

Understanding Informality in China: Institutional Causes and Subsequent Measurement Issues

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Introduction

Since the market reform of the late 1980s, the Chinese labor market structure has experienced major changes. One of the most important changes is the rapid growth of labor informality. In the sociality era, most Chinese urban workers participated in the formal labor market as the majority of them were employed in state-owned enterprises, provided with life-long employment security and a wide range of employment benefits. The labor market today is totally different from that of the pre-1980s. The Chinese labor market is now fragmented and stratified with an emergence of workers with different employment positions. Labor informality has grown consistently and rapidly and has become a main mode of employment (Cooke, 2008). Properly measuring the size of labor informality in China and understanding its sources has become more important than ever.

However, measuring the size of labor informality in China is not an easy task. For one thing, the concept of labor informality is in and of itself opaque. There is a lack of agreement among researchers as to what defines labor informality. Consequently, researchers conceptualize labor informality differently depending on the research questions asked. For another, the concept of labor informality originally emerges as a *residual term* defining the labor force *left out of* the formal sector, or more specifically, out of the wage-employment relationship (Hart 1973). Therefore, we rely on national labor market contexts to define what is *formal* to understand what is *informal*, leaving the concept of labor informality highly contingent upon national contexts. Studies of labor informality based on other parts of the world might not explain China's labor informality well enough due to every country's distinctive nature of labor informality. Put differently, the proxies used in Latin America might not be useful in Asia because labor informality is defined differently. The abovementioned reasons complicate the measurement processes of labor informality in China. As such, pinning down what labor informality is in China and how we should approach the concept is a challenging task.

One factor contributing to conceptual opaqueness is the various institutional causes of labor informality from region to region (if not country to country). In this chapter, we are to explore the institutional origin of labor informality in China and to compare it with other parts of the world. Labor informality is a combination of both voluntary members and involuntary members (Maloney 2001; Perry, Maloney, Arias, Fajnzylber, Mason, and Saavedra-Chanduvi 2007). By focusing on the institutional causes, this chapter is to explain why workers are in the informal sector *involuntarily*. We are to show that the conceptualization of labor informality has its political root in China and, hence, leads to distinctive measurement challenges. To illustrate how China's labor informality has its unique characteristics, we compare China to Latin America, specifically to Brazil.

The chapter argues that, compared to Latin America, China's labor informality is the result of 1) the emphasis on labor contracts under its socialist doctrine, and 2) the trajectory of the welfare state development. The first factor leads to the possibility of overlooking a subgroup of informal sector workers who hold labor contracts but still suffer from employment insecurity; the second factor leads to the suggestion that the 'social insurance access' is not a suitable criterion to measure the size of labor informality in China. The second factor also distinguishes China from Brazil regarding their labor informality composition. While the possession of labor contract and participation in social insurance programs are important aspects of formal employment in Brazil, identifying informal employment using the same criteria may yield inaccurate estimates of informal employment in China.

Regarding the measurement issues, established scholarship reached consensus that the self-employed workers are part of labor informality (International Labour Organization 2002). Following the distinctive origin of labor informality in China, the chapter also identifies three other precarious employment types in the formal sector that should be considered as informal jobs. These job types are: those without labor contracts, part-time workers with labor contracts, and dispatched workers with labor contracts.

We use our conceptualization of labor informality to measure labor informality in China, and the existing survey data show that the size of labor informality in China has increased from 17.38% in 2012 to 25.06% in 2014. The increase in China's labor informality is attributed not only to the growth of the self-employed but also to the expansion of formal sector precarious employment. The growth of informal employment in the formal sector contrasts with Brazil where the size of formal sector informal employment has decreased from 58.5% in the 1990s to 47.2% in the 2000s (Charmes 2009: p.36).

This chapter starts by providing an overview of the terms currently used by the international community to study labor informality. It is a useful exercise to fix what those terms are referring to as researchers sometimes use those terms to mean different ideas in different studies. Next, we review the historical development of labor informality in Latin America, specifically in Brazil, which is ensued by a detailed discussion on the causes of labor informality in China. We then discuss and propose the ways in which labor informality should be measured in China, and use existing survey data to provide an overview of China's labor market informality. The chapter measures the size of labor informality using two rounds of nationally representative labor survey data of 2012 and 2014, and ends with the political and policy implications for studying informal economy in China.

Definition of Labor Informality

Though the concept of labor informality is evolving and remains controversial, it is still useful to provide an overview of the terminology currently used by the international community. At the theoretical level, the definition of labor informality "is concerned with the characteristics of jobs, rather than the economic units to which they belong" (Charmes, 2009: 28). The defining characteristics of labor informality are jobs that "has no written contract and lacks social protection" (Charmes, 2009: 28). Researchers may refer to this phenomenon as informal employment or the informal sector. In this chapter, labor informality and the informal employment are interchangeable terms we use to refer to all jobs falling under the category of labor informality.

Under this definition, labor informality/informal employment is comprised of two parts: *informal self-employment* (i.e., informal employment in the informal sector) and *informal wage-employment* (i.e., informal employment in the formal sector). Informal self-employment consists of own-account workers, who are self-employed people with no employees; employers, who are self-employed people with paid employees; unpaid contributing family workers; and members of producer's co-operatives (wherever these exist) (Chen 2008). Another term we use to refer to informal self-employment is *the informal sector*. On the other hand, informal wage-employment consists of people who work in a wage-employment relationship but who are without adequate (or any) legal and social protection. Groups that belong to this category are: informal employees, who are unprotected employees with known employers (regardless of enterprise sizes);¹ casual workers, who exchange their labor for income on daily/seasonal basis that have no fixed employers; and subcontracted workers who produce for piece-rate from small workshops (Chen 2008). According to Chen (2008), across the developing world, informal self-employment composes more share of labor informality than informal wage-employment. As we show in the following sections, the prevalence of informal self-employment was indeed the case in most Latin American countries, including Brazil. Yet, we will show that informal self-employment was never a meaningful category in China until the 1980s.

