new separated firms out of the subsidiary part with the subsidiary part's assets; if the subsidiary part's assets were not enough to

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<sup>138</sup> ILSS RTT, op. cit., p. 7.

cover the compensation to handle the transforming workers' status issue, then the primary part's assets could be used.<sup>139</sup>

Clearly, dissolving SOE Zhigong's permanent labor relations for full SOE restructuring, big or small, required the compensation which virtually confirmed their stakes in the Danwei properties as the *Danwei personnel*. The full SOE restructuring process also involved ownership transformation with large SOE's full corporatization and small SOE's full privatization. In this regards, China came to accept that the process of SOE Zhigong status transformation and its ownership reform could not but go together in terms of *dual transformations (liangge zhihuan)*.<sup>140</sup> The *dual transformations*, initiated in Changsha of Hunan province, handled Zhigong's status issue by recognizing SOE Zhigong's stakes with allocation of the restructured company's shares. Indeed, there were many cases of restructuring large SOEs based on separating the primary part and subsidiary part which handled Zhigong's status issue with the shares of newly organized firms out of the separated subsidiary part.<sup>141</sup> In many areas, to arrange compensation for the restructured SOE Zhigong with a number of free shares became a widely implemented practice (Garnaut et al. 2005: 35).

The compensation for Zhigong's losing of the *Danwei personnel* status, revealed a critical defect of Xiangang program because it did not specify the very content of compensation for those Zhigong who were suppose to leave their Danwei.<sup>142</sup> Obviously, RSC based Xiangang

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<sup>139</sup> Wen Zongyu, "Guoqi gaige zhong Zhigong shenfen zhihuan he buchang de zhengce ji caozuo wenti," p. 29.

<sup>140</sup> China should "combine both transforming SOE Zhigong's status and reform of SOE ownership system. First of all, liquidating SOE properties, China, with the resources, should grant economic compensation to their Zhigong and should cut off the original relations between SOEs and their Zhigong." ILSS, op. cit., p. 227.

<sup>141</sup> Lü Zheng and Huang Sujian, op. cit., p. 168.

<sup>142</sup> "The program to grant Xiangang Zhigong living expenses is, after all, a compensation for the Zhigong's past labor contribution, and at the same time living supports for indigent Zhigong. In practice, the nature

program was the social system which tried to dissolve SOEs' redundant workers' the *Danwei personnel* status through three-year support for living and re-employment. Yet, the radical privatization process of small SOEs, articulating the necessity of the compensation for redundant Zhigong, contradicted Xiagang program that originally did not contain a scheme of compensation. That limitation caused a demand that Xiagang Zhigong should be arranged their compensations.<sup>143</sup> Indeed, it was not clear at first whether or not compensation should be arranged for those Xiagang Zhigong who would leave RSCs. Some thought there was no need for compensation because they already got the living supports in RSC. Others argued they should have compensation to the amount that those contract workers had when they left their workplace. However, a majority of the populace came to share the idea that compensations for Xiagang Zhigong were necessary not for the workers who lost their jobs in market system but for the dissolved Zhigong of special social status.<sup>144</sup>

Even if Xiagang program was introduced as the critical system to induce redundant SOE Zhigong to leave their Danwei, it turned out to be not a decisive precondition for dissolving their labor relations. As observed before, Xiagang programs in many areas did not organize reliable RSC system. Yet, the number of Xiagang Zhigong expanded really rapidly and there were already in the late 90s total 11 million Zhigong who did not have their work posts in their workplaces, which was the number that many areas' RSCs could not afford to arrange such

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of the program has not been clarified and most enterprises kept grant it with egalitarian scheme. Consequently, the program did not settle compensation issue ...” DRC SRRTT, op. cit., p. 79.

<sup>143</sup> “Targeting Xiagang Zhigong, China should take the measure of providing special economic compensation. Xiagang Zhigong is a special group in the SOE reform, as they sacrifice themselves and take the burden of SOE reform costs. Thus, when they leave RSC and dissolve their labor relations, they should be unmistakably granted with economic compensation.” ILSS, op. cit., p. 281.

<sup>144</sup> Yu Faming, op cit., p. 45.

social benefits as Xiagang program had promised.<sup>145</sup> The credibility of Xiagang program was severely damaged: even the original regulation that Xiagang Zhigong had to leave RSC after three-years' benefits seemed to hard to apply in many cases, and the "government's many related policies which set up in the morning are modified in the evening."<sup>146</sup> In short, Xiagang program did not play significant role in ensuring Xiagang Zhigong's basic living and supporting their reemployment either. Xiagang turned out to be just a flawed system to play active role in dissolving redundant Zhigong's labor relations.

At the same time, Xiagang program also increased the ratio of state's burden to SOE restructuring costs. The center came to provide its financial support for many areas' Xiagang programs: its budget accounted for 29.5 billion *yuan* - 45 percent of total mobilized resources for Xiagang Zhigong's living supporting funds in 2000.<sup>147</sup> RSC programs in some areas, the center had to arrange total 65 percent of the programs, which were far beyond original "three-three" scheme.<sup>148</sup> Therefore, for the leadership, it would be better to stop Xiagang program and dissolve redundant SOE Zhigong's labor relations directly without the mediation of Xiagang program. Indeed, China decided that from the new millennium new RSCs would not be allowed to set up and that SOEs' new discharged Zhigong would not take the Xiagang scheme any more; instead, they had to dissolve labor relation with their Danwei and would directly turn into the unemployed under the cover of the unemployment insurance system.<sup>149</sup> Of course, Xiagang Zhigong who had already entered RSCs had to leave with the termination of their three-year

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<sup>145</sup> ILSS, op. cit., p. 276.

<sup>146</sup> Ibid.

<sup>147</sup> Zhu Ling, op. cit., p. 131.

<sup>148</sup> He Jinying, "Shehui baozhang zhong de zhengfu zeren," p. 22.

<sup>149</sup> *Xinshiqi laodong he shehui baozhang zhongyao wenxian xuanbian*, pp. 492-3.

Xiagang program. The decision implied that Xiagang Zhigong would completely disappear within three years.

In principle, Xiagang program intended to introduce a transitional scheme in dissolving Zhigong's labor relations with their Danwei. Unemployment system, for all its urgency, did not emerge spontaneously in China without its pre-requisite social conditions, the embeddedness.<sup>150</sup> When China decided to depend mainly on Xiagang program to handle redundant SOE Zhigong with its living and re-employment supports, Xiagang program functioned as an initial program to introduce unemployment system with its linkage to (still immature) unemployment insurance system. However, with the decision to terminate Xiagang program, the leadership initiated so-called the *merging* (*binggui*) process integrating the dual programs of Xiagang and unemployment insurance system into a single unemployment insurance system. Hence, discharged SOE Zhigong had to leave their Danwei and enter labor market directly with the single unemployment insurance coverage.

The *merging* was the decision to depend only on still immature unemployment insurance system after the termination of Xiagang program which was introduced as a cushion system to absorb a shock for the redundant Zhigong to dissolve the labor relations under the condition of the urban society's missing unemployment system. The decision was made suddenly for evident defects of Xiagang program itself without concrete evidences that the urban society came to have socially acceptable unemployment system. Obviously, one critical reason why China tried to organize RSC based Xiagang program was the fact that lots of redundant SOE Zhigong would

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<sup>150</sup> The leadership clearly realized that without systemically organized social security system, Zhigong would not accept the reform of lifetime tenure system, which had defied its labor market formation. "Since immature social security system and narrow social placement route, small numbers of Xiagang Zhigong can pass through the process of unemployment and reemployment." *Laodong neican*, 1995, Issue 9, p. 5.

not leave their *Danwei*, as the urban society was ready to accept unemployment system with single unemployment insurance system. So the *merging* decision made the redundant SOE Zhigong dissolve labor relations to be unemployed even without mediation of RSC supporting, which would involve socially much more volatile process.

Here we need to examine the meaning of the *merging* decision in SOE restructuring process. Under the sensitive situations the leadership felt urgent pressure to clarify the very condition of how to dissolve Zhigong's labor relations directly. Obviously, it turned out that many Xiang Zhigong would not leave their RSCs and dissolve their labor relations, because "quite many SOEs have problems in granting economic compensation and paying off various debts they owed to Zhigong."<sup>151</sup> Making the existing Xiang Zhigong urgently leave their RSCs, China realized required resources to settle SOE liabilities such as unpaid wages, social insurance premiums, and arrange economic compensation.<sup>152</sup> Of course, the same condition was to be applied to those redundant SOE Zhigong who had to dissolve the labor relations directly without RSC supporting program. Hence, the *merging* decision clearly meant that "those redundant personnel without exception should not be handled with Xiang scheme any more; instead, with the provision of economic compensation and unemployment supports, they should directly enter into labor market."<sup>153</sup> With the *merging* decision China realized that it had to set up organized compensation system for SOE Zhigong to match their loss with losing their *Danwei* personnel.

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<sup>151</sup> ILSS, op. cit., p. 264.

<sup>152</sup> "Laodong kexue yanjiusuo fu suozhang Yu Faming tan jianli shichang daoxiang jiuye jizhi de ruogan wenti," p. 9.

<sup>153</sup> ILSS, op. cit., p. 280.

Obviously, SOEs had to pay their leaving Zhigong's economic compensations,<sup>154</sup> but many SOEs could not take the burdens to grant redundant Zhigong enough compensations.<sup>155</sup> Their serious financial condition, the cause of restructuring, made individual SOE's asset liquidation not necessarily guarantee enough resources to arrange economic compensation for their leaving Zhigong. Local governments could play active role in the process of *separating personnel from the assets* just as the case of Mianyang city, but their financial conditions were really diverse. So there were many areas that could not afford to support their SOEs' efforts for *separating personnel from the assets*. Mianyang city's success did not mean that all other areas also could achieve same achievement.

Then the question was whether the center had to support the '*separating personnel from the assets*' process rose. Indeed, there was discussion of how to mobilize required resources for the compensation with expectation of the center's more active role.<sup>156</sup> There already existed a critical view regarding the existing haphazard practice of arranging economic compensation for leaving Zhigong: "Formerly, in dealing with Xiang Zhigong's labor relations, China primarily took a measure depending on local governments and enterprises to share the burden to dissolve the relations." But that policy could not resolve the issue clearly, confronting "a series of

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<sup>154</sup> "Strictly carrying out SOE bankruptcy regulations, we have to make SOEs themselves pay economic compensation for their permanent workers who are to resolve the labor relation with them. We should never let the government directly take the burden again." ILSS, op. cit., p. 268.

<sup>155</sup> Ibid., p. 226.

<sup>156</sup> "Accordingly, we suggest three ways to raise funds. First, local governments can establish working funds. Each SOE can use the funds in turn in their process of "separating personnel from the assets" and handle their personnel placement issue. This measure cannot raise very much funds but can be quite effective. ... Secondly, SOEs themselves can raise funds by adjusting their own capital structures. Since SOEs can be listed with only their better part of assets, they will try to optimize their own capital structure. With parts of withdrawn capital, SOEs can handle their Zhigong's labor relations. Thirdly, the [central] government can raise funds by issuing reform bonds. We suggest that the government issue three to five year SOE reform bonds to raise required funds for personnel adjustment in the SOE reform process and alleviate the government's financial pressures." ILSS, op. cit., p. 280.

contradictions and predicaments.”<sup>157</sup> In this context, there grew a social voice that demanded central government’s active role in granting Zhigong’s economic compensation.<sup>158</sup> In this respect, the *merging* decision turned the compensation into a salient issue as Xiang Zhigong had to leave their RSCs with clear dissolving their labor relations, and there followed growing clear voice demanding the center’s more direct engagement.<sup>159</sup>

The leadership, however, did not decide how the center would support the compensation for Xiang Zhigong in SOE restructuring process. Its hesitation had to do with its possible financial burdens. But as the unsettled compensation issue kept interrupting urgent SOE restructuring, there were growing demands for the center’s active financial engagement to handle Xiang Zhigong’s compensation issue.

“Speaking from the national level, primary costs for SOE restructuring are mainly concentrated in the issues of Zhigong’s placement and their status transformation. Some experts estimate the costs about above a trillion *yuan*. ... any single financial source cannot cover all these huge amount of money. ... Viewed from today’s fund raising scheme, it is required that the state, on the one hand, should arrange required policy supports for SOEs to liquidate their properties; the central budget, on the other hand, should arrange required supports for those troubled areas (as the case of its supportings for Xiang Zhigong basic living guarantee). Otherwise, those [troubled] areas cannot make great progress in making their Xiang Zhigong leave RSC and handling their labor relations, which extends to the issue of SOE reform and economy system transformation.”<sup>160</sup>

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<sup>157</sup> Ibid., p. 267.

<sup>158</sup> There emerges a suggestions that for those SOEs that have troubles in paying compensation for their Xiang Zhigong to leave their RSCs, each level financial system should take responsibility to pay a part of compensation: local governments settle their SOEs’ compensation issue and the center settles the central SOEs’ compensation issue. Especially, “for those extremely troubled areas and their SOEs such as old industrial areas, resources developing cities, or resource drained mining areas, the central government should grant subsidies.” ILSS, op. cit., p. 282.

<sup>159</sup> “For those SOEs in production suspension without financial capacities, I suggest that the government should step forward to mobilize financial sources for the costs to arrange troubled SOE Xiang Zhigong to leave their RSC.” Luo Shenfu, “Xiang Zhigong “san nian chu zhongxin” zenmo chu?,” p. 16.

<sup>160</sup> “Laodong kexue yanjiusuo fu suozhang Yu Faming tan jianli shichang daoxiang jiuye jizhi de ruogan wenti,” pp. 9-10.

Even with the growing demands, the center, however, did not identify if it would systemically engage in the compensation process. Hence, the *merging* decision demanded that China set up more reliable compensation scheme for Xiagang Zhigong, but the compensation system still remained unclear.

The *merging* decision was by no means a solution to handle the defects of Xiagang program. Nevertheless, instead of the adjustment of the restructuring pace, *grasping the big and releasing the small* continued. Parallel to the privatization of small SOEs, the corporatization of large SOEs was pushed to become globally competitive corporations with the plan to enter WTO system. Especially, the area concentrated with large SOEs in resources draining industry contained huge numbers of Xiagang and unemployed Zhigong who were political very volatile group.<sup>161</sup> As the collective action made by Daqing's Zhigong, restructuring process of those resource draining industrial areas could cause really serious social instability.<sup>162</sup> Yet, for all with the potential hazard for social stability, the restructuring of large SOEs did not stop. Indeed, China from the year of 2001 intensified the level of restructuring its economic structure, and even some huge monopolistic SOEs in their *reducing personnel for efficiency* projects made some meaningful achievements.<sup>163</sup> Then, how could China carry out its sensitive SOE restructuring process even with *merging* decision which just terminate Xiagang program without resolving its defects, the compensation to handle Zhigong's status as the *Danwei personnel*?

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<sup>161</sup> Liu Ping, "Xin eryuan shehui de shengcheng ji shehui zhengce xuanze," p. 18.

<sup>162</sup> "Leaner Factories, Few Workers Bring More Labor Unrest to China," *The New York Times*, March 19<sup>th</sup>, 2002.

<sup>163</sup> According to the survey of eight SOEs belong to the center (including CNPC, Sinopec Corp., and China Telecom) these enterprises until the early 2002 already reduced total eight hundred thousand Zhigong. Qiao Jian, "Xin yi lun jigou tiaozheng xia de Zhongguo laodong guanxi ji gonghui de yinying duice," p. 2.

In addition to compensation issue, the *merging* decision raised another critical issue: Xiangang Zhigong's social security after dissolving the labor relations. It remained unclear how those Zhigong who could not find new jobs after dissolving the labor relations could manage their living, as there was no reliable social security system. This was the main reason why China tried to organize Xiangang program with following supportive systems in terms of "three security lines." The issue originated from China's unique way to organize the urban society exclusively based on the Danwei system. The Danwei as a social system organized the urban society in terms of Zhigong's community, which was supposed to arrange a full employment for the entire urban citizens with comprehensive welfare benefits. No any other social system was to support the living of anyone who did not belong to the Danwei system. As there was no social system beyond the Danwei, it was impractical to expect that any citizens could manage their living if they did not belong to the Danwei system. In this vein, SOE restructuring that was to dissolve the Danwei system could end up with the perils of institutional vacuum of urban social system. It meant Zhigong would lose the very social ground to make their living in the urban society.<sup>164</sup>

SOE Zhigong started to demonstrate their apprehensions about their future livings with corresponding doubts about political accountability of the leadership about the reform.<sup>165</sup> With no independent social security system beyond the Danwei, Zhigong would not be sure about their living if they were separated from the Danwei. Hence, if China tried to push SOE reform

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<sup>164</sup> Following SOE reform to handle its problem of running the society, "formerly stable Danwei based secured situation has been shaken and previous Danwei security nets have been broken down." Dai Lüguo, "Shanghai shehui baozhang tizhi jianshe gouxiang," p. 162.

<sup>165</sup> Zheng Gongcheng's following statement represents the declining Zhigong's political trust about the leadership involved with the issue of China's social security system. "Our country's social security system from the start of the reform already encountered the crisis of shaky social credibility. The origins of this shaky credibility come from our loopholes of social security network; unfulfilled social security benefits for the reason of our inconsistent reform programs, and exaggerated propaganda which excessively emphasize individual responsibilities." Zheng Gongcheng, "Tuijin woguo shehui baozhang gaige de ji dian sikao," p. 212.

without setting up a new system beyond the Danwei, it would cause serious social tensions. In this context, there emerged demands of setting up new social security system for the socialist market economy.<sup>166</sup> Obviously, China clearly realized that “SOE can be relieved from existing social functions only after China set up genuinely socialized social security system.”<sup>167</sup> Therefore, a social security reform needed to transform the Danwei-based autarky welfare system into socially managed new system.<sup>168</sup><sup>169</sup> China initiated its efforts to organize social security system which could handle workers’ various risks in market system beyond the Danwei bound labor insurance system.<sup>170</sup> From the early 90s the efforts to set up new social security system beyond the autarky Danwei came to be articulated as the issue of how to organize new social insurance system beyond the Danwei’s labor insurance system.<sup>171</sup> Yet, as the case of unemployment insurance that we observed before, the urban society did not respond the efforts eagerly at first, and the government also did not set up a compulsory premium levying system even when SOEs did not pay their premium.<sup>172</sup>

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<sup>166</sup> Chang Kai, *Laodong guanxi laodongzhe laoquan*, p. 98.

<sup>167</sup> Cai Fang and Lin Yifu, *op. cit.*, 184.

<sup>168</sup> “Our country’s social security system under former planned economic system virtually was not social security or social welfare system; rather it was government and enterprise’s security and welfare system.” Chang Kai, *op. cit.*, p. 222.

<sup>169</sup> “As SOEs were under the condition of serious market competition in market system, there emerged gradually clear contradictions [of Danwei system] and existing Danwei security system already became incompetent. Formerly stable Danwei based security system started to agitate and conventional Danwei security nets were damaged. As the matter of obvious fact, Danwei based security system should be dissolved and socialized security system should be established.” Dai Lüguo, *op. cit.*, p. 162.

<sup>170</sup> “The system of social protection in China is built on individual employer liability programs rather than on social insurance schemes. Whereas major benefits such as pensions and health insurance are typically provided directly by the state in many other countries, in China it is the SOEs that are primarily responsible for both the financing and administration of their own labour insurance and welfare funds, which constitute the principle pillar of China’s social security system” (Hu: 286).

<sup>171</sup> “... single cases of social insurance reform started in the 8th FYP period and proceeded encircling the primary nexus of SOE reform” (*Laodong neican*, 1996, Issue 7, p. 5).

<sup>172</sup> “Now our country has not yet promulgated labor law, let alone social security law. Levying social insurance premium primarily depends on ministry of labor’s documents, which have big flexibility and lack legal resorts. Concerned bureaus also do not actively apply these rules. In this context, if enterprises

However, the urgency of SOE restructuring required China to set up quite organized social insurance system. The following statement of Wang Jianlun, deputy minister of MOL, in 1995 showed the leadership's growing apprehensions about China's inappropriate condition of social insurance system: "Today the social insurance issue for the Zhigong of problematic or bankrupt SOEs is a critical factor which will affect social stability."<sup>173</sup> Li Boyong, the minister of MOL, also said that "we, with the measure of social insurance, should provide SOEs with potent supports to make "bankruptcy without shocking." In fact, after SOEs reform and following market competition, bankruptcy and merger are just normal phenomena."<sup>174</sup> China enforced Labor Law in 1995, which "called for the adoption of five different funds to be managed by local governments rather than enterprises: pension, unemployment compensation, accident and disability, maternity, and medical insurance" (Naughton 1997: 189). Hence, China decided to set up five social insurance systems as the primary social security system to organize post-Danwei urban society. The institutional arrangements were expected to free SOEs from their heavy social burdens and made them genuine economic units. If SOEs "only fulfil responsibility of paying social insurance premium according to regulations, they do not have responsibility to grant social insurance benefits, and they also no more carry out daily management of the subject of social security."<sup>175</sup>

If China wanted to discharge the redundant Zhigong from their Danwei, it had to set up new social systems beyond the Danwei, in which discharged SOE Zhigong could manage their

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delay pay or not pay their premium, social insurance agency cannot implement this. From the considerations of socio-political stability, even for enterprises which did not pay their premium for long period, administrative measures have been seldom used." *Laodong neican*, 1994, Issue 2, p. 23.

<sup>173</sup> *Laodong neican*, 1995, Issue 5. p. 7.

<sup>174</sup> *Laodong neican*, 1995, Issue 11, p. 4.

<sup>175</sup> Cai Fang and Lin Yifu, op. cit., p. 188.

livings until they could find out their new jobs in labor market.<sup>176</sup> In addition to alleviating SOE's heavy social burdens, China's SOE reform needed to set up new social institutions of reliable social security nets for their redundant Zhigong to dissolve the labor relations. Yet China by 1997 could not wait until it could organize quite reliable social insurance system beyond the Danwei and decided to carry out full scale SOE restructuring for its urgency. In this context, China came to introduce Xiangang program to handle redundant Zhigong's labor relation issue, because without reliable social security system those redundant Zhigong would not leave their Danwei.<sup>177</sup>

Organizing Xiangang program did not mean that China did not need to set up reliable social security system any more. Xiangang program was only short term program for two or three years without the guarantee of reemployment; after the program, those Xiangang Zhigong had to dissolve their labor relations. So, Xiangang program itself from the start was not enough to make redundant Zhigong leave their Danwei, as it did not clarify their social security entitlements after dissolving the labor relations.<sup>178</sup> Xiangang program let RSCs pay Xiangang Zhigong's social insurance premiums while they were in the program for two or three years; their entitlements to

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<sup>176</sup> The following statement clearly shows the fact that SOE reform cannot succeed without comprehensive reform of urban Danwei system in terms of setting up its new social institutions beyond Danwei. "With its series of reform programs, China could set up new institutions between Danwei and its society, which, China hoped, could not only absorb Danwei's redundant workers but also engage in new businesses. However, surveyed areas [Chongqing and Shenyang] have not developed new institutions beyond Danwei mature enough, and, they of course, could not play proper roles [to absorb those redundant workers]. Therefore, in order to minimize social disorder, it is reasonable to assume that Danwei could not but take responsibility for caring SOE redundant workforces once again." JIL, *Chūgoku kokuyū kigyō kaikaku no yukue: rōdō shakai hoshō shisutemu no hen yō to kigyō soshiki*, p. 159.

<sup>177</sup> "But our country's social security system has many loopholes and its covering level remains low. Plus, thinking about these redundant personnels' tolerable capabilities, it is still not ready enough to push all of them toward society. In sum, judging from our country's real conditions, we cannot push total redundant personnels toward society; instead, we can only arrange their social insurance and organize their reemployment on the premise that they are not disengaged completely from SOEs" *Laodong neican*, 1997, Issue 5, p. 1.

<sup>178</sup> "... since China has not yet set up a new social security system, Xiangang, to many workers and their family, means losing income, benefits, and their basic living guarantee." Chen Feng:, op. cit., p. 4.

the emerging social insurance remained unclear. In this context, China tried to establish reliable Xiagang program in terms of the “three security lines” with the unemployment insurance and the urban minimum living guarantee program. We can tell here that the leadership understood that Xiagang program by itself could not entail a significant consequence without organizing related social security system.

Yet, the “three security lines” did not turn into a well-organized system to support Xiagang program. The unemployment insurance system just remained in immature conditions, and the efforts to organize the urban minimum-living guarantee program were not necessarily organized as the final protection line of the reliable “three security lines.” Social Policy Research Center of Chinese Academy of Social Science made a survey of Liaoning province’s five cities in 2004, which illustrated that, among the beneficiaries of the minimum-living guarantee program, only small numbers had been under the cover of Xiagang and unemployment insurance system.<sup>179</sup> Obviously, the “three security lines” were not organized well enough for Xiagang Zhigong to leave their Danwei smoothly. In order to organize reliable “three security lines,” the State Council in 1999 promulgated the “regulations of unemployment insurance” out of the leadership’s efforts to upgrade it to reliable one. As unemployment insurance systems in some areas were under the really serious financial pressures, the regulations decided to raise the premium rates (enterprises should pay 2 percents of their total wages, and Zhigong also have to pay 1 percent of their wages).<sup>180</sup> But the unemployment insurance system was to cover part of Xiagang Zhigong’s basic living under the “three-three system” of RSC based Xiagang

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<sup>179</sup> To the question whether they had gotten supports of Xiagang program before minimum living support program, only 6 percent replied yes. Again, to the question whether they had gotten unemployment insurance payments before minimum living support program, only 13 percent replied yes. CASS CSPS, “Liaoning sheng chengshi jumin zui di shenghuo baozhang zhengce pingxi, p. 62.

<sup>180</sup> Cai Fang and Lin Yifu, *op. cit.*, p. 191; ILSS, *op. cit.*, pp. 138-9.

program.<sup>181182</sup> Because of its meager financial ground, it was not practical to expect much from the unemployment insurance system in organizing the reliable “three security lines.”

The context of the efforts to organize the unemployment insurance system affected the leadership’s growing skeptical position of Xiangang system. As Liaoning and its neighboring rust-belt provinces’ layoffs and unemployment in 1999 “had reached levels of over 30 percent of the total workforces” (Gallagher: 145), Premier Zhu Rongji visited Liaoning province in the April of 2000 to examine the area’s SOE restructuring process, stating that China needed to set up a new labor dissolving scheme that, instead of Xiangang, would discharge redundant Zhigong directly from the Danwei with entitlement to unemployment insurance. The visit demonstrated the leadership’s efforts to check how to keep pushing full-scale SOE restructuring without depending on Xiangang program. So, instead of arguing to set up more organized RSC based Xiangang system, Premier Zhu said “accelerating the building of a unified, standard and sound national social security system is fundamental in deepening reform, stabilizing society, and developing the nation.” He thought that “setting up an independent social security system separated from the Danwei system is the critical foundation of socialist market economy system.”<sup>183</sup> The emphasis of reliable social security system reflected the leadership’s clear understanding of undeniable defects of Xiangang program. In this context, China tried to set up a

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<sup>181</sup> DRC SRRTT, op. cit., p. 83.

<sup>182</sup> In 1999 the program levied total 12.4 billion yuan and spent total 9.4 billion yuan with remaining funds 3 billion yuan. Of the total spending of the year, the program used its 42.3 percent for covering Xiangang Zhigong’s basic living and 36.2 percent for unemployment insurances. Since unemployment insurance still had to cover parts of Xiangang Zhigong’s basic livings, some areas’ program faced the situation of receiving not enough for granting. Liaoning province estimated in 1999 that its next year Xiangang Zhigong would be 600,000, which would make the programs’ deficits about 700 million yuan. Jiang Min, op. cit., pp. 32-3.

<sup>183</sup> *People’s Daily*, 2000 April 28.

reliable unemployment insurance system as soon as possible, as it thought over terminating RSC system.<sup>184</sup>

With the *merging* decision, the unemployment insurance system became the single system to support those discharged Zhigong. Hence, a critical content of the decision was how to establish reliable unemployment insurance system for those Zhigong to leave their RSC.<sup>185</sup> The leadership felt urgency to set up a reliable unemployment insurance system with the expectation that it would bring about a system in which labor market could arrange reemployment and society arranges social security for the unemployed.<sup>186</sup> In this context, China made the efforts to incorporate the *outer system* companies into the system to handle the issue of its limited covering boundary, hoping that it could ground even on the new *outer system* units to provide reliable benefits to more Xiagang Zhigong after they left RSCs.<sup>187</sup> By the end of 2002, the number of total participants of the unemployment insurance system reached to 101.8 million.<sup>188</sup> The number of unemployment insurance beneficiaries also expanded rapidly, while the number of Xiagang Zhigong started to decrease from 2000 with the *merging* decision, as the

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<sup>184</sup> “In order to establish social security system independent from SOEs, we should timely devise and start measures to transfer from “RSC” security to unemployment insurance security.” He Ping, “Zhongguo shehui baozhang tixi yanjiu baogao,” 2000, p. 5.

<sup>185</sup> The leadership realized that China had to set up unemployment insurance to substitute RSC. “...we need to actively and reliably push the transition project from RSC provision of Xiagang Zhigong living guarantee to unemployment insurance system” (ILSS, op. cit., p. 280). In this context, The Fifth Plenum of the Fifteenth CCP Congress decided that “completing unemployment insurance system a step further, we should based on experiments bring SOE Xiagang Zhigong basic living supporting program into unemployment insurance system.” Wang Jiexiang, ““Binggui” de shijian yu sikao,” p. 8.

<sup>186</sup> “This [the *merging* decision] presents China with urgent demands of setting up sound unemployment insurance system. Only after establishing unemployment insurance system for urban Zhigong, SOEs can transfer their burdens of surplus Zhigong on behalf of the state and society to both labor market which will handle Zhigong’s needs of reemployment and society which with the scheme of mutual aids will arrange social security for Zhigong who are between jobs.” Cai Fang and Lin Yifu, op. cit., p. 67.

<sup>187</sup> China in 2002 expects total 5 million will be covered by unemployment insurance, which is 1.5 million larger than 2001. Wang Dongjin, “Laodong baozhang zhidu gaige de xingshi yu renwu,” p. 9.

<sup>188</sup> *Zhongguo renkou tongji nianjian* 2003, p. 265.

following table shows. As the portions of decreasing Xiagang Zhigong were transferred to the unemployment insurance system, it becomes more active social system.

Table 4-1. Declining the Total Number of SOE Xiagang Zhigong and Increasing the Total Number of Unemployment Insurance Beneficiaries (Unit: Thousand)

	2000	2001	2002	2003
Total Number of SOE Xiagang Zhigong	6,572	5,154	4,099	2,602
Total Number of Unemployment Insurance Beneficiaries	3,297	4,685	6,570	7,416

(Source: *Zhongguo laodong he shehui baozhang nianjian* 2004: p. 478; 566-7)

Despite these efforts, the unemployment insurance system remained as a minor social security system. Especially, the society did not seem to expect it as a serious social system in terms of handling Xiagang Zhigong's deep misgivings of unemployment. The system granted only a small amount of insurance money for the unemployed, just above the urban minimum living guarantee program. For the leadership, "the function of unemployment insurance in system transformation is relief. ... In China unemployment insurance should not become a part of stable "social income"; its function of economic securities should be temporary, basic, and short-term."<sup>189</sup> It was also non-practical to raise the benefits level, as China was expecting more numbers of the unemployed with the decision to push radical restructuring continuously. The government officially admitted its real unemployment rate for the first decade of the new millenium would remain above 10 percent.<sup>190191</sup> In this context, there was skepticism about the

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<sup>189</sup> Luo Guifen, "Zhuanxing qi de Zhongguo shiye baoxian: youxiao zhidu de jianli yu wanshan," p. 667.

<sup>190</sup> DRC SRRTT, op. cit., p. 82.

<sup>191</sup> Indeed, China can not expect that its future real unemployment rate will be better, as its total labor supply, in both urban and rural, will be 780 million by the end of 2010, which, with the estimation of 7% annual GDP growth rate, will make its real unemployment rate, 12-24 percent. Luo Guifen, op. cit., p. 666.

unemployment insurance system in SOE restructuring process, as its limited resources could not support a great numbers of those released Zhigong out of full-scale SOE restructuring process.<sup>192</sup>

Obviously, the *merging* decision was not accompanied by a reliable unemployment insurance system, and it still remained as a deficient system to play crucial roles in managing the process of dissolving Xiagang Zhigong's labor relations.<sup>193</sup> Indeed, it is quite curious that China did make serious efforts to set up reliable unemployment insurance system. It is thus important to examine the very contents of China's emerging new social security system, i.e., the five new social insurance systems and the urban minimum living guarantee program. Of new social systems, there emerge two salient systems. First, the urban minimum living guarantee program, out of Xiagang program's three security lines, turned into a critical system with the increasing social demand for well-organized basic level residual social system. The other salient one is not an unemployment insurance system but a pension system which interestingly turned out to be the focal system of the five new social insurance systems, as the society expressed much more sensitivity for the issue than any other social programs. When China announces the *merging* decision in 2000, it clearly emphasizes the urgency to set up more reliable socialized pension system.<sup>194</sup> After Premier Zhu visited Liaoning province in 2000 to check its new social security system, the center allowed special experiment program for the province to organize its sound pension system, which will be discussed in detail in chapter 6. Considering that Xiagang and RSCs were introduced to handle sensitive issue of dissolving SOE's inherited redundant

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<sup>192</sup> According to estimation based on the SOE redundant Zhigong and newly increased labor forces, total number of personnel who will need unemployment support would be about 30 million. This required annual unemployment supporting funds 150 billion *yuan*, but raised actual unemployment insurance funds in 2001 was only 18.7 billion *yuan*. Yang Liangchu, *Zhongguo shehui baozhang zhidu fenxi*, p. 76.

<sup>193</sup> For many Chinese, it does not look appropriate to set up unemployment insurance with three percent premium rate to support China's more than 10 percent actual unemployment rate. Gao Shusheng, "Shehui baozhang: women gai zou na tiao lu," p. 44.

<sup>194</sup> *Xinshiqi laodong he shehui baozhang zhongyao wenxian xuanbian*, pp.488-90.

Zhigong, it is quite curious that the *merging* decision was accompanied by efforts to organize a reliable pension system for the pensioners, instead of efforts to set up a reliable unemployment insurance system.

### **(Summary of the Part I)**

China's unique reform of gradualism has to do with its long lingering SOE reform. In order to construct the socialist industrial system rapidly China initially organized the urban society with the Danwei system based on the Zhigong labor system. The leadership maintained Zhigong low wage system to mobilize the urban society's labor at low cost for the construction of the socialist system with the combination of its commitment to arrange formal employment for the entire *inner system* Zhigong which, regardless of their skill level, guaranteed their employment and comprehensive welfare benefits. Yet, the formal employment exclusive labor system turned out to be incapable of providing enough jobs for the society, and the leadership, to realize full employment in the urban society, assigned much more labor forces to the Danwei system regardless of the labor demands, which ended up huge numbers of underemployed workers within the Danwei system. After the reform with the increasing market competition with the new *outer system* firms which was free from Zhigong labor system, more and more SOEs came to face financial troubles, and the leadership initiated the reform to permit their management autonomy, which, however, ended up welfarism out of the insider control issue. There was clear limits to carry out the reform of the Danwei system, as far as it was bound with Zhigong labor system, so the leadership came to decide to corporatize SOE system in terms of 'pure economic unit' so that it could concentrate on its economic performance after shedding off the heavy social functions involved with the Zhigong labor system.

The Danwei system did not have a serious problem in the plan economy, because it was under the cover of the unified financial system in terms of “big pot rice” scheme.<sup>195</sup> The Danwei-based labor insurance system was organized with two components: the Danwei as its enforcing units and the state revenue as the last resort to cover its deficiency. The state did not put much resource to maintain the Danwei system for the Danwei’s guaranteed earnings due to the condition of no market competition. Yet the market competition after reform with new *outer system* units slashed the assured earnings, so the state could not play its supposed role as the last financial resort to maintain the “big pot rice” system. Hence, a critical content of SOE reform involved efforts to break away from “big pot rice” system, which tried to reorganize the Danwei as independent financial system clearly separated from the state financial system. The new *outer system* units were from the start pure economic system without social burdens to organize their workers’ living, so they could outperform SOEs.<sup>196197</sup> In contrast, SOEs were organized with the frame of the Danwei system to accomplish CCP’s political commitments to arrange urban workers full employment and all around welfare benefits.<sup>198</sup> SOEs were under the unequal competition condition, as they had to carry out bulky social burdens to maintain the Zhigong

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<sup>195</sup> “For our past decades’ plan economy system, the roles of our government and enterprises were seriously misplaced: enterprises became direct responsible subjects for arranging the rights of Zhigong living and the government became the direct responsible subject to guarantee the enterprises immortality.” Zheng Gongcheng, *Lun Zhongguo tese de shehui baozhang daolu*, p. 87.

<sup>196</sup> “The *inner system* enterprises, SOE and urban COEs, still to a considerable degree guarantee their Zhigong’s status, by retaining the practices of public ownership system. In other words, the *inner system* Zhigong’s job security and treatment is better than that of the *outer system* workers: even when the *inner system* enterprises have financial problems, their Zhigong’s wage and bonus are paid as normal condition ... By contrast, the *outer system* enterprises ... only have smaller social burdens than the *inner system* enterprises, which allow them to heighten their labor productivity very much and increased employee’s economic incomes.” Feng Tongqing and Xu Xiaojun, op. cit., p. 37.

<sup>197</sup> “Accordingly, their [social] burdens are light and managements can be vigorous, which formulates their competitive edges in their competition with SOEs. Of course, this condition is not helpful for the reform of SOE system.” Li, *Shehui Baozhang yu Shehui Jiegou Zhuanxing*, p. 136.

<sup>198</sup> For a long time SOEs all along has taken social responsibilities for employment and social stability, as Danwei system “bundled together production tasks and worker welfare delivery” (Naughton 1997: 186).

labor system.<sup>199</sup> So their poor performance after the reform could not be simply attributed to their poor management.<sup>200</sup> In this context, there emerged a consensus about setting up equal competition condition for the *inner* and the *outer system* units with efforts to alleviate SOE's heavy social burdens.<sup>201</sup> Hence, SOE reform in the 90s came to focus on how to dissolve inherited the autarky Danwei welfare system after shedding off the bulky social functions in terms of corporatization trying to transform SOE system into pure economic system. The most urgent issue was how to dissolve the labor relations with the redundant Zhigong inherited from the underemployed Zhigong.

However, the Zhigong labor system did not have a scheme to dissolve the labor relations due to its permanent worker system which guaranteed SOE Zhigong's job security. Indeed, despite a series of efforts SOE system just remain lingering, because the leadership could carry out SOE reform only to the extent that the Zhigong society could accept. When China decided full scale SOE restructuring in the context of *grasping the big and releasing the small*, it still remained unclear how it could push the restructuring process which had to discharge huge numbers of redundant Zhigong. In this context, China decided on Xiagang system, which tried

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<sup>199</sup> Since SOEs have undertaken numerous social functions, they have to set its critical parts of resources away from pursuing their business objectives, and, of course, "funding these social services has significantly pushed up SOEs' labour costs" (Hu: 292).

<sup>200</sup> "Under this condition, SOEs take advantage of their role for social responsibility and try to attain government's recognition that they are under the condition of unequal competitions which entails their poor management. Without clear information regarding SOE's genuine performance, SOEs also can conceal even their management losses that are not caused by these reasons under the excuse of social responsibilities assigned by the government. Together with condition of unequal competition, SOE's assigned surplus personnel also have become an excuse to negotiate [about special treatments] with the state and to demand maintaining soft budget constraints." Lin Yifu, Cai Fang, and Li Zhou, op. cit., p. 97.

<sup>201</sup> "Compared with non-state economy, SOEs still take the programmed burdens to arrange welfare benefits for their Zhigong, which makes them incapable to compete non-state sector in the market. In this context, it is so obvious that the success of SOE reform depends on if China can separate this programmed burden from SOE, so that SOEs are condition in a fair competing condition." Cai Fang and Lin Yifu, op. cit., p. 184.

to provide supports for Xiagang Zhigong's reemployment before clearly dissolving the labor relations by establishing RSCs.<sup>202</sup> Then, the push of full scale SOE restructuring based on *grasping the big and releasing the small* achieved a critical result, which extended even to the ownership reform in terms of full privatization of huge numbers of small SOEs and clarifying the state exclusive ownership of large SOEs, respectively. In this context, between 1995 and 2001, the number of SOEs and state-controlled enterprises dropped from 118,000 to 47,000, which was accompanied with drop of total employment in the SOE sector by 36 million (Garnaut et al. 2006: 53).

SOE Zhigong do not persistently resist SOE restructuring and they also admit its inevitability with increasing numbers of SOEs' financial troubles after the reform. They understand the problem of the *inner system's* Zhigong labor system based on permanent labor relations within competitive market condition, which defys SOE restructuring and corporatization eventually. Indeed, the level of labor unrest responding for the magnitude of the layoff since 1997 is not extraordinary, so the urban society seemes to rather accept the changes (Garnaut et al. 2005: 9). Blecher discusses this in terms of workers' acceptance of market hegemony in the reform process.<sup>203</sup> This, however, does not mean that the urban society is ready to leave the Danwei system. Indeed, China's lingering SOE reform process involves socio-political process which tries to articulate a scheme to dissolve SOE Zhigong's labor relations with the Danwei, such as Xiagang and proper compensations.

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<sup>202</sup> "A part of SOE Zhigong virtually does not have work to do already but it is hard to expect that they can voluntarily leave their Danwei. This is because their relations with their workplaces have not dissolved and SOEs also cannot renounce their various long term promises with their Zhigong which have not been explicitly mentioned but have been tacitly agreed. Under this situation, SOE redundant personnel can only exist with the form of "leaving work posts", in other words, "Xiagang"..." Li Yingsheng, *Shehui Baozhang yu Shehui Jiegou Zhuanxing: Eryuan Shehui Baozhang Tixi Yanjiu*, p. 159.

<sup>203</sup> Please see Marc J. Blecher, "Hegemony and Workers' Politics in China," *The China Quarterly*, 2002

Xiagang program was set up as an initial system to undertake the unprecedented process of dissolving Zhigong's labor relations with the transition period provided supporting program for reemployment. Then, out of the urgent SOE restructuring process, there articulated the compensation that the urban society could accept as the very condition to dissolve Zhigong's labor relations. The very contents of the "proper" compensation involved the demands of identifying Zhigong's stakeholder position derived from the insider status of the Danwei system predicated on the permanent workers system. Hence, China can dissolve Zhigong's labor relations only after it can figure out the very condition to handle the social meaning of losing Zhigong's the *Danwei personnel* status. Obviously, it turns out that dissolving labor relations with Zhigong required delicate conditions that had to be fulfilled.

At the same time, the urban society did not have the unemployed before due to the system's former commitment to realize full employment, so there was no social system to support those unemployed. Hence, it required setting up new social system beyond the Danwei that those Zhigong can depend on after they left their Danwei. Otherwise, those discharged Zhigong were to manage their living within vacant embeddedness condition beyond the Danwei, which is the condition that the urban society cannot accept. In this context, SOE corporatization reform to be pure economic unit is accompanied with the efforts to organize a new social security system which can provide a scheme of social embeddedness for those urban citizens who do not belong to the Danwei system. Indeed, China's efforts to set up new social security reform beyond the Danwei, such as five social insurance systems and the urban minimum living guarantee program, are closely related with SOE corporatization reform.<sup>204</sup>

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<sup>204</sup> "The establishment of our country's social security system always involves SOE reform. It constantly serves to SOE reform by stripping SOE's social functions and alleviating SOE's excessive employment

Obviously, SOEs could not dissolve the labor relations with their redundant Zhigong, as the urban society was not ready to accept the unemployed. The very process to figure out the conditions to dissolve Zhigong's labor relations out of SOE restructuring process involved the embeddedness politics to make the society accept unprecedented the unemployed after dissolving Zhigong's former permanent labor relations. Hence, the articulated conditions that have to fulfil to dissolve Zhigong's labor relations virtually means that obvious embeddedness politics involved with dissolving redundant Zhigong's labor relations comes to fashion the very process of SOE corporatization process. Indeed, SOE restructuring process is followed with a series of efforts to handle the unsettled scheme of embeddedness for those who are to dissolve the labor relations, such as Xiagang system, the "proper" compensation that those leaving Zhigong can accept, and new social security system beyond the Danwei that can support those new unemployed. All the efforts have to do with the social process to fashion socially acceptable unemployment system beyond the Danwei system to push full scale SOE restructuring in terms of embeddedness politics.

The embeddedness politics has a tricky aspect, however. China tries to introduce Xiagang program to absorb the shock to dissolve Zhigong's labor relations, but the leadership, with its later found defects, decides to merge it into single unemployment insurance system. So terminating Xiagang program means dissolving SOE Zhigong's labor relations only with immature the unemployment insurance system, which for the society was even harder condition to accept than Xiagang. Then, how could single unemployment insurance system handle the urgent issue of dissolving Zhigong's labor relations even both Xiagang and unemployment insurance system had been previously not enough?

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burden." Jin Si and Sheng Tao, "Shehui baoxian tizhi jianshe chengxiao xianzhu yunzuo jizhi buduan wanshan," p. 197.

Then, was the *merging* decision made, after China set up more reliable compensation scheme for those who had to leave their Danwei? Dissolving Zhigong's labor relations require providing the "proper" compensation which can handle Zhigong's the *Danwei personnel* status, which, however, demands huge amount of money and it remains unclear how to mobilize the required resources. Hence, lots of SOEs in the restructuring process even with local governments' support cannot afford to arrange economic compensation for their redundant Zhigong. So the issue ultimately depends on if the center decides to engage in the compensation, but the center does not clarify its idea. Indeed, the *merging* decision was not based on a reliable scheme to arrange the "proper" compensation for those Zhigong who dissolve the labor relations directly without Xiangang program, so it can entail volatile social responses in SOE restructuring process.

China's efforts to set up new social security system beyond the Danwei could make up those deficiency parts of embeddedness scheme involved with the *merging* decision. Xiangang program was introduced to let the redundant Zhigong initiate dissolving their labor relations process under the urban society's scarcity of any social security system beyond the Danwei. Especially, the *merging* decision makes the unemployment insurance system as a single scheme to manage dissolving Zhigong labor relation process. Yet, as we observed, the unemployment insurance system by no means mature system which can resolve Xiangang Zhigong's deep misgivings after dissolving the labor relations. Of course, China tries to set up other social insurance systems such as the urban minimum living guarantee program as well. But it was not directly related with the process of dissolving the labor relations with redundant Zhigong, as it was only a residual social program that the majority of Zhigong was not expected to depend on

after dissolving their labor relations. China did not decide the *merging* to terminate Xiagang program, after it organized a reliable new social security system for those newly laid off workers.

Hence, the *merging* decision contradicted the China's very embeddedness politics that made the leadership set up Xiagang system. Apparently, the urban society is so sensitive about the very condition whereby the redundant Zhigong can dissolve the labor relations, so SOE restructuring process turns out to be bound with related embeddedness politics. But the *merging* decision was not made after China sets up sound scheme of embeddedness, such as, the "proper" compensation, or quite reliable social security system, whereby the redundant Zhigong could accept the process of dissolving their labor relations. Indeed, the *merging* decision looks just like giving up Xiagang program without addressing the social sensitivity involved with dissolving Zhigong labor relations, which, then, could cause really serious social resentments. So the *merging* decision raises a critical puzzle in understanding China's SOE restructuring process.

Interestingly, however, the efforts to set up new social security system beyond the Danwei have been focusing primarily on setting up new reliable pension system. Indeed, the new socialized pension system turned out to be the most salient system in the emerging new social security system in China, instead of unemployment insurance system. Then, can this provide a clue to solve the puzzle of the embeddedness politics involved with the *merging* decision? In order to address the puzzle, I, in the following chapters, will examine China's pension reform to uncover the reason why China's efforts to set up new social insurance system beyond the Danwei have been carried out mainly focusing on the pension system, especially, out of the context of the embeddedness politics in dissolving Zhigong labor relations for SOE restructuring.

## Part II

China's Pension Reform, the System Transformation, and its Discontents

## 5. China's Pension Reform and the Danwei's IPD

Before the reform, China's urban society was organized with the Danwei system exclusively. It was assumed the Danwei would exist in perpetuity, and the Danwei's Zhigong were permanent workers who were free from the risk of unemployment. There was no need for a social system beyond the Danwei for those who did not belong to the Danwei system. Then China's SOE corporatization reform expanded to a restructuring process and ownership reform, including privatization, which did away with SOEs as a permanent system in urban society. Zhigong were no longer permanent workers, and needed a new social system beyond the Danwei that could support those who were not the Danwei system's permanent personnel. With the push for a radical restructuring of SOEs, China urgently needed to set up a new social system for those growing numbers of Xiangang Zhigong who would soon be leaving the Danwei system. Otherwise, the restructuring would fail to go smoothly. SOEs could not layoff redundant Zhigong without leaving those former workers unable to maintain their living standards.<sup>1</sup> In March 1998, China set up the Ministry of Labor and Social Security (MOLSS), which inherited from the Ministry of Labor (MOL) the responsibility for providing social insurance to urban workers (Teneve, et al.: 19). China's new social security system beyond the Danwei emerged out of the embeddedness politics of SOE corporatization.

Yet, those SOE workers who had lost their work posts were not the only group to be frustrated in the SOE restructuring process; there were also many retired SOE Zhigong who could not receive their full pensions given their Danwei's troubled situations, even if they depended primarily on those pensions to live. The pensions of the retired Zhigong constituted a

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<sup>1</sup> When alternative arrangements for social system beyond Danwei are not set up, "enterprise reform is halted in its tracks since liquidations, joint ventures, or mergers cannot proceed smoothly until the social obligations of state-owned enterprises are assigned elsewhere" (*Old Age Security*: 1-2).

critical part of the Danwei's running labor insurance system, and SOE retirees could receive from their Danwei life-long pensions that reached up to from 70% to 100% of their retirement wages and constituted their principal source of personal finances.<sup>2</sup> Under the Zhigong labor system, retired SOE Zhigong were supposed to be treated equally as working Zhigong.<sup>3</sup> For most retired Zhigong, the Danwei pension was their primary economic resource, which allowed them to maintain almost the same standard of living they had before their retirement without having to depend on their own savings. Indeed, for retired SOE Zhigong, the stakes involved with the Danwei-based pension provision were extremely high, going far beyond the benefits of employment or other social insurance entitlements.<sup>4</sup> The delayed or partial payments of pensions turned out to be a truly sensitive political issue. As early as 1993, retired Zhigong from financially-troubled SOEs were already initiating collective action since their old workplaces could not grant appropriate pensions (Perry: 51). The situation worsened as increasing number of SOEs fell into financial distress. By the end of 1997, the total estimated number of retirees who could not receive their expected pensions had grown to 2.4 million, and the total amount of unpaid pension monies had rocketed to 3.7 billion *yuan*.<sup>5</sup> In this context, those retired Zhigong who could not receive their pensions in full were treated by China as a problem that was just as

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<sup>2</sup> Yamamoto, *Gendai Chugoku no Rodo Keizai 1949-2000*, p. 366.

<sup>3</sup> "In fact the highest principle or value standard of SOEs (or the government) should take was same treatment for the broad employment and same treatment for the all retired" Feng Tongqing, *Gonghui zai chengbao zulin he gufenzhi zhong mianlin de wenti ji qi duice*, p. 17.

<sup>4</sup> To the question of their incomes, most retirees even in 2000 chose pension (89.4%); only small number of them chose working (3.2%) saving (2.2%), or depending on children (4.8%). "10 chengshi qiye Xiangang Zhigong he li tuixiu renyuan jiben zhuangkuang de chouyang diaocha," p. 53.

<sup>5</sup> Gao Shusheng, *Shehui baozhang gaige: he qu he cong*, p. 136.

sensitive as those working Zhigong who were unable to be paid their wages as the SOE reforms were being carried out.<sup>6</sup> There was much discussion about this:

“In the process of SOE reform, the most critical issue which can even decide the success of the reform itself is how to sincerely guarantee basic living of SOE’s great numbers of Zhigong and their retirees. Today, quite many numbers of troubled SOE Zhigong cannot receive wages on time, and their retirees also cannot receive pensions on time. ... The situation has resulted in many social problems such as collective appeals to higher authorities, strike, and so on.”<sup>7</sup>

When China tried to carry out the SOE reform process, it realized it needed to check whether retired Zhigong could receive their expected pensions from their Danwei. As one writer put it, “a critical program of stabilizing Zhigong ranks is resolving troubled SOEs’ Zhigong and retirees’ basic life issues.”<sup>8</sup> It became very clear that SOEs under the restructuring process had to arrange for their current working Zhigong’s basic livelihoods and their retirees’ pensions.<sup>9</sup> Premier Li Peng mentioned the huge implications of the pension system for facilitating enterprise reform, sustaining social stability, and establishing a socialist market economic system. He said that China was in a period of transition, in which some SOEs were in poor financial condition, and consequently could not grant wages to their workers and pensions to

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<sup>6</sup> “With the deepening of SOE reform, some enterprises’ economic efficiencies have declined to reach production stopping or operation reduction, and even bankruptcy. Accordingly, the Zhigong and retirees of these bankrupt and troubled enterprises are in living hardship and there emerge some unstable symptoms in some areas.” *Laodong Neican*, 1995, July, p. 8.

<sup>7</sup> He Ping, *Guoyou qiye gaige zhong de shehui baoxian*, p. 5.

<sup>8</sup> *Laodong neican*, 1994, Issue 5, p. 1.

<sup>9</sup> “In the process of enterprises reform and market competition, bankruptcy and merging are normal phenomena. Of these various related issues, the prominent one today is how to treat those involved persons: first, how to place working Zhigong; secondly, how to manage retirees.” *Laodong neican*, 1995, Issue 11, p. 4.

their retirees. This was obviously destabilizing society. In order to handle this situation properly, he argued, China should establish a reliable pension system.<sup>10</sup>

In June 1998, the CCP and State Council issued a “notice regarding sincerely handling the SOE Xiangang Zhigong’s basic living security and re-employment tasks.” It demanded “two absolute guarantees (*liangge quebao*)” for both SOE Xiangang and the basic living standards of retired Zhigong. With numerous SOEs restructuring, China realized that it was urgent to focus its efforts on providing full basic living support to the growing ranks of Xiangang Zhigong. At the same time, China also tried to guarantee the basic living standards of SOE retirees by setting up a reliable new pension system. By the first half year of 1998, the total accumulated pension arrears at the national level had risen to 8.7 billion *yuan*. When SOE retirees did not receive their pensions for a long period, it became a touchy issue that always spawned strong reactions from Chinese citizens. In this context, the notice demanded that full pensions should be granted without delay; no tardy granting should be allowed; and past unpaid pensions should also be paid. The State Council also issued subsequent notices in 1999 and 2000 to emphasize the urgent tasks of the “two absolute guarantees.”<sup>11</sup>

While other social security programs still remained marginal to workers’ concerns at least for the time being, the Xiangang program and pension system became salient social issues in China’s embeddedness politics around the full scale SOE restructuring process. Yet, as we observed before, it is quite curious that the leadership abruptly decided to terminate the Xiangang program. This created a situation where a still immature unemployment insurance system had to cope with those Zhigong whose labor relations with their Danwei had been terminated, and

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<sup>10</sup> Gu Yue, “Zhongnanhai de Shiye,” pp. 5-6.

<sup>11</sup> Zhang Jun, “Shehui baoxian duixiang de shehuihua guanli fuwu wenti yajiu,” P. 134; Hong Dayong, “Gaike yilai Zhongguo chengshi fupin gongzuo de fazhan lichen,” p. 77.

where society had not yet expressed its serious resentments about the unreliability of that system. Instead, society articulated its extreme sensitivity to the pension system of China's new five social insurance systems. According to a survey conducted by ACFTU in 1997, the percentages of its workers' interests in pension and unemployment insurance were 74% and 6.9% respectively.<sup>12</sup> In China, pensions were the most socially sensitive issue, and unemployment insurance was just a "secondary issue," (*ciyaode wenti*) which covered only a limited number of people for a specific period.<sup>13</sup> Zhigong expressed their most explosive grievances about unpaid pensions rather than unpaid wages or Xiangang benefits (Hurst and O'Brien: 350).

It was under these circumstances that China's emerging new social security system turned out to be highly centered around pensions. While other social security systems still remained in an embryonic stage, China tried to set up a reliable new pension system with its SOE restructuring process. In fact, it initiated its pension reforms much earlier than a full push on restructuring SOEs. Furthermore, its pension premium rate was even higher than those in the pension systems of many developed welfare states. The State Council's unified scheme of 1997 set the premium rate at 28% (8% paid by the individual 8 percent, and 20% by the enterprise), which far exceeded the rates of many welfare states in the Western world.<sup>14</sup> There were demands that China adjust its pension-centered social security system by boosting unemployment insurance, such as raising its low premium rate to reserve enough resources for supporting the expanding numbers of unemployed.<sup>15</sup> How did the pension system, instead of the

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<sup>12</sup> Feng Tongqing, *Zhongguo gonren de mingyun*, p. 42.

<sup>13</sup> Interview, 2005 June 28th.

<sup>14</sup> Indeed, their rate in general do not exceed 20 percent (Germany is 17.7%, England is 19.45%, and Japan is 11.3-13.6%). Yang Liangchu, *Zhongguo shehui baozhang zhidu fenxi*, p. 70.

<sup>15</sup> Obviously, China's unemployment insurance premium rate (3%) is still lower than those of many other countries' unemployment insurance (Canada 7.74%, Germany 6.8%, and Franch 6.8%). Indeed, the policy to raise unemployment insurance premium rate can be made without increase social burdens for

unemployment insurance system, become the country's most salient social security issue, especially when the process of radical restructuring generated a high unemployment rate? This was one of the most critical puzzles in China's reform. As the world in the 1990s underwent a decade of welfare reform in order to adjust existing social policies to a changing global socio-economic context, a critical theme of welfare reform was the retrenchment of existing social programs, and many countries tried to reduce their spending on pension benefits (Bonoli: 8). Yet out of the radical SOE restructuring process, China tried to set up new social security system beyond the Danwei, focusing mainly on the organization of a reliable pension system. How did China's embeddedness politics in restructuring the SOE system come to focus on setting up a well-funded pension system, while China was turning into a global workshop that could produce products economically through its low labor costs?

Pension systems are not identical. They show wide institutional differences in their benefit formulas, financing sources (taxes or contributions), and financing methods (fully-funded or PAYG), and in the roles played by private and occupational provisions (Bonoli: 13).<sup>16</sup> This diversity has to do with differences in the way each country organizes its labor relations. China organized its pre-reform era's pension system in terms of the Danwei-based PAYG system, which constituted a critical component of the Zhigong labor system. A PAYG system arranges pensions for retirees from the contributions of current workers. Hence, it is a system based purely on generational transfers. Without any funds being reserved, this system pays for an

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the entire social insurance system by reducing pension's existing premium rate. Yang Liangchu, *op. cit.*, pp. 84-5.

<sup>16</sup> Pension system can also be divided into two different sub systems: defined benefit scheme and defined contribution scheme. The former runs pension system to guarantee a certain amount of pension, no matter what kind of financing method they choose. By contrast, the latter runs a pension system with certain amount of funds organized by defined contribution and each worker's pension depends on each worker's total contributions.

earlier generation's pensions with the next generation's contributions. By contrast, a funded system arranges for retiree pensions to be paid by a reserved fund constituted from the pensioners' previous contributions. The amount of pensions paid ultimately depends on workers saving for their retirement. A main feature of the pension system under the Zhigong labor system was the Danwei-based generational transfer, which provided retiree pensions from working Zhigong contribution without any fund reservations. This was compatible with a permanent worker system without any labor mobility.

With the "1951 Labour Insurance Regulations," China set up its first pension system, which was financed by supplementary wages, and created a unified pension management system for all SOE Zhigong after their retirement (set at age 55 for women and 60 for men) through the accumulated funds within ACFTU (Lee, Peter Nan-shong: 10). Two years later, China changed the system into a national pension trust fund underwritten by mandatory contributions of 3% of the country's total wage bill (Davis: 237). Until 1966, SOEs paid 3% of total amount of Zhigong wages as a Zhigong's Labor Insurance premium, which was divided between 30% accumulating in the ACFTU account and 70% building up in each enterprise's union account.<sup>17</sup> With the onset of the Cultural Revolution, however, the labor insurance system could not work properly. China's formal systems came under serious contentious political attacks. ACFTU could not play its proper function, undermining the reliability of the Zhigong pension system. As a result, each enterprise depended on its own financial system to pay pensions to retired Zhigong, and China's pension system became the responsibility of the Danwei.<sup>18</sup> One social consequence of the Cultural Revolution was empowering the Danwei system, which came to be entrusted with various social functions. Indeed, one historical effect of the Cultural Revolution was to paralyze

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<sup>17</sup> *Shenzhen shi shehui baoxian zhi*, p. 53.

<sup>18</sup> *Shenzhen shi shehui baoxian zhi*, p. 53.

the labor insurance system, which led the SOEs to incorporate full welfare functions into the Danwei system. China's pension system also changed from being a national program under ACFTU into the Danwei-based parochial program. In 1969, the state officially changed its pension system to a system that would be arranged by each SOE itself, which made the state insurance system into the Danwei insurance system.<sup>19</sup>

Before the reform, China's urban social security system was ultimately managed by the Danwei system without financial engagement from the center.<sup>20</sup> Pension payments to retirees under this system depended entirely on the Danwei's financial system. Yet, no Danwei reserved any special funds for their retired Zhigong's pensions, arranging instead for pensions to be paid from their operating funds. Funding was organized as a PAYG system. No special funds were set aside for pension grants. The primary scheme of China's pension system before the reform was the Danwei-based PAYG system that ultimately depended on each Danwei's revenues without the reservation of any special pension funds. At first, each Danwei could pay pensions to their retirees out of its own revenues, and the Danwei-based PAYG system worked without serious problems. As a newly-established state, the country had "relatively few people qualified during the first two decades of Chinese Communist Party rule" (Davis: 227).

Yet, the Danwei-based pension system gradually came to face financial problems as the numbers of retiring Zhigong kept increasing. By 1978, the Danwei-based pension system began to feel the demographic pressure from an increasing ratio of pensioners to workers, as it faced

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<sup>19</sup> "The 1969 Measure" was often taken as a form of "work-unit-centred" provision, which legally permitted industrial enterprises to make use of their own financial resources to disburse the expenditure of retirement pensions" (Lee, Peter Nan-shong: 10).

<sup>20</sup> "Despite the fact that these labour insurance and welfare benefits are mandated by the state, financing from the central government budget has been insignificant. ... Out of total budgetary expenditures on social welfare, a tiny amount was actually spent on employment-related benefits such as pensions, while the biggest part was earmarked for natural disaster relief and social assistance for the poorest stratum of the population" (Hu: 286).

unique conditions arising from the sudden expansion of retired Zhigong. When China officially terminated the Cultural Revolution, it allowed large numbers of former rusticated urban youth to return to urban society. But the country's urban society could not create new jobs. In fulfilling its goal of full employment, it already had many redundant workers. Under those conditions, China decided to encourage SOE Zhigong to take early retirements by offering some incentives, such as increasing retirement benefits, lowering the minimum service years required to qualify for retirement,<sup>21</sup> and for a time guaranteeing a job in the state sector for a Zhigong's child following his retirement (the so-called *dingti*). In just one year (December 1978 to 1979), China's total number of retirees doubled, and the number in the following years kept growing (Davis: 228).

At the same time, another serious problem developed: some SOEs had to handle much heavier pension burdens because they had many more retirees. Those SOEs that had been founded earlier had more retirees, and their dependency ratios were more unfavorable than those of the new SOEs. Indeed, those SOEs established either in the pre-revolutionary era or during the first two FYP years had more retired Zhigong and, therefore, substantially greater pension liabilities than their newly founded counterparts. The contrast between the Danwei became even more severe after the post-Cultural Revolution reform with the practice of encouraging early retirements in order to be able to place younger workers. The Danwei had very different numbers of retirees and very different pension burdens, creating an unequal competition among them. This inequality was reinforced by the SOE corporatization reform, especially the new practice of allowing increased managerial autonomy, such as profit-retention, that made the SOEs financially more autarkic. In this context, even fiscally sound SOEs could run in the red

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<sup>21</sup> *Old Age Security*, p. 16.

because of the pension obligations to their numerous retirees. Obviously, it was not a recipe for harmony if enterprises with different social burdens had to compete with each other.

In response, China tried to devise a new collective scheme for its pension system. It demanded that all enterprises pay the same standard pension premium to their local labor bureaus, regardless of the number of their retired Zhigong. Then those local labor bureaus would grant the pensions to the retirees. Naturally, without any joint funding mechanism and dependent on individual enterprises, China's pension system began to impose very uneven financial burdens on those enterprises (Davis: 238). From 1981 on, China endorsed local undertakings in social pooling (*tongchou*) trust funds, which was not a national pension reform but only an approval of local experiments for a new system of funding pensions. The emerging pooling trust funds did not cover all the Danwei in the experimental areas, and Premier Zhao Ziyang in 1987 "called for the gradual expansion of "pooling retirement pensions for employees on a provincial, municipal or county basis" (Davis: 238-9). China's reform of the SOE Zhigong pension system was initiated with the "pooling" of the individual SOEs' social burdens to arrange for the livelihoods of retired Zhigong.<sup>22</sup> This aimed at resolving the problems created by the differences among enterprises in their burdens, which had originated mainly from their established years in existence.<sup>23</sup>

The expansion in the ranks of SOE retirees had to do with China's new urban policies after 1978 that sought to arrange more employment opportunities for a large influx of new workers. The situation worsened in the 80s as the country's urban population underwent a natural aging process. SOE Zhigong who had entered the SOEs as young workers in the New China of the early 50s were now reaching retirement age in the reforming China of the 80s. This

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<sup>22</sup> Gao Shusheng, "Zhongguo Shehui Baozhang Zhidu Gaige: Huigu yu Qianzhan ," p. 263.

<sup>23</sup> JIL, *Chugoku no rodo shakai hoshu shisutemu no kisoteki kenkyu*, p. 28.

fundamentally altered the ratio of pensioners to workers, and greatly increased the SOEs' financial burdens.<sup>24</sup> The number of retirees jumped fivefold between 1978 and 1985, and pension costs rose from 2.8% of the urban wage bill to 10.6%.<sup>25</sup> Since a retired Zhigong's pension was covered by the Danwei system, the changes vividly highlighted the SOEs' growing welfare burden. In 1990, the total number of retired Zhigong reached 2.3 million. Those retirees were provided with average annual pensions of 2,099 *yuan* when the average annual wage for a working Zhigong was 2,140 *yuan* (the replacement rate was 98.1%).<sup>26</sup> By 1995, the number of retired Zhigong exceeded 30 million, which was ten times the number in 1978 (Lardy: 44). The following table shows that in the first half of the 90s, the expansion of pension costs far surpassed the growth in the number of people who joined China's urban pension system.

Table 5-1. Growing Imbalance between Workers and Pensioners in SOEs and COEs.

	1990	1991	1992	1993	1994	1995
Workers (millions)	106.8	109.6	108.7	109	105.5	103.2
Pensioners (millions)	13.2	14.7	15.9	17.7	19.1	22.4
System dependency ratio (%)	12.4	13.4	14.6	16.2	18.1	21.7
Wage expenditure (billions of yuan)	223.5	251.3	291.5	351.9	448.8	533.7
Pension expenditure (billions of yuan)	22.6	26.6	32.5	42.0	56.5	70.7
Pension-wage ratio (%)	10.1	10.6	11.1	11.9	12.6	13.2

(Source: *Old Age Security*, p. 15)

In addition, many SOEs increased the pension provisions to their retirees. The SOE reform efforts in the 80s, such as allowing profit-retention (*lirun liucheng*), reforming taxes on profits, and CRS, were followed by a moral hazard issue as welfare provisions, including pensions, exploded. The total costs of SOEs' welfare benefits for their retirees - pensions, medical care, and living subsidies - increased annually by 16.9% between 1980 and 1994. In the

<sup>24</sup> In 1978 there were 33 workers for each retirees; by the end of 1985 the nationwide ratio had fallen to 13:1, and in the old industrial sectors it was as high as 5:1 (Davis 1988: 229).

<sup>25</sup> *Old Age Security*, p. 16.

