



Labor and Globalization

Max J. Zenglein

**Institutional Framework and
Dysfunctionality of the
Transitional Chinese Wage
Bargaining Regime**



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Dedicated to my parents

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Abbreviations

ACFIC	All-China Federation of Industry and Commerce
ACFTU	All-China Federation of Trade Unions
AHK	Auslandshandelskammer
Asian Tigers	Hong Kong, Singapore, South Korea, Taiwan
CB	The Conference Board
CEC	China Enterprise Confederation
CEC/CEDA	China Enterprise Confederation/Chinese Enterprise Directors' Association (after fusion)
CEDA	Chinese Enterprise Directors' Association
CEMA	Chinese Enterprise Management Association
CLB	China Labor Bulletin
CME	Coordinated Market Economy
C_{min}	local minimum monthly living cost
CPC	Communist Party of China
CPI	Consumer Price Index
CPPCC	National Chinese People's Political Consultative Conference
E_{AV}	absolute value of the minimum monthly living
E_{pro}	proportion value of the minimum monthly living
GCC	German Chamber of Commerce in China
GDP	gross domestic product
HR	Human Resources
Hukou system	Household registration system
ILO	International Labor Organization
LLC	Limited Liability Corporation

LME	Liberal Market Economy
MLSS	Minimum Living Standard Scheme
MNE	Multi-national enterprise
MOLSS	Ministry of Labor and Social Security
MW _L	Local minimum wage
NBS	National Bureau of Statistics
NGO	Non-governmental organization
NPC	National Peoples Congress
NTCC	National Tripartite Consultative Committee
NTUC	National Trades Union Congress
NWC	National Wage Council
OECD	Organisation for Economic Co-operation and Development
ÖGB	Austrian Trade Union Federation
PAP	People's Action Party
PBOC	People's Bank of China
PRD	Pearl River Delta
P _{sup}	number of family members supported
RMB	Chinese Yuan
SASACS	State-owned Assets Supervision and Administration Commission of the State Council
SNEF	Singapore National Employers' Federation
SOE	State-owned enterprise
STEC	State Trade and Economic Commission
TCC	Tripartite Consultative Committees
TVE	Town and Village Enterprise
WKO	Austrian Federal Economic Chamber

Preface

During the course of conducting my research I sometimes drifted off imagining what I would write in my preface once I had completed my dissertation. Now that I am actually in the process of writing the preface truly makes me realize what a long journey it has been and that a significant stage in my life has been completed. Completing a PhD is rewarding for the knowledge, academically as well as personally, that is accumulated over time. It however also is a major project with many academic challenges pertaining to one's research, but also with the challenge of maintaining an environment allowing the research to continue. Personal perseverance and the valuable support from people around me have been fundamental in completing this journey.

My academic career certainly was not straightforward, taking many turns as along the way, academically and geographically. After starting out in industrial engineering, I quickly realized that what I am truly interested in is economics and political science. Luckily, after becoming increasingly aware of this, I managed to change my course of study without wasting too much time. I spent formative years in Buffalo and Berlin increasingly becoming absorbed by institutional economics. It provided a link between political science and economics, linking fundamental interests of mine and fueling my desire to learn more about it. I was first introduced to institutional economics during a mandatory economics class at the TU Berlin and later during a class on East Asian economics at SUNY Buffalo. The topic fascinated me though I was still lacking any precise understanding of the concept of institutional economics. The seed however was planted.

I was fortunate to have encountered a magnificent academic environment in Buffalo which made me learn to enjoy researching and analyzing. The experience was then only amplified while completing my masters at the Berlin School of Economics and Law. The course work further ignited my interest in institutional economics, while student jobs introduced me to academic research. I greatly benefited from experiences under Prof. Jürgen Müller's research project on airports. The project exposed me to a web of researchers working together, exchanging ideas, and exploring concepts. Truth be told, I began to really enjoy research.

Most significant however was my work with Prof. Hansjörg Herr for who I worked as a research assistant at the same time. Next to a seemingly endless quest for data on a variety of topics, he introduced me to labor markets, wage bargaining and Keynesian theory, decisively influencing my perception. Ultimately it led to my focus on wage bargaining mechanisms for my master thesis. Another consequence was that he exposed me to developments in China and, after completing my masters, asked if I was interested in going to China for a teaching position. I didn't hesitate and the foundations for my research interest in institutions, wage bargaining systems, and transitional economies were established.