Labor Informality in Latin America

Before we jump to the discussion of labor informality in China, we first discuss the phenomenon in Latin America. This section serves as the reference point to which we compare China's labor informality later in the chapter. In Latin America, the institutional origin of labor informality is associated with the continent's welfare state type. Latin America's welfare state is a Bismarckian welfare state, which is characterized by insurance-based social policies. Such insurance-based security regime is not a coincidence, but a deliberate policy choice along with the production regime choice across countries in Latin America (Haggard 2008; Wibbels and Ahlquist 2011). The social insurance model directly contributes to the rise of labor informality in Latin America. This section details the reasons behind Latin America's prevalent labor informality phenomenon and its trend overtime; we will pay special attention to the Brazil case.

1. The Cause: Development Strategy and Social Insurance

To trace how the Bismarckian welfare state is related to labor informality, it is important to first understand why social insurance was the common social policy type in Latin America. In a nutshell, the social insurance model emerged as a companion policy along with the development strategy in early years for many Latin American countries. The dominating development model was the import-substitution-industrialization (ISI) strategy, which reached its peak as the policy choice in the 1950s and 1960s. The ISI strategy involves two parts. On the one hand, government

¹ Another labor market classification that might be confusing is that existing literature defines enterprises with fewer than five workers as *informal enterprises*, and enterprise with more than five workers are *formal enterprises*. Some researchers would classify all the employers and their paid employees working in micro-enterprises with fewer than five workers as part of the labor informality (e.g., Charnes, 2009). However, we find this way of classification confusing as it mixed both informal self-employment and informal wage-employment. From employee's perspectives, as long as they are not protected with legal contract and social protection, they are considered informal employees. It does not matter how big the firm is.

subsidizes the chosen industrial sectors to begin the process of industrialization. The chosen industries usually produce commodities that were supposed to be imported from overseas. On the other hand, the government helps eliminate the international competitors by either setting higher trade barriers or manipulating the exchange rate (or both).²

What accompanied the ISI strategy is the social insurance-based welfare state. This is a strategic combination that happened not just in Latin America, but also in other ISI-oriented economies. Wibbels and Ahlquist (2011) argue that to promote and to implement the ISI strategies successfully, governments need to cultivate the labor force suitable for the ISI class structure. As a result, countries adopting the ISI model also incline to adopt the social insurance model, which can easily have a narrow range of beneficiaries and would help maximize the beneficiaries' wage overtime. Due to the contributory nature of social insurance policies, such policy model tends to protect only the better-off of the formal sector and strengthen the existing social hierarchy, especially in the developing world (van Ginneken 2003). These are usually workers associated with the ISI-related industries. Together, these policies create the privileged working and middle classes that serves both as the central labor force and the core consumers of the products they produce.

Brazil followed the ISI plus social insurance path described in Wibbels' and Ahlquist's argument. Among all the Latin American countries, Brazil was one of the first countries adopting the ISI model. In the 1930s, Brazil joined Chile, Argentina, Uruguay, and Mexico and became the first batch of the ISI strategy followers. The protectionism strategy emerged against the backdrop that the world just came out of the 1929 Great Recession, and the Keynesian ideology of big government started to gain its popularity (Haggard 2008). The ISI model was promoted strongly by the then populist leader Getúlio Vargas, who was the president of Brazil from 1930-1945 and 1951-1954. His successor, Juscelino Kubitschek de Oliveira (1956-1961), deepened the ISI industrialization furthermore. During that time, Brazil successfully established automobile and steel industries. The ISI strategy has also created a strong and organized labor force in Brazil. Between the 1970s and the 1980s, the unionization rate in Brazil was more than 35 percent. Even though the rates decreased to 24.8 percent in the 1990s after the debt crisis, the strength of the unionized labor in Brazil was still stronger than other countries in the region. For instance, around the same time, the unionization rate was 4.4 percent in Guatemala (Inter-American Development Bank 2003).

When Getúlio Vargas became the leader of Brazil, he not only focused on fostering the economy through a series of tariff and quotas, he also passed several legislative bills to provide pension and health insurance to a number of occupational groups. According to Malloy (1979), the passage of social insurance programs was a top down effort to link the "potentially powerful groups into dependency relationship (p.19)" with the state, and to stratify the society internally into competing groups all of which have to rely on the state.

2. The Consequence: Measures and Trends of Labor Informality in Latin America

The direct impact of the insurance-based social protection regime is that it defines what labor informality is (or is not) in Latin America. In Latin America, the most prominent conceptualization

² To learn more about the ISI strategy and its evaluation, please see Bruton (1998). To learn more about why some countries are more likely to adopt the ISI strategy, please see Wibbels and Ahlquist (2011).