<sup>26</sup> Yamamoto, op. cit., p. 341.

same period, the total benefits for each retiree increased from 40.10 *yuan* to 365.30 *yuan*, which greatly exceeded the growth rate of a working Zhigong's wages, 7.8%.<sup>27</sup> In fact, the costs of pensions and other benefits for retired SOE Zhigong increased annually by 30.3%, which even exceeded China's GNP growth rate.<sup>28</sup> In the mid-90s, the ratio of SOE retirees to working Zhigong increased to 25%, while the ratio of SOE redundant personnel rose to 30%. Together, both groups took up more than 50% of working Zhigong's total wages.<sup>29</sup>

The Danwei-based pension system had been organized with a scheme of defined benefits without any clear regulation of contributions. The Danwei organized their pension systems as a PAYG system. Before the SOE reforms, the system ran smoothly. SOEs had only small numbers of retired Zhigong, and were guaranteed profits in a system with no market competition. The numbers of retired Zhigong, though, could not remain the same. As time passed, more and more Zhigong retired from their SOEs, a process accelerated by the post-Cultural Revolution reform of inducing early retirements. China's Research Group for the Social Security System estimated the PAYG system would require a contribution rate of 39.27% in 2033, when the dependency ratio would reach its peak.<sup>30</sup> Obviously, given this rapidly deteriorating dependency ratio, the Danwei-based PAYG pension system was unsustainable. Moreover, influenced by a rampant fad of welfarism, SOEs expanded the scale of pensions granted to retired Zhigong without any serious constraints.

Most of all, as SOEs began to face emerging market competition with the outside world, they were no longer guaranteed profits. Ever more SOEs came to face problems in granting full

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<sup>27</sup> Lin Yifu, Cai Fang, and Li Zhou, *Zhongguo guoyou qiye gaige*, p. 94.

<sup>28</sup> JIL, op. cit., p. 70.

<sup>29</sup> Weng Zhiyong and Yu Tijun, "Baotuo kunjing chongsu huihuang: Shanghai guoyou qiye de gaige yu fazhan qushi baogao," p. 13.

<sup>30</sup> *Old Age Security*, p. 24.

pensions to their retired Zhigong. In the 90s, it was no longer just a question of the Danwei having unequal pension burdens. Growing numbers of SOEs were incapable of granting full pensions to their retired Zhigong.<sup>31</sup> This raised the issue of the Danwei-based PAYG system's eventual unsustainability. During the 90s, the structural problem of the Danwei-based PAYG system became all too apparent, as more and more Danwei proved themselves unable to handle expanding social pension demands without reaping guaranteed profits. Trying to cope with the SOEs' increasingly heavy pension burden even in the face of the tougher financial conditions many Danwei confronted, China realized it had to reform the existing Danwei-based PAYG scheme.<sup>32</sup> Indeed, from 1979 on, China gradually realized that it needed new policies and institutional alternatives to handle the growing financial burden of pension payments and the sudden expansion of social pension demands (Lee, Peter Nan-shong: 10). Since the Danwei system was the very system paying retired Zhigong pensions, the efforts to introduce a new pension system came to be carried out as a critical part of the SOE reform process.

### <The Reform of 1991 and 1993>

In 1991, the State Council made a critical pronouncement on pension reform with its “decision on enterprise Zhigong pension insurance system reform (State Council Document no. 33 of 1991),” in an attempt to introduce a new Zhigong pension system beyond the Danwei with the form of Basic Pension Insurance (hereafter BPI). Unlike the Danwei-based Zhigong pension system, China realized that it needed to set up a new insurance system that only set for itself the limited goal of satisfying the “basic needs” of retirees by guaranteeing retired Zhigong's basic

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<sup>31</sup> Cai Fang and Lin Yifu, *Zhongguo jingji*, p. 186.

<sup>32</sup> “PAYG is not appropriate financing scheme for the country whose population has high dependency ratio.” Zheng Gongcheng, *Lun Zhongguo tese de shehui baozhang daolu*, p. 86.

living above the poverty line.<sup>33</sup> Considering its economic and financial capacity, China realized that it could not provide rich pensions to retirees and that pensions had to be controlled and be set at an appropriate level.<sup>34</sup> China considered that by controlling pensions at the lowest level, the BPI system could ease the financial burdens on the growing numbers of SOEs that were having trouble competing in the market. Out of the need to lower the social cost of arranging pensions for retired Zhigong, the main feature of the new BPI system was to pay basic pension benefits to retired Zhigong.<sup>35</sup>

At the same time, the new pension system was expected to free the Danwei from their existing pension obligations to their retired Zhigong. Going forward, the Danwei just paid premiums. The primary goal of the reform was to relieve the SOEs' heavy pension burdens by organizing a social pooling system.<sup>36</sup> The "social pooling system (*shehui tongchou*)" was conceived as a unified social insurance fund that levied new premiums or a social security tax. The social insurance's goal was to achieve mutual relief for the SOEs. By organizing a resource pool to pay pensions to retirees, China hoped to create a new socialized pension system that was separate from the Danwei and would release SOEs from their heavy pension burdens. China also introduced a way for individual workers to contribute to their future entitlements.<sup>37</sup> By enhancing the finances of the pool with new contributions from the workers themselves, China

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<sup>33</sup> Jiang Chunze and Li Nanxiong, "Zhongguo yanglao baoxian sheng ji tongchou yi hou de maodun fenxi yu duice yanjiu, p. 10.

<sup>34</sup> "[T]o ease the financial costs of transition, it is proposed that the transitional benefits of current pensioners and current workers be held to a politically acceptable minimum" (*Old Age Security*: 45).

<sup>35</sup> Since it was to arrange only basic pension, China also planned to set up some supplementary systems such as voluntary enterprise pension and personnel saving pension as well.

<sup>36</sup> A key objective of social security reform in China is to relieve individual enterprises of full direct responsibility for their workers' retirement pensions by establishing pension funds that pool resources and risks among enterprises (Hu: 298).

<sup>37</sup> China's new pension system was to be made up with not only enterprise but also individual worker's contributions decided by local bureaus according to certain amount of their total wage. Yamamoto, op. cit., p. 342.

expected that the new BPI system could reduce the SOEs' pension obligations and handle the increasing pension demands from a rapidly aging population. This decision revealed the main theme of China's pension reform of the 90s: Organize a new socialized BPI system that was based on a social pooling system and that was enhanced with contributions both from enterprises and individual Zhigong. This, it was hoped, would replace the Danwei-based PAYG system that was supported by the Danwei' operating budgets.

China, however, realized that the decision in 1991 to include contributions from individual workers was not enough. Even if Zhigong contributed payments, the new system did not allow for setting up individual accounts. The pension benefits of individual workers were only vaguely linked to the amounts of their own total contribution. China's efforts to introduce a new accumulated funding system did not clarify any incentives that would link individual pensions to the amounts of his or her own contributions. A sound institution cannot be organized without an appropriate structure of incentives that can adjust to and coordinate interests.<sup>38</sup> China considered introducing a new system of individual pension accounts. From 1992 on, Shenzhen and Shanghai each launched experiments in individual accounts.<sup>39</sup> Looking at the two cities' experiments, China leadership concluded the country's pension reform had to include creating a new system of individual accounts. Since the total pension each worker received after retiring would depend on the accumulated funds within his or her individual account, the new system was expected to strengthen the workers' understanding of their pension entitlements and thereby

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<sup>38</sup> "This reform enhances the Zhigong's awareness of self help and joining pension responsibility; reduces SOEs social burdens; and establishes internal premium commitment and mutual interest mechanism among enterprise, Zhigong, and social insurance system ..." He Ping, *op. cit.*, p. 14.

<sup>39</sup> Recording annually a part of their basic pension fund into each worker's individual account, which, after divided by 120, would be granted back monthly to account owners after their retirement. *Laodong neican*, 1995, Issue 4, p. 16.

increase the incentive to participate and contribute to their individual accounts.<sup>40</sup> In November 1993, the Third Plenum of the CCP's 14th National Congress announced a major plan to organize a new BPI system, "a social pooling system combined with individual accounts."<sup>41</sup>

Most important, an individual account system can accumulate social resources because its main feature is that the state can use it as a compulsory saving mechanism. The state is given control over workers' saving for their livelihoods after retirement. Along with recording the premium payments from the employer, an individual account notes the contributions from the worker. China thought the individual account system could resolve the problems of the former PAYG system, which had not saved any resources at all to meet society's increasing pension demands. With this new system, it was believed, the government would not need to worry about Zhigong pensions, since each worker's pension benefits would depend entirely on the accumulations within the individual accounts.<sup>42</sup> The individual account system was regarded as critical for repairing the flaws in the existing Danwei-based PAYG pension system. Adopting it was a truly critical development in China's pension reform. It initiated a direct reform of the existing Danwei based PAYG system, which had not had any arrangements to accumulate funds. China decided to set up individual accounts with intent that they could be used to accumulate pension funds for an aging workforce.

Consequently, China reorganized the urban pension system beyond the Danwei, replacing it with a new BPI system that combined a social pooling system with individual accounts. Yet,

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<sup>40</sup> JIL, op. cit., p. 71; According to He Ping, "our country has decided mid-term development principles for the social security system construction: following the momentum of the reform, it is focusing on economic efficiency with emphasis of individual responsibilities, and tries to readjust SOE and the state's burdens with the introduction of individual account." He Ping, "Zhongguo shehui baozhang tixi yanjiu baogao (2000)," p. 10.

<sup>41</sup> JIL, op. cit., p. 46.

<sup>42</sup> *Laodong neican*, 1995, Issue 4, p. 16.

social pooling systems and individual accounts are very different animals. New BPI system was unique in its attempt to combine two dissimilar systems. China's new pension system focused on two reform targets: one was how to socialize the parochial Danwei pension system; the other was to introduce a way to accumulate funds and reform the Danwei-based PAYG pension system. China decided to set up a social pooling system for the former and individual accounts for the latter. The social pooling system was not a funded system to accumulate resources for future pension, but a socialized resource pool to arrange for the payment of a "base pension." The goal was to practice the principle of mutual assistance by ensuring all workers enjoyed the same pension level according to an established social wage rate, regardless of which Danwei they had belonged to. Individual accounts were a separate system for individual account owners to accumulate resources toward their own future pensions. The sole goal of setting up the accounts was to realize the principle of self-help.<sup>43</sup> In transforming the Danwei-based PAYG system, the pension reform of the early crafted a new socialized new pension system that rather than giving China a completely funded system, ended up created a partially accumulated funded system.

### **<The Reform of 1995>**

The leadership realized they had to reform its Danwei-based pension system, which was severely challenged by the introduction of market competition to China. Suddenly, pension reform became an urgent issue. It was perceived the continued existence of the Danwei-based

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<sup>43</sup> Jiang Chunze and Li Nanxiong, *op. cit.*, p. 13.

Zhigong pension system could disrupt the SOE corporatization reforms.<sup>44</sup> In 1995, the State Council promulgated a “notice regarding deepening reform of the enterprise Zhigong pension system (State Council Document No. 6 of 1995),” which tried to accelerate the pace of pension reform by specifying the measures.<sup>45</sup> In order to organize a “social pooling system combined with individual account” pension system, China had to decide on the balance between the two systems. The decision of 1993, however, had only articulated the principle of combining the two without specifying their relative scales. A decision on this would determine the very nature of the new pension system: whether it would mainly be a pension system based on mutual assistance that could ensure all pensioners a certain basic pension and that depended on a social pooling system or whether it would primarily be a self-help pension system that relied on individual accounts. It turned out that China’s leaders were unable to conclude how to combine those two parts of the BPI.<sup>46</sup> Instead, they decided to allow an experimental period before determining the final structure of Zhigong BPI system. The notice of 1995 suggested two different approaches. After receiving approval at the provincial level, municipalities and prefectures were permitted to implement one of the two systems.

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<sup>44</sup> “Since the late 60s, the practice of China’s pension system was run by the form of corporation insurance. The pension of retired Zhigong was primarily managed by the SOEs, which undertook its whole costs and managements. In this context, SOEs became “small society,” which, by giving them critical social burdens, hinders seriously the development of old enterprises, especially large and medium SOEs. As China has successfully developed its economy and has deepened its economic transformation continuously, its enterprises’ management mechanisms have to be transformed: alleviating their social burdens, equal participating in market competitions. The previous SOE-based pension system has already become incompatible with the real current situations and cannot satisfy the demands of SOE reform.” *Laodong neican*, 1995, Issue 2, p. 2.

<sup>45</sup> *Xinshiqi laodong he shehui baozhang zhongyao wenxian xuanbian*, pp. 167-171.

<sup>46</sup> While the State Commission for Restructuring Economic Systems argued that China should choose bigger individual account system, MOL demanded that China should focus on larger social component system (*Old Age Security*: 4).

Plan I, entitled “Small Social Pooling and Big Individual Accounts,” tried to set up a BPI with the individual account as its core. The social pool would be funded by 7% of wages. Individual accounts took 16% of total wages, with the individual worker contributing 3% from his own wages, the enterprise putting in 8% of that worker’s wages, and the enterprise adding a further 5% of the average local wage.<sup>47</sup> The basic idea of Plan I was that the Zhigong’s livelihood after retiring would ultimately depend on their own lifetime accumulations. The monthly amount of the pension paid to individuals after retirement would be calculated by dividing by 120 the accumulated funds in their individual accounts.<sup>48</sup> In contrast, Plan II, called “Big Social Pooling and Small Individual Accounts,” aimed to set up a BPI system stressing the social pool, which would go up to 35% of local wages,<sup>49</sup> while individual accounts would remain at only 4% or 5% of the Zhigong’s average wage.<sup>50</sup> Here, the pensions paid to retired Zhigong depended mainly on the social pooling portion of the BPI. In allowing this experimentation, it was obvious China’s leadership was hesitant to decide on the relative scales of social pooling part and individual accounts.

Given the indecision of how to organize the new BPI system, the process of creating the social pooling system turned out to be quite bumpy. Before the reform, urban society was by no means an integrated single entity. Rather, it was an aggregation of compartmentalized individual Danwei systems, which generated some conflicts in the efforts to set up a social pooling pension system beyond the Danwei. Serious tensions erupted between those Danwei that could afford to grant pensions to their retirees and those that could not. Among the Danwei, there was an extreme diversity of pension burdens and the numbers of retirees. SOEs with long histories had

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<sup>47</sup> JIL, op. cit., p. 31.

<sup>48</sup> *Laodong neican*, 1997 Issue 8, p. 4.

<sup>49</sup> JIL, op. cit., p. 31.

<sup>50</sup> *Laodong neican*, 1997 Issue 8, p. 4.

great numbers of retired Zhigong, and the dependency rate of those older Danwei was very high. New enterprises and growing enterprise in the new *outer system* had only small numbers of retirees, and enjoyed very low dependence rates. Furthermore, after the reform, the Danwei had very different financial conditions, and held widely diversified interests in the efforts to organize a new socialized pooling pension system. Hence, divergent interest positions among the Danwei put many areas in quite complex situation which tried to set up a new social pooling system in which the Danwei only paid premiums and new socialized pension system granted entire retirees' pension.

A basic principle for organizing a socialized pension system to replace the old Danwei system was that each area had to fix a premium rate applicable to all of its enterprises regardless of the numbers of retired Zhigong in individual Danwei. Enterprises with low dependency rates, however, resisted joining the new socialized pension systems. Consequently, at first, many local governments were unable to create socialized pension systems. Some cities devised ways to adjust to this, making the Danwei with larger numbers of retirees pay more pension premiums.<sup>51</sup> In many areas, the actual implementation of the social pooling system depended on the practice of "remitting the difference" (*chae bojiao*). The supposed ideal was that the Danwei would pay premiums to Social Insurance Agencies (hereafter SIAs), which would then assume the responsibility of granting full pensions to retirees. In actuality, many Danwei paid to the SIA only the funds that remained after deducting the Danwei's retiree pensions from their total pension premium (Frazier 2010: 78).<sup>52</sup> This was the reason why many SOEs remained

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<sup>51</sup> The World Bank discovered the practice that many SOEs' contribution rate depends on their number of retirees. "In many cases an enterprise's contribution rate depends in part on its own pension obligations" (*Old Age Security*: 3).

<sup>52</sup> Wang Yan, et al., "Zhongguo yanglaojin yinxing zhaiwu zhuangui chengben gaige fangshi ji qi yingxiang," p. 304.

responsible for record-keeping and for the delivery of pension benefits (Old Age Security: 2). In those cases, the SIAs just collected pension premiums for a social pool without paying full pensions to all retired Zhigong from the Danwei that had joined the pool. Those Danwei were not released from their pension burdens, and were only allowed to deduct from the premiums they paid to the pool the pension payments they had made to their retirees. Even with the efforts to set up a social pooling system, the pension arrangements for retired Zhigong remained the Danwei liability. Not surprisingly, it was the old Danwei with numerous retirees that assumed the heaviest financial burdens.

Obviously, the practice of “remitting the difference” limited the actual scope of the new social pooling system. The Danwei were still bound to their pension liabilities. The new social pooling system failed to create a fully socialized pension arrangement system that removed each Danwei’s burden. In places following this practice, there were cases where the Danwei did not have enough resources to pay their pension obligations. Some financially-troubled Danwei paid their pension premiums from the budget reserved for granting pensions to their retired Zhigong, making it even more difficult for them to pay the pensions. The fact that a Danwei joined the social pooling system did not guarantee its retirees would receive full pensions. Since many areas were unable to set up a social pooling system that went beyond “remitting the difference,” the retirees in many problem-ridden SOEs were unable to have their full pensions paid on time, even though a major reason for setting up a socialized pension system was to guarantee full pensions to retired Zhigong from every Danwei.<sup>53</sup>

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<sup>53</sup> “... for some enterprises’ poor performance and many areas’ practice to organize social pooling system depending on “remitting the difference,” those troubled enterprises retirees cannot get their full pension on time.” *Laodong Neican*, 1996, Issue 5, p. 25.

Why was it so difficult to unbound the Danwei from their pension obligations to their retired Zhigong? China tried to introduce socialized new pension system to handle the impending condition that the existing Danwei based PAYG pension system could not grant full pensions for their rapidly expanding numbers of retirees. But it could deal with the issue of expanding numbers of the pensioners on the condition that it would not take the liability to grant pension for the existing retirees. This is because the Danwei system had not accumulated any resources for paying pensions to the retired Zhigong. So without an extra reliable financial foundation to handle the retired Zhigong's pension the new socialized system could not grant full pension for them. Under this situation if the new pension system needed to granting full pension for the all retired Zhigong with the new socialized pension system virtually means that the Danwei with small number of retirees had to pay more for the Danwei with many retirees.

Hence, the crux of the issue to organize socialized pension system was how to devise a method that could mobilize enough resources to handle the Danwei's current retired Zhigong. Here, we need to pay particular attention to the actual process of how the new pension system's social pool worked. It was organized to ensure every worker from every Danwei enjoyed an equal "base" pension, but it also came to play a silent and major role in granting pensions to existing retired Zhigong. A fundamental goal of China's pension reform was to set up a new pension system beyond the Danwei system in order to reorganize the SOEs into genuine economic units free from heavy social burdens. To succeed, the reform required measures be found to deal with the existing Danwei system's pension commitments to retired Zhigong. Yet, without devising such measures, China simply decided to introduce the new socialized new

pension system.<sup>54</sup> As a result, for the moment, the newly organized social pooling system assumed the role of granting pensions to retired Zhigong.

In carrying out the SOE corporatization reform of the 90s, China realized it had to deal with the pension issue, and came to rely on the social pooling component of the new BPI system. At the end of 1994 and early 1995, the MOL issued two related documents demanding each area should make the proper arrangements to provide for the basic livelihood of retirees from problematic SOEs. China's leadership came to embrace the idea that if SOEs that had participated in a social pooling system went bankrupt, their retirees' pensions would be covered by the SIAs.<sup>55</sup> It was expected that in more and more areas' social pooling system would go beyond the practice of "remitting the difference," and grant pensions to retired Zhigong.<sup>56</sup> In this context, China articulated that if those Danwei participating in the new BPI system paid their full premiums, the new social insurance system, rather than the Danwei, would pay out full pensions to retirees.<sup>57</sup> There were also attempts to find a way to handle the pensions of those Danwei that participated in the social pooling system, but could not pay their premiums. The government tried to set up regulations that could approve requests by troubled enterprises to defer their payments of the social insurance premium. During the deferral period, it was hoped, the SIAs would then help these enterprises grant sufficient pensions to their retirees.<sup>58</sup>

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<sup>54</sup> "Obviously, China, under its market reform, cannot maintain its parochial welfare system depending on Danwei system, which ran independent welfare system within the enterprise's boundary. In this context, China tries to set up a brand new institution which "socially takes care of all retired Zhigong by setting up social insurance fund." Yamamoto, *op. cit.*, p. 438.

<sup>55</sup> *Laodong neican*, 1995, Issue 5, p. 8.

<sup>56</sup> Zhao Chenhui argues that the "notice regarding deepening reform of SOE Zhigong pension system (the State Council no. 6 document of 1995)" clarified that social pooling funds following the rules would cover the retired Zhigong pension. Zhao Chenhui, "Buchang: yanglao boaxian zhidu zhuangui de qudongqi, p. 26.

<sup>57</sup> *Laodong neican*, 1996, Issue 2, p. 20.

<sup>58</sup> *Laodong neican*, 1996, Issue 7, p. 12.

Financially, however, whether the social pooling system would have the needed resources to cope with the retired Zhigong's pensions remained unclear. Under the Danwei-based PAYG system, China had not accumulated pension funds. Thus, when China began to set up a new partially-funded pension system that combined a social pooling system and individual accounts, it lacked any inherited resources. It had no social pooling funds to use to pay currently retired Zhigong. Most important of all, the new social pool had been originally designed to provide a "base" pension to all program participants, which combined with accumulations within individual accounts would pay future pensions to current employees.<sup>59</sup> When China created a new social pooling system, it did not mobilize the required financial resources to grant pensions to retired Zhigong. Therefore, even though still in its early stage of development, the social pooling system had to grapple with the issue of granting pensions to retirees. This was one important reason why the practice of "remitting" practice survived the reform. Combining the social pooling system and the individual accounts was ad hoc way to handle the demands of China's growing numbers of future pensioners rather than a permanent approach to making grant pensions to existing retired Zhigong. It was not financially ready to take on the role of paying out retiree pensions, and its financial foundations were weakening. As the SOEs' economic performance worsened in the face of severe market competition, ever more of them went into severe budgetary deficits and had no choice but to default on their pension premiums. One of the most salient issues of organizing the social pooling system was the decline in the collection rate of funds year after year.<sup>60</sup>

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<sup>59</sup> Obviously, the new partially funded pension system can arrange future pension for the current working Zhigong as a system to handle its rapid ageing process.

<sup>60</sup> According to some data, national rate of pension premium receipts kept declining, between 1992 and 1997, with the records of 95.7, 92.4, 90.5, 90.0, 87.0, and 80.0 percent, respectively. Wu Zuxing, "Woguo yanglao baoxian tizhi lujing xuanze bianqian de fenxi," p. 30.

In the new pension reform notice of 1995, China took a step forward to establish a new socialized pension system. By year's end, the number of working Zhigong who had joined the BPI's social pooling system had reached 87.3 million, while the number of retired Zhigong who were participating was 22.4 million.<sup>61</sup> These numbers did not mean that more of the pensions paid to retired Zhigong were being covered reliably by the new BPI system. In many areas, the social pooling systems were not ready to grant full pension to retirees. By the end of the year, many SOEs and COEs had undergone restructuring, which could not but impact the pension provisions for their 1.63 million retirees. The total number of retirees who could not receive their full pension regularly was almost 700,000, and the total amount of pension in arrears rose up to 788 million *yuan*.<sup>62</sup> By the end of 1996, the total number of retirees who did not receive their full pensions had expanded to 1.17 million.<sup>63</sup> The new social pooling system had not yet developed to the point where they could grant full pensions to all retired Zhigong. Retired workers still had to depend on their Danwei for their pensions, while whether those pensions could be paid was determined by the Danwei's own financial conditions. For all with the efforts to set up a social pooling system, the Danwei were not released from their onerous pension obligations. Many strapped Danwei could not pay full pensions to their retirees. As it turned out, the pension reform's attempt to set up a new socialized system beyond the Danwei did not necessarily mean that the existing retired Zhigong's pensions could be settled by default; Instead, the issue of granting full pensions to retired Zhigong remained a serious problem, and disrupted the attempt to organize a new socialized pension system. Accordingly, among the most urgent tasks in China's pension reform to set up a socialized pension system was also how to set up a

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<sup>61</sup> *Laodong neican*, 1996 Issue 7, p. 4.

<sup>62</sup> *Laodong neican*, 1996 Issue 8, p. 6.

<sup>63</sup> *Laodong neican*, 1997, Issue 3, p. 27.

system that could grant full pensions to the retired workers of SOEs even while those enterprises were undergoing radical economic restructuring.

Under such conditions, enterprises with low dependency rates had no desire to join the socialized pension system, because they would be required to pay premiums that were larger than the pensions they granted their own retired Zhi Gong. By participating in the pool, they would be underwriting the retiree pensions of troubled Danwei. There was no doubt that creating a viable social pooling system able to pay pensions to retirees meant that wealthier Danwei with small numbers of retirees would expend many more funds than they otherwise would. This generated large conflicts of interest within urban society. While some SOEs under severe financial stress could not pay their pension premiums, some financially-sound enterprises attempted to veil the actual amount of their total wages to avoid paying the premiums. Faced with declines in the amounts of premium collected, some areas were forced to raise the premium rates they assessed enterprises in order to be able to pay retirees their pensions.<sup>64</sup> This, though, did not resolve the financial difficulties those areas faced, because it placed a heavier burden on enterprises. The result was not only that even more troubled SOEs defaulted on their premiums. Affluent units, including new *outer system* enterprises, worked even harder to evade their payments.<sup>65</sup> The pension reform process fell into a vicious circle of fiscal failure.

Indisputably, the difficulties faced by the social pooling systems had to do with the fact that they came to grant pensions to retired Zhi Gong without acquiring the financial means to do

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<sup>64</sup> “Some areas under the condition that their pension revenues cannot cover their expanses already start to increase premium rate of social pooling system. Indeed, the premium rates in those cities of old industrial areas have already reached to over 29 percent, and SOE burdens do not diminish but expand.” SDPC AMR, *Guanyu jianli he wanshan woguo shehui baozhang tixi de yanjiu*, p. 128; While the national average enterprises pension premium rate in 1996 was around 23 percent, some cities’ rate reached to even more than 30 percent. *Laodong neican*, 1996, Issue 5, p. 25.

<sup>65</sup> Most of all, the heavy pension burdens suffocate potential chances of new *outer system* enterprises to start their new business in the area, which makes the areas more difficult to draw new financial bases.

so. For all the reforms on socializing the Danwei-based pension system, the practice of “remitting the differences” continued to tie the pension burden to the Danwei. In such a sensitive situation, China’s leadership did not seek to set up a unified BPI system to cover all of urban society. Under this situation the leaders allowed local governments to choose between Plan I and Plan II in order to implement their own systems. With serious tensions growing among the Danwei, each area was permitted to carry out local pension experiments and to work out its own ratios for organizing a new BPI system.

In practice, local governments were given the discretion not only to select their own pension systems from Plan I or Plan II, but also to select different combinations of the two systems. From this emerged another pension system that blended both plans in various ways. Suddenly, China’s new socialized pension systems became more diverse. Since each local government could choose its own ratios of social pools and individual accounts, experiments led to pension systems that had unintended social consequence and to regional BPI systems that were too diversified, all unlikely candidates to be parts of a unified national pension program.<sup>66</sup> As one observer put it, “in terms of diverse premium standards and granting schemes, the national BPI system in its practical program has been extremely diversified (*wuhua bamen*).”<sup>67</sup> China’s leadership was unwilling to accept such a regionally diversified pension system, and decided to set up a new unified pension system in 1997.

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<sup>66</sup> Each area chooses roughly three different models, which makes each area have quite different scale of individual account (from 3 percent to 17 percent). Yet even within these three models, each area has its unique combination of programs and measures, China’s three pension models end up with even more diverse subcategories and “consequently, each area virtually has its own program.” *Laodong neican*, 1996, Issue 5, p. 25; “The government may have inadvertently contributed to further fragmentation of the system by proposing two plans. By allowing localities to choose between them or any combination of components of the two, it has opened up a Pandora’s Box. ... This has led to creation of hundreds of schemes all over the country” (*Old Age Security*: 17).

<sup>67</sup> Zheng Gongcheng, op. cit., p. 187.

## <The Reform of 1997>

1997 was politically a very sensitive year: It began with a full scale restructuring of the SOEs. Xiagang policy was launched. Huge numbers of redundant SOE Zhigong were supposed to leave their Danwei. Despite all the attempts to set up a new socialized funded pension system, however, many Danwei still had to arrange for their retired Zhigong's pensions, leaving many SOEs that would be targeted for restructuring with numerous retirees to care for as well. At the same time, those retired Zhigong who were unable to receive their promised pensions turned out to be a very volatile group. Without including proper arrangements to pay pensions, the restructuring had the potential to precipitate truly serious social tensions. The SOEs found it impossible to dodge the issue of how to set up a new pension system that could handle retiree entitlements. On the one hand, the young socialized pension system already was unable to grant full pensions to currently retired Zhigong, a situation that threatened to deteriorate even further when the impending full restructuring of SOEs would dissolve labor relations with huge new numbers of redundant Zhigong. On the other hand, China needed to create a truly reliable socialized pension system even while the Danwei were undergoing full-scale structural change.

Up to this point, there had been some missteps in the creation of the new social pools. The most prominent problem was the regionally fragmented pension system.<sup>68</sup> Each local government had implemented its own policies, standards, and measures that were supposed to be the most suitable for their own areas. The Chinese leadership worried about the possibility that

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<sup>68</sup> "... the pension funds' pooling level is too low and its adjustment capability is too weak, which results in some areas' pensions in arrears and pensioners without basic living guarantee; some areas have problems of embezzling or misusing pension funds; and various schemes of pension system coexist together, which not only hinders Zhigong's free nobilities but also cause many problems in pension management. The primary contradiction that induces all these problems is basically ununified system and decentralized management system." He Ping, *Guoyou qiye gaige zhong de shehui baoxian*, pp. 66-7.

in this situation, the center would lose its regulatory capacity and that local pension systems would become even more diversified.<sup>69</sup> In talking about the highly differentiated pension schemes emerging from local experiments, one commentator noted those “made it extremely difficult to adopt a national policy on pensions” (Frazier 2010: 57). Setting up a unified pension system became an extremely urgent part of the SOEs’ impending radical restructuring.<sup>70</sup> The MOL and the SIAs in many areas attempted to merge the fragmented BPI systems with such measures as upgrading social pooling levels, enhancing premium payment rates, and reinforcing the socialized management of retired Zhigong with the SIAs directly granting pensions to them.<sup>71</sup> In July 1997, the State Council promulgated a “decision on the reform of establishing a unified enterprise Zhigong BPI system (State Council Document no. 26),” making it clear the government’s goal was to bring the different regional pension plans under one umbrella.

The State Council approached unifying China’s pension system from three different angles.<sup>72</sup> First of all, it was decided to unify the enterprise and Zhigong pension premium rates by stipulating that the enterprise’s premium should be no higher than 20% of Zhigong wage funds and that individual Zhigong should pay no less than 4% of standard wages. This was a clear effort to alleviate and limit the SOEs’ burden by increasing the premiums contributed by individual workers. It was in keeping with the pension reform’s critical goal of enhancing the competitiveness and developmental momentum of the SOEs.<sup>73</sup>

Second, the 1997 decision imposed a uniform level on individual accounts in the amount of 11% of each Zhigong’s wage. Each Zhigong’s premium rate was set at 8%, and the

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<sup>69</sup> *Laodong neican*, 1996 Issue 5, p. 25.

<sup>70</sup> It has become so clear that “the most challenging task of China’s pension system reform is to reduce the fragmentation and make the system and its administration more unified” (*Old Age Security*: 27).

<sup>71</sup> *Laodong neican*, 1997, Issue 2 p. 22

<sup>72</sup> *Laodong neican* 1997, Issue 9, p. 6.

<sup>73</sup> *Laodong neican*, 1997, Issue 9, p.7.

enterprise's contribution to his or her individual account was lowered to 3%.<sup>74</sup> Then after subtracting this 3% from 20% of the Zhigong's wage, the enterprise contributed the remaining 17% to the social pool.

Finally, the new decision proposed to unify the Zhigong BPI's pension system by combining the "base" pension and the individual account's pension.<sup>75</sup> The intent was to speed up the socializing process of administering China's social insurance, transferring the management of pensions from the enterprises to an independent pension agency as soon as possible. Unlike the 1995 decision, the 1997 proclamation did not only aim to combine social pools and individual accounts. It also proposed the creating of a unified pension granting system that had nothing to do with the Danwei. As long as the practice of "remitting the difference" continued to exist, distressed SOEs could find no significant relief. It became so evident that the Danwei's involvement in paying pensions was the most pressing issue in China's efforts to carry out pension reform.<sup>76</sup>

The 1997 decision sought to contain this widely-found practice in order to remove the Danwei from the country's social system and let them reorganize themselves to become pure

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<sup>74</sup> In this context, the areas that previously had selected plan I will lower the individual account rate to 11 percent of Zhigong's wage and the areas that previously chose plan II will raise the rate to 11 percent of Zhigong's wage. *Laodong neican*, 1997, Issue 9, p. 35-6.

<sup>75</sup> The monthly standard of base pension is the 20 percent of the previous year's average wage of each province and the monthly grants of individual account pension are decided by dividing with 120 total accumulations in individual accounts. *Xinshiqi laodong he shehui baozhang zhongyao wenxian xuanbian*, p. 255.

<sup>76</sup> In this context, MOL issued a document (MOL Document 420 of 1996) for socialized management of SOE Zhigong pension with special emphasis on socialized pension granting independent from Danwei system. *Laodong neican*, 1997 Issue 8, p. 16.

economic units.<sup>77</sup> Only if the SIAs assumed the responsibility of granting full pensions to all retired Zhigong could the Danwei finally be freed from their pension burdens.<sup>78</sup>

The problem was that it was uncertain whether just creating a unified pension system by integrating the social pools and the individual accounts would be enough to free the Danwei from the burden of granting full pensions to their retirees. The social pools, originally, had not been designed as a way to grant pensions to retired Zhigong, but as a system to provide equal “base” pensions to their participants. During the process of constructing the Zhigong BPI system, China never devised a special system to grant the pensions of Zhigong who had already retired. Instead, it was simply assumed those pensions would be handled by the new social pooling component of the new BPI system. The idea of a social pool was to use the resources of the Danwei with light pension burdens to support those Danwei with heavy pension obligations. This was a critical reason why the social pooling system remained underdeveloped and why struggling Danwei were still saddled with paying pensions to their retirees through “remitting the difference.” As ever more SOEs could not pay their pension premiums, the financial foundations of the social pools in many areas weakened and deteriorated.

The crux of the reform was whether socialized pensions granted by SIAs could completely release the Danwei from their pension burdens. The Zhigong BPI system was obligated to grant pensions to the retired Zhigong, even if it had neither any additional funds nor any transferred resources from the former Danwei-based PAYG pension system. Without having devising any special financial measures, the social pools in each area came to assume the

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<sup>77</sup> Indeed, with socialized pension granting by SIAs all retired Zhigong can get their pension regardless of their Danwei situations, SOEs can be released from the pension burdens after just paying their premiums, which involves a process to transform Danwei as social system into economic system. JIL, *Chūgoku kokuyū kigyō kaikaku no yukue: rōdō shakai hoshō shisutemu no hen yō to kigyō soshiki*, p. 207.

<sup>78</sup> Zhang Yizhen and Xia Bing, “Tiqian tuixiu zhengce ying ji zao xiouzheng,” p. 45.

responsibility of granting pensions. The very nature of the social pooling system was thereby transformed from providing “base” pensions to current workers into a main system for handling pension payments to the existing retired Zhigong. Individual accounts were relegated to being an accumulation system for the future pensions of current workers. In effect, China constructed the Zhigong BPI system as a strict funded and genuine accumulation pension plan built on defined contributions (DC).<sup>79</sup> But in arranging to pay pensions to retired Zhigong, who were a legacy from the old Danwei-based PAYG system, the leadership gave the social pools many of the significant characteristics of a defined benefits plan.<sup>80</sup>

Through this choice, China fashioned anew partially-funded pension system rather than a fully-funded one. Finding a balance between the social pooling system and the individual accounts meant deciding on how to divide the collected premiums between granting pensions to retired Zhigong and saving funds for the future pensions of current workers. With the active commitment of using the social pooling system to grant pensions to retired Zhigong, the political debate on the relative share of funds between social pools and individual accounts had very little to do with finding the optimal combination to provide for the future pensions of current workers. Rather, discussions simply revolved around whether more resources should be saved for future pensions to current workers or whether as many funds as possible should be directed to paying pensions to retired Zhigong. In 1995, China’s leaders failed to decide on the unified ratio of new BPI system’s two components, and were unsure about which should take the greater share of the new pension system.

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<sup>79</sup> China’s Danwei based PAYG system “has been transformed into a partial accumulation system with individual account; pension payments are being transformed from defined benefit to a combination of defined benefit and defined contribution...” (Garnaut, et al. 2005: 88).

<sup>80</sup> Obviously, the articulated principle of how to organize financial bases for the emerging BPI is “levying according to the outlay, having slight surplus in balance, and saving partial accumulations.” *Laodong neican*, 1997, Issue 9, p. 35.

With the 1997 decision, China's new unified Zhigong BPI system assigned only a small minor part to individual accounts and the role of the leading star to the social pools.<sup>81</sup> China's new Zhigong BPI system was quite unique. It introduced a funded scheme to reorganize the existing PAYG system, but it only provided for a limited accumulation of funds. The potential of building up individual accounts to pay for the future pension demands of an aging population were checked by the immediate and urgent demand to grant pensions to retired Zhigong. By giving the leading role to social pools, China designed the Zhigong BPI as a system to pay off the large inherited liabilities from the former pension system rather to accumulate funds for the future. This partially-funded pension system broke no new financial ground, but did free the Danwei from their old pension burdens. Henceforth, the regional SIAs would assume the responsibility of granting pension to retired workers.

Historically, at first, many countries found it was quite easy to initiate their pension programs with a PAYG scheme, and felt no urgency to organize a system for accumulating funds. But as populations aged and pension obligations grew, the PAYG system began to look to be unsustainable. Many countries today with serious aging problems are trying to reform their PAYG pension systems into funded plans that can meet increasing pension demands with accumulated reserves. Those efforts at reform, however, will face a big systemic problem: If additional financial resources are not found to deal with the pension needs of current pensioners, rapidly aging populations will find it tempting to target the accumulated funds to meet immediate demands for funds. When a country reorganizes a PAYG system into a funded, it cannot avoid the fundamental issue of Implicit Pension Debts (hereafter IPD), the total amount of a pension system's promises. A PAYG system's liability to pensioners is an IPD, and cannot be settled

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<sup>81</sup> Interview, 2005, July 5th.

just by introducing a new funded system. Those countries that try to introduce a funded pension system to replace a PAYG system have to decide how to handle the old system's IPD. In China's pension reform, the SOEs' pension commitments to their retired Zhigong was the country's IPD. Out of SOE reform process China came to uncovered the IPD issue derived from the Danwei system's former pension commitment for retired Zhigong.

The Danwei-based PAYG system developed as part of a labor insurance system for retired Zhigong and was funded by each Danwei's revenues. In the pension reform, the SOEs' pension commitments to their retired Zhigong was the country's IPD.<sup>82</sup> To understand the reform, we need to focus on how China handled the SOEs' inherited IPD during the restructuring of the SOE. After introducing the labor contract system, China created a new pension system for its new generation of workers, who were no longer permanent employees and who were the first social group in the country to contribute part of their salaries toward their pension benefits (Davis: 239). The *new (xinren)* was the term used for this younger generation of contract workers who paid pension premiums from the very beginning of their working careers. Their future pensions would ultimately depend on the amount of the premiums they had paid into the new pension system. To these young workers, pensions were not a serious concern.

Retired Zhigong were called the *old (laoren)*. These workers had already retired before China initiated its new pension system, and had no individual accounts or any records of paying previous premium payments. When their old Danwei were facing financial difficulties or were being restructured, they could not be sure of receiving their entitlements since the Danwei had been the sole source of their pension payments. Yet, China attempted to restructure many

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<sup>82</sup> Danwei's IPD can be measured by "the present value of benefits that the state enterprises would have to pay to current pensioners and to current workers on the assumption that the pension system was terminated when the estimate was made" (Lardy 44).

troubled SOEs without finding alternative ways to handle the Danwei system's IPD issue.<sup>83</sup> The full-scale restructuring of the SOEs began in 1997. Even before then, many retired Zhigong were already not receiving their pensions. After 1997, even more retirees failed to receive their entitled pensions. The very process of restructuring the SOEs had uncovered the IPD owed to the *old*, something that society could not ignore. In response, China implemented the "two absolute guarantees" to protect the retirees' pensions as well as the Xiagang Zhigong's livelihoods.

As more SOEs met with financial troubles, China tried to solve their pension problems by setting up a new socialized Zhigong BPI system in the hope that it could handle the pensions of retired Danwei Zhigong.<sup>84</sup> In 1997, when the radical restructuring of SOEs and the Xiagang program were just on the horizon, the Danwei's IPD owed to the *old* threatened to become an explosive problem. This explains why the unified Zhigong BPI system created by the State Council in 1997 was not mainly an accumulation system funded by defined contributions, but a very substantial social pooling system following defined benefits principles to handle pension payments to the *old*.<sup>85</sup>

Yet, as we observed, China's social pooling system did not necessarily have enough funds to pay for the retired Zhigong's pensions. How could pensions be granted by the social pools when those pools were supposed to expend their resources on covering the "base" pension

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<sup>83</sup> "The current pension system is severely underfunded, and deficits are increasing in many regions" (Garnaut, et al. 2005: 89).

<sup>84</sup> Obviously, protecting Zhigong's social insurance entitlements is a critical goal of China's efforts to set up the social pooling system. He Ping, "Zhongguo shehui baozhang tixi yanjiu baogao (2000)," p. 4.

<sup>85</sup> The emerging contents of the social pooling scheme come to include three different principles. First, benefit standard principle, which means that the benefits will remain without changes according to the state's unified regulations; secondly, social collective-relieves and generational transfer; finally, the fund raising scheme with "deciding levying based on outlay, PAYG, and small accumulations." He Ping, op. cit., p. 4.

of the new system? The decision of 1997 spoke about keeping the “old way for the *old*,” which promised retired Zhigong they would receive their promised pensions even if the new pension system replaced the old Danwei system.<sup>86</sup> The leadership had decided to make a full commitment that the Danwei’s IPD owed to the *old* would be settled after all.<sup>87</sup> The retired Zhigong, the 1997 decision confirmed, did not need to worry about their pensions even when their old Danwei were undergoing a full restructuring. It was not clear at all where the funds would come from to pay the *old*. But the commitment had been made.

In theory, it was possible that as SOEs carried out the restructuring process, they kept the Danwei based pension system without finding a new system to replace it. It was also possible that in as more retired Zhigong were unable to receive full pensions, the Danwei reorganized their pension systems and adjusted the pension benefits to amounts that were smaller than what had been promised. Such a change would at least have ensured that all retired Zhigong received pensions. This never happened. While growing numbers of retirees were unable to receive their promised pensions, the total amount of granted pensions kept rising.<sup>88</sup> In 1995, the average pension provision for each retired Zhigong reached 4239 *yuan*, which was 2,513 *yuan* more than in 1990’s average of 1,726 *yuan*.<sup>89</sup> Zhigong pensions were never adjusted to a lower level. They only increased. The pensions of retired Zhigong were untouchable. The Danwei system’s IPD owed to the *old* was a non-negotiable issue.

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<sup>86</sup> The State Council document no. 26 of 1997 decided that “those who already retired before the decision will be granted the same pension according to the former regulation.” *Xinshiqi laodong he shehui baozhang zhongyao wenxian xuanbian*, p. 256.

<sup>87</sup> The urban society can expect that “[C]urrent pensioners will continue to receive their current pensions with full adjustment for increases in the consumer price index” (*Old Age Security*: 45).

<sup>88</sup> BPI’s benefit level is too high and even in rising tendencies. He Ping, *Guoyou qiye gaige zhong de shehui baoxian*, p. 66.

<sup>89</sup> *Laodong neican*, 1996 Issue 7, p. 4.

Setting up the unified Zhigong BPI system, though, did not necessarily mean that each area's social pool had enough resources to grant full pensions to their retired Zhigong. There was great uncertainty whether the new system could actually fulfill the pension commitment of retaining the "old way for the *old*". We will now examine the actual processes of pension reform in three different cities. Their experiences highlighted the quite different socio-economic conditions found in China's urban society as the reforms were carried out.

### <The Politics of Arranging Transition Costs: Shanghai, Shenyang, and Shenzhen>

In their dependency ratios, Chinese cities bore very different pension burdens. If they had older SEOs in greater numbers, older *inner system* Danwei on larger scales, and retirees taking up a bigger share of their population, they were more likely to have unfavorable ratios and heavier burdens. Regardless of their differences, though, all cities had to deal with their IPDs mainly through the BPI system's social pooling component without having help from other major tools to mobilize the required financial resources. The viability of each BPI system, in turn, was determined by the city's economic condition, which reflected whether it had successfully restructured its *inner system* Danwei and introduced new *outer system* units during its period of reform. The more successful a city's reform had been, the sounder its finances, and the stronger the capacity of its BPI system to cope with retiree pensions. Indeed, after completing their reforms, Chinese cities had very diverse socio-economic conditions. The following three cities that I will examine here can be seen as three ideal types of those conditions. I will also explain each city, with its different socio-economic circumstances, approached the unavoidable problem of its IPD.

## (Shanghai)

With the reform, Shanghai experienced serious market competition earlier than other cities, and its Danwei were exposed earlier to financial pressures to manage their social insurance programs. Moreover, Shanghai's Danwei-based pension system faced the problem of a rapidly aging workforce. As the leading industrial area in China, Shanghai had a long history, and its ratio of old Zhigong to young Zhigong was much higher than in any other Chinese cities. The city's industries were teeming with old Zhigong. As the following table shows, Shanghai's dependency ratio was the highest in China.<sup>90</sup>

Table 5-2. Shanghai's Increasing Dependency Ratio (Unit: 10,000)

	1978	1980	1982	1984	1986	1988	1990	1992
Total Number of Zhigong	422.8	446.9	na	487.4	500.2	509.7	508.1	511.1
Total Number of Retirees	48.1	96.4	na	128.5	138.7	149.3	159.1	166.0
Dependency Ratio	0.11	0.21	na	0.26	0.27	0.29	0.31	0.32

(Source: Zhou Guoliang, *Shanghai chengzhen yanglao baoxian zhidu bianqian he shuzhi moshi*, p.77)

From the 80s on, many SOEs and COEs in Shanghai were finding it difficult to secure enough funds to arrange for pension payments to their retired Zhigong.<sup>91</sup> Because the city urgently needed to reform its Danwei-based pension system, it initiated its pension reform earlier than other cities.

Shanghai enterprises had quite diverse pension burdens according to their dependency rates, which depended on when they were established. After the reform, many new enterprises launched their businesses in the city. Those new enterprises, unlike the older ones, did not have many retirees and were free from heavy pension burdens. It was an unfair game when having

<sup>90</sup> According to Shanghai city's Labor Bureau's survey in 1984, the ratio of retired Zhigong to working Zhigong in textile industry already reaches to 49 percent and retiree's pension reached to 46 percent of working Zhigong's total wage. *Shanghai Laodong zhi*, p. 356.

<sup>91</sup> SLSBK, *Xiang laodongli shichang quanmian guodu de yanjiu*, p. 161.

very different social burdens, the old enterprises had to compete in the market with the new firms. The Danwei-based pension system created conditions of unequal competition, which could potentially frustrate China's efforts and reforms to set up competitive markets. In 1986, Shanghai initiated its pension reform with the proposal to create a pan-city unified pooling system (*quanshi tongchou*).<sup>92</sup> The city was the very first in China to inaugurate its pension reform by setting up a unified management of the SOE retirees' living costs. There were still deeply entrenched interests in Shanghai's Danwei-based pension system that made the undertaking to set up a unified pooling pension system rather bumpy. The city's leadership went through a complicated process of negotiations and persuasion with its enterprises, ending up with five ways to accommodate different tax adjustments and grace periods to link the various Danwei in a unified pension management system (Lee, Peter Nan-shong: 14-5). As a result, this reform of 1986 could not lead to the creation of a well-organized post-Danwei pension system all at once.<sup>93</sup>

Before the reform, all of Shanghai's Zhigong were entitled to enjoy pension benefits, which were funded by a PAYG system with a replacement rate of almost 90%. After the reform, in the light of the city's rapidly deteriorating dependency ratio, this defined benefits plan became an extremely serious liability. From 1993 on, Shanghai's pension reform transformed its defined benefits plan into a defined contribution system by introducing individual accounts into its unified pension management system. With this, the city undertook an experiment in running a new partially-funded pension plan combining a socially unified management system and an individual account system. Every Zhigong who participated in Shanghai's unified pension

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<sup>92</sup> Ibid.

<sup>93</sup> At the end of 1990, the number of SOE working Zhigong participating social unified pension management system reached 2.76 million; and SOE retired Zhigong reached 9 hundred thousand. Zhou Guoliang, *Shanghai chengzhen yanglao baoxian zhidu bianqian he shuzhi moshi*, p. 75.

system could set up an individual lifetime account. The Zhigong's future pension payout would depend on the amount saved in his individual account.

By introducing individual accounts, Shanghai changed the state's existing single pension responsibility system into a collective responsibility shared among the state, enterprises, and individual Zhigong.<sup>94</sup> The experiment was expected to relieve Shanghai's exploding pension burden. Between 1993 and 1998, the rate set for the Shanghai pension system's individual accounts was 16%. This included the individual's premium (starting out at 3% in 1993, and increasing by 1% annually); the social average wage of 5%; and the premium wage (decreasing by 1% every two years from 8% in 1993).

By itself, Shanghai's new pension system could not curb the city's rapidly deteriorating dependency ratio, because the ratio had as much to do with its population structure as with the speed of the SOE restructuring process. Shanghai's population was aging far more quickly than in any other cities in China. At the end of 1998, there were 2.2 million retirees, which was 548,000 more than in 1992, an annual increase of 4%. At the same time, the ranks of Shanghai's working Zhigong were thinning rapidly. This was not the simple, straightforward outcome of a decline in the new workforce, but was the social consequence of the city's reform of the *inner system*. Shanghai's restructuring of its uncompetitive SOEs, called "personnel reduction for efficiency," removed many redundant workers. In 1992, the number of Shanghai's working Zhigong was 4.9 million. By the end of 1998, it had gone down to 4.1 million. Furthermore, the city's *inner system* could not provide new jobs. In 1980, there were 213,000 new employees. In 1998, this number had dropped to 183,000.<sup>95</sup> In Shanghai, the sudden accelerated aging of its

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<sup>94</sup> SLSBK, *op. cit.*, p. 165.

<sup>95</sup> Guo Shizheng, "Guanyu jietuo woguo yanglao jiben jijin kunjing de zonghe sikao: cong Shanghai de xianzhuang shuo qi," p. 11.

population from the mid-90s on was the social consequence of having restructured the city's SOEs.

In parallel to the rapid aging of Shanghai's workforce was the continued deterioration of its dependency ratio. Naturally, the ratio was related to the city's aging workforce. But Shanghai's radical restructuring of its SOEs also reduced the number of current working Zhigong as well as expanded the number of retirees by promoting early retirement. When the city launched its pension reform, its dependency ratio was 0.25. After 1997, the ratio had risen over 0.5, which meant that fewer than two working employees were supporting one retiree. In 2000, the ratio reached 0.52, when the country's average ratio was 0.27. The next year, it had risen again to 0.54. In the following years, the number of retirees afterwards would increase even more quickly than the number of working Zhigong. Shanghai expected the dependency ratio would reach 0.78 by 2010.<sup>96</sup>

Because of the city's unfavorable dependency ratio, the financial foundation of its emerging partially-funded pension system became very unstable. When the city undertook its pension reform in 1993, the pension system's fiscal situation was sound. No one doubted Shanghai would achieve its goals of crafting a partially-funded system. Before 1998, Shanghai's pension funds were running an accumulated funding surplus of tens of billions of *yuan*. This dramatically changed as the city's dependency ratio worsened. The fortunes of its pension funds declined. As early as 1999, Shanghai's pension system was beginning to go into the red. That year, the deficit was hundreds of millions of *yuan*. The red ink increased to 2 billion *yuan* in 2000. By 2001, it was up to 4 billion *yuan*.<sup>97</sup> The size of Shanghai's accumulated pension funds

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<sup>96</sup> Zhou Guoliang, *op. cit.*, p. 79; Guo Shizheng, *op. cit.*, p. 11.

<sup>97</sup> Zhou Haiwang and Xiao Lichun, "Renkou yu shehui jingji de xietiao fazhan," p. 37.

quickly shrank. Some analysts projected the city's saved funds would be used up by 2002.<sup>98</sup> Shanghai's IPD had reached at least tens of billions of *yuan*. It was now critical for the city to solve the problem of its massive IPD.<sup>99</sup> As in the rest of China, Shanghai's Danwei-based system had not reserved any funds for future payouts, and there would be a huge transition cost from assuming the Danwei's pension debts to retired Zhigong. During the period of implementing pension reform, Shanghai also saw the use of some improvised and deceptive practices, such as using parts of funds in individual accounts that rendered them individual accounts in name only. The ruse was an obvious challenge to the city's efforts to set up a true partially-funded pension system, because it made those individual accounts "empty accounts." Such practices aroused some concern about their impact on the financial condition of Shanghai's pension system.<sup>100</sup>

Yet, there were only a few who questioned whether Shanghai had the strength to handle its IPD through its pension reforms. China's leadership had high hopes that the city could solve its pension problems with its high economic performance, especially following the Pudong development that would generate many new jobs. "Then Shanghai, depending on these newly recruited Zhigong and its rapidly increased wages, can mobilize many more pension premiums to pay future retiree pensions into their individual accounts."<sup>101</sup> Even with the practice of the "empty accounts," society was extremely confident about Shanghai's capacity to deal with its inherited IPD.

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<sup>98</sup> Guo Shizheng, *op. cit.*, p. 10.

<sup>99</sup> Dai Lüguo, "Shanghai shehui baozhang tizhi jianshe gouxiang," p. 163.

<sup>100</sup> "If Shanghai cannot handle this issue, then it will not only directly impact on Shanghai's socio-economic development but also can even end up with economic decline and social crisis." Zhou Haiwang and Xiao Lichun, *op. cit.*, pp. 37-8.

<sup>101</sup> *Laodong neican*, 1994, Issue 10, p. 15.

“From the end of the 80s, Shanghai’s textile industry began to suffer. Nonetheless, Shanghai has never had problems in paying pensions. It is true that some enterprises that had financial problems sometimes could not pay wages to their working workers. But all of Shanghai’s retirees have never had unpaid pensions, especially, after Shanghai initiated a social pooling system from the 80s. Unlike the northeastern area, it has never experienced any social unrest caused by pension arrears.”<sup>102</sup>

“Shanghai’s retirees have no problem in attaining their pensions. Its financial capabilities can fully cover the resources required for pensions. While Shanghai formerly paid a great deal to the central government, it can now retain more resources with the implementation of the dividing tax system. Moreover, its success in its economic reform in general has enriched the city’s financial capabilities.”<sup>103</sup>

Seeing Shanghai’s vigorous economic performance after the reform, despite the city’s huge IPD, not many doubted it would possess the financial means to cope with the pensions granted to its Zhigong retirees.<sup>104</sup>

### **(Liaoning and Shenyang)**

With its many privileged SOEs in heavy industry, the Northeastern area of China once represented the very heart of the country’s socialist development. Seeing the growth of heavy industry to be development itself, China as a “demiurge state” systematically mobilized its social and financial resources for investment in the construction of heavy industries in the Northeastern area. The area, however, discovered it was not exempt from China’s ongoing market reforms and its heavy industries lost their competitiveness. No longer was it the country’s leading industrial area. The Northeast was now nothing more than a rusty old industrial region that would have to restructure a slew of uncompetitive SOEs. Liaoning province is a representative case of one of the localities in the Northeastern area that required fundamental reform. Indeed,

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<sup>102</sup> Interview, 2005. July, 26th.

<sup>103</sup> Interview, 2003. Oct., 17th.

<sup>104</sup> “Of course, Shanghai has some problems in its social security system, but they are not serious ones.” Interview, 2003. July. 15th .

as stated by one observer, “Liaoning as an old industrial base has made critical contributions to China’s industrial development. But from the 80s on, it has faced serious economic predicaments because of its irrational economic structure, low industrial level, and problematic SOEs.”<sup>105</sup>

In restructuring troubled SOEs, Liaoning was not only faced with many redundant Zhigong, but also large numbers of retired Zhigong who were living exclusively off the pensions arranged by their Danwei. By the end of 2000, as a legacy of the socialist system, the number of Liaoning’s retired Zhigong reached 2 million, the highest number in China. In addition, the ranks of its Xiangang Zhigong continued to expand. Liaoning’s dependency ratio was deteriorating drastically.<sup>106</sup> In 1997, there were 472,000 retired Zhigong who were not fully granted their pensions.<sup>107</sup> The situation had become extremely sensitive. Liaoning’s government had no choice about financially supporting the pension system.<sup>108</sup> But given the province’s poor economic performance, pension revenues fell far short of total outlay. It has been estimated that between 1997 and 2000, the deficits in Liaoning’s pension system ballooned from 800 million *yuan* to 8.5 billion *yuan*.<sup>109</sup>

As the provincial capital of Liaoning, Shenyang shared all the problems afflicting the Northeastern area’s decaying industrial system. Many of the city’s large-scale heavy industrial SOEs were saddled with increasingly serious financial issues and badly needed to be restructured. Yet, there was no reliable pension system beyond the Danwei. Restructuring the Danwei would mean that their retired Zhigong lost the source of their livelihoods. It was in this very delicate state of affairs that Shenyang initiated its efforts to introduce a new social scheme

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<sup>105</sup> Liu Haining and Mu Huaizhong, “Liaoning sheng yanglao baozhang defang caizheng zhichi nengli yanjiu,” p. 24.

<sup>106</sup> Ibid.

<sup>107</sup> CASS CSPS, “Liaoning sheng chengshi jumin zui di shenghuo baozhang zhengce pingxi,” p. 16.

<sup>108</sup> Liu Haining and Mu Huaizhong, *op. cit.*, p. 25.

<sup>109</sup> Ibid., p. 24.

into its Danwei-based pension system. From October 1992 on, the city enforced a new program demanding its *inner system* Zhigong pay 2% of their wages toward their basic pension premiums.<sup>110</sup> In 1993, Shenyang embarked on the social pooling of its pension funds to covering all SOEs and COEs above the level of the county. The total number of mobilized enterprises was 7,792, with 1.5 million participating Zhigong.<sup>111</sup>

In 1994, Shenyang stepped up with a new wave of SOE reforms focusing on restructuring the industrial system. Twenty-four large SOEs were selected by the city to be experimental sites for being remade into modern enterprises.<sup>112</sup> One result of this ambitious effort to restructure problematic SOEs was that the number of working Zhigong began to fall. In 1994, the number of Zhigong in Shenyang's SOEs was reduced to 1.37 million, 93,000 less than in the previous year. The number of COE Zhigong in 1994 declined to 728,000, 44,000 fewer than in 1993.<sup>113</sup> In its search for a more reliable socialized pension system, Shenyang hoped to create an approach that combined social adjustments with individual accounts. To test this proposed new pension plan, Shenyang ran experiments in seven picked sectors and regions, including construction, textiles, and its economic and technical development areas. In addition, the city set up pension funds that would be mainly based on the Zhigong's accumulations over their working years, but that would be supplemented by social adjustments. Individual accounts were funded by the individual's premium of 3% and the enterprise's premium of 13.5%, while another 4.5% came from social adjustment funds. The number of Zhigong in the units participating in the socialized pension system reached 1.8 million.<sup>114</sup>

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<sup>110</sup> *Shenyang nianjian*, 1993, p. 414

<sup>111</sup> *Shenyang Nianjian*, 1994, p. 32.

<sup>112</sup> *Shenyang Nianjian*, 1995. p. 23.

<sup>113</sup> *Ibid.*, p. 431.

<sup>114</sup> *Ibid.*, p.23 and 433.

Such pension plans introduced after 1994 by Shenyang, however, were quite experimental. They attempted to reform the existing PAYG system without taking the SOE's financial capacities into serious consideration. As the capital of Liaoning Shenyang had many old SOEs organized soon after the new Socialist China had been founded. Most of the city's SOEs had long histories and large numbers of old workers who had begun their work years from a very early period. When Shenyang began to restructure its SOEs, it found those had extremely aged workforces and their retirees who were entitled to pensions were growing by leaps and bounds. This massive infusion of aging workers into the city's existing pension system worsened the dependency ratio, making it especially urgent to set up a new socialized pension system.

In January 1997, Shenyang unveiled a new pension premium rate. In the past, enterprises paid a premium into the social pool that was 18% of total wages and 40% of retirement costs. To many old enterprises, this was a huge liability. In response, the city then integrated the enterprise's pension premium into a single payment of 25.5% of its total wages. From a beginning base of 3% of his wages, the premium paid by the individual worker would grow annually by 0.5% until it reached a cap of 8%. Individual accounts were recorded to be 11% of wages, a figure based on the total amounts of individually paid premium and the premiums contributed by enterprises.<sup>115</sup> Then, in 1997, Shenyang followed the State Council's "decision to establish the unified enterprise Zhigong BPI corresponding to the demands of the socialist market economic system."<sup>116</sup>

Although the growing number of retirees was a serious problem, there was another systemic reason for the city's deteriorating dependency ratio. As Shenyang's *inner system*

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<sup>115</sup> *Shenyang Nianjian*, 1997, p. 468.

<sup>116</sup> *Shenyang Nianjian*, 1998, p. 32.

enterprises became much less competitive after the reform, those firms sought to improve their economic performance by reducing their redundant workforces. During the second half of 90s, as the city struggled to restructure enterprises in distress, the number of employed workers dropped severely, and the number of SOE Zhigong who participated in the pension system declined, falling, for example, from 752,000 in 1997 to 710,000 in September 1998. Those developments badly shook the financial stability of Shenyang's pension system.<sup>117</sup> Already suffering from the effects of an old population, Shenyang's ratio of retirees to working Zhigong was dealt a further blow by the restructuring of the SOEs. A pension system cannot be sound if too many retirees depend on a small working workforce. The restructuring of Shenyang's SOEs produced skyrocketing numbers of Xiagang Zhigong, and badly impaired the social foundation of the emerging social pool in its new pension system.

Table 5-3. Shenyang's Ratio of Retirees to Working Zhigong (Unit: 10,000)

Year	Number of Zhigong			Total Number of Retirees	Ratio of Retirees to Working Zhigong
	Total	SOEs	COEs		
1993	234.9	145.8	77.2	67.9	28.9
1994	229.5	137.6	72.8	68.7	30.8
1995	225.5	139.6	66.8	63.3	28.1
1996	218.7	137.0	61.7	59.5	28.5
1997	210.2	133.9	55.5	67.4	32.1
1998	193.5	123.0	44.1	69.2	47.9
1999	181.2	115.8	39.0	67.7	51.2

(Source: *Shenyang Nianjian*, 2000)

Most damaging of all, as a result of the restructuring process, Shenyang's pension system lacked the resources to grant full pensions to retired Zhigong. Before the reform, like all Chinese cities, Shenyang had not reserved any pension funds; after creating the new pension system, neither could the city expect its SOEs to make significant contributions since they were all losing

<sup>117</sup> Guo Jiyang and Wang Yongxi, *2001-2020 nian Zhongguo jiuye zhanlue yanjiu*, p. 274.

out in market competition. Many underperforming SOEs could not pay their social insurance premium. In 1998, between January and September, the unpaid premiums by Shenyang's SOEs reached 172 million *yuan*. The SOEs that could not to pay their September premium came to the staggering total of 3,424 - 90% of which had already stopped production - accounting for 27% of the SOEs participating in the pension system. Not surprisingly, Shenyang's pension funds ran a giant deficit. The city expected that in just this particular year, its pension funds would be short 2,400 million *yuan*.<sup>118</sup> Reeling from such losses and unable to pay pensions to growing numbers of retired Zhigong, Shenyang saw serious collective actions of protest in 1998 and 1999.<sup>119</sup> Faced with this grave situation, the city did not even try to fill individual accounts, choosing instead out of desperation to draw on the funds in those accounts to grant pensions to retired Zhigong.

The most obvious flaw in Shenyang's pension system was its high dependency ratio. From 1996 on, its yearly revenues just could not meet its yearly outlays.<sup>120</sup> The city could not raise the premium rate: The enterprises and individual workers were already paying premiums that were 32% of the total wage.<sup>121</sup> Shenyang felt it had no choice but to request special financial support from China's central government and borrowed 6,600 million *yuan*.<sup>122</sup> With the new funds in hand, the city was able to do a better job of guaranteeing full pensions to retirees from enterprises that had been especially hard hit. In 1998, Shenyang claimed it had

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<sup>118</sup> SDPC AMR, *Jin hou san nian woguo jiuye xingshi yu duice yanjiu*, pp. 102-3.

<sup>119</sup> "Since Shenyang's SOE's economic condition is not good, their many retirees nowadays cannot get pension adjustment according to the rise of its price level. There are even many retirees who cannot get their pensions, which causes really serious social resentments. ...Shenyang does not have Xiangang Zhigong's collective action; but it has numerous retirees' collective actions such as visiting the city hall to appeal ... ." Guo Jiyan and Wang Yongxi, *2001-2020 nian Zhongguo jiuye zhanlue yanjiu*, p. 273.

<sup>120</sup> Jin Si and Sheng Tao, "Shehui baoxian tizhi jianshe chengxiao xianzhu yunzuo jizhi buduan wanshan," p. 195.

<sup>121</sup> *Ibid.*, p. 200.

<sup>122</sup> *Shenyang Nianjian*, 1998, p. 286.

basically realized the goal of granting full pensions on time, even though the city had outlays of 2.6 billion *yuan* and levied only 2 billion *yuan* (a levying rate 85.4%).<sup>123</sup> Such built-annual deficits meant that Shenyang's pension system would have even more problems in coming years. While pension demands were sure to grow, it was unreasonable to expect Shenyang would be able to raise additional revenues. Already by the end of 1999, total participation in Shenyang pension system was up to 1.3 million and, but the total amount of collected premiums was only 2.2 billion *yuan*, which was a levying rate of just 84.5%.<sup>124</sup> The pension deficit was estimated to be 1.37 billion *yuan*.<sup>125</sup> If the city wished to arrange full pensions for its retired Zhigong, it badly needed to find a more reliable source of revenue than such makeshift measures as borrowing.

In 2000, Shenyang's total social security outlay was 1.9 billion *yuan*, which including pension payments of 1.3 billion *yuan*. Of the monies that paid for the total outlay, the city's own resources accounted for only a minor share. Shenyang's city government contributed 470 million *yuan*, and its district governments paid 70 million *yuan*, while financial support drawn from government levels above Shenyang came to 1.4 billion *yuan*.<sup>126</sup> Shenyang by itself could not afford to assume the burden of arranging pension for retirees.<sup>127</sup> China's leadership and central government were propping up the city's pension system. Without this financial support, Shenyang's pension system was unsustainable.<sup>128</sup> Its system was incapable of handling the

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<sup>123</sup> Ibid.

<sup>124</sup> *Shenyang Nianjian*, 2000, p. 254.

<sup>125</sup> Guo Jiyan and Wang Yongxi, op. cit., p. 274.

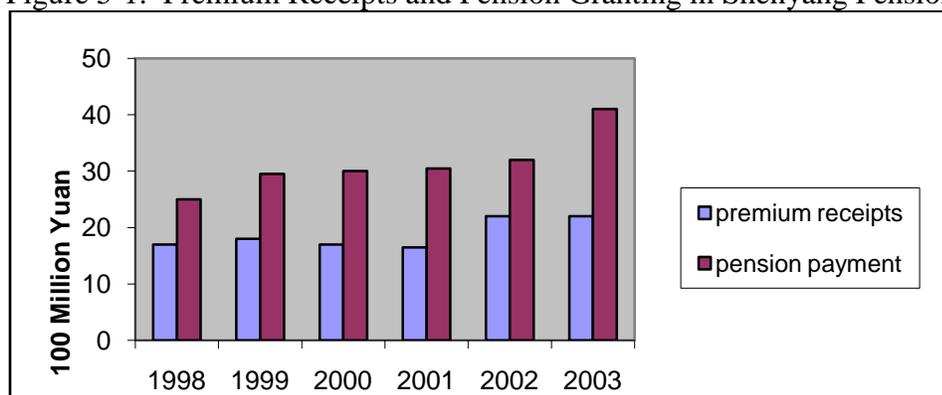
<sup>126</sup> *Shenyang nianjian 2001*, p. 204.