The idea of pursuing my PhD began to develop with the first drafts of research proposals based on my master's thesis. The biggest challenge however was to find an adequate PhD program. After many applications to various institutions I was thrilled to have been accepted to the University of Hong Kong's economics department. Despite the phenomenal academic environment there, it quickly became apparent to me that the program I enrolled in was not compatible with my own objectives. After much soul searching I came to realize that it would be an excruciatingly long five years if I was not able to identify myself in what I was doing. Following much debating I decided to take the difficult decision to resign. Despite being short

in nature, the half year spent at HKU provided me valuable technical insights and provided me access to the superb libraries at the university. The shock however was a major blow to my ambitions, though in hindsight I think it was the best choice and I am convinced I made the best of my time at HKU.

I was fortunate to find a job with the German Chamber (AHK) in Shenzhen across the border within a relatively short time frame. It turned out to be a stroke of luck, but I still needed to secure a position to pursue my PhD. After about a year I was able to secure a research PhD at the University of Kassel with the help of Prof. Herr and Prof. Christoph Scherrer. Meanwhile I negotiated a deal with my employer allowing me sufficient time to conduct my research. After years in the making a research environment which was working for me, had been created. In many aspects this constellation was a fortunate one. Both my professional experience working as an economist as well as my research activities reinforced each other. It allowed me to balance my academic approach with practical insights. Being close to companies enabled me to accumulate in-depth knowledge of how policies affect companies. To a great extent I was able to benefit from these extensive insights, which were not just limited to short field studies many researchers typically engage in, but during my entire research. Equally important was my ability to collect substantial data from the surveys I conducted. From the amount of requests I have received from academics requesting access to companies to conduct surveys, I have a very good understanding of the difficulties researchers face, so I highly appreciate the fortunate position I was in to collect my data.

A challenge certainly was being relatively isolated and not being able to engage in frequent and structured exchanges with other PhD students or academics. Such exchanges are vital not only for finding direction on the research topic, but also on technicalities as well as motivational issues pertaining to the dissertation. This required more proactive actions on my part and I also benefited from participating at several colloquiums in Berlin. Of course during a dissertation one will encounter frustrating moments. Getting stuck on a certain topic, struggling with data or becoming distracted with other obligations are major obstacles. There were times where over months I was only able to do minimal work on the dissertation. The longer the time period was the more difficult it is to pick up the work again, as in order to oversee the entire complexity of the dissertation requires vigilant attention. The most productive periods were when I was fully engaged with my mind constantly working on whatever I was just working on. However, then too you need to be attentive not to drift off trying to encompass yet another aspect. Towards the end as the dissertation increases in volume and you have read many sections countless time, I must admit, I struggled wanting to look at it again. But these experiences are all part of the process. There are many ups and downs and it is important to keep motivated and have a clear direction in mind where the research is going.

Despite working and researching on China since 2008 I actually lived in Hong Kong and Macau during the course of my dissertation. I also spend considerable time in Taiwan, where I also retreated to do some of the most challenging writing and editing parts. The experiences there exposed me to a variety of influences which I could greatly benefit from. Chiefly, it helped me to put developments in a more political context, but also to learn from experiences there. On a personal note it made me ever more appreciate personal freedoms, a free press, and open societies. It also gave me a much deeper understanding of Chinese culture, which I

found strongest in Taiwan. Had I written down my perception of China in 2007 and compared it to my present perception there would have been an enormous difference. This may not be totally surprising given the amount of time I have spent researching on China. It is a highly interesting and complex country to conduct research on, this in itself was always a great motivation.

Completing a PhD requires the help from a lot a people. Foremost, I want to thank my parents who believed in me and always supported my decisions. In my academic life that started from changing my major and transferring to Buffalo, to continuing my masters in Berlin and eventually my PhD in Hong Kong, as well as my decision to continue in Kassel. There were many discussions challenging my arguments, but these were also fundamental in shaping my perception and determination. Without their moral and financial support none of this would have been possible for me. The quest for education should not be taken for granted and my parents were amazing in supporting my academic pursuit across three continents and three degrees. As always I had the solid foundation of a great family enabling me to follow my dreams. For this I am greatly thankful.

