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Social Stability and Efficiency Wages:  
The Case  
in the Context of the Chinese Labour Market

A Thesis Submitted in Partial Fulfillment of the Requirements  
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*To my son Alfred (Yuxin) as my special gift for his one year old birthday*

## Abstract

Chinese gradual and piecemeal reform has generated dual labour market sectors: the state sector vs. the non-state sector. One important feature of reforms in the state sector is that balancing the objective of maintaining social stability against that of improving productivity is highlighted. In this thesis I suggest that this trade-off is inherent in the policy of *xiagang* which allows state owned enterprises to layoff workers but forces them to continue providing some wages and non-wage benefits.

The aim of this thesis is to examine the relationship between social stability and a range of variables such as wages, effort levels, employment, output, productivity and profitability. To fulfill it, this thesis builds a theoretical model that extends the Shapiro and Stiglitz no-shirking efficiency wage model to include characteristics of the Chinese context. The most important innovation in this model is the introduction of a social stability parameter that reflects some key features of *xiagang* such as a low likelihood of workers being laid off. The likelihood of layoffs could be lowered in the interest of social stability.

A comparative static analysis is undertaken on this model. It shows that with an increase of this social stability parameter, the overall wages, unskilled worker's effort levels and their employment tend to rise, but the overall profit levels and skilled worker's effort levels tend to decline; Skilled worker's employment, the overall output and productivity may either increase or decrease. This implies that profitability may be improved by lowering the social stability parameter, but that improvement is more likely to be realised through cutting labour costs at an expense of shifting more workers into *xiagang* rather than through improving the overall productivity.

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## Contents

Abstract	II
Acknowledgements	III
Contents	IV
Abbreviations	VII
Tables	VIII
Graphs	IX
Chapter 1: Introduction	1
Chapter 2: A Review of Chinese Labour Markets in the Transition	5
2.1 Introduction	5
2.2 A Review of the Pre-reform Chinese Labour System	6
2.2.1 Basic Characteristics of the Pre-reform Chinese Labour System	6
2.2.2 The Characteristic of the Pre-reform Chinese Rural Labour Segment	7
2.2.3 The Characteristic of the Pre-reform Chinese Urban Labour Segment	8
2.2.4 A Brief Comparison between the Rural Labour System and the Urban Labour System	11
2.2.5 Summary	12
2.3 A Review of Reforms in the Chinese Labour Market	13
2.3.1 The General Characteristics of China's Reforms and the Emergence of a Dual Labour Sector in China during the Post-reform Period	13

2.3.2	Reviews of Major Chinese Labour Market Reform Policies in the State Sector	15
	- Reforms on Employment Policies in the State Sector	15
	- Reforms on Wage System in the State Sector	17
	- Xiagang: a New Phase of Chinese Labour Market Reforms in the State Sector	18
	- Summary	22
2.4	An Examination of the Progress and Prospects of Chinese Labour Market Reforms	25
2.4.1	Introduction	25
2.4.2	Reviewing the Progress of the Chinese Labour Market Reform	26
2.4.3	Prospects of the Chinese Labour Market Reform	31
2.5	Conclusions	35
Chapter 3:	The Shapiro and Stiglitz No-shirking Efficiency Wage Model: The Case of the Chinese Labour Market in the Transition	37
3.1	Introduction	37
3.2	Reviews of the Shapiro and Stiglitz No-shirking Efficiency Wage Model	37
3.3	A General Critique of the Shapiro and Stiglitz No-shirking Efficiency Wage Model	43
3.3.1	Introduction	43
3.3.2	The Bond Argument	43
3.3.3	Other Critiques of the S-S Model	45
3.3.4	A Review of Empirical Evidence	47
3.3.5	Summary	48
3.4	Extensions to the S-S Model	49
3.5	The S-S Model: The Relevance to the Chinese Labour Market	51
3.6	Reviews of Others' Literature that Applies Efficiency Wage Theories into the Context of the Chinese Labour Market	54

3.7	Conclusions	59
Chapter 4: The No-Shirking Efficiency Wage Model in the Context of the Chinese *		
	Labour Market	60
4.1	Introduction	60
4.2	The Basic Assumptions of the Model	61
	4.2.1 Workers Effort Decision	61
	4.2.2 Firms' Decision	66
4.3	Comparative Statics	67
	4.3.1 Wage	67
	4.3.2 Optimal Effort Levels	68
	4.3.3 Employment	70
	4.3.4 Output	71
	4.3.5 Productivity	72
	4.3.6 Profits	74
4.4	Summaries	76
Chapter 5: Conclusions		
		81
References		
		83



## Abbreviations

The following abbreviations are used in this thesis:

CRS	The Contract Responsibility System
LMP	Labour's Marginal Productivity
NSC	No-Shirking Condition
NSOEs	Non-state owned enterprises
RMB	Renminbi (China's currency name)
SOEs	State owned enterprises
TFP	Total Factor Productivity
TVPs	Township and village enterprises
The S-S model	Shapiro and Stiglitz no-shirking efficiency wage model
VMP	Value of Marginal Productivity

## Tables

Table 1	Chinese Rural Labour Force Change, 1952-92 (million)	8
Table 2	Average Annual Growth Rates, GNP and Population, 1952-80	11
Table 3	Annual Economic Growth Comparison between China and Selected Eastern Europe Countries	13
Table 4	Components of Total Wage Bill in State Sector	30
Table 5	Per Capital Industrial Output in Different Enterprise Groups	33
Table 6	Average Wage of Staff and Workers by Different Ownership	34

## Graphs

Fig. 2.1	A Chart of the Chinese labour market reform proceeding	24
Fig. 3.1	Equilibrium Unemployment	40
Fig. 3.2	Li's Model	54
Fig. 3.3	Effort Function Curves of SOEs and NSOEs	58
Fig. 4.1	Effort Curves	68