<sup>127</sup> In this context, Shenyang government thinks about liquidating parts of the state assets and in 2001 initiates some experiments of liquidating state assetsto squiz the resourcesto make up its limited pension resources, which, however, does not end up with desirable outcome (Jin Si and Sheng Tao, op. cit., p. 198).

<sup>128</sup> Interview, 2005, July 13th.

Danwei's IPD issue. The center had decided that in such cities as Shenyang, the promised payments to retired Zhigong could not simply be allowed to remain at the level of the regional pension system. This is why Shenyang could maintain its pension system even when its collective pension premiums were much lower than its pension outlays for many consecutive years. Shenyang was not allowed to fail.

Figure 5-1. Premium Receipts and Pension Granting in Shenyang Pension System



(Source: Jin Si and Sheng Tao: 191)

### (Shenzhen)

Shenzhen before the reform was a small fishing village in Guangdong province. When it became a city in 1979, its total population was only 300,000. Most residents lived in rural areas, the number of urban Zhigong was only 40,000.<sup>129</sup> After the reform, Shenzhen suddenly blossomed into a new metropolitan city, and became a new hub of China's booming economy. Its GDP production expanded from 196 million *yuan* in 1979 to 143 billion *yuan* in 1999. During this period, its GDP annual growth rates rose as high as 31.2%.<sup>130</sup> In 1999, among Chinese cities, Shenzhen ranked fourth in GDP production, and was second largest in both industrial profits and its tax contributions to central revenue. Most important of all, the city

<sup>129</sup> Liu Kaiming, *Bian yuan ren*, p. 39.

<sup>130</sup> *Shenzhen Tongji Xinxi Nianjian*, 2000, p. 16.

ranked first in per capita labor productivity.<sup>131</sup> It was no wonder that Shenzhen's average wage expanded rapidly and became the highest in China.<sup>132</sup> Without a doubt, the city was a symbol of China's prosperity after the reform.<sup>133</sup>

Shenzhen's success came from its unique socio-economic conditions: As a small village, it did not suffer from many of the economic and labor constraints found in other Chinese cities. After the reform, Shenzhen succeeded in organizing a booming new *outer system* economy. At first, because of its geographical proximity to Hong Kong, Shenzhen could absorb investment from Hong Kong in the form of the *sanlai yibu* units.<sup>134</sup> Their production met the demands from Hong Kong to have low-level processing businesses in Shenzhen's surrounding rural areas. The *sanlai yibu* units were not formal firms, but they benefitted from being part of Shenzhen's economic momentum and were able to take in foreign investment. Subsequently, China set up the Shenzhen Special Economic Zone (hereafter SEZ), which created a much more systemically favorable investment environment for foreign investors. In 1992, Shenzhen began to follow an industrial policy of restraining the activities of the embryonic *sanlai yibu*, and attempted to transform them into FIEs with formal legal status.<sup>135</sup> Following the emergence of FIEs, the city saw the development of various forms of *outer system* firms, such as stockholding enterprises, private enterprises, individual economic units, and stock cooperative companies.

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<sup>131</sup> Liu Kaiming, op. cit., p. 3.

<sup>132</sup> Shenzhen Zhigong's Average Wage (unit: yuan)

1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
679	881	1023	1209	1378	1532	1726	1920	2162	2352	2551

(Source: *Shenzhen shi tongji nianjian*, 2004)

<sup>133</sup> This is the reason why Deng Xiaoping made his famous "southern tour remarks" in Shenzhen which articulated new catchphrase, "development is the absolute principle (*fazhan si ying daoli*)."

<sup>134</sup> Literally, the term refers to three forms of processing enterprises (those enterprise that process raw materials on clients demands, assemble parts for the clients and process according to client's sample) and one form of enterprise engaging in compensation trade.

<sup>135</sup> Consequently, there are more than 300 *sanlai yibu* units which are transformed into FIEs in 1992. Liu Kaiming, op. cit., p. 78.

China's urban society had been organized solely by the Danwei and Zhigong systems. Having only a tiny number of Zhigong, Shenzhen was not constrained by the Zhigong labor system, and was free to organize its economic system primarily around the new *outer system* units with investments coming from abroad.<sup>136</sup> Foreign investors could open new businesses in Shenzhen without having to satisfy the social regulations of the Zhigong labor system. The *sanliai yibu* employed a very flexible labor system with temporary workers.<sup>137</sup> With an eye to attracting more foreign investment for rapid development, from 1980 on, the Shenzhen SEZ did not apply China's permanent worker system to FIEs and joint-stock companies. Instead, it initiated the labor contract system.<sup>138</sup>

Shenzhen's unique conditions produced another critical social outcome. Originating as a small town at first, the city did not have enough people to meet the immense labor demand from the booming *outer system* enterprises. From the very start then, Shenzhen did not restrict workers from moving to the city from other areas, and permitted the *outer system* enterprises to employ them. In other Chinese cities, the practice of socialist embeddedness created an exclusive social system for the *inner system* Zhigong. Urban society set up systemic blocks, such as the Hukou system, to prevent peasants from moving to the cities. Shenzhen, however, was free from such constraints, and welcomed migrant workers during its early period of reform. One writer observed: "As Shenzhen is free from the social constraint of the planned economic system's historical legacy of 'dual urban-rural systems,' its new enterprises do not follow the conventional labor system, but employ labor forces under the flexible labor contract system or

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<sup>136</sup> The companies that process raw materials on clients' demands, assemble parts for the clients and process according to the clients' samples; or engage in compensation trade.

<sup>137</sup> Shenzhen SEZ's survey on 4000 *sanlai yibu* units reveals that 98 percent of their employees are temporary workers. Chang Kai, *Laodong guanxi laodongzhe laoquan*, p. 163.

<sup>138</sup> Gu Shutang, et al., *Shenzhen jingji tequ diaocha he jingji kaifaju yanjiu*, pp. 97-98.

temporary employment. Given the limited supply of the city's original labor force, Shenzhen's new enterprises, considering comprehensive labor costs and productivity, generally want to employ migrant workers who demand relatively lower wages and less special treatment."<sup>139</sup>

In 1983, the number of migrant workers in the city's FIEs, SOEs, and *sanlai yibu* units were already exceeding that of the Hukou workers. After 1989, more than 85% of Shenzhen's employed workforces were drawn from migrant workers.<sup>140</sup> By 1987, Shenzhen's migrant workers surpassed half a million. In 1989, the city's temporary population had risen to 1.2 million. Then in 1990, Shenzhen's total population was 2 million, with migrant workers as three-fourths of its total workforce and the temporary population making up two-thirds of its total residents (*changchu renkou*). During the 90s, Shenzhen's temporary population kept increasing. In 1993, it reached 2 million. By 1999, the city's total population exceeded 4 million, of which the temporary population was almost 3 million.<sup>141</sup> Shenzhen was unique among Chinese cities in the proportion of its citizens to migrants, with the former being much fewer in numbers than the latter.

In the same way, while Chinese urban society was not ready to accept the labor contract system, from 1982 on, Shenzhen was using it as its formal employment system with the "temporary regulation of Guangdong province SEZ enterprise labor wage management." Under the "centralized labor allocation system (*tongbao tongpei de laodong zhidu*)," contract workers were not the state's permanent workers, but an enterprise's employees who enjoyed high labor mobility and who worked as long as their labor contracts lasted. The city's labor relations were organized as a market-based system, because the *outer system* enterprises wanted to employ their

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<sup>139</sup> Liu Kaiming, op. cit., p. 12.

<sup>140</sup> Ibid., p. 7.

<sup>141</sup> Ibid., p. 7, and pp. 41-2.

workers purely according their own demands for labor. Shenzhen's *outer system* economy soon outgrew its *inner system* economy, making market based employment its dominant form of labor. In being free from the Zhigong labor system, Shenzhen was unique in China.

Shenzhen's unique labor composition could be identified from the titles used for its workers. Since the city was not tied to the socialist labor system, its workers were seldom represented by the term Zhigong; instead, they were frequently called Yuangong. Zhigong was only reserved for personnel who worked in the *inner system*. The concept of Yuangong was much broader, referring to employees employed in both the *inner* and *outer systems*. In addition, each category of worker had a very different social status. One of my interviewees made this observation: "Zhigong basically refer to those SOE workers who have quite stable social position with lifetime tenure. In contrast, the term Yuangong primarily refers to employed workers in the labor market. Thus, they have quite a different social status. While Zhigong have a consciousness as being the master of their workplace, Yuangong have only a sense of being employees in their workplace. In the same vein, when you mention Xiagang, we always say Xiagang Zhigong, since Xiagang refers to the system's special treatment of Zhigong. But there is no such expression as Xiagang Yuangong."<sup>142</sup> As Shenzhen had only small numbers of conventional Zhigong, its official documents frequently used the term Yuangong to refer to its labor force. This, too, was different from other Chinese cities.

Shenzhen needed to set up social systems that could handle labor relations with contract workers, including the issue of a pension system.<sup>143</sup> The city at first did not have a clear idea about how to organize a pension system for contract workers, and just applied the Danwei-based

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<sup>142</sup> Interview , 2003, July 13th

<sup>143</sup> A critical issue in introducing labor contract system in China was how to handle Zhigong's worries about their living after the retirement. Therefore, the issue of how to arrange social insurance system was a critical part of China's efforts to introduce the labor contract system. Gu Shutang, op. cit., p. 99.

pension system used for *inner system* Zhigong in other Chinese cities.<sup>144</sup> Very soon, though, the city found it could no longer postpone its efforts to set up a different social system for its contract laborers. In January 1982, Shenzhen began to organize a socialized pension system for contract workers in FIEs, with FIEs paying a premium of 25% of their contract workers' wages.<sup>145</sup> Then in 1983, the city issued "Shenzhen's temporary regulation to execute social labor insurance" (Shenzhen Government's No. 214 Document of 1983), which proposed to create a social insurance system for all contract Zhigong employed in both FIEs and *inner system* enterprises.<sup>146</sup> With this announcement, Shenzhen made it clear it wanted to build up social labor insurance funds with premiums paid by both outer and inner enterprises.<sup>147</sup> The labor insurance company, working under the city's labor bureau, would handle labor insurance matters.<sup>148</sup>

To guarantee Zhigong pensions in Shenzhen's SOEs, in 1985, the city announced the method it would use for the social pooling of SOE pension funds.<sup>149</sup> This system was to apply exclusively to the socialized pension system for SOE Zhigong, and was entirely separate from the system for contract workers.<sup>150</sup> With the 1985 decision, Shenzhen came to have two

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<sup>144</sup> Indeed, the city had only small number of SOE Zhigong, but before 1981 it had the exclusive *inner system* pension system. *Shenzhen shi shehui baoxian zhi*, p. 47.

<sup>145</sup> *Shenzhen shi shehui baoxian zhi*, p. 51 and 53.

<sup>146</sup> CASS IIE SISRT, "Shehui baoxian zhidu gaige: Shenzhen moshi shuping," p. 34; *Shenzhen shi shehui baoxian zhi*, p. 48, and 51.

<sup>147</sup> While FIEs paid 25 percent of their labor service fees as the premium, the *inner system* enterprises paid monthly 20 percent of the total wage as their contract workers' premium. Gu, Shutang, op. cit., p. 99; *Shenzhen shi shehui baoxian zhi*, p. 53.

<sup>148</sup> Gu Shutang, op. cit., p. 99.

<sup>149</sup> In 1985 Shenzhen government promulgated its regulation on how to set up unified pension funds system for its entire SOE retirees (Shenzhen Government no. 178 Document of 1985), which demanded that SOEs pay as premium 19 percent of their total wages. *Shenzhen shi shehui baoxian zhi*, p. 49; CASS IIE SISRT, op. cit., p. 34.

<sup>150</sup> By the end of 1985, there are 1039 enterprise that join in the pension system for the contract worker, which covers total 19 thousand their contract workers; and there are 678 SOEs which participate in

different social pension systems: one for the contract workers in every enterprise, and the other for SOE Zhigong who had permanent worker status. In 1987, Shenzhen established a social insurance program for temporary workers, except for those in *sanlai yibu* units. Under the program, enterprises paid a monthly premium of 25.5 *yuan*, and workers paid 3 *yuan*. Shenzhen had crafted three separate and independent pension systems for its workers according to their status as SOE Zhigong, contract laborers, and temporary workers.<sup>151</sup>

Realizing that the Danwei-based pension systems were in distress because they had not accumulated any pension funds, at the end of 1989, the State Council selected Shenzhen as a city where they could experiment with funded plans. Shenzhen became the first city in China to experiment with an individual account system by introducing a new way to combine the social pooling and individual account systems.<sup>152</sup> This new pension plan unified the city's previously separate pension systems by building a collective contribution system whereby the state, enterprises, and individual workers all shared the burden of arranging pensions for Shenzhen's workers, regardless of their status or workplace ownership. In 1992, the city issued the "temporary rule for Shenzhen social insurance," merging the city's different premium rates by worker status and enterprise ownership and setting them at a standard 21% of paid wages. Individual workers were to contribute premiums 5% to 10% of their wages, and enterprises paid the remainder.<sup>153</sup>

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pension pooling system for SOE Zhigong, which covers total 22.8 thousand SOE Zhigong. *Shenzhen shi shehui baoxian zhi*, p. 53.

<sup>151</sup> Ibid., p. 54, and p. 47.

<sup>152</sup> Based on Shenzhen experiment, the third plenum of the fourteenth CCP Central Committee in 1993 decides the scheme as China's new national pension scheme. Li Yingsheng, *Shehui Baozhang yu Shehui Jiegou Zhuaxing: Eryuan Shehui Baozhang Tixi Yanjiu*, p. 142; *Shenzhen shi shehui baoxian zhi*, p. 49.

<sup>153</sup> *Shenzhen shi shehui baoxian zhi*, p. 54.

Shenzhen was a young city. After the reform, the city itself was newly constructed and its population consisted mainly of young men and women. The more Shenzhen's *outer system* enterprises developed, the more young migrant workers entered the city. In 1990, the average age in the city was 25.8, with an average age of 23.98 for its temporary residents was 23.9.<sup>154</sup> Having such a young workforce, the majority of the population engaged in economic activities. The population census conducted in 2000 revealed that those who were between 15 and 64 accounted for 90% of its total registered populations. Those who were over 65 years of age made up only 1.1% of Shenzhen's population.<sup>155</sup> This unique population makeup endowed the city with extremely favorable conditions for setting up its new pension system.

Shenzhen enjoyed yet another advantage. Starting out with few Zhi Gong, after the reform, the city still had only a very small number of retired Zhi Gong, who were less than 10% of working Zhi Gong. Shenzhen was free from any financial pressure to grant large pension payouts to retirees, and had only a very light IPD to settle. Shenzhen was free from the legacy of the old socialist system, a critical advantage for setting up its socialized pension system. It could accumulate funds to cover the future pensions of current workers without having to worry about obligations to SOE Zhi Gong.

Shenzhen could even afford to reduce its pension premium rate, something that was unheard of in any other Chinese cities. In order to expand coverage to every Shenzhen citizen, in 1996, the city modified its 1992 BPI scheme with a decision to reduce the premium rate from the 1992 rate of 21% to 19% of wages. Now individual workers would share 4% or 5% of the new premium rate, and enterprises would contribute 14% to 15%. The new decision also stipulated the premium rate for temporary workers to be 10% of wages, 3% of which was paid by

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<sup>154</sup> Liu Kaiming, op. cit., p. 43.

<sup>155</sup> Ibid., p. 46.

individual workers and 7% contributed by the enterprise. Such reductions lightened the burdens of both the enterprises and the workers, and improved the city's investment environment. In 1999, in announcing the "rule of Shenzhen SEZ rule of enterprise employee BPI," Shenzhen further adjusted the premium rate down to 17%, with the individual worker paying 5% and the enterprises 12%.<sup>156</sup> There was one catch: Enterprises paid higher premiums for Shenzhen citizen, and therefore preferred to hire migrant workers. In response, in 2001, Shenzhen issued the "Shenzhen SEZ's law of social pension for enterprise Yuangong." The new law unified the enterprise premium rate for both citizen and migrant worker to the same 8% of wages. The modification also reduced the SEZ's pension premium rate to as low as 13% of wages. The individual worker contributed 5%, while the enterprise paid the new lower rate of 8%.<sup>157</sup>

Finally, having a small IPD burden, Shenzhen could construct a viable pension system centered around the individual account. The temporary rule of 1992 stipulated that the total premium of 21% of Zhigong wages was divided between 16% for the individual account system and 5% was reserved for the social pooling component. The 1996 regulation reduced the premium rate to 19% percent of Zhigong wages, which allocated 13% to individual accounts and 6% to social pooling funds.<sup>158</sup> In 1999, Shenzhen again cut the premium rate, this time to 17%, with adjusted relative rates of 11% going to individual accounts and 6 percent to the social pool.<sup>159</sup> Two years later, the city unified the premium rate for both citizen and migrant workers to 13% of wages. Now 11% was directed to individual accounts, and a mere 2% to the social

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<sup>156</sup> *Shenzhen shi shehui baoxian zhi*, pp. 54-5.

<sup>157</sup> *Ibid.*, p. 55.

<sup>158</sup> *Ibid.*, p. 54.

<sup>159</sup> *Ibid.*, p. 47.

pooling fund.<sup>160</sup> Shenzhen's ability to build an individual account-centered pension system was truly exceptional in China.

SOEs, to become pure economic units, had to shed the social functions of the Danwei system, including the obligation of granting pensions to their retired Zhigong. The very effort to corporatize the SOEs was unavoidably linked to the termination of the Danwei-based pension system. It turned out that reforming the SOEs necessitated introducing a new socialized pension system to replace the old parochial Danwei pension system. As it became more obvious the PAYG system could no longer handle the pension demands of urban society's aging population, a funded plan was needed to underpin the new socialized pension system. China decided to introduce a new partially-funded socialized pension system combining the social pooling and individual accounts system. The leadership allowed regional experiments to test what the best combination of the two component parts might be. The outcome was the emergence of highly diversified regional variations of the new pension system. Then the decision of 1997 set up a unified plan for organizing the two components of the socialized pension system.

The decision did not lead to the creation of a perfect and sustainable pension system everywhere in the country. China's leadership was focused on how to combine the social pooling and individual account systems into a new socialized pension system. Just setting up a new unified socialized pension system, though, did not guarantee retired Zhigong they would receive their promised pensions.

Each area had its own number of retired SOE Zhigong inherited from the Danwei system. Shenzhen was a unique, since it had only had to deal with very few retired SOE Zhigong. In contrast, both Shanghai and Liaoning provinces inherited large numbers of *inner system*

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<sup>160</sup> Ibid., p. 54.

enterprises from the old socialist system. Restructuring their SOEs required them to try setting up a new socialized pension system beyond the Danwei as well as a system they could rely on to pay pensions to retired Zhigong.

In many areas, the very process of restructuring the SOEs brought to the fore the urgent issue of the Danwei system's existing pension commitments, in other words, the IPD. Creating a funded plan to replace the Danwei's PAYG pension system also necessitated a decision be made about the thorny problem of the IPD left by the Danwei's PAYG system. China's leadership, however, had not clarified how the IPD left by the Danwei system could be addressed. When the leadership announced its decision about unifying the relative scales of the social pooling and the individual account systems, it had nothing to say about how to solve the Danwei-system's pension obligations to its retirees.

In this absurd situation, for the moment, the leadership permitted the new regionally-organized social pooling systems to handle the area's IPD problem in their area, but without specifying any financial tools to be used by the systems. The individual account remained the only system left to save resources for the future pensions of current workers. The issue became how to divide pension resources between the two systems.

In those areas with an onerous IPD, the new social pool frequently became seen as the major tool for granting pension entitlement to the *old*. Many Chinese cities tried to organize their social pooling systems for this purpose.<sup>161</sup> In the end, the leadership opted for combining a "big" social pooling system with a "small" individual account system, and to let the social pools handle the IPD without explaining how they would do so. In the same way, when the new BPI

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<sup>161</sup>“Shenzhen's BPI system fund accumulation and management are more focusing on individual account system than those of other cities. By contrast, other cities generally emphasize their social pooling parts. Thus even if they accumulate funds, their pension systems still have more PAYG character than Shenzhen system.” CASS IIE SISRT, *op. cit.*, p. 36.

systems were being organized as regionally, it ended up being used to address each area's IPD issues. No matter how unclear where the financial resources would come from to pay retiree pensions, the process of organizing an area's new socialized pension system demonstrated it was impossible to bypass the problem of the Danwei system's IPD obligation to the *old*.

The IPD problem was to be dealt with by the "big" social pooling system, which was supported with the pension premiums paid by an area's enterprises and their workers. The financial capacities of those enterprises and workers to pay the premiums depended on a city's or region's economic performance after it had completed its reforms: Were troubled SOEs successfully restructured? Were new *outer system* enterprises introduced to the area? The answers to those questions determined how financially strong a social pooling system was and whether an area or city could handle its IPD. Under the old socialist system, the *inner system* Danwei organized urban society, leaving what were in most areas a burdensome IPD legacy. Shanghai did successfully turn itself into the hub of a booming market new economy with the help of prosperous new *outer system* enterprises. But not every area carried out its economic reform as successfully as Shanghai did. There were areas in China, such as Shenyang, where economic conditions became tougher after the reform. Areas with numerous retired Zhigong and poor economic performances were unable to levy enough resources to handle their IPD.

The pension reform of 1997, of course, had much to do with the efforts to cope with the IPD left by the Danwei, but it did not create a social pooling system that furnished each area with the finances and a plan to settle its IPD obligations. It was an authorization by the center to allow each area to handle its IPD in its own way. China's leaders did not devise any financial tools for the social pooling system. In areas that could not raise sufficient resources to grant pensions to their retirees, the social pooling system could only cover a limited portion of the

pension expense. It remained unclear whether a regional IPD handling system could assume full responsibility for arranging pensions in the region. It was also impractical to expect that the social pooling systems in many areas, especially those with huge numbers of SOE retirees and poor economic performance after the reform, could grant full pensions to all of their retired Zhigong.

When China's launching in 1997 of the full-scale restructuring of its SOEs was followed by the announcement of the "two absolute guarantees" and the "old way for the *old*" to ensure the *old*'s pension would be paid, regardless of how strong or weak a region's BPI finance were, it was yet another confirmation the problem of the IPD could not be overlooked. It was somewhat problematic that the IPD was to be settled through a regional IPD handling system that did not have reliable or sufficient financial resources. The situation became even more difficult when one result of restructuring the SOEs was that increasing numbers of them could no longer pay their pension premiums. In 1992, the national rate of premium payment was 96.3%. In 1993, it was 93.3%. By the first three quarters of 1998, it had dropped all the way to 80%.<sup>162</sup> In June 1998, the total amount of enterprise premiums in arrears were up to 34.8 billion *yuan*, which was almost equal to 36.8% of China's total pension outlay in 1997.<sup>163</sup> The number of enterprises that had defaulted for amount greater than 1 million *yuan* had gone up to about 4,900.<sup>164</sup> According to a "united notice" in 1999, the pension premiums in arrears by SOEs came to 38.3 billion *yuan*. Some 200 large SOEs were in arrears for more than 10 million

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<sup>162</sup> Jiang Chunze and Li Nanxiong, op. cit., p. 11.

<sup>163</sup> Ci Qinying, "Guanyu jiben yanglao baoxian tongchou "tiao kuai zhi zheng" de sikao," p. 30.

<sup>164</sup> Jiang Chunze and Li Nanxiong, "Zhongguo yanglao baoxian sheng ji tongchou yi hou de maodun fenxi yu duice yanjiu," p. 11.

*yuan*.<sup>165</sup> The statistics showed how unreliable the finances of the new Zhigong BPI's social pools were.

To make matters worse, another practice impaired the financial base of the Zhigong BPIs. Originally, before the reforms, China had set up early retirement as a compensation for some special jobs that were unsuitable to be incorporated into a low wage system. As we noted earlier, after the Cultural Revolution, China permitted a wave of early retirements to arrange for work posts in the cities to become available to formerly rusticated youth. Later, as part of restructuring, offering early retirements became a practice for many SOEs to reduce their redundant Zhigong. At first, considering the conditions of the transition to a new system, China authorized the practice of “early retirement” only for Zhigong who would be retiring soon. As restructuring SOEs became more urgent, however, early retirements became more widely and more broadly practiced, including Zhigong who would normally need to work some more years to before they could retire. Many redundant Zhigong became pensioners immediately rather than joining the ranks of the unemployed. In Shanghai during 1993, RSCs of the textile and electrical machinery industries accepted 115,000 new Xiangang Zhigong and released 58,000 Zhigong, of whom re-employed Zhigong were 10,000 and early retired Zhigong were 22,000.<sup>166</sup> The SOE restructuring in the Northeast's rust belt also relied on the wide practice of early retirements. From 646,241 in 1989, the number of Liaoning pensioners shot up to 3.15 million in 2003 (Frazier 2010: 107). Indeed, from January to August of 1998, the total number of increased retirements was 2 million, which included 700,000 (35.2%) personnel who had retired illicitly.<sup>167</sup>

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<sup>165</sup> Li Yingsheng, *op. cit.*, p. 136; The notice was made collectively by MOL, the State Economy and Trade Committee, and MOF, the China's Securities Supervisory Board, and the State Bureau of Industry and Commerce.

<sup>166</sup> *Laodong neican*, 1997, Issue 4, p. 26.

<sup>167</sup> Yang Fangfang, “Woguo yanglao baoxian zhidu yanbian yu zhengfu zeren,” p. 22.

The restructuring of large numbers of SOEs and early retirements reduced the number of working Zhigong who could pay pension premiums to support the Zhigong BPI system. The dependency ratio of the pension system of China's entire *inner system* deteriorated badly. China, however, did not have the accumulated funds to deal with expanding social pension demands.<sup>168</sup> The full-scale restructuring of SOEs, coupled with widespread early retirements, could not but weaken the already enfeebled finances of the new pension systems in many areas. From 1996 on, the Zhigong BPI funds in some areas began to drip red ink. In the first half of 1998, the basic pension funds of 17 provinces were running deficits. By year's end, the number of provinces with deficits had expanded to 21. It was in 1998 that for the very first time, the national average basic pension funds went into the red.<sup>169</sup> In the same year, the social pooling systems for 22 provinces ran deficits, with a total shortfall of 4.2 billion *yuan*.<sup>170</sup> Topping off all the bad news for 1998 was that the country's entire Zhigong BPI system's total revenues of 145 billion *yuan* were outstripped by total spending of 151 billion *yuan*, the very first year the system had closed in the red.<sup>171</sup>

In the late 90s, the financial condition of the Zhigong BPI in many areas worsened. The total deficit of the Zhigong BPI in 1998 was 5.8 billion *yuan*. The shortfall in the next year reached to 15 billion *yuan*, and shot up to 30 billion *yuan* in 2000.<sup>172</sup> The following table shows the numbers of units unable to grant pensions and retirees not receiving their pensions were

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<sup>168</sup>The World Bank estimated that the reserves of China's pension system in the mid-1990s were only 30 billion *yuan*, which was only 0.6 percent of GDP and less than a third of the pension payments made to retirees in 1994 (*Old Age Security*, p. 15).

<sup>169</sup>Liu Yansheng, "Huanjie qiye shehui baoxian feiyong fudan duice yanjiu," pp. 50-1.

<sup>170</sup>Wang Yan, et al., op. cit., p. 305.

<sup>171</sup>Liu Cuixiao, "Woguo yanglao baoxian de lishi zhaiwu wenti," p. 97.

<sup>172</sup>Ma Jie, "Shi xi tiqian tuixiuwenti dui woguo yanglao baoxian zhidu de yingxiang," p. 620.

increasing in the second half of the 90s. In 2000, the total accumulated unpaid pension was at 16.6 trillion *yuan*.<sup>173</sup>

Table 5-4. Data on Pension Arrears

Year	Number of Units Owing Pensions	Number of Retirees Whose Pensions were Unpaid	Total Amount of Pension Arrears (Unit: million <i>yuan</i> )
1994	NA	1,747,202	NA
1995	NA	1,506,711	NA
1996	19,971	1,712,549	NA
1997	NA	NA	NA
1998	NA	NA	NA
1999	29,919	3,647,004	6,824.91
2000	43,617	3,881,306	7,167.18

(Source: *Zhongguo Gonghui Tongji Nianjian*, 1995-1996, p. 128; 1997, p. 166; 2000, p. 136; 2001, p. 90)

Such numbers revealed the structural problems of China's new Zhigong BPI system. As the state had not decided clearly how to settle the Danwei IPD issue, the financial base of the Zhigong BPI system was not sound enough to arrange full pensions for retired Zhigong. In more and more areas, without access to special measures, the Zhigong BPI systems were unable to mobilize enough resources to settle the IPD problem.

In many areas, the Zhigong BPI systems could not grant full pensions to retired Zhigong. China's leaders tried to find some way to help the pension systems of those troubled areas. The 1997 regulations mandated a gradual transfer of existing county level social pools to the provincial level. The next year, the State Council ordered that the Zhigong BPI social pools at the provincial level should be used to enhance the mutually supporting functions of their pension funds beyond narrow city boundaries – in other words, to help the province's social pool systems

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<sup>173</sup> He Ping, "Zhongguo shehui baozhang tixi yanjiu baogao (2000)," p. 10.

at lower levels.<sup>174</sup> In 1999, MOLSS and MOF issued a notice abolishing the county level pools and having them transferred to prefecture or municipal pools by the end of 2000 (Frazier 2010: 60). By reorganizing the local social pooling systems to be moved to the upper provincial level, China was trying to have the IPDs of troubled areas addressed by larger social pools that supposedly could provide more mutual support.

At the same time, the existing Zhigong BPI's social pooling systems had been organized at the municipal level. China had allowed the emerging BPIs in the cities to play a role in the regional handling of the IPD. As ever more cities sought to improvise their own special measures, each municipality formulated its own pension system and developed its own separate interests.<sup>175</sup> The leadership tolerated it when many cities attempted to make their own lower-level pension programs independent of their province's pension system.<sup>176</sup> This was not all that surprising because China's pension reform had been initiated by those experiments at the lower administrative levels. After several years of local decision-making and practice, different interests and relations had emerged at the lower regional levels.<sup>177</sup> Chinese cities, moreover, had different IPD burdens and different capacities to handle them. Now by proposing IPD issues could be addressed at the provincial level, China's leaders overlooked that the country's cities might have their own interests, and might be unwilling to surrender those to establish pension

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<sup>174</sup> Liu Cuixiao, op. cit., p. 97.

<sup>175</sup> "Many localities intentionally differentiate their schemes from others and introduce nontransparency so as to retain authority over their own program and the surplus funds that are emerging in the short run. As a result, there are now hundreds of separate pension schemes in China" (*Old Age Security*, p. 23).

<sup>176</sup> "To realize institutional unification, many provinces try to devise their unification measures. Yet some cities, with the provincial government's permission, take different measures from those of their province, such as Shangdong's Qingdao city, Zhejiang's Ningpo city, and Hubei's Wuhan city, and Hebei's Handan city. These reform measures or enforcing methods are emerged based on its sincere analysis and calculation of each area's socio-economic developmental condition, enterprises and pension funds' supporting capabilities, and demographic aging situation and tendency." *Laodong neican*, 1996, Issue 5, p. 24.

<sup>177</sup> *Laodong neican*, 1996, Issue 9, p. 33.

pooling systems at the provincial level. In Liaoning province, 35 of its 44 cities lacked enough funds to run their own pension pooling systems. But nine cities did have the resources, creating a rift between the haves and the have nots. “Hence, the push to upgrade the provincial level pension pooling system cannot but end up ‘supporting the skinny by taking from the chubby,’ which is supported by those in the red (Chaoyang, Tieling, and Fuxing) but objected to by those with surpluses (Dalian and Anshan).”<sup>178</sup> Nor were provincial governments eager to accept the responsibility for provincial social pools. If they did, they would be taking on all IPD issues within their borders.<sup>179</sup>

Much of this confusion and conflict could be traced to when China’s pension reform failed to provide any systemic mechanisms for handling the IPD inherited from the Danwei. In consequence, each area and city had to fall back on its own resources and try to find its own solution. The Chinese leadership’s attempt to guarantee pensions to retired Zhigong by setting up a new socialized Zhigong BPI actually emboldened parochial regional interests.<sup>180</sup> On the one hand, it was understood the IPD was a delicate issue that had to be solved. On the other hand, an indecisive Chinese leadership never articulated who would have to accept the final liability of settling the IPD issue.<sup>181</sup> As the push to restructure the SOEs gathered steam, each area became very sensitive and defensive about its own IPD burden, making it very difficult to coordinate and adjust the many different interests involved.

Given this political background, China did not find it easy to create provincial social pooling systems. The Zhigong BPI system remained a fragmented system with local social pools

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<sup>178</sup> Jiang Chunze and Li Nanxiong, *op. cit.*, p. 8.

<sup>179</sup> Feng Lanrui, “Shehui baozhang shehuihua yu yanglao jijin sheng ji tongchou,” p. 57.

<sup>180</sup> “The evolution of a new welfare regime in China created a highly fragmented system in which each city and county operates its own pension and other social insurance funds” (Frazier, 2010: 23).

<sup>181</sup> “But the issue regarding who will pay the pension of the retirees after the restructuring SOE is still under serious debates.” *Laodong neican*, 1996, Issue 4, p. 34.

organized mostly at the municipal level. In 1999, of the 27 provinces already trying to establish social pools at the provincial level, only Hainan province and four cities that were directly controlled by the center completed arrangements to participate in the provincial social pools; another 17 provinces were only able to set up small-scale coordinating funds with contributions that were just 1% or 2% of city-level pensions funds; the remaining provinces could not even collect coordinating funds from their cities.<sup>182</sup> By the end of 2001, except for a few provinces and the four municipalities under direct central control, most social pooling systems remained at levels below that of the province.<sup>183</sup> The proposal to create provincial-level socialized pension systems failed. China's pension fund system stayed fragmented and concentrated at the level of the municipality.

It was unacceptable that increasing numbers of retired Zhigong could not receive their promised pensions. Many areas, including even Shanghai, began to raid the accumulated funds in their individual account systems to pay pensions to their retired Zhigong. In quite a few areas, the Zhigong BPI arranged pensions for their retired workers without even bothering to differentiate between the two components of the pension system. Most areas saved very little for the future, spending virtually all of their resources on arranging pensions for retired Zhigong.<sup>184</sup> This observation was made at the time: "As the total amount of the social pooling funds can only cover one-fourth of total pension payment today, the funds within individual accounts cannot help being used to pay pensions to the retired Zhigong, which makes the individual accounts empty and 'exist only in name (*mingcun shiwang*)'..."<sup>185</sup> Society had come to acknowledge the reality that to guarantee retired Zhigong their pensions, the only practical solution was the mixed

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<sup>182</sup> Wang Yan, et al., op. cit., p. 304.

<sup>183</sup> Liu Cuixiao, op. cit., p. 100.

<sup>184</sup> Wang Jiangang, "Yanglao baoxian gaiwei fenzhang guanli hou mianlin de wenti he duice," p. 79.

<sup>185</sup> Zhao Chenhui, op. cit., p. 27.

management of both the social pools and the individual accounts by diverting funds from the individual accounts to pay retiree pensions.<sup>186</sup> The use of the empty account became a ubiquitous practice, because it had been accepted that urban society was obligated to grant full pensions to retired Zhigong.

The practice placed all paid premiums into what was now really a single pension fund, turning the new Zhigong BPI into a PAYG system. Funds collected for the individual accounts were never actually accumulated. A current worker's individual account simply became a bookkeeping device to keep track of his contributions (Frazier 2010: 31). The common use of the empty account threatened to ruin the Zhigong BPI, but did nothing to solve the problem of China's inherited IPD.

Although the empty account relegated the accumulating funded pension to an accounting fiction, its continued use was unsustainable. At some point in the future, the current workers who had paid into the individual accounts would retire too, and claim their own pensions from individual accounts that had never actually accumulated any funds. It would be then that the de facto single pension fund system faced an even more severe financial crisis. At best, the empty account could only be a makeshift measure. Eventually, any pension system that relied on it would have to settle an even heavier bill.<sup>187</sup> The empty account, if improperly used, was a time bomb that would explode sooner or later.<sup>188</sup> Many pension systems, though, found it too

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<sup>186</sup> Mo Taiji, "Geren zhanghu yu yanglao baoxian de gongneng pouxi," p. 347.

<sup>187</sup> "Indeed, new pension system itself does not incorporate the scheme of how to resolve the historical burdens. Then, Zhigong under the combining both social pool and individual account system have to take double premiums: one is the accumulation for their own future; the other is resources for the pension payment of the already retired Zhigong. In fact these funds will not be even enough to cover their pension payment in the future." Zhao Chenhui, *op. cit.*, p. 27.

<sup>188</sup> "Obviously, the empty individual account already has become a hidden huge financial problem, which can, once become dominant one, render the whole financial bases of the new pension system in danger..." Zhao Renwei, "Guanyu Zhongguo shehui baozhang tizhi de gaige sikao," p. 42.

tempting not to use the practice. The unfunded amount in empty accounts was 14 billion *yuan* in 1997, jumped to around 45 billion *yuan* in 1998, and surged yet again to over 100 billion *yuan* in 1999.”<sup>189</sup> China’s leaders clearly knew how widespread the practice was, and understood the final result would be the collapse of the Zhigong BPI. They tried to develop new solutions. In 2000, the State Council issued the “experimental program to perfect the urban social insurance system” (State Council Document No. 42 of 2000), which focused on how to reorganize the individual account as a real account where funds were actually deposited. What we learn from all this is that many of China’s pension fund managers attached so much importance to honoring the obligations to retired Zhigong, they were willing to do so to the point of ruining the individual account system. The use of the empty account was an outcome of the social process identifying the IPD as an urgent issue that could not be evaded.<sup>190</sup>

From the very beginning, the Zhigong BPI was a local pension system and, as such, could not avoid involvement from local governments. Many local governments had to arrange for the payment of pensions to the retirees of SOEs that were under their direct control. In many areas, once it was clear the new Zhigong BPI systems were on shaky financial ground, the local governments became increasingly engaged with them. Furthermore, local governments now had more revenue sources than before. One major aspect of China’s reform was transforming what had been a centrally-unified financial system into a multi-level one that shared revenues among the central, provincial, city, and county governments. Urban society now expected that local governments should play a more active financial role in building the Zhigong BPI and mobilizing resources to pay the pensions of retired Zhigong.

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<sup>189</sup> Wu Zuxing, *op. cit.*, p. 30.

<sup>190</sup> In this context, there emerged understanding that the genuine issue of empty account was who would take the responsibility to pay pension of the retired Zhigong. In other words, it involved the issue of who would cover IPD. Cai Fang and Lin Yifu, *op. cit.*, pp. 190-1.

Unfortunately, in many areas and cities, the IPD problem could not be settled with only the engagement of their local governments. After the reforms, there were serious regional disparities across China. The financial conditions of the country's local governments were extremely diverse.<sup>191</sup> If a local government had only a limited financial base, it was unable to organize a stable Zhigong BPI. Many of the inland areas in China did not have the wealth and financial benefits the coastal areas enjoyed. Coming out of the restructuring reforms, the country's rust belt, including Liaoning province, were not better off and the financial prospects of their local governments were poor, since they had very feeble *outer systems* and huge, insolvent *inner system* legacies. Their financial conditions remained quite shaky. Ironically, it was these poor areas, often crowded with unprofitable SOEs and having very few financial resources, that had to assume some of the country's heaviest pension obligations to retired Zhigong.<sup>192</sup> The retired workers who did not receive full pensions resided in regionally diverse places, but it was also true they tended to be concentrated in certain areas. In 1998, 2.83 million retirees did not fully receive their pensions. A staggering 82.5% of the total unpaid pensions, totaling 3,868 million *yuan*, was owed to retirees who lived in mining sectors and in just seven provinces - Heilongjiang, Liaoning, Jilin, Hebei, Xinjiang, Shanxi, and Sichuan.<sup>193</sup> In those areas, even though fully engaged with their Zhigong BPI systems, the local governments did not have the funds to pay their *inner system* retirees.

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<sup>191</sup> Plus, while many provincial and municipal governments could drive temporarily some funds from their budgets to support their pension system, lower governments such as county level could not follow suit, because they were usually under tougher budgets conditions. JIL, *Chugoku no rodo shakai hoshu shisutemu no kisoteki kenkyu*, p. 30.

<sup>192</sup> Those regions dominated economically by the traditional state sector, such as the Northeastern provinces, generally had a heavier social burden than those regions having a larger non-state sector that tended to have younger workforce and fewer social obligations than the state sector (Hu: 293).

<sup>193</sup> Yang Liangchu, op. cit., p. 71.

Gradually, China's leaders realized that when local governments with limited finances were incapable of dealing with their pension issue, the central government had to draw on its own revenues to support them.<sup>194</sup> As more SOEs underwent restructuring, the local governments in an increasing number of areas found it difficult or impossible to fund their pension systems. The central government responded by giving financial support. In particular, after 1998, regional pension systems that were short of funds received quick support from the center.<sup>195</sup> A year earlier, as the full-scale restructuring of the SOEs, was moving ahead the state had spoken about the "two absolute guarantees," indicating it had finally decided to respond seriously to society's anxieties about the uncertainty over retiree pension. To carry out the two guarantees, the central government arranged for many sorts of financial support to struggling local governments. Between 1998 and 2001, about 130 billion *yuan* went to support the Xiangang program and pension provisions in old industrial and mid-western areas.<sup>196</sup> The dominant share of the subsidies went to cover unpaid pensions; in 2002, the center government's subsidy for the "two guarantees" increased to 54.7 billion *yuan*, of which 40 billion *yuan* were for pension grants.<sup>197</sup> After 2002, the state's support to the Xiangang program ceased when, the program was officially ended by the *merging* decision.

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<sup>194</sup> "In principle local governments take responsibilities for local SOEs and the central government takes the responsibilities for the central SOEs. Yet if local governments in those areas with the issues of economic backwardness, concentration of with old industries, and financial debts, cannot handle (economic compensation and the historical debts), then let higher level governments or the central government support financially." (ILSS, *Zhongguo Laodong Kexue Yanjiu Baogaoji 2000-2001*, p. 265.

<sup>195</sup> Wang Yan, et al., op. cit., p. 305; Zheng Gongcheng, "Tuijin woguo shehui baozhang gaige de ji dian sikao, p. 217.

<sup>196</sup> Nie Mingjuan, "Quanmian jianshe you zhongguo tese shehui baozhang tixi," pp. 11-2.

<sup>197</sup> Gao Shusheng, "Shehui Baozhang: Women gai zou natiolu," p. 42.

Table 5-5. The Central Government's Financial Subsidies to the Zhigong BPI and Xiangang Zhigong Basic Living Support Program, 1998-2004 (unit: billion *yuan*)

	1998	1999	2000	2001	2002	2003	2004	Total
Subsidies for Old Age Pension	2.5	17.5	33.8	34.9	40.8	47.4	52.2	229.0
Subsidies for Xiangang Zhigong Basic Living Program	7.6	9.0	13.3	13.5	13.9	/	/	57.3

(Source: Data from an interviewee)

In areas with troubled pension plans, the central government's financial support to pension grants dwarfed the contributions from the local governments. "Between 1998 and 2001, of the total government financial support for pension funds, the central government assumed 90%, while local government took less than 10%."<sup>198</sup>

With the help of the central government, China realized its goal of covering the basic living expenses of Xiangang Zhigong and the pension payments to retired Zhigong. After June 1998, the problem of large amounts of pensions being in arrears was brought under control. The rate of granting full pensions on time began to rise. According to a survey by MOLSS, after September 1998, occurrences of pensions being in arrears had disappeared. Many areas began to grant retroactive pensions, which had reached a national total of 3 billion *yuan*.<sup>199</sup> A survey conducted in 2002 showed large achievements had been realized in granting full pensions on time. There still remained 18.4% of pensioners who faced some problems in receiving their pension on time, but those were taking place mainly in cities lower than the prefecture level. Ten percent of unpaid pensions remained in the socially unified pension system, but more than half of those had been overdue less than six months and unpaid pensions that were older than one year constituted less than 20% of the total unpaid pensions.<sup>200</sup>

<sup>198</sup> He Jinying, "Shehui baozhang zhong de zhengfu zeren," p. 22.

<sup>199</sup> Jiang Chunze and Li Nanxiong, op. cit., p. 6.

<sup>200</sup> Yang Jianmin and Sun Bingyao, "Li tuixiu renyuan shehui baozhang diaocha baogao," p. 524.

With their adoption of the “two absolute guarantees” and the “old scheme for the *old*” 1997, China’s leaders affirmed their commitment to settling the Danwei system’s inherited IPD. Even though they did not clarify any concrete measures, out of the push for a full-scale restructuring of the SOEs, they made it evident the pensions the Danwei owed their retirees would be settled unconditionally. The burden to settle the Danwei IPD was transferred from the SOEs to the Zhigong BPI, even it remain unclear how to devise a reliable financial measure to grant full pension for the retired Zhigong.

### **(Summary)**

This chapter has explained that the corporatization reform of the SOE did not only involved dissolving labor relations with redundant SOE Zhigong, but also the handling of the Danwei system’s pension commitments to its retirees. As the Danwei, unlike enterprises in market system, granted pension to SOE retired Zhigong directly out of their revenues, the reorganizing them into pure economic units meant to retirees the very system that granted their pension would be reorganized. This made their pension entitlements uncertain.

In this context, as part of reforming the SOEs, quite early on, China had initiated efforts to introduce a new pension system. It had done so especially with the aim of handling the heavy pension burdens of the old SOEs, which had numerous retirees, by introducing a new socialized pension plan beyond the Danwei. The ranks of retired Zhigong expanded rapidly as time passed, while the economic performance of SOEs worsened in competitive market conditions. As a result, more and more retired Zhigong did not receive their expected pensions from their Danwei.

China attempted to set up a socialized pension system outside the Danwei, by combining social pooling and individual account systems to build partially-funded pension systems.

The process of introducing the new socialized pension reform, however, did not go smoothly. A widespread practice called “remitting the difference” undermined the new pension system. In many areas, the pension system was still bound to the Danwei rather than being transformed into a fully socialized pension system. This was because the socialized pension reform had to handle the Danwei system’s IPD issue without devising a reliable financial measure. Under the condition without clarifying how to handle the Danwei’s system inherited IPD issue, the decision of 1995 allowed each area to devise its own plan combining social pools and individual accounts in different proportions. Yet, after China had begun its strong push in 1997 for a full-scale restructuring of the SOEs, many SOEs were incapable of granting full pensions to their retired Zhigong, which turned out to be a very touchy political issue in urban society. In this context, the leadership in 1997 decided to set up a unified pension system made up of a “big” social pooling system and “small” individual accounts in the hope the “big” social pooling system could be used to grant full pensions to retired Zhigong in place of the Danwei.

This partially-funded unified Zhigong BPI system, however, did not necessarily mean the pension plans were now equipped with enough financial resources to grant full pensions to retired Zhigong. The new socialized Zhigong BPI system did not inherit any resources from the Danwei-based PAYG system, which itself had not saved any resources for granting pensions. Indeed, the Zhigong BPI system’s social pooling system was set up to grant the program participants’ a “bases” pension. It was not a system to grant pension for the retired Zhigong. Accordingly, China’s leadership decided the Zhigong BPI system’s social pools would address the IPD, even if the Zhigong BPI system still lacked a clear mechanism to cope with the

Danwei's IPD. Indeed, the leadership could not overlook if there were retired Zhigong who could not have their supposed pension. In addition to the program of "two absolute guarantees," the pension reform of 1997 also affirmed the concept of the "old scheme for the *old*," which guaranteed that retired Zhigong would receive the same pension entitlements originally promised them by their former Danwei. Despite those major decisions, China had not yet devised the measures needed to solve the IPD issue.

In many areas, the Zhigong BPI systems were faced such severe financial difficulties that the practice of the "empty account" was commonly applied to ensure retired Zhigong would receive their pensions. Local governments often tried to support their area's Zhigong BPI system, but they had their own financial problems too. Finally, the central government saw it could not ignore that growing numbers of SOE retirees were not receiving their pensions, and stepped in to provide subsidies to those areas whose Zhigong BPI systems could not arrange the pension payments. Out of carrying out its process of pension reforms, China had discovered the IPD owed to the *old* was not the Danwei's internal problem that could be ignored. In actuality, granting and guaranteeing full pensions to retirees was an absolutely critical and necessary precondition for carrying out the full restructuring of the SOEs and the corporatization of the Danwei. In the SOE reform process, the Danwei system's IPD issue turned out to be a critical precondition to settle. Yet, China did not clarify how to finance required resources to settle it, and the crux of the politics in SOE reform process left undecided.

## 6. Pension and the Politics of the *Merging* Process

China faced serious frustrations in its efforts to restructure many troubled SOEs mainly because it had trouble dissolving labor relations with large number of redundant SOE Zhigong. For this reason the leadership decided to introduce Xiagang program, which, however, was terminated shortly with the *merging* decision. It is quite puzzling that China tried to introduce Xiagang program to soothe the social sensitivity about the process of dissolving Zhigong's labor relation, so terminating Xiagang program could only make society more volatile. Yet, as the former chapter illustrates a critical content of SOE reform was how to ensure retired Zhigong's pension to relieve old SOEs' heavy pension burdens for their retirees by organizing new socialized pension system. Hence, SOE reform might also need to address Xiagang Zhigong's pension issue before dissolving their labor relations. The Danwei's IPD issue could not be bound only to the retired Zhigong, but also extended to Xiagang Zhigong. Then, the SOE reform process needed to devise a scheme which could handle the Xiagang Zhigong's pension issue. If Xiagang Zhigong's pension entitlements turned out to be a critical precondition for them to dissolve the labor relations, then the *merging* process could proceed smoothly with a scheme of ensuring their pension entitlements. In this context, I will examine how the actual *merging* process proceeds.

Under the planned economy system, China implemented the "unified labor placement system" whose function was to assign jobs to every citizen. The aim of this system was not have any unemployed workers. Unemployed workers were not considered unemployed but were in a temporary "waiting jobs" (*daiye*) period until the system arranged jobs for them. The urban society could achieve the full employment. However, this inevitably brought about a social cost:

SOEs had to employ much more personnel than they needed.<sup>1</sup> In the competitive market conditions after the reform, those less competitive SOEs could neither support their inherited employees nor play the former role as social system to realize the goal of full employment. Moreover, in order to reorganize SOEs as competitive economic units, there suddenly emerged the urgent task of how to reduce those excessive personnel who SOEs had employed for the goal of full employment. The Danwei system was full of redundant Zhigong. The legacy of its former labor scheme of artificial full employment was a critical source of its incompetitiveness.<sup>2</sup>

Since the SOE restructuring process involved reducing the redundant labor forces, the problem was complicated by the fact that China did not have socially accepted unemployment system. The urban society was organized as Zhigong labor system based on the permanent worker system, which did not incorporate a scheme to layoff redundant workforces from troubled SOEs. Hence, China in 1986 initiated the labor contract system. Under the labor contract system, employers needed not reemploy contract workers when their labor contracts expired.<sup>3</sup> However, as observed before, China could not apply it to the existing permanent workers of the *inner system*. Quite naturally, the new labor system was not palatable for the permanent workers: contract workers were treated as minor, disadvantaged workers not only in

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<sup>1</sup> Even if China did not officially have an issue of unemployment, it all the while did have the issue of “hidden unemployment.” Li Yingsheng, *Shehui Baozhang yu Shehui Jiegou Zhuanxing: Eryuan Shehui Baozhang Tixi Yanjiu*, p. 140.

<sup>2</sup> Because of socialist system’s artificial full employment, China had been maintaining very high labor force participation rate and the rate could not drop quickly before China reorganized its labor system. Indeed, the rate in 1996 was still 85.4 percent and it dropped to 84.9 percent in 2000, which was still higher 11.6 percent than the world average rate, 73.3 percent. Ceng Xiangquan and Li Lilin, “Woguo laodongli shichang zhong de jiuye zhengce zhichi,” p. 27.

<sup>3</sup> Accordingly, from 1986 unemployment was no more a clandestine issue but an official issue to discuss in public. Li Yingsheng, *op. cit.*, p. 140.

employment stability but also in welfare benefits such as pension, medical care, and housing.<sup>4</sup> Indeed, the labor contract system did not articulate its own scheme of social security benefits in a way that could assuage the existing permanent workers' worries about losing their labor insurance entitlements. Consequently, China could not apply the labor contract system to the existing permanent workers, and made newly employed workforce members the contract workers.<sup>5</sup> The labor contract system was not a successful scheme to layoff SOE's redundant Zhigong, the permanent workers.

Then, China for the urgent SOE restructuring process devised Xiagang system, which separated redundant Zhigong from their work posts without fully dissolving the labor relations. Because the Danwei system wedded employment and the social insurance system, it did not provide any social security system benefits anyone did not belong to the Danwei. This presented a predicament in SOE reform, as society could not accept those Zhigong who should have dissolved their labor relations. Under the condition without reliable social security system in order to sooth the redundant Zhigong worries, China without clearly dissolve labor relations set up a transition phase in the process to dissolve the labor relations with granting living the support, various reemployment aids, and payment their social insurance premiums which let them retain the social insurance entitlements.

Yet, Xiagang was only a temporary program, which usually lasted three years and after the period Xiagang Zhigong would have to leave their RSCs without guarantee of reemployment. Xiagang program had its own systemic defects as well: It was set up to support troubled SOEs' restructuring process, but it still financially depended on troubled SOEs without organizing new

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<sup>4</sup> Indeed, the contract workers, unlike permanent workers, were supposed to pay their social insurance premium. Feng Tongqing and Xu Xiaojun, *Zhongguo zhigong zhuangkuang: neibu jiegou ji xianghu guanxi*, p. 168.

<sup>5</sup> Ibid.

reliable financial sources. Accordingly, many areas faced problems in mobilizing required resources for Xiagang system and RSCs in many regions were never organized into a new scheme of reliable social system which could provide reliable living fees and fruitful reemployment aids to dissolve Xiagang Zhigong's labor relations.

In this context, many RSCs affiliated financially with troubled SOE could not afford to cover their Xiagang Zhigong's social insurance premium. Many SOEs under the serious financial strain had problems paying their dues. Additionally, many local governments were not eager to pay their dues. Many RSCs lacked the resources to pay social insurance premiums for their Xiagang Zhigong. Accordingly, in many areas that could not pay social insurance premiums for the Xiagang Zhigong, Xiagang system could not be seen as a reliable social system.<sup>6</sup> According to the survey of 1997 conducted by MOL and UNDP in four cities (Shenyang, Qingdao, Changsha, and Chengdu), of the total Xiagang Zhigong, only 17 percent were reimbursed their medical fees; 22.2 percent were paid unemployment insurance premium; and 39.8 percent were paid their pension premium by their Danwei. A total of 48.3 percent of Xiagang Zhigong was not provided with any of these payments.<sup>7</sup>

At the same time, to dissolve the labor relations with redundant Zhigong, many SOEs tried to arrange some economic compensation. Indeed, compensation became more urgent issue in China, as many SOEs had to reduce their surplus personnel for the restructuring process. However, at first China did not articulate the clear principles of compensation for those Zhigong who dissolved their labor relations. As I illustrated before, it turns out that the contents of the

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<sup>6</sup> MOLSS survey conducted in the July of 1999 for the 9834 Xiagang Zhigong identifies that Xiagang Zhigong worried most seriously about whether or not they would lose their pension and medical insurance entitlements. Yu Faming, *Xiagang Zhigong laodong guanxi wenti toushi*, p. 16.

<sup>7</sup> Li Peilin, Zhang Yi, and Zhao Yandog, *Jiuye yu zhidu bianqian: liangge teshu qunti de qiuzhi guocheng*, p. 47.

compensation package which those Zhigong wanted was a scheme that could virtually confirm their stakeholder positions. Xiagang, however, did not incorporate a compensation scheme that could ensure their stakes as the permanent workers of the Danwei system. China made a series of efforts to introduce compensation schemes that redundant Zhigong could accept so as to be induced to dissolve the labor relations before its full push of Xiagang program. Following the efforts to introduce a new labor system, China issued three different regulations on how to dissolve Zhigong's labor relations. First, by introducing labor contract system into SOE, China tried to provide living subsidies (*shenghuo buzhuifei*). Second, by setting up the "labor law," it stipulated economic compensation (*jingji buchangjin*) for those cases violating or dissolving the labor contract. Finally, for SOE Zhigong of the bankrupt Danwei, the "state council's notice regarding issues to carry out SOE bankruptcy" stipulated a one-time resettlement payment (*anzhifei*). However, these were not designed to handle a large number of redundant Zhigong that would be created by the urgent SOE restructuring process.<sup>8</sup> Indeed, China had not yet articulated how its compensation scheme could make its Xiagang Zhigong give up their Danwei permanent worker status and dissolve the labor relations.

Many SOEs, especially those small ones, were quite vulnerable to market competition, having no choice but to restructure themselves. That inevitability required them to reduce their redundant workforce even without clearly articulated compensation schemes, so they, instead of employing Xiagang, took measures to make a "buyout of work years" (*maiduan gongling*) to completely dissolve the labor relations with their redundant Zhigong.<sup>9</sup> Indeed, "buyout of work years," referred to a practice of dissolving SOE Zhigong's labor relations with a "one time

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<sup>8</sup> Yu Faming, op. cit., p. 19.

<sup>9</sup> In this context, some Xiagang Zhigong in the restructuring process "are offered a one-time severance package (*maiduan gongling*) and are encouraged to go out and fend for themselves as individual entrepreneurs" (Gallagher: 51).

compensation payment to Xiagang Zhigong according to their work years and former wage level.”<sup>10</sup> The measure of “buyout of work years” enabled SOEs to dissolve labor relations with their redundant Zhigong, which thereby freed them from the previous responsibilities to take care of their Zhigong. This means that SOEs came to be ready for full corporatization process beyond the Danwei. In particular, China made a series of efforts to introduce an economic compensation scheme for the workers who had to dissolve the labor relations. The result was a plan to provide a compensation of one month’s wage for each work year served.<sup>11</sup> In this context, the practice of discharging SOE Zhigong was carried out in many areas with lump sum severance provisions. Of course, the amount of actual payment varied by area.<sup>12</sup>

Yet, “buyout of work years” never became an official compensation scheme to regulate the process of dissolving the entire Zhigong’s labor relations. SOE Zhigong did not want the compensation in the form of “buyout of work years” to dissolve their labor relations completely. They felt strongly that this method could not provide enough compensation for the loss of their unique permanent worker status. Indeed, urban society was very sensitive to the policy of “buyout of work years” in terms of whether a one-time arrangement of placement fees or economic compensations could appropriately settle the whole previous work years of the permanent workers. In this context, the discussions of “buyout of work years” came to focus on the social meaning of dissolving Zhigong’s permanent workers status.<sup>13</sup>

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<sup>10</sup> Li Peilin and Zhang Yi, *Guoyou qiye shehui chengben fenxi*, p. 116.

<sup>11</sup> Sun Qunyi, “Xiagang Zhigong chu zhongxin de buchang, p. 36; Yu Li and Meng Tao, “Guoyou qiye “maiduan gongling” de wenti yu guifan, p. 57.

<sup>12</sup> Sun Qunyi, *op. cit.*, p. 36.

<sup>13</sup> SOEs came to initiate “buyout of work years” push by “taking measure of arrangement of one time placement fees or economic compensation for the enrolled permanent workers to “buyout” Zhigong’s the everlasting permanent worker status. Ultimately, “buyout of work years” was targeted at “transforming” SOE Zhigong status into normal social employees.” Jiang Chunhai and Liu Xiaoyan, “Maiduan gongling de jingji buchang yu zuiyou junheng,” p. 89.

A striking point for Zhigong was that “buyout of work years” related to its legal bases which turned out to be ultimately depended on the regulations of the labor law enacted in 1995. The labor law, however, was set up as a legal system to regulate China’s new contract workers. Then, the scheme of “buyout of work years” was to dissolve the labor relations with new contract workers rather than those redundant SOE Zhigong.<sup>14</sup> Hence, for many SOE redundant Zhigong, dissolving their labor relations clearly with “buyout of work years” was virtually absurd thrust based on simple presumption that those *inner system*’s permanent workers as new contract workers. Consequently, many redundant Zhigong could not accept “buyout of work year” as an appropriate compensation scheme to dissolve their permanent worker status.<sup>15</sup>

“With the little capacities to settle their debts owed to Zhigong and arrange compensate, some problematic SOEs tries to push their redundant Zhigong to dissolve the labor relations by executing so-called “buyout of work years.” There are even some SOEs that try to dissolve the labor relations with provision of only two or three thousands *yuan* to each Zhigong. These measures, of course, can cause Zhigong’s fierce discontents and even ignites serious social problem.”<sup>16</sup>

China was very sensitive to those “buyout” which dissolved labor relations with Zhigong without adequately reflecting Zhigong’s permanent worker position. There emerged social voices which blame some SOEs’ “buyout” process without reflecting Zhigong’s interests.<sup>17</sup> China did not officially authorize the practice of “buyout” of Zhigong’s work years in dissolving

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<sup>14</sup> Yu Li and Meng Tao, op. cit., pp. 55-7.

<sup>15</sup> Indeed, the real practice of the “buyout work years” just arranged small compensation as the case of dissolving labor relations with those new contract workers after the labor contract system, so it turns out lacking any legal bases. Liu Jihua et al., “Guoqi gaizhi hou Zhigong liyi baohu wenti de falü yanjiu,” p. 26.

<sup>16</sup> Yu Faming and Guo Yue, “Guanyu guoyou qiye zhuanzhi guocheng zhong laodong guanxi chuli de jidian sikao,” p. 43.

<sup>17</sup> A big SOE seriously encroached Zhigong’s rights, as it executed “buy-out” with total seventy thousand Zhigong within about a year even without allowing workers representative’s discussion about “buy-out” condition. Huang Hetao and Zhao Jianjie, “Jingji jiegou tiaozheng yu laodong guanxi zhongjian,” p. 23.

their labor relation.<sup>18</sup> But it did not prohibit it, either. It followed that there were many cases where “buyout” were used to dissolve Xiagang Zhigong’s labor relations in the urgent SOE restructuring process.<sup>19</sup> This means that China did not initiate its Xiagang push with an appropriate compensation scheme that could handle Xiagang Zhigong’s permanent worker status. Indeed, a critical defect of Xiagang program was its lack of a compensation scheme that those Xiagang Zhigong could accept to dissolve their labor relations.

In order to restructure a high number of beleaguered SOEs, China could no longer put off the efforts to dissolve the labor relations with Xiagang Zhigong. With the clear defects of Xiagang program, the leadership decided to terminate it with a plan of shutdown of all RSCs and no more of Xiagang program’s living supports for newly laid-off workers.<sup>20</sup> The decision put those redundant workers directly under unemployment insurance system after dissolving the labor relation, as the unemployment insurance system came to remain a single supporting program only for newly laid-off workers. This is why the effort was labeled as the *merging*, as it integrated the former Xiagang system and the unemployment insurance system for the laid-off SOE workers into an unemployment insurance system. Yet, terminating Xiagang system itself could not be a solution because it just meant that China demolished its temporary cushion system to absorb the social shock of SOE restructuring process. Considering the immature social insurance system beyond the Danwei, the *merging* process might cause more serious social tensions. The *merging* decision, therefore, contradict the very embeddedness politics that made China introduce Xiagang program beforehand. Most of all, the *merging* decision was not

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<sup>18</sup> Yang Shenghua, “Tan qiye chanquan jiegou tiaozheng zhong Zhigong shenfen zhuanhuan wenti,” p. 17.

<sup>19</sup> Jiang Chunhai and Liu Xiaoyan, op. cit., p. 89.

<sup>20</sup> Indeed, from the January of 2001, SOEs were not allowed to set up RSCs and newly laid-off workers do not enter RSC. Thus, Xiagang system would be terminated in 3 years, as all existing Xiagang Zhigong have to leave RSC within 3 years.

predicated on a clear compensation scheme that Xiangang Zhigong could accept as appropriate to dissolve their permanent worker status.

To make SOEs dissolve labor relations with their Xiangang Zhigong, instead of a simple decision to stop Xiangang program, China needed to arrange required social preconditions whereby SOE Zhigong could dissolve their labor relation with their Danwei. Indeed, China's reform required a new social insurance system which, instead of the Danwei system, allows urban workers to maintain their social insurance entitlement even after they dissolve their labor relations with their enterprises.<sup>21</sup> China had not yet set up a reliable social security system beyond the Danwei, and most non-state enterprises did not provide their employees with social security benefits.<sup>22</sup> This was the reason why Xiangang Zhigong wanted to maintain their labor relations with their Danwei.<sup>23</sup> Indeed, MOLSS's survey of total 9834 Xiangang Zhigong in 10 cities in 1999 revealed that 91 percent of them did not want to dissolve the labor relations with their original workplaces.<sup>24</sup>

Interestingly, while initiating Xiangang program, China began to focus on "two absolute guarantees" in its emerging social security system. The leadership realized that to ensure retired Zhigong's pension granting would be really critical.<sup>25</sup> In order to make the urban society accept

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<sup>21</sup> Cai Fang and Lin Yifu, *Zhongguo jingji*, p. 188.

<sup>22</sup> "Yet since current social security system itself has many problems, it is really hard for majority of Xiangang Zhigong to reenter institutionalized social security system, if they once dissolve their labor relations with their original SOEs. Not to mention those Zhigong who are transferred to unemployed, most of those Xiangang Zhigong who are already reemployed are employed in informal sectors; if they are employed in formal sector, most of them are employed just temporarily. Indeed, Xiangang Zhigong are generally placed beyond institutionalized security system." DRC SRRTT, "Zhongguo chengzhen shiye baoxian zhidu gaige de huigu yu qianzhan," p. 80.

<sup>23</sup> As a new social security system – independent from enterprises – was yet to be developed, Xiangang workers hesitated to terminate the relationship with their employing enterprises. Lee and Warner: 183.

<sup>24</sup> Yu Faming, *op. cit.*, p. 15.

<sup>25</sup> "Arranging basic living guarantee of bankrupt and troubled SOE's Zhigong and retirees will play critical roles for stabilizing Zhigong group and create sound conditions for reform and development.

Xiagang program and SOE restructuring, therefore, the leadership decided to ensure not only that Xiagang Zhigong's living support would be provided, but also that retired Zhigong's full pension would be secure. Those two guarantees meant that the unemployment insurance system would remain in a minor role in the actual running Xiagang process. China initiated its 'waiting placement' (*daiye*) insurance in 1986 to mainly enable SOEs to release their redundant Zhigong, but even after 10 years its social program for the unemployed was not able to play its proper roles when SOEs implemented Xiagang programs to release their redundant Zhigong. Instead, the "two absolute guarantees" enabled many SOEs to carry out the sensitive restructuring process.<sup>26</sup> Interestingly, it turned out what was at stake in SOE restructuring process was not reliable unemployment insurance for those discharged redundant workers but sound pension system for retired Zhigong. We uncovered in the former chapter that the efforts to set up reliable new pension system for retired Zhigong was a critical precondition for SOE restructuring process. In the same vein, the pension entitlement for Xiagang Zhigong could not remain up in the air in SOE restructuring process.

Formerly Zhigong's pension entitlements and the amount of their pensions after the retirement depended on their continuous work within their Danwei. Thus, once Zhigong left their original Danwei for any reason, they lost their entitlement to the Danwei pension.<sup>27</sup> Therefore, if SOEs had discharged their redundant Zhigong, then the workers would have involuntarily forfeited their pension entitlement. Xiagang Zhigong were no more permanent workers and supposed to dissolve their labor relations, so they could not but worry about their

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Each level labor department should take the program of guaranteeing basic living of Zhigong and retirees as not only a critical daily work but also a long term task." *Laodong Neican*, 1995, Issue 7, p. 9.

<sup>26</sup> Gao Shusheng, "Shehui Baozhang: Women gai zou natiolu?," p. 44.

<sup>27</sup> This was a practical reason why there was a very limited cases of labor transferring among different Danwei before the reform.

pension entitlements after they dissolve the labor relations with their Danwei.<sup>28</sup> Obviously, dissolving their labor relations, Xiagang Zhigong did not want to give up their pension entitlement. Hence, they became even more sensitive about their pension entitlement as they had to dissolve the labor relations eventually. Xiagang Zhigong had interests in their Xiagang benefits, but they invested more interests in their future pension entitlement.<sup>29</sup> Undoubtedly, the issue that Xiagang Zhigong concerned the most was their pension entitlement.<sup>30</sup> According to MOLSS survey of 10 cities in 2000, Xiagang Zhigong worried most about losing their entitlement to pension and medical insurances after dissolving the labor relations; these two concerns accounted for 83.2 percent of answers.<sup>31</sup>

Increasingly, a significant number of redundant Zhigong came to dissolve their labor relations with a form of retirement, even if not by an entirely official route. Especially amidst the full-scale restructuring push of *grasping the big and releasing the small*, many redundant Zhigong dissolved their labor relation with a scheme of virtual retirement. “Internal retirement” (*neitui*), referred to that informal retirement arranged by the Danwei (usually for those Zhigong who would retire within 5 years) with the commitment of paying basic living expenses and social insurance premiums until their retirement, so they could get their full pension after the

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<sup>28</sup> Indeed, this is a critical reason why China decided Xiagang system, as it cannot but allow Xiagang Zhigong to remain within their workplace, even after it separated surplus Zhigong from their work posts with the efforts for “labor organizing optimalization.” Yamamoto, *Gendai Chugoku no Rodo Keizai 1949-2000*, p. 367.