I am deeply thankful to Prof. Hansjörg for the help and advice he has provided me during my academic journey starting from graduate school in Berlin. Not only did he act as a mentor on academic issues, he also supported and encouraged me to pursue my PhD. As an advisor I could rely on swift and helpful advice. I also owe many thanks to Prof. Christoph Scherrer who accepted me as a PhD student in an uncomplicated manner and provided helpful insights for this dissertation. I was very lucky with my advisors and for this I am very grateful. Generally during my student life I was very fortunate to have benefited from talented academics at my universities in Buffalo, Berlin, Kassel and Hong Kong.

The favorable constellation of writing my PhD while working for the German Chamber would not have been possible without the help of Alexandra Voss. The members of the regular general manager roundtable were an extremely valuable source of information. Here I would like to especially like to thank Michael Hartl and Axel Strittmatter. Thank you also to Chi-Hang Lee who had my back many times when working in the Shenzhen office. Many thanks also to I-Wen Wang who cultivated my interest in Taiwan and equally helped to keep me motivated. Thank you also to Marcus Knopp for the many discussions in Hong Kong over the years. Last but not least, a very special thank you to Nan Nan Li, who had to live through my many mood swings but always kept on motivating me and giving me the occasional push when I needed it most. Overall I was truly blessed to having been surrounded by very supportive and helpful people.

1. Methodology and Research Framework

1.1 *Research context*

Over the past three decades China has been undergoing a tremendous transformation process. Considering its size and effects on the rest of the world it is only natural that such a significant event will be under intense scrutiny from scholars and policy makers alike. By 2015 China has already emerged as a one of the world's largest economies and has been a major source for global economic growth. During its economic revival China was able to lift an unprecedented number of people from poverty by significantly increasing the standard of living. Due to its growing economic weight China's developments have become increasingly relevant to the rest of the world; a constellation fairly unique to an emerging economy. It was with the famous Southern Tour in 1992 by then paramount leader Deng Xiaoping that China established the foundation of its 'socialist market economy'. Following his equally famous "feel the stones while crossing the river" phrase, China has chosen a unique and pragmatic approach in transforming the country: adjusting the institutional design while testing arrangements and adjusting them when necessary. Absent of significant political reforms during China's economic ascent the legitimacy of the Communist Party of China (CPC) continues to originate from it further advancing economic growth and increasing peoples' livelihood. Changing the underlying fundamentals of its economic system were prerequisites to the implementing the reform and opening-up process which ultimately led to the successful transformation. However, despite its impressive performance and continuous rapid growth China's transformation of its economic system is far from completion.

The magnitude and transformation speed of China's economic system has had substantial effects on its institutional framework. The focus however have been on establishing an export-led growth model with a greater emphasis on market mechanisms, privatization and entrepreneurship, although strictly confined within a socialist market economy dominated by the central government. Though directly affected by reform efforts, the labor market initially was not at the center of attention. Despite the rapid economic growth the CPC was increasingly being confronted with rising social tensions and conflicts. To counter these effects labor market institutions were granted greater prominence as the CPC began to identify the developments in the labor market as well as wage determination mechanisms of central importance to questions related to social, political, and economic stability in China. Consequently the labor market has increasingly become a critical component to the government's reform efforts and its continuous economic progress. Recent efforts attempting to rebalance the employee-employer power balance, strengthening the legislative framework, experimentation with trade unions and collective agreements, as well as the implementation of minimum wages indicate that the labor market, given its relevance for more sustainable economic development, has become a more prominent issue to the government's policy agenda.¹

¹ Although not identical the terms CPC and government will be used synonymously to reflect the nature of the one-party state.

Naturally, the labor market and its institutional design have profound domestic consequences for China. Indirect and increasingly direct reforms affecting the labor market have had far-reaching implications not only for the economy but for the Chinese society as a whole. Over time Chinese industrial relations have substantially changed from governmental paternalism to a more market oriented system for large portions of the labor force. In this process previous labor market institutions have either been transformed or abolished while new ones have been slow to develop. Since reforming its economy China's labor market has vastly transformed a rigid wage determination system to one with a higher degree of flexibility: first, government institutions which were solely responsible to allocate jobs, guaranteeing income and social security under the pre-reform regime labelled the 'iron rice bowl', have progressively been abolished. Second, the unified grade wage system (wage grid) which ensured fairly small wage dispersion disappeared as the importance of market mechanisms in the economic system advanced. Third, the household registration (hukou) system which created a major obstacle to labor mobility has been reformed unleashing a tremendous shift from rural to urban areas.