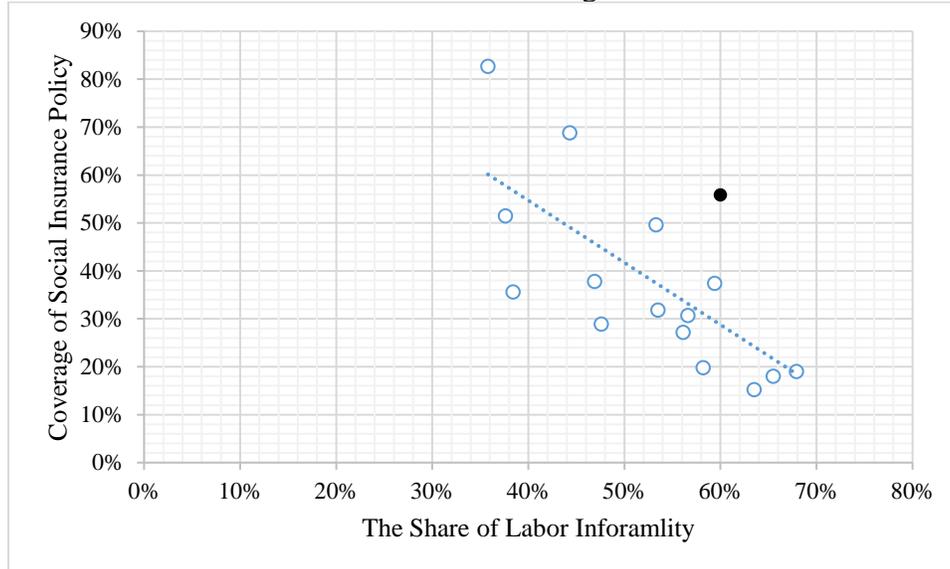
of labor informality follows the “legalistic/social protection” criteria (e.g., Perry et. al. 2007; Baker and Velasco-Guachalla 2018). That is, labor informality is when workers are in employment relationship that is “not subject to standard labour legislation, taxation, social protection, or entitlement to certain employment benefits” (International Labour Organization 2002). Even though the legal criterion (i.e., whether one is employed with a labor contract) and the social protection criterion (i.e., whether one enrolls in the public-run social benefit programs) are distinctive, Baker and Velasco-Guachalla (2018) argue that the two criteria overlap to a great deal in the Latin American context, precisely because a social insurance based welfare state means that “a formal employment contract brings with it enrollment in the state-run social security system (p.173)”. In other words, the early development of social insurance policies leads to the fact that a labor contract usually includes the publicly mandated social benefit. When an employer avoids providing a legally binding labor contract, they are usually trying to avoid the social benefit an employer is obligated to pay for. As such, it is the social protection programs that divide Latin America’s labor market into the formal and informal employment (Levy 2008; Levy and Schady 2013)

Under the Bismarckian welfare state, as mentioned above, workers are considered employed *informally* when they are not registered under any social insurance programs (e.g., public pension and health insurance, etc.). Hence, one usual proxy used in survey data to approach a worker’s formal/informal status is related to whether they enroll in public-run social insurance policies or not. For instance, Baker and Velasco-Guachalla (2018) used related survey items in the Latin America Public Opinion Project (LAPOP) to identify whether a worker is in an informal wage-employment relationship or not. The survey item they use asks whether respondents have social security (in the 2006 and the 2008 wave) or health insurance (in the 2008 wave) through their employers (Baker and Velasco-Guachalla 2018).

On the size of labor informality, the average share of the non-agricultural informal employment in Latin America is 54.2 percent before 2000. While Brazil had the share of labor informality dropped from 60 percentage point to 51 percentage point within 10 years, countries, such as Argentina and Bolivia, experienced an increase of labor informality during the same period (Charmes 2009: 34). Because the social security regime is highly connected to the labor market regime, the major form of labor informality in Latin America is *informal self-employment*. In the 1990s, informal self-employment constituted 61 percent of the non-agricultural informal employment while informal wage-employment made up the other 39 percent. The pattern is the almost identical across Latin American countries. Brazil has a more balanced composition of labor informality in the region as informal self-employment only leads informal wage-employment by six percentage points at the 53 percent versus 47 percent difference in the 2000s (Charmes 2009: 36).

Such a balanced composition is also a reflection of a relatively higher social insurance coverage rate in Brazil. Compared to other countries in the region, 55.8 percent of the employed workers aged above 20 are covered in contributory social insurance programs in Brazil, ranking Brazil as the fourth most covered country (Levy and Schady 2013: 201). Overall, because the social insurance coverage directly links to the size of labor informality, there is a strong and negative correlation between the two in Latin America (see Figure 1). When the social insurance coverage is larger, labor informality is smaller, and vice versa. The solid black dot is where Brazil stands relative to other countries in the region.

Figure 1: The Relationship between Labor Informality and Social Insurance Coverage



Data Source: Charmes (2009), Levy and Schady (2013)

To sum up, this section briefly discussed the institutional cause of labor informality in Latin America. Due to the early development of the social insurance models in the region, the size of labor informality in Latin America is directly related to employers trying to avoid paying for the state-run social insurance benefit. As such, three characteristics can best summarize the informal employment in Latin America. First, informal self-employment constitutes the most part of the informal employment in Latin America. Second, the higher the social insurance coverage, the lower the informal employment size. Third, enrollment in any state run social insurance programs or not is a good proxy for labor informality.

Chinese Labor Informality in Historical Perspective

In this section, we turn our focus to China. We trace the rise of labor informality in China through the historical perspective. We show that China's small informal employment in early years was attributed to its communist ideology, and how the phenomenon of labor informality has grown rapidly after China began its market reform after 1978. Moreover, because social benefit in China is tied closely to the household registration system, labor informality in China, then, is related to firms hiring rural migrant workers who are not entitled to the social benefit in urban cities under the household registration system. We trace in detail the various types of labor informality arising in China over the last three decades.

1. Labor informality in the early market reform era (~1990s): The growth of the informal sector

Compared to other developing countries, China has a relatively small informal employment. The underdevelopment of the informal employment is attributable to its socialist legacy. While labor informality has existed in China even under the socialist economic system, it was not recognized as a fully developed concept (Chen and Hamori, 2013). Before the economic openness and reform started in the late 1980s, most urban workers are employed in state-owned enterprises

(SOEs) and were provided with generous employment-based welfare benefits, such as housing, education, pension benefits, health care. Hence, there was little room for the informal employment to emerge in the urban labor market. Under the socialist economic system, the informal employment could not squeeze in the rural labor market as well because individual rural workers were affiliated with collective lands and the products were managed by the communes.

The informal employment has emerged and started to develop with the market reform in the late 1980s. The informal employment began to grow from the Chinese rural areas. Rural economic activities started to be arranged on the basis of contracts. Individual rural workers provided a contracted number of products to the township government and sold the surplus products at the informal urban market. Rural de-collectivization also played a role in facilitating the growth of the informal employment by releasing a large number of workers who previously engaged only in agriculture and not in other forms of economic activities. An increasing number of rural workers participate in economic activities in the informal sector—unregulated and under-monitored economic sector— by selling small food or fruits or by repairing shoes, bicycles, or keys (Cook, 2008). The economic activities of these self-employed workers are unregulated and under-monitored by the state.