<sup>29</sup> Non-payment of wages or a lack of Xiagang benefits could be viewed as temporary sacrifice, but “non-payment of pensions constituted a fundamental breach of contract” (Hurst and O’Brien: 351).

<sup>30</sup> ILSS, *Zhongguo laodong kexue yanjiu baogaoji 2000-2001*, p. 282.

<sup>31</sup> The survey also showed that Xiagang Zhigong worried about how to find out new jobs (63.85 %); emotional attachment to their workplace (39.31 %); and what if Danwei would not pay off debts owed to them (34.14 %). “10 chengshi qiye Xiagang Zhigong he li tuixiu renyuan jiben zhuangkuang de chouyang diaocha,” p. 51.

retirement.<sup>32</sup> In addition, as observed before, many redundant Zhigong left their Danwei with the scheme of “early retirement”.

Even if “early retirement” was not an officially authorized measure, there were some strong reasons why it became a widely conducted practice. First, for SOEs, it cut labor costs related to redundant Zhigong, such as wages and social insurance premiums. Second, for local governments, it could quiet the social tension related to SOE restructuring without necessarily increasing their burden in the new Zhigong BPI system. Finally and most significantly, for those redundant Zhigong, it allowed them to keep their pensions rather than rely on small unemployment insurance benefits.<sup>33</sup> Indeed, the main reason why redundant Zhigong wanted to maintain labor relations was the peril of losing their pension entitlement after their leaving of their Danwei. They could dissolve their labor relations more readily only if their pension entitlements should be secure. For these reasons, whenever possible, many SOEs undertook the restructuring process, not by direct layoffs, but by ushering out their redundant workers through retirement.

Hence, the Xiagang push for the urgent SOE restructuring process needed to clarify how to guarantee Xiagang Zhigong’s pension entitlements. This means that China’s pension reform efforts to set up a new socialized system beyond the Danwei amidst the SOE restructuring process involved addressing not only how to grant full pension for retired Zhigong, but also how to ensure Xiagang Zhigong’s pension entitlements after they leave their Danwei. It was then necessary to examine how the pension reform process simultaneous to the SOE restructuring process could ensure Xiagang Zhigong’s pension entitlements after they left their Danwei. Indeed, the crux of the issue was whether the new socialized pension system could ensure

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<sup>32</sup> Lu Jun, “Xiagang Zhigong yuanhe buyuan chu zhongxin,” p.28.

<sup>33</sup> Liu Qilan and Wan Bin, “Jieshi “tiqian tuixiu” xianxiang,” pp. 17-8.

redundant Zhigong's pension entitlement after they left their Danwei, i.e., if they were to participate in the system and pay their premiums, then the social insurance system would handle their retirement affairs when they reach retirement age and grant pension to them.<sup>34</sup>

Setting up a socialized pension system alone, however, could not guarantee SOE Zhigong's pension entitlement issue. Many financially troubled SOEs could not pay their full social insurance premium, which rendered many Zhigong's individual accounts within the Zhigong BPI system insufficient.<sup>35</sup> Furthermore, after the three-year Xiagang program, Xiagang Zhigong could neither expect RSCs' premium payments to continue nor easily realize re-employment that would pay their pension premium until their retirement. There was no guarantee many Xiagang Zhigong could pay their premium, which would imperil their pension entitlements. Here is the tricky part of Xiagang system: it tried to dissolve Xiagang Zhigong's labor relations without setting up a scheme that could settle the sensitive pension issue.

On the surface, the "two absolute guarantees" looked quite reasonable. They promised basic living costs to two social groups who lost the most in the SOE restructuring process, the Xiagang and the retired Zhigong. These groups came to lose their basic living in SOE restructuring process, as their entire living had been organized within their Danwei. Hence, only with the "two absolute guarantees" could Xiagang Zhigong rely on RSC for their basic living, and retired Zhigong could count on a pension. The program of Xiagang, however, did not clarify Xiagang Zhigong's pension entitlement issue. The leadership tried to guarantee only Xiagang Zhigong's temporary living supports and retired Zhigong's pension without articulating a scheme to link Xiagang system to the emerging system of Zhigong BPI entitlement. Thus, a

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<sup>34</sup> *Laodong neican*, 1995, Issue 7, p. 9.

<sup>35</sup> Zhu Ling, "Lun Guoyouqiye Xiagang Zhigong jiben shenghuo baozhang zhidu xiang shiye baoxian zhidu bingui: yi Hubei sheng wei zhongxin," p. 132.

fundamental defect of Xiagang program was that it focused on only whether Xiagang Zhigong could be covered by temporary supports without clarifying how to handle their long-run pension issue.

Within this context, a significant number of Xiagang Zhigong lost their pension entitlements after they left their Danwei. The term “personnel who have lost the entitlement” (*duanbaoren*) referred to those former Zhigong, who had an unclear claim to their pension entitlement despite their participation in the new pension system. In essence, most of them failed to pay their premiums after dissolving the labor relations:

“A sizeable numbers of Zhigong have become virtually “personnel who have lost the entitlement” (*duanbaoren*): since many SOEs for their consecutive years of hard financial conditions could not arrange social insurance for their Zhigong; individual Zhigong also could not pay their own premium; and their new workplaces were not familiar of how to connect their employed Xiagang Zhigong’s former entitlements to their new benefits system.”<sup>36</sup>

The number of premium payers in the Zhigong BPI system in 2000 was 83.1 million. This figure dropped by 1.1 millions in the next year. The drop corresponded to same group who could lose their pension entitlements in the restructuring process.<sup>37</sup> Considering a slim chance of re-employment, many Xiagang Zhigong who left their Danwei in the restructuring process were in peril of losing their future pension entitlements, even if they participate in the new socialized pension system. Hence, many Xiagang Zhigong did not want to leave their RSCs after their Xiagang program expired. In this way, those personnel who lost their entitlement would disrupt China’s efforts to set up a reliable social security system that might help them and make the urban society accept the restructuring process.

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<sup>36</sup> Qi Qin, *Feizhenggui jiuye yanjiu*, p. 23.

<sup>37</sup> Ma Jie, “Duanbao yousi yu qiujie,” pp. 4-5.

A critical reason that Xiagang Zhigong must have feared losing pension entitlement after dissolving labor relation was that it remained unclear how their pension credits earned within the Danwei pension system would be counted. As China's Zhigong BPI system was organized as a partially funded system, wherein the amount of benefits, unlike the former Danwei based PAYG scheme, depended on how much each worker had paid in premiums. As the *new* affiliated with only the reformed pension system, there were full records of their premium payment. Hence if they could pay their premium for more than 15 year under the new system, they need not worry about their pension after the retirement.<sup>3839</sup> By contrast, those aged working Zhigong who had started their work years before the new pension system did not have any previous record of paid premium, and their pension benefits in the new pension system remained obscure. Yet, with the scheme "old way for the *old*" of the 1997 decision, the retired Zhigong would have the same amount of pension that the former Danwei based PAYG system would have granted. Hence, the *new* and the *old* did not have serious apprehensions as to how much pension money that they would have even with the swith to the new partially funded pension system.

There remained a group whose pension entitlement in the new pension system was more complicated: those who had started their work year in the old Danwei-based PAYG pension system but retired in the new partially funded pension system. They were called the *middle*. The *middle*, unlike the *old*, paid the premium for the new system; yet their premium-paid years, unlike the *new*, covered only part of their work history. Hence, the *middle*'s pension entitlement required a tricky method of calculation, since they belonged to two different pension systems.

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<sup>38</sup> Additionally, pension of the *new* was the issue of long time after, so China still had enough time to handle its related issue.

<sup>39</sup> The individual who paid pension premium for less than 15 years could not access to the basic pension after the retirement, and the saved money in the individual account would return to the account owner. *Xinshiqi laodong he shehui baozhang zhongyao wenxian xuanbian*, p. 256.

With the initiation of the new Zhigong BPI system, the *middle* just started to pay the premium and build up their individual accounts, but they - especially those aged *middle* - had spent their most work years under the Danwei-based pension system without any records of their former contributions. In short, only a small portion of their entire contributions after the formation of new pension system was recognized. The new system could not represent their pension credits for their supposed pension entitlements under the old system.<sup>40</sup> Consequently, without an articulated scheme linking their former contribution to the new pension system, the *middle*'s pension entitlement still remained unclear. With improper treatment, the *middle* might not receive their whole pension based upon their entire work contribution in both pension systems, even if they paid their premiums after dissolving their labor relations. As long as this issue of how to handle the Danwei's IPD owed to the *middle* in the pension reform process stayed unsettled, there emerged a socio-political peril that the *middle* who could not have their full supposed pension would become "personnel who have lost the entitlement".

IPD is transition costs that a country must settle to set up a new funded pension system out of a PAYG pension system. China's pension reform, which set up the newly funded socialized pension system out of its Danwei-based PAYG system, was not an exception. China also clearly understood that it had to pay the transition costs in terms of IPD.<sup>41</sup> How to settle the former pension system's IPD was a critical part of China's efforts to set up a new socialized

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<sup>40</sup> With the initiation of China's new BPI system, the *middle* started to have their individual accounts, which, however, did not clarify the issue of how to handle their former labor contributions in the former system that had not be recorded at all. He Ping, *Guoyou qiye gaige zhong de shehui baoxian*, p. 83.

<sup>41</sup> China clearly realized that the reform from PAYG to funded system always involved pension fund deficiency, in terms of the hidden debts or the transition costs. Gao Shusheng, "Zhongguo Shehui Baozhang Zhidu Gaige: Huigu yu Qianzhan", p. 267; Cai and Lin clearly state that the "transition costs" involved the reform from PAYG system to funded pension system because the reform inevitably uncovers critical amount of shortfall in the existing pension funds that were mainly made in the pre-reform system. Cai Fang and Lin Yifu, op. cit., p. 190.

pension system, and the issue turned into the precondition to the reform of the SOE system. Nevertheless, China's pension reform did not clarify its scheme of how to handle the IPD issue. The social pooling component of the new regional Zhigong BPI system became a main system to address the issue by granting full pension for the *old*, following the scheme of the "old way for the *old*." Yet, in order to grant full pension for the *old* under the new funded socialized pension system, China came to overlook the *middle*'s pension entitlement issue. The *middle* paid the premiums for the new pension system, and a critical part of their contribution constituted the social pooling necessary for granting full pension for the retired Zhigong without assurance of their pension fully reflecting their former pension credits within the Danwei system. The *middle* were placed in a precarious position, paying 'the double payment', as they were supposed to pay the premium for their future pension and contribute to the resources for pensions of the retired. Obviously, the *middle*'s interest position was not fully recognized in the pension reform process.<sup>42</sup>

To make matters worse, the practice of "empty accounts" put the *middle* in an even more marginal position. The makeshift measures to arrange pension funding for the *old* drained resources from the *middle*'s individual accounts. The scheme for funds accumulation within an individual account in the Zhigong BPI system was designed to arrange pension for current working Zhigong – the *middle* and the *new* - but the practice spoiled the financial basis of the individual account system. After all, it rendered the *middle*'s future pension entitlement in greater peril, representing an asymmetric condition of the entitlement between the *old* and the *middle* in the pension reform process: in addition to the burden of double payment, the *middle* faced the fact that even those funds within the *middle*'s individual accounts might be used to

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<sup>42</sup> Discussion of how to handle the middle's complicated interest position, please see He Ping, "Zhongguo yanglao baoxian jijin cesuan baogao," pp. 323-5.

grant full pension for the *old*. All the outcomes resulted from the government's strong commitment to arranging pension payments to the *old* without an articulated scheme to handle IPD issue. In this respect, China's new pension system fell short of available resource to grant full pension for the *old* and to rely on those saved funds within the *middle* and the *new*'s individual accounts. This means that the IPD issue owed to the *middle* are overlooked for the moment and that the pension entitlement of the *middle* came to be even more marginalized.

Of course, the majority of Xiangang Zhigong belonged to the *middle*. They were required to dissolve their labor relations in the SOE restructuring process in the absence of a clarified scheme to handle the Danwei's IPD owed to them. This means that they could not be sure of how to get their full supposed pension, as they had only records of premium paid in the new pension system, without clear scheme of how to handle their pension credits within the former Danwei system. Here the critical question was how China might solve the Danwei IPD issue: "as many medium and small scale SOEs are under extensive restructuring process, some have already been merged and even gone bankrupt. However, as China did not run society based safety nets beyond the Danwei, large numbers of Xiangang and unemployed Zhigong could not find any system that fulfilled the social insurance pledge that SOEs had made to them."<sup>43</sup> Thus, many Xiangang Zhigong could lose their pension entitlements, unless the new Zhigong BPI system articulated a scheme to draw upon Xiangang Zhigong's former pension credits under the Danwei system.

The most critical condition was that Xiangang Zhigong's former contributions for the previous pension system were systemically integrated into the new system. Without such a condition, they would not have been sure of their full pension benefits, even if they and RSC pay

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<sup>43</sup> Huang Hetao and Zhao Jianjie, op. cit., p. 26.

their premiums in the new system.<sup>44</sup> Accordingly, many Xiangang Zhigong, especially elder Zhigong, could not be free from the worry of losing their pension entitlement, as they spent entire their work years within their Danwei. This is the reason why many Xiangang Zhigong did not want to even enter their RSCs, as they had to dissolve their labor relations with their Danwei after the program without any assurance of receiving their pension entitlement. This could cause serious social tensions, and China hesitated pushing full-scale SOE restructuring.<sup>45</sup> In this context, China decided that *merging* to terminate Xiangang program. The major defect of Xiangang program was its silence of how to address the IPD issue clearly, the utmost concern for Xiangang Zhigong to dissolve their labor relations for the sake of the SOE restructuring process. From this vantage point, I will examine how Shanghai and Liaoning in their SOE restructuring process handle the IPD issue in their SOE restructuring process to ensure their Xiangang Zhigong's pension entitlements.

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<sup>44</sup> Indeed, one critical reason how Shanghai's Xiangang system could be successful was that the city's Xiangang system clearly guarantee Xiangang Zhigong's pension entitlement. "Since Xiangang system only takes Zhigong's work post, it cannot but allow surplus Zhigongs to remain in their enterprise. Accordingly, for the task of SOE's reducing surplus workers, it can get only "half result with twice efforts (*shibeigongban*)."

In order to reform this condition, some cities [in fact Shanghai] initiated trade level "entrusting (*tuoguan*)" system by establishing RSC which is entrusted with the task of taking care of Xiangang Zhigong. After Zhigongs are entrusted to RSC, they can break the relations with their original Danwei, as RSC is given the custody of their work years, pensions, housing funds ... " *Nanfang zhoumo*, 1998, January 16th.

<sup>45</sup> According to the statistical data, the total accumulated number of SOE Xiangang Zhigong in 1999 were 20.2 million, which equaled to 27 percent of total SOE Zhigong number in 1992 (75 million). Of course, this was the really radical decline of SOE Zhigong numbers, but SOEs' market share in the same period declined radically too. Considering the declining SOEs' market share, SOEs still retained much numbers of surplus personnel. According to the some directors of large and medium SOEs in such places as Tianjin, Hunan, and Liaoning, they still had their surplus personnel with the rate between 30 and 50 percent. Yang Yiyong, *Zhongguo Zhuangui Shiqu de Jiuye Wenti*, p. 122.

### <Shanghai and Xiebao Practice>

As we observed before, Shanghai set up quite an organized Xiagang system based on reliable RSC, which could guide the process of dissolving labor relations with many redundant Zhigong. This alone does not mean that it set up a reliable system capable of settling the Xiagang Zhigong's pension entitlement after they dissolved their labor relations.

Shanghai came to handle those redundant Zhigong differently by their ages in the process of running Xiagang program. While allowing early retirement for aged Zhigong, it encouraged young Zhigong to enter labor market as soon as possible.<sup>46</sup> Older Xiagang Zhigong, who had a few years till they reached retirement were allowed to retire early and leave their Danwei, and those young Zhigong dissolved the labor relations with economic compensation to the amount of one month wage out of their one work year. It still remained unclear how to productively dissolve those Xiagang Zhigong in the middle age.<sup>47</sup> Many of the so-called forty-fifty group Zhigong were very anxious about their future after leaving their Danwei. Likewise, the city was anxious about how to make them accept the market reforms.<sup>48</sup> As a result, Shanghai tried to set up a reliable Xiagang program to handle the labor relations of those volatile forty-fifty Zhigong in restructuring sectors, but it remained unclear about how to handle their pension entitlement after dissolving their labor relations.

Xiagang program itself could not ensure Xiagang Zhigong's pension entitlements after they dissolved the labor relations, as it only paid the premiums while they were in RSCs. The

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<sup>46</sup> *Laodong neican*, 1997, Issue 4, p. 26.

<sup>47</sup> Yu Faming and Guo Yue, "Dui Shanghai shi 'xiebao' fenliu Xiagang Zhigong de sikao," p. 21.

<sup>48</sup> "Those days Shanghai citizens' thinking still remained in old scheme and did not catch up the situation. Especially, the so-called 40-50 group could not be released directly, as they did not have enough consciousness to realize employment beyond Danwei system. Thus, they needed some room to adjust themselves to the new situation." Interview, 2003, Oct. 21st.

Danwei arranged the process of Zhigong's retirement when they reached retirement age, so those unemployed who did not belong to the Danwei could not retire with the full entitlement to pension benefits. Yet the Danwei retirement system made sense only in the condition of the permanent worker system, and this was an obvious reason why those redundant Zhigong did not want to leave their Danwei. For the unemployed who were quite old with little chance for reemployment and who did not belong to any new enterprises, Shanghai issued a measure in 1997 which could arrange their retirement process when they reach retirement age.<sup>49</sup> In addition to this measure, Shanghai's aged Xiagang Zhigong wanted a reliable system that could ensure their supposed full pension entitlements after dissolving the labor relations. From this emerged a practice between 1996 and 2001 which the Danwei and their Xiagang Zhigong negotiated with each other to decide how to handle those Zhigong's pension entitlement after they left their Danwei. This gradually meant that the Danwei cover the leaving Zhigong's "two premiums" (*liangjin*) of the new pension and medical insurance system with a scheme of Xiebao (*social insurance entitlement retaining consultation*).<sup>50</sup> With the Danwei's commitment to pay "two premiums," Shanghai's Xiagang Zhigong could dissolve the labor relations because, even if have to find out new jobs by themselves outside the Danwei, the Danwei addressed their two largest concerns - pension and medical insurance entitlement.<sup>51</sup>

Shanghai articulated a scheme of Xiebao whereby SOEs negotiated with their Xiagang Zhigong about how to pay the "two premiums," enabling Xiagang to retain their pension and medical insurance entitlements after dissolving the labor relations. The concrete contents of Xiebao negotiation were different from Danwei to Danwei: sometimes a Danwei provided 100

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<sup>49</sup> SLSBK, *Xiang Laodongli Shichang Quanmian Guodu de Yanjiu*, p. 165.

<sup>50</sup> He Xiaoxing, "Yong jingjixue lilun fenxi Laodong he shehui shebao guanxi liang fenli xianxiang," p. 93.

<sup>51</sup> Interview, 2005, July 29th.

percent of the social insurance fee, but in other cases, they might 1/9, 2/8, or 3/7.<sup>52</sup> The rates were quite diverse. By the end of 1998, Shanghai's three experimental industries arranged Xiebao program which covered all eighty-thousand Xiagang Zhigong in those areas. Of these Xiagang Zhigong under Xiebao agreement, only 0.4 percent of them pay their entire premiums. Meanwhile, those who enterprise pay the entire premiums account for 64 percent and those who enterprises pay more than half of the premium account for an additional 32 percent.<sup>53</sup> Shanghai's entire data were not quite different. Indeed, two-thirds of Shanghai's Xiebao agreements provide that SOEs paid the entire social insurance premium.<sup>54</sup> Xiebao became less a matter of negotiation and more of a virtual system that said the Danwei paid most of the "two premiums."

As each Danwei's financial conditions were quite diverse, some of them had troubles arranging their leaving Zhigong's remaining premiums. Thus, to make the measure systemically reliable, Shanghai's government could not help intervening. If SOEs had had troubles paying the premiums according to their agreements, SOEs' above authorities intervened and arranged financial resources to settle the Xiagang Zhigong's social insurance entitlement.<sup>55</sup> Here the center stayed out of the city's efforts to articulate Xiebao scheme of compensation. Thus, Xiebao was Shanghai's scheme of embeddedness for restructuring the *inner system*, and it ultimately depended on Shanghai's financial system without the center's financial support. Of course, Shanghai with its wealthy economic conditions could support those SOEs that had trouble arranging Xiebao obligations to their Xiagang Zhigong, while other cities might not.

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<sup>52</sup> Interview, 2005, July 25th.

<sup>53</sup> Yu Faming, *op. cit.*, p. 61.

<sup>54</sup> Yu Faming and Guo Yue, *op. cit.*, p. 22.

<sup>55</sup> Interview, 2003, Oct. 21st.

Shanghai's Xiebao scheme targeted mainly those 40-50 years old Zhigong who were too young for early retirement and too old to get new jobs in labor market, as it allowed those permanent workers to accept dissolving the labor relations through the promise of continually paid premiums. "In the period of Xiebao both the individual and their original Danwei according to the related regulations continuously pay social insurance premiums for pension, unemployment insurance, and medical cares. ... This policy resolves those Xiagang Zhigong's worries about their future after they leave RSC by opening up a "green path" for those Xiagang Zhigong and dismissing their anxiety of the "change" of their social security relations."<sup>56</sup> By enabling Xiagang Zhigong to retain the entitlements, Shanghai's Xiebao scheme allowed its SOEs to dissolve the labor relations with their Xiagang Zhigong.<sup>57</sup> "Xiebao has become the main scheme to handle its Xiagang Zhigong. By the end of 1998, Shanghai Xiebao program covers total more than one hundred ten thousands Xiagang Zhigong."<sup>58</sup>

Here we can infer that the efforts to dissolve the labor relations with volatile so-called 40-50 group in Shanghai centered on the issue of how to handle their social insurance entitlement. The crux of the problem in dissolving the labor relations was how to constitute their social insurance entitlements even after they dissolve the labor relations. Shanghai's Xiebao proved acceptable to its Xiagang Zhigong, because it assured their two most sensitive concerns, pension and medical insurance entitlements were addressed. With a scheme that could ensure social

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<sup>56</sup> Luo Shenfu, "Xiagang Zhigong "san nian chu zhongxin" zenmo chu," p. 17.

<sup>57</sup> "As compatible scheme with the efforts to set up RSC and marketization of its employment system, Shanghai, reflecting Xiagang personnel's difficulties and its market maturity condition, sets up a series of policies to encourage Xiagang personnel leave RSC and enter labor market. Of course, the scheme of Xiebao is a critical part of the policies. ... Negotiating social insurance entitlements, Xiagang personnel can hold their social insurance entitlements with their original workplaces (in reality in social insurance organization), which is ... the most efficient scheme to separate them from SOEs and push them to labor market with." "Ben shi jiuye yu shehui baozhang gongzuo youguan qingkuang," p. 7.

<sup>58</sup> Yu Faming and Guo Yue, op. cit., p. 21.

insurance entitlements, Shanghai could dissolve inherited redundant Xiagang Zhigong's labor relations even without arrangement of compensation. Realizing that "buyouts" (*maiduan*) could not play a significant role in the process of dissolving Xiagang Zhigong's labor relations,<sup>59</sup> Shanghai articulated a scheme to link Xiagang Zhigong's entitlements into new social insurance systems, which in the end was compensation for the scheme. By paying social insurance premiums continuously, Xiebao was a form of compensation for those Xiagang Zhigong who dissolved their labor relations.<sup>60</sup>

Xiebao in Shanghai was a critical institutional breakthrough because it settled the most serious obstacle which had impeded Xiagang Zhigong from leaving their problematic Danwei. A critical hole in the existing Xiagang and RSC system was its negligence of Xiagang Zhigong's social insurance entitlements after they dissolved the labor relations. Thus, by arranging Xiagang Zhigong's social insurance entitlements after they dissolved the labor relations, Xiebao fixed the failings of existing Xiagang and RSC system. Under Xiebao, Shanghai could dissolve the labor relations with them. Shanghai could not dissolve the labor relations with the redundant SOE Zhigong for all its efforts of SOE restructuring from the early 90s and Xiagang program, until it articulated Xiebao scheme, which ensured payment on Xiagang Zhigong's social insurance entitlements.<sup>61</sup>

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<sup>59</sup> "The method of "buy-out" is obviously a clean and clear measure, but it can probably engender new burdens to the future society. Instead, Xiebao as a form of compensation, which based on an amortization scheme for an extensive duration, not only reduces the difficulties of SOEs and the government's one time payments, but also grants these Zhigong with durable and stable basic security..." SLSBK, op. cit., p. 169.

<sup>60</sup> Yu Faming, op. cit., p. 62.

<sup>61</sup> Of the total 985 thousand Shanghai's Xiagang Zhigong from the 90s, about 5 hundreds thousands leave their Danwei with the arrangement of Xiebao. Dai Lüguo, "Shanghai shehui baozhang tizhi jianshe gouxiang, p. 288.

Zhigong would dissolve their labor relations only after they could be sure to maintain their social insurance entitlement. At this point, we can clearly identify a critical principle of China's reform: China has to separate redundant Zhigong from the *inner system* for SOE restructuring without dissolving their social insurance entitlements. Through the Xiebao scheme, Shanghai addressed the key issue in dissolving Xiagang Zhigong's labor relations: "the labor relations can be cut, but the social insurance relations cannot be cut; the labor relations can be dissolved, but the social insurance entitlements should be connected."<sup>62</sup>

### <The Liaoning Experiment and the Merging Project>

Shanghai's successful scheme of Xiebao could not be widely implemented. For most of China's other cities, it was not affordable. Considering the high cost of premium payments made by SOEs, Xiebao cost so much that only a few rich cities such as Shanghai could adopt affordably.<sup>63</sup> Many SOEs could not arrange premium payment for their Xiagang Zhigong after dissolving the labor relations, since the very reason that they should try to dissolve those labor relations was their serious financial hardship. Thus, for all of Shanghai's success, it is not reasonable to expect that the Xiebao scheme could work in other areas. Next, to see how the issue might be more widely address, I will examine how Liaoning province dissolved the labor relations with its Xiagang Zhigong for the purpose of SOE restructuring, especially focusing on the process of the Liaoning experiment.

While Liaoning's SOE working Zhigong totaled 2.7 million in the year 2000, its total Xiagang Zhigong totaled 1.4 million at the same time. Additionally, its total COE working

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<sup>62</sup> Yu Faming, op. cit., p. 62.

<sup>63</sup> Yu Faming and Guo Yue, op. cit., p. 22.

Zhigong was eight hundred thousand alongside nine hundred thousand COE Xiagang Zhigong.<sup>64</sup> The province's big number of Xiagang Zhigong was a systemic obstacle to its efforts to restructure the *inner system* units. This was because SOEs could not fully dissolve labor relations with such great numbers of Xiagang Zhigong in a very limited period, even if Xiagang Zhigong were supposed to dissolve the labor relations before the program's expiration. As observed before, Xiagang system did not fully support China's SOE restructuring process; as a result, China decided to terminate it in 2001. The *merging* decision that followed, however, does not mean that it set up a system that could better dissolve the labor relations. Dissolving Zhigong's labor relations in the *inner system* was out of the reach of the *merging* decision, because dissolving those relations required an establishment of a reliable social system under which those Zhigong continue to be entitled to social security benefits.

Examining Liaoning province's social security construction process in April of 2000, Premier Zhu indicated that the province's social security system was not organized enough to support its SOE reform.<sup>65</sup> He stated that the urgent task was to improve the current social security system at each level government to make sure that each area could arrange for retirees to get their full pensions on time. Yet, it seems obvious that Liaoning with its limited financial resources and a large number of Xiagang Zhigong could not organize a reliable social security system by itself. Thus, Premier Zhu made a commitment that the center would devise a special

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<sup>64</sup> Wang Xin, "Shidian hou Liaoning shehui baozhang mianlin de wenti ji duice," p. 28.

<sup>65</sup> Premier Zhu said that "social insurance funds lack capacities for effective guarantee and some areas' pension funds are in the red; not only cannot grant full pension to some retirees; but also has the historical debts. Plus, some Xiagang Zhigong cannot get their full basic living allowance, as the "three-three scheme" to mobilize fund for SOE Xiagang Zhigong basic living allowance still remains immature. There are also some Xiagang Zhigong do not get basic living security for their enterprises stop production. Sometimes, these social groups visit upper authorities to appeal (*shangfang*) or interrupt the public orders." *Renmin ribao*, 2000, April 28 th.

experimental program for the province.<sup>66</sup> This was the initiation of the Liaoning experiment, which attempted to resolve how a reliable pension system for its huge numbers of Xiangang Zhigong may be established. In the context of this experiment, China came to face a critical loophole of the Zhigong BPI system, which was the widely conducted “empty account” practice used to grant retired Zhigong’s full pension on time. This practice made the individual accounts only nominal. China also understood that if it is not handled properly, the “empty account” practice may eventually become a time bomb for its new pension system.<sup>67</sup> Taking into account concerns that the Zhigong BPI system should address the “empty account” practice, the center allowed Liaoning to start new special experiment which aimed at setting up real filled individual accounts from July of 2001.<sup>68</sup>

By amending the existing scheme to fund the individual accounts that combined premiums paid by workers and enterprises, the Liaoning experiment decided that the individual accounts were to be composed of only the premium paid by workers, whereas the social pooling fund would be constituted by premiums paid by the enterprises. While the individual accounts constituted of workers’ premiums would cover the future pensions of those account holders, the social pooling system constituted by enterprises’ premiums would cover pensions for those already retired Zhigong.<sup>69</sup> Since the “empty account” became a broadly conducted practice and

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<sup>66</sup> He said that the state council would issue special programs to reorganize reliable social security system by the end of the year and Liaoning would be the first case to experiment the program. *Renmin ribao*, 2000, April 28.

<sup>67</sup> Wang Jiangang, “Yanglao baoxian gaiwei fenzhang guanli hou mianlin de wenti he duice,” p.79.

<sup>68</sup> The state council in December 2000 issues the “experimental measures to perfect urban social security system(the state council document 42 of 2000),” which clearly decide to organize reliable individual accounts system by settling the “empty account” issues, and the Liaoning experiment follows the experimental measures. Gao Shusheng, “Liaoning shidian qidong de qian qian hou hou,” pp. 6-7.

<sup>69</sup> The Liaoning experiment to set up separated individual accounts has changed its pension system “from single scheme of partially funded system to double schemes of PAYG and fully accumulated funded system.” Cai Fang and Lin Yifu, op. cit., p. 193.

many areas tried to grant full pension to the retirees with their limited social pooling funds, the Liaoning experiment aims to counteract that with these funding measures. The goal of Liaoning experiment to fill real individual accounts required organizing sound social pooling system which could grant full pension to the retirees. To that end, Liaoning decided to reduce the individual account contributions from 11 percent to 8 percent. That is, that the individual account contributions constituted only premium 8 percent of their wages. At the same time, the experiment tried to increase the scale of social pooling system to 20 percent. The social pooling system was constituted entirely of employers' premiums at the rate of 20 percent of the social wages, and without assigning parts to individual accounts.<sup>70</sup> In this way, the experiment increased the scale of the social pooling system without increasing the total premium scale paid by workers and enterprises.<sup>71</sup>

This adjustment, however, was not enough. The social pooling fund could not cover the gigantic outpouring of funds necessary to Liaoning's pension requirements. Considering the long history of socialist industrial construction efforts in the area, Liaoning had already had huge numbers of retired Zhigong. What was worse, its pension system came to face a second larger challenge; its dominant SOE system could not avoid the tide of radical restructuring in the late 90s, and increasing numbers of its SOEs could not pay their premiums. Indeed, the Zhigong BPI systems in many cities within Liaoning Province faced extremely serious revenue deficiencies making it difficult for them to grant pensions to the retired Zhigong. Some adjustments of the relative scale of individual accounts and social pooling were not enough for them to fill the real individual account system while granting full pension to the retirees as well. We have seen how

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<sup>70</sup> Cai Fang and Lin Yifu, *op. cit.*, p. 193.

<sup>71</sup> It is a rational policy, because it makes equal different SOEs' social burdens. Indeed, Liaoning's enterprises formerly pay their pension premium according to the number of their retirees, but now they need to pay according to the number of employees. Interview, 2005, July 13th.

the “empty account” practice emerges under the conditions in which social pooling funds could not grant full pensions to retirees. Accordingly, the Liaoning experiment was an effort to figure out how to finance the social pooling funds to grant full pension to the retired Zhigong without depending upon the funds in individual accounts. Yet, in the reeling economy after the reform, they could not afford to raise the required resources.

In light of this problem, the center decided to support Liaoning financially to make its individual accounts real ones. They did so by contributing special funds along with Liaoning government with the ratio of center funds to province funds at 3:1.<sup>72</sup> Between the June of 2001 and the end of 2004, the center arranged total 5 billion *yuan* special financial supports for Liaoning’s social pooling system. In the same period, Liaoning government raised total 1.7 billion *yuan* in financial supports. By combining the special financial support with the total levied premiums 7.1 billion *yuan* was raised, and the province pension system was able to grant full pension to the retired Zhigong.<sup>73</sup> With the center’s financial support, Liaoning was relieved of large share the burden in granting pensions to the retired Zhigong, which allows it to re-organize the filled individual account system as well.<sup>74</sup> With the center’s massive financial support, the province could grant full pension to the retirees without depending on accumulation individual accounts, so it could organize “genuine” individual accounts at the same time.

The primary goal of Liaoning experiment was to organize a reliable new pension system based on filled individual accounts, while also granting full pension to retirees. In other words, the experiment involves the efforts to organize sustainable partially funded pension system

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<sup>72</sup> Gao Shusheng, op. cit., p. 9.

<sup>73</sup> Geng Shuyan, “Liaoning: zuoshi geren zhanghu chengxiao mingxian,” p. 34.

<sup>74</sup> Indeed, within the one and half year after Liaoning initiates the experiment, total funds in Liaoning pension system’s individual accounts expand to 4.7 billion *yuan*. Gao Shusheng, op. cit., p. 9. By the end of 2004, the total funds in the individual accounts again expand to 13.8 billion *yuan*. Geng Shuyan, op. cit., p 34.

which could grant pension to the retirees without spoiling the individual accounts, and thereby stabilized the financial status of the current working Zhigong's future pensions. Not surprisingly, the efforts to make genuine individual accounts while also granting full pension to the retirees, required a great deal of financial resources because it needed to set up funded pension system out of former PAYG system which had not left fund accumulation.<sup>75</sup> The soundness of the individual account could ensure current workers' future pensions, and so it could instill trust among Xiagang Zhigong that the new pension system would grant their pension in the future. Having this sure allowed them to dissolve the labor relations. Yet, unlike Shanghai's Xiebao which covers the premium after dissolving the labor relations, this was not a sufficient system that could fully ensure the total amount of pension that Xiagang Zhigong might expect.

The Liaoning experiment was not a simple measure to set up filled real individual accounts, but also constituted an effort to introduce a post Xiagang labor dissolving scheme within the context of the *merging* decision. It aimed not only to set up filled real individual account, but also to push the *merging* project with efforts to more readily dissolve SOE Zhigong's labor relations.<sup>76</sup> The Liaoning experiment held this as its major goal. In three years of experiments it would dissolve labor relations with a total of 1.3 million Zhigong.<sup>77</sup> To that end, *merging* was followed by a push to dissolve labor relations directly without the Xiagang program's support. However, efforts to organized filled individual accounts in the Zhigong BPI system were not a sufficient condition for the redundant workers to dissolve their labor relations.

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<sup>75</sup> Anonymous, "Shidian zhong de Liaoning shehui baozhang," p. 12.

<sup>76</sup> "Even if the Liaoning Experiment has various contents, but it is primarily consisted of two goals: one is making filled real individual accounts, and two is merging Xiagang and unemployment." Gao Shusheng, "Jin yi bu zuo hao shehui baozhang gongzuo de maodun fenxi he duice jianyi," p. 25.

<sup>77</sup> Anonymous, "Shidian zhong de Liaoning shehui baozhang," p. 13.

As proof, Liaoning had many Xiagang Zhigong who needed to dissolve the labor relations following the *merging* decision, but the Liaoning experiment still lacked some conditions that its Xiagang Zhigong could accept, unlike Shanghai's Xiebao system. The question became, how would Liaoning without a scheme that could dissolve Xiagang Zhigong's labor relations carry out the *merging* project?

As we observed, there were various debt and credits relations between the Danwei and their permanent workers. SOEs could dissolve labor relations only after they could settle all the debts owed to their Xiagang Zhigong. Zhigong would not resolve their labor relations with their SOEs, if they had credits to be paid off by their work units. Accordingly, the *merging* project required payment by SOE's of any form of debts that it was owed to their Zhigong. Of the 1.24 million Xiagang Zhigong who dissolved their labor relations with the *merging* project in Liaoning province, 661,000 personnel had credits due by their work units, which reached total 4.25 billion *yuan*. The average credit per Zhigong was 6837 *yuan*. Broken down this total credit was consisted of 44.7% wage arrears, 13.5% "collected common funds" (*jizikuan*), 10.3% medical fees, 7.3% heating fees. To address this outstanding issue Liaoning government issued a policy document demanding that SOEs should refund at least 50 percent of their debts to Zhigong before the end of 2002.<sup>78</sup>

In addition to paying off the debts, it also required to arrange proper compensation for those Zhigong who dissolved their permanent labor relations. Xiagang Zhigong would dissolve labor relations only after they were given what they felt to be "proper" economic compensation. Liaoning realized in the course of its experiment that there were two major challenges in dissolving Xiagang Zhigong's labor relations: the first was how to settle SOE's debts to

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<sup>78</sup> Liu Xiaonan and Cheng Tao, "Chengzhen shehui baozhang shidian gongzuo chengxiao xianzhu yunxing jizhi riqu wanshan," p. 148.

Zhigong, and the second was how to arrange economic compensation that the Zhigong would accept.<sup>79</sup> Of course, SOEs were the subjects to pay off the debts and arrange economic compensations to dissolve the labor relations with their Xiagang Zhigong. Wage arrears and uncovered medical fees were SOEs' debts owed to their Zhigong, which should be paid off by SOE themselves.<sup>80</sup> Along the same line, it fell to SOEs to arrange economic compensation that those Xiagang Zhigong could accept as they dissolve their labor relations.

Many SOEs with their limited financial resources had trouble paying off their debts, let alone arranging the compensation. Only small numbers of SOEs could pay off the debts owed to their Zhigong with one time deals, and most SOEs must negotiate with their Zhigong about how to settle the debts.<sup>81</sup> Many SOEs could not arrange "proper" economic compensation and could not dissolve the labor relations with their numerous Xiagang Zhigong. Consequently, "compensation has become the primary issue in handling Xiagang Zhigong's labor relations."<sup>82</sup> In Liaoning, 70 percent of enterprises that needed Xiagang Zhigong to dissolve the labor relations could not arrange economic compensation.<sup>83</sup>

In principle, "economic compensation was not the government's liability but the enterprise's. Labor law stipulates that enterprises should pay economic compensation when they dissolve labor relations with workers, and that the government will only provide required and proper support to those very problematic enterprises." However, the local government's role could not remain a minor one, as Liaoning was tasked with the hasty dissolution of labor

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<sup>79</sup> "Shidian zhong de Liaoning shehui baozhang," p. 13.

<sup>80</sup> Liaoning experiment clarifies that SOEs should handle their debts owed to their Xiagang Zhigong when it tries to dissolve the labor relations with them. Wang Xin, op. cit., p. 29.

<sup>81</sup> Wang Xin, op. cit., p. 29.

<sup>82</sup> Yu Faming, op. cit., 2000, p. 35.

<sup>83</sup> Sun Qunyi, op. cit., p. 37.

relations with the Xiagang Zhigong.<sup>84</sup> Thus, Liaoning's local governments came to play a large part in supporting financially their problematic SOEs that could not arrange economic compensation for their Xiagang Zhigong.<sup>85</sup> Yet, as Liaoning's economic performance after the reform remained quite feeble, the government's financial condition was not sound either. While its old *inner system* enterprises were in the middle of serious restructuring process, its *outer system* enterprises, unlike those in booming coastal area cities, still remained quite weak. Thus, even if Liaoning's local governments wants to support their SOEs with trouble arranging economic compensation, they could not support them sufficiently and lots of Liaoning SOEs were not able to arrange the "proper" compensation that Xiagang Zhigong would accept.

In this context, there emerged a social voice demanding that the state should mobilize far greater resources for Liaoning's financially problematic SOEs, so that they might arrange the requisite compensation to dissolve labor relations with their Xiagang Zhigong.<sup>86</sup> Yet, the primary goal of the Liaoning experiment is not to arrange these deals, but to organize a really reliable new pension system based on filled genuine individual accounts, while granting full pensions to retirees. As we saw, this requires huge financial resources gathered through the center's special financial supports. Indeed, the efforts to set up filled individual accounts were achieved. However, this was not without a hefty price tag. Considering the center's huge subsidies of the pension program, it was uncertain that the center could mobilize the extra resources to support the compensation required to dissolve Liaoning Xiagang Zhigong's labor relations. However, given the urgency of the task to dissolve Xiagang Zhigong's labor relations, the center could not easily sidestepped the predicaments facing Liaoning's *merging* efforts.

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<sup>84</sup> "Shidian zhong de Liaoning shehui baozhang," p. 14.

<sup>85</sup> Gao Shusheng, "Liaoning shidian qidong de qian qian hou hou," p. 8.

<sup>86</sup> Yue Songdong, "Wanshan shehui baozhang mibu lishi qianzhang: Liaoning wanshan chengzhen shehui baozhang tizhi zhounian diaoyan baogao," p. 16.

*Merging* was critical part of the Liaoning experiment. The experiment was not just an effort to fund individual accounts or pay retirees, and a goal of merging was to induce Xiagang Zhigong to dissolve their labor relations. Thus the experiment was not complete if it did not address how Xiagang Zhigong might receive proper compensation that they could accept in exchange for dissolving their labor relations. Since it had been established that Liaoning was not fully up to the task, the center again came to support the experiment to aid SOEs in arranging proper compensation for their Xiagang Zhigong. Liaoning stipulated its measure to merge Xiagang to unemployment insurance system: “when SOEs with management problems try to dissolve their labor relations with their Zhigong, either in RSC or not, they should pay economic compensations, whose funds are constructed by the central government, local government, and enterprises themselves with the ratio of 5:3:2.”<sup>87</sup> The center also articulated a support scheme for newly laid off workers who were not covered by the Xiagang system any more: to dissolve the workers labor relations clearly from the bankrupt enterprises or enterprises in the red for two consecutive years, the center arranges one third of economic compensation.<sup>88</sup>

With the central government’s significant financial support, Liaoning could address the issue of economic compensations and successfully dissolved Xiagang Zhigong’s labor relations. By August of 2002 its *merging* process saw a total 773,000 SOE Zhigong dissolved their labor relations. Of this 773,000, there were only 89,000 Zhigong who received their economic compensations from their work units (12 %). The remaining 654,000 Zhigong got their compensation through government financial support (88%). The total cost of Liaoning’s economic compensation for *merging* reached 6 billion *yuan*, which meant average compensation for a Zhigong is 7839 *yuan*. Of this total compensation, the central government supplied 2.44

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<sup>87</sup> Ibid.

<sup>88</sup> Gao Shusheng, op. cit., p. 9.

billion (40%), local government collected 1.64 billion *yuan* (27%); and SOEs paid 1.98 billion *yuan* (33 %).<sup>89</sup> The process moved swiftly with this intervention. The total number of Liaoning Xiagang Zhigong who dissolved labor relations by the end of 2002 reached 1.2 million with total economic compensation hitting 10 billion *yuan*. By the yearend figures, a Zhigong's average compensation was 8250 *yuan* and Liaoning realized 95 percent of its goal of the *merging* process.<sup>90</sup>

Through the granting of economic compensation, Liaoning could successfully carry out the *merging* process to terminate its Xiagang system. From 2001 Liaoning Province did not allow its enterprises to set up new RSC and did not allow new laid-off workers to enter RSC. By the end of 2002, the number of its RSC reduced to 371 from the number of 4801 in 2000. In the same period the number of Xiagang Zhigong in RSC also reduced to 39,000 from the previous total of 44,000.<sup>91</sup> Liaoning eventually closed its remaining RSCs and achieved the *merging* project which transfers a total 1.7 million SOE Xiagang Zhigong into the unemployed insurance system.<sup>92</sup> Of those 1.7 million SOE Xiagang Zhigong, only 290,000 were provided the compensation by their Danwei exclusively. By contrast, the remaining 1.4 million were supported by compensation arranged with the center and Liaoning government's financial support. The average compensation for those 1.7 million SOE Xiagang Zhigong was 8704 *yuan*. Through the successful *merging* process, Liaoning could smoothly restructure a total of 1475

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<sup>89</sup> Liu Xiaonan and Sheng Tao, "Shehui baozhang shidian gongzuo quanmian tuijin chengguo xianzhu," p. 140.

<sup>90</sup> Shi Hanbing, "Shuxie yifen manyi de dajuan," p. 10.

<sup>91</sup> Gao Shusheng, op. cit., p. 9.

<sup>92</sup> Wang Xin, op. cit., p. 28.

SOEs.<sup>93</sup> In dissolving millions of Zhigong's labor relations, the Liaoning experiment achieved the goal of the *merging* to terminate Xiagang system.<sup>94</sup>

The arranged compensation did not handle Xiagang Zhigong's pension entitlement issue directly. Hence, many Xiagang Zhigong who needed more years to retire were not sure about the amount of their future pension when they left their RSCs. As we discussed earlier, the new socialized pension system did not articulate a scheme to handle the *middle*'s pension entitlement after their retirement. Yet, out of the Liaoning experiment, there emerged a practice where many Xiagang Zhigong pay their required premiums to the Zhigong BPI system with the compensation they received, which resolved their worries of the loss of pension entitlement after dissolving the labor relations. Here the compensation the Liaoning experiment devised evolved into a scheme that allows them to maintain their pension entitlements even after they dissolve the labor relations with their Danwei. Confidence in their pension entitlements through compensation led Xiagang Zhigong to dissolve their labor relations smoothly, even if they could not expect to be reemployed in other SOEs again.<sup>95</sup> Here we circled back to the fact that ensuring Xiagang Zhigong's pension entitlements emerges was a critical precondition for those Xiagang Zhigong to accept dissolving their labor relations. In addition to organizing filled individual accounts, the Liaoning experiment facilitated its *merging* process to dissolve the labor relations with its many redundant Zhigong by arranging compensation, which they used to maintain their pension entitlements. Hence, it turns out that the condition necessary to dissolve labor relations with Xiagang Zhigong was not compensation itself, but a scheme that could guarantee their pension entitlements. In the context of the Liaoning experiment, it became clear that "proper"

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<sup>93</sup> Duan Junming and Shen Guangbo, "Liaoning wanshan chengzhen baozhang tixi shidian de shijian yu tansuo," pp. 27-9.

<sup>94</sup> CASS CSPS, "Liaoning sheng chengshi jumin zui di shenghuo baozhang zhengce pingxi," pp. 9-10.

<sup>95</sup> Interview; 2005, July 5th.

compensation which Xiagang Zhigong could accept was compensation sufficient to ensure their pension entitlements after they dissolve their labor relations.

Both Shanghai's Xiebao and the Liaoning experiment share a condition whereby their Xiagang Zhigong dissolved their labor relations: that is, a scheme that can ensure those Xiagang Zhigong's pension entitlements. It seems that the main reason redundant Zhigong not to want to leave their Danwei is the peril of losing their pension entitlements. Thus, we may infer that a measure made to dissolve their labor relations in the *merging* process have to ensure their pension entitlements.<sup>96</sup> In other words, in order to dissolve labor relations with Xiagang Zhigong and carry out the *merging* process, China's other areas would also need to set up a scheme that could ensure Xiagang Zhigong's pension entitlements after they left their Danwei.

As discussed previously, Shanghai's Xiebao measure was feasible only for wealthy cities. Like Liaoning many other cities tried to arrange economic compensation that their Xiagang Zhigong would accept. The compensation individual Xiagang Zhigong might receive was quite diverse, as the Danwei's served different functions and had different financial circumstances. Many Danwei that tried to dissolve labor relations with their Xiagang Zhigong did not have enough resources to grant the compensation that their employees expected. The amount of compensation awarded usually depended on the negotiation between the Danwei and their

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<sup>96</sup> In this context, for merging Xiagang program into unemployment insurance system, Wang Jiayang suggested a policy scheme, "protecting the *aged*, supporting the *middle*, and pushing the *young*." "Protecting the *aged*" referred to the measure of internal retirement for those Zhigong who would reach official retirement age within 5 years. "Supporting the *middle*" referred to the labor security arrangement for Zhigong in middle age (men between 40 and 49 and women between 35 and 44) by new labor management organization such as payment of their pension premium until they reach retirement age; and then these Zhigong entered labor market individually for their employment. The so called "pushing the *young*" was the policy for young Zhigong (men under 39 and women under 34) whose labor relations were directly resolved and terminated and enter labor market for reemployment. Wang Jiayang,, "'Binggui" de shijian yu sikao," p. 9.

Xiagang Zhigong.<sup>97</sup> As many SOEs under financial pressure could not arrange sufficient compensation for their Xiagang Zhigong, their local governments tried to support them. However, in most areas financial conditions too strained to expect that local governments could play active role in arranging compensation for their Xiagang Zhigong. Consequently, many areas faced difficulty when restructuring their SOEs and dissolving labor relations with the Xiagang Zhigong since it was not practical to expect that local governments can support their Danwei in arranging the compensation for their Xiagang Zhigong. There were also many areas that needed to carry out the urgent *merging* push for SOE restructuring, which means they had large numbers of Xiagang Zhigong who would become unemployed.<sup>98</sup> In order to complete the *merging* process, they needed to mobilize enough financial resources to compensate their Xiagang Zhigong. Since many of them could not attain the required resources, they expected the center to provide financial supports as it did in Liaoning.

The center could not mobilize financial resources of that scale for all of China within the very limited period of the *merging* process. It was not practical to expect that the center could extend its supports for the Liaoning experiment to the rest of China. As the center paid a lot for the experiment, it realized that the experiment could not be applied to other areas.<sup>99</sup> After the

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<sup>97</sup> The amounts of compensations were quite different by each enterprise. Indeed, how to arrange entitlement continuity depended on the outcome of each negotiation between enterprise and Zhigong. In the negotiation process, there followed the recognition about the how long each Zhigong had worked in the workplaces. This was a basic principle. But how much compensation each Zhigong would get totally depended on the each enterprise's conditions.

<sup>98</sup> Xiagang situation in some provinces was more serious than other areas and there were eight provinces whose Xiagang Zhigong exceeded one million (Liaoning, Jilin, Heilongjiang, Jiangsu, Shandong, Henan, Hubei, and Hunan). The total number of these eight provinces' Xiagang Zhigong was 11.5 million, which reaches to 53.4 percent of national total number of Xiagang Zhigong. Unsurprisingly, four provinces' ratios of Xiagang Zhigong to the total number of Zhigong are more than 30 percent: Liaoning (37.3%), Jilin (31.85), Heilongjiang (31.3%), and Tianjin (30.7%). Hu Angang, "Zhongguo Chengzhen Shiye yu Shehui Baozhang," p. 50.

<sup>99</sup> Interview, 2003, March 21st.

Liaoning experiment, the center undertook similar experiments in only two neighbor provinces, Jilin and Heilongjiang. The outcomes were much less stark in these cases. In spite of that many local governments did not try to reduce their redundant Zhigong even when their SOEs had serious financial problems in the hope that they could receive extra financial supports from the center. This hope turned out to be a delusion.<sup>100</sup> Indeed, the center avoided providing compensation for SOE restructuring as long as it could. Accordingly, the Liaoning experiment did not look like it could become a model national program. A result of this was that many other China's areas came to feel that Liaoning had been served with a "special meal (*bianfan*)," in the form of large financial support from the center.<sup>101</sup>

Quite naturally, the center only engaged its support selectively in those areas which held critical political significance in the *merging* process. Liaoning, by virtue of its large number of Xiagang Zhigong, was one of the most politically sensitive cases. Providing support for the Liaoning experiment illustrated the upshot of structuring the *merging* process as a scheme to dissolve the labor relations with Xiagang Zhigong.<sup>102</sup> To understand why Liaoning was such politically sensitive case, we need only consider the number of its Xiagang and retired Zhigong, those groups accounted for almost one tenth of entire China's total Xiagang and retired Zhigong.<sup>103</sup> Thus, without the center's support, Liaoning province could not carry out the *merging* process, which would raise skepticism in urban society about the leadership's commitment to carry out the *merging* process. The center support for the Liaoning experiment did not mean that its unlimited support. Indeed, the experiment was only three year program,

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<sup>100</sup> Wang Yan, et al., "Zhongguo yanglaojin yinxing zhaiwu zhuangui chengben gaige fangshi ji qi yingxiang," p. 305.

<sup>101</sup> Gao Shusheng, op. cit., p. 9.

<sup>102</sup> The center already supports Liaoning even before it initiates the experiment and arranges in 2000 total 5.5 billion *yuan* as a specialized fund support for social security. Gao Shusheng, op. cit., p. 9.

<sup>103</sup> Wang Xin, op. cit., p. 28.

and even with the support of the center there were many Liaoning SOEs that still could not settle the debts owed to their Xiangang Zhigong through the *merging* process.<sup>104</sup>

The success of the Liaoning experiment did not mean that it could be applied nationally to support the very urgent *merging* process. As a result, many areas' *merging* process in danger of failing, since those areas had neither a reliable financial bases like Shanghai, nor the center's support as it was provided in Liaoning. Shanghai and Liaoning were outliers in China's *merging* process. The majority of remaining areas could not adopt those measures which made the *merging* process progress rather smoothly in both areas. Without devising a separate scheme to ensure Xiangang Zhigong's pension entitlement, China cannot but fall short of carrying out the *merging* process. Indeed, in 2001 there emerged a number of Xiangang Zhigong who facing the expiration of the three year Xiangang program came to leave their RSCs without dissolving their labor relations, as their social security entitlements remain unsettled.<sup>105</sup>

### <Shitong Practice and IPD Issue>

While both Shanghai's Xiebao and Liaoning's compensations schemes could settle Xiangang Zhigong's worries about losing their pension entitlements by covering their pension premium payments after they leave their Danwei, but the measures were not the sufficient to ensure that their pension entitlements were fully secure. This is because pension entitlements depended not only on premium payments made after dissolving labor relations, but also on

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<sup>104</sup> By the July of 2002 after the Liaoning initiate the experiment until the July of 2002, it is discovered that Liaoning SOEs that underwent the *merging* process owe total 3.59 billion *yuan* to their 541 thousand Zhigong. In the *merging* process, only 85 thousand of them can get one-time full compensation of two hundred and ten million *yuan*, and for the remaining 456 thousand Zhigong's 3.38 billion *yuan* both the SOEs and their Zhigong in the *merging* process negotiate and sign up payment agreements. Liu Xiaonan and Sheng Tao, op. cit., p. 144.

<sup>105</sup> He Xiaoxing, op. cit., p. 94.

pension credits earned within the Danwei. A further reason that many Xiagang Zhigong worried about their future pension after dissolving the labor relations was there was no scheme which incorporated their pension credits accrued under the former Danwei pension system. This was the Danwei's IPD owed to their Xiagang Zhigong, and Xiagang Zhigong's pension entitlements drew only on their contributions to individual accounts after the new pension system without a clear settlement regarding those former credits. As they had not had individual accounts before new pension system, their individual accounts did not fully represent the amount of their pension benefits based on their total contribution. It was necessary to devise a measure to grant proper credit to those individual accounts reflecting the amount of the former Danwei pension system's IPD owed to those Zhigong.<sup>106</sup>

The outcome for Xiagang Zhigong's pension benefits remained vague until China clearly settled the question of the Danwei's IPD owed to the *middle*.<sup>107</sup> The matter of how to settle IPD issue was the minimum condition to ensure Xiagang Zhigong's pension entitlement before they dissolve the labor relations. If this condition could be met it might allow them to dissolve their labor relations with their Danwei even without compensation that might cover their pension premiums after dissolving the labor relations. Yet, as we observed in the former chapter, China's pension reform of the partially funded socialized Zhigong BPI system did not devise a scheme that could handle the Danwei's IPD owed to the *middle*. Only with the *merging* decision to dissolve Xiagang Zhigong's labor relations in the SOE restructuring process, did China come to realize that it must devise a scheme that could settle the Danwei's inherited IPD. Even without the center's financial support in many areas the *merging* process could evolve alongside the new

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<sup>106</sup> Zhang Mirong, "Geren zhanghu shi zhang hua guanli qianjian," p. 20.

<sup>107</sup> Only after the state devise its measure to handle the hidden debts clearly, Xiagang Zhigong can maintain their entitlements, even after they dissolve their labor relations with their Danwei. Ceng Xiangquan and Li Lilin, op. cit., p. 27.

pension system if it incorporated a scheme to settle the Danwei's inherited IPD owed to the *middle*.<sup>108</sup>

In this context, there emerged the so-called Shitong practice. Shitong literally means “counting equal,” it refers to the practice whereby the new pension system started to count Xiagang Zhigong's work years before the advent of the new pension system towards their premium paid years. In this way the *middle* could have their virtual accounts which preserved credits for their contribution under the former Danwei pension system. Under Shitong, Xiagang Zhigong did not need to worry about losing their former pension credits based on former work years. Thus, when dissolving their labor relations, they also did not need to worry about losing former credits contributed under the previous pension system. Shitong not only allowed Xiagang Zhigong preserve their pension entitlement even after they dissolved their labor relations, but it also counted their entire history of yearly premiums paid. Since premiums paid under the past system could satisfy the required premium contributions under the new pension system, aged Xiagang Zhigong did not need to worry about losing their pension entitlement after dissolving their labor relations. The practice of Shitong acknowledged their status as workers who had contributed significant premiums. Meanwhile those Xiagang Zhigong who were short several work years could hold their entitlements even after leaving their Danwei, if only they paid the remaining premiums before their retirement. These conditions were critical to Xiagang Zhigong who would dissolve their labor relations.

China came to view the Shitong practice as a broader scheme to ensure Xiagang Zhigong's pension entitlement, and it let each area's Zhigong BPI system credited former work

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<sup>108</sup> Indeed, China already realized that it had to set up a special ‘transitional pension’ for the *middle* in terms of the compensation for their former years' contributions that do not have concrete records. He Ping, *Guoyou qiye gaiye zhong de shehui baoxian*, p. 70.

years within the Danwei system as premium paid years. By assuring Xiagang Zhigong's pension entitlements and credits, the practice of Shitong made way for the new pension system to truly succeed the former Danwei based pension system. In sum, Shitong was a scheme which systemically linked Zhigong's former credits that they had earned under the Danwei-based PAYG system to the new Zhigong BPI system. With full recognition of their former pension credits, Xiagang Zhigong did not need to worry about losing their pension entitlement after they dissolve their labor relations. Under this system their pension entitlement came to depend on both their former credits within the Danwei-based PAYG system and their premium payment for the new system. With this assurance linking Xiagang Zhigong's former pension credits to the new pension system China could ensure Xiagang Zhigong's pension entitlements after dissolving their labor relations.

Shitong was a scheme to incorporate the Danwei inherited IPD owed to the *middle* into the Zhigong BPI system. As a virtual system to handle the IPD issue, Shitong provided Xiagang Zhigong with a pension entitlement assurance system, which in turn made them accept dissolving the labor relations. Indeed, Xiagang Zhigong did accept Shitong scheme as a condition to dissolve the labor relations, because it addressed their IPD issue and ensured their former pension credits after dissolution of their labor relations. Out of the emerging Shitong practice we can identify a primary condition of the *merging* process, the settlement of the Xiagang Zhigong's IPD issue. It became that a minimum condition for dissolving Xiagang Zhigong's labor relations was assuring their pension entitlements through the settlement of the inherited IPD issue.

The center was aware of early on that the *merging* project needed to handle Xiagang Zhigong's IPD issue in a way that would assure their pension entitlements. In setting up the new

socialized pension system, the center had already contemplated a Shitong measure as a way to settle the IPD issue in 1995.<sup>109</sup> Yet, it hesitated to take the measure over concerns for its potential cost. At that time the center was not sure of how to mobilize the required financial resources to settle the entire IPD issue. In the urgent context of the *merging* project, the center did not forbid those areas that initiated Shitong practice to undertake *merging*. The center remained silent about the practice, perhaps because it did not put the huge financial burden of settling the IPD on the center in the same way that the Liaoning experiment did. Shitong was widely conducted in many areas undergoing the *merging* process. By its silence, the leadership virtually came to authorize it.

In 2005 the state council issued the “decision on refining the enterprise Zhigong BPI system,” which set up a “transitional pension” for the *middle* based on their Shitong periods. This formed a concrete scheme to turn pension credits within the former pension system into actual pension benefits.<sup>110</sup> The decision made Shitong a national system, which came to officially ensure Xiagang Zhigong’s pension entitlement, as it recognized concrete pension benefits under the new pension system out of credits within the former Danwei pension system. The “transitional pension” was virtual compensation for the *middle*’s pension credits saved within the former PAYG system under which they did not have individual accounts.<sup>111</sup> The broad adoption of Shitong settle the Danwei’s IPD owed to the *middle*, by arranging the “transitional” pension, which ensured Xiagang Zhigong might receive their full pension, even if

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<sup>109</sup> “The state council’s notice regarding deepening enterprise Zhigong pension system reform” (the state council’s no. 6 document of 1995) suggested two potential schemes of how the new pension system recognized Zhigong’s former labor contributions. While first option was that new system entitles Zhigong to pension if they have previous 10 working years, second option was that new system decides Zhigong’s pension entitlement by accounting their previous working years as their premium paid years (i.e. Shitong).

<sup>110</sup> Jia Kang, et al., “Guanyu Zhongguo yanglaojin yinxing zhaiwu de yanjiu,” p. 18.

<sup>111</sup> Ibid., p. 17.

they dissolved their labor relations with only a limited period of paid premium records under the Zhigong BPI system.

As we observed before, China's pension reform mainly focused on how to set up socialized new pension system beyond the Danwei which could grant full pension to the retired Zhigong. It left unclear how to handle the *middle*'s former pension credits, i.e., the Danwei's IPD owed to the *middle* before the new system of individual accounts. Furthermore, the "empty account" practice even made their individual accounts unreliable. While the "empty account" practice solved an urgent need to grant full pensions to the *old*, it did so at the expense of the already marginalized *middle*'s individual accounts. Though the *middle*'s pension entitlements could as yet remain unsettled, their retirement loomed and they might hamper efforts to restructure SOEs issue. Even if it did not strictly eliminate the "empty account" practice, it did ensure their deserved pension entitlements would be derived from their former work years with the commitment to grant the "transitional" pension after the retirement. While the problem of funding the *middle*'s pensions might seem to loom on the horizon, the *merging* process brought securing the *middle*'s pension entitlement to the forefront, and made it as urgent an issue as the pensions of the *old*.

To dissolve labor relations with Xiagang Zhigong it was necessary to arrange compensation which could virtually handle the inherited IPD issue. Without confidence of their future pension entitlement, Xiagang Zhigong would not dissolve the labor relations. Even if most of China could not follow the path of Shanghai's Xiebao or the Liaoning experiment which arranged, directly or indirectly, payment of pension premiums after workers dissolve labor relations with their Danwei, Shitong provided a less immediately costly alternative to ensure that the *middle* might draw the pension that they would have expected from their Danwei based

former pension system. The Shitong scheme to handle the Danwei IPD owed to the *middle* was the very condition required to ensure Xiangang Zhigong might draw the pension entitlement that they thought deserve. Hence, by clear settlement of the Danwei IPD issue, Xiangang Zhigong sure of their pension entitlements would dissolve the labor relation.

The appeal of the Shitong scheme sheds light on why “buyouts” (*maiduan*) were not acceptable for Xiangang Zhigong. The “buyout” was a form of compensation for sure, but it was one time severance payment which varied at each Danwei, and acceptance entailed giving up their any future claims of entitlements.<sup>112</sup> As the term “buyout” was the contraction of “buyout of work years” (*maiduan gongling*), accepting it was to give up later pension claims derived from contributions in work years. Yet, Zhigong’s work year had virtual meaning of their pension credits that they earned out of their former contribution for the Danwei pension system, a critical component of their pension entitlements after the retirement. Hence, dissolving labor relations based on the “buyout of work years” scheme rendered those ex Zhigong to be “personnel who have lost entitlements” (*duanbaoren*).<sup>113</sup> Indeed, throughout the restructuring process many collective actions occurred regarding the “buyout” scheme to dissolve the labor relations with arrangement of lump-sum compensation (Frazier 2010: 85).

Ultimately, urban society rejected the “buyout”, because the compensation it provided did not link work years to pension entitlements. China’s pension reform process did not clearly decide if former work years could constitute grounds to claim pension entitlement when a person had started their work years long before the new pension system with its individual accounts.<sup>114</sup>

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<sup>112</sup> Under the buy-out system, the enterprise makes a lump-sum payment when an employee is laid off, and the employee forfeits any future claim to enterprise resources (Hurst and O’Brien, 349-50).

<sup>113</sup> Obviously, “buyout” for Xiangang Zhigong means not only “unemployment” but also “losing security.” Yu Li and Meng Tao, op. cit., p. 59.

<sup>114</sup> He Ping, “Zhongguo shehui baozhang tixi yanjiu baogao,” *Shehui baoxian yanjiu* (No. 4, 2001), p. 6.

Xiagang Zhigong's work years involved the IPD that their Danwei owed to them, and this should constitute a critical portion of their pensions after the retirement. If SOE restructuring process did not handle the pension credit issue properly while dissolving Xiagang Zhigong's labor relations, then those Xiagang Zhigong lost a critical portion of the pension entitlement that they deserve.

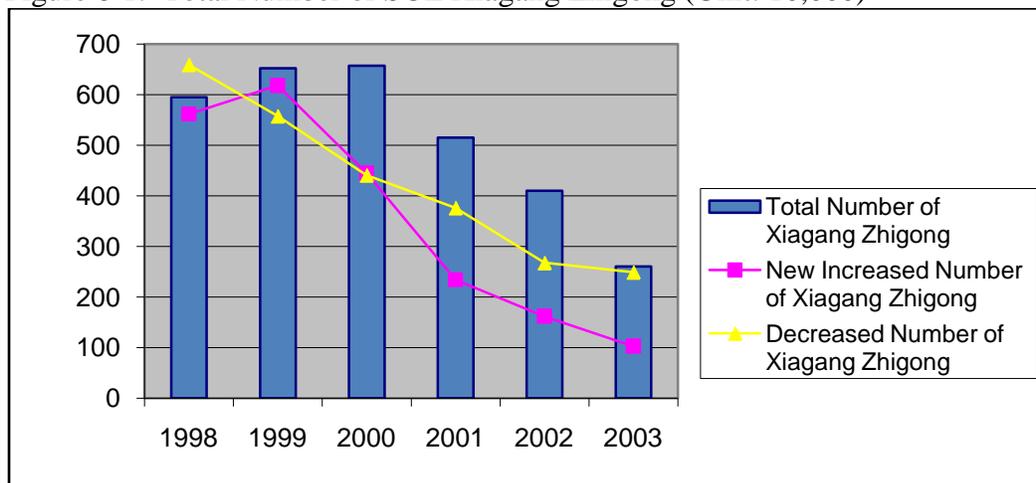
Urban society finally settled on the Shitong practice which allowed the new pension system to incorporate Xiagang Zhigong by recognizing their former premium paid in a scheme to ensure their pension entitlement. It was a sort of virtual scheme that counted their former work years under the old system as their premium paid years before the new pension system. Under this system they did not need to worry about their pensions even if they did not belong to their Danwei when they retire. Shitong could assure Xiagang Zhigong's pension entitlements because it was a program by which the new pension system granted full recognition of pension credits that they had earned for work years within the Danwei. This virtually handled the Danwei's IPD owed to Xiagang Zhigong before dissolving their labor relations. With the recognition of their former work years as their premium paid years under the new pension system, Xiagang Zhigong got real compensation for real pension credits attributed virtually to the new system.