Despite the massive changes, the current institutional design of China's labor market and its system of industrial relations has no clearly outlined development strategy observable as policy experimentation at different levels continue. Conflict of interests, in combination with the sheer size of the country, and lack of uniformly reliable institutional arrangements have created major obstacles for the implementation of any clear strategies. Currently it remains an open question what kind of the institutional design in the labor market will prevail. The other question in terms of an evolving Chinese industrial relations regime is its suitability both in terms of its economic and political development. For the most of the previous decades China has chosen a unique approach in transforming the country and has attempted to adjust the institutional design accordingly during this process. Similar developments are now observable in the labor market and its wage determination mechanisms. The Chinese labor market presently is extremely dynamic as it is in the process of shaping and reinventing itself. A better understanding of its institutional composition and wage determination mechanism is therefore desirable.

1.2 Research objective

A Chinese workplace relation system is in the making which can help explain the different conclusions for different segments of the labor market after the reforms introduced market mechanisms. Current competitive labor markets are coexisting with government control and attempts of collective contracts (Chan, 2000), but it is still unclear which system will prevail. Few studies have dealt with a more comprehensive analysis of the labor market's complexity, but here too institutions are not the main focus (e.g. see Knight and Song, 2005). Adding to the complexity are tremendous changes which the labor market has undergone since 2008, making it difficult to compare research findings. The ongoing debate on the Chinese wage bargaining system echoes the complexity of the Chinese labor market and conflicting conclusions for different segments by various authors. In some cases, the different perspectives can be explained by the different time periods or sectors of the labor market which have been the focus of analysis. When dealing with the Chinese labor market most literature only briefly mentions the concept of institutional economics but it basically remains

at the side lines while the emphasis is on conducting empirical analysis of certain labor market segments.

As the Chinese labor market continues to transform itself it is ever more important to understand its underlying institutional framework. Unlike macroeconomic policies, changing the institutional structure is a long process (Qian, 1999) in order to establish durable norms and rules which govern behavior (Frazier, 2002), in this case wage bargaining. Much research has been conducted testing existing theories, but China's experience has left room for developing new theories, especially in the area of institutional change (Qian, 2002). Fleisher and Yang (2008) state that dealing with the labor market transformation is one of the most challenging tasks for the Chinese government and note that there is a lack of understanding of the current institutional design as well as its direction. However, understanding how institutional change comes along is of great importance for future policy decisions (Hope, Yang and Li, 2003). China's path of transition is a unique one and further research in the area of institutional change in the labor market can contribute to a better understanding of issues fundamental to the reform process (Qian, 2002).

The objective of this research is to examine the institutional framework of Chinese industrial relations and to evaluate their respective influence specifically focusing on wage setting mechanisms. During the approach the limitations of existing theory will be emphasized to account for the individual characteristics of the Chinese system. The aim is to identify institutions and relevant organizations in respect to their influence in the wage determination process and evaluate macroeconomic functionality of wage developments. The thesis of the research question is as follows:

The transitional Chinese labor market has a dysfunctional, government dominated wage determination system with no consistent institutional structure.

The following research questions will be examined in this process:

1. Identify the institutional pillars and their interaction in the wage determination process
2. Illustrate how the institutional design influences wage determination
3. Examine elements of coordination and centralization by classifying the wage bargaining regime
4. Exemplify limits of existing theory in its application to China's wage determination
5. Analyze the macroeconomic functionality of the wage bargaining regime

The research approach aims to create a better understanding of the distinct characteristics of the Chinese labor market and shall contribute to outline the institutional framework within which the Chinese wage bargaining system is evolving. The objective is to first analyze the institutional setting of the current industrial relations and related wage determination followed by an analysis of its functionality. This applied methodology will help identify where the Chinese wage determination is heading under its current setting, expose inadequate and absent institutions, and provide a basis for further policy advice for a wage determination arrangement best suited for the functional wage determination.