While the size of the informal sector has grown rapidly since the marketization, the divide between formal and informal labor was not a fully developed as a concept that stratifies the labor market. Until then, the rural-urban dichotomy was more decisive than the emerging divide between formal and informal labor (Cooke, 2008). The divide between formal and informal labor reinforced the divided between urban and rural labor market, rather than cross-cutting the divide between urban and rural labor market, as the informal employment rises mostly from the rural areas whereas the urban formal labor market remains insulated from the shock of marketization.

The dichotomy between the formal and informal employment has gained importance as the informal employment penetrated the urban market. The informal employment has emerged in the urban market in forms of informal private enterprises since the early 1990s. These informal private enterprises are composed of less than seven employees or are usually owned and managed by an individual or by a family. These enterprises are regulated and monitored not as strictly as formal enterprises, such as the SOEs, collective enterprises, or foreign enterprises. The growth of these informal enterprises in the urban labor market has been fast and has contributed a lot to the urban employment (Huang, 2009).

2. Labor informality in the market reform era (Mid 1990s~early 2000s): Labor informality's contagion to Formal Sector

In its early stage of the market reform, the size of labor informality has grown due to the emergence of the informal self-employment. Starting from the late 1990s, however, labor informality has permeated into the urban formal sector. The urban economy previously predominated by the SOEs has become diversified with the rise of private enterprises and foreign enterprises and the restructuring of the SOEs. The newly emerging formal sector—foreign and private enterprises—have become the large consumer of informal employees.

Most of foreign enterprises and emerging private enterprises were focused on export-oriented and labor-intensive industries. In order to attract these firms' investments to their own localities, local governments have strived to secure a stable supply of cheap and low-skilled labor. Hiring

urban workers, however, was not a cost-efficient deal for many of foreign firms. Under the Chinese household registration system (i.e., the *hukou* system), urban workers were entitled to various welfare benefits provided by the enterprises they are employed. Hiring urban workers inevitably accompanied increase in labor costs. In this context, Chinese local governments loosened its restriction on rural to urban migration and encouraged rural workers to migrate to urban areas and to work in foreign and private enterprises. Profit-motivated foreign and private firms could reduce labor costs by employing these migrant workers as they were exempt from the obligation to provide employment-based welfare benefits to these workers (Knight et al., 1999). These migrant workers received lower wages than urban workers, were exposed to various forms of labor exploitation and experienced a high level of employment insecurity.

These migrant workers often lacked a written labor contract, were compensated with lower wages, and experience a high level of employment insecurity. Nor could they claim the employment-based welfare benefits their formal counterparts could claim. While the concept of employment relationship built on labor contract was introduced in the Labor Law of 1994, many workers entering to the emerging foreign and private firms did not establish a formal relationship with their employers due to their lack of knowledge. Employers in the emerging economic sector took advantage of the nascent and incomplete institutional arrangements and the lack of migrant workers' legal knowledge and successfully hired them with lower wages. Firms did not inform workers about the existence or the role of labor contract or even discouraged workers from signing onto the labor contract for employer's fear of increasing labor costs. These workers' employment relationships could not be monitored, managed, or regulated properly by relevant authorities or local governments as their employment relations with the firms were not built on labor contracts. Nor were there proper regulations to protect the informal employed workers from various forms of labor abuse. The SOE restructuring started in the late 1990s has further facilitated labor informalization in the formal sector. Many laid off workers generated by the SOE reform engaged in short-term, part-time, nonstandard jobs created in the formal sector.

It was then that the Chinese authority officially recognized the existence of labor informality. In 1996, Shanghai labor authority introduced the concept of 'non-standard flexible employment' to indicate various forms of labor informality characterized by temporary, fixed-term, casual workers in formal sector and self-employed (Wang et al., 2016). Chinese government has deliberately avoided describing these non-standard workers as informal and adopted the term of 'flexible' worker instead in order to dilute the negative connotation and to reduce the delegitimizing effect that the term 'informal' may bring to the society.

This new group of informal workers, who are employed in the wage-employment relationship but without written labor contracts, are similar to the self-employed or employees in small-scale private business in that they are all informal wage-employment that has a high level of employment insecurity. Yet, this new groups of informal workers are different from informal self-employment in that they are employed in formal sector enterprises that are subject to government regulation. It makes an important difference between informal wage-employment workers and informal self-employed workers. A research comparing these two groups under labor informality found important differences between the two. In China, informal wage-employed workers lacking labor contracts earn lesser money and have lower level of subjective well-being than informal self-employed workers. Yet, they work shorter hours and are provided with better social protection than informal self-employed workers (Liang et al., 2016). These differences come from the fact

that the formal sector is regulated more intensively by the state regulation and is affected more directly by labor regulations and laws. The differences between the two groups loom larger with the implementation of the Labor Contract Law of 2008, which I am turning to now.

3. Labor informality in the 2010s: the emergence of dispatch workers

The Chinese labor market in the 2010s has experienced major changes with the implementation of the Labor Contract Law (hereafter, LCL) of 2008. While the concept of labor relationship built on labor contracts has been introduced since the 1994 Labor Law, it was not until the enactment of the 2008 LCL that employment contract requirement has fully been implemented. The 2008 LCL was enacted in response to the growing level of social instability caused by the poor treatment against migrant workers. For the Hu Jintao-Wen Jiabao administration that rose in power with the catchphrase of “harmonious society”, maintaining social stability and reducing labor discontents have become an important issue. By enacting a more enforceable and protective labor law, the Chinese government tried to improve workers’ working environment and to reduce social instability (Meng 2017; Gallagher et al. 2014; Li and Freeman 2015). With the implementation of the LCL of 2008, the Chinese government has made it mandatory for workers to sign labor contracts with their employers. Employers were punished when they failed to sign a labor contract with their employees within a month from the employment relations began. The implementation of the LCL had workers possess a higher sense of employment security and claim various labor rights.