Since the crux of the issue in dissolving Xiagang Zhigong's labor relations is the matter of how to settle the Danwei's IPD. Shitong turns out to be a crucial development in granting compensation deemed proper by Xiagang Zhigong. Through Shitong, the new pension system succeeds in settling the Danwei's inherited IPD by addressing credit for former work years unlike the "buyout" method. More so than "buyout" and the Liaoning experiment, Shitong is a way to arrange "proper" compensation for Xiagang Zhigong, and it allows China to dissolve Xiagang Zhigong's labor relations to carry out the *merging* process broadly. The results of the

Shitong scheme tell us that “proper” compensation in the context of the *merging* process to dissolve Xiagang Zhigong’s labor relations is compensation that addresses the issue of the Danwei’s IPD. Shitong does so by grating pension credits earned in former work years within the Danwei through a “transitional” pension under the new system.

Indeed, urban society came to articulate its position that such sensitive issue as Xiagang Zhigong’s pension entitlement should be settled with virtual compensation to the amount of their former work years.<sup>115</sup> In this context, Shitong scheme came into being in the context of a critical content of “proper” compensation to dissolve Xiagang Zhigong’s labor relations. This staunch position has to do with a deeply rooted social expectation that “proper” compensation required to dissolve the labor relations must fully confirm pension entitlements derived from former work years. In this context, the leadership came to authorize the Shitong practice, and through it many areas were able to advance their *merging* programs by dissolving labor relations with Xiagang Zhigong to whom they granted virtual compensation for their former work years.

Figure 6-1. Total Number of SOE Xiagang Zhigong (Unit: 10,000)



(Source: *Zhongguo laodong he shehui baozhang nianjian*, 2004, p. 478)

<sup>115</sup> DRC SRRTT, op. cit., p. 81.

The declining number of Xiagang Zhigong in the above table represents the success of the *merging* process. It represents the ability of SOEs to discharge their inherited redundant Zhigong, the very condition to restructure many troubled SOEs. Furthermore, it points to the eventual articulation of a scheme to dissolve the labor relations with SOE Zhigong who started their work years as the permanent workers. Indeed, the *merging* process has made a decisive breakthrough in the realization of SOE reform.

As we observed before, China's pension reform represents efforts to set up a new socialized pension system beyond the Danwei capable of handling retired Zhigong pensions, as many SOEs undergoing the restructuring process could not grant full pension to their retirees. Consequently, pension reform focused mainly on whether those retired Zhigong could be granted full their pension in the context of the SOE restructuring process, and it did not grant the same attention to the *middle's* pension entitlement issue. However, the radical SOE restructuring process, which needed to layoff redundant Zhigong brought the matter of Xiagang Zhigong's pension entitlements into focus. Independently wealthy Shanghai's Xiebao program and the center funded Liaoning experiment uncovered the condition society would accept to dissolve labor relations, that was a compensation scheme that could ensure pension entitlement labor relations were dissolved. However, these were limited geographically. Whereas Shitong worked as a system arrange virtual compensation that honored pension credits within the Danwei system more broadly. Both social and political process identify the Danwei system's inherited IPD as unavoidable issue in dissolving Xiagang Zhigong's labor relations, and Shitong is the result. The *merging* process to bring about urgent SOE restructuring makes addressing the Danwei's inherited IPD owed to the Xiagang Zhigong as immediately necessary as guaranteeing pensions for retired Zhigong through pension reform.

While Shitong could help Xiagang Zhigong to dissolve their labor ties, it did not guarantee that they left their Danwei without any worries about their pension entitlements. Shitong only virtually handled the IPD issue by assigning credits. Full pension reform which sets up a funded system out of the former PAYG system needed to settle inherited IPD issue with tremendous financial resources. The resources required to address the former PAYG system's pension commitment was an enormous transition costs. The former system did not have the resources to fund the new one. For more than four decades the Danwei based PAYG system did not save resources required to arrange pensions for retirees as it promised. Pension reform employed the "old way for the *old*" principle to fully confirm the retired Zhigong's promised pension. In order to handle the issue of inherited IPD owed to the *old*, China introduced a partially funded pension system in which social pooling was used to grant full pension to the retirees. This, however, turned out insufficient in many areas and many areas came to follow the "empty account" practice. To make the matter worse, many areas also allow "early retirement." This turns many Zhigong who might otherwise pay premiums until their full retirement into pensioners who further strain the pension system.

The Shitong scheme that evolved out of the *merging* process credited Xiagang Zhigong's former working years towards their pension entitlement in the new pension system, and therefore fully confirmed their former pension credits within their Danwei. Yet, problem arose because Shitong was effectively an unfunded mandate. It facilitated *merging* but it was not followed by any serious efforts to set up reliable financial measures. Just as the Zhigong BPI system's social pooling aspect was used to relieve the burden of granting pensions for retired Zhigong, it had been relied upon to grant pensions for Xiagang Zhigong as well. However, many areas' Zhigong BPI systems turned out to be incapable of granting pension for even the retired Zhigong, let

alone the Xiagang Zhigong. While it worked as a virtual practice, in reality Shitong relied on the BPI system that was not sufficient to grant pensions to retired Zhigong or take on the additional burden of the inherited IPD owed to Xiagang Zhigong. It could not be expected to pay those pensions without new reliable financial resources. At present the social pooling system of the Zhigong BPI system tasked with heavy burdens of arranging pensions for the *old* could not afford to take additional burden of the *middle*. It seemed clear that dissolving Xiagang Zhigong's labor relations required tremendous financial resources. Yet, China did not devise a new reliable financial ground to handle their "transitional" pension.<sup>116</sup> So for all with the pension entitlement assurance system based on Shitong, it still remained unclear if Xiagang Zhigong could have actual their "transitional" pension after the retirement.

Shitong expanded the total scale of the Danwei's IPD in an effort to settle the *merging* process. Pension reform involved efforts to set up a scheme that could arrange proper compensation in order to dissolve Zhigong's permanent relations with the Danwei. Proper compensation was defined in terms of settling the Danwei's IPD owed to both retired and Xiagang Zhigong.<sup>117</sup> The number of retirees who joined the Zhigong BPI's social pooling system by the first half of 2001 reached 32.4 million. Meanwhile, the total number of aged working Zhigong who started their working years under the old pension system exceeded more than 100 million.<sup>118</sup> Thus, the IPD owed to both the *old* and the *middle* was phenomenal. The pension transforming costs to set up new funded pension system out of the former Danwei based

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<sup>116</sup> Liu Cuixiao, "Woguo yanglao baoxian de lishi zhaiwu wenti," p. 89.

<sup>117</sup> "The central issue in establishing new pension system under market economy lies in how to figure out an appropriate way to compensate and how to raise compensating funds." Zhao Chenhui, "Buchang: Yanglao Boaxian Zhidu Zhuangui de Qudongqi," p. 27.

<sup>118</sup> Liu Cuixiao, *op. cit.*, p. 89.

PAYG system might reach a trillion *yuan*.<sup>119</sup> In the context of the pension reform process China came to realize that the IPD issue could not be settled with the pension reform measures which only set up a new partially funded socialized pension system.<sup>120</sup>

Yet, in spite of the impending issue, the socialized BPI system's social pooling component remained the primary tool used to dissolve labor relations with both the *old* and the *middle* in the context of the SOE restructuring process. By promising future pension entitlements Xiagang Zhigong were thought to have "proper" compensation. It was easy to take a skeptical view of the social pooling system's ability to handle the huge IPD issue. In order to convince Xiagang Zhigong of the security of their pension entitlements without devising sufficient financial grounding it was necessary to manage the social credibility of the new pension system's sustainability. This was done in large part by granting full pension to current retirees. There were, however, many areas where the pension system struggled to grant full pensions to the retired Zhigong, and in those areas the center had provided its supports.

While it might not be practical for other areas to expect the center's financial support in the case of the Liaoning experiment, where it was given to dissolve the labor relations, the center could not overlook the crisis of confidence it would provoke if retirees were forced to go without. The center could not overlook the trouble that many areas' Zhigong BPI systems faced when granting full pension for the retired Zhigong. This was because society would lose the confidence in the new system's ability to provide actual pension benefits to Xiagang Zhigong's after their retirement. This would stall the progress of Shitong as a means to create a condition under which workers would dissolve their labor relations. Hence, it was necessary to ensure that

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<sup>119</sup> Ibid.

<sup>120</sup> "Without proper handling of the systemically caused debts, huge amount of deficits in China's new pension system cannot be made up forever." Shi Yuren, "21 shiji woguo shehui baozhang zhidu mianlin de tiaozhan de duice," pp. 16-7.

the current pension system was able to grant full pension to retirees now, so that society remained trusting of the pension system's ability to grant full pensions to Xiangang Zhigong in the future. As a result, the center's annual financial support for those areas struggling to grant full pensions to retirees expanded consistently from 1999 to 2002. Center support expanded from 16.3 billion in 1999, to 33.8 billion in 2000, 34.9 billion in 2001, and 40.9 billion *yuan* in the year 2002.<sup>121</sup>

Struggling SOEs and their local governments could not contribute substantially to the push for full scale SOE restructuring process. The only practical resources that could be mobilized were the central government's budgets and the center arranged serious amounts of support. Nonetheless, the center did not officially recognize its responsibility in handling of the Danwei's inherited IPD. Instead, it limited itself to a supplementary role in those cases where the regional Zhigong BPI system could not handle the IPD for the *old*. Indeed, even where the center came to engage its resources, the center still tried to play only a secondary role. It did not explicitly admit its official responsibility. Especially, in addition to the pension for the current retirees, it had been turned out that the Danwei IPD owed to the *middle* should be settled out of the *merging* process, and the center came to have more reasons to distance itself from the IPD issue even more. Of course, it was not easy to measure the total scale of the Danwei IPD. There had been different estimations of its scale, but none of them thought it as something affordable for the center.

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<sup>121</sup> Gao Shusheng, "Jin yi bu zuo hao shehui baozhang gongzuo de maodun fenxi he duice jianyi, p. 26.

Table 6-1. Various Estimates of the Total Amount of IPD

	Guo Shuqing	MOLSS	World Bank	Fang Haiyan	TGB
Estimation Year	1994	1995	1996	1997	2000
Measured Hidden Debts (billion <i>yuan</i> )	1,050.0	2,873.5	1,917.6	3,508.2	6,714.5
Sampling Cities	State Danwei's Zhigong	National Population Statistics	Shenyang Shanghai	Unclear	Nanjing
Estimating Mode	Rough	Rough & Strict	Strict	Strict	Strict

(Source: He Ping, "Zhongguo yanglao baoxian jijin cesuan baogao," p. 327)

Instead, there was a voice demanding that the center should be careful about increasing support for areas with problem at funding the Zhigong BPI system, as the scale of IPD issue to handle only got worse with the full scale SOE restructuring process.

“Since not only the compliance rate of premium payment is low and even in decline, but also the [pension] system transition costs have not been settled, many areas’ pension funds pool already have fallen into the condition of financial bankruptcy. Without financial resources to pay its pension debts, many local governments cannot help paying retiree’s pension continually by using the accumulations in the individual accounts. But even so, the funds are still not enough and local governments try to cover the deficiency with their local revenue. As a matter of fact, local and the central government are in the middle of bailing out lots of financially troubled local pension systems. Thus, if the situation is not properly handled, then it will threat financial sustainability of the central government.”<sup>122</sup>

The serious struggle that many areas faced in meeting the payments promised under the Zhigong BPI systems at once compelled the center to contribute and also caused the center to shrink from recognizing full responsibility to support those areas. The total scale of the *inner system* IPD owed to the *old* and the *middle* was so enormous that the center would face really serious financial strain if it decided to pay off those debts directly out of its financial system.<sup>123</sup>

<sup>122</sup> Wang Yan, et al., op. cit., p. 304.

<sup>123</sup> There is even analysis as follows: while the inherited IPD scale extends to two to three trillion *yuan*, as most of current mobilized pension premiums are used to grant full pension for the retirees, annual fund

Additionally, full financial backing would turn a socially sensitive issue into a political one, which the state wanted to avoid. For these reasons, leadership did not want to clarify official policy on how much the center would take the responsibility to handle the Danwei's inherited IPD issue.

Under these sensitive situations, local governments tried to address the issue of how pension systems might work properly to ensure those Xiangang Zhigong's pension entitlements. Of course, lots of them with troubled financial conditions could not actually arrange enough supports for their BPI system. While there were those that try in earnest, there were also local governments that did not make sincere efforts to support the areas' pension systems. They did so with the expectation that the center would arrange the necessary supports. Hence, the center as a part of its distancing efforts branded certain "moral hazard" areas. The center then tried to clarify that it would not support those "moral hazard" areas which did not make full efforts to grant pensions to retired Zhigong. Correspondingly, there emerged social voices which demanded that local governments play a more active role in resolving the *middle's* pension issue.<sup>124</sup> In the absence of clear scheme to handle the IPD issue, there was an ongoing buck-passing game between the local governments and the center.

The center's contributions of financial support do not mean that it decided to fully recognize its IPD responsibility.<sup>125</sup> Between 1998 and 2002, the central finance system provided

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accumulation reaches to around ten billion *yuan*; so with the current accumulation process it will take two or three hundreds years to settle IPD issue. Liu Cuixiao, *op. cit.*, p. 92.

<sup>124</sup> "The division of rights and responsibilities between the central and local governments remain unclear. ... Local governments from the Fenshuizhi of 1994 already hold relatively stable financial sources but do not have corresponding responsibilities for social security." He Jinying, "Shehui baozhang zhong de zhengfu zeren," p. 22.

<sup>125</sup> "Recent years the state takes some funds out of its financial revenues to handle the issue of the retired Zhigong's pension payment. Yet, this is not a measure of clearing off its debts; rather, taking the

subsidies for social security totaling 260 billion *yuan*. However, considering the total scale of the Danwei IPD, these subsidies from the center were only a small part of the total debt, the rest of which had been laid upon society.<sup>126</sup> Even while the government had arranged not small amount of money, it did not set up a master plan to systemically settle the whole IPD issue for the new funded pension system. In the context of full scale SOE restructuring and China's pension reforms, it became clear that the Danwei IPD must be settled. However, the question of how to mobilize the required resources remained.

In this context, need for pension reforms which set up a socialized system beyond the Danwei became obvious: on the one hand, the new pension system fully recognized Zhigong interests inherited from the former system; on the other hand, it depended on a social pooling system without the center's official financial commitment. Without the center's support the social pooling system practically passed the burden of making pension payments to the *inner system*.<sup>127</sup> The leadership tried to handle SOE's IPD issue in the context of full scale SOE restructuring by setting up a new socialized pension system, which, however, did not identify the central government's official responsibility to resolve IPD issue. Indeed, the center tried to avoid making an official commitment in the settlement of the Danwei's inherited IPD owed to the *old* and the *middle*, even as it arranged significant resources to support troubled pension systems in many areas. This was a primary reason that while China undertook to make social insurance law early on, the emerging Zhigong BPI system remained only as local system for

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circumstance into consideration, it is a provisional measure to handle the problem.” Shi Yuren, *op. cit.*, p. 17.

<sup>126</sup> In this context, Huang and Zhao worried about center's limited amount supports because it was a potential but massive threat to the China's advance to market system and its social stability. Huang Hetao and Zhao Jianjie, *op. cit.*, p. 26.

<sup>127</sup> Zhao Chenhui, *op. cit.*, p. 26.

quite long time rather than a system under the state's legal regulation.<sup>128</sup> China remained undecided how to handle the Danwei IPD issue in trying to avoid an official responsibility to settle the inherited IPD issue.

As the center limited its role to that of arranging support for those areas with deeply troubled pension systems in need of urgent assistance, the government virtually reinforced the existing scheme of the municipal Zhigong BPI system. The center could afford to provide support for those pension systems in a few problematic areas, as it did not need to resolve the entire IPD issue. With the center's supports those cities under serious financial pressure could manage to run their pension system, and in most areas the pension system could grant pensions to their retired Zhigong. Hence, even if the state did not settle the entire IPD systemically, China's municipal Zhigong BPI system had managed to maintain its credibility by granting full pensions to the retired Zhigong, which in turn made Xiang Zhigong trust that they would also receive their full pension upon retirement. The nature of the center's support did not involve efforts to set up a systemic measure which could handle the total IPD. Instead, it remained quite a casual program to the extent that the center lent its support only in certain dire cases, so that each area could grant pensions to their retired Zhigong. Consequently, the IPD issue remained a local issue handled by the regional Zhigong BPI system.

As the municipal Zhigong BPI system had turned out to be the primary system to handle the Danwei IPD issue, China could not carry out its original plan to upgrade the social pooling to the province level. This was because it was extremely difficult to align diverse interests among different areas with diverse IPD burdens, without devising a scheme that handled the IPD issue

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<sup>128</sup> "The tension between the central and local Chinese governments over pension is further evidence in the failure by policymakers and legislators in Beijing to craft an acceptable SIL. Drafts of the SIL date back to the mid-1990s, but until 2009 at least, disagreement among ministries over the provisions in the draft law kept it stalled within the NPC..." (Frazier 2010: 68).

at the system level. Each city's IPD scale and economic conditions were relatively unique, which made the interest adjustment required to organize an upper level social pooling system quite complicated. Hence, limited achievements in the efforts to upgrade social pooling to province level could be attributed to emerging regional interests.<sup>129</sup> Not until the IPD issue of the Zhigong BPI system was settled clearly could an upgrade of social pooling to provincial level produce a meaningful outcome.<sup>130</sup> For these reasons, China did not push its plan for provincial level pooling of the pension system. When asked why the efforts to upgrade pooling to province level remained fruitless, interviewees replied that China did not try seriously to realize provincial pooling any more.<sup>131</sup> Consequently, without an articulated system level scheme to settle the Danwei IPD, China's emerging socialized pension was bound to be only a city level system.

The *merging* process highlighted the fact that the Danwei's IPD issue could not be overlooked, but it was not followed by plans to establish a system to mobilize reliable financial resources to handle the issue. Instead, the center tried to stay as far away from the issue as it could, and let the regional pension system's social pooling part handle it. As the socialized Zhigong BPI system remained coordinated at municipal level rather than province level, each city has to organize and run its own pension system. Therefore, what the center was really doing was foregrounding the IPD issue through the push for *merging* and placing the burdens of handling inherited pension commitment to each city's pension system.<sup>132</sup>

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<sup>129</sup> Indeed, for all many advantages of higher-level social pooling "... the deepest reason [for unsuccessful provincial pooling system] is the barrier of interests, in other words, the partial interests of cities and counties within provinces." Feng Lanrui, "Shehui baozhang shehuihua yu yanglao jijin sheng ji tongchou," p. 23.

<sup>130</sup> Liu Cuixiao, op. cit., p. 100.

<sup>131</sup> "China needs more time to implement the program of social pooling at the provincial level. In fact, I think it is almost impossible to initiate this in near future." Interview, 2005, July 16th.

<sup>132</sup> In this context, local officials "scorn welfare reforms as unfunded mandates thrust upon the localities by the center" (Lee 2007: 19).

The question became, could the center maintain this position, or lack thereof? The number of retired Zhigong increased over time. This was not a linear progression: the number of retired Zhigong exploded in the course of the SOE restructuring process with serious numbers of early retired workers. Hence, it remained uncertain if individual area's Zhigong BPI system could continue handle the inherited IPD issue without devising a new reliable financial ground. The financial resources of many local governments remained scarce with the implementation of the full SOE restructuring process. It might not be practical to expect them to increase let alone sustain this level of engagement. In this context, even with the center's strong desire to stay away from providing fuller financial support for the regional pension systems, its support had increased.<sup>133</sup>

Under the conditions of limited center support the Zhigong BPI's regional IPD system could not contain the "empty account" practice. As the center did not systemically handle entire IPD issue, but only arranged financial support for those areas that required urgent assistance to pay retirees, there remained many struggling that areas could not help but use money accumulated within individual accounts to grant pensions to retirees. The fact that China's center had come to handle pension in arrears in many troubled areas did not necessarily mean that it has clearly settled the empty account practice. Without systemic settlement of IPD, many areas' Zhigong BPI system could not stop the "empty account" practice. Some experts questioned whether the "empty account" practice was actually in conflict with a reliable socialized pension system that could grant full pension for the retired Zhigong. It did pay the retirees and it allowed Xiangang Zhigong to trust their "transition" pension entitlement would be

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<sup>133</sup> Between 1998 and 2001 the center's portion in the supports for BPI extends over 90 percent, while local governments' portion remains less than 10 percent. Liu Cuixiao, *op. cit.*, p. 100.

available upon retirement.<sup>134</sup> As the Liaoning experiment remained only a regional program rather than turning into a national program, other areas pension reform did not make serious efforts to set up filled individual accounts.

Between 1998 and 2004 the center provided more than 170 billion *yuan* in support of the Zhigong BPI system, which, turned out not to be even enough. In many areas the Zhigong BPI systems had trouble granting full pensions to retired Zhigong, which resulted in the expansion of the “empty account” practice. By the end of 2004 the total scale of the embezzlement from individual accounts reached 740 billion *yuan*<sup>135</sup> and by the end of 2005 had expanded to 800 billion *yuan*.<sup>136</sup> The persistent “empty account” practice was a consequence of China’s decision that the regional Zhigong BPI systems remained the primary mode to handle IPD issue. If the center had been to support all of those areas with problems granting pensions in order to curtail the “empty account” practice, this would represent an admission that the regional Zhigong BPI systems were not able to handle the IPD issue and it would necessitate universal center supports. Hence, even if the center supports many areas in which the pension systems had trouble granting full pension to retired Zhigong, it stuck firmly to the scheme that the regional Zhigong BPI system was the primary system to handle the IPD issue. Consequently, the center limited its financial support to level that could maintain the credibility of the Zhigong BPI system in paying retirees and did not seek to curtail the “empty account” practice.

The “empty account” practice persisted, as the new pension system’s social pooling aspect had to arrange retired Zhigong’s pensions without reliable financial resources. Only after

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<sup>134</sup> There were voices that China did not have to set up individual accounts, as far as the new pension system could grant pension to the retirees. He Ping, “Zhongguo yanglao baoxian jijin cesuan baogao,” p. 323.

<sup>135</sup> Tang Yaoguo, “Shitong jiaona ruhe huanzhang,” p. 23.

<sup>136</sup> Lin Mingming, “Shehui baozhang yanjiu de ling yi shijiao shehui baozhang ruogan chanquan wenti,” p. 37.

the creation of a new scheme that could bolster the social pooling system's limited resources to arrange pension for the retirees, could the widely employed "empty account" practice be contained. The "empty account" practice at once aided and contradicted with efforts to set up a new funded pension system, as it both gave credibility to the new system, but also virtually turned the new pension system into a PAYG system again. Thus, without clarifying how to handle inherited IPD issue at the system level, China's efforts to set up partially funded socialized pension system ended up reverting to a PAYG system.<sup>137</sup> It became clear that issuing a central document to set up real filled individual accounts without settlement of the IPD issue could not resolve many areas' "empty account" practice.<sup>138</sup>

For the above reasons, some criticized China's radical pension reform of the 90s. China tried to establish a combined social pooling and individual accounts system without deep consideration of how to handle the Danwei's IPD issues. As a result, many areas had to grant pensions to their retired Zhigong with only limited financial resources, resulting in the with "empty account" practice. The diverse financial conditions of many areas' Zhigong BPI and their various IPD burdens rendered the efforts to coordinate an upgrade of social pooling to provincial level fruitless.<sup>139</sup> Indeed, the leadership's aversion to establishing a system level scheme settling the inherited IPD issue while dissolving labor relations with *old* and the *middle* had a critical consequence for the structure of the emerging BPI system: the BPI system was

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<sup>137</sup> What JIL actually observed from China's pension reform was an emerging pension system which was run under each city government's financial system with almost as same scheme as PAYG. JIL, *Chūgoku kokuyū kigyō kaikaku no yukue: rōdō shakai hoshō shisutemu no hen yō to kigyō soshiki*, p. 32.

<sup>138</sup> "A survey of 32 social security specialists conducted by the "China Social Security" magazine (March of 2000) shows that: regarding issue of making empty individual account real one, 42.7 percent of them replied that the program had small possibilities; 25.6 percent of them thought it was basically impossible; 24.4 of them admitted its possibilities; and 7.3 percent of them did replied." SDPC AMR, "Guanyu jianli he wanshan woguo shehui baozhang tixi de yanjiu, P. 125.

<sup>139</sup> Zhong Gongcheng,, "Tuijin woguo shehui baozhang gaige de ji dian sikao," p. 213.

bound at city level. The city level BPI system had to address the unavoidable IPD issue without reliable financial backing of a regional or central IPD system. The direct result of this was the “empty account” practice in many areas.

The difficult process of SOE restructuring ultimately depends on dissolving labor relations with redundant Zhigong; Shanghai’s Xiebao, the Liaoning experiment, and the practice of Shitong point to the fact that those permanent workers will dissolve their relations only with a scheme to ensure their future pension entitlement. It is the practice of Shitong that emerges out of the *merging* process which especially enforces that the minimum condition required is to ensure pension entitlement. Through Shitong workers are given confirmation of former pension credits to constitute pension entitlement under the new socialized pension system and have been widely shown to dissolve the labor relations corresponding to this practice. What this means is that dissolving Xiagang Zhigong’s labor relations requires settlement of the Danwei’s inherited IPD owed to those workers.

In this context, the *merging* process articulates Shitong as a way to address IPD issue for the purposes of the SOE restructuring process, but it requires significant unsecure financial resources. China does not devise a reliable financial basis for this support, but expects the Zhigong BPI’s social pooling component to handle it. As we observed before, the Zhigong BPI’s social pooling component takes on the role of granting full pensions to retired Zhigong, but in many areas with limited resources the system of social pooling cannot fulfill this obligation, which results in the “empty account” practice. Hence, in addition to being shouldered with the burdens of pension provision for retired Zhigong, the regional Zhigong BPI must also take on the burdens of the Danwei IPD owed to Xiagang Zhigong. Without devising

new reliable financial sources the practice of Shitong which emerges out of the *merging* process puts an extra strain on the regional Zhigong BPI system.

Authorization of the Shitong may defer responsibility to a future date in many cases, but it highlights that the IPD issue cannot be overlooked. Shitong will need to be followed by a systemic scheme to mobilize enough resources to handle the impending IPD. This has already begun. In addition to the financial engagement of local governments, the center has arranged significant supports for those BPI systems experiencing difficulty granting pensions. In this context, some believe that it would be better to set up a single national social pooling system, which would turn each area's IPD into a single national debt to be settled with through the central budgets.<sup>140</sup> Yet, the center wants to limit its support to a supplementary role in handling the inherited IPD issue, and the municipal Zhigong BPI system remains the primary system to handle the IPD issue in spite of limited regional resources, which perpetuate the broadly conducted "empty account" practice. The "empty account" practice is the outcome of an urgent need to grant full pensions to the *old* even at the expense of the *middle*'s individual accounts. The matter of the *middle*'s pension can be put off until their retirement. Yet, this reprieve is destined not to last very long, as increasing numbers of the *middle* are set to retire soon and the system will have to handle its obligation.<sup>141</sup>

If the "empty account" practice isn't put in check, it will make the future pension burden much heavier. The proliferation of the "empty account" practice raises doubts about the Zhigong BPI system's financial readiness to grant full pensions to Xiangang Zhigong after their retirement.

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<sup>140</sup> Liu Cuixiao, op. cit., p.100.

<sup>141</sup> "If the government uses these funds to compensate pension deficiency of the former system, then, it encroach current working Zhigong's entitlement. Of course, these Zhigong sooner or later will retire, then, the government will take heavier burdens just after it shook off its old one." Zhao Chenhui, op. cit., p. 26.

Thus, recognition of Shitong does not necessarily mean that Xiagang Zhigong will have actual “transitional” pension accordance with their former working years. While the practice of Shitong allows many areas to carry out the *merging* process with the assurance of Xiagang Zhigong’s pension entitlements will be met, it by no means makes the Zhigong BPI systems financially sustainable so that they can actually grant full pensions to Xiagang Zhigong after their retirement.

## 7. The Historical Debts, Labor Market, and the Market Transformation

Out of the *merging* process the very condition that Xiagang Zhigong can accept to dissolve their permanent labor relations proves to be an assurance of their pension entitlements when they reach the retirement age even if they do not belong to the Danwei system. Shanghai's Xiebao, the Liaoning experiment, and Shitong practice confirm that ensuring Xiagang Zhigong's pension entitlement is the precondition for them to dissolve their labor relations. Despite a series of efforts, SOE reform has been drifting for decades, not successfully finding out an exit strategy from the Zhigong labor system. SOE reform can make breakthrough beyond Zhigong labor system only after China can ensure both retired and Xiagang Zhigong's pension entitlement. Accordingly, the most sensitive issue in SOE restructuring process is how to reform the Danwei system's pension issue. To become genuine economic system, SOEs need to be free from the burdens of granting pension for their retired Zhigong. In this context, China tries to carry out the pension reform mainly to devise a measure to settle the Danwei system's IPD owed to the *old* and the *middle*.

Yet, the efforts to ensure retired and Xiagang Zhigong's pension entitlement do not clarify how to finance the required resources to grant their full pension. Especially, Xiagang Zhigong need more years for their retirement age, so it was not urgent to decide how to mobilize resources for their pension. Hence, though confirming Xiagang Zhigong's pension credits to dissolve their labor relations, China still remained unclear about how to mobilize required financial resources. Confirming Shitong only verifies the unavoidable Danwei's IPD issue in dissolving Xiagang Zhigong's labor relations without devising reliable financial scheme. The result puts only the new burdens to handle Xiagang Zhigong's IPD on the regional Zhigong BPI

systems. Shitong itself is not a solution for the Danwei's IPD issue; instead, it demands only a measure to handle even heavier IPD issue for both retired and Xiangang Zhigong, and there follow deep concerns about the credibility of the pension system.<sup>1</sup> It still remains to be seen whether they can really have their promised "transition pension" after they reach retirement age.

China fails to set up its new pension system through its clear resolving of the IPD issue; instead, without devising reliable financial sources, it provides a new pension system to handle mainly the urgent IPD issue. China has set up regional pension systems, and the social pooling system in each area comes to handle the area's Danwei IPD issue. Yet, the IPD issue cannot be settled with the new pension system's social pooling part which depends on SOEs and their Zhigong's pension premium payment, as many SOEs are under serious financial hardships or even undergo restructuring process. The Zhigong BPI systems in many areas face troubles in granting full pension for their retired Zhigong. Of course, Xiangang Zhigong will get their pension from the Zhigong BPI system after they reach the retirement age. Hence, granting full pension for the retired Zhigong is critical for Xiangang Zhigong to trust about the Zhigong BPI system to grant their future pension. If some areas' new pension systems face financial issues to grant full pension for the retired Zhigong, it seriously shakes Xiangang Zhigong's expectation of their future pension entitlement.

In this context, many local governments come to support their areas' pension system, but others cannot afford to settle the issue, either. As SOEs and many local governments do not have enough resources to settle IPD issue, there emerge voices that demand the center's more active financial engagement for the urgent SOE restructuring. Hence, many Xiangang Zhigong's

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<sup>1</sup> "It has been 6 years to carry out new pension system combining social pooling and the individual accounts, which reveals the fact that the huge amount of the inherited debts without reasonable settlement measures will bring about a series of social problems." Liu Cuixiao, "Woguo yanglao baoxian de lishi zhaiwu wenti," p. 93.

pension entitlement still remain unclear, as far as China does not clarify how to finance the required resources to settle the Danwei system's inherited IPD owed to SOE Zhigong.

Under the urgent situation, the society urges that the center reveal its plan of how much it will put its resources for SOE reform.<sup>2</sup> The center is the single practical source to mobilize available money to handle the Danwei's IPD issue, while it hesitates to lead the move and lets the new regional pension system treat the issue. In this context, there entail the "empty account" practice in the area, and the efforts of Liaoning experiment to contain the practice to set up filled real individual accounts, which does not become a national scheme. It is not a sustainable condition at all.

"Obviously, the government lets the new pension system's social pooling funds work as compensation to settle the inherited burdens, hoping it can gradually realize compensation for the *old* and the *middle* in terms of generational transferring scheme. This means that the government remains silent about the interests of the *old* and the *middle* in the former system and lets the new pension system compensate them by collecting social pooling resources, which virtually transfers the burdens to SOEs and Zhigong. The scheme is by no means rational nor sustainable."<sup>3</sup>

The inherited IPD issue requires some special measures to settle for the urgent SOE restructuring, which practically cannot but depend on the center's more active financial role.<sup>4</sup> This virtually involves the issue of whether the central government should take the liability of the Danwei's IPD owed to their Zhigong. Indeed, with the urgent condition to ensure Zhigong's pension entitlement for SOE reform, the issue of the center's liability for the Danwei's IPD issue

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<sup>2</sup> He Ping, "Zhongguo shehui baozhang tixi yanjiu baogao," (2001), p. 6.

<sup>3</sup> Zhao Chenhui, "Buchang: Yanglao Boaxian Zhidu Zhuangui de Qudongqi," p. 26.

<sup>4</sup> "The state cannot leave the inherited IPD owed to the *old* and the *middle* in a muddled account but it cannot settle it depending only on the budgets. This is because each content of reform costs should be divided by the state, Danwei, and individuals; and the pension reform should follow the same rule. ...the state, Danwei, and individual Zhigong should divide a certain ratio of the inherited IPD burdens, with the state's assigned main liability..." Liu Cuixiao, op. cit., p. 102.

becomes the crux of the final phase of long dragging SOE reform process for decades. In this context, it is required to examine how the efforts to address the Danwei IPD issue end up with a socio-political decision of whether the center comes to engage more actively or not. The center wants to stay away from the issue, repressing the rising social voices demanding the center's more active financial engagements. Otherwise, it may not stay away from the issue, as the Zhigong BPI system's social pooling system turns out to be incapable of handling the primary condition to reform SOE system without devising new reliable financial measures.

Interestingly, the process to dissolve Zhigong's labor relations becomes involved with the efforts to figure out relevant measures to handle their unique status as the *inner system's* permanent workers, as the permanent labor relations with the *inner system* contain a social meaning of status. As we observed, dissolving SOE Zhigong labor relations involves a very sensitive embeddedness politics in China, which needs to arrange "proper" compensation that SOE Zhigong can accept in the context of losing their permanent worker status. Even the urgent SOE restructuring process needs to fulfill the very condition that Zhigong can accept for dissolving their labor relations within the context of dissolving their permanent worker status. Zhigong's permanent workers status weaves various debts and credits relations between them and the Danwei without periodic settlement in terms of accounting periods. So, in addition to economic compensation as in the market economy system, the compensation that Zhigong can accept to dissolve the labor relations should reflect their special status as the permanent worker with articulated special scheme to settle all inherited debts and credits. The compensation would remain dormant if the permanent worker system could persist. In essence, the "proper" compensation to dissolve Zhigong's labor relations depends on how to settle all related debts and credits that have been weaved with Zhigong's permanent worker status.

Because Xiagang program does not incorporate the scheme for the “proper” compensation in dissolving Zhigong’s status issue, it does not play its expected crucial roles in the urgent SOE restructuring process. Hence, the leadership decides to terminate Xiagang program and merge it into the unemployment insurance system. The decision then necessitates the condition to dissolve the labor relations directly without the mediation of Xiagang program and by articulating the compensation that can handle their status issue. This is because Xiagang program did not clarify how to compensate Xiagang Zhigong and because it was not even clear whether it needed to grant them compensation when they leave RSCs. Out of the *merging* process, the society comes to accept that compensation for Xiagang Zhigong, as dissolving their labor relations, unlike those cases of dissolving labor relations with new contract workers, involves dissolving their special social status.<sup>5</sup>

China gradually captures the delicate process of dissolving Zhigong’s permanent labor relations by transforming their status. The process requires measures including “settlement of SOEs’ various debts owed to Zhigong; payment economic compensation (for those bankrupted cases, placement fees); and properly handling Zhigong’s previous pension and medical insurance issue including payment of their formerly unpaid premiums.”<sup>6</sup> The society then comes to accept that dissolving Zhigong labor relations require measures including compensation and social security entitlements that can handle their unique the permanent Danwei worker status. As we observed, a scheme of *separating personnel from the assets* emerged in dissolving Zhigong’s labor relations. This confirms that their stakeholder positions have to do with the compensation to handle their unique status issue. Furthermore, how to handle Zhigong’s entitlement to social

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<sup>5</sup> Yu Faming , “*Xiagang Zhigong laodong guanxi wenti toudi: ruhe jiejie xiagang zhigong chu zaijiuye fuwu zhongxin de wenti*,” p. 45.

<sup>6</sup> Yu Faming and Guo Yue, “Guanyu guoyou qiye zhuanzhi guocheng zhong laodong guanxi chuli de jidian sikao,” p. 42.

security after dissolving the labor relations turns out to be a critical condition to dissolve the labor relation, as China has not yet set up reliable social security system for those who dissolve their permanent worker status. This involve their sensitive status issue, as it remains undecided how to handle their social benefits that they are supposed to be entitled as the Danwei personnel after they leave their Danwei.<sup>7</sup> Dissolving Zhigong labor relations turns out to be issue of how to handle their unique status as the permanent Danwei workers, which extends to all the related debts and credits that they have to clearly settle that have been covered under the permanent relations. In this context, SOE reform involves a social process to figure out the “proper” compensation that can settle all the inherited debts and credits involved with Zhigong’s unique status as the *inner system*’s permanent workers.

The scheme of *separating personnel from the assets* emerged out of social consensus-building process of the compensation. In other words, it confirms Zhigong’s stake within SOE properties. Hence, SOE restructuring process (ownership reform) is accompanied with the social process confirming their Zhigong’s stakeholder position for SOE properties. It means this process involves a full recognition of their master position in the Danwei system which builds up the *inner system* economy. In other words, this socio-political process identifies Zhigong’s unique status as the *Danwei personnel* out of urgent SOE restructuring process, by providing compensation that virtually confirms their stakes within their SOE assets. In the past, Zhigong as the *Danwei personnel* were paid only tiny wages for their full labor contributions for their

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<sup>7</sup> “Today social insurance reform still falls far behind labor system reform. Especially, it is quite challenging how to put social security system to those Zhigong who held the original permanent workers status. There are, according to some data, about millions of Shanghai citizen who belong to this group who entered to Danwei system and initiated their work years under the state’s unified financial system of plan economy system. ... How to compensate those “deducted” amounts for the past decades (primarily pension, medical, and housing) is not only an obvious big issue for Shanghai’s social stability but also the very crux of Shanghai’s reform and development.” Dai Lüguo, “Shanghai shehui baozhang tizhi jianshe gouxiang,” p. 163.

Danwei, as they were supposed to be rewarded with comprehensive welfare benefits within their Danwei. The compensation for dissolving Xiagang Zhigong's labor relations, unlike that of those contract workers, should incorporate a scheme of dissolving Zhigong status as the Danwei system's permanent personnel by drawing the resources from a part of SOE properties. In this context, the process turns out to be the "transforming" (*zhihuan*) Zhigong status: to compensate them for the status transformation requires using part of SOE properties in the SOE restructuring process.<sup>8</sup>

A critical feature of Zhigong status as the *Danwei personnel* has to do with their virtual stakes within their Danwei as the insiders. SOE restructuring and consequent ownership reform including privatization, therefore, involves the process of its properties reform, and the process comes to confirm Zhigong's stakes that has been constructed with the low wage system through "proper" compensation for dissolving their Danwei personnel status. Hence, when SOEs are sold, local governments can use part of the assets to compensate Xiagang or discharged workers; otherwise, they can reduce the price of the assets to compensate the new owners for taking responsibility for employees who will have to be compensated if they are fired in the future (Garnaut et al. 2005: 107).

In so doing, both SOE ownership and Zhigong's status transformation are eventually combined through various forms of property ownership reform: selling, restructuring, merging, and transforming to share-holding system. In particular, many small SOEs are separated from the state ownership and dissolve their dependent relations with the government to enter the market; their Zhigong with one or several forms of economic compensations then enter the

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<sup>8</sup> Liang Kaiye, "Lun guoqi gaizhi zhong de Zhigong shenfen zhihuan jingji buchang he renyuan anzhi," p. 57.

market.<sup>9</sup> Indeed, many small SOEs' restructuring extends to the ownership reform accompanied by the process to confirm Zhigong's stakes within their SOE properties through compensation in terms of handling their Danwei's permanent personnel status. For example, MOF's no. 313 document of 2002 clarifies that compensation for those Zhigong to dissolve their labor relations in the SOE corporatization and restructuring process can be paid by deducting those SOE assets under the restructuring process.<sup>10</sup> With the recognition of using a part of SOE properties in the restructuring process, the leadership accepts that dissolving Zhigong labor relations cannot neglect their stakes within SOE properties derived from their permanent Danwei personnel status. In the same vein, the leadership, as we observed, also accepts that even large SOE restructuring process adopts the compensation procedure by transferring the redundant workers to the newly organizing spin-off companies after dividing the primary and subsidiary part. Dissolving labor relations in large SOEs also necessitates ceding a portion of the SOE properties.<sup>11</sup>

Here is the critical dilemma. Mostly Xiang Zhigong comes from many small SOEs under the ownership reform which do not have enough assets to arrange compensation for their Zhigong. Their transformation process, therefore, rather remain stuck without making meaningful progress.

“From the practice of current reform process, the costs of SOE restructuring turns out to be quite high, and the heaviest part of it is the compensation for transforming Zhigong's status. In the process of our province's ownership reform, some SOEs for

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<sup>9</sup> Zhu Shubin, et al., “Dui difang zhong xiao guoyou qiye gaige shishi “liang ge maiduan” de sikao,” p. 131.

<sup>10</sup> Wen Zongyu, “Guoqi gaige zhong Zhigong shenfen zhihuan he buchang de zhengce ji caozuo wenti,” p. 29.

<sup>11</sup> SETC no. 859 document (2002) was a result of discussion of eight related authorities regarding the issue of handling large SOEs' redundant Zhigong's labor relations based on separation of the primary and subsidiary part.

the big amounts of compensation costs cannot engage in transforming Zhigong's status program; or only carry out dissolve their original labor relations without compensation arrangement. There are some cases that even clearly states that "regarding the compensation for Zhigong status transformation, as the original enterprise does not have assets to handle it, so won't pay anymore," which directly encroaches Zhigong's legitimate rights, and make them organize collective actions such as appealing to higher authorities, or encircling related government departments, etc..."<sup>12</sup>

Indeed, the great portion of small SOEs that undergo the restructuring process belongs to local governments with the intensified competition with those new *outer system* units, and some local governments try to arrange the compensation for their Xiangang Zhigong by liquidating parts of their properties.<sup>13</sup> Many local governments, however, cannot mobilize enough resources to arrange compensations for their affiliated SOE Zhigong under the restructuring process. In this context, there emerge social demands that the central government should play more active roles to support those SOEs in financial trouble as regards providing enough compensations out of their properties based on various grounds.<sup>14</sup> Hence, dissolving Zhigong labor relations is not based on full compensation for their *Danwei personnel* status by confirming their stake within SOE properties; but it rather has to be pushed under the urgency to carry out SOE restructuring process. The essence of SOE restructuring process is whether the state comes to financially engage to ensure Zhigong's stakes. This question involves a social reflection process to decide the very nature of dissolving Xiangang Zhigong's labor relations, bringing an important question

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<sup>12</sup> Huo Yanmei, et al., "Guoqi gaige zhong Zhigong shenfen zhihuan de buchang moshi tantao," p. 22.

<sup>13</sup> Qingdao city sold some of its land and made total five hundred and thirty million *yuan*s thereby it can pay off its various debts amount to ninety one million *yuan*, including social security fund, twenty six million *yuan*. Huang Hetao and Zhao Jianjie, "Jingji jiegou tiaozheng yu laodong guanxi zhongjian," p. 27. With this clear compensation, the city's Xiangang Zhigong can leave RSC earlier than the original plan, which means that the city's SOEs could dissolve their labor relations with their Zhigong without serious social troubles.

<sup>14</sup> The center has to support for such reasons as, the government has to protect the weak; or the government has to compensate, as it breaches former socialist labor system based on permanent worker system unilaterally. Huang Huabo, "Zhigong shenfen zhuanhuan yu shenfen jiazhi buchang, p. 11.

of whether there is a system-level reason that the state has to engage in the light of the state and SOE Zhigong's relations. As SOE redundant Zhigong cannot have enough compensations that they can accept, there follows social process that articulates the specific reason why the central government has to provide more financial supports in terms of the state's liability.

### **<Formation of the System's Historical Debts>**

China before the reform was a socialist "demiurge" state which absorbed most production factors in its society to invest them for rapid industrial development. So, SOEs transferred most of their products to the state to let it decide how to invest to realize the rapid socialist industrialization. SOEs in the pre-reform era were by no means an independent economic system for profits and efficiency, but factories that ultimately belong to the system to construct the socialist system all together. As SOE ultimately belonged to the state's financial system under the "unified levying and outlay" financial system, the state was the ultimate organizer of the entire *inner system*. Hence, SOE management for long time was not each SOE's own business but a part of the state's administrative decision of the social resources allocation. SOEs necessarily have no management autonomy, as the state not only appointed their managers but also virtually decided entire SOE system's investment plans. Accordingly, the state cannot deny that it has a critical responsibility for many SOE's poor performances.<sup>15</sup> There exists a broader social consensus in China that if SOEs cannot arrange economic compensation for Xiangang

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<sup>15</sup> In this context, the state should grant economic compensation for Xiangang Zhigong to dissolve the labor relations, "as the government was the decision maker as well as the executor of the former system, it should take full responsibility for all problems from the former system." Huang Huabo, *op. cit.*, p. 11.

Zhigong, then the state cannot but engage and support them.<sup>16</sup> In particular, the Liaoning experiment decision, whereby the state comes to provide financial supports for the area's many troubled SOEs in granting compensations to dissolve the labor relations with redundant Zhigong, has to do with the fact that the state cannot be free from SOEs' poor performance.

In the context of a socialist "demiurge" state, China set up SOE based on the Danwei system which organized the urban society with Zhigong labor system. Their low-waged labor contributed to the system construction. Hence, SOE Zhigong are not simple employees of enterprises that pursue mainly economic profits but the personnel of the Danwei system as social unit oriented to the rapid socialist industrialization. The state tried to absorb most of what the society produced to reinvest them for the rapid socialist industrialization, while checking the society's consumption at minimal level with SOE Zhigong's low wage system combined with jobs security and full welfare benefits. In short, SOE Zhigong were workers not only of each Danwei but also of the entire *inner system*.<sup>17</sup>

Indeed, SOE Zhigong belonged to the Danwei and the system at the same time; the state was the virtual "employer" of the *inner system's* entire Zhigong. Accordingly, dissolving Xiagang Zhigong's labor relations, unlike unemployment in market economy, is not a simple process to dissolve economic relations between employers and their workers, but a sensitive political process to dissolve the former special relations between the state and the Danwei system's Zhigong. The compensation to dissolve Xiagang Zhigong's labor relations cannot

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<sup>16</sup> "In the old system, the state had unlimited liabilities to SOE Zhigong for the reason that the government absorbed entire Zhigong's labor products with the scheme of turnover profits and taxes to reinvest. Accordingly, it is true that SOEs should be the first responsible subject to pay their liabilities and economic compensations, but the government as the owner of state properties also has joint liabilities" ILSS, *Zhongguo Laodong Kexue Yanjiu Baogaoji 2000-2001*, p. 265.

<sup>17</sup> SOE Zhigong are not enterprise's own employees but to a considerable degree the "state's Zhigong." Yu Faming, *Xiagang Zhigong laodong guanxi wenti toushi: ruhe jiejie xiagang zhigong chu zaijiuye fuwu zhongxin de wenti*, p. 36.

remain SOEs' exclusive liabilities. If Xiagan Zhigong dissolve their labor relations, they will lose the labor relations not only with their Danwei but also with the system. So, when problematic SOEs reduce their redundant Zhigong, such a measure inevitably involves the process of dissolving Zhigong labor relations – as state workers - with the state. In this respect, the state practically cannot be free from the liability to arrange compensation.

In case that Xiagan Zhigong should leave their RSC and turn into the unemployed, it critically means that they lose not only their labor relations with their Danwei, but also their position as the state personnel. Especially, with the clear defects of Xiagan program, the efforts to dissolve redundant Zhigong's labor relations has come to focus on the compensation issue which transforms their state worker status. The process of SOE restructuring process led to “providing the permanent workers with economic compensations and terminating the “state Zhigong” status. Then, under the condition of altered nature of their employers, those Zhigong, who still remain within their restructured enterprises, establish their new labor relations with new the status of “enterprise's Zhigong.”<sup>18</sup> Obviously, this has to do with social recognition of Zhigong as the state worker. “SOEs and the state in the plan economy system were ‘two parts in a single body’ and those permanent workers actually were the state Zhigong. Thus, the government in the process of Zhigong status transformation, should take the responsibilities for compensation and handle properly interest relations among the government, SOEs, and Zhigong.”<sup>19</sup> Hence, the state has to engage in the compensation efforts for SOE redundant Zhigong in the context of dissolving their state worker status, for the state has eventual liability for SOE management.

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<sup>18</sup> ILSS, op. cit., p. 277.

<sup>19</sup> Yang Shenghua, “Tan qiye chanquan jiegou tiaozheng zhong Zhigong shenfen zhuanhuan wenti,” p. 18.

At first, it remains unclear how to compensate Zhigong in altering their labor relations, or state worker status. Then, with the *merging* decision China has to devise required measures to dissolve the labor relations directly without the intermission of Xiagang program. The *merging* efforts to terminate Xiagang system needs to dissolve Xiagang Zhigong's labor relations, which, unlike laying off workers in market system, involves terminating Zhigong's status as the state workers. Also, the compensation does incorporate a unique socio-political dimension for Zhigong who lose their state worker status. The success of *merging* Xiagang system into unemployment insurance system ultimately depends on if those Xiagang Zhigong are arranged to the "proper" compensation scheme.

For Xiagang Zhigong to dissolve their labor relations means losing their state worker status, which requires "proper" compensation in terms of buyout of the state workers status. "The so called SOE Zhigong status transformation refers to completely change the state Danwei's Zhigong status inherited from the former system ... and transform them into equally competing subjects in labor market... This is the inevitable requirement for the establishment of socialist market employment system and the crux of deepening economy system reform a step forward. Regarding the issue of how to achieve this, general view point is "buyout" (*maiduan*) of Zhigong's state worker status with economic compensation."<sup>20</sup> This involves the process to dissolve SOE Zhigong's labor relations comes to devise a compensation scheme which handles Zhigong's status issue with the measure of buyout in terms of dissolving their state worker status.<sup>21</sup> There is the "hidden permanent labor relations" that both the government and Zhigong

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<sup>20</sup> Huang Huabo, op. cit., p. 11.

<sup>21</sup> "The genuine meaning of transforming Zhigong status, from the state's perspective, is dissolving the state's all-embracing unlimited liabilities with the measure of buyout (i.e., granting proper compensation); and from Zhigong's perspective it is dissolving the dependent labor relations with their SOEs (actually the state) with a certain amount compensation" to give up their entitlements to system's employment

cannot escape derived out of the fact that Zhigong transferred their labor related property rights to the system. So dissolving Zhigong's labor relations the state cannot be free from the compensation for dissolving the special relations in terms of buyout Zhigong's state worker status.<sup>22</sup> The essence of buyout of Zhigong status is to dissolve Zhigong's labor relations with the compensation for their former labor contribution as the state workers because their former labor contributions for their Danwei have not been fully rewarded by their wages but are supposed to remain within the Danwei system. So, their compensation should include their unpaid rewards for their former contribution for their Danwei and the system in terms of buyout of their state worker status.

“Zhigong status buyout is the state's making compensation for their [SOE Zhigong] former contribution from legal and humanitarian perspectives; i.e., the government and SOEs' buyout of Zhigong's former status (i.e., quantifying the assets to decide every person's share); in other words, returning the payments that should have been given for Zhigong's former contribution for their Danwei and the state and turning them into social men [beyond the Danwei personnel].”<sup>23</sup>

In this context, restructuring SOEs' state assets pay compensations for Zhigong status transformation; if they are not enough, the state assets can be used to supplement the shortage of compensation fund. Especially, the land use right that has been used by the SOEs under restructuring can be utilized to supplement the deficient part of the compensation. It has become clear that “payment of compensation for [Zhigong] status transformation as the reform cost

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guarantee and all round welfare provisions. Liang Kaiye, “Lun guoqi gaizhi zhong de Zhigong shenfen zhihuan jingji buchang he renyuan anzhi,” p. 57.

<sup>22</sup> “Zhigong hand over their labor (property) rights to the state, and lose labor owners' many related rights such as making own labor decision, moving, and choosing jobs, . . . . Hence, speaking from the economic perspectives, as the permanent workers and SOE properties are based on close ownership relations, when the government dissolves the permanent worker system, it has to arrange Zhigong compensation.” Jiang Chunhai and Liu Xiaoyan, “Maiduan gongling de jingji buchang yu zuiyou junheng,” pp. 90-1.

<sup>23</sup> Zhu Shubin, et al., op cit., p. 133.

should be handled by the state in terms of “buyout” with the state properties.”<sup>24</sup> Hence, transforming Zhigong status with the measure of buyout involves dissolving the state worker status beyond the insiders of the Danwei system with the compensation derived out of the system’s liabilities for their former contribution to the system construction as the state workers.

Here, the crux of proper compensation for buyout of Zhigong status is Zhigong’s work years that contributed to the construction of the socialist system.<sup>25</sup> Then, the crucial contents of the buyout explain why the urban society has been so sensitive about the practice of “buyout of work years” (*maiduan gongling*). At first, it remains unclear why the practice is not enough for the urban society. With the practice of “buyout of the status” articulated, the society comes to identify the problem that the practice does not incorporate the compensation of Zhigong’s status transformation into their work years dedicated to the system construction. Indeed, the practice of “buyout of work years” is the effort to dissolve Zhigong labor relations completely with one-time severance payment or economic compensation. So, it is by no means a proper way to compensate for their work years of low-waged labor sacrificed for the system construction.

On the contrary, the new contract workers, according to the “labor law,” have to leave their workplace after their labor contracts expire.<sup>26</sup> Dissolving their labor relation with the expiration of the labor contract does not need any compensation in terms of settlement the system’s liability. The practice of “buyout the work years” turns out to be a suitable scheme

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<sup>24</sup> Huo Yanmei, et al., op cit., p. 22.

<sup>25</sup> “Separating personnel from the system (*renzi fenli*) should fundamentally handle the state Zhigong’s status. Xiangang Zhigong belong to a special group in SOE reform: they not only sacrifice themselves for SOE reform but also take burdens of significant reform costs. Thus, no matter how to restructure SOEs, it is required to raise some funds as compensation to use for buy-out SOE Zhigong’s work years ... This is the way how those Zhigong can dissolve their labor relations with the original workplace and fundamentally transform their state Zhigong status ... .” Wang Jiarui and Liu Jing, “Zhong xiao qiye tuichu de nandian yu duice,” p. 12.

<sup>26</sup> Yang Shenghua, op. cit., p. 18.

only for dissolving labor relations with the new contract workers who do not hold the state worker status. With the articulation of compensation for dissolving Zhigong's status, China has realized that the compensations for Zhigong and for new contract workers cannot be the same.<sup>27</sup>

In this context, the proper way of buying out the work years that SOE Zhigong can accept comes to incorporate a condition of the state's compensation for those Zhigong's former contribution to the system as the state workers. The proper way of sufficient compensation should count Zhigong's former contribution years. Hence, the genuine contents of "buyout of the work years" turn out to be "buyout of the status" through a proper compensation.<sup>28</sup> Especially, with the *merging* decision, the work year issue in dissolving the labor relations with SOE redundant workers has turned into the system's unavoidable compensation liabilities for their former labor contribution for the system construction. The proper buyout of the work years has come to involve the system-level's compensation in dissolving the labor relations.

The Danwei system handled a critical part of Zhigong's work year issue by granting pensions after the retirement. Then, out of SOE restructuring process, Zhigong's pension entitlement becomes a critical part of compensation to handle Zhigong's work year issue. The work year issue can be settled with confirmation of their pension entitlement that their Danwei previously promised, which virtually means the compensation for their former labor contribution for the system as the state workers. An important component of the compensation for the work

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<sup>27</sup> "First, it needs to set up compensation boundary. The labor contract system in practice is the cut-off point of new and old labor system and it should be the reference to categorize Xiagang Zhigong for their different treatments. The main target for the compensation is the old Zhigong who initiate their work years before the labor contract system." DRC SRRTT, "Zhongguo chengzhen shiye baoxian zhidu gaige de huigu yu qianzhan," p. 80.

<sup>28</sup> "The "buyout the working years" emerges as the outcome of transforming the permanent worker system, and SOEs and the government should fulfill it for Zhigong's working year accumulation for their Danwei and society." Yu Li and Meng Tao, "Guoyou qiye "maiduan gongling" de wenti yu guifan," p. 56.

year involves how to ensure their earned pension credits within their Danwei for their past work years. Then, dissolving Xiagang Zhigong's labor relations is not a plain "buyout" of economic relations between SOEs and their Zhigong but "buyout of the Zhigong status" as the state workers, as long as it is based on a scheme that can ensure their pension entitlement derived out of their low-waged labor contribution for the system construction.

How to handle SOE Zhigong's entitlement to the new social insurance system has emerged as a very sensitive social issue.<sup>29</sup> Especially, with the decision to terminate Xiagang system, the Chinese society becomes even more sensitive about Xiagang Zhigong's entitlement in its new social insurance system, as they have to leave their RSCs in soon.<sup>30</sup> A critical feature of the Danwei welfare system was the low wage system with a rationale that Zhigong, under the Danwei's provision of all-round welfare benefits, did not need to depend on their salaries for their everyday livings. Their labor contribution to their Danwei was rewarded mainly in real benefits provisions instead of cash wages. In this regard, the low wage system was a mechanism whereby Zhigong saved their welfare credits within their Danwei: the credits were supposed to turn into their welfare benefits, including pension after the retirement. Because pension represents aged Zhigong's own savings of their entire work years' devotion in SOEs, SOEs have

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<sup>29</sup> "Social Insurance is like "explosive warehouse". According to Zhou Zhanshun, the director of State Bureau for Letters and Calls, the total amounts of letters from all parts of the country rebound again from 1993 and it keeps rising ten years. The reasons for people's sending letters, especially those of collective appeal to higher authorities, are relatively concentrated some issues: among the eight major issues, SOE reform, labor, and social security are ranked in the first row." Gao Shusheng, "Shehui baozhang: women gai zou natiolu," p. 42.

<sup>30</sup> "From 2001, the entire country following the center's planning carries out the work of discharging Xiagang Zhigong out of RSCs... Many do not want to dissolve the labor relations with their SOEs. The primary reason for this has to do with the fact that those issues such as Xiagang Zhigong's pension, medical insurance, economic compensation and SOE owed debts turn out to be hard to handle rationally. ... The very condition for them to leave their RSCs is fulfilling the state's promise for the state workers under the plan economy system and properly handle SOE Zhigong social security issue after losing their work post." Zhao Junkang, "Zhuangui shiqi guoqi Xiagang Zhigong de shehui baozhang yanjiu, p. 574.

to pay off as debts in the long run.<sup>31</sup> Of the social insurance entitlements, Xiagang Zhigong's pension entitlements, of course, turns out to be the most sensitive issue, when they leave their RSCs.

Xiagang Zhigong in the former Danwei-based pension system did not pay premium for their individual accounts. Instead, they contributed their full labor under the low wage system with the trust that the system would arrange their pension after the retirements. Xiagang Zhigong clearly understand that the low wage system was a “prior deduction” of Zhigong labor system to mobilize their labor systemically for the rapid socialist industrialization. Its industrialization was accompanied by the system's commitment of pension provision after the retirement. Their welfare entitlements were not regarded as a privilege but as their non-negotiable right. So, Zhigong dissolve their labor relations only with the systemic guarantee of their pension entitlement to the amount of their former contribution for the construction of China's socialist system.<sup>32</sup> The system's commitment to arrange Zhigong's pension then has become the precondition for Xiagang Zhigong to dissolve the labor relations.

Accordingly, the very compensation that Xiagang Zhigong can accept as “proper” is how to ensure their pension entitlement even after they dissolve the labor relations. The “proper” nature of the compensation needs to involve their ensured pension entitlements fully grounded on their former work years. This is the reason why Shitong scheme come into being out of the

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<sup>31</sup> Hurst and O'Brien mention that “pensions represent the work accumulation of past decades and constitute part of the surplus value created by one's labour. A firm's obligations, in other words, may be deferred but they ultimately come due” (Hurst and O'Brien: 351).

<sup>32</sup> “... to merge Xiagang and unemployment into single system, the predicaments related with interest relations should be settled at first. As many people have observed, recently there appear three different obstacles: first of all, large scale of Xiagang Zhigong initiated their work when there was no labor contract system; indeed the old system not only pledged their virtual life time tenure but also carried out “prior deduction” (*yuxian kouchu*) of their labor contribution under the low wage system, which in dissolving labor relations should be compensated ... .” DRC SRRTT, op. cit., p. 80.

*merging* process in order to ensure Xiagang Zhigong's pension entitlements that they earned from their former work years. In Shitong scheme, the Zhigong BPI system fully succeeds to the Danwei system's IPD owed to Xiagang Zhigong. Thus, Shitong scheme can handle their sensitive work year issue properly. Consequently, the compensation for Xiagang Zhigong to dissolve the labor relations comes to incorporate a scheme systemically linking the compensation to Zhigong's pension entitlement in the emerging new social security system. In addition, there emerges a voice that parts of compensation funds for Xiagang Zhigong should be assigned to the new pension system in each area.<sup>33</sup>

China needs to devise a reliable measure that can fulfill Shitong scheme. Social voice demanding the state active engagement to ensure Xiagang Zhigong's pension entitlements has already risen, since it turns out that they are to be arranged with "proper" compensation for dissolving their state worker status in terms of the state's own liability to "buyout of the status." With the *merging* decision, in particular, China has to treat the compensation issue urgently, and there follows social process which comes to identifies the state's liability in terms of the hidden debts.

"Under our former distribution system in terms of "low wages, high welfare, and high accumulation," SOE Zhigong's wages were the incomes that covered only basic consumer goods, and those incomes that would cover their pension, housing, medical treatment, etc., were not provided as monthly wages but through those channels or forms such as collective welfare funds, tax and profits for the government, reserved profits within the Danwei, constitutes the "state owned assets" or "collective welfare systems (funds)," which have been managed and used by the state and the Danwei for long time. No doubt, these "state owned properties" or "collective welfare system (funds)" really exist with various forms of

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<sup>33</sup> "Parts of compensation money should be separated to be transferred to social insurance funds, which will constitute the "transition costs" by regarding those Zhigong's working years as their premium payment years before China initiates individual accounts in ZHIGONG BPI system. Thus, the measure will resolve Zhigong's worries about their future living, because they, no matter whether they are laid off or remain in their original workplace, can maintain their old age pension entitlement, if they continuously pay their pension premium." Yang Shenghua, op. cit., p. 18.

concrete “properties,” which from the records of their accounting system appears as the owner (state)’s rights but in their nature are “rights of those SOEs’ working Zhigong as the creditors,” and the state and SOEs’ obligation in terms of unpaid Zhigong’s wage natured incomes over the years, which can be called as concrete debts “that should have been paid as long term wages and social insurance premium” ... . The debts that “should be paid as long term wages and social insurance premium” remained as “hidden debts” all along without appearing in the state and SOEs’ balance as debts before the SOE restructuring process, which, however, should be uncovered and take proper measure to pay off in the restructuring process.”<sup>34</sup>

In this context, there emerges a clear social voice in the urban society, claiming that Xiagang Zhigong’s existing pension credits within their Danwei are the state’s “hidden debts” owed to SOE Zhigong beyond the Danwei level. “Under the condition of former plan economy system, the state owed a kind of hidden debt to SOEs in terms of the state’s liabilities to provide the society with social securities. Thus, when SOE Zhigong leave the state economy sector, the state should clearly calculate their hoard of social insurance premium which has been accumulated with the scheme “prior deduction,” and then, as a measure of state’s compensation, record the amount into individual Zhigong’s social insurance premium account to return them to individual Zhigong.”<sup>35</sup> Hence, in terms of the hidden debts, the state has to arrange proper compensation for Xiagang Zhigong which can ensure their pension entitlement after all. This means that the state has to engage a more active financial role, while, as we observed, the state tries to limit its supports to those areas so critical to maintain the credibility of the entire regional IPD handling system. The state does not want to officially recognize its liability for the Danwei IPD issue.

The *merging* decision is accompanied by the social process identifying clearly the reason why the state cannot stay away from the Danwei’s IPD issue, as ensuring Xiagang Zhigong’s

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<sup>34</sup> Xu Tiexiang, “Guoqi Zhigong shenfen zhihuan de yi ci xing buchang tanxi,” p. 17.

<sup>35</sup> Zhang Qingren, “Wanshan shehui baozhang tixi shi cujin guoqi Zhigong dao fei guoqi jiuye de zhongyao huanjie,” p. 14.

pension entitlement has turned out to be a critical condition to dissolve their labor relations. As Shitong principle confirms that the Danwei's IPD issue needs to settle before dissolving Zhigong's labor relations, it needs some reliable scheme that can fulfill the Shitong principle in the *merging* process. In this context, there follows social voices claiming the state's liability for the Danwei IPD issue: as the state with the Danwei system was to grant pension for their former work year's labor contribution under the low wage system for the system construction. After all, the state cannot overlook its ultimate liability.<sup>36</sup> Indeed, under the very urgency to ensure Xiagang Zhigong's pension entitlement, the *merging* process comes to articulate social voices claiming that the Danwei's IPD should be the state's hidden debts, and the state cannot overlook their pension entitlement predicated on their former labor contribution for the system construction as the state workers.

Xiagang Zhigong's pension entitlements is a return for their former low-waged labor contribution for their Danwei, and the emerging social voice claiming each Danwei's IPD as the state's eventual liability includes the social process that dissolves Xiagang Zhigong's labor relations within the scheme of dissolving their state worker status. Indeed, the urban society's articulated voices demands the state's more active engagement in hidden debts, revealing the nature of Xiagang Zhigong as the state workers who sacrificed through their low-waged labor for their entire work years. The social process of identifying the Danwei's IPD as the state's eventual liability results from the political process that dissolving Zhigong's labor relations

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<sup>36</sup> "... all the required expenses for Zhigong's retirement had been accumulated within the system. Today Zhigong are ousted from state economic system's labor relations; but it is quite irrational to expel Zhigong without rational compensation or even putting other social expenses on their shoulders. It is from any point of view practically impossible, without rational compensation, to reform state economic system and build up new labor relations." Huang Hetao and Zhao Jianjie, *op. cit.*, p. 26.

comes to be handled in the context of handling their state worker status.<sup>37</sup> The state's liability as the historical debts that can ensure Xiagang Zhigong's pension entitlements contains the social articulation of "proper" compensation for dissolving their state worker status in terms of "buyout of status." As we observed before, dissolving Zhigong labor relations has to settle clearly all related debts-credits relations derived from their permanent labor relations through a "proper" compensation that they can accept, and, out of urgent *merging* process, it turns out that the "proper" compensation for dissolving Zhigong's unique status extends to the social demand for the settlement of the state's hidden debts related to their state workers status.

Setting up the socialized Zhigong BPI system in SOE reform process spawns the efforts to figure out a scheme which can handle the Danwei's IPD owed to the retired Zhigong, since the Danwei system is no more permanent system as it used to be. The pension reform process decides the principle of "the old way for the *old*," which confirms that the new pension system fully succeeds to the Danwei system's IPD owed to the retirees. Then, entire retired Zhigong's pension entitlements can remain untouched even when their Danwei undergo a radical restructuring process. Yet, the new pension system tries to handle the retired Zhigong's pension mainly depending on the social pooling part without devising reliable financial sources. With the articulation of social voice of the state's hidden debts out of the *merging* process, the Danwei's IPD owed to the retired Zhigong is also refashioned as the state's unavoidable hidden debts. Hence, the pension reform to set up a reliable socialized pension system that can grant full pension for the retired Zhigong comes to be accompanied with social voice demanding the

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<sup>37</sup> "The crux and primary goal of the policy adjustment (to the *merging*) are the issues of how to appropriately handle the inherited liabilities from the old system. If the issues are properly settled, there will be no more the "status" issues of Xiagang Zhigong... ." DRC SRRTT, op. cit., p. 77.

state's confirmation of its ultimate liability to ensure full pension granting for the retirees.<sup>38</sup> Out of *merging* process, the emerging social voice demanding the state's hidden debts covers the Danwei IPD owed to the retired Zhigong as well. SOE reform now needs to dissolve the permanent labor relations not only with redundant Zhigong but also retired Zhigong who the Danwei grants pension after the retirement. Following the efforts to set up a new socialized pension system to grant a full pension for retired Zhigong even when their Danwei undergo restructuring, the scheme of "old way for the *old*," requires measures to handle the Danwei IPD. The society also begins to take it as the state's hidden debts out of the context of "buyout of status" through the "proper" compensation for dissolving retired Zhigong's state worker status based on their former contribution for the system.