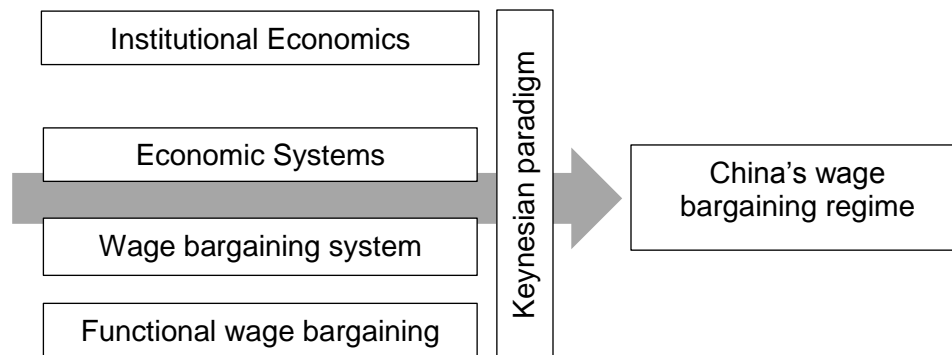
1.3 Research approach

1.3.1 Theoretical framework

Next to economic aspects the labor market directly interacts with social and political aspects making it an exceptionally crucial element of any economic system. The outcome of the wage bargaining process in particular significantly influences wider aspects of a nation's society. Within the labor market regime industrial relations and the underlining system of wage determination are the outcome of a specific institutional arrangement. It is therefore a prerequisite to comprehend the theoretical context of economic systems within which the wage bargaining system is embedded. Starting with economic systems, labor market and wage bargaining regimes, the theoretical context will conclude with defining functional wage bargaining as it will be used for this research approach.

The groundbreaking works of Ronald Coase, Douglas North and Oliver Williamson in the area of institutional economics will formulate a vital theoretical element for economic systems. Their approach introduced crucial theoretical findings on the functioning of institutions, though this research will also highlight theoretical limitations in the applicability to analyzing China. Using the foundations of institutional economics, the theoretical framework will be expanded to include theories in defining and classifying economic systems, including their categorization of industrial relations. The concept was most prominently brought forward by authors including David Soskice, Peter Hall, Rogers Hollingsworth and Robert Boyer. The variety of economic systems approach will supplement institutional economics theory, but it will also be noted, that the application of the theoretical framework has its limitations in its application to emerging economies. As a further theoretical building block, the academic debate pertaining to optimal wage bargaining regimes around the hypothesis introduced by Lars Calmfors and John Driffill will be critical evaluated. The debate will include a theoretical conceptualization of the degrees of centralization and coordination in wage bargaining regimes. Finally, a functional wage bargaining regime will be defined to complete the theoretical building blocks of this research.

Figure 1. Theoretical building blocks



The theoretical context will exemplify the consequences of unregulated market mechanisms while highlighting the relevance of institutions as building blocks for functional wage bargaining. Accordingly, as Figure 1 illustrates, the principal theoretical framework of the approach utilized will be rooted within the Keynesian paradigm. Although the Keynesian theoretical framework does not contain any explicit institutional structure within economic systems, it encompasses a theoretical openness to the relevance of institutions in fostering a functional wage bargaining regime while acknowledging that weak or absent institutions enhance macroeconomic instability. The definition of what encompasses functional wage bargaining regime will be clearly defined within the context of the Keynesian paradigm and its focus on macroeconomic stability. Functionality will restrict itself to evaluating the outcome of the wage bargaining regime on three macroeconomic variables. First, the effect on price levels will be evaluated. Wage developments resulting in stable price developments will be seen as contributing to macroeconomic stability. Second, a functional wage bargaining regime should contribute to limiting income dispersion and inequality. Third, the impact on consumption demand will be evaluated. In order to establish sustainable economic development consumption demand should be strengthened. The theoretical building blocks shall contribute in providing a necessary interdisciplinary approach centered on the Keynesian paradigm to apply existing theories to the complexity of the Chinese labor market in terms of its institutional design as well as its future development path.