Whether the Labor Contract Law of 2008 reduced the size of informal labor, however, is subject to debate. The passage of the LCL has certainly increased the proportion of workers with labor contracts (Gallagher et al. 2014). The proportion of contracted worker has increased not only within the urban worker group but also in the migrant worker group. With the implementation of the law, workers gained power to file labor disputes, to claim their social rights, and to protect themselves from rampant labor abuse. The strict enforcement of labor regulations, however, ironically incentivized employers to hire workers indirectly or through non-standard ways so that they can reduce the higher labor cost associated with stable employment positions. This creative implementation of the LCL and business’s exploitation of the LCL created a large number of nonstandard workers whose employment position is not necessarily in violation of the labor contract law but is still precarious, the so-called “precarious employment” (Cook 2008; Swider 2015). Dispatch worker is the most common form of these precarious jobs.³ Employment precariousness has transmitted not only to vulnerable industries or private enterprises susceptible to higher labor cost but also to the well-protected sectors such as state-owned manufacturing enterprises (Park and Cai 2011b). In the worst case, dispatch workers compose more than two thirds of full time employees at SOEs (CLB, 2013). The state has overlooked, if not facilitated, the growth of this new type of precarious employment to boost labor market flexibility (Wang et al., 2016).

Nevertheless, whether to see these precarious workers as informal sector workers or not remains a controversial issue. Some argue that precarious workers should be classified as formal workers in that precarious workers establish formalistic labor relations with their employers, at least in paper (Gallagher et al. 2014). Others, on the other hand, see precarious workers as informal

³ Different terms are used to indicate this group of workers—dispatch workers, subcontracted workers, agency workers.

workers (Ren and Peng 2007; Park and Cai 2011a; Wang et al. 2016). Precarious workers are paid less or irregularly and experience a higher level of job insecurity. They also receive less welfare benefits than formal sector workers. Some labor agency firms have bargained with the local labor bureau and social insurance companies so that they can allow these labor agency firms to provide only limited social benefits to the agency workers (Wang et al. 2016). They are hardly monitored by labor authorities due to the complexity of the employment relationship they have with the firms they are working for. In this regard, some even evaluate that the LCL has unintentionally contributed to an increase of informal wage-employment in the formal sector, rather than eradicating it. The increase in the number of precarious workers (i.e., informal wage-employed workers with labor contracts) is a new phenomenon that has received relatively fewer attention from the previous literature on Chinese labor informality. This chapter considers the size of the precarious workforce in measuring the size of labor informality in China.

4. Labor informality and the revision of the Labor Contract Law in 2013

The over-expansion of precarious workers, especially explosion in the number of dispatch workers, has worried Chinese government about its ramification on its economic development and social stability. The Chinese government's turn to domestic-consumption oriented model also played a role in motivating the state to revise the LCL in a way that prevents employers from taking advantage of the loopholes of the law and hire workers informally without being caught by the labor contract law. The revised labor contract law of 2013 restricts the use of dispatch worker, stipulates the six-month limit on using temporary workers and set the maximum percentage of dispatch workers in a firm's total employees. Yet many observers cast doubt on the effectiveness of the revised law in reducing the abuse of non-standard employment and are suspicious that employers will find a way to circumvent the new law.

Measuring the Size of Labor Informality in China

Following the discussion on the rise of labor informality in China, this section focuses on the ways in which we can measure China's labor informality. It has been a challenge to measure labor informality accurately in China, partly due to the government's neglect on purpose. Therefore, we provide various ways of measuring China's labor informality and discuss the job categories that should be included under labor informality.

1. The difficulty of measuring Chinese labor informality

Measuring the size of labor informality in China is challenging. Despite the substantial increase in the size of labor informality, the Chinese government has shown little enthusiasm in understanding the size and source of its labor informal (Park et al. 2012). While the Chinese official statistics provides a remote estimate of labor informality, they are far from consistent (Zhou 2013). The Chinese government's lack of effort to understand its labor market informality is in sharp contrast to other large uneven developing countries, such as India, where the government intervenes proactively in measuring the size of informal employment. Even in reports produced by the International Labour Organizations (ILO), where the size of informal employment of various countries is reported, the size of Chinese labor informality is either not reported or is represented by the size of informal employment of four large cities in China.

The Chinese government's lack of enthusiasm in understanding the nature of its labor informality is also evidenced by the term it uses to describe informal economy. The term 'informal employment' as a concept was first introduced by Shanghai authority in 1996. Yet, the Chinese government has deliberately avoided using the term 'informal (非正规, *feizhenggui*)'. Instead, the Chinese government adopted a term 'flexible (灵活, *linghuo*)' employment in order to dilute the negative connotation that the term 'informal' may bring to the society (Cook 2008). The Chinese government's denial of 'informal' economy has delayed the attempt to systematically examine the extent and characteristics of the Chinese labor informality, not to mention enactment of relevant policies and regulations regarding informal employees (Liang et al. 2016). While burgeoning literature on Chinese labor informality approximates the size of the informal sector by using various survey data, this lack of official statistics or publicly available firm-level surveys complicates deep understanding of the Chinese labor informality.

Measuring the size of labor informality in China is also challenging because the sources of labor informality have been changing and have become diversified over the past few decades. Labor informality comes both from *wage-employment* and *self-employment*. Two key characteristics distinguish the two categories (Hart, 1985). First, *wage-employment* is monitored and regulated by the state and the relationship between employer and most employment relationships are built on explicit labor contracts. It is possible, however, for employers to hire workers informally by not establishing their relationship based on labor contracts. Economic globalization and price competition has facilitated the informal employment in the wage-relationship. *Self-employment*, on the other hand, is not subject to the state's regulations. The employment-relationship is not built on a written contract. Most workers outside of wage-employment are either self-employed or employees in small enterprises not regulated by the state. Their employment relationships are characterized by a high flexibility and instability.

2. Estimates from official statistics using the residual methods

There have been important and meaningful academic attempts to measure the size of the Chinese labor informality. One of the major approaches is to estimate the size of informal economy at the macro level by using national-level official statistics and the other is to use various survey data.