Hence, out of the *merging* process, the urban society articulates its clear demands that the Danwei system's IPD owed to both the *old* and the *middle* should be identified as the hidden debts that the state has to handle eventually. The urban society also articulate the idea of the state's total hidden debts owed to Zhigong in terms of the *old*'s total pension and the *middle*'s pension credits that they earned from the former labor contribution for the system.<sup>39</sup> Both retired and Xiangang Zhigong know that their relations with their Danwei cannot last forever with the Danwei's pension provision after the retirement as before and that they have to dissolve the relations with their troubled Danwei after all. However, it turns out that they can dissolve the permanent labor relations only with the compensation that can ensure their pension entitlement.

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<sup>38</sup> "Many [social security] specialists admit that the burden of caring retirees in pension reform process is a historically inherited issue which has been created from the former planned economy system. Accordingly, they think that the state has to take the final responsibility." SDPC AMR, *Guanyu jianli he wanshan woguo shehui baozhang tixi de yanjiu*, p. 128.

<sup>39</sup> "The required amounts to grant the pension to the *old* and fill up the unfilled accounts of the *middle* are in reality the "hidden debts" that the state owes to Zhigong." Jiang Chunze and Li Nanxiong, "Zhongguo yanglao baoxian sheng ji tongchou yi hou de maodun fenxi yu duice yanjiu," p. 13.

Ensuring the *old* and *middle*'s pension entitlement in SOE restructuring process requires a scheme that can settle the Danwei IPD owed to them. Out of the *merging* process, then, there follows the social demands of the state's ultimate liability to settle it in the context of "proper" compensation for dissolving their state worker status in terms of "buyout of the status."

The growing social demanding of the state's liability to handle the Danwei IPD in terms of hidden debts owed to both the *old* and the *middle* stimulates a social process that articulates the system's "historical debts" that the system cannot overlook in the pension reform process. "The so called "historically inherited problem" mainly refers to the hidden debts or the transition costs that the state under its plan economic system owed to SOE Zhigong in terms of their pension through the mechanism as followings: Zhigong took only low wages; SOEs handed over all their profits to the state; and the state used those profits to expand its industrial system."<sup>40</sup> In fact, both the *old* and the *middle* "under PAYG system not only contributed to cover the pension of retired Zhigong of former generation, but also made labor contributions in terms of the "prior deduction" under the low wage system, which constituted the government's revenue."<sup>41</sup> Indeed, the urban society draws the "prior deduction" of Zhigong's low waged labor contribution into the discussion of the Danwei IPD issue. The discussion includes the social reflection of why the state should not overlook pension in arrear in many areas. Out of this process, there emerge the state's historical debts that consist of the basic pension for the *old* and the "transition" pension for the *middle*.<sup>42</sup>

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<sup>40</sup> Shi Yuren, "21 shiji woguo shehui baozhang zhidu mianlin de tiaozhan de duice," p. 16.

<sup>41</sup> Mo Taiji, "Geren zhanghu yu yanglao baoxian de gongneng pouxi," p. 347.

<sup>42</sup> "The hidden debts derived from the former pension system in the pension transformation process are consisted of the basic pension for the *old* and the "transition" pension for the *middle*," Jia Kang, et al., "Guanyu Zhongguo yanglaojin yinxing zhaiwu de yanjiu," p. 17.

It also turns out that the leadership cannot stay away from the social reflection process, as the following discussion on the origin of how Xiangang program:

“Why did the government decide not to directly lay off those Zhigong who lost their work posts in the public economic sector but to “Xiangang”? The reason is there were special interests or “trust” relations among the government, SOEs, and Zhigong under the plan economy system. The government and SOEs, on the one hand, made commitment to virtual life time employment and related pension and medical care for Zhigong who had started their work year before China initiate the labor contract system; on the other hand, they carried out “prior deduction” of Zhigong’s labor contribution through low wage system and constructed parts of the state property accumulations. Because of this special historical “legacy” and consideration of immense scale of involved personnel in relatively concentrated timing, the government and SOEs could not simply take measure of discharging Zhigong but choose Xiangang ... .”<sup>43</sup>

The state cannot be free from the claim that the Danwei IPD is the state’s hidden debts, as the constructed state’s properties as a whole contains the resources supposedly to pay SOE Zhigong’s pension. Therefore, the state cannot deny that SOE Zhigong with the scheme of “prior deduction” contributed their low-waged labor to the system construction, on the one hand, and that their pension entitlements are a critical measure to compensate for their contribution with the Danwei system, on the other hand. The state necessarily treats to improve the pension system in which many cannot have their pension or suspect about their future pension, as it cannot neglect its ultimate liability out of its properties to ensure SOE Zhigong’s pension entitlement.<sup>44</sup> In this respect, the process of articulating the very reason of the state’s hidden debt involves the social formation of the system-level’s liability as “historical debts” to settle the Danwei IPD owed to the *old* and the *middle* in dissolving their labor relations. In the political

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<sup>43</sup> DRC SRRTT, op. cit., p. 78.

<sup>44</sup> “As the historical (pension) burdens were formed under the former planned economy system; as the *old* and the *middle* pension funds have turned into the state properties; and as the government itself decided the former scheme of Zhigong’s investment and returns; it is so obvious that the state should be the provider of compensation fund ... .” SDPC AMR, op. cit., p. 129.

condition whereby the state cannot deny the hidden debts in the Danwei IPD in dissolving SOE Zhigong's labor relation within the context of "proper" compensation to handle their state worker status, the Danwei system's IPD has turned into the system's historical debts that the state has eventual liabilities.

The critical contents of the system's historical debts formation has to do with the efforts to estimate its total scale. Yet, it turns out to be quite tricky to measure because it is not a simple scale estimation of the total scale of the Danwei's IPD. It is rather the scale of the pension liability that the system cannot overlook in the urgent SOE restructuring process.<sup>45</sup> The actual amount of the historical debts did not exist from the start, but it can only be decided out of the political process of how much the system comes to recognize it. So, the scale of the historical debts is not issue of how to measure accurately, but issue of how much the system recognizes its liability. Unlike the case of the *old*, whose pension was already decided when they retired, the *middle*'s pension benefits ultimately depends on how much the system recognizes their pension credits for their work year contribution for the system construction in the process of dissolving their labor relations. This is why with the *merging* process the total scale of the historical debts have exploded, as China, in addition to its liability to arrange pension for the *old*, comes to recognize the *middle*'s pension credits. Huang Hetao and Zhao Jianjie estimate that the government's total debts involving compensations and making up required social security funds reach at least to 4 trillion *yuan*.<sup>46</sup> Song Xiaowu and others even estimate that China in the future

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<sup>45</sup> This is why even World Bank's measurements at two different times are quite different. It estimated in 1997 that China's total historical debts might reach to 46-69 percent of its GDP in 1994; but with a different way it estimated in 1998 again that the debts may reach to 94 percent of China's GDP, even with the fact that China's GDP expanded significantly in the period. Wang Yan, et al., "Zhongguo yanglaojin yinxing zhaiwu zhuangui chengben gaige fangshi ji qi yingxiang," p. 305.

<sup>46</sup> Huang Hetao and Zhao Jianjie, "Jingji jigou tiaozheng yu laodong guanxi zhongjian," p. 26.

thirty years may need to take the burden of 7.6 trillion *yuan*.<sup>47</sup> Of course, each has its own estimation criteria, so it is not easy to tell which one is more accurate. But what we can still tell is that the various efforts to estimate the historical debts' scale involves the social formation process of the historical debts out of the reform in terms of deciding how much the system has to pay to ensure SOE Zhi Gong's pension entitlement.

With the social formation of the historical debts, the pension reform also needs to be understood as the issue of how to handle them.<sup>48</sup> Then, more and more people come to accept that resolving the historical debts is the precondition to establish working new pension system, not vice versa.<sup>49</sup> Hence, the primary contents of the pension reform has turned out to be an issue of how to settle the historical debts for both the *old* and the *middle*: in addition to granting the promised pension for the *old*, China's pension reform has to ensure Xiangang Zhi Gong's pension entitlement after they dissolve the labor relations. Although its efforts on the surface seem to introduce a funded scheme beyond the Danwei based PAYG system, the underlying driving forces which fashion the very process of the pension reform have to do with the issue of how to handle the Danwei system's IPD issue to ensure pension entitlements of the retired and Xiangang Zhi Gong as the Danwei system promised. The historical debts of the system are recognized as the state's eventual liability as its hidden debts.

With the social formation process of the system's historical debts in SOE reform process, the system has to devise a reliable financial ground for the ensured pension entitlements.

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<sup>47</sup> He Xinhua et al., "Guanyu Woguo Qiye Zhi Gong Yanglaobaoxian Tizhi Gaige Yingxiang Yinsu de Fenxi," p. 539.

<sup>48</sup> "On the one hand, in order to realize genuine [pension] transformation, it is required to carry out calculation in details of the historical pension debts owed to the middle and old Zhi Gong and make a thorough investigation of required total amount of compensation money as soon as possible. Zheng Gongcheng, "Zhongguo yanglao baoxian zhidu: kuo shiji de gaige sikao, p. 277.

<sup>49</sup> Zhao Chenhui, op. cit., p. 26.

Ironically, however, this is not what really happens. As the social formation of the historical debts become clearer, the system has to settle much more pension liabilities in terms of the state's hidden debts. This situation makes the state reluctant to take the liability. Initially, the leadership did not set up independent pension funds for SOE Zhigong pension granting, and the Danwei granted their retired Zhigong's pension with their budgets. Hence, the state hesitates to recognize the hidden debts officially, as the Danwei system's IPD remains a huge scale of the pension commitment without any reserved resources that have been accumulated for the entire period of the efforts to set up the socialist system under the CCP. In this context, with the formation of the system's historical debts, the leadership does not want to take any special financial measure to implement it, and the social pooling part in the new regional pension system remains the primary system to grant pension for their retired Zhigong.

As we observed, the new pension systems in many regions had limited financial resources, only to face troubles in pension granting and to entail the empty account practice in broad areas. Then, out of the *merging* process, there merges Shitong scheme to ensure Xiangang Zhigong's pension entitlement as they expected from their Danwei even after dissolving the labor relations. In addition to already bulky pension burdens for the retired Zhigong, Shitong puts another heavy burdens on the regional pension system. Thus, officially recognizing the state's the hidden debts can be accepted as its commitment to take the unlimited liabilities for the huge amount of the inherited Danwei system IPD owed to entire Zhigong. In this context, there emerge voices that demand a cautious approach in handling the Danwei's IPD issue with the scheme of the historical debts.<sup>50</sup> Even if the system cannot avoid the historical debts to ensure

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<sup>50</sup> "The state should be very careful about Zhigong BPI system's various kinds of promises with sincere consideration of the result of the promises on the state's debt fluctuation and the society in present and future." Liu Cuixiao, op. cit., p. 93.

the retired and Xiagang Zhigong's pension entitlement, the state wants to limit the amount of its liability within its affordable scale. Hence, regarding the issue of how to handle the historical debts, academia has different ideas, and the government does not make its position clearly.<sup>51</sup> Hesitating to confirm its official liability of the historical debts, the state lets the regional pension system handle the issue. Hence, many regions under serious financial pressure to grant full pension for the retired Zhigong have no choice but to continue the "empty account" practice. The persistent "empty account" practice can shake the very ground of the credibility of the new pension system, as the individual accounts that will be the pension of the current working Zhigong exist only in name. It also means a very shaky financial ground of the new pension system. Still, it remains uncertain whether those Xiagang Zhigong's pension can really get their supposed "transition" pension after the retirement, according to the Shitong principle. This situation signals the peril that they cannot get the "proper" compensation as the buyout of their state worker status.<sup>52</sup>

Without digging out new financial sources, it is impractical for the regional pension system to handle inherited IPD issue owed to the retired and Xiagang Zhigong. Inevitably, there surges social demands for devising an additional financial system that can ensure not only the retired Zhigong's pension granting but also Shitong scheme to provide Xiagang Zhigong's "transition" pension. The leadership also clearly realizes the urgency to set up new social security funds which can support the regional pension system's shaky financial bases. Indeed, out of the *merging* process, the precondition to make Xiagang Zhigong leave their RSC to

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<sup>51</sup> Liu Cuixiao, *op. cit.*, p. 92.

<sup>52</sup> "The issue of compensating Zhigong's labor contribution in the old system already has gotten broad recognition . . . . Yet, the state even today has not set up specific regulations regarding compensating standards and compensation measures, which renders the practices of economic compensation uninstitutionalized and each does what it thinks right." DRC SRRTT, *op. cit.*, p. 80.

dissolve the labor relations is the confirmation to fulfill the state's promise of their social security under the planned economy system. Hence, "establishing social security compensation fund for those SOE Zhigong who dissolve their labor relations is the inevitable route to handle the issue."<sup>53</sup>

The "decision of the CCP Central Committee regarding some critical issues of SOE reform and development" made at the Fourth Plenum of the 15<sup>th</sup> CCP Central Committee in 1999 states that devising new resources mobilizing routes for social security by taking various measures, which includes, among others, liquidation of part of state properties.<sup>54</sup> Indeed, China comes to think about liquidating part of the system properties instead of reallocating the government budget outlays.<sup>55</sup> The Danwei based PAYG system does not save the resources for their Zhigong' pension. This, however, does not mean frittering away, but put them somewhere in the system properties under the socialist single fiscal budget system. Even without special funds for Zhigong pension, the system properties constructed by Zhigong's low waged labor surely contain the resources for their pension, so a part of them can be used to make up for limited resources of regional pension system. In June of 2001, State Council finally issues "provisional measures for raising social security funds from liquidating SOE assets."<sup>56</sup>

China also decides to set up National Social Security Fund (hereafter NSSF) in 2000, and, in addition to the initial government budgets of 80 billion *yuan*,<sup>57</sup> the fund depends mainly on sales of SOE stocks, such as 10 percent of the IPOs on domestic and international exchanges

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<sup>53</sup> Zhao Junkang, *op. cit.*, p. 574.

<sup>54</sup> Liu Changping, "Yanglao baoxian zhidu "hua zi changzhai" zhanlue yanjiu," p. 105.

<sup>55</sup> "Payment of reform costs comes not necessarily out of the public budget system. In fact, the liquidation of state assets can be a critical or even a primary source for the payment of the reform costs." ILSS, *op. cit.*, p. 229.

<sup>56</sup> Liu Changping, *op. cit.*, p. 105.

<sup>57</sup> Nie Mingjuan, "Quanmian jianshe you zhongguo tese shehui baozhang tixi," p. 12.

or transferring 10 percent of non-tradable shares in listed SOEs (Frazier 2010: 64). Though facing some issues such as a sharp falling-down of the market prices or an opposition to those agencies that are controlling SOEs, the scheme to constitute NSSF resources with part of SOE assets to secure pension arrangement remains untouched. Indeed, the scale of funds keeps expanding with the central government's budgets allocation and transferring 10 percent of SOE IPO proceeds. At first, the government's budget allocation constitutes the biggest portion of the funds.<sup>58</sup> It, however, drops quite radically year by year to 25 percent of raised funds in 2005, while the proportion contributed by the 10 percent of SOE IPO has been increasing (Leckie and Pan: 90).

There have announced many rules of how to organize and invest the fund in detail, but there is no clear announced scheme of how to use the fund (Leckie and Pan: 95). As the most urgent social security issue is Zhigong's pension, nevertheless, it is natural to expect the fund to be used to handle urgent situation in Zhigong's pension granting after all. Under the condition that the regional pension system covers those current pension outlays, NSSF is supposed to operate as strategically reserved fund controlled by the center to ensure the entire pension system. For the regional pension systems in financial hardships, credibility matters in the smooth using of the funds. Especially, Shitong principle that confirms the *middle*'s pension credits out of the *merging* process puts even more pension liability on the regional pension system that already has heavy pressure to grant full pension to their retired Zhigong. Thus, it is required to set up some extra measures which can make the new regional pension system credible to handle inherited IPD issue for both the *old* and the *middle*. NSSF as the strategic fund can support the

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<sup>58</sup> By the end of June in 2004, NSSF has accumulated 143.2 billion *yuan*, in which the central government's budget allocation reaches to 104.8 billion *yuna* (73.1%). Gao Xiqing, "Quanguo shebao jijin touzi jingying guanli," p. 23.

regional pension system in financial hardships; by doing so, it can maintain the credibility of the pension system even with additional burdens to handle the *middle*'s IPD. As a result, even if Shitong scheme puts the additional *middle*'s pension burden on the system, NSSF allows the regional pension system to maintain the credibility to grant the supposed full pension for the retired and Xiagang Zhigong after their eventual retirement. With the expectation of the secure support through the system's strategic funds, the Shitong principle is no more a simple notice of the principle in the *merging* process but rather a reliable policy based on the system's commitment.

Using part of the state properties as the guarantee of Xiagang Zhigong's pension entitlement, the system comes to recognize its eventual liability in handling the Danwei's IPD issue.<sup>59</sup> Indeed, out of the *merging* process, the "proper" compensation to dissolve Xiagang Zhigong's labor relations in the form of their pension entitlement has turned into not just SOE's exclusive liability but also the system's comprehensive one. It has become clear that the state cannot stay away from the burdens to handle the Danwei system's IPD owed to Xiagang Zhigong to dissolve the labor relations. Of course, the obligation to ensure the *old*'s pension entitlement also turns out to be the state's eventual liability, as China comes to organize NSSF out of a part of the state properties to maintain the credibility of the new socialized pension system to grant full pension for them. The very efforts to devise pension entitlement assurance system for both the retired and Xiagang Zhigong through setting up NSSF reveals the political process confirming the system's liability as the historical debt.

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<sup>59</sup> "... transferring parts of state property should be regarded as one of many financing measures, which, speaking from the economic forms, is a measure to realize the state responsibility by transferring a part of state property to cover the deficit of the *middle*'s accounts. Again, since existing state properties do incorporate parts of historically undeducted or remaining pension, even if it is not easy to separate them from individual SOE properties, it is still possible to clarify them from the total state properties." SDPC AMR, op. cit., p. 130.

The construction of NSSF identifies that the Zhigong pension cannot help depending on parts of SOE assets that should have been set up as the fund for their pension granting under the scheme of prior deduction of the Zhigong's low wage system. In other words, organizing NSSF out of the state properties tells us that, under the condition that the inherited Danwei IPD issue should be settled in SOE reform after all, the state cannot deny that a part of its properties may well be used to settle the IPD issue. Though not officially confirming its liability to ensure retired and Xiang Zhigong's pension entitlement, the center devises a strategic scheme by setting up NSSF out of the state properties to maintain the credibility of the Zhigong BPI system. Here, the state by no means recognizes its full liability to handle the entire inherited IPD issue but set aside a part of its properties to the amount that can maintain the credibility. Accordingly, NSSF involves delicate politics which leaves the financially unstable regional pension system as the primary system to handle inherited IPD issue without busting the credibility of the whole pension system, while limiting the center's financial engagement at minimal level.<sup>60</sup>

This involves a social process of articulating the unavoidable historical debts of the system in SOE reform process. In order to dissolve Zhigong's permanent relations with their Danwei, the state has to engage in the pension reform process to ensure their pension entitlement.<sup>61</sup> The pension entitlement is liability of not only each Danwei but also the system itself, as the Danwei are part of the system to construct the socialist system. So, if each Danwei cannot fulfill its liability to arrange supposed compensation to ensure Zhigong's pension

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<sup>60</sup> The center's goal of establishing NSSF is to keep itself from the escalating commitments to those troubled local pension systems with financial subsidies (Frazier 2010: 64).

<sup>61</sup> "The pension burdens in the pension transforming process have been fashioned under the socialist system, which is historically constructed inherited issue owing to the original system, so the state should be the final burden-taker." Zhao Chenhui, *op. cit.*, p. 26.

entitlements, the state on behalf of the system may well engage to settle the liabilities.<sup>62</sup> In this context, without the system's official recognition of the liability, devising a measure which can buttress the credibility of the pension system through the strategic fund based on the state's properties accompanies the political process of articulating the historical debts as the state's liability. The state with NSSF can still limit its burdens to the level that can maintain the credibility of the new pension system.

China finally sets up its social insurance law after its long struggle to figure out legal system to regulate its social security system in the post-Danwei era. It took years to set up an official legal system to organize pension system, as the issue of how much the center takes the liability remained undecided. Yet, with the social articulation of the system's historical debts accompanied by NSSF, the standing committee of the NPC passes the Social Insurance Law in 2010, which states clearly that the government will cover all the premiums of those Zhigong's Shitong period before the Zhigong BPI system (article no. 13). This stipulation means that the state clearly confirms its eventual liability to handle the Danwei IPD owed to their Zhigong.

As discussed before, it becomes clear that the Danwei IPD as the system's historical debts derived from the "prior deduction" of SOE Zhigong's low wage labor contribution for the system construction with the system's pension commitment after their retirement. Hence, if the Danwei cannot handle their IPD issue, the state has to finance required resources. The very nature of constructing NSSF out of the state properties involves the political process that virtually

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<sup>62</sup> "This is because the state in the plan economy system took the policy of unified levying and outlay financial system whereby the state could maintain long term high accumulation rate, as SOE's most profits and taxes were transferred to the state. In this context, for SOE Zhigong, China organized the labor scheme of low wage, full protection, and high benefits. This made SOE Zhigong virtually the state's Zhigong and their social insurance and welfare benefits were fully covered by SOE and the state. Today SOEs under the restructuring process and some SOEs bankrupt, which renders their Zhigong inaccessible to their original securities and benefits. For these Zhigong, the government should compensate them to the amount that they made accumulation." Yang Shenghua, *op. cit.*, p. 17.

confirms the state's eventual liability to ensure pension entitlement to dissolve retired and Xiagang Zhigong's permanent labor relation with their Danwei. Here, out of the process, Zhigong's permanent workers status extends beyond their Danwei personnel to the state workers who contributed their labor to the system constructions. On the surface, Zhigong's relations with the system are not clear at first.<sup>63</sup> Then, out of the *merging* process, the sensitive issue of the Danwei's IPD in dissolving Zhigong's labor relations turns out to be not an issue that can remain as the Danwei's own issue but rather the system's unavoidable liability. What lies under the process is the virtual recognition of Zhigong's work year as their "prior deduction" of labor contribution under the low-wage system as the state workers. In short, the formation of the historical debts based on the state's eventual liability to ensure Zhigong's pension entitlement shows the process of dissolving Zhigong's permanent labor relations not only with the Danwei but also with the system as the state workers.

The compensation that Xiagang Zhigong can accept as "proper" to dissolve the labor relation is not a simple economic compensation for the laid off workers in market economy but the social settlement of their pension credits earned from their work year. Because such a settlement is the system's unavoidable historical debts in the *merging* process, China needs to treat the work year issue through the system's confirmation of Zhigong's pension entitlement. Here, the social formation of the system's historical debts has a social meaning of providing "proper" compensation of buying out their state worker status. China then articulates a scheme of "proper" compensation virtually identifying their state worker status beyond the *Danwei personnel*. Of course, the premise of this socio-political decision refers to the state's

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<sup>63</sup> "The enterprise-centered welfare system tied the workers not to the state directly, as in Eastern Europe, but to the enterprise work-unit" (Gallagher: 108).

unavoidable liabilities for those who contributed their full low waged labor contribution for the system.

Out of the pension reform and the *merging* process, there emerges a unique embeddedness politics which confirms the state's eventual liability in terms of "proper" compensation to buy out Zhigong's status as the state worker. Therefore, even if the state does not want to make an official commitment for the Danwei IPD, it cannot avoid the eventual liability to ensure SOE Zhigong's pension entitlement to dissolve their labor relations. Even when the Danwei becomes bankrupt or fully privatized in the restructuring process, the pension credits of their former Zhigong (both the *old* and the *middle*) for their former work years as the state worker should remain officially untouched. In this sense, the essence of embeddedness politics in SOE restructuring process is the compensation for dissolving SOE Zhigong's labor relations, which, instead of organizing reliable unemployment insurance system, requires to handle properly their status issue as the system's unavoidable historical debts.

SOE reform process has been accompanied with a series of pension reform efforts, such as Shanghai's Xiebao, the Liaoning experiment, and Shitong principle. With the formation of the system's unavoidable historical debts, China sets up an institutional template whereby it can push the full SOE restructuring in terms of "grasping the big and releasing the small." Then, released from the pension burden for the retirees with a reliable socialized pension system, SOEs can be reorganized as pure economic units. Plus, with the assurance of their pension entitlement, Xiagang Zhigong of small SOEs can dissolve their labor relations in the restructuring process, including selling off for privatization; on the other hand, Zhigong of big SOEs can also accept their Danwei's reorganization process on the condition of separating the subsidiary parts from the primary part and transferring their redundant workers to those separated subsidiary units.

Indeed, with the articulation of the system's unavoidable historical debts, SOEs finally are released from the pension liabilities to the retirees, then laying off their redundant Zhigong. This progress allows China to carry out the full SOE restructuring process successfully. This is how China completes its long dragging SOE reform under the reform of gradualism.

Now, China can lay off redundant SOE Zhigong without any mediation of Xiangang program, which ends up with huge number of the unemployed.<sup>64</sup> This does not simply mean exploding its unemployment rate but its successful devising of a new unemployment system that the society can accept. Out of the *merging* process, the new unemployment system takes its roots in the society beyond the former *daiye* system. Between 1995 and 2003, the number of state-owned and state-controlled industrial enterprises fell from 118,000 to around 34,000, and total employment in the SOE sector fell by around 44 million. The number of lost state-sector jobs totaled 17 percent of urban employment in 2003. During the period, official urban unemployment increased from 2.9 to 4.3 percent, but the true unemployment rate is much higher. Giles, Park, and Zhang estimate that the unemployment rate among urban permanent residents increased from 6.1 percent at the end of 1995 to 11.1 percent at the end of 2002 (Garnaut, et al. 2005: 89-90). Here, the expanding numbers of the unemployed are not the result of the policy failure but rather a consequence of successful process of dissolving SOE Zhigong's labor relations. Essentially, the urban society accepts the new unemployment system which allows China to complete SOE reform.

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<sup>64</sup> Actual unemployment rate in the *merging* process is much higher than the official unemployment rate. Some provinces' actual unemployment rates reaches even over 10 percent: Liaoning (11.8%), Hubei (10.6%), Tianjin (10.5%), Jilin (10.2%) and Heilongjiang (10.0%). Hu Angang, "Zhongguo Chengzhen Shiye yu Shehui Baozhang," p. 50.

## <Dissolving Zhigong Labor System and the Labor Market Formation>

In order to construct the socialist system China organized the urban society with the Danwei system based on Zhigong labor system and a critical content of SOE reform involves the efforts to free the Danwei system from existing Zhigong labor system. Especially, with the intensified market competition, lots of SOEs faced serious redundant workers issue inherited from Zhigong labor system's full employment commitment. Yet, the Danwei have troubles in discharging them, as Zhigong labor system is based on the permanent worker system without regulations to dissolve their labor relations. Hence, the breakthrough in dragging SOE reform has to do with if China can dissolve the labor relations with inherited redundant Zhigong and it turns out that the very condition to dissolve Xiagang Zhigong labor relations is setting up a scheme that can ensure their pension entitlement. The *merging* is a breakthrough in China's reform, as it decides to dissolve the labor relations directly with those permanent workers, which is accompanied with the socio-political process to make the permanent workers accept this decision. The *merging* process to terminate Xiagang program identifies the fact that Xiagang Zhigong's pension entitlement is a precondition to settle before dissolving their labor relations with the Danwei. Indeed, the crux of China's pension reform is how to handle the Danwei's IPD issue in the SOE reform process, and without squaring it, those troubled SOEs cannot dissolve the labor relations with their retired and Xiagang Zhigong. Only after China can settle the IPD issue with articulation of the system's historical debts, the *inner system* Danwei are unbound from Zhigong labor system. China can complete SOE reform, as it organizes new unemployment system that urban society can accept. Now SOEs in addition to labor contract system for the young employees can layoff their aged redundant workers based on their labor

demands, which means that the *inner system* Danwei come to be free from Zhigong labor system eventually. This is the eventual termination of Zhigong labor system that survives the reform process for decades.

Yet China organized urban society with the Danwei system, so Zhigong labor system which constituted the Danwei system was the primary scheme to organize urban society. SOE reform cannot remain only as enterprise restructuring but inevitably extend to comprehensive reform of the existing scheme to organize the urban society. Hence, a social consequence of SOE reform with the efforts to dissolve the permanent Zhigong's labor relations involves dissolving Zhigong labor system itself, the primary constituting scheme to organize urban society. China tried to organized Zhigong labor system to provide entire urban citizen with formal employment based on job security and full welfare benefit regardless of their labor skill. So preserve urban formal employment for urban unskilled workers, the leadership decided to prohibit new unskilled labor force from rural areas with Hukou system. So SOE reform that can dissolve the labor relations with their redundant workers with the confirmation of their pension entitlement extends to reform of the existing scheme of organizing the urban society which was to arrange formal employment for the all urban unskilled workers.

Zhigong was the term that refers to the formal workers in the Danwei system, which incorporates clear sense of their recognized high social status as the system workers who were entitled to the Danwei system's comprehensive welfare benefits. Zhigong's positions as the system's formal workers were predicated on unique 'bilateral monopoly relations' between the state and Zhigong, whereby SOE Zhigong had to provide their labor only to the state through their Danwei and the state only allowed Zhigong labor system as exclusive labor relations in urban society. The 'bilateral monopoly relations' was the socio-political base formulating

Zhigong status as the state worker, who provided low waged labor and were entitled to all round welfare entitlements as the *inner system*'s formal workers.

In fact, China tried to organize and maintain Zhigong's high status as the state's formal workers, since it represents how China imagined its ideal citizenship under the socialist system, which, however, was predicated on a comprehensive solidarity of urban workers by incorporating great numbers of urban unskilled workers as the system's formal workers. Indeed, China's Zhigong labor system tried to organize the entire labor relations with formal employment exclusively without distinction of workers' labor skills by repressing internal labor market within the Danwei in terms of deskilled production system. The wage differences between unskilled workers and skilled workers or staffs were limited.<sup>65</sup> This limited scale of wage differentiation was predicated on the idea of socialist citizenship, which claimed broad solidarity among workers regardless of their skill levels. At the same time, with the Danwei's lifelong welfare systems, China guaranteed the life of its skilled and unskilled workers within same welfare systems in order to check some evolution of differentiated treatments of its workers according to their level of skills. Indeed, the socialist citizenship was predicated on the ideal of sense of solidarity of the entire urban citizens without distinction of their labor skills.

Yet, Zhigong labor system faced a serious predicament in realizing full employment, as it tried to employ vast numbers of unskilled labor forces as the privileged permanent workers. Plus, mainly engaging in heavy industry which is capital intensive system, SOEs could not afford to arrange enough work posts for its huge numbers of the urban unskilled labor forces.

Accordingly in order to maintain the very unique Zhigong labor system which only organizes formal labor system without distinction of skilled and unskilled workers, China could not but

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<sup>65</sup> The government permitted only 8 grades in wage-levels, even this sometimes came under political attack as during the Cultural Revolution.

check new unskilled labor force from rural areas to enter urban society with Hukou system. Quite ironically, China's decision to organize entire labor relations with formal employment without distinction of labor skills ended up with the unique Zhigong labor system which came to set up a new social distinction along the boundary of urban society and rural areas.<sup>66</sup> In order to maintain this unique Zhigong labor system China could not allow other forms of labor relations in urban society under the form of the state and Zhigong's 'bilateral monopoly relations'. As the members of the system's of exclusively recognized Zhigong labor system, urban society's unskilled workers come to fill the most of the *inner system's* formal posts, which might not be possible, if they were in market system. Hence, a critical nature of Zhigong's labor scheme is an extremely favorable system for the urban unskilled workers who can take the formal employment position with full welfare benefits without worries of unemployment. This is an outcome of Zhigong labor system which tries to organize the *inner system* Danwei's all work posts with formal employment exclusively for entire urban citizens regardless of their labor skill level.

Gradually, it has become so apparent that urban society cannot stick to the formal employment relations exclusively. China experiences a serious trouble to arrange full employment for the urban society with limited number of work posts, as the *inner system's* formal employment cannot offer enough jobs for the urban society and block new migrant labor forces from rural areas. For those rural labor forces who have to remain in countryside, the leadership allowed new *outer system* units, such as TVEs, in rural areas based on quite flexible informal labor relations. Then, the urban society also follows suits and permits small scale *outer system* units. Indeed, allowing the *outer system* units, China can introduce a competitive market

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<sup>66</sup> Indeed, those migrant peasants for a long time were regarded as potential perils for the urban society such as the term of 'blind floating' (*mangliu*) implies.

condition without patent ownership reform with the dual economic systems in terms of the *inner* and the *outer system* units based on completely different labor scheme. While the *inner system* organized with formal employment exclusively for Zhigong, the *outer system* organized with informal employment relations free from Zhigong labor system. Hence, China's development of *outer system* economy system entails expanding numbers of new jobs that cannot be available under the regulation of Zhigong labor system. Shanghai, the leading city in China's reform process, has quite robust *outer system* economy from the early period and its expanding *outer system* economy has changed its labor relations. The yearly new increased workers in Shanghai's private and individual economic units in 1990 are 12.5 thousand, which accounts for 8.8 percent of its total new employed. Then the number expands to 289 thousand in 1995, which account for 73 percent of the years' total new employed. With the robust development of Shanghai's *outer system* economy, more and more its workers are employed in informal scheme of employment.<sup>67</sup>

Lots of *outer system* units in the urban society engage in the tertiary business sector, which has been suffocated for long time to develop heavy industry. For this underdeveloped service sector, there are big unrealized social demands of the sector in Chinese urban society. Thus, if China can realize the demands and develop the sector, it will not only enhance its economic efficiencies but also create more jobs. In this context, China starts to pay attention to tertiary business sector. It is true that the *outer system* in the tertiary sectors organized with informal employment, as a crucial part of the tertiary business, unlike industrial sector, is organized with quite flexible labor relations. China realizes that social demands for service take more diverse contents, so in order to satisfy the various social demands service sectors cannot

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<sup>67</sup> Sun Keqin, "Yanlao baoxian gaige yu Shanghai shehui hexie fazhan," p. 306.

but take diverse production scheme based on more flexible labor relations.<sup>68</sup> Obviously, the informal employment comes to take root in the urban society with the expectation that the *outer system*'s potential to offer more jobs. Indeed, China starts to expect that a great number of newly emerging jobs are informal employment and as early as in 1996 does express its interests in informal jobs as way to realize SOEs' redundant personnel's reemployment.<sup>69</sup>

Then, after dissolving the labor relations, the *inner system*'s unskilled workers who consist the majority of Zhigong can realize their reemployment according to the demand of their labor in the labor market. So they cannot but be reemployed primarily in the *outer system*'s many informal jobs which demand unskilled labor. There is close affinity between unskilled labor and informal employment, so informal employment is affordable positions for those lots of unskilled SOE Zhigong. Those lots of unskilled Xiagang and unemployed Zhigong can easily realize their reemployment in informal employment. According to the survey conducted between June and September of 1999, majority of Xiagang Zhigong attain their reemployment mainly in the informal forms of jobs, such as temporary workers (59%), manual labor workers (18.6%), seasonal workers (5.2%); and only limited numbers of them were reemployed as formal contract workers (6.9%).<sup>70</sup> Between 1998 and 2002, total number of SOE Xiagang Zhigong reached to 27.1 million and 18 million of them realized their reemployment, which obviously depends on informal employment. Indeed, the survey of MOLASS in 2001 showed that about 90 percent of reemployed Xiagang Zhigong were employed in informal sectors such as

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<sup>68</sup> "In the world level structural transformation, both developing and developed country alike, the ratio of service sectors are expanding. Most of those service sectors share the feature of small scale and flexible work, which provides mainly non-fulltime and hourly waged work posts." Jin Yihong, "Fei zhenggui laodongli shichang xingcheng he fazhan zhong de jige wenti," p. 8.

<sup>69</sup> *Laodong neican*, 1996 Issue 8, p. 15.

<sup>70</sup> Yang Yiyong, *Zhongguo Zhuangui Shiqu de Jiuye Wenti*, p. 115.

temporary workers, part time workers, or dispatching workers.<sup>71</sup> China has realized that informal employment can be the main route to realize Xiagang Zhigong's reemployment, because its flexible scheme of employment can fashion more jobs for a society's broader unskilled workers.<sup>72</sup>

Of course, one tricky issue involved with Xiagang Zhigong's reemployment is how they accept those informal jobs offered by the new *outer system* units. Xiagang Zhigong can accept those new informal jobs of the *outer system* units with the assurance of their pension entitlement with the hope to be pensioner after the retirement. Indeed, Shanghai's Xiebao scheme allows the Danwei to dissolve labor relations with Zhigong by paying their three social insurance premiums to ensure their social insurance entitlements. Then, those Zhigong leave their Danwei and accept their new informal jobs in the new *outer system* units, as they are to be entitled to the social insurance entitlements after all even when the new units do not join the social insurance program. Those *outer system* units also have no trouble in hiring those Zhigong, as they need not to care their social insurance entitlement.<sup>73</sup> Indeed, the measure is expected to promote unemployed Zhigong's re-employment, since their new employers do not need to pay social insurance premium.

Other areas also dissolve the labor relations with their Xiagang Zhigong only with assurance of their pension entitlement with the articulation of the system's historical debts, which allows those Xiagang Zhigong to accept new informal jobs of the *outer system* units without worries of losing their pension entitlement when they reach the retirement age. Hence,

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<sup>71</sup> Wang Dongjin, "Wanshan laodong shehui baozhang zhidu cujin linghuo jiuye jiankang fazhan," p. 10.

<sup>72</sup> "Since, informal employment has capacities to absorb relatively broader range of workers regardless of their age, education, and skill level, it can provide critical employment room to unskilled labor forces..."

<sup>73</sup> Wang Junjie and Li Yong, "Feizhengui jiuye: Chengzhen Jiuye Xinsulu," p. 11.

<sup>73</sup> Interview, 2003, Oct. 31st.

the assurance of pension entitlement is the very condition whereby lots of *inner system's* unskilled workers accept those informal jobs in labor market. Indeed, ensuring Xiagang Zhigong's pension entitlement resolve the most troubled issue for them to face in achieving their reemployment in temporary jobs; as most of informal jobs do not offer social insurance program, so they are not sure about their pension entitlements. The informal jobs in their nature are not compatible with quite organized labor regulations including social insurance programs. Xiagang Zhigong can accept informal jobs only after reconciling the internal conflict between social security and informal jobs by assuring their pension entitlement with the articulation of the system's historical debts.

As Xiagang Zhigong can realized their reemployment mainly in many *outer system* informal jobs, the social meaning of those informal jobs have changed. China starts to carefully articulate a new view about increasing informal employment in terms of its potential benefits to offer new jobs for the exploding numbers of Xiagang Zhigong.<sup>74</sup> “Obviously, three non-conventional forms of employment (such as non-industrial sector, non-public owned enterprises, informal employment) are Xiagang Zhigong's main reemployment routes.”<sup>75</sup> Realizing that informal employment can create lots of new work posts which will reduce the social tension involved with Xiagang and unemployed workers, China has changed its position of informal employment. Under the former single Zhigong labor scheme, informal employment in urban area was supposed as something that should not exist, which, however, cannot be maintained any

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<sup>74</sup> “Informal employment or terms such as temporary employment, clandestine employment, and self-arranging employment also frequently appear in newspapers. Yet the correct way to interpret these concepts has not yet set up. I think that informal employment refers to temporary works that are beneficial for the society and also for the employed as it offers new income source, which is engaged by the urban unemployed ..., or by the SOEs' leftover Xiagang Zhigong .... .” Lü Gengzuo, “Guli Xiagang Zhigong feizhenggui jiuye de ji dian sikao, p. 48.

<sup>75</sup> Yang Yiyong, op. cit., p. 115.

more. Li Qiang argues that “[T]here exists a traditional erroneous conception of informal employment, regarding it as illegal” and “[A]n international consensus has been reached that the informal sector and informal employment cannot be equated with the underground or law-violating economies” (Li: 131). Indeed, China starts to differentiate informal employment from abnormal or illegal labor practices, and comes to recognize informal employment as a normal form of employment in the emerging labor market.<sup>76</sup>

Another new tone that leads the discussion of informal employment is that informal employment does not represent underdevelopment, as every country in the world, developing or developed, has quite large size of informal employment. Criticizing a ILO’s 1991 report that defined informal sectors as “those production or service units of low wages, low rewards, without organization and system in many developing countries,” some argue that informal employment is not an employment scheme in developing countries. Instead, in many developed countries such as U.S., European countries, and Japan, side jobs and non-fulltime jobs are quite normal, as informal sectors and their informal employment in developed countries have by no means been reduced. Accordingly, informal employment takes a critical position not only in the employment of developing countries but also that of developed countries.<sup>77</sup> Plus, China has also noticed that some developed countries handle their employment pressure quite successfully

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<sup>76</sup> “Informal employment is a normal form of employment. ... Basically employment refers social activities of get remunerations by engaging various working activities. The key point of employment does not depend on what kinds of form of labor or employment involved; rather it depends on if the way to make remuneration is legal or not.” Qi Qin, *Feizhenggui jiuye yanjiu*, p. 1.

<sup>77</sup> “Informal sectors as tiny scale production or service units with low income, low rewards, no organization, and no systemic constructing institutions, are not the phenomena limited only within developing countries. According to our observation, there are still many side jobs, part-time jobs, and employment outside of the tax and social security system even in economically developed countries such as United States, EU, and Japan.” Chen Huai, “Feizhenggui jiuye: zhanlue yu zhengce,” p. 13.

depending on their informal employment.<sup>78</sup> “The experiences of other countries tell us that the expansion of non-full time employment not only provides their workers with more employment opportunities but also plays positive roles such as reducing unemployment rates and alleviate enterprises wage burdens...”<sup>79</sup>

China also accepts the idea that informal employment is inevitable within the globalized economy system. Obviously, competitive market system makes enterprises keep reorganize themselves into more efficient productive system, which needs flexible labor system and slimmer formal labor system. Plus, in the globalized economy system with the intensified capital mobility, formerly divided each country’s labor market comes to be closely interconnected and the capital can easily reorganize the production system if it can find out cheaper labor spots in globally interconnected labor system. This means that some business sectors that can maintain formal sector within domestic labor market cannot maintain their formal sector’s position. Thus, globalization inevitably means expanding scale of informal employment.<sup>80</sup> In this context, China’s decision to join in WTO means that its employment cannot but depend more on informal employment.<sup>81</sup>

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<sup>78</sup> “Recent days, a critical reason of some countries’ recent declining unemployment rate has to do with their policies to develop flexible informal employment. Netherlands can decline unemployment rate from 7.5 percent of 1994 to 2.7 percent of 1999 with its very dynamic informal employment.” Yang Yiyong, *op. cit.*, p. 84.

<sup>79</sup> Jin Weigang, “Woguo feiquanrizhi jiuye wenti yanjiu,” p. 17.

<sup>80</sup> “As a result, labor forces in developing countries have to compete not only with each other in domestic labor market but also with other developing countries’ labor. ... Today not just China but entire world is almost same: most of them gradually regard the expectation that many people can have stable and high wages works as an idea in remote Utopia. In contrast, temporary and low wage jobs are the reality that cannot avoid. Consequently, informal or informal employment are suddenly become a big trend in the new millennium’s global world” Tang Jun, “Fei zhenggui jiuye bu ke bi mian,” p. 46.

<sup>81</sup> “Entering WTO system, China’s enterprises are under the pressure of serious competitions. Thus, they can only opt for low cost management which has become their virtually single available way to survive and relatively low labor cost has become their exclusive competitive edge. Generally, this has been regarded as private enterprise’s management scheme, but it is not any more, as SOEs and even some state organizations that try “corporation style management” today also follow suit. ... Obviously, we have

Indeed, China comes to admit that informal employment is a critical component in the formation of China's market based employment system beyond Zhigong labor system.<sup>82</sup> Hence, it comes to be regarded as a crucial part of China's market reform.

“Today our country's the most urgent strategic tasks are bringing about market mechanism, pushing industrial restructuring, and speeding up urbanization. Informal employment sectors can fashion a preparing stage for those who can venture their own self business; it can also construct a necessary process in terms of factors' new combination and optimal selection for the formation and development of new industry. At the same time, informal employment is an indispensable part of urban economy, as it is a critical outer momentum that can break down our conventional system's irrational “self-sufficient” and self-servicing” consumption scheme and irrational division of labor scheme such as “big and complete” or “small but complete.”<sup>83</sup>

China comes to reach full acknowledgement of new informal employment in its market economy. All this process involves how Chinese society comes to accept informal employment. Here, we can identify the fact that China comes to abandon a critical part of Zhigong labor system, which has denied informal employment with the efforts to organize entire labor relations with formal employment for those numerous urban unskilled workers. With the full recognition of the informal employment, China does abandon its former labor scheme based on formal employment exclusively, which still remains in the *inner system* Danwei even after the reform. So those *inner system's* unskilled workers have to dissolve their labor relations and cannot but engage in newly emerging various informal positions that demand those unskilled labor. Of

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virtually smaller leeway in our labor costs. Accordingly, informal employment which has characters of low wages, small benefits, and unstable will become China's critical scheme of employment for a time in the future.” Tang Jun, op. cit., p. 46.

<sup>82</sup> “Informal employment from the start is established on the voluntary organized market employment system. Following the development of informal employment sectors, market based employment system finally become the primary route of urban employment. This inevitably facilitates the reform of our conventional employment system ... .” Yan Zhongxing, “Shiying linghuo jiuye yanqiu wanshan shehui baoxian zhidu,” p. 34.

<sup>83</sup> Chen Huai, op. cit., p. 15.

course, a sensitive issue here is if those Xiagang Zhigong can dissolve the labor relations and accept those informal jobs. Obviously, ensuring their pension entitlement in terms of virtual compensation based on the system's historical debts is precondition for them accept all this process. Indeed, the urban society's full recognition of the informal employment beyond Zhigong labor system is predicated on the ensuring Zhigong's pension entitlement with the articulation of the system's historical debts.

At the same time, China also gradually comes to allow new migrant workers to enter the urban society unlike the hitherto rigorous Hukou system restriction which systemically prohibits new migrant workers from entering the urban society. First of all, under the condition of dual economy systems the *outer system* economy including new informal sectors come to grow, which is followed by social demands for new labor forces for those new informal employment positions. Yet the expanding *outer system's* new informal sectors, unlike the *inner system* SOEs, offer only informal employment positions which the urban citizens does not takes; so those jobs are virtually filled up with the migrant workers from rural areas.<sup>84</sup> New informal sectors informal jobs are by no means the contentious spot where the urban citizens and the migrant peasant workers compete. In this context, the emerging new informal employment come to employ new peasant workers without causing serious social tensions, which makes the urban society accept new numerous unskilled labor forces in the informal sectors. Indeed, most of migrant workers engaged mainly in urban service business which usually took the form of informal employment scheme.<sup>85</sup> In the mid 90s the ratio of peasant workers to the total rural

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<sup>84</sup> At first urban young workers reject certain careers such as 3K jobs in informal sectors, which allowed migrants to enter those urban jobs (Solinger 1997: 197).

<sup>85</sup> The census data on migrant people conducted in Beijing in 1999 clearly showed that migrant workers were engaged in various forms of service sectors: construction sites (27.6 %), commercial business (16.3

labor forces already reached to 18 percent, which accounted for 35 percent of total urban labor forces.<sup>86</sup>

Migrant workers have become undeniable constituents of the labor relations of urban society, and urban society comes to recognize their existence with a construction of their social position in terms of the peasant workers (*nongmingong*) who holding rural peasant status participate in the urban labor market.<sup>87</sup> “According to estimate, the number of rural-urban migrants currently working in urban settings has reached 130 million, either as laborers or as small businessmen. With the restriction imposed by a number of barriers including household registration, all-rural-urban migrants and most other people temporarily residing in the cities can only find jobs in the informal sector. ...” (Li: 127). Obviously, the distinction of formal/informal sectors under the dual economy systems of the *inner* and the *outer system* turns out to be a very social condition whereby new peasant workers come into being.

With the growing the *outer* system economy, more and more peasants move to urban areas for their jobs and the leadership came to lift many previous restrictions that have divided the urban society from rural areas. Especially, with the development of a market economy, the urban society also has gradually realized that it needs cheap and hard-working new migrant workers, and from many small cities more and more urban societies admit the reality of migrant workers’ participation in their labor market. It is true that market economy provides the large numbers of Chinese peasants who formerly had to remain in rural areas with an opportunity to

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%), service involved jobs (14.1 %), manufacturing sector (13.8 %); and restaurants (12.9 %). Jin Yihong, op. cit., p. 8.

<sup>86</sup> Feng Tongqing and Xu Xiaojun, *Zhongguo zhigong zhuangkuang: neibu jiegou ji xianghu guanxi*, p. 10.

<sup>87</sup> “Plus, they can be pressured to pack their stuffs and return to their hometown at any time. The status of temporary residents and employment with temporary resident certificate represents the nature of peasant workers’ employment.” Li Peilin, Zhang Yi, and Zhao Yandong, *Jiuye yu zhidu bianqian: liangge teshu qunti de qiuzhi guocheng*, p.165.

participate in the new urban labor markets. The constraints of the Hukou system on peasants' moving have been reduced evidently.<sup>88</sup> At the same time, rural areas also have its own reason to find out new employment opportunity in the urban labor market. The Chinese government estimated that total scale of surplus rural workforces in 1996 was 60 million and 45 million entered into its urban areas.<sup>89</sup> However, the condition of rural areas' surplus labor force is even more serious than this. TVE capacities to absorb rural labor are no more sturdy and the total number of TVEs workers after 1996 started to decline.<sup>90</sup> Accordingly, a critical portion of rural labor forces somehow have to find out their jobs in urban society and China estimates that it "has about 150 million rural surplus workforces who need to migrate."<sup>91</sup>

In this context, the total scale of the peasant workers expand rapidly. According to the 5<sup>th</sup> national census conducted in 2000, total peasants who leave their hometown more than half year has reached to one hundred and twenty million, in which total eighty million of peasant who enter urban society for industrial and tertiary sectors.<sup>92</sup> According to the 'group for rural socio-economic investigation' in the State Bureau of Statistic, in year 2000, there are 74.35 million peasant workers in urban areas.<sup>93</sup> Of the total China's rural labor forces in 2001 (four hundred eighty millions), more than 33 percent of them are engaging in non-agricultural sectors which are

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<sup>88</sup> "In the management of migrant workers, Fengtai District and Beijing Municipality as a whole apply a regime requiring every migrant to submit "five certificates"—that is, a temporary residence certificate, a certificate ensuring the safety of the house (room) rented, an employment certificate, a marriage and childbirth certificate (for females), and a permit authorizing business activities. ... The questionnaire survey found that "incomplete procession of the five certificates" was a widespread phenomenon, as over 60% of the migrant workers did not have the complete set of certificates..." (Li: 135).

<sup>89</sup> *Laodong neican*, 1996, 10, p. 7.

<sup>90</sup> Total number of TVE employee at the end of 1996 was 135 million, which declined to 125 million in 1998. Li Yingsheng, *op. cit.*, p. 85.

<sup>91</sup> Mo Rong, *Jiuye lanpi shu 2003-2004 nian*, p. 82.

<sup>92</sup> Liu Kaiming, *Bian yuan ren*, introduction.

<sup>93</sup> Chang Jinxiong, "Nongmin shimin hua jincheng zhong de fei zhenggui jiuye," p. 56.

mainly offered in urban areas.<sup>94</sup> China estimates in 2002 that total number of peasants who leave their native village for jobs reach to 94 million.<sup>95</sup> As more and more peasant workers participate in the urban labor market, they come to engage in most business areas including industrial sectors: urban industrial sectors (37.22%), construction sectors (14.41%), service sector (12.2%) and restaurant business (11.93%).<sup>96</sup>

Urban society accepts the peasant workers as they take informal jobs out of the *outer system* economy, which the urban citizens do not have interests. Yet, the situation has changed with the urgent SOE restructuring process, as many Xiangang Zhigong come to participate in the urban labor market after they dissolve their labor relations. In the urban labor market, they cannot easily find out new formal jobs as their work posts within their Danwei, so they cannot but take those new informal sectors' informal jobs. Indeed, as Xiangang Zhigong start to engage in informal sectors, Chinese informal employment is no more urban ghetto sector for the ruralites. As observed before, with the articulation of the system's unavoidable historical debts the *inner system* Zhigong dissolve the labor relations and try to find out new jobs in labor market. With the confirmation of their pension entitlement the *inner system's* unskilled workers comes to accept those new informal jobs offered by the *outer system* units. Indeed, even if they are reemployed in expanding informal jobs with the peasant workers together, they do not worry about their future, because they, unlike their counterparts from rural areas, are fully entitled to pension benefits just as the Danwei system promised before.

A critical constituent of informal employment is Xiangang and unemployed Zhigong who are employed in small private enterprises and individual economic units, or engage in temporary

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<sup>94</sup> Cai Fang and Lin Yifu, *Zhongguo Jingji*, p. 58.

<sup>95</sup> Zhang Chewei, "Zhongguo chenzhen laodongli shichang mianlin de zhuyao wenti ji qi zhengce tiaozheng, p. 16.

<sup>96</sup> Ceng Xiangquan and Li Lilin, "Woguo laodongli shichang zhong de jiuye zhengce zhichi," p. 28.

or seasonal ‘labor service’ (*laowu*) activities. The other critical constituent is the peasant workers who mainly engage in construction, remodeling labor, or maintaining security, cleanliness, planting, or street food stall, house maid, or other service jobs.<sup>97</sup> Consequently, with radical SOE restructuring process, informal sector in China today consists of two groups: Xiangang Zhigong who was supposed to belong to urban formal sectors and peasant workers who have been a major social group for informal employment.<sup>98</sup> At the end of 2002, total number of urban employed personnel were 248 million in which, according to Chinese government rough estimation, 75 million (30%) were employed in informal employment; plus there were total about 100 million peasant workers in urban labor market in which 70 million were employed in informal sectors. Thus, Chinese government estimated that total numbers of personnel in informal employment reached to 145 million.<sup>99</sup> Obviously, the peasant workers are critical players in China’s new market economy system who constitute new informal sectors with those discharged former SOE Zhigong altogether.

In this context, the urban society’s attitude about peasant workers has changed as well. “We should demolish our excessive administrative and economic restrictions to the immigrant peasant workers; and break down the division of urban-rural labor market by gradually reducing administrative restrictions on peasant workers’ urban employment; and gradually arranging levied migrant worker management fees to be used for migrant workers...”<sup>100</sup> In this context, the derogatory term of “blind migrant” to refer irrational aspects of peasant workers’ fervor to

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<sup>97</sup> Yi Shoukuan, “Woguo linghuo jiuye de shehui baoxian wenti yanjiu,” p. 18.

<sup>98</sup> China’s urban non-standard employment consists of four major groups: (1) many young workers who try to get their jobs after their graduation; (2) peasant workers moving between urban and rural areas; (3) reemployed urban residents; (4) voluntarily joins non-standards sector to be employed or starts their own business. Of course, (2) and (3) are the main labor forces of China’s non-standard employment. Tan Lin and Li Junfeng, “Woguo feizhenggui jiuye de xingbie tezheng fenxi,” p. 12.

<sup>99</sup> Wang Dongjin, op. cit., p. 10.

<sup>100</sup> Jin Yihong, op. .cit., p. 9.

enter the urban society is gradually substituted with the more neutral term such as “peasant workers’ tide” (*mingongchao*).<sup>101</sup> China realizes that ruralites labor flow into urban society “has become a undeniable factor and potential energy for China’s economic growth.”<sup>102</sup> The reform clearly enhanced the value of outside labor and improved the social attitudes about migrant rural labor forces and this reevaluation of the peasant workers is followed with even critical positions of Zhigong labor system.

“Under the conventional system, SOE unskilled labor’s price highly exceeded its marginal labor productivities and its wage exceeded its market wage rates. Thus, considering various benefits arrangements such as pension, medical insurance, housing, and so on, the price of hiring urban normal labor highly exceeded that of migrant workers. In addition, migrant workers rather take those hard jobs, easy to manage, and are able to be laid off according to enterprise production demands or their wish. Thus, with the situation that new jobs for reemployment mainly come from non public sectors, *it is a rational choice to allow peasant workers to take those new jobs and make them market actors* [emphasis added].”<sup>103</sup>

In this context, China’s Hukou system has become more flexible and the urban society is ready to allow more peasant workers to cross the social boundary.<sup>104</sup> “Only after the informal labor market emerges in urban society allowing quite free labor flow, the peasants can enter the urban labor market, which, inevitable part of market economy reform, breaks through the blockade separating urban-rural systems under the plan economy system.”<sup>105</sup> Indeed, there emerged voices which argued that China should demolish its outdated Hukou system even as

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<sup>101</sup> Cai Fang and Lin Yifu, *op. cit.*, p. 57.

<sup>102</sup> Feng Tongqing and Xu Xiajun, *op. cit.*, p. 10.

<sup>103</sup> Wang Daben, “Chengshi jiuye: Xiagang he zai jiuye,” p. 96.

<sup>104</sup> Indeed, there are big regional differences in the actual practice of running Hukou system today which frequently depends on the scale of city. Whereas small cities are inclined to be more open in terms of openness for peasant immigration; the large cities are inclined to be more exclusive in their running Hukou system. Indeed, small city’s hukou system today has become virtually open to migrant peasant; medium city’s hukou are in the process of opening its gate by lowering their conditions for new peasant immigration; but big metropolitan city such as Beijing or Shanghai have not made any significant progress in their reform of Hukou system. Cai Fang and Lin Yifu, *op. cit.*, pp. 68-9.

<sup>105</sup> Shen Xiaomei, “Shilun woguo laodongli shichang de jiegou tezheng,” p. 11.

early as 1994.<sup>106</sup> The leadership, however, does not decide to demolish Hukou system officially. But with the expanding numbers of peasant workers Hukou system cannot remain as the old days. “As China’s employment practices have grown out of its plan system, its labor mobility has expanded a lot and lots of peasant workers are employed in urban sectors. There are still remaining programs checking rural labor’s urban entry in the early 21<sup>st</sup> century, the household registration system in small cities and most big cities has already become flexible system.”<sup>107</sup>

Hukou system was established to organize the urban society with Zhigong labor system exclusively with a goal of providing formal work posts to the entire urban society including its lots of unskilled workers. Hence, weakening Hukou system virtually means that a critical components of Zhigong labor system to organize the *inner system*’s unskilled workers with formal employment relations have been fading. Indeed, the efforts to dissolve Xiagang Zhigong’s labor relations comes to reduce the *inner system*’s formal employment relations. At the same time, with the development of new *outer system* economy, China’s new labor relations involves expansion of informal labor relations: on the one hand, displacement of existing formal labor forces with informal labor relations such as reemployed Xiagang Zhigong in new informal employment; on the other hand, recognition of informal labor relations organized with those peasant workers, which virtually remove Hukous system’s restriction of new unskilled workers from rural areas to join the urban labor relations. In sum, recognition of the peasant workers with malleable Hukou system means that the urban society is no more bound with Zhigong labor system which tries to organize entire urban unskilled workers with formal employment relations.

In this context, Zhigong is no more the primary concept to represent the real condition of China’s labor relations, and China starts to use new term, Congye Renyuan (*employed*

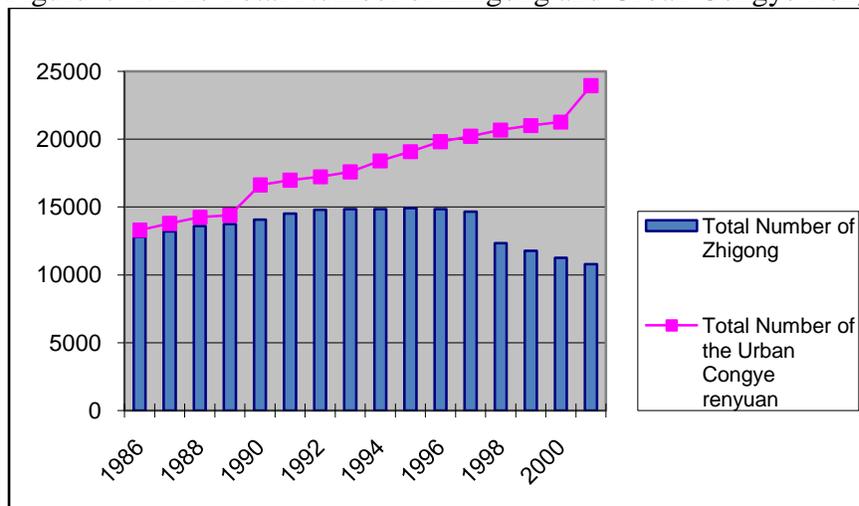
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<sup>106</sup> *Laodong neican*, 1994, Issue 4, p. 19.

<sup>107</sup> Cai Fang and Lin Yifu, *op. cit.*, p. 56.

personnel) from 1994 out of its former terms, Shehui Loadongzhe (*social workers*), which was not significant indicator, as its number was almost identical to Zhigong number. But with the increase of the new *outer system* enterprises, the scale of China's labor relations cannot be captured with the numbers of Zhigong, and China needs new term which can capture entire employed workers including those who belong to increasing *outer system* units. In this context, China's Statistical Yearbook starts to use Congye Renyuan which refers to entire employed workers in both the *inner* and *outer system* together. Therefore, the decision to use Congye Renyuan, instead of Shehui Laodongzhe represent not a simple term change but critical change of China labor system with the expanding the *outer system* economy.<sup>108</sup>

Figure 7-1. The Total Number of Zhigong and Urban Congye Renyuan



(Source: *Zhongguo tongji zhaiyao*, 1998, p.35; 1999, p.33, p.36; 2000, p.42; 2001, p.46, 2002, p.45; *Zhongguo laodong he shehui baozhang nianjian*, 2002, pp.508, 509).

The above graph shows clearly the relation of decreasing numbers of Zhigong and increasing numbers of the urban Congye Renyuan: in the 80s two categories are almost identical;

<sup>108</sup> The book states that the term is a critical indicator to examine China's national situation, as it "represents in a certain period its real employment condition of the entire labor resources." *Zhongguo tongji nianjian*, 1994: p. 131.

then they start to emerge a gap in the 90s with the increasing the *outer system* units; finally, they show reverse relations from the late 90s which has to do with SOE restructuring and Xiangang push. The shrinking total number of Zhigong with the expanding the urban Congye Renyuan, especially after the *merging* efforts, represents dissolution of Zhigong labor system in the urban society. Indeed, the efforts to dissolve the Zhigong's labor relations result in the radical drop of total number of SOE Zhigong, which involves dissolution of the Zhigong cohort eventually.

Dissolution of Zhigong labor system means that the *inner system* Danwei cannot remain as a system to arrange formal employment for urban unskilled workers.<sup>109</sup> “Zhigong of the conventional formal sector (indicating SOEs and urban COEs) declined in a huge scale, 44.3 million, whose ratio in the total employed personnel declined from 73.5 per cent in 1995 to 45.1 per cent in 2000.”<sup>110</sup> Accompanied with the changes, those restricted SOEs are no more a system of formal work positions, as they come to incorporate new informal employment relations as well.<sup>111</sup> At the same time, the *outer system* enterprises' labor relations also experience some diversification beyond informal employment. With the development of the *outer system*, their labor system cannot be organized with informal labor relations exclusively any more. In order to be efficient formal economic units the new *outer system* enterprises also

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<sup>109</sup> Privatized lots of former small SOEs with the involvement of foreign investment by merger or acquisitions come to reorganize its labor relations based on the labor contract “to control salary and welfare increases, lay off noncore workers, hire younger workers, and hire migrant or rural workers for low-skilled positions” (Gallagher: 146).

<sup>110</sup> Hu Angang and Yang Yunxin, “21-shiji de zui da tiaozhan: Zhongguo jiuye zhuangkuang fenxi,” p. 149.

<sup>111</sup> “...restructuring can have an impact on the structure of the workplace. We look at the ratio of full-time to casual workers relative to the year of gaizhi. The ratios of full-time to casual workers are estimated using regression analysis, and the results are shown in figure 4.9. There is clear trend toward a higher share of casual, most likely migrant, workers. The trend seems to predate the gaizhi process. Gaizhi seems to reverse the trend temporarily, but the process accelerates following the second year after restructuring. Firms that are privately controlled tend to have the lowest ratio of full-time to casual workers” (Garnaut, et al.: 102).

need skilled workers, so more and more of them employ more numbers of formal workers.<sup>112</sup>

This has to do with the *outer system*'s internal differentiation in terms of emerging formal sector out of its initial informal sectors and those new formal *outer system* enterprises are based on formal labor relations with many skilled workers. Indeed, the formal sectors include not only the *inner system* Danwei but also newly emerging *outer system*'s formal sectors. Hence, while the employment ratio of conventional formal sector has radically declined, that of new formal sectors (such as FIEs and stock cooperative companies) has noticeably expanded from 4.6 percent in 1995 to 9.3 percent in 2000.<sup>113</sup>

China's reform process entails not simple track of employment in terms of declining the *inner system* employment and expanding the *outer system* employment. It rather involves more complicated process: while the *inner system* enterprises undergo declining formal employment and increasing informal employment, the *outer system* enterprises come to employment more in both formal and informal employment. Indeed, the distinction of the *inner* and the *outer system* units are not identical to the distinction of formal and informal employment relations, as both units all together incorporate both formal and informal employment relations according to their demands of different skilled workers. The urban society is no more organized with *inner system*'s formal employment exclusively but rather depends on the labor relations according to the labor demands of different labor skill with little distinction of the *inner* and the *outer system*. Of course, this has to do with the formation of full labor market system in China.

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<sup>112</sup> According to Beijing city labor bureau survey report of total 349 the *outer system* enterprises in 2000, formal employees account for 50.5 per cent and unofficial employees account for 49.5 per cent. Kang Shiyong, "Linshigong jiben yanglao baoxian wenti yanjiu," p. 13.

<sup>113</sup> Of course, there are still lots of *outer system* units which remain as informal sector and the employment (including those individual employed personnel) has considerably increased with the ratio expansion from 10.7 per cent of 1995 to 16 per cent of 2000. Hu Angang and Yang Yunxin, op. cit., pp. 148-9.

The formation of full labor market beyond the distinction of the *inner* and the *outer system* means termination of Zhigong labor system in the urban society eventually. Now the *inner system* units do not arrange formal work posts for those urban unskilled workers any more, which virtually means abolition of the *inner system* unskilled workers' special position in the urban society. Zhigong labor system still remain the *inner system* Danwei after the reform, so market based labor relations emerge only as the informal jobs of those new *outer system* units. Indeed, with the formation of full labor market the different labor organizing scheme between the *inner* and the *outer system* units has disappeared. What this means is the fact that the origin of the different labor scheme, the *inner system* Danwei's initial role to arrange formal jobs for entire urban citizens including numerous unskilled workers, has also disappeared. Now the urban society is no more organized as a highly favorable system for the *inner system* unskilled workers such as checking informal jobs or new unskilled labor forces from countryside. Indeed, the full labor market in the urban society is predicated on increasing informal jobs out of the *outer system* units and expanding new peasant workers over much lowered Hukou system. This is the complete termination of Zhigong labor system in the urban society.

China can complete dragging SOE reform with abolishing Zhigong labor system in urban society, which entails the formation of full labor market system beyond the distinction of the *inner* and the *outer system* units. What this means is the fact that China's reform makes breakthrough beyond the dual economy system. Indeed, China's reform starts with permission of the *outer system* units to enter market competition instead of patent ownership reform, which comes to coexist with inherited the *inner system* Danwei in terms of the dual economy systems. Competitive condition of the dual economy systems removes many SOEs' monopoly positions, which entails a series of efforts to reform SOE system. Yet, the dual economy system persists

very long, as China does not devise its measure to free the Danwei from Zhigong labor system. Even under serious financial condition, many SOEs cannot layoff their exploding redundant Zhigong inherited from the Zhigong labor system as they had to employ much more workers than they needed to realize full urban employment. Indeed, the main content of SOE reform is how to introduce market based labor relations beyond Zhigong labor system,<sup>114</sup> which will turn the Danwei system into pure economic system and complete lingering SOE reform over decades eventually.