1.3.2 Methodology and scope

As has been outlined within the theoretical framework employed for this research, the main focus is on the institutional design of the wage determination system of Chinese industrial relations. That being said, the aim is not to develop a model which can be used to estimate the actual price of future wages in China. Much more the scope is limited to obtain an understanding of how Chinese wage bargaining functions while applying the pre-defined theoretical framework. Hence, the overriding focus of the wage bargaining regime is on the macroeconomic elements of the Chinese economy rather than a microeconomic elements. While recognizing that China is a diverse and large country which brings fundamental challenges to the research question, the focus will encompass developments throughout the country. Given that the Chinese economy is still undergoing substantial reforms which include regional experimentation, differences in the institutional design of wage bargaining will be observable. However, any regional experimentation is carried out under the authority of the central government. Depending on the outcome of limited experiments, policies are either dropped or extended at the national level. This approach was most notably illustrated with the introduction of special economic zones (SEZ). Equally it is important to view developments in China within the greater reform context and how it has affected the system of wage determination since the establishment of the People's Republic of China in 1949. The main focus of the research however will be on the period after 2003 when the central government under the CPC began to explicitly reform the labor market.

Focal point of the research is the relevant position of institutions in the wage bargaining system. Key areas therefore will focus on:

1. Government control and legislature
2. Employers' role in the wage determination process
3. Employees' position in the wage determination process
4. The role of trade unions and employee representation
5. The functioning of tripartite industrial relations

Some elements of the dissertation pertaining to the theory of wage bargaining systems build on the build on my master theses at the Berlin School of Economics (now called Berlin School of Economics and Law), parts of which have been previously published.² Other elements of the dissertation on the development of the Chinese labor market, trade unions and its minimum wage regime were part of ongoing research during my dissertation and have been also published previously (see Zenglein, 2008 and Zenglein, 2011). The parts however have been revised and adjusted in large parts when integrated into this dissertation.

1.4 Data collection

The research methodology depends on multiple sources of information in an effort to account for different perspectives and interpretations. The channels used for data collection include both qualitative and quantitative channels for data collection and verification. The mixture accounts for the complexity and often obscure nature of developments in China. Using available official data and verifying developments through interviews as well as own data collection should allow for increased precision in specifying the dynamics in Chinese wage determination. The qualitative part was conducted through informal interviews throughout the course of the research, while the quantitative part relied on official data published by the National Bureau of Statistics (NBS) as well as surveys conducted by the German Chamber of Commerce in China.

1.4.1 Qualitative research

Since November 2008 I acted as the German Chamber of Commerce's regional manager for Shenzhen and West Pearl River Delta. The German Chamber of Commerce in China (GCC) is the official representative body for German industry and part of Germany's global network of chambers of commerce abroad, Auslandshandelskammer (AHK). As of 2014 the AHK Greater China had around 2,800 members in mainland China, 300 in Hong Kong, and 250 in Taiwan.³ The organization in the Greater China regions maintains four main regional offices in Beijing (north China), Shanghai (east China), Guangzhou (south and southwest China), Hong Kong (Hong Kong and Macau), and Taipei (Taiwan) covering business interests of German industry in the respective regions. Depending on the presence of German companies different branches are operated. Because of a concentration of around 350 German companies in Shenzhen an office was opened in the city in May 2009 and I was responsible for Shenzhen, the southern part of Dongguan as well as the Western Pearl River Delta, mainly Zhuhai and

² Published titled US Wage Determination System (Zenglein, 2007)

³ For legal reasons the AHK in Taiwan is not permitted to allow membership. The figure represents the number of German companies operating in Taiwan.

Zhongshan. As of 2010 the task of economic analysis was progressively expanded, leading to the position of Economic Analyst Greater China in 2012, covering China, Hong Kong, Macau and Taiwan. As of May 2014 my analytical position was further promoted to a full time position and I was transferred to the German Chamber of Commerce's Beijing office.

Through my position I obtained access to government officials, trade unions, and senior staff of German but also Chinese companies. In this process I was able to collect substantial input for my research through informal interviews or discussions in which I was able to obtain opinions and evaluations pertaining to my research. Labor relations and wage developments, being a major concern of companies, were helpful in engaging in meaningful and helpful discussions to understand how wages are determined and what the key drivers of wage determination are. The constellation has allowed me to visit around 50 factories mainly within the Pearl River Delta, but also in Sichuan, the Yangtze River Delta, the Bohai Rim and in China's north eastern provinces. Further, I greatly benefited from regular informal exchanges with company representatives. Foremost I benefited from chairing 41 general manager roundtables in Shenzhen on a monthly basis, enabling me to obtain invaluable information. My position further put me into the position that researchers approached me on five different occasion, further allowing me to engage in discussions from a different angle. Additionally, interviews were arranged with labor organizations in Hong Kong and Shenzhen.