Most research using official statistics adopts the residual approach in which the size of labor informality is measured by the gap between the total urban labor force and the number of formal employees (Park and Cai 2011b; Cook 2008; Huang 2009; Hu and Zhao 2006; Zhang et al. 2015). The number of total urban labor force comes from the annual sample surveys of the entire population conducted by the National Bureau of Statistics (NBS). The number of formal employees is estimated as the number of workers counted and reported by urban firms of different ownerships (Park and Cai 2011a). The Chinese official statistics further breakdown the number of reported workers by four different ownerships; 1) State-owned enterprises; 2) collective enterprises; 3) other enterprises; and 4) private enterprises and self-employed.

There is a debate regarding which workers are supposed to be considered as 'formal (sector) workers'. Some works treat the entire number of reported workers as the size of formal sector workers. In calculating the size of labor informality, these works subtract the number of reported workers from the number of total urban labor force (Park and Cai 2011a; Zhang et al. 2015). The gap between the number of total labor force and of registered workers implies that there are uncounted urban labor forces. These uncounted workers, by definition, are informal in a sense that

their employment status is not counted by the formal system. It is likely that these workers' employment stability or security cannot be monitored and managed very effectively.

Other works share the point that 'uncounted' workers reflects the size of informal workers but they are different in that they treat workers in private enterprises and self-employed as 'informal sector' workers (Huang 2009; Hu and Zhao 2006). These works subtract the sum of formal sector workers—the number of employees in state-owned enterprises, collective enterprises, and other enterprises—from the number of total employment. This approach provides a larger estimate of the size of labor informality as it treats not only 'uncounted' workers but also private enterprise- and self-employed workers as informal workers.

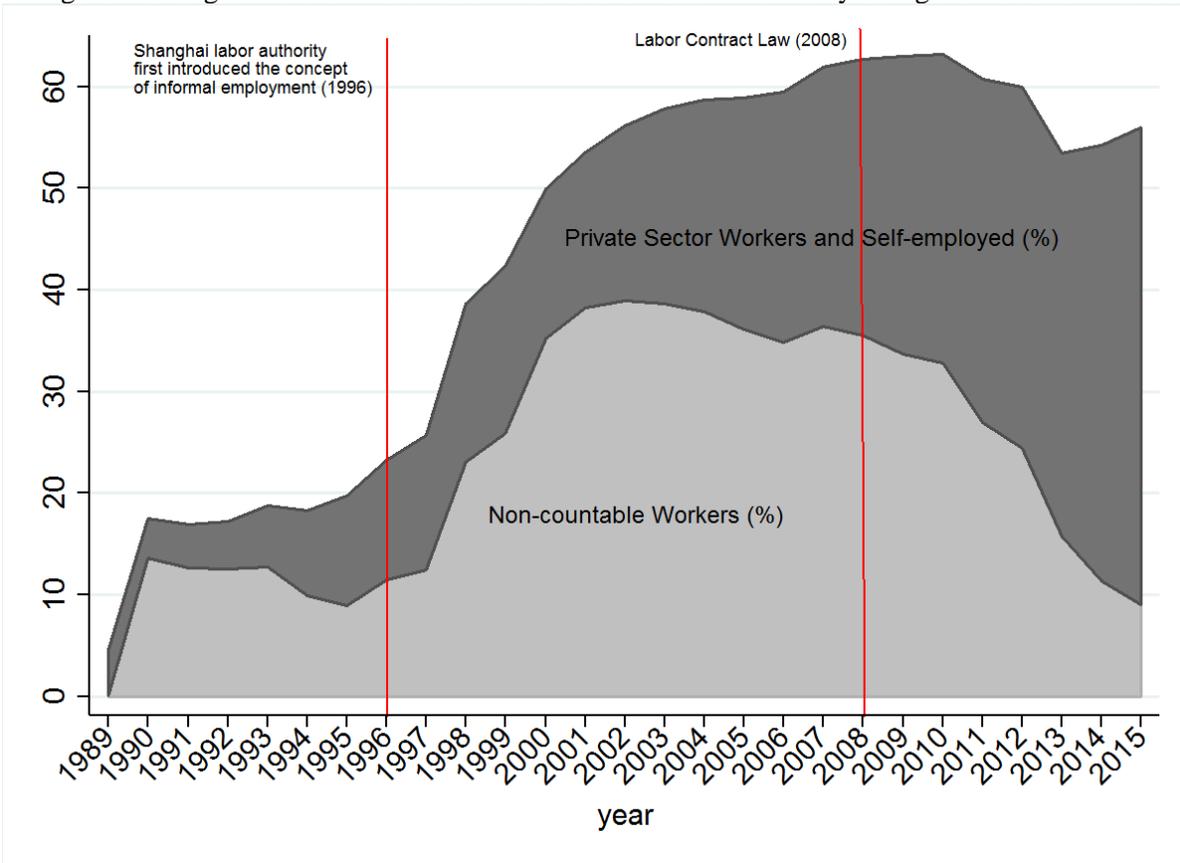
While this approach is widely used, this residual approach may provide a limited and potentially flawed description of the size and characteristics of Chinese labor informality. First, it is not clear who constitutes the 'uncounted' worker group. Some argue that the number of uncounted workers is likely to capture the number of informal employees in formal sectors (Hu and Zhao 2006). Others, on the other hand, interpret this number as the number of workers in informal sectors such as unregistered private and self-employed sectors (Park and Cai 2011a). This unclarity and limited information on uncounted worker group makes it hard to understand the changing nature of Chinese informality and diverse sources from which labor informality is created.

Moreover, the post mid-2000s estimate of labor informality measured by the residual approach is suspected to be systematically biased and is not likely to capture the changes in Chinese labor informality. Until the mid-2000s, the size of labor informality measured by the residual approach was approximately equal to other estimates of labor informality in urban China (Chen and Hamori, 2013). Hence, the residual estimate was broadly used to grasp the changes in Chinese labor informality. Since the mid-2000s, however, the estimate from the residual method has started to show bigger mismatch with estimates from other surveys and reports.