Completing SOE reform also means termination of sustained the dual systems under the reform of gradualism to organize integrated single market system. SOE restructuring is not an industrial adjustment process reflecting economic cycle, but transforming the *inner system*, the backbone of the Chinese socialist system, into pure economic system after being released from Zhigong labor system, which involves breakthrough in China's gradual reform of the dual economy system. At the same time, this involves eventual dissolution of Zhigong labor system in the urban society that remains within the *inner system* Danwei even after the reform, which entails full labor market formation without distinction of the *inner* and the *outer system*. Hence, the formation of full labor market after dissolving Zhigong labor system within the *inner system* Danwei in China is the very condition whereby China realize the market transformation eventually.

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<sup>114</sup> “Dissolving the labor relation is a critical task of Liaoning experiment. To revive SOE’s vitality, it needs not only dissolve existing labor relations but also establish new labor employment system, which has to handle Liaoning province’s old system problem that has lasted for the last 50 years.” “Shidian zhong de Liaoning shehui baozhang, p. 13.

### <Embeddedness Politics for the System Transformation>

Dissolving Zhigong labor system and full labor market formation means the *inner system* unskilled workers' special position fades away. As we observed in the efforts to introduce labor contract system, dissolving Zhigong's labor relations is very sensitive issue in urban society, which obviously has to do with the fact that the majority of Zhigong, the *inner system*'s unskilled workers, do not want to lose their existing special positions as the permanent workers. Hence, China can complete SOE reform beyond the gradualism only after it can to dissolve the special position of the *inner system* unskilled workers, which entails formation of full labor market and achieve the market transformation eventually. China's market transformation ultimately depends on if it can devise related measures in the SOE reform process which enable the *inner system* unskilled workers accept to lose their special positions in terms of disembedding the urban society from Zhigong labor system.

Interestingly, it has been turned out that assurance of the *old* and the *middle*'s pension entitlement is a critical precondition for the Danwei system to dissolve the labor relations with their aged Zhigong. Obviously, the pension reform to ensure the *old*'s pension entitlement and the efforts of *merging* to dissolve Xiagang Zhigong's labor relations from their Danwei involve politics of articulating social condition whereby the *inner system*'s unskilled workers dissolve the labor relations with their Danwei. With assurance of future pension entitlements, China can turn lots of the *inner system*'s unskilled workers into the unemployed, who are then reemployed in new *outer system* firms' many informal jobs. This is the way how China comes to dissolve retired and Xiagang Zhigong's permanent relations with their Danwei. Indeed, with the establishing pension centric social embeddedness scheme, SOEs are no more the Danwei system

that is bound to Zhigong labor system to arrange formal work positions for the urban society's unskilled workers. Now SOEs are not organized with the socialist formal labor relations exclusively regardless of worker's labor skill but have become an economic system that can hire and lay off employees according to the demands of different skilled labor. So the distinction of the *inner* and the *outer* system is no more identical to the distinction of formal and informal employment system, as both of them employ their workers in both formal and informal positions. With the allowed informal employment relations the urban society comes to open to new unskilled labor forces including peasant workers. This is the outcome of dissolving Zhigong labor system with the new pension system, which means that the special position of the *inner system* unskilled workers evaporates in the urban society eventually with the assurance of their pension entitlement.

Here China's efforts to set up new reliable pension system have little to do with "decommodification," but rather involves introducing labor market system in the urban society after removing Zhigong's labor relations from the Danwei as an institutional template for "commodification" of its labor relations. Indeed, a critical nature of China's pension reform is not just devising some measures for social protection to absorb the shock of SOE restructuring but rather constituting a socio-political arrangement to build up new labor market beyond Zhigong labor system. Indeed, assurance of pension entitlement involves emerging primary scheme of social embeddedness to transform the *inner system* Danwei into pure economic units that are no more bound with Zhigong labor system, which entails the full labor market formation in the urban society beyond the dual economy's distinction of the *inner* and the *outer system*. In order to set up full labor market system, China first has to "disembed" the urban society from Zhigong labor system predicated on the *inner system's* unskilled workers' special positions,

which requires new social system as a ground for the disembedding process whereby those *inner system*'s unskilled workers accept the process. It is an embeddedness politics of disembedding. China's new pension system works as an institutional foundation for disembedding the urban society from Zhigong labor system and complete the labor market system. Indeed, a critical nature of China's pension reform is not just a devised measure for social protection but also virtual scheme to constitute a political arrangement to complete its long dragging market transformation after dissolving Zhigong labor system.

Zhigong's pension entitlement has turned out to be the primary condition to dissolve Zhigong labor relations, because Zhigong will not dissolve the labor relations with their Danwei until all their pension credits inherited from Zhigong labor system are settled clearly. China can complete its lingering SOE reform eventually with the measures that can ensure retired and Xiagang Zhigong's pension granting, which turns out to be an issue of how to handle the Danwei's IPD owed to them. China comes to handle it with the articulation of the system's unavoidable historical debts based on the state's eventual liability by organizing NSSF out of the state owned properties to support those troubled areas in granting pension for their retired Zhigong. Even if the state does not officially recognize its liability, it organizes a strategic funds out of SOE properties that can be used to support those areas with troubles in handling their IPD issue, which can maintain the new pension system credibility. So even without raising required all resources to handle the entire IPD issue, the strategic fund that can support those areas with troubles in granting pension makes the regionally organized new pension system sustainable at least. Indeed, the very process of China's pension reform and the *merging* process end up with the social articulation of the system's unavoidable historical debts out of the urgent SOE restructuring process which requires to ensure Zhigong's pension entitlement after they dissolve

the permanent relations with their Danwei. The system cannot neglect the inherited the Danwei IPD issue to dissolve Zhigong labor system in the market transformation, because the system itself set up the Danwei system to grant pension for Zhigong to the amount of their former work year labor contribution for the system. In this context, even if China did not save a special resource for the pension granting under the Danwei based PAYG system, it cannot deny the fact that the state properties do incorporate the resources that should have been set up as pension funds to grant pension to retired Zhigong.

What this means is that the process of dissolving Zhigong labor relations is predicated on recognition of Zhigong's stakes as the state workers within the state properties in terms of the system's compensation for Zhigong's former work year labor contribution for the system construction. Hence, Zhigong can dissolve the labor relations, as they can accept as "proper" the system's virtual compensation with the system's confirmation of its former pension commitment for their former labor contribution as the state workers, which involves full recognition of their former state worker status. In this context, dissolving Zhigong's labor relations is turned out to be predicated on politics of buyout of their state worker status through the system level's "proper" compensation that they can accept for their working year labor contribution as the state workers. This entails the dissolving Zhigong labor system itself in the urban society which is predicated on the *inner system* unskilled workers' special position as the state workers. Of course, the *inner system* unskilled workers do not want to lose their special positions, so dissolving their permanent labor relations involves very sensitive political process. It turns out that they can only accept compensation which confirms their promised pension entitlements for their former work year labor contribution for the system construction in terms of buyout of their state worker status. With the articulation the historical debts which involves buyout of the state

worker status, the *inner system*'s unskilled workers can dissolve their labor relations, which dissolves the system and the *inner system* urban unskilled workers' special relations eventually.

In this context, the new pension system becomes the focal point of its emerging new scheme of social embeddedness out of SOE restructuring process, as it comes to unbind the urban society from Zhigong labor system and complete the market transformation beyond the dual economy system. China carries out its market transformation with dissolving Zhigong labor system, which requires an embeddedness politics in terms of setting up new pension system to ensure Zhigong's pension entitlement. Compared with other new social system, the emerging pension system in China has turned out to be special: whereas unemployment insurance system and the urban minimum living guarantee program are introduced to absorb social shock of labor market system in the post Danwei era, the socialized Zhigong BPI system out of the pension reform and the *merging* process has turned out to be institutional precondition to dissolve Zhigong labor system in the urban society. Indeed, new pension system does not follow the formation of full labor market system but rather induces full labor market in the urban society by setting up a scheme that with the articulation of historical debts can dissolve the *inner system* unskilled workers' existing special position. This is why China's emerging new social system out of embeddedness politics of disembedding for the market transformation ends up highly salient pension system.

## 8. The Politics of Socialist Accountability and China's Bounded Embeddedness

Completing the SOE reform allows China to realize the market transformation with the formation of full labor market beyond dual economy systems by disembedding the urban society from Zhihong labor system. After the new pension system that can ensure Zhihong's pension entitlement with the articulation of the historical debts, the urban society can dissolve Zhihong labor system, which is a highly favorable system for the *inner system's* unskilled workers. The assurance of their pension entitlement turns out to be the very condition that the *inner system's* numerous unskilled workers can accept to leave their highly favorable positions, which completes SOE reform and ends up the market transformation. The main contents of embeddedness politics of disembedding the urban society from Zhihong labor system for the market transformation is how to handle the inherited Danwei's IPD issue owed to their Zhihong. Hence, the long journey to figure out how to separate Zhihong labor system from the Danwei system in order to reform SOE system - the very origin of China's gradual reform process - comes to an end, with the articulation of the system's historical debts out of urgent SOE restructuring process. The articulation is fulfilled by the state's de facto confirmation that the system has the eventual liability for the Danwei's inherited IPD owed to their retired and Xiangang Zhihong. Then, what is the political meaning of the market transformation predicated on Zhihong's pension ensuring scheme with the historical debts?

To rapidly develop socialist industrial system, China before the reform organized the Danwei system, which could systemically mobilize what the society produced based on a unique scheme of a social pact with SOE Zhihong, which virtually fashioned Zhihong labor system in terms of combination of low wage, employment guarantee, and all round welfare provisions.

Under the plan economy system, China organized the *inner system* under the unified financial system as a scheme to mobilize investment resources for rapid industrialization. SOEs paid all their profits to the state constructed by Zhigong's low waged labor contribution, and the state as a return came organize SOE system to arrange Zhigong's living with the life time employment and comprehensive welfare provisions. SOE turned into welfare units for their Zhigong, as China's labor insurance system assigned most welfare functions to SOEs especially after the Cultural Revolution. Hence, the Danwei were independent socio-economic welfare units that at the same time belonged to the state's system.<sup>1</sup>

SOE workers (especially the *inner system's* unskilled workers) before the reform were beneficiaries of China's socialist system with comprehensive welfare benefits. Such a systemic arrangement aimed at maintaining their low wage system to accumulate social production for the heavy industry. For SOE Zhigong, their welfare entitlements were not simple benefits for the social privileged but their nonnegotiable rights for their contribution for the system. Zhigong labor system that organized the Danwei system was the embeddedness scheme for the socialist accumulation with the low wage system's "prior deduction." There was an implicit social pact between the state and entire SOE Zhigong: Zhigong under the low wage system contributed their full labor products for the construction of socialist system in exchange for systemic provision of all round welfare benefits. "The trinity system of employment-welfare-security, institutional structure fashioned under the state economy system, generated specific hidden contract in the plan economic system: Zhigong consented to transfer part of resources to manage labor relations to the state, so let the state collected, used and managed those funds (including Zhigong pension

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<sup>1</sup> Another critical feature of China's Danwei based social security system had no legal foundations; rather the system was organized in terms of political or administrative programs. Zheng Gongcheng, *Lun Zhongguo tese de shehui baozhang daolu*, p. 86.

funds); and the state consented to provide the trinity services of employment-welfare-security.”<sup>2</sup> Even though there was no official contract between the state and Zhigong, the system clearly implied that the state should take full responsibilities of Zhigong’s living.<sup>3</sup>

The nature of China’s pension reform is different from that of other countries’ pension reform process beyond their existing PAYG system, as China’s pension reform redesigns the socialist social pact between the system and the *inner system* Zhigong to mobilize their low-waged labor for the system construction. The pension system is also quite unique, as it, unlike the Danwei’s other social systems which can simply halt with SOE reform, suddenly become the most urgent issue to handle in the process of dissolving Zhigong labor system. As the social pact regarding Zhigong pension entitlement is the commitment to grant the benefits for the coming future, the issue of how to handle the commitment inherited from previous social pact still remains in terms of the Danwei IPD issue. Zhigong formerly contributed their full labor under the low wage system, because they thought that they would be entitled to pension benefits after the retirement. Therefore, their work years mean their low wage labor contribution with scheme of “prior deduction” which is to be paid as their pension from their Danwei. SOE Zhigong do not dissolve their labor relations with their Danwei without assurance of their pension entitlement that they earned as pension credits with their former labor contribution for the system.<sup>4</sup> SOE Zhigong’s pension entitlement issue suddenly becomes the focal issue for the urgent SOE restructuring process.<sup>5</sup>

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<sup>2</sup> Zhao Chenhui, “Buchang: yanglao boaxian zhidu zhuangui de qudongqi,” p. 25.

<sup>3</sup> Wang Daben, “Chengshi jiuye: Xiangang he zai jiuye,” p. 94.

<sup>4</sup> In addition to the rapid expansion of liabilities to banks, SOEs in the restructuring process also realized that they had much more liabilities which had accumulated systemically in terms of their pension liabilities to their retirees (Lardy: 44).

<sup>5</sup> “... in the middle of transforming economic system and deepening SOEs reform, following the gradual realizing the principle of ‘grasping the large and releasing the small’, the development of various forms of

A tricky feature of the Danwei based PAYG pension system is that it was not formally incorporated into the government's fiscal system. Run by the urban Danwei system after the Cultural Revolution, the pension system was organized in PAYG scheme under the autarky Danwei welfare system. The Danwei had to grant their retired Zhigong's pension without any reserved pension funds. The pension reform after the reform involved the efforts to figure out how the Danwei handle their inherited IPD issue.<sup>6</sup> Yet, it is not practical to expect that the Danwei could manage their IPD issue, as many of them under financial troubles could not afford to handle their inherited IPD issue by themselves. There followed a question of whether the state should engage in the pension reform process more actively, because the Danwei system is no doubt a constituting part of the state's *inner system* economy. The system cannot overlook the Danwei system's troubles in handling their IPD issue. As the urgent SOE restructuring process cannot proceed without the clear settlement of the *old* and *middle*'s pension entitlement, the leadership comes to devise required measures that can make sure a new regional pension system can manage their pension granting.

From the measure of "two absolute guarantees," the state sincerely expressed determination to confirm the pension entitlement for the retired Zhigong, which was a "wise measure to "escorting carefully" (*baojia huhang*) SOE reform and industrial restructuring."<sup>7</sup>

What the decision means is the fact that the state cannot stay away from the former pact between

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economic components and increasing cases of corporation merging and bankruptcy will inevitably affect a portion of Zhigong's actual interests. Now the most prominent issue is Zhigong's pension issue, which is a hot issue in the SOEs reform; and the Zhigong pension reform in the restructuring SOE is also a tough one of the many hot issues." *Laodong neican*, 1996, Issue 4, p. 34.

<sup>6</sup> "Before the reform SOEs' finance system belonged to the state's unified levying and outlaying financial system. Thus, SOEs for the decades before the reform did not accumulate the fund for their retired Zhigong's pension. But suddenly the pension funds have been turn over to SOEs' burdens, which naturally constitute a part of the historical debts." Lin Yifu, Cai Fang, and Li Zhou, *Zhongguo guoyou qiye gaige*, p. 93.

<sup>7</sup> Gao Shusheng, "Shehui baozhang: women gai zou natiolu," p. 42.

SOEs and their retired Zhigong after all. At the same time, it has been turned out that the state has to ensure Xiagang Zhigong's pension entitlement before they dissolve labor relations.

“...both parties [SOEs and their Zhigong] are under the constraints of hidden pact which cannot neglect. Hence, when SOEs unilaterally layoff their permanent workers they arrange money for “buyout of work years,” which is the payment as compensation for the layoffs; especially, the permanent workers' accumulated pension for their work year should be compensated. If SOEs are short of resources, then the central and local governments as the owner of SOEs also have the liability to provide compensation with their budget.”<sup>8</sup>

Here it turns out that the proper way of “buyout of work years” that the permanent workers can accept to dissolve their labor relations is determined by whether the compensation incorporates a scheme that can ensure their pension credits derived from their work years' low-waged labor contribution in their Danwei. Lack of such compensation indicates a clear breach of the hidden pact, which is the main reason why Xiagang Zhigong resist seriously those “buyout of work years” when how to handle their pension credits remains unclear. In the SOE restructuring process, as Hurst and O'Brien show, the most sensitive social issue for the Chinese citizens is their pension payment. Delayed or partial pension payments always expedite any form of collective actions. Obviously, China still remains as an authoritarian political regime, but the leadership is not only tolerable about these pensioners' collective actions, but also eager to take serious measures to handle pension payment issue.<sup>9</sup> The leadership cannot overlook that many retired Zhigong cannot have their promised pension from the Danwei system. In the same vein, Xiagang Zhigong worry about their pension entitlements the most in SOE restructuring process,

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<sup>8</sup> Yu Li and Meng Tao, “Guoyou qiye “maiduan gongling” de wenti yu guifan,” p. 56.

<sup>9</sup> “Almost without exception, they cited pensions as a more legitimate grievance than unpaid wages or Xiagang benefits. ... she would never consider demonstrating in order to obtain the Xiagang benefits to which she is entitled. Rather, she would protest only if, upon reaching retirement age, her pension were delayed or resolve” (Hurst and O'Brien: 350).

and China also comes to make efforts to set up a new reliable scheme which can ensure their pension after they leave their Danwei.

So for the efforts of “two absolute guarantees,” the center arranges a large amount of financial supports, and majority of them are used to grant full pension for the retirees.<sup>10</sup> The system turns out to be not able to stay away from the situation that areas’ Zhigong BPI system cannot handle the inherited Danwei’s IPD to arrange pension for their retired Zhigong. At the same time, out of the *merging* process, China also articulates Shitong scheme which confirms Xiangang Zhigong’s pension credits that they earned within their Danwei as their previous premium paid years within the new Zhigong BPI system. This puts additional burdens on the new pension system in addition to its already onerous burdens to grant full pension for the retired Zhigong, and China decides to set up NSSF out of the state properties to make them trust their full pension granting. Finally, it also enacts new social insurance law which officially confirms the state’s eventual liability for the Danwei IPD. Indeed, this formation of the system’s eventual liability involves a political process of turning the Danwei’s IPD into the system’s liability, originated from the context of the hidden pact between the Danwei and their Zhigong. China’s pension reform and the *merging* efforts uncover the very condition of SOE reform, ensuring SOE Zhigong’s pension entitlement. That is, the social confirmation of historical debts the system takes on leads to the social identification process of the state’s eventual liability in the settlement of the Danwei IPD owed to both the *old* and the *middle*.<sup>11</sup>

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<sup>10</sup> The amounts of the center’s financial supports for the program until 2002 reaches to 54.7 billion *yuan* and 40.8 billion *yuan* of them were used to guarantee retired Zhigong’s pension. Gao Shusheng, *op. cit.*, p. 42.

<sup>11</sup> “... from the above analysis of the nature of the pension system’s historical debts, we think, as Zhigong’s pension entitlements come from the government’s promises, so the government has to take the responsibility for its previous promises; in other words, the government is the responsibility subject of the

This is the process of how the hidden pact between the Danwei and their Zhigong comes to extend to the social pact between the state and the *inner system* Zhigong. The Danwei system that organizes the urban society belongs to the state as a part of the system, so the pact between the Danwei and Zhigong cannot just remain within each Danwei boundary but extends to the level of the system and Zhigong. Dissolving Zhigong's labor relations with their Danwei requires the clear settlement of Zhigong's pension entitlements issue which is supposed to be arranged within their Danwei. Then, the hidden pact of the Danwei system turns out to be the system's eventual liabilities with the form of historical debts. This involves the process of how the historical debts have been socially constructed in the market transformation, as it turns out that the system after all has to ensure Zhigong's pension entitlement to the amount of their earned pension credits with their former work year labor contribution for the system.

Indeed, Zhigong labor system is based on very unique scheme of embeddedness in terms of hidden pact between the system and Zhigong: Zhigong fully provided their low waged labor for the system with the system's commitment to grant reliable pension after the retirement even without reserving any resources for their pension in terms of entrusting the job to organize and manage the pension resources to the state.<sup>12</sup> In this context, it becomes broadly shared idea that accumulation and outlay of the social security funds inevitably belong to the state's responsibility.<sup>13</sup> Hence, Zhigong expect state's confirmation of the commitment to arrange their

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pension system's historical debts, and has to take the responsibility to payback the pension system's historical debts." Liu Cuixiao, "Woguo yanglao baoxian de lishi zhaiwu wenti," p. 92.

<sup>12</sup> "Under the hidden pact, Zhigong's pension funds were "externalized" to be under the state's control; and risks were also "externalized" in terms of state's liabilities. Following the principle of balance of rights and responsibilities and of risks and returns, the state as risk taking subject, naturally controlled and used the funds. Zhigong as risk free subjects, regardless of economic environments or their workplace's performances, could receive stable pension and expect rational incomes; and they naturally entrusted the running of funds to the state." Zhao Chenhui, *op. cit.*, pp. 25-6.

<sup>13</sup> Cai Fang and Lin Yifu, *Zhongguo Jingji*, p. 189.

pension entitlement before they dissolve the labor relations. If Zhigong cannot have their promised pension, then they accept it as system's unilateral breach of the pact, which clearly infringes their rights inherited from Zhigong labor system.<sup>14</sup> SOE Zhigong regard their pension entitlement as their non-negotiable rights derived from the former social pact within their Danwei for their former low-waged labor contribution for the construction of the socialist system. Such contribution forms the historical debts the system takes as the social pact in the system transformation process. Hence, the articulation of the system's historical debts involves the process to identify the previous hidden pact between the system and Zhigong as the precondition to dissolve Zhigong labor system for the market transformation.

As we observed, SOE reform process exposes the insider control issue which out of Zhigong's stakeholder position as the *Danwei personnel* entails welfarism that even managers cannot contain, let alone dissolving the labor relations. It has only turned out that China can handle SOE Zhigong's the unique *Danwei personnel* status based on permanent labor relations with the virtual confirmation of their pension credits in terms of their stakes within the state properties, which allows SOEs to dissolve labor relations with their redundant Zhigong. Indeed, social articulation of the historical debts comes to dissolve Zhigong's the *Danwei personnel* with the confirmation of their pension credits in terms of their stakes within the state properties to the amount of their former work year contribution for the system constructions.

Ensuring Xiagang Zhigong's pension entitlement with the system's historical debts is a scheme that virtually confirms Zhigong's status as the former socialist system constructor with the recognition of their stakes within the state properties to the amount of their earned pension

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<sup>14</sup> For many Xiagang Zhigong, non-payment of wages or a lack of Xiagang benefits could be viewed as temporary sacrifice, but "non-payment of pensions constituted a fundamental breach of contract" (Hurst and O'Brien: 351).

credits with their former work year contributions for the system. Hence, the social process of articulating the system's the historical debts involves the political recognition of Zhigong's former labor contribution as the state workers for the system construction.

Ensuring Zhigong's pension entitlements is virtual compensation for their former work years' low waged labor contribution for the system under the Zhigong labor system. In this context, the system comes to confirm the Danwei system's IPD owed to the *old* and the *middle* as its eventual liability in terms of historical debts. Each Danwei's IPD owed to the *old* and the *middle* is the pension entitlement that ultimately the system promised with Zhigong labor system, so it turns into the system's historical debts. Here in dissolving their labor relations the formation of the system's historical debts involves the politics of identifying Zhigong's state worker status in terms of articulating proper compensation for their former labor contribution for the system. China can pass through the final bottleneck of the SOE reform with a scheme to dissolve Zhigong labor relation in terms of handling their state worker status, as the articulating process of the system's historical debts comes to reconfirm the system's liability to arrange SOE Zhigong's pension to the amount of their former labor contribution as the state workers for the socialist system construction.

The essence of SOE reform in China's market transformation involves an issue of how to dissolve Zhigong labor system, the scheme to organize the Danwei system for the urban society predicated on the *inner system* unskilled workers' special positions. The dissolving process necessarily becomes a political process of reconfirming the former social pact between the system and Zhigong as the condition to dissolve their state worker status according to Zhigong labor system's socialist embeddedness scheme. The reform thus neither denounces nor alters the system's liabilities predicated on the former socialist embeddedness scheme binding the system

and the *inner system* Zhigong. Instead, substantial settlement of the liabilities has been turned out to be the very condition to disembody the urban society from Zhigong labor system as the social contract. This means that China's market transformation is contingent on dissolving the *inner system* unskilled workers' special position. By ensuring their pension entitlement based on their former labor contribution as the *Danwei personnel*, China fully recognizes the *inner system* unskilled workers' former labor contribution for the system construction.

The *merging* is not just measure to merge authoritatively Xiagang system into the unemployment system but social process to articulate the scheme that the Xiagang Zhigong can accept for dissolving their labor relations with their Danwei, which entails social formation of the historical debts. Even if China is still an authoritarian political system, it cannot be free from the former hidden pact. China tries to organize reliable pension system to ensure the *inner system* retirees' pension, which involves virtually confirming the system's liability inherited from the former hidden pact of Zhigong labor system. Even under the authoritarian political system the Danwei IPD owed to the *old* and the *middle* turns out to be the system's unavoidable liability. One of critical ironies in China's market reform is that the very leadership that made the socialist system has tried to lead the process of its market transformation, so it cannot prevaricate the system's liability inherited from the former pact with the society. The reform does not exonerate the system from the pension commitment to aged SOE Zhigong who contributed their full labor under the low wage system for the system construction. Instead, dissolving Zhigong's labor system depends on how to fulfill the system's pension commitment previously promised under Zhigong labor system. The articulation of the system's historical debts in dissolving Zhigong's the *Danwei personnel* status involves the buyout of Zhigong's state worker status as the system constructors by confirming the system's pension commitment

to the amount of their credits accrued from their former work year contribution for the system. Hence, the process of dissolving Zhigong labor relations turned out to be predicated on politics of socialist accountability with a compensation that fully recognize their former contribution for system construction out of the social pact of Zhigong labor system.

The process of dissolving Zhigong labor system is predicated on sincere fulfillment of the social pact of Zhigong labor system. It turns out that the market transformation process, after all, depends on the politics of recognizing the system's eventual pension liability inherited from Zhigong labor system, which virtually constitutes the contents of the social contract that the system has to fulfill in the market transformation.<sup>15</sup> Hence, the very process of emerging social contract out of the market transformation tells us that very unique socialist accountability politics is working in the process. China's process of embeddedness politics for disembedding the urban society from Zhigong labor system for the market transformation does not depend on unilateral politics of authoritarian repression to dissolve the *inner system* unskilled workers' state worker status for "commodification," but rather on politics of socialist accountability which confirms the system's historical debts owed to them. The formation of the historical debts out of the process of dissolving Zhigong labor system identifies the very unique politics of socialist accountability which has fashioned the process of China's market transformation.

### **<Shenzhen and its Migrant Workers' Pension Withdrawal Practice>**

China's pension reform is not just a part of its emerging new social security system in the post Danwei era. Instead, it is the central system in its effort to organize new social security

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<sup>15</sup> Indeed, the system's historical debts involves the social fact that "between Zhigong and the state (or SOEs), there virtually exist contract relations that the state provides Zhigong's pension entitlement." Wu Zuxing, "Woguo yanglao baoxian tizhi lujing xuanze bianqian de fenxi, p. 30.

system, as it turns out to be the primary scheme of embeddedness to dissolve Zhigong labor system in the system transformation. As Zhigong want to confirm their pension entitlement before dissolving the permanent labor relations, China's efforts to set up new social security system comes to mainly focus on how to organize reliable new pension system which can settle the Danwei's IPD owed to the *inner system* Zhigong. Then, the emerging social embeddedness scheme out of the market transformation has become the primary contents of social system to constitute China's new market system. Indeed, settlement of the system's historical debts is the primary scheme which constitutes the basic contents of China's emerging new embeddedness system for its market economy system. What this means is that the socialist social embeddedness scheme does not disappear with the reform; instead, it, as social contract, remains as primary institutional template to fashion the very contents of the embeddedness for China's new market economy system. In a nutshell, the formation of the system's "historical debts" involves the political process of China's market transformation which comes to reorganize the contents of Zhigong labor system as the very scheme of social contract for China's market system. Hence, out of embeddedness politics for disembedding for the market transformation China has come to confirm the very contents of socialist embeddedness predicated on Zhigong labor system as the crux of socio-political scheme to constitute China's new market system.

China's new social embeddedness scheme, with the salient pension system which fully recognizes the *inner system* Zhigong's former labor contribution, regulates the market system's entire labor relations including the *outer system* workers and peasant workers. Here, we need to understand how the politics of socialist accountability to dissolve Zhigong labor system for the market transformation works in organizing China market system's entire labor relations beyond the *inner system* Zhigong. In this context, I pay attention to Shenzhen's pension system in terms

of how it constitutes its unique labor relations. Shenzhen is unique, as it has only limited numbers of SOEs and its major economic actors are new vigorous *outer system* enterprises. Its major workforces are not SOE Zhigong but young migrant workers who are employed in lots of foreign invested *outer system* enterprises. As a result, the city's new pension system can tell us how China's new pension system out of the politics of socialist accountability for the market transformation can embrace the *outer system* units and their relations including migrant workers.

With its unique labor composition independent of SOE Zhigong, Shenzhen accepts the migrant workers as its major work forces. "The migrant workers in other Chinese cities mainly engage in informal scheme or their own individual business. Yet, Shenzhen's formal sectors as well as informal sectors and its individual businesses all employ migrant workers and in many cases even as their primary labor subjects. This is the unique phenomenon in China's urban employment structure."<sup>16</sup> The city has recognized migrant workers, including peasant workers, in its labor relations in the new *outer system* units:

"The number of Zhujiang Delta area's peasant workers has already surpassed the area's original Zhigong and there emerge some new "immigration cities." The majority of these peasant workers are incorporated into enterprise system. Indeed, economic development in these areas has benefited from peasant workers' labor contributions and the local governments also hold welcome, open, and cooperative manner to these peasant workers."<sup>17</sup>

Obviously, Shenzhen cannot achieve its rapid development without depending on migrant workers. Migrant workers in the city since 1987 have produced more than 90 percent of its manufacturing production and more than 60 percent of its tertiary industrial production.<sup>18</sup> The city's "investigation report of Shenzhen millions of temporary workers" as early as in 1990

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<sup>16</sup> Liu Kaiming, *Bian yuan ren*, p. 142.

<sup>17</sup> Li Peilin, Zhang Yi and Zhao Yandong, *Jiuye yu zhidu bianqian: liangge teshu qunti de qiuzhi guocheng*, p. 211.

<sup>18</sup> Liu Kaiming, *op. cit.*, p. 7.

already indicated that “temporary workers are *the subjects of Shenzhen working class*; they are not only the primary forces to construct Shenzhen’s economy; but also critical parts of Shenzhen’s social life” (emphasis added). Shenzhen’s small scale of original *inner system* and its limited Zhigong cannot claim the primary social position in the process of its outperforming economic development.<sup>19</sup>

This unique composition with the majority of labor forces consisting of migrant does not change. According to the census conducted in the November of 2000, the ratio of Shenzhen citizen to the total population was lower than one sixth.<sup>20</sup> Yet, it is hard to measure accurate scale of temporary population, for various reasons, such as their high turnover rate and ununified measuring practices. The official number of Shenzhen’s temporary population in 1998 was 2.8 million, but Shenzhen city population bureau estimated that the number reached to 3.65 million. At the end of 2000, the number of Shenzhen Hukou labor forces was about 730 thousands, but the number of migrant workers who had finished the labor bureau’s formal employment procedures were more than 3 million.<sup>21</sup> However, the 5th population census conducted in the November of 2000 revealed that the city’s total population reached to 7 million, which consisted of Shenzhen citizens 1.2 million and temporary population 5.8 million. Thus, the census identified that the real Shenzhen Hukou labor force ratio to its total labor forces was lower than

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<sup>19</sup> Indeed, Shenzhen society can recognize the problem of the *inner system*’s labor system as early as the first half of 80s. “As everyone knows, our country’s long-term conducted centralized labor allocation system is not compatible with current labor productivity and our country’s economic condition. Its employment system which can only enter without leaving system regardless of performance is the direct reason to lead our economy to low productivity, poor efficiency, and slow development.” Gu Shutang, et al., *Shenzhen jingji tequ diaocha he jingji kaifaju yanjiu*, p. 97.

<sup>20</sup> Liu Kaiming, op. cit., p. 45.

<sup>21</sup> He Tao, “Shenzhen tequ shiye baoxian tiaoli yu guowuyuan shiye baoxian tiaoli de bijiao ji gaige jianyi,” p. 458.

one eighth.<sup>22</sup> The expansion of the migrant workers became even faster in the new millennium. Shenzhen's temporary population exceeded 9 million in 2004 and its fluid population accounts for 80 percent of its total population. The city estimates in 2005 that its total temporary population reached to 10.3 million in which its citizens were only 1.7 million.<sup>23</sup>

As Shenzhen is free from the institutional legacy of China's plan economic system, it is not bound with inherited social burdens of taking care of Xiangang and retired Zhigong, ie, the historical debts for its aged Zhigong. Hence, as we observed before, the city could organize its Zhigong pension system with lower premium rate and individual account centered system. At the same time, its majority of workforces were composed of the migrant workers, its social security program from the start could not remain as an exclusive system for its small numbers of its citizens. As early as in 1987, the city already issued its social insurance program for its temporary workers (Shenzhen Government no. 10 Document of 1987), which for the first time stipulated temporary worker's pension entitlement in China if they, regardless of their enterprise ownership types, pay pension premium over 10 years. Temporary workers' social insurance premium rate was 19 percent of their total wages, of which enterprise paid 17 percent and individuals paid 2 percent.<sup>24</sup> So, it set up separated social insurance systems by the ownership types and workers status. Then, the city also initiated its reform to unify its fragmented social security system by different ownership types and different worker status<sup>25</sup> and in 1992 issued "Shenzhen's temporary regulation on social insurance system." Shenzhen tried to demolish the

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<sup>22</sup> Liu Kaiming, op. cit., p.:42 and 45.

<sup>23</sup> *Shenzhen Tequbao*, 2005, July 30th.

<sup>24</sup> As average monthly wage of Shenzhen's temporary workers in 1987 was 150 *yuan*, enterprise had to pay 25.5 *yuan* and individual workers had to pay 3 *yuan*. *Shenzhen shi shehui baoxian zhi*, p. 54.

<sup>25</sup> Indeed, the state council already from the late of 80s started the experiments of expanding social security coverage in Shenzhen earlier than other Chinese cities. Li Yingsheng, *Shehui Baozhang yu Shehui Jiegou Zhuanxing: Eryuan Shehui Baozhang Tixi Yanjiu*, p. 142.

boundary of enterprise types and worker status and carry out unified pension system covering entire work forces, including permanent Zhigong, contract workers and temporary workers.<sup>26</sup>

However, even with its limited legacy of the former socialist *inner system*, Shenzhen realized that it was not easy to set up seamlessly unified social security system including both the *inner* and the *outer system* together. In the process to set up a unified social security system, there rather emerged an internally multi-layered system which reflects the actual different conditions of its various *outer system* enterprise and their workers.<sup>27</sup> In the July of 1996 the city initiated “Shenzhen temporary regulation on basic pension system,” which reduced the burdens by lowering Shenzhen citizen’s premium rate from 21 per cent to 19 percent (employers paid 14-5 percent and individual paid 4-5 percent); non Shenzhen citizen’s premium rate from 21 percent into 10 percent (employers paid 7 percent and individual paid 3 percent).<sup>28</sup> At the same time, the 1996 temporary regulation also adjusted its coverage boundary by allowing “sanlaiyibu” enterprises below the district level and their workers with temporary residency to stay outside of the system.<sup>29</sup> Then, Shenzhen promulgated “Shenzhen Economic Special Zone’s Yuangong basic pension law” in 1999, which also confirmed the 1996 temporary regulation’s two different schemes by allowing different premium rates for the Shenzhen citizens and temporary workers.<sup>30</sup>

This fragmented social security system was not what Shenzhen government wanted to maintain. In the September of 2000 the government summoned a meeting for social insurance coverage expanding work meeting to realize its pension system’s full coverage of entire its

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<sup>26</sup> *Shenzhen shi shehui baoxian zhi*, p. 52.

<sup>27</sup> Hu Zhusheng, *Lun Shenzhen shehui baozhang zhidu gaige*,” p. 23.

<sup>28</sup> *Shenzhen shi shehui baoxian zhi*, p. 50; CASS IIE SISRT, “Shehui baoxian zhidu gaige: Shenzhen moshi shuping,” p. 35.

<sup>29</sup> *Shenzhen shi shehui baoxian zhi* p. 52.

<sup>30</sup> *Ibid.*, p. 55.

workforces within three years.<sup>31</sup> In the same vein, revising existing its pension law, Shenzhen People's Congress at the end of 2000 passed the "Shenzhen Special Economic Area's Law of Yuangong Social Pension." To expand the number of the program participants, the law decided to incorporate those migrant workers in "sanlaiyibu" enterprises, stock cooperatives, village enterprises who had been excluded from the Shenzhen's pension system.<sup>32</sup> Furthermore, to upgrade the unified level of its social security system, the law promulgated that those migrant Yuangong, like Shenzhen citizen, pay 13 percent of their wage for pension premium (enterprises pay 5 percent and workers pay 8 percent) and they also, like Shenzhen citizens, put 11 percent of their wage into individual account.<sup>33</sup> The law surely sets up quite unified social security system regardless of ownership types and workforces origins.<sup>34</sup> Because of the efforts to set up a unified pension system, the total number of participants in Shenzhen's enterprise pension system in 2003 reached to 2.3 million. The citizens were 629 thousand and the migrant workers 1.7 million.<sup>35</sup>

Nevertheless, joining the pension system is one thing and becoming its beneficiaries is another. Even if Shenzhen's migrant workers participate in the city's pension system, but it is not practical for most of them to expect the city's pension benefits. First of all, for the reason of their high turnover rate, it is really rare that they can hold their jobs in Shenzhen until their

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<sup>31</sup> Huang Fei, "Ying jin kuai wanshan woshi wai lai laowugong de yanglao baoxian zhidu," pp. 174-5.

<sup>32</sup> *Shenzhen shi shehui baoxian zhi*, p. 52; Li Xince, "Qiantan laowugong tuibao wenti ji yanglao zhidu gaige," p. 31.

<sup>33</sup> Gui Shixun, "Woguo chengzhen wailai congyerenyuan yanglao baoxian moshi yanjiu, p. 30.

<sup>34</sup> Yet the law at the same time set aside parts of existing pension funds to set up new local supplement pension system for the Shenzhen citizen exclusively. *Shenzhen shi shehui baoxian zhi*, p. 52. Indeed, Shenzhen demands that its enterprises pay one per cent of their Yuangong wage to constitute its local supplement pension for its citizens who pay 15 years pension premium. For those Shenzhen Yuangong whose premium payments do not reach 15 years, Shenzhen in addition to the amounts in their individual accounts grant one time living supports. Accordingly, the only difference in pension treatment between migrant Yuangong and Shenzhen Yuangong who initiated their work after the August of 1992 were the "local supplement pension" and one time living supports for the Shenzhen citizens. Gui Shixun, op. cit., p. 30.

<sup>35</sup> *Shenzhen shi shehui baoxian zhi*, pp 51, 52, and 55.

retirement age and retire in the city.<sup>36</sup> A critical part of jobs offered to them comes from informal sectors which, sensitive to market conditions, provide only limited period of employment. Many migrant workers were at first employed in “sanlaiyibu,” villages and small town enterprises, and Taiwan and Hongkong invested enterprises, whose labor relations were usually uninstitutionalized. Their labor relations were very unstable and these workplaces also suffered from their boss abscondence, enterprise closing, or even wage embezzlement.<sup>37</sup> The city at the early years did not demand that their labor relations should be based on formal labor contracts. In addition, their high turnover rate also had to do with their low skill labor, because unskilled labor can be easily replaced by other unskilled labor.<sup>38</sup> “Except for minorities of white-collar workers and the technicians, the Shenzhen majorities of “labor service workers (*laowugong*)” engage in labor-intensive simple physical works which do not need high skills. Thus, they cannot remain in Shenzhen, as their limited human capital can be easily substituted by lots of other “labor service workers.”<sup>39</sup> There are both clear reasons in both demands and supplies of migrant workers’ labor market, which ends up with their high turnover rate.

Even if their employment is unstable, they still can be entitled to the social security system. If they can stay in Shenzhen to find out new jobs and keep paying the premium, then they are to be entitled. But this is not a realistic option that most of them can take. When migrant workers lost their jobs for various reasons, they are supposed to leave the city, instead of

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<sup>36</sup> “Total number of migrant workers who had been employed until 1997 was estimated more than 20 million. ... Of course, a part of them stay and continuously struggled, but more of them flew to other cities or returned to their hometown to initiate their own business.” Liu Kaiming, *op. cit.*, p. 26.

<sup>37</sup> Liu Kaiming, *op. cit.*, p. 100.

<sup>38</sup> “These labor forces are low educated, under skilled, and highly mobile. According to estimation, their annual turnover rate reached to 30 to 40 percent.” He Tao, *op. cit.*, p. 458.

<sup>39</sup> Li Xince, *op. cit.*, p. 30; More than 60 percents of Shenzhen temporarily residents engage in labor intensive low end sectors such as construction and repairing, “sanlaiyibu” enterprises, and restaurant; while their rate of engaging in high end sectors, such as high-tech research, finance, professional services is less than 10 percent. *Shenzhen tequbao*, 2005, July 30.

trying to find new one there, since they do not have Shenzhen Hukou. Indeed, most migrant workers leave for other cities for new jobs or their hometown, when they lost jobs in Shenzhen. Accordingly, it is not easy for migrant workers to satisfy Shenzhen's requirements for their pension entitlement, total 15 years of premium payment. The combined effects of high turnover rate and Hukou system do not entitle the migrant workers to Shenzhen's pension system.

As the migrant's turnover rate is high, their reward system has been mainly converged into wage exclusive system instead of providing other benefits. Indeed, social benefits usually involve long term labor relations. Most labor relations in Shenzhen do not last quite long and its emerged labor relation is wage-exclusive labor system. As the labor relations mainly organized with the wage between the *outer system* employers and the migrant workers, most of the labor disputes in Shenzhen have to do with wages issues.<sup>40</sup> Shenzhen society has realized that it has to set up some measures to arrange more reliable wage system for the migrant workers. Otherwise, its high turnover labor system cannot be sustainable.<sup>41</sup>

As the labor relations between the *outer system* enterprises and the migrant workers have coagulated as simple wage relations, Shenzhen detaches itself more from social benefits relations.<sup>42</sup> Since the relations are basically temporary, simple wage system is more convenient system for both employers and employees. For the employers who want to organize their production system flexible enough to adjust to dynamic of market demands, wage exclusive

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<sup>40</sup> "90 per cent of Shenzhen handled labor disputes in the last 10 years have to do with the issue of wages. Nearly most labor strikes are initiated with wage issues. Indeed, there were many enterprises employees whose wages are embezzled and in arrears at the end of the year by lunar calendar." Liu Kaiming, op. cit., p. 101.

<sup>41</sup> Shenzhen was the first city in China that initiated its minimum wage system in 1992. Liu Kaiming, op. cit., p. 154.

<sup>42</sup> However, this does not mean that the migrant workers' wage is higher than that of Shenzhen citizen. For example, Shenzhen's citizen in 1999 earn monthly at least more than 600 *yuan* wages; but the migrant workers average monthly wages were only about 400 *yuan*. Liu Kaiming, op. cit., pp. 7-8.

labor relation without other benefits is the best scheme. For the employees who expect to leave their workplace soon, wages are a much better reward system than those benefits which need more time to be realized. Most of all, China has set up a region-specific social pension system without any system to handle pension issue for workforces who come to work in various different regions. "Today's regionally organized pension fund system is intensely contradictory to peasant workers' mobility across different regions. Indeed, after peasant workers switch their jobs, they cannot transfer and maintain their pension entitlement."<sup>43</sup> There is a fundamental contradiction between the social security system bounded to a city unit and mobile labor forces whose workplaces do not necessarily belong to a single city. Thus, the migrant workers cannot trust about their future entitlement in Shenzhen. Accordingly, both the employers and the migrant workers do not welcome the government's push to expand Shenzhen's social security system to entire the labor forces.

Most of Shenzhen's enterprises usually hide their real number of employees and report only a small part of them to the government.<sup>44</sup> The city demands that enterprises register all of their migrant workers, which, however, leads to heavy costs for both the employers and the migrant workers. The formally registered migrant workers frequently have to pay 300 *yuan* personally for the temporary resident certificates and 6 *yuan* labor contract fees. Their

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<sup>43</sup> Liu Yan, "Shilun jianli ke chixu fazhan de nongmingong shehui baozhang zhidu," p. 66.

<sup>44</sup> "FIEs employed 56 percent of total 2.2 million migrant workers in 1997, which was followed by SOEs (16.7 %), "sanlaiyibu" enterprises (14.4%), and private enterprises (12.6%). Yet these numbers were based on Shenzhen's official data of registered migrant workers. Generally speaking, SOEs and big FIEs tend to follow official regulations and most of them sign up labor contract and register for employment. Accordingly, the number migrant workers in these enterprises are quite close to the real number; but there are quite diversities for "sanlaiyibu" enterprises, small scale Taiwan and Hongkong invested enterprises, and private enterprises to follow official regulations. Indeed, labor bureau yearly discovers around 4 hundred thousands unregistered employees to register and most of them are employees in these enterprises. Indeed, with the establishment of Shenzhen special economic zone, "sanlaiyibu" enterprises became the largest employers of the migrant workers, but their statistical number of employee remained quite small." Liu Kaiming, *op. cit.*, p. 143.

employers also have to arrange (injury insurance, pension, medical insurance,) and local police fees according to their numbers of registered migrant workers.<sup>45</sup> These measures reflect the legacy of China's previous dual social systems, which, however, has nothing to do with Shenzhen itself. It does not match very flexible labor relations such as Shenzhen, which indeed needs more migrant workers to satisfy its expanding labor demands. Consequently, both the employers and the migrant workers try to avoid registering for the certificates, and many migrant workers have not been incorporated into the official statistical system.<sup>46</sup>

Most of all, the employers do not need to pay social insurance premium for those unregistered migrant workers. Meanwhile, China tries to set up more organized social security system, demands that its society join the new system. This policy placed many *outer system* enterprises are under the new pressure to pay social insurance premiums according to the number of their migrant workers. However, this is big burdens for the many enterprises in Shenzhen, because China's social insurance premium is linked to a city's wage level and Shenzhen's wage is the highest in China.<sup>47</sup> Especially, for many enterprises with many unregistered migrant workers, their social insurance premium is suddenly really big burdens.<sup>48</sup> There was wide spread

<sup>45</sup> Liu Kaiming, op. cit., p. 143.

<sup>46</sup> Indeed, the 5th national population census conducted in the November of 2000 found out that there were wide spread practices of employing migrant workers without arrangement of "temporary resident certificates" and "manual labor certificates" in Shenzhen's Baoan and Longgang district. The ratio of even those factories that arranged these issues quite well only reached to 50 per cent. In this context, it's not hard to expect that the real numbers of employed immigrant workers in "sanlaiyibu" and private enterprises are higher than that in SOEs. Liu Kaiming, op. cit., p. 143.

<sup>47</sup> The Monthly Wage Ranking of China's Provincial Level Big Cities in 2003

Ranking	1	2	3	4	5
City	Shenzhen	Guangzhou	Hangzhou	Beijing	Ningbo
Monthly Wage (Yuan)	2551	2401	2056	2004	1974

(Source: Zheng Qingzhong, et al., "Shenzhen shi laodong li shichang gongzi fenpei xianzhuang yu duice," p. 31).

<sup>48</sup> This is the one reason why Shenzhen government decide its premium rate lower than other cities.

practice with in many enterprises in which they did not actually pay premium for their migrant workers.<sup>49</sup>

“At first, Shenzhen folks do not have enough understanding about the social insurance. There are no retirees of the contract workers, as the contract workers just start their jobs. Thus, enterprises dislike the ideas and employees do not have interests in social insurance. When Shenzhen labor bureau and labor insurance company staffs come to enterprises to mobilize participants for the social insurance system, some enterprises get angry with the perception that notorious Hwang Shiren comes again to charge fees. Some enterprises do not open gate for them.”<sup>50</sup>

In this context, the Shenzhen government does not try to apply the premium regulation very rigorously.<sup>51</sup> It has to consider the impact on the Shenzhen’s investment condition. Many FIE entrepreneurs who I interviewed in Shenzhen in the late 2003 told that they did not pay their full social insurance premium to the amount for their entire number of employees. They usually under implicit sanction of the local government paid only some parts of social insurance premium that they had to pay.

At the same time, Shenzhen’s uniqueness has developed a distinct attitude about the migrant workers. Unlike most other Chinese cities, Shenzhen does not need migrant workers to make its pension system sustainable. Even in Shenzhen early retirement is also widely

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<sup>49</sup> “An official of Shenzhen labor bureau disclosed that an enterprise with 500 Yuangong (Shenzhen Yuangong 200 and migrant Yuangong 300) would have to pay extra social welfare costs monthly 600 *yuan* more, if it, in the same condition, employed a Shenzhen Yuangong, instead of a migrant worker.” Liu Kaiming, op. cit., p. 8.

<sup>50</sup> *Shenzhen shi shehui baoxian zhi*, p. 53.

<sup>51</sup> “Many people for several years have had ambiguous understanding about the issue of “labor service workers” joining in pension system. Some think if “labor service workers” join in pension system, then it would increase burdens of the enterprises, put bad impact on investment condition, and expel foreign investors. ... These ideas put the work to provide pension entitlement to our city’s migrant “labor service workers” in a very awkward situation: even though Shenzhen’s pension regulations explicitly stipulate that migrant workers have to participate in pension system, we actually never strictly execute the regulation and try to fully levy pension premium from migrant workers in a fair and square manner.” Huang Fei, op. cit., p. 173.

conducted practice, as its high pension level induces its citizens to try early retirement.<sup>52</sup> Thus, the city also experiences expanding numbers of early retired workers, which deteriorates the dependency rate, and the city also think about if it needs to expand its old age pension system's coverage boundary.<sup>53</sup> Shenzhen, however, is not in a desperate condition. First of all, it is almost free from the legacy of former socialist system, and it has only limited number of retired citizens with Shenzhen Hukou. Secondly, with its energetic *outer system* units, Shenzhen enjoys its prominent economic condition in comparison with other cities. Finally, the ratio of its own workers to the total number of its workforces still remain quite low, as its vigorous *outer system* units keep absorbing great numbers of migrant workers from outside. Hence, even with the practice of early retirement, Shenzhen, unlike China's most other cities, does not face a serious financial condition in granting pension to its citizens.

Noticeably, there emerges a tendency in Shenzhen pension reform which tries to organize its pension system as an exclusive one for its citizens, even if its majority of workforces are migrant workers. One of the most prosperous cities in China, Shenzhen can set up very affluence pension system for its citizens. The city has not only the highest wage level, but also the highest replacement rate of pension system in China.<sup>54</sup> The number of retirees in 2003 who were granted enterprise pension was 44 thousand and their monthly pension were 1910 *yuan*.<sup>55</sup> Many Shenzhen citizens believe that providing pension entitlement to migrant workers by expanding the numbers of the system's beneficiaries will encroach the accumulated funds for

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<sup>52</sup> "This high level of pension provision makes lots of working Zhigong in various ways try to achieve early retirement and jump into the group who receive pension benefits." Huang Fei, op cit., pp. 177-8.

<sup>53</sup> "... as the number of paying urban basic pension premium enormously expands, it will be advantageous to lessen the negative effects on the balance of basic pension funds budgets caused by Shenzhen citizens' "young aging" practices." Gui Shixun, op. cit., p. 31.

<sup>54</sup> The replacement rate of Shenzhen's pension system is almost 100 percent, which is also high number in China. Huang Fei, op. cit., p. 178.

<sup>55</sup> *Shenzhen shi shehui baoxian zhi*, pp. 51-2 and p. 55.

their pension. Indeed, as long as the migrant workers are not been entitled to the pension system, the Shenzhen citizen can be entitled to its affluent pension system exclusively. Yet, as China push to its social security system to incorporate the migrant workers, Shenzhen citizens come to worry about the possibility that “migrant workers can shake Shenzhen’s pension fund accumulation and put an unbearable burden on Shenzhen city.”<sup>56</sup>

What Shenzhen really worry about is the possibility that migrant workers turn into its pensioners who fulfill all the requirements. Of course, most migrant workers with high turnover rate are not expected to be entitled to the pension. Without the Shenzhen Hukou, they are rarely able to stay in the city until their retirement age to fulfill the requirements. However, even a small portion of entitled migrant workers can have financial impact on its pension system, as Shenzhen citizens constitute only small minority of its total working populations. Accordingly, Shenzhen comes to set up even fastidious requirements for the migrant workers’ entitlement. The “Shenzhen Economic Special Zone’s law of social pension for enterprise Yuangong” decided in the July 2002 that those migrant Yuangong, to be entitled to pension, should pay 5 consecutive year premiums before they reach their retirement ages.<sup>57</sup> It is quite ironic that Shenzhen’s law on the one hand demands that migrant workers should participate in the pension system, but, on the other hand, tries to render the migrant workers more difficult to be entitled to pension.<sup>58</sup> This irony represents Shenzhen society’s sensitivity even for such a slim chance that the migrant workers turn into its pensioner.

Shenzhen’s *outer system* units and their migrant workers do not want to participate in the pension system, and the society also wants to exclude those migrant workers from the benefits of

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<sup>56</sup> Huang Fei, op. cit., p. 173.

<sup>57</sup> Liu Yan, op cit., p. 66; Li Xince, op. cit., p. 30.

<sup>58</sup> Huang Fei, op. cit., p. 173.

its pension system. In this respect, new practices as *modus vivendi* emerge in Shenzhen to handle the migrant worker's conflicting position: it allows the migrant workers who leave the city to withdraw their pension account with full refunds (*tuibao*).<sup>59</sup> In fact, the migrant workers still have their accounts in Shenzhen's pension system, as they have to pay the premium for the program to which they are hardly entitled. Officially, the accounts which belong to individual worker are the record about how long the worker pays the premium to decide his entitlement to the pension. The account is the record to decide each worker's entitlement, but it is meaningless records for the most migrant workers. China, however, does not make clear regulations whether migrant workers can claim their accounts when they leave their work cities. Shenzhen is the first city in China which comes to institutionalize the scheme which enables its migrant workers to withdraw their individual accounts.

Most of Shenzhen's migrant workers welcome this new practice, because they know that they have very slim chance to be entitled to the pension.<sup>60</sup> Even though they have to participate in the social security system to which that they are not actually entitled, they can still accept the regulation as long as they can get full refunds. Then, their paid premium can be regarded as savings that they can withdraw when they leave the city. Moreover, the amount of refund is quite big money for them. According to minimum premium standard 1531 *yuan*, *manual labor workers'* total amount of refunds from one year pension participation will be more than 2000 *yuan*. It is also guaranteed refunds from Shenzhen social insurance organization which is free

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<sup>59</sup> The origin of the practice can go back to "Shenzhen's temporary regulation on basic pension" (1996). In order to encourage the migrant workers' participation willingness, the regulation not only reduced their premium rate from 21 percent of their wages to 10 percent, but also stipulated that their paid premium, if they leave the city, would be transferred to their destination's social insurance organizations or themselves. Hu Zhusheng, *op. cit.*, p. 23; *Shenzhen shi shehui baoxian zhi*, p. 50.

<sup>60</sup> "Under the condition that they have little chance to be entitled to their pension even with their pension participation, so they really do not want to spend their money for the pension that they cannot see any hope." Liu Yan, *op. cit.*, p 66.

from the risks of embezzlement or in arrearage. One primary reason for migrant workers to participate in pension “is to attain some amounts of cash income by withdrawing their accounts when they leave the city.”<sup>61</sup>

Since 2001, the number of Shenzhen migrant workers who withdraw their pension account when they leave the city has rapidly increased. The number in 2000 is only 20,000, and reaches to 100 thousand in 2001, which expand to 250,000 in 2002. Plus, its expanding speed also highly outpaces that of increasing number of pension participants. The number even reaches to almost half of Shenzhen’s newly increased number of pension participants between 2003 and 2004.<sup>62</sup> According to the data of Shenzhen city’s social insurance fund management center, the total number of Shenzhen migrant workers who withdraw their pension account in 2005 reaches to 650,000.<sup>63</sup> The practice of withdrawing pension account has become quite institutionalized part of Shenzhen’s social security system. It has become a part of the city’s everyday life to observe queuing migrant workers in the social insurance bureau to withdraw their pension accounts.

As the number of migrant workers who withdraw their pension accounts keep expanding, Shenzhen’s total amount of pension funds may be reduced, which can lead people to worry about Shenzhen pension system’s sustainability. However, the government does not worry about its exploding number of migrant workers who withdraw their pension account when they leave the city because the city can run its pension system despite the migrant workers’ withdrawal of their pension accounts. While Shenzhen’s original citizens account for small number of its total populations, those leaving migrant workers will be replaced by other new migrant workers, so

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<sup>61</sup> Li Xince, *op. cit.*, p. 30.

<sup>62</sup> *Ibid.*

<sup>63</sup> Liu Yan, *op. cit.*, p. 66.

the entire pension funds can remain at the same level. At the same time, since Shenzhen's individual pension accounts have 11 percent of the total 13 percent of paid premium (enterprises pay 5 percent and individual workers pay 8 percent), the city still have remaining 2 percent of premium, which, considering its small ratio of the citizen within its entire labor forces, is enough resource to finance its social security system.<sup>64</sup>

Indeed, what Shenzhen worries the most is the possibility that the migrant workers are formally entitled to its pension system. According to an interviewee, "Shenzhen would rather fully refund the money in their individual accounts, because the city cannot grant existing high amount of pension for our citizens, if those huge numbers of migrant workers are entitled to the pension benefits. What Shenzhen really worries is the situation when most migrant workers get the entitlement to the pension as Shenzhen citizens."<sup>65</sup> Thus, the main focus of the city's social security policy for the migrant workers is how to exclude them from its affluent social security system by setting up incentives system to push migrant workers leave the city when they are unemployed by organizing the withdrawing process as convenient as possible.

Considering Shenzhen's unique social condition - its small ratio of original Zhigong to the majority of its migrant workers - we can expect that its emerging social system can be a more open system to the migrant workers. No one in the city can deny the migrant workers' essential contributions for the economic construction. "Thus, it is proper that they are also allowed to enjoy the affluent fruits of Shenzhen economic construction and social development. Legally they also join in the basic pension system, which enables them to be entitled to the right to enjoy

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<sup>64</sup> Obviously, the withdrawing practice that only allow to take the money within their individual accounts encroaches the peasant workers' social insurance rights. Cui Chuanyi, "Nongmingong shehui baozhang zhidu de xuanze," p. 70.

<sup>65</sup> Interview, 2005, July 27th.

“reliable old years” (*lao you suo yang*).”<sup>66</sup> Shenzhen is free from the burdens of historical debts as its major work forces are consisted of migrant workers in lots of vigorous *outer system* enterprises, so it can maintain its pension system without the pressure to raise its premium rate. However, its migrant workers, though the major labor forces, are virtually excluded from the entitlement to Shenzhen’s socialized pension system, and its emerging social security system has turn out as an exclusive system for its small numbers of citizens.

Indeed, as China’s new pension system has been organized mainly to ensure the *inner system* Zhigong’s pension entitlement by confirming the Danwei system’s IPD as the system’s historical debts in terms of embeddedness politics for disembedding, which virtually authorizes their state worker status, Shenzhen’s pension system comes to be a system for its limited numbers citizens without accepting its major work forces as beneficiaries. This is a devise to organize Shenzhen’s social security system as an exclusive system for its own citizens under the condition of Shenzhen transplanted dual social systems. Shenzhen comes to have a system that are incompatible with its social condition, as it transplants the system that mainly serves China’s system transformation to ensure the *inner system* Zhigong’s pension entitlement.

There is intrinsic mismatch between the new socialized pension system to ensure SOE Zhigong’s pension entitlement that they are supposed to have from their Danwei and migrant workers in the urban labor market who are suppose to work there only temporarily under Hukou system. As the title of the new socialized pension system is the Zhigong BPI system, its main target is the *inner system* Zhigong, and it remains unclear whether it should include those new migrant workers in the *outer system*. China’s labor law stipulates that both employers and employees should participate in the social insurance systems and pay the premiums. Yet, the

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<sup>66</sup> Huang Fei, op. cit., p. 173.

“temporary rule of levying social insurance premiums” (1999) states that the pension system levies the premium from the urban corporations’ Zhigong. This strongly implies that those new peasant workers are not supposed to pay the premiums.<sup>67</sup> Indeed, it turns out not easy to expand the Zhigong BPI coverage to those new *outer system* enterprises employees beyond the *inner system* Zhigong. The Zhigong BPI in the early 1998 covers 96 percent of SOEs, 53 percent of COEs, and only 30 percent of other forms of enterprises. Even with serious efforts to extend the system coverage in the first half of 1999, lots of employees in the *outer system* enterprises still remain outside the system. The main target of the expansion is the *outer system* enterprises with expectation that more numbers of participants will lighten the burden of granting pension for the current retired Zhigong. Then, those new *outer system* enterprises will take much heavier burdens after they join the system, which will impair their management condition and capacities to offer new jobs in the urban society.<sup>68</sup>

The efforts to bring those new *outer system* enterprises into the Zhigong BPI system are not to arrange the benefits for their employees but rather to enlarge the Zhigong BPI’s financial bases to ensure the *inner system* Zhigong’s pension entitlements. Hence, joining the system ironically means that those *outer system* enterprises come to pay much heavy social burdens not for their employees but mainly for the *inner system* Zhigong. “The current social insurance system in its nature is not compatible with the condition of peasant workers. It is inherited from SOE’s Zhigong insurance system under the previous plan system. The design of its premium system does include the costs of market transition cost. Their burdens practically take over deficits of social insurance funds, making the premium rate too high.”<sup>69</sup> Originally, the major

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<sup>67</sup> Wang Chengfu, “Ruhe jiaqiang nongmingong ruoshi qunti de shehui baozhang,” p. 12.

<sup>68</sup> Liu Cuixiao, *op. cit.*, p. 98.

<sup>69</sup> Cui Chuanyi, *op. cit.*, p. 70.

advantage of many *outer system* medium and small enterprises comes from the fact that they are free from the social burden of caring their employees' welfare benefits. Hence, if those labor-intensive TVEs are to join the pension system mandatorily and pay the same premium as the *inner system* enterprises, their increased labor costs would eat up most of the profits. Many of them cannot avoid even bankruptcy.<sup>70</sup> Hence, the issue of how to settle the system's historical debts owed to Zhigong in the market transformation process has turned out as the primary scheme of social embeddedness, and those social positions beyond the *inner system* Zhigong remain neglected. Those *outer system* employees' positions remain beside the socialist accountability politics predicated on the system's recognition of the *inner system* Zhigong's former labor contribution as the state workers.

Then, how can we grasp this persistent social distinction even with China's full market transformation beyond the dual economy system? Is it simple issue of time lag in the adjustment to the market transformation? Does it have to do with some structural reasons involved with China's market transformation process? To answer these questions, we need to understand the nature of its embeddedness politics that has fashioned its market transformation process. China has completed its market transformation after dissolving Zhigong labor system with the formation of historical debts, as the system comes to confirm the Danwei's IPD as its eventual liability in terms of confirming the social pact between the system and Zhigong. Hence, the historical debts involve the transition costs that the system has to handle to make breakthrough for the market transformation by dissolving Zhigong labor system remaining in the *inner system*.

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<sup>70</sup> Liu Cuixiao, op. cit., p. 98.

## <China's Ownership Reform and Politics of Bounded Embeddedness>

Socialist systems for the economic development tried to mobilize social resources systemically for the investment in heavy industry because heavy industry meant development itself. To achieve its goal of rapid industrialization China tried to organize the *inner system* economy with SOE in terms of compulsory capital accumulation system. We can see this from the following table. It shows the ratio of government finance to the national basic construction investment, which remained almost 80 percent until the late 70s. It also shows that more than half of the state revenue came from its enterprises, i.e., SOEs. Hence, SOEs constituted around half of the state revenue, which played the primary role to construct socialist system.

Table 8-1. SOEs and Constructing the Socialist System in China before the Reform

	1954	1959	1964	1969	1974	1979
The State Revenue from Enterprises (%)	38	57.3	53.3	54.4	52	42
The Ratio of the State Revenue in the Basic Construction Investment (%)	82.7	77.5	85.5	89.6	82.6	79

(Source: *Zhongguo Tongji Nianjian* 1981, p. 295; 1983, p. 447)

Indeed, to achieve rapid industrialization China organized the *inner system* economic units, SOEs, as a part of the state's financial system, so each SOE was ultimately under the state financial system. In pre reform China the state was the single subject who decided virtually how to invest entire social resources; and SOEs were by no means independent economic actors but rather the state appurtenances for economic accumulation to construct socialist system.

A critical part of SOE's contribution for the state revenue came from Zhigong's low wage system, as it virtually deducted in advance from their payment to mobilize social resources for investment. Although SOE Zhigong were no doubt the privileged social group in China, their incomes and living standards were not improved significantly under its low-wage policy.

China's average wage remained in almost same low level before it changed radically from the 80s. There was big gap between SOEs' increased labor productivity rate and their wage growth rate between 1952 and 1978: whereas SOE's labor productivity increased from 100 to 266 for the years, the wage increased only from 100 to 115.2.<sup>71</sup> This means that for 26 years of the planned economy system, SOE Zhigong only got decreasing rewards.<sup>72</sup> Therefore, SOE Zhigong contributed their low-waged labor construction to the system construction needed to be compensated at the system level through the Danwei's reliable pension provision that could guarantee their living after the retirement. In the urban society, SOE Zhigong's pension entitlement was virtually attained through their contributions in building up China's socialist system before the reform.<sup>73</sup>

Under the plan economy system, SOEs belonged to the state's big unified financial system in terms of "unified collection and unified payment (*tongshou tongzhi*).” In fact, Zhigong's pension system before the reform was organized as the Danwei based PAYG system, whereby each Danwei granted their retirees pension under the condition that the entire *inner system* ultimately belonged to the unified state financial system. In other words, the Danwei provided pension to the retired Zhigong with their financial resources but each Danwei's financial resources were part of the state's financial system. Therefore, even with full scale push of SOE restructuring, which makes their Danwei no more permanent system that can be free

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<sup>71</sup> Nakagane Katsuji, *Chugoku keizai hattenron*, p. 146.

<sup>72</sup> Between 1952 and 1978 the accumulation rate (*jileili*) increased from 21.4 percent to 36.5 percent; some year it even reached to 43.5 percent. But in the same period Zhigong's average annual wages increased only to 0.38 percent and Zhigong's annual wages in 1978 was only 615 *yuan* with average savings of only 21.88 *yuan*. Jiang Chunze and Li Nanxiong, "Zhongguo yanglao baoxian sheng ji tongchou yi hou de maodun fenxi yu duice yanjiu," p. 14.

<sup>73</sup> "Worker's entitlements to social insurances are predicated on the fact that they for the society have accomplished in advance their labor responsibilities." He Ping, *Guoyou qiye gaige zhong de shehui baoxian*, p. 6.

from merging or bankruptcy, they still believe in their entitlement to the pension based on their former social pact with the system. Indeed, SOE Zhigong thought they were not just the privileged of the system but rather as the genuine builders of socialist system by sacrificing their wages and consumption under Zhigong labor system. The perils of losing pension entitlement come to intensify Zhigong's consciousness of their interest to claim their status as the builder of SOE system.<sup>74</sup>

However, the system does not set up a reliable scheme to ensure those Zhigong's pension entitlement when their Danwei cannot settle their IPD under the restructuring process. This means that despite Zhigong's labor contribution for their Danwei in terms of "prior deduction," the system did not establish special funds to reserve the required resources for their pension granting; instead, the state just reinvested them to achieve rapid socialist industrialization:<sup>75</sup>

"Under the plan economy system, those deducted pension premiums were not accumulated with the fund format, but the state invested significant part of them through financial budget channel to be the state properties. Hence, a significant part of the state properties to the amount above three trillion *yuan* today is Zhigong's deposit of their pension resources ..."<sup>76</sup>

Zhigong's sensitive pension entitlement in the process of dissolving their labor relations has become the issue of how to handle their stakes within the system properties to the amount of their pension entitlements. Hence, we can understand the very reason of social construction of

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<sup>74</sup> From the serious collective actions of retirees who cannot have their supposed pension, we can identify their consciousness of socialist system builder. Indeed, retirees' 'appeal to higher authorities' and 'silent sitting' for their unpaid pension come with slogan, "SOE builders have nothing to eat." Gao Shusheng, "Shehui baozhang: women gai zou natiaolu," p. 42.

<sup>75</sup> "The total amounts of state properties right after the establishment of new state were only 20 billion *yuan*, which reached to 3 trillion and 495 billion *yuan* in 1993, the 173 times of its original value, which is including old cadres and old Zhigong's vast historical contribution. Before the reform, we took heavy industry first policy based on the scheme of low wage, low consumption, and high accumulation, in which all SOE's profits were transferred to the state, even including pension funds for the retirees." Zhao Chenhui, op. cit., p. 25.