The interviews and fieldwork over the course of my research provided me with valuable first-hand input, enabling me to adjust my research focus, verify observations, and update my knowledge. Further it enabled me to receive direct feedback on government policies and their effect on wage determination. Due to the nature of my employment for an employer organization, my interview partners were over proportionally senior company representatives. Concerning the research topic and the majority of the literature on labor relations focusing on the perspective of workers, this methodology is somewhat unusual. I am however confident that this approach has helped benefited my work. Over the past six years I have noticeably altered my opinion on many topics pertaining to China and its developments. In many cases the insights I have gained lead me to adjust and alter conclusions.

1.4.2 Quantitative research

A. German Chamber of Commerce in China surveys

The case study on German companies used in Chapter 9 draws on findings of the GCC's flagship annual surveys, the Business Confidence Survey (GCC, 2014) and the Labor Market and Salary Report (GCC, 2014b), aiming to evaluate the wage determination system in China from the companies' perspective. The GCC had a keen interest in providing German companies with greater information on wage developments in China as it consistently ranked as one of the most pressing challenges companies were facing in their local operation. What started as a simple wage survey among German companies in the Pearl River Delta in 2009, developed into a comprehensive wage survey covering all branches in China by 2012. The latest survey used for the case study of wage determination and developments at German companies includes data based on the feedback of 356 responses on 36 job categories as well as specific questions related to wage determination mechanisms. The substantial dataset

enabled me to validate observations and adjust my research approach, and to specify my interview questions.

Though independent of this research, all surveys conducted by the GCC were exclusively designed, managed and analyzed by myself in my position as the organization's economic analyst. While the annual Business Confidence Survey was an online only survey, the wage survey was made available online as well as by filling in information in an excel sheet. The latest wage survey used for this research was conducted between August 25th and September 26th 2014 being sent out to 2.800 German member companies throughout China. Representative of the distribution of German companies in China, the majority were located in first tier cities in Shanghai (31.5%), followed by Beijing (11.5%) as well as Guangzhou/Shenzhen (11.0%). The remainder were located in second and third tier cities around the Yangtze Delta (32.5%), around the Bohai Rim and north eastern China (8.7%), and the Pearl River Delta (5.1%). In terms of number of employees the distribution was as follows: <50 (35.8%), 50-250 (39.7%), 251-500 (13.4%), >500 (11.2%). The top five industries Machinery (27.9%), Automotive (16.5%), Electronics (8.2%), Plastics/Metals (7.9%) and Consumer Goods (6.8%) accounted for 2/3 of the responses. Lastly, 58.7% of the responding companies were engaged in manufacturing.

B. Official Chinese Statistical data

The Chinese government collects and publishes vast amount of data through its annual statistical yearbooks as well as complementary data released by the National Bureau of Statistics (NBS). Most relevant for this research data published on employment and wages were used. The statistical yearbooks are available online and typically have a time delay of 10 months, which means the most recent data for most data was 2013. Where possible data was updated with the most current data available for 2014. In some cases, especially for regional data or data from irregularly released reports older data was used. Time lines were for the most limited to starting in 2004 to illustrate most current developments, as the research focus is between 2003 and 2014. NBS data was complemented to by data released by provincial and municipal Labor and Social Security Bureaus, though this is chiefly limited to minimum wage related data where the local administration maintains jurisdiction over.

1.4.3 Reliability and usability of Chinese statistics for data analysis

Official statistical data has been controversial with a reputation for lack of quality and reliability, significantly limiting the econometric output which can be generated from it. However there is an ongoing debate about the actual quality of the official data (see Koch-Weser (2013) / Holz (2013a) / Holz (2013b) / Chow (2006) / Rawski (2001)). According to Holz (2007) the government deliberately controls which data is published, ensuring that the bits of information fit the government propaganda while data out of line will not be made publically available. Chow (2006) on the other hand argues that official statistics are used for national economic policy making and planning by the government and the statistics offices at all levels are obliged by law to provide accurate measurements. Without a conclusive answer different opinions prevail when it comes to evaluating data quality, but most researchers will agree that the data is questionable and needs to be regarded with caution.