The residual estimate shows a decreasing trend of the size of uncounted workers (see Figure 2). Some might interpret this as decrease of informal wage-employed workers after the strict enforcement of the Labor Contract Law. Yet, various survey data and reports witness an increase, not decrease, in both informal wage-employment and informal self-employment after the implementation of the Labor Contract Law (Liang et al. 2016). Estimates from individual level surveys below also show that the size of informal wage-employment has grown and taken the largest portion of labor informality in China. The decreasing number of uncounted workers since the late 2000s from the residual approach is not likely due to actual downsizing of labor informality in wage-employment relationships but is more likely due to the changes in reporting system. For most research projects that adopted the residual method, this potential systematic bias was less of a problem because they stopped measuring the size of informal sector using the residual method before 2008—the year the Labor Contract Law is implemented. For a more recent update of the size of labor informality, the residual estimate is likely to suffer from this potential systematic bias.

Not only does the residual approach provide a flawed estimate of the number of informal wage-employed workers, it also risks an underestimation of the size of labor informality in wage-employment relationship by treating all workers in formally registered firms as formal workers. As discussed, labor informality exists even in formally registered sectors and with different forms—those who without labor contract and various forms of precarious workers with labor contract. The residual estimate of labor informality collapses these worker groups and obfuscate understanding the changing nature of Chinese labor informality and various sources from which labor sector workers are generated.

Figure 2 Changes in the Chinese Labor Market and Labor Informality Using the Residual Method



3. Estimates from Survey data

To supplement the limitation coming from the residual approach, many resort to individual-level survey data. Survey estimates of labor informality may not provide information on longitudinal changes in Chinese labor informality as the residual estimates do. Yet, they provide a more nuanced information on Chinese labor informality as they provide detailed information on differences in employment sectors, employment positions, and social-economic characteristics of workers who constitute different informal sector worker groups. Most survey estimates of labor informality, for example, provide a breakdown of informal self-employment and informal wage-employment.

Most research identifies the self-employed workers as informal sector workers (Cook 2008; Park and Cai 2011a). For labor informality in wage-employment relationship, the possession of labor contract is adopted as the core criterion in deciding a worker's employment position (Liang et al. 2016; Park et al. 2012; Chen and Hamori 2013). Another variant of this approach is to examine not only a worker's possession of labor contracts but also his/her social insurance (pension, health insurance, unemployment insurance) participation status (Park et al. 2012).

While the possession of labor contract and participation in the social insurance program are important aspects of formal employment, identifying labor informality by focusing only the

possession of labor contract and participation in social insurance program may yield an inaccurate estimate of the size of labor informality. While the possession of labor contract is a necessary condition for formal employment, it is not a sufficient condition for formal employment. Cooke (2008), for example, criticizes that defining labor informality in terms of the lack of a labor contract and social insurance coverage may risk tautology and fail to capture precarious employment—such as formal sector workers who contracted as temporary workers or workers who are employed indirectly by labor dispatch agencies. These “precarious” workers have a higher level of employment insecurity even when they signed labor contracts (Cook 2008; Swider 2015).

This chapter tries to capture the size of this precarious employment in addition to the size of labor informality captured by the number of employees lacking labor contracts. We define precarious employment as wage workers with labor contracts who are employed indirectly by labor dispatch agencies, are paid on non-regular basis, and are employed as a part time worker and estimate the size of this worker group.

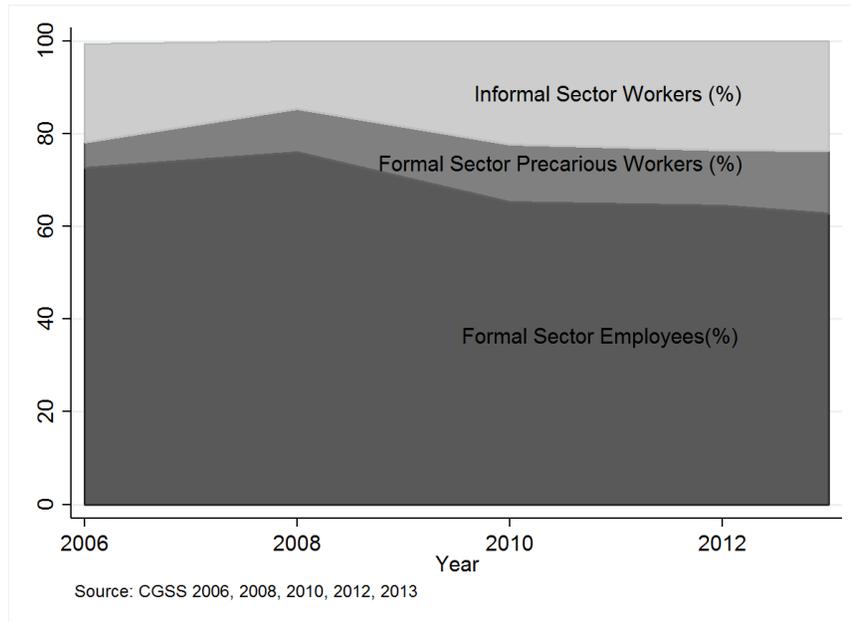
4. A snapshot of Chinese labor informality in the 2010s

This section describes the recent changes in Chinese labor market and composition of labor informality using two nationally representative survey datasets. As discussed, survey data are limited in providing a longitudinal description of development of Chinese labor informality. It is because there are only a few survey projects that were conducted over years with consistency.

The China General Social Survey is a widely used survey that was conducted over various years, starting from 2003. The most recent round of survey was conducted in 2013. Figure 3 describes longitudinal changes in the composition of non-agricultural employment in China that the CGSS captures. The dark-grey area and medium dark grey area show the size of employees in formal sector, while the medium-dark grey area captures the size of precarious workers in formal sector, defined by workers who do not have fixed employer or are hired indirectly by labor dispatch agencies. Many of them are likely to lack labor contract. The dark-grey area captures the size of formal sector employees who are hired directly by a fixed employer. Although both workers are in formal sector, workers hired by a fixed employer have a higher level of job security. Yet, this does not mean that all formal sector employees are formal. There can be workers without labor contract or are employed temporarily. The light grey area captures the size of informal sector employees and it includes employees in petty enterprises (getihu), employees who work for family business, or self-employed.