<sup>76</sup> Zhao Chenhui, op. cit., p. 25.

the system's historical debts, which comes to organize NSSF eventually in terms of confirming the system's eventual liability to ensure their pension entitlement with a part of state properties:

“... the state did not saved the required pension funds that it should have saved for the Zhigong's future pensions. The *middle* and retired Zhigong in low waged format paid in advance the hoard of social security funds toward the state and part of pension resources constitute a part of the state assets. So replenishing social security funds after liquidating part of the state assets is the actual recognition of the retired Zhigong and the *middle*'s pension property rights. Indeed, they are creditors of the hidden debts... .”<sup>77</sup>

Out of the process to dissolve Zhigong's labor relations for SOE restructuring, there emerges the system's historical debts which involves politics of identifying Zhigong's pension credits at the Danwei level as the system's eventual liabilities and of recognizing their creditor position for the state properties. The process of confirming Zhigong's stakes within the state properties in term of “buyout of the state workers status” comes to articulate their creditor status. In short, SOE Zhigong turn into the creditor for the state properties in the system transformation, which involves a critical part of China's ownership reform.

SOE restructuring process in terms of *grasping the big and releasing the small* entails either privatization for lots of small SOEs and full corporatization of those remaining big SOEs that the state comes to hold its exclusive ownership. Most of small SOEs and COEs have been privatized, and large SOEs in strategic sectors have been restructured into corporations with form of limited liability shareholding companies and listed on domestic and international stock exchanges. By 2004 the total number of SOEs dropped to 192 thousand out of 2.16 million in 1996 (Oi 2005: 123). Accordingly, the state comes to set up exclusive ownership for those restructured large SOEs, which, however, does not mean its limited reform, because those large

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<sup>77</sup> Lin Minming, “Shehui baozhang yanjiu de ling yi shijiao shehui baozhang ruogan chanquan wenti,” p. 37.

SOEs are fully corporatized, so no more bound with Zhigong labor system to maintain their redundant Zhigong for the political reasons. These SOEs are fully corporatized economy system under the state exclusive ownership, which are free from involvement of the stakeholder such as Zhigong. Hence, small SOE privatization and big SOEs corporatization process involve the process to set up clearly defined exclusive ownership system after dissolving the labor relations with their Zhigong. Completing SOE reform in line with dissolving Zhigong labor system thus incorporates its own scheme of ownership reform including privatization of small SOEs and corporatization of those large SOEs under the state's ownership. In this sense, the articulation of the system's historical debts which confirms Zhigong's pension credits within the state properties turns out to be a precondition for SOE ownership transformation.

The formation of the system's historical debts involves the politics of dissolving Zhigong labor relations in terms of buyout of their unique status. Hence, SOE ownership reform that is predicated on dissolving Zhigong labor relations with the articulation of the historical debts involves the process of buyout of their unique Zhigong status. In this context, the process of SOE ownership reform comes to be captured as the 'dual transformations' (*liangge zhihuan*) scheme, which refers to the package process of Zhigong's status transformation and SOE ownership transformation.<sup>78</sup> Especially, SOE reform undertakes full scale ownership reform accompanied with Zhigong's status transformation particularly after the "decision of CCP

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<sup>78</sup> "SOE reform should realize the 'dual transformations'. First is through transferring property rights transforming nature of SOE from the original whole people's ownership to diversified private enterprises owed by enterprise internal employees or outsider investors, which dissolves the dependency of the transformed enterprises on the government and realizes the reform goal of 'withdrawing SOEs and expanding private companies' (*guotui minjin*). Second is providing Zhigong a certain economic compensation to transform Zhigong's original status of the whole people's system workers to set up market based labor relations with the transformed enterprises, which dissolves Zhigong's dependent relations on their Danwei. This is the so called "Zhigong's status transformation"." Liang Kaiye, "Lun guoqi gaizhi zhong de Zhigong shenfen zhihuan jingji buchang he renyuan anzhi," p. 57.

Central Committee on major issues concerning SOE reform and development” in 1999.<sup>79</sup> There follows a consensus that SOE ownership transformation should be intertwined with Zhigong’s status transformation based on recognition of their stakeholder status (as creditors) for the SOE properties with the formation of the system’s historical debts.

The very process of transforming Zhigong status confirms their stakeholder status as the creditors for the system’s historical debts. Dissolving Zhigong labor relations based on the system’s historical debts means transforming Zhigong’s status with compensation that confirms their pension credits within the state properties to the amount of their former low-waged labor contribution for the system constructions. Hence, based on the system’s historical debts SOE ownership reform turns out to be predicated on confirming Zhigong’s creditor positions for the state properties to ensure their pension entitlements. Then, after the confirmation of their credits within the state properties, the state can set up its exclusive ownership for the remaining state properties:

“Today the issue of Zhigong status transformation is a result of reform of SOE ownership structure. Indeed, without SOE ownership reform, there would be no Zhigong status transformation. Accordingly, *its nature should be the separation of SOE Zhigong and the owner of the SOE properties*. ... it requires that the owner should provide Zhigong a certain amount of economic compensation.”<sup>80</sup> (emphasis added)

Zhigong’s status issue in SOE ownership reform cannot be settled without the state’s compensation, and in this context there follows confirmation of Zhigong’s pension credits within the properties of SOE owner, the state. This involves the process of identifying Zhigong’s stakeholder position as creditors of the state properties. What we can grasp here is the fact that the

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<sup>79</sup> Wang Haisu and Wang Feng, “Dui guoyou zhongxiao qiye “jubu xiuke” zhong Zhigong shenfen zhihuan de jidian sikao,” p. 30.

<sup>80</sup> Yang Shenghua, “Tan qiye chanquan jiegou tiaozheng zhong Zhigong shenfen zhuanhuan wenti,” p. 17.

state has become clear owner of the entire SOE properties after recognizing Zhigong's stakeholder position as creditors of the system's historical debts. Accordingly, SOE ownership reform process is predicated on transforming Zhigong status which comes to dissolve Zhigong's stakeholder position not as owners but as creditors, and the state comes to set up its exclusive ownership for the inherited SOE properties.

Trying to uncover the reason of lingering SOE reform, many studies suggest that the principal agent issue of the SOE system hinders the efforts to corporatize the Danwei system, as it causes many corporate governance problems in market economy system.<sup>81</sup> Yet, setting up a proper corporate governance system in the reform process requires to clarify who is principal, i.e., the owner with exclusive residual claims first, and the principal agent issue emerges in those enterprises with clarified ownership system.<sup>82</sup> The ownership reform has not been the primary goal in SOE reform process, and the issue of who is the genuine owner as the principal remain unclear. All this leaves the principal agent issue in China very nebulous. Instead, as it turns out, the genuine driving forces that have led SOE reform process is to disembed the Danwei from Zhigong labor system by articulating a scheme to dissolve Zhigong's labor relations that the permanent workers can accept. Only with the system's historical debts can China disembed the Danwei out of Zhigong labor system after clarifying Zhigong's stakeholder position as the creditors for the system's historical debts, which completes SOE corporatization process eventually with clear ownership system.<sup>83</sup>

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<sup>81</sup> Please see the chapter 4 in Lin Yifu, Cai Fang, and Li Zhou, *Zhongguo guoyou qiye gaige*.

<sup>82</sup> Please see Michael Jensen, *A Theory of the Firm: Governance, Residual Claims, and Organizational Forms* (Harvard University Press, 2001)

<sup>83</sup> "SOE reform since 16<sup>th</sup> CCP Congress has focused primarily on ownership reform to set up various shareholding companies based on modern enterprise's governance system, which, at the same time, is accompanied with the efforts to transform Zhigong's SOE worker status with economic compensation to

Corporatization process requires a new architecture of clearly defined ownership which is based on the amount of the share guarantees owner's exclusive residual claim. Indeed, China's corporatization following SOE restructuring involves the process of clarifying ownership reform to decide who holds the exclusive residual claims. China can complete SOE corporatization after disembedding the Danwei system from Zhigong labor system with the measure to transform their Danwei system 's stake holder position. China's ownership reform ultimately depends on how to identify Zhigong's stakes within their Danwei in terms of their pension credits as the creditors for the system's historical debts, and the remaining part of the state properties after those to handle SOE Zhigong's pension entitlements turns into the properties that SOE owner, the state, holds its exclusive residual claim. It has become clear that China's ownership transformation is predicated on settlement of the *inner system* Zhigong's stakeholder position with the confirmation of their credits for the state properties to the amount that can ensure their pension entitlements.

The pension reform in the SOE corporatization process comes to identify the system's historical debts which confirms Zhigong's pension credits within the system. Here the articulation of the system's historical debt is not the dividends of the system properties for the *inner system* Zhigong as the owners but as the creditor to whom the system owed, which needs to settle first in SOE corporatization process; and then those remaining system's properties after the historical debts have become the state's own properties with its exclusive ownership. China can settle Zhigong's insider control issue within the Danwei by confirming their pension credits that they earned with their former low-waged labor contribution for the system. Only after confirming the historical debts as Zhigong's inherited pension credits can the state set up its

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become members of society beyond Danwei personnel." Xin Zijian, "Dui guoqi gaizhi zhong youguan wenti de sikao," p. 12.

exclusive ownership for the remaining system properties for the remaining system properties. So those large restructured SOEs turn into fully corporatized enterprises with the state's exclusive ownership free from the insider control issue involved with Zhigong's former master position within the Danwei system. After the restructuring process of *grasping the large and releasing the small*, the state has become the genuine owner of those fully corporatized large SOEs out of the very essence of the *inner system* economy. Then, only after clearly setting up the state ownership does the leadership try to maximize the owner's interests by handling the principal agent issue of those corporatized large SOEs. In this context, addressing the issue of former fragmented management of SOEs, the State Council establishes State-owned Asset Supervision and Administration Commission (SASAC) in 2003 as a system to systematically supervise 196 large restructured central SOEs under the state ownership.<sup>84</sup>

The ownership reform in China's market transformation incorporates redistribution politics of the system properties that has been constructed under the socialist system. The market transformation process comes to redistribute the constructed system properties into those resources to handle the system's historical debts to ensure SOE Zhigong's pension entitlement; and the state's properties including its exclusive residual claims for those fully corporatized large SOEs. Here we can identify a critical reason why social construction of the historical debts is accompanied with organizing strategic funds such as NSSF instead of the system's official recognition of the Danwei's entire IPD. If the historical debts were predicated on the system's official recognition of the Danwei's entire IPD, much more portion of the system properties would have to cover the historical debts. Then, the scale of remaining state properties would be reduced. Because there is a trade-off relation between the historical debts and the state-owned

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<sup>84</sup> Of course, its critical objective is creating a government agency that would assume ownership over SOE reform (Garnaut, et al., p. 33).

properties in the market transformation, the state tries to maximize its portion by limiting the scale of the historical debts that it is liable as small as possible.

In order to maximize the state-owned properties in its market transformation, the leadership tries to limit the center's official financial engagement and the regional pension system remain as the main system to handle the inherited IPD issue. In the pension reform process, the Danwei's IPD has turned out to be the system's liability, but is not followed by a clear scheme of how the system resources are to cover the liabilities. Therefore, China organizes NSSF as a strategic fund that does not cover the deficits of all those areas with troubles in granting full pension for the retirees but solely as reserve that can be used in very critical situation to make sure the entire pension system's sustainability. So the system cannot avoid the Danwei's IPD issue out of the context of its social contract with Zhigong; however, such an awareness of the problem is not accompanied with efforts to devise concrete measures to mobilize required resources, especially, how much the center has to engage in. Indeed, the articulation of the historical debts virtually involves the decision that the center comes to take as its ultimate liability to handle the inherited Danwei IPD issue. Nevertheless, the leadership does not clarify its liability scale, as it tries to limit the center's financial role as supplementary one by organizing NSSF next to the regional Zhigong BPI as the primary IPD handling system. The articulation of the historical debts does not mean that the center's reluctant position to recognize the former Danwei system's entire IPD as its liability has changed.<sup>85</sup>

The Zhigong BPI system is organized mainly at county level cities, but it is supposed to be reorganized at provincial level, and integrated into the single national program eventually.

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<sup>85</sup> "As the pension responsibility between government and SOEs; and the center and local governments remain unclear for long time, there emerges a clear trend that SOEs come to depend on the governments and local governments come to depend on the center, so the center's liabilities and burdens have become even heavier." Liu Changping, "Yanglao baoxian zhidu "hua zi changzhai" zhanlue yanjiu, p. 104.

Yet, organizing strategic NSSF as the form of center's financial engagement in handling the historical debts without devising fundamental measure to handle the entire IPD issue leaves the interests of each area's pension system hard to coordinate to be integrated at provincial level, let alone at the national level. Indeed, each pooling area's fund management takes a sort of independent and sealed management mode, and each area's social pooling fund is responsible for payment of its basic pension and "transitional" pension. If the pooling funds are unable to make ends meet, the pooling area's local government takes final responsibility financially.<sup>86</sup> The division of liabilities between the center and the local governments still remain unclear and the social pooling system has not yet find out its best fit level, so despite of national and provincial pooling plan, the social pooling system still remain at lower county level city.<sup>87</sup> So even if some related bureaus announced that many areas already achieve provincial pooling plan, all those are not the real provincial pooling. Most provinces have not yet realized their pooling system and their pooling level still remains at county level cities with some cases of setting up provincial adjustment funds at best.<sup>88</sup> In short, the inherited IPD issue needs handled by social pooling system of each area's pension system in terms of regional IPD handling system.

The Zhigong BPI system still remains as sub-provincial regional system, as China has not devised a scheme that can coordinate diverse interests out of each area's diverse financial burdens to handle its IPD. If the state takes the full liability to settle the system's historical debts, then each area's diverse IPD burdens will be fade away. This can reorganize the Zhigong BPI system into integrated single pension system at national level. In this context, China's social insurance law whereby the state officially confirms its liability to settle the Danwei IPD pledges

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<sup>86</sup> Fang Qian and He Wenjiong, "Jiben yanglao baoxian guanxi diqu geju yu zhengfu jian boben," pp. 71-2.

<sup>87</sup> Li Shaoguang, "Yanglao baoxian gaige: ying tuoshan chuli hao liangge guanxi," p. 20.

<sup>88</sup> Jiang Shoufu, "Zhongguo shi shebao zhuanxu cong "niehe" zouxiang "chuncui," p. 13.

the plan to reorganize to be a single national pension system. Yet, the law, interestingly, makes a reservation that the state will decide when it will turn into a single national program.<sup>89</sup> What this implies is that even if the state cannot neglect the system's historical debts, but the regional Zhigong BPI system at the sub provincial level for the moment remain as the primary system to handle the Danwei IPD issue. Obviously, the state wants to take its properties under its exclusive ownership as much as possible, by minimizing its liability scale to settle the historical debts. Hence, despite the official confirmation of the system's unavoidable historical debts, the Zhigong BPI's social pooling part is to remain as the primary system to handle IPD issue for a considerable period. Hence, troubles of those areas in granting pension do not necessarily get the center's financial engagements.

In this context, the leadership decides to expand the ratio of social pooling part in order to address many areas' pension system's financial troubles to handle inherited IPD issue with the State Council's "decision of how to improve the Zhigong BPI system" in 2005. It decides to expand social pooling system from 2006 by transferring 3 percent of enterprise payment that formerly constituted individual accounts, which cuts individual account scale from 11 percent to 8 percent of each workers' wages paid by individual workers.<sup>90</sup> This means that China plans to handle the IPD issue mainly depending on the social pooling system. Yet, the decision does not realize its intended goal, as it cannot settle the social pooling part's limited financial bases and many areas' empty account practice persists without containment.

The decision depends on the experience of three year Liaoning experiments initiated in the July of 2001, which tries to make individual accounts real ones by enhancing financial bases

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<sup>89</sup> The law's article 65 (or 64) states that "The basic pension insurance fund will be coordinated on a national basis gradually and the other social insurance funds will be coordinated on a provincial basis gradually. The specific time frame and steps will be prescribed by the State Council."

<sup>90</sup> Tang Yaoguo, "'Shitong jiaona" ruhe huanzhang," p. 23.

of the social pooling part. However, after ten years the experiment proves to be futile: its efforts to fill up individual accounts without devising a system to settle IPD issue cannot engender meaningful outcomes and Liaoning's pension deficits in 2011 reach to about 20 billion *yuan*. The deficits of Liaoning's social pooling system cannot be resolved with the small ratio adjustment, so its efforts to contain its empty account practice turns out to be futile. Indeed, the effect of Liaoning experiment to fill up individual accounts mainly comes from the center's significant financial supports for the three years. Then, leadership does not turn the Liaoning experiment into national program, so most areas do not undertake serious push to fill up individual accounts as Liaoning experiment. The total scale of the entire Zhigong BPI system's "empty account" in 2011 comes to reach to 1.3 trillion *yuan*.<sup>91</sup>

The Liaoning experiment involves the efforts to handle "empty account" practice by making the individual accounts filled genuine ones with the center's financial supports. Then, its social pooling system can grant full pension for the retirees without depending on the resources in the individual accounts. It involves the efforts to figure out how to organize reliable social pooling system that can handle inherited IPD issue. However, the experiment does not turns into a national program, as the center does not want to make full commitment to support all those social pooling systems with troubles in granting full pension. It has been turned out that many areas' social pooling system cannot handle their inherited IPD without the center's financial supports, but the state has a good reason to limit its financial engagement to secure the more state's properties in the system transformation. For all with articulation of the system's historical debts to settle the Danwei's IPD, the state just takes a supplementary role in handling inherited IPD issue after the Zhigong BPI's regional IPD handling scheme, and the empty account practice

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<sup>91</sup> Xu Haiyan, "Liaoning chengzhen qiye Zhigong yanglao baoxian kunjing de zhidu fenxi," pp. 98-9.

remains rampant. In this context, there emerge voices claiming that only after the center cover the social pooling system's limited resources to arrange pension for the retirees, the new pension system can have filled genuine individual accounts.<sup>92</sup>

The persistent "empty account" practice means that many areas' pension systems cannot manage their individual accounts clearly separated from their social pooling system. Even with the long term efforts, the regional pension system has not turned into a reliable system to handle inherited IPD issue because the leadership tries to limit the state's financial engagement in the settlement of the historical debts only as the last resort and the regional pension system's social pooling part remain as the primary system to handle it. The articulation of the historical debts does not mean the state's full engagement to settle its ultimate liability for the Danwei system's IPD, and each area's pension system still tries to make ends meet in granting pension for its retired Zhigong, even depending on the resources of its individual account. Despite the efforts to set up a reliable new socialized pension system the inherited Danwei system's IPD issue still looms around because the state tries to secure its exclusively owed properties as much as possible in the system transformation.

Under this condition, it is not practical to expect that China's new pension system can accept those new peasant workers to be its beneficiaries. The new pension system is the official system that covers both the *inner system* Danwei and the *outer system* firms, so many peasant workers in the *outer system* firms are supposed (later mandatory) to join the pension system which is organized primarily for the *inner system* Zhigong. Even if many peasant workers in the

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<sup>92</sup> "However, after running divided account system based on the filled individual account, a part of the paid pension premium should go to individual accounts to make real individual account. At the same time, enterprise's premium rate should remain as before, annual premium revenues of social pooling parts are certainly not enough to cover total required amounts of each year's retired Zhigong pension outlays; and the deficits should be covered by the government's revenue." Wang Jiangang, "Yanglao baoxian gaiwei fenzhang guanli hou mianlin de wenti he duice," p. 80.

*outer system* firms come to join the Zhigong BPI system, it, however, does not necessarily mean that their future pension entitlements. This is because China's new pension system is bound as a system primarily to handle the system's inherited IPD issue owed to the *inner system* Zhigong.<sup>93</sup>

If China can organize a genuinely unified single national pension system covering its entire citizens, then it will provide same benefits to its all citizens without the distinction of Zhigong and the peasant workers.<sup>94</sup> Even if China comes to articulate the system's historical debts, its pension system still remain as regional program which is supposed to handle inherited IPD issue with its social pooling part without devising reliable financial measures. So many areas' social pooling systems cannot provide enough resources to handle their IPD issue to grant full pension to the retired Zhigong. Under the very stressful financial condition, the regional pension system cannot afford to accept those newly joined peasant workers as its genuine beneficiaries. So even with the articulation of the system's historical debts, as the state wants to maximize its properties with its exclusive ownership in the system transformation, the Zhigong BPI system's social pooling system still remain as the primary system to handle IPD issue. Under the condition, the Zhigong BPI system cannot but remain only as the system that can focus on how to ensure the *inner system* Zhigong's pension entitlement exclusively.

It has turned out that the Danwei system owes IPD to its Zhigong and the system's historical debts are constructed to handle it. Yet, there is no the inherited Danwei IPD issue owed to the peasant workers, because the Danwei system was organized as the system for the urban citizens exclusively and rural peasant under the Hukou system could not be the formal

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<sup>93</sup> "The crux of the process is how to handle properly the relations between the so called "the *inner system* personnel" (those SOE Zhigong who already got recognized old age pension from the government) and "the *outer system* personnel" (those new employees without recognized old age pension from the government)." Hu Xiaoyi, "Lun jin yi bu kuoda yanglao baoxian fugaimian," p. 14.

<sup>94</sup> Feng Lanrui, "Shehui baozhang shehuihua yu yanglao jijin sheng ji tongchou," p. 57.

Danwei personnel. Hence, as the Zhigong BPI's social pooling system is set up mainly to handle the inherited Danwei's IPD issue, the peasant workers do not take it as their system, so they are quite skeptical about their entitlement to the pension system.<sup>95</sup> This explains the practice of the peasant workers' withdrawing from Shenzhen's pension system when they leave the city, even if Shenzhen's majority of workforces are consisted of the peasant workers. The tricky part in the withdrawing is that the peasant workers can only take the amount within their individual account paid by themselves, while the remaining part reserved within the social pooling system with a part of enterprise paid premiums still stays in the city's pension system to be used for the pension of its own citizens. What this means is the fact that the peasant workers are not only blocked to access the city's social pooling system resources but also even contribute the social pooling for the city's Zhigong. In this context, there emerge voices that suggest setting up independent pension system for the peasant workers with the much lower threshold and based on individual account exclusively without scheme of social pooling.<sup>96</sup>

The primary embeddedness scheme to constitute China's market system is the Zhigong BPI system, which should ensure the *inner system* Zhigong's pension entitlement without devising a reliable financial measure to settle inherited IPD issue. Meanwhile, those employees in the *outer system* come to participate in the system that cannot afford to arrange the benefits for them. Indeed, the efforts to expand the system coverage including the *outer system* enterprises are not to arrange the benefits to the *outer system* employees in the future but to get urgent financial relieves for the social pooling system to grant full pension for the retired Zhigong. Ironically, out of the market transformation process has the new pension system been constructed as the primary embeddedness scheme to organize China's new market system, but it cannot open

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<sup>95</sup> Lu Haiyuan, "Jianli nongmingong shehui yanglao baoxian zhidu de tansuo," p. 5.

<sup>96</sup> Bianjibu, "Shehui baoxian yao bu yao di menkan," p. 20; Lu Haiyuan, op. cit., p. 8.

the system to peasant workers who are new labor forces to constitute China's new market system. Indeed, the market transformation process is predicated on the confirming the system's pension commitment for the *inner system* Zhigong. Not until the issue is fully settled and regional pension system are released from the inherited IPD issue, therefore, can it be practical to expect that the urban society will open its social system for those new peasant workers even if they are allowed to participate in the urban labor market.<sup>97</sup>

Zhigong was the exclusive scheme of citizenship that CCP tried to construct under the socialist system. Completing lingering SOE reform and the market transformation process, after all, depends on how to dissolve Zhigong labor system in the urban society, the very scheme of socialist citizenship. Hence, the compensation for SOE Zhigong for the restructuring could not be treated as a simple economic issue between SOEs and their employees in terms of severance payments; rather, it was a very sensitive political issue involved with the social contract between the state and its citizens. In this context, the emerging condition for the process, the system's historical debts, identifies the very fact that social contract between the system and Zhigong originated from Zhigong labor system works as the very condition for dissolving Zhigong labor system. This is the very contents of socialist accountability politics for the market transformation which allows the urban society to be released from Zhigong labor system in terms of embeddedness politics for disembedding.

The articulation of the system's historical debts in terms of Zhigong's stakes in the system's properties involves the full recognition of the labor contribution of Zhigong especially those *inner system* unskilled workers as the state workers for the construction of the socialist

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<sup>97</sup> Indeed, an interviewee admits that until the pension system comes to fully settle the IPD issue, so its social pooling system is free from the pension provision burden for SOE Zhigong, the inherited urban-rural division will remain for a while. Interview, 2005, July 5th.

system. Here, the social meaning of the market transformation is by no means denial of former way to construct the socialist system but rather full recognition to ensure the system builders' pension entitlement as return for their former labor contribution. The politics of socialist accountability for the market transformation involves the politics of recognizing the former scheme to construct the socialist system with virtual confirmation of the *inner system* unskilled workers' pension credits within the system properties. Here, the historical debts to ensure the *inner system* unskilled workers' pension entitlement systemically recognize their past labor contribution for the construction of socialist system under Zhigong labor system and takes it as virtual criterion to organize scheme of social embeddedness for the market transformation. Hence, the system's historical debts have turned out to be the very scheme of social contract for the market transformation after dissolving Zhigong labor system with the full recognition of their former low waged labor contribution for the system construction.

In sum, as a result of socialist accountability politics in the market transformation, China's new social embeddedness scheme for its market system virtually confirms the *inner system* unskilled Zhigong's stakes within the system properties in terms of full recognition of their labor contribution for the system construction, which, however, remain as the exclusive system for the *inner system* Zhigong without allowing same recognition to those new *outer system* employees. Even if the historical debts are the system's unavoidable liabilities, the central government just let the Zhigong BPI's social pooling system handle inherited IPD issue; so, each area's pension system has been entirely occupied with the task of how to grant full pension for their retired Zhigong with little chance to accept new peasant workers as the beneficiaries. This unique upshot of China's market transformation has to do with its socialist accountability politics to dissolve Zhigong labor system from the urban society with full

recognition of the *inner system* Zhigong's former labor contribution for the system construction; and the very social system to set up to handle the system's historical debts, however, turns out to be unaffordable to accept the new peasant workers as the beneficiaries.

The politics of socialist accountability in the market transformation entails very unique consequence in the distribution of the system properties constructed under the socialist system. The state comes to retain the inherited system's properties including its exclusive ownership of those fully corporatized large SOEs after organizing strategic NSSF as its financial liabilities for the unavoidable historical debts; the *inner system* Zhigong can hold the stakes within the system properties to the amount that can ensure their supposed pension entitlements in terms of the system's historical debts; but those peasant workers who are allowed to enter new urban labor market are not allowed any stakes from the constructed socialist system, as the very politics of the market transformation in terms of the socialist accountability does not recognize their former contributions for the system. Indeed, China's market transformation process based on the socialist accountability politics recognizes the *inner system* Zhigong's stakes within the system properties in terms of the system's historical debts to ensure their pension entitlements, which, however, ends up with a system that blocks the peasant workers to attain any such recognition.

## 9. Conclusion: Embedded Authoritarianism and China's Market Transformation

China before the reform organized its urban society with the Danwei, and every urban citizen was supposed to belong to them. The Danwei, either SOEs or COEs, functioned as a social institutions making citizens' urban life possible. Especially, SOEs in the pre-reform era ultimately belonged to the system not only as economic units but also as individual welfare units to organize the urban life. They provided their workers with permanent jobs and every possible form of welfare benefits, including housing, education, medical care, and pensions. Indeed, China's SOEs were not run as economic organization for efficiency but as a social system for their workers' welfare. Thus, China's urban (welfare) system can be captured as "work-unit welfare socialism" (Gu: 133). The process of SOE reform could not but involve the politics of how to transform the Danwei system into a pure economic system.

As the Danwei system was organized through Zhigong labor system, the urban society consisted of Zhigong. China tried to organize the urban society to mobilize its labor for the rapid construction of socialist industrial system, and came to articulate Zhigong labor system. One of the main features of Zhigong labor system was the low wage system for the low-cost system construction, which was compensated with arrangement of formal work positions in the *inner system* Danwei, regardless of labor skill levels, for the entire urban society with employment security and all-round welfare benefits. Hence, it was the very favorable system for those urban unskilled workers who were entitled to the Danwei system's formal work posts with full welfare benefits. In order to maintain the system, China needed other related systems: checking any *outer system* units in the urban society and new labor forces from rural areas ended up with

Hukou system. This means that Zhigong before the reform was the exclusive scheme of citizenship in the urban society.

From the early period, the efforts to arrange the formal work position for the entire urban society exposed limited job offering issues. The problem was exacerbated with China's industrial policy that primarily focused on mainly heavy industry with only small labor demand. With the frustration of limited numbers of jobs, China, unlike other socialist countries, initiated its own reform quite earlier. As the reform goes on, it becomes clear that Zhigong labor system in terms of low wage, full employment, and comprehensive welfare provisions cannot be sustainable. The reform entails increasing wages, expanding welfare expenses, and still limited creation of the *inner system's* formal jobs creations. China comes to allow the *outer system* units, which at first emerge mainly in rural areas. A critical feature of China's reform is decentralized liberalization that allows local level initiatives to engenders new vigorous *outer system* economic units, such as TVEs and FIEs .

Organized with market-based labor relations free from the social burdens bound to Zhigong labor system, the *outer system* units can develop quite rapidly. Even if the *outer system* units remain in rural areas, it means that Zhigong labor system is no more the single labor form in China. With the different labor organizing systems, the *inner system* Danwei and the *outer system* units cannot compete in the same condition, and many *inner system* Danwei that compete with the *outer system* units come to face serious financial conditions. Especially, the new competitive condition has turned those underemployed Zhigong within the Danwei into redundant workers who need to dissolve the labor relations. The Danwei can no longer guarantee life-long employment for their Zhigong. In other words, SOEs have to change their nature from welfare units into efficient production units which can even go bankrupt.

China tries to introduce a new labor contract system to replace Zhigong's permanent worker system. Yet, as it is so volatile an issue in urban society, the leadership decides to apply it to those newly employed workers, and those existing SOE Zhigong remain the permanent workers. Zhigong labor system survives the reform of the labor contract system, and those increasing numbers of financially troubled SOEs cannot reduce their redundant personnel.

The success of China's SOE reform, therefore, depended on whether China can terminate the permanent worker system and enable SOEs to release their surplus Zhigong to society as the unemployed by introducing flexible labor relations to replace existing permanent Zhigong labor relations.<sup>1</sup> Under the pressure of the urgent SOE restructuring China has made efforts to introduce Xiangang system to lay off large numbers of redundant SOE Zhigong especially since 1997. As many Chinese accept the market reform as the inevitable track to follow, they come to accept SOE restructuring itself. Nevertheless, it does not mean their approval of Xiangang as a severance scheme. Their former livings were totally embedded in their Danwei, so the limited period of Xiangang program turns out to be insufficient to dissolve their permanent labor relations.

SOE corporatization reform virtually means the end of "work-unit welfare socialism" based on the Danwei system. The reform involves reorganization of the Danwei system which as social system organizes urban society through Zhigong labor system in terms of embeddedness scheme. Only after they become free from Zhigong labor system can SOEs turn into genuine economic units beyond the Danwei system. In other words, SOE reform in China

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<sup>1</sup> "For the past 20 years, our country has taken all sorts of measures to reform SOE's employment system: enforcing labor contract system for the newly recruited workers; optimizing labor combination; and then enforcing labor contraction system to total workforces, and so on. The goal and intention of the reform has been establishing SOE's autonomy in its employment; and setting up wage system which reflects labor productivity and [employment] system whereby Zhigong can enter and leave." ILSS, *Zhongguo Laodong Kexue Yanjiu Baogaoji 2000-2001*, p. 221.

involves the politics of dissolving Zhigong labor system, the very scheme of pre-reform China's socialist embeddedness system.

Yet, it is not a simple process of dissolving existing embeddedness scheme, but, at the same time, a process of setting up a new scheme of social embeddedness that can support the released former Zhigong from their Danwei. As the Danwei system is the single embeddedness scheme to organize urban society, dissolving the Danwei means a sudden collapse of the entire urban social system. A reliable new social security system replacing the existing Danwei system would let SOE Zhigong leave their workplace. A critical feature of China's embeddedness politics in restructuring SOE with *grasping the big and releasing the small* is the politics of welfare system build-up instead of simple welfare retrenchment. Indeed, China needs to reconfigure a new scheme of social embeddedness to dissolve Zhigong labor system in terms of embeddedness politics for disembedding the urban society from Zhigong labor system. One critical reason why China's SOE reform has been lingering for a long time is that China has not articulated new social embeddedness scheme.

SOE Zhigong cannot accept the reform that tries to dissolve only their labor relations without setting up a reliable scheme to ensure their pension entitlements previously promised by Zhigong labor system. Zhigong pension entitlements are predicated on their total work years within the Danwei system, so the stake for them is extremely high. Between the Danwei and their Zhigong is a mutual obligation in the Danwei's pension provision in return of their full low-waged labor contribution. The crux of the issue is then how to ensure their pension entitlement that their Danwei promised even after Zhigong dissolve their labor relations with their Danwei.

The Danwei grant pension to their retired Zhigong, which is really heavy burdens for many SOEs within competitive market condition. To relieve SOE's heavy pension burden,

China tries to set up a new socialized pension system beyond the Danwei. At the same time, dissolving labor relations with their exploding redundant Zhigong requires to ensure their pension entitlements after they dissolve their labor relations with their Danwei. In short, the primary issue in SOE corporatization is how to ensure both retired and Xiang Zhigong's pension entitlements even after they dissolve the permanent relations with their Danwei.

The labor contract system cannot reform Zhigong labor system, as it is not accompanied with efforts to set up a new social embeddedness scheme. Xiang system turns out to be not an enough embeddedness scheme to dissolve Zhigong labor system, and it is terminated with *merging* decision. Then, in the radical restructuring process through the *merging* efforts, China comes to find out the very condition that Zhigong can accept as “proper” compensation, ensuring their pension entitlements. Indeed, out of the urgent SOE restructuring process, the society engages in collective reflection process, thereby figuring out the condition that the urban society can accept to dissolve Zhigong labor system. It turns out that Xiang Zhigong dissolve the labor relations with Shitong scheme, which let the new pension system confirm their pension credits within their Danwei and ensure their pension even if they dissolve the labor relations with their Danwei. An interviewee argues that “if CCP cannot arrange Zhigong's pension properly, then it will lose its power eventually. No doubt about that. And if any other political group takes power after CCP, it cannot be free from the pension issue, either.”<sup>2</sup>

Zhigong's pension entitlement surges as the primary issue that causes serious collective actions involved with SOE restructuring. Parallel to the efforts to set up a reliable new socialized pension system, collective actions regarding pension does subside in the early 2000s (Frazier 2010: 28). With the new pension system ensuring both retired and Xiang Zhigong's

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<sup>2</sup> Interview, 2003, Sept. 16th.

pension, the Danwei system can be detached from Zhigong labor system. Out of urgent SOE restructuring process, China's newly emerging social embeddedness scheme has turned out to be a pension centered system.

With the new socialized pension system, SOEs can dissolve the labor relations with their redundant Zhigong after all. This process involves the termination of Zhigong labor system in urban society predicated on the special relations between the system and the *inner system's* unskilled workers. The *inner system* Zhigong are no more permanent workers, and China eventually completes its lingering SOE reform, as SOEs turn into pure economic units no more bound to Zhigong labor system. At the same time, with the development of the *outer system* firms, urban society comes to incorporate many informal jobs and new peasant workers. Consequently, the urban society is no more exclusive system for the *inner system* Zhigong which is outright favorable system for the *inner system's* unskilled workers. This involves a full disembedding the urban society from Zhigong labor system and dissolving Zhigong labor system eventually.

In dissolving Zhigong labor system, the urban society can have a full labor market system as both the *inner system* and the *outer system* units are organized with market-based labor relations. China's efforts to set up a new pension system free the urban society from Zhigong labor system. So, the simultaneous processes of SOE restructuring and new socialized pension system beyond the Danwei confirm the politics of Polanyi's "dual dynamics" whereby the urban society allows a new urban space for the labor market beyond Zhigong labor system. This formation of a full urban labor market without a distinction of the *inner* and the *outer system* involves China's eventual completion of its market transformation, which has been lingering around the dual systems for decades. Distinction of the *inner* and the *outer system* remains as

long as the Danwei system is bound to Zhigong labor system. It takes decades for China's reform efforts under the gradualism to complete the market transformation, only after it can dissolve Zhigong labor system in urban society along SOE restructuring.

With the formation of a full urban labor market beyond Zhigong labor system, a new working class can emerge out of the labor market which can be free from previous organized dependency on the Danwei system. Labor market formation in a society entails reshuffling previous segmented social relations into a single social entity with its own voice. In fact, China passes its national labor law in 1994, which has a social meaning of erasing the existing differences of the permanent, contract, seasonal, and migrant workers regardless of their types of enterprises in terms of the *inner* and the *outer system* (Gallagher: 110). Hence, the demolition of the different labor relations fashioned under the socialist system can lead to the formation of a single working class. Of course, each country has its unique history of working class formation, which may lead to its distinctive nature of labor politics,<sup>3</sup> but the emerging working class does play critical roles in the politics of market system with its articulated voices and coordinated actions.

The labor market formation in China results from dissolving Zhigong labor system in the urban society out of SOE restructuring process, after reorganizing SOEs with market based labor relations as their *outer system* counterparts. Paying attention to the breakdown of the dual system of the *inner* and the *outer system*, many discuss China's labor politics in terms of the replacement of Zhigong labor system with market-based one. Solinger's study of migrant workers "concludes with prediction that the then current conditions of migrants in China's nonstate sectors signaled the future for workers in the public sectors" (Gallagher: 62). Similarly,

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<sup>3</sup> Please see Ira Katznelson and Aristide R. Zolberg, eds., *Working Class Formation* (Princeton University Press, 1986).

Harvey captures the very nature of Chinese reform in terms of neoliberalism under the authoritarian system, which under the politics of authoritarian repression tries to dissolve Zhigong labor system for SOE restructuring through proletarianization of Zhigong.<sup>4</sup>

There has been a debate on Chinese labor politics: whether the nature of its labor politics ends up with contentious one or rather institutionalized one. No doubt dissolving Zhigong labor system is very sensitive political issue in the reform process, which is the critical grounds to capture contentious nature of China's labor politics. Yet, the real labor reform process shows rather a tamed contentious character, as the case of collective actions regarding pension entitlement subsidies. Lee's study divides two labor groups and observes their different volatility.<sup>5</sup> Hurst also tries to grasp regionally differentiated collective action patterns made by laid-off workers in terms of how they are shaped by regional political economy condition (Hurst: 109). The labor reform process is not outright contentious one. Gallagher, following Guthrie's position, understands China's labor reform as a more institutionalized process than a contentious one in her study of many FIEs' engagement in SOE restructuring process, which introduces new market-based labor relations into the reorganized Danwei.

The labor market formation process is the outcome of introducing the *outer system's* market-based labor relations after dissolving Zhigong labor system. Regarding the issue of how its potential volatility comes to be tamed, there have been two representative accounts - proletarianization under the authoritarian system or institutionalization with contagious marketization process. I think both accounts are flawed because the main reason for the tamed

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<sup>4</sup> The party has acceded to "the massive proletarianization of Chinese workforces, the breaking of the 'iron rice bowl', the evisceration of social protections, the imposition of user fees, the creation of a flexible labour market regime, the privatization of assets formerly held in common" (Harvey: 150).

<sup>5</sup> Please see Ching Kwan Lee, *Against the Law: Labor Protests in China's Rustbelt and Sunbelt* (University of California Press, 2007).

labor volatility has to do with emerging new pension system that ensure Zhigong's pension entitlement in terms of embeddedness politics for disembedding. The state cannot but confirm its eventual liability in terms of the historical debt even if it tries to avoid it, so China's labor politics is not unilaterally framed within repressive authoritarian scheme. At the same time, the labor relation turns out to be ultimately predicated on the social pact between the system and Zhigong, so the labor politics is not a simple process of expansion of market based labor relations. China's new market-based labor relations come into being neither as a result of repressive proletarianization under the authoritarian system nor as a result of Zhigong's rather smooth acceptance of new market based labor system.

Here we need to understand the meaning of new socialized pension system for dissolving Zhigong labor system in the urban society. The crux of the pension reform is how to handle the Danwei's IPD owed to their Zhigong. The pension reform focuses on how to ensure retired Zhigong's pension as the Danwei promised before, and the *merging* efforts to terminate Xiagang program comes to articulate Shitong scheme, which settles the Danwei system's IPD owed to Xiagang Zhigong. Most SOEs under the restructuring process are already in serious financial conditions, so they cannot settle the IPD issue by themselves. For the urgent SOE restructuring process China needs to devise some measures to settle the Danwei's IPD issue, and the state comes to engage financially to ensure new socialized pension system to grant full pension to their Zhigong. The process articulates the historical debts of the system, virtually confirming the Danwei's IPD as the eventual liability of the system.

The articulation of the system's historical debts reveals a direct relation between the system and the *inner system* Zhigong, framing the process of transforming SOE Zhigong's state worker status. As the urban society was organized with the Danwei system to achieve a rapid

socialist industrial system, SOE Zhigong were the very social group who constructed the socialist system under the low wage system in line with Danwei's pension commitment. Hence, pension was the reward for their Zhigong's former low-waged labor contribution to the system. Here, dissolving Zhigong labor system for the market transformation is not simple to level Zhigong in terms of proletarianization. Rather, it incorporates a political process to recognize their former labor contribution as the state worker for the construction of the socialist system.

As China dissolves Zhigong labor system with the articulation of the system's historical debts, the very process depends ultimately on the confirmation of their pension entitlements, a critical return for their former low-waged labor contribution. Hence, the politics of China's market transformation in line with dissolving Zhigong labor system has nothing to do with a simple denial of the special position of Zhigong (especially those *inner system* unskilled workers). Instead, it involves a full compensation for their former contribution for the system construction as the state workers. So, out of the market transformation process the system's unskilled workers lose their special position as the state workers with the *inner system's* formal work posts, but the very process has been carried out under the condition of a full recognition of the special position that they have held hitherto in terms of the system constructors.

The embeddedness politics for disembedding the urban society from Zhigong labor system for the market transformation add up to how to ensure Zhigong's pension entitlement, which comes to articulate the historical debts that the system cannot avoid after all. Accordingly, the implicit social contract between the system and Zhigong needs to be heightened. Dissolving Zhigong labor system for the market transformation is bound to the scheme of politics of socialist accountability. Indeed, recognizing the system's unavoidable pension commitment is the very contents of political accountability that the leadership has to

respect in dissolving Zhigong labor system process. Here, the discussions of social contract and political accountability look contradictory with China's authoritarian political system. Then, why does authoritarian China carry out its market transformation not with its political repression but rather with the politics of the system's historical debts articulation? How can we understand the political accountability in China's market transformation despite its authoritarian political system?

The question leads us to another critical track of the reform. Alongside gradual SOE reform, China also proceeds the reform in terms of decentralized liberalization, which allows local level economic ventures to engender new *outer system* economic units such as TVEs and FIEs. This new *outer system* units look quite similar to England's putting out system emerged in the countryside, which brought about new modern factory system eventually beyond the regulation of its urban guild system.<sup>6</sup> This historical development was the condition which allows the country's liberal political system. Accordingly, we may expect similar development of political liberalism out of its decentralized liberalism which allows new *outer system* units independent from the existing system's very own SOEs. The *outer system* can derive its economic momentum as it is free from Zhigong labor system. So, dissolving Zhigong labor system means that market based labor relations come to expand to the entire *inner system* beyond the *outer system* units, which frees the urban society from the former socialist labor regulations. We can expect that the very process of the market transformation can bring new accountability politics in China in terms of growing liberalism which can check its authoritarian system eventually.

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<sup>6</sup> British guilds system faded early from the Tudor and Stuart period, "when rapid population growth and increasing demand for British goods (especially textiles) abroad encouraged the early and widespread development of the putting out system of production in rural areas" (Thelen: 93).

Here, we need understand a critical feature of China's new pension system, which remains as a regional program mainly at the city level even with the leadership's efforts to upgrade to the provincial system. Observing emerging China's regionally diversified welfare systems, Hurst tries to uncover subnational welfare reform politics focusing on how local governments are constrained by their different interaction patterns with the center as well as their various economic capacities (Hurst: Chap.3). In the same vein, Frazier also tries to understand China's regional pension reform politics in terms of why many local governments that try to develop their market economy under the decentralized condition try to set up their pension system. Mainly focusing on local governments, their discussions, however, miss the most critical part of the pension reform, the articulation of the system's historical debts. Indeed, the proper question in the regional pension system would be why the pension reform ends up with the articulation of the system's historical debt; and why even with the historical debts China's new pension system continuously remain as the city level program, which each regional pension system handles its Danwei's IPD issue, after all.

China's reform with decentralized liberalization allows its local governments to engage active economic roles and many reform efforts have been made at the local level. The pension reform also started at local program to set up new socialized one beyond the Danwei based PAYG system without devising a scheme to settle the Danwei's IPD issue. In order to dissolve Zhigong labor system for the market transformation, both retired and Xiagang Zhigong's pension need to be ensured. As regional pension system does not have reliable financial bases to handle this, the center comes to confirm the historical debts with NSSF to ensure regional pension system to grand the pension for the pensioners. Even if the social insurance law clearly confirms the state's eventual liability, but it includes a reservation. The center does not take its full

liability for the Danwei IPD right now, and the regional pension system remains as the primary system to run the new pension system. The regional Zhigong BPI system with the system's historical debts involves a delicate politics of arranging market transformation costs: how to divide the burdens between the center and regional pension system. Indeed, the center limits its financial engagement only as the last resort if the regional pension system does not handle their IPD issues.

As regional pension system remain as the primary system to handle inherited IPD issues with only limited financial grounds, each area's pension system tries its best to make meets ends to ensure pension for its pensioners. Under this condition, the regional pension system cannot pay attention to the pension entitlement of those new peasant workers, even if they join the program. Despite the articulation of the system's historical debts, local pension system remains as the primary system to handle inherited IPD issue from the Danwei system. So the new pension system cannot but focus on Zhigong's pension entitlement exclusively, while neglecting those new peasant workers' entitlement.

China's new pension system is by no means universal or citizenship-based system financed from general tax revenue based on T. H. Marshall's welfare idea of social right for entire citizens. Instead, it is organized as a social insurance system, which covers not entire citizens but only those program participants. The tricky part here is the system does not even ensure all those program participants, such as new peasant workers. Indeed, China has tried to set up its new pension system out of its efforts to reform its SOE system with the primary goal to ensure SOE Zhigong's pension entitlement, while leaving the issue of entitlement of those who were not the *inner system* Zhigong before unclear.

Welfare system is an outcome of political recognition of who is to be entitled.<sup>7</sup> So we can understand the nature of China's welfare reform with the contents of its recognition. Indeed, its new social security reform with salient pension system involves political recognition for the market transformation to introduce labor market beyond Zhigong labor system. Its social forces solicit the state's recognition for their deserved position in the transformation and the historical debts formation out of the pension reform is the outcome of the recognition politics in the market transformation. The very nature of China's politics of socialist market transformation can be grasped by uncovering the contents of its recognition of the historical debts formation in terms of its political process to decide whom the government has owned how much debts.

Recognizing who are entitled and who are not, the state virtually engages in the process of configuring social boundaries in terms of those with recognition and those without, which decides a critical scheme of social relations among different social positions. The nature of political system depends on how the relations of its different social positions are fashioned in terms of its primary scheme of social boundary. Various social groups align and contend with each other to attain their political recognition for their deserved social positions, and social boundary after all is the product of their ceaseless process of efforts for recognition. Of course, the very scheme of social boundaries is the outcome of interactions among different social positions, and it once fashioned then works as a critical mode of forming the very contents of social relations in terms of those recognized and those not.

As China's pension reform has turned out to be the issue of how to pay off the system's historical debts, the target of the entitlement are not those new poor under the market system but those social groups whom the system is supposed to have owed debts. China comes to set up

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<sup>7</sup> According to Frazer, social welfare provision virtually has effects of recognition. Nancy Frazer and Alex Honneth, *Redistribution or Recognition? A Political-Philosophical Exchange* (Verso, 2003) p. 64.

new welfare system with highly salient pension system, not because the pension is an institution of moral economy to support its aged workers in market system, but because it is the “historical debts” that Danwei and ultimately the system have to pay off, after all, for the market transformation. Whereas those new peasant workers who did not belong to the *inner system* enter the urban labor market without recognition of the system’s historical debts, so they can hardly expect their pension entitlement in the urban society even if they pay their pension premium. Obviously, the *inner system* Zhigong represent not only its privileged social group under the socialist system but also exclusively recognized creditors whom the system owes the historical debts in the market transformation.

Ironically, the recognition politics of China’s new social security system for extricating from socialist system does not destabilize the categorical boundaries of former socialist social relations, but rather maintain them with formation of system’s historical debts. There had been a social boundary that constituted the very foundation of the socialist system in pre-reform China, such as clear cleavages of urban and rural societies. It is true that with the introduction of market relations the cleavage has become weaker to the level of opening urban labor market; but the political process comes to embed its new market system in the recognition bound with its former socialist categories. The liquidation of socialist system does not demolish the existing socialist social boundary; rather in some sense it sustains them as a scheme to organize new market relations. Indeed, China’s welfare reform has somehow revitalized previous social categorical boundary in terms of entitled urban citizens and unentitled peasant workers.

Markell clearly articulates potential risks involved with politics of recognition: as recognition always involves the claiming of sovereignty in some bounded forms, he worries about the perils that can entail binding or limiting the very potentials of the human political

condition.<sup>8</sup> Indeed, a welfare system that grants recognition of entitlement to some social groups can incorporate the risks of binding or limiting the polity's potential to transform into another scheme of social boundaries. The critical issue here is if recognition politics guarantees political conditions that those minor social positions can claim their new recognition with the strategy to destabilize the existing dominant social boundaries, the very reason why they remain only in minor social positions. In fact, the "true politics" in terms of testing of every possible human potential can be attainable when the dislocation of existing social configuration happens.

"...politics becomes possible at a moment of dislocation, when an external element disrupts the ability of the dominant structure to contain and subsume all alternatives. Previously fixed elements are freed from the existing ordering principle; contestation and struggle ensue as rival possibilities compete to reestablish a new order. Dislocation is definitive of politics because different elements are no longer fixed in their predetermined place and must be reordered, rearranged into a new logic" (Kohn: 21).

The issue here is the social boundaries among uneven social positions are fixed or open to change. Social boundary with little chance to change will perpetuate existing deviant social relations with fixed salient and marginal social positions. Then, social voices do not represent various social positions' spontaneous claims, but only reflect some systemically privileged ones under the system authorization. If this is the case, even when the political authority is quite responsive of its social voices, the accountability can hardly be identified in terms of democratic political process. Instead, it rather reinforces its authoritarian nature as it even empowers those special social positions. Indeed, the very essence of democracy lies in the potential that it with a systemic chance of power change defies the risks that any segment of society can perpetuate their dominant position. Whereas the very essence of an authoritarian system involves how it

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<sup>8</sup> Patchen Markell, *Bound by Recognition* (Princeton University Press, 2003).

build up its deviant social relations with some segments of the society to which the state is quite responsive while neglecting others, and the deviant social relations politically have only little chance of reshuffling. The critical issue here is not if categorical distinctions exist in a society, but if it guarantees the possibility that existing scheme of relations among social positions can be refashioned with new scheme of social boundary. So the forms of social boundaries should not be rigid or strict; and the relations among social positions should be in the process of constant flux.

If a political system is responsive to different social demands with equal chances, then it is not an authoritarian system. But if it is only responsive to some authorized social position while neglecting others, then its social accountability involves authoritarian political process which reproduces dominate social positions over others with little chance to reshuffle among their relations. This is what really happens when China carries out its market transformation with articulation of the system's unavoidable historical debts, which has confirmed the system's special relations with the *inner system* Zhigong under the socialist system even at the expense of the new migrant workers' positions.

As the market transformation process is embedded in the social pact of Zhigong labor system, those new labor forces from rural areas are allowed to enter the urban labor market without recognition of the system's historical debts as given to the *inner system* Zhigong, which consequently denies their former contribution to the socialist system construction and their related states within the system properties. China, even with the market transformation, consists of two distinct categories, the urban society and rural areas, as the contents of recognition with the historical debts for the market transformation has turned out to be bounded with the *inner system* Zhigong while leaving those rural population neglected. As a result, even if China out of

the market transformation process comes to dissolve Zhigong labor system, the primary scheme to organize China's socialist system, the confirmation of the social pact of the Zhigong labor system between the system and Zhigong has turned out as the exclusive institutional template to constitute the primary embeddedness scheme to organize China's new social system after the transformation.

It is true that fragmented welfare programs, unlike universal citizenship based ones, are often found among countries in which political process is fashioned in terms of patronage or particularism, in which politicians deliver more favorable benefits to narrow social groups (Frazier 2010: 46). This can happen if beneficiaries of social programs are concentrated in privileged sectors of the labor force such as public sector unions. Organized groups such as employees in formal sectors in an authoritarian system can access their government to assign more social resources to them and those governments also tend to respond to the demands of organized small groups rather than the preferences of the diffused and unorganized majority such as alleviating poverty or inequality for the whole economy (Frazier 2010: 177). In this case bigger amount of social spending can end up with worse income equality rather than redistribution.

China's social security system in the urban society plays only small income redistribution function; on the contrary, it even enlarge the gaps. The national survey data in 1995 reveal that the social security system pay those wealth houses 87 percent more than poor houses, and, especially, the benefit gap out of the pension has turned out the most serious, which extends to 4.2 times.<sup>9</sup> The pension reform has been carried out not for the urban society's income redistribution but for the ensuring the *inner system* Zhigong's pension just as their Danwei

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<sup>9</sup> Liu Cuixiao, "Woguo yanglao baoxian de lishi zhaiwu wenti," p. 95.

promised before. Under the condition that the urban society does not pay attention to its own income redistribution, it cannot be expected that it can take the new peasant workers' pension entitlement into consideration.

China's rural areas were separated from its urban socialist system as an independent system that did not belong to the *inner system* directly, even if it transferred their products to the urban society under the scissor price system, which was a critical condition for the urban society to construct socialist system rapidly. As rural areas remained out of the system before the reform, there was no obvious debts and credits relations between the system and rural areas, which makes the peasants silent about their credits in the market transformation. The contents of China's reform predicated on full dislocation of the existing social relations should include compensations for the peasant workers who were not allowed to enter the urban society but forced to contribute their products for the urban society under the scissors price system. But the transformation process has turned out as an compensation for the *inner system* Zhigong exclusively. So the migrant workers can enter the urban labor market only with the recognition politics involved with the historical debts which is bounded within the urban society focusing on the *inner system* Zhigong exclusively. With the articulation of the historical debts confirming the social pact between the system and the *inner system* Zhigong has become the primary scheme of social embeddedness for the market transformation, which entails a social consequence of exclusion of other social positions.

With the politics of socialist accountability in the market transformation China does not dislocate existing social boundary but rather fashion its new social relations of the market system replicating its former scheme of social boundary. What we can observe in politics of socialist

accountability is power that makes the sustained distinction possible in the market transformation, which reveals the very nature of its authoritarian political system.

The distinction is not limited to the new pension system but extends to other critical social systems as well. The urban minimum living standard guarantee program (*dibao*) and the various “community service” (*shequ fuwu*) program are social programs for urban residents only. The new pension system cannot cover all welfare demands the urban society faces with the market system and China tries to set up these programs to mainly cover those urban citizens who remain unemployed after dissolving the labor relations with their Danwei but still need to wait some more years to be pensioners and those former COE workers who are not able to prove their pension entitlements as their former working records are not preserved in the messy restructuring process. These programs are targeting primarily those minor urban citizens who are not covered by the pension system rather than peasant workers. Most of all, Hukou system survive the market transformation, as even with the labor market formation the Chinese government has not officially declared its abolition, and this is the main reason why peasant workers rural in the urban labor market cannot access those benefits that the urban citizens can enjoy such as child education in the urban school system.

The new pension system, the central social system for the market transformation, has turned out to be the system to settle unavoidable IPD issue for SOE Zhigong; and other constructed new social systems target for primarily the urban citizens. The emerging urban social system in terms of the embeddedness scheme constructed out of its market transformation is bound to the urban society which does not incorporate peasant workers as its beneficiaries. It is fair to say that the peasants today can enter the urban labor market with much reduced constraints; but they still remain outside the boundaries of the urban society just as sojourners in terms of the “secondary

citizens” rather than its full members.<sup>10</sup> The social distinction between the urban citizens and rural peasant not only survives but rather fashions the very process of the market transformation in terms of setting up a system to safeguard the urban citizens’ rights in the post Danwei era.

Social institutions are the outcome not necessarily of articulation of collective beneficial equilibrium but rather of power relations out of social conflict over the distributions which frequently end up with favorable system for particular segments of a community (Knight: 8 and 42). Social institutions are frequently ends up with distribution outcomes that favor some segments of social positions while neglecting others, which, after all, involves power that can make such distinction sustainable. The origin of social institutions is power in a society with a successfully forged social coalition out of various social positions that can set up its favorable system.<sup>11</sup> In fact, a skillful dimension of power involves the politics of differentiation rather than simple repression. Since differentiation always entails inclusion for some and exclusion for others, it always involves power: include what is accepted but exclude what is rejected. In fact, power can reinforce itself when it can generate a sense of order, which frequently emerges with the clear division of what is accepted and what is rejected. Consequently, political authority will be enhanced in a process of distinguishing between high and low; or between majority and minorities; or between the normal and the abnormal. Sewell argues that the typical cultural strategy of authority and domination is “not so much to establish uniformity as it is to organize differences.” Power institutions constantly engage in efforts “not only to normalize or

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<sup>10</sup> “Their low participation rate and deficiency social security rights have to do with their low wage, big mobility, and hard working condition; but its primary reason is the effect of dual system dividing urban and rural areas. Even if peasant workers are already industrial workers and constitute critical parts of urban population, they still remain in the urban society as the “second citizen” position who have different status with unequal rights from urban citizens.” Cui Chuanyi, “Nongmingong shehui baozhang zhidu de xuanze,” p. 69.

<sup>11</sup> Indeed, “...institution building involves forging coalitions and thus mobilizing various social and political actors in support of particular institutional configurations” (Thelen: 31).

homogenize but also hierarchize, encapsulate, exclude, criminalize, hegemonize, or marginalize practices and populations that diverge from the sanctioned idea” (Sewell: 56).

This offers a critical ground to understand the meaning of China’s new social system with the distinction of entitled urban Zhigong to the historical debts and those unentitled migrant workers who have to join the system even without entitlements. The distinction has emerged as the system comes to confirm its historical debts as the social contract for its urban Zhigong exclusively in the market transformation. In the same vein, China’s emerging other new social systems are also targeting those urban citizens who are covered by the new pension system, which means the emerging new social system in the market system is still bounded to the urban citizen only. So the former distinction of the urban society and rural areas survive the market transformation, which means the existing scheme of power under CCP remain untouched.

The power that constitutes the scheme of social relations involves political process of reproducing a certain contents of the social order. A critical aspect of constituting social distinction with recognized one and not involves political process of fashioning social order. Distinguishing recognized positions from those neglected practically decides a normative claim on which the recognized position is predicated as a constitutive rule of its political community, which consequently constitutes a critical principle of social order. China’s recognition politics in the historical debts formation for the market transformation involves its politics of fashioning the nature of the social order in the transition to market system. By constituting two distinct social boundaries, it can arrange the direction of the semiotic flow, which can generate “a sense of order” for the market transformation in terms of the *inner system* Zhigong exclusive pension entitlement with recognized the system’s historical debts without recognizing such entitlement for peasants. Here lies a hidden irony of China’s market transformation. Since the crux of the

reform is recognition of system's historical debts owed to the urban society, its recognition politics constitute its ordering principle of its market system, which fully respects former socialist social orders, after all. China's legacy of socialist system provides the very template for the emerging social order of its new market system.

China complete lingering SOE reform by dissolving Zhigong labor system with the articulation of the system's historical debts. Obviously, market transformation process cannot be carried out is without related ownership reform, so the market transformation means that China has carried out its own ownership reform.

People are often puzzled by how China can achieve its outstanding economic performance without patent ownership reform. Yet, after China allows new *outer system* economic units, there emerges competitive market condition where both the *inner system* and *outer system* firms compete with each other. Then, there follows serious SOE restructuring process, mainly those small scale SOEs, by dissolving labor relations with their Zhigong. This is the process to release SOEs from Zhigong labor system to reorganize them into pure economic system. Then, the leadership with the scheme of *releasing the small* sell off those small SOEs released from Zhigong labor system, which involves their ownership reform including privatization. By contrast, with the scheme of *grasping the large* large SOEs usually do not undergo radical restructuring such as bankruptcy, but they also freed from Zhigong labor system, which complete their corporatization reform by establishing the state's clear ownership in terms of the state's exclusive residual claims.

China completes its market transformation by dissolving Zhigong labor system from the urban society with articulation of the system's historical debts in terms of its virtual confirmation to ensure Zhigong's pension entitlements. Here the historical debts involves the very process of

ownership reform in China's market transformation. The 'dual transformation' tells us that SOE ownership reform requires compensation reflecting Zhigong's status with their stakes within the Danwei properties.

The system's historical debts which confirms Zhigong's stakeholder position within the system properties involves China's ownership reform politics in terms of how to handle those system properties constructed under the socialist system for the market transformation. China can complete the market transformation with its own way of property rights clarification only after it recognizes the system's historical debts owed to Zhigong to the amount of their former working years for the construction of the socialist system with their pension entitlements. China's politics of market transformation comes to divide the system's properties constructed under the socialist system primarily into the state properties with the exclusive ownership of remaining SOEs after the restructuring of the "*grasping the big and releasing the small*" and the *inner system* Zhigong's stakes within the state properties to ensure their pension entitlements that the system promised under Zhigong labor system.

China has completed its market transformation only after it can dissolving Zhigong labor system in urban society with the system's historical debts. As the crux of the Zhigong labor system is the special relation between the system and the *inner system* unskilled workers, its dissolving means those *inner system* unskilled workers cannot maintain their former day's special positions with the articulation of the system's historical debts, which confirms their stakes within the system properties to ensure their pension entitlements. So the *inner system* unskilled workers cannot hold their state worker status any more but they can maintain their inherited rights to the amount of their former low waged contribution for the system construction. The politics of China's transformation is based on socialist accountability, which

virtually confirms social contract between the system and Zhigong, especially, those *inner system* unskilled workers with their confirmed stakeholder positions of the system properties.

Yet the system's historical debts is bound only to the *inner system* Zhigong. The system cannot neglect its liability to ensure Zhigong's pension entitlement in SOE corporatization process, but it does not have saved its resources systemically to handle the Danwei IPD issue. So its new regionally organized pension system has to make every effort to ensure their Zhigong's pension entitlement with only little chance to take care of new peasant workers. Obviously, the system does not recognize the historical debts for those peasant workers, so they are denied any stakes in the system properties out of the transformation process. The ownership reform with the system's historical debts is bound to the *inner system* Zhigong only, and China comes to distribute the system properties in the market transformation to the state owned SOE properties and the *inner system* Zhigong's stakes, while neglecting any stakes for those peasant workers. The upshot of China's own way of ownership reform in the transformation is the sustained division between the urban society as the stakeholders and the rural areas without any recognized stakes. Here out of the contents of ownership reform with the result of the historical debts formation to dissolve Zhigong labor system we can identify a unique contents of social order that only recognize the *inner system* Zhigong's stakes in the market transformation.

With the dissolving Zhigong labor system in the urban society peasant workers can enter the labor market without recognition of the system's historical debts. They are not allowed any stakes within the system properties constructed under the socialist system, as they were not the state workers before, which, however, was not their own choice but the system's decision. Most of all, they also made their own contribution for the system construction under the scissors price system by providing cheap agricultural products to the urban society, so let the urban society

build up socialist industrial system rapidly just as Zhigong's labor contribution under the low wage system. Even with this condition, the transformation does not recognize their stakes within the system properties.

With the limited resources to ensure Zhigong's pension entitlement as the system promised to them before, the new pension system is organized as a system for the *inner system* Zhigong exclusively. The urban society accepts new peasant workers in its labor market under the condition of Zhigong's recognized stakes in the system properties to ensure their pension entitlement. Peasant workers also seems to accept the condition to enter the urban labor market without making serious voices for the entitlements, as the case of most migrant workers in Shenzhen who withdraw from the city's pension system when they leave the city. Here we can identify power scheme that patterns a certain semiotic flow in the market transformation. Obviously, some scheme of fixed semiotic flows have fashioned the very process of China's market transformation process in terms of power, which makes China's entire society accept the politics of socialist accountability in the market transformation with the recognition of *inner system* Zhigong's exclusive stakes.

Many discussions of transition to democracy suppose that it requires some forms of contentious politics, such as political cleavage within leadership or growing social resistance from below. Of course, here social resistance virtually means increasing power of working class with maturing market system, but for all its amazing economic performance after the reform Chinese working class does not look getting vigorous with new momentum. Here the issue is not just the workers' feeble or unorganized collective actions but abortive formation of working class itself. Recognition politics in China's market transformation shape its social relations of the market system along the boundary of former social categories under the socialist system,

which means its suffocated chance of dislocation of former distinction of urban society and rural areas. Even if urban citizens and migrant workers can participate in the urban labor market at the same time, they cannot develop shared identity in terms of single working class.

The social boundary inherited from the socialist system not only survives the market transformation but also fashions the very scheme of social relations of its market system, and this is the reason why the society today even with the open urban labor market seldom reveals its new voice of new working class that goes beyond the social boundary of urban citizens and migrant workers. The labor market formation in China with dissolving Zhigong labor system does not entail a social process of its working class formation. China's new social security system out of its market transformation is not a result of its emerging working class politics; rather it defies the formation of class politics by reinforcing the pre-reform social boundaries between urban and rural dichotomy. The social distinction survives the market transformation, as the social relations within the open urban labor market are fashioned not out of their spontaneous interactions but out of power process that reproduces them within some predestined scheme.

The politics of socialist accountability which has fashioned in the market transformation process does not contain China's authoritarian system but instead reconfirms it. The social contract between the system and the *inner system* Zhigong remain as exclusive social embeddedness scheme to organize its market economy system, and on this condition the urban society allows new labor forces from outside to enter its labor market without recognizing their full membership. So even with the transformation the social distinction remain untouched but rather reconfirmed, which means the very power that makes such distinction keeps organizing the society without reshuffling existing scheme of order. The persistent social boundary is a

critical reason why China's market transformation even with its outstanding economic performance does not seem to nourish new social grounds for new voices demanding for a democratic political system.

The development of liberalism in England has to do with its development of the rural putting out system beyond the regulations of the urban guild system, which dissolves the urban guild system eventually. China's market transformation also has to do with its development of the *outer system* beyond the urban society organized with the Danwei system, which entails competitive market condition and comes to corporatize the Danwei into a pure economic system with dissolving Zhigong labor system. But China's transformation, unlike the England case, is based on the political process which by no means denies the existing scheme of organizing its social relations but rather reconfirms it as the very scheme to organize its market system. The power that organized its socialist system is still working to organize its social relations for the market system. In this context, China's politics of socialist accountability out of the market transformation does not entail new liberalism but reproduces its authoritarian system.

The primary contents of politics involved here is how to make the *inner system* Zhigong accept the reform to dissolve the Zhigong labor relations, which is so sensitive that SOE reform has been lingering for such a long time to figure out the answer. China has made long efforts to handle Zhigong labor system all the process of the reform, ever since it starts the reform with the frustration of Zhigong labor system's limited capacities in creating jobs for the urban society. With the articulation of the system's historical debts the *inner system* Zhigong can accept the reform to dissolve Zhigong labor system eventually, which allows China to achieve the market transformation.

The urban society can dissolve Zhigong labor system not with the process of the *outer system*'s new labor relations' expansion to the *inner system* but with the politics of figure out the *inner system* Zhigong's acceptable condition for the market based labor relations. Consequently, the market transformation is predicted on the full respect of the *inner system* Zhigong's position even at the expense of other social positions. Even in the market transformation, there has been very strong tenacious relation between the system and the *inner system* Zhigong, which allows the very scheme of social boundaries inherited from the socialist system to survive the reform. The sustained social distinction is the result of the existing power that reproduce the distinction remain untouched. The politics of socialist accountability in the market transformation binds that embeddedness politics for disembedding to the exclusive social contract between the system and the *inner system* Zhigong, which reconfirms the *inner system* Zhigong's favorable position as ever. This systemic constructed unequal social condition is the very results of its authoritarian system. In this context, we can tell that the very process of China's market transformation ends up with politics of "embedded authoritarianism."

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