The size of informal sector (light grey area) is growing while the size of formal employment (dark-grey area) is shrinking. The increase of labor informality in China is attributable not only to the growth of informal sector but also to the expansion of formal sector precarious employment (in medium dark grey area). The growth of formal sector labor informality is in contrast to Brazil where the size of formal sector informaml employment has decreased from 58.5% in the 1990s to 47.2% in the 2000s (Charmes, 2009).

Figure 3. Labor Employment by Sectors



Two rounds of a most recent nationally-representative survey, China Labor Dynamic Surveys of 2012 and 2014, show a similar trend with more detailed breakdown of labor informality (See Figure 4 and 5). According to the survey, the size of informal self-employment has increased from 17.38% in 2012 to 25.06% in 2014.

Formal sector employees with labor contract takes 41.05% and 36.23% of entire non-agricultural workforce in 2012 and 2014, respectively. Yet, 20.69% and 21.9% of these contracted workers are either employed indirectly by labor dispatch agencies, paid weekly or daily wages, or are employed as part-time workers.

In 2012, slightly more than a half (50.32%) of formal sector employees lack labor contracts, taking 41.57% of entire non-agricultural workforce in China. The proportion of formal sector employees lacking labor contracts has increased in 2014 to 51.2% of formal sector employees.

Overall, both macro-level statistics and micro-level survey data evidence the growth of labor informality in China. A further breakdown of employment status and job characteristics show that the growth of Chinese labor informality is attributable both to the growth of informal sector and the growth of informality within formal sector.

Figure 4: 2012 Chinese Workers' Employment Composition

Formal sector (employees)—82.62%		Informal sector
Employees with labor contract 41.05%	Employees with labor contract, full time position who are employed directly by the firm 32.55% (79.31% of contracted workers)	Self-employed Other firms 17.38%
	Employees without labor contract 41.57% (50.32% of formal sector workers)	
	Employees with Precarious job positions 8.5% (20.69% of contract workers)	

Figure 5: 2014 Chinese Workers' Employment Composition

Formal sector (employees)—74.94%		Informal sector
Employees with labor contract 36.23%	Employees with labor contract, full time position who are employed directly by the firm 28.28% (78.1% of contracted workers)	Self-employed 25.06%
	Employees without labor contract 38.71% (51.2% of formal sector employees)	
	Employees with Precarious job positions 7.95% (21.9% of contracted workers)	

Conclusion and Implications

The goal of this article is to introduce the institutional causes of informality in China and the subsequent measurement issue. To better illustrate how China's informality has a distinctive origin from other BRIC countries, we use Brazil as the representative case of Latin America for comparison. The major takeaways are as follows.

First, compared to Brazil, and other Latin American countries, where labor informality largely takes the form of informal self-employment, the Chinese labor market has started with a relatively small segment of informal self-employment. The small size of informal self-employment is directly attributed to China's socialist legacy. In China, the market reform of the late 1980s has increased the size of informal sector, creating a large number of informal sector employees (Park et al., 2012). Yet, as the marketization deepens, labor informality has spread to wage-employment relationship. The increased demand for cheap and low-skilled labor from the growing number of

foreign and private enterprises have facilitated the labor market dualization, increasing both the size of informal self-employment and informal wage-employment.

Second, due to the household registration system in China, social benefit is tied closely to an individual's birth place. As such, even though the "legal/social protection" criterion that can be combined and viewed as the same thing in Brazil, it should be used separately in China. In China, a labor contract is not associated with state-run social insurance benefit. In Brazil, employers would purposely avoid signing the labor contract to alleviate paying for the social benefit costs. In China, employers can sign labor contracts without paying a lot of (if any) social benefit. This is why we observe a rise of informal employment in the formal sector in China. Dispatched worker is a classic example. By law, dispatched workers have labor contract, but with a third party, not with the firm they work in. For employers', the purpose of having a third party, which is usually a firm that is solely responsible for sending dispatched workers, signing the labor contract is to help alleviate the labor costs and to lessen the benefit package employers must pay out. In this regard, dispatched workers are also subject to high job insecurity and low (to zero) social benefit, which makes their circumstance almost the same as other informal workers, even though dispatched workers have labor contracts. To sum up, having a labor contract or not does not really define labor formality/informality in China.

Third, the size and composition of labor informality is highly affected by government policies. Brazil's Bismarck style welfare state incentivize employers and exclude workers from the formal sector (or more precisely, the wage-employment relationship). The social insurance-based welfare state results in *informal self-employment-based* labor informality in Brazil. In China, there has been an increase of *informal wage-employment jobs* due to the implementation of the Labor Contract Law of 2008. While the law has increased the proportion of workers with labor contracts, it has also created many precarious workers, such as part-time workers or dispatch workers.

Some implications can be derived from the conclusion. At the theoretical level, the diverging paths and sources of labor informality have made Chinese informal workers highly heterogenous. They have been treated differently in the labor market and received different types of benefits from their employers or from the state. Such heterogeneity also distinguishes China's labor informality from other BRIC countries' labor informality. Hence, in order to better grasp the size and nature of the Chinese labor informality, it is essential to understand various paths from which labor informality is generated. If we only define labor informality with the "no labor contract and no social benefit" criterion, like how we did in Brazil, we may fail to capture precarious employment, workers with labor contract but without enough social benefit and job security, as a form of informal employment in China. In this chapter, we take the initial step and discuss how we should measure informality in China given the various sources of labor informality.

A related issue is that it begs further theoretical debate whether the current conceptualization of labor informality can travel across countries. We are in need of better dataset that can produce more internationally comparable data on labor informality. Due to the data availability issue, many of the studies out there only use 'self-employment' as the proxy for labor informality (e.g., Berens 2015). The 'self-employment' proxy is not only not comprehensive but also not really useful for cross national comparison. How to create better proxies for labor informality for cross national analysis is an important question to be explored as the next step.

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