While the main focus of the data debate is on GDP growth, a recent study by Nakamura, Steinsson, and Liu (2014) constructs an alternative inflation measure comparing it to the official CPI. The authors conclude that official data correlates well with their alternative figures, but that it tends to “present a smoothed version of reality”. Both inflation measures tend to move in the similar direction at the same time, but the volatility of the alternative CPI tends to be much stronger. Data shows that between 1996 and 2003 official inflation was higher than the alternative measure, while, with the expectation of 2009, most recent data indicates that official inflation figures are considerably lower than the alternative price levels. Wage data is equally patchy. Average wage figures issued by the NBS focus on urban areas only, contributing to a distortion of actual developments. Wage studies of the NBS often contemplate its data published in the annual statistical yearbook. Though generally helpful these are infrequent and often provide different figures for the same categories published in the statistical yearbook. Both examples exemplify the limitations of using official data in China. Any researcher focusing on China or emerging economies in general will quickly learn to envy other researchers being able to use readily available data from the EU or US.

While official data for GDP, inflation, or wage developments are readily available other data related to analyzing the Chinese wage bargaining system are far scarcer. Most importantly China does not release official data on productivity or unit labor costs. Additional studies by the NBS contemplate some of the shortcomings, but are dissimilar and infrequent. Case studies such as the wage survey by the German Chamber can provide additional data, but their findings are limited by regional concentrations and tend to be very limited in scope. Data on union membership and collective agreements are not provided by the National Bureau of Statistics, but by the ACFTU itself which, as will be shown below, tends to exaggerate quantity at the expense of quality of any data related to its work. Clearly, more precise knowledge of data pertaining to the economy should be in the general interest of Chinese policy makers. From a global perspective the size of the Chinese economy and its impact on the global economy would make it desirable to improve the data availability and quality. In terms of policy decisions related to Chinese wage bargaining system as well as examining its functionality, improved data availability is crucial. The limitations in itself might be a serious obstacle in creating the most suitable institutional framework. Recognizing that some indicators are deeply flawed while others come closer to reality, they are the best gauge to monitoring the Chinese economy. Data quality is likely to vary depending on the specific indicator but data unreliability will leave a general haze over the true state of the economy. At present a mix of official data, case studies and estimates are the best methodology researchers can employ in evaluating the functionality of the Chinese wage bargaining regime.

1.5 Chapter structure

After an outline of the research methodology in chapter 1, Part I of the dissertation will outline the theoretical framework of economic systems and wage bargaining institutions. Chapter 2 aims to introduce the theoretical foundations of institutional economics, stressing the relevance of institutions and the limitations of market mechanisms. This is followed by illustrating how differences in the institutional design impact resulting variations in economic systems using the examples of selected countries. Finally, the chapter will focus on how

economic systems transform themselves and how this is relevant to the current situation in China.

Chapter 3 shifts the focus on labor market and wage determination institutions. Specifically, the chapter will highlight the roles of market mechanisms, the relevance of country specific economic structures, the interaction of employer and employee representative bodies, as well as the role of the government and how they all impact in what way wage are determined from a theoretical perspective. As a core element of the theoretical framework employed, the Calmfors-Driffill hypothesis on optimal wage bargaining systems as well as the concept of classifying wage bargaining systems by degrees of coordination and centralization will be introduced.

Following the introduction of the theory behind wage bargaining institutions, Chapter 4 introduces the Keynesian paradigm and will define functional wage bargaining. Wage functionality in the Keynesian theoretical framework, as will be defined, centers on the wage norm. The chapter continues by elaborating on the role of institutions in achieving a functional wage regime and will provide further examples of the variety of wage bargaining regimes found across advanced economies.

Concluding the theoretical part Chapter 5 shifts the focus from advanced economies to transitional and developing countries. Specifically the experiences of the Asian Tigers in Hong Kong, Singapore, South Korea, and Taiwan will be used. Their economies share not only economic and political similarities, but also cultural parallels which will establish a helpful benchmark for putting developments in China into context. The chapter will identify specific institutional feature found there and emphasis the limitations of applying theory focusing on advanced economies.

After having established the theoretical framework, the second part of the dissertation shifts its focus on developments in China. Chapter 6 outlines the historical development of the Chinese labor market by briefly sketching the institutional starting point in the pre-reform era. The chapter continues to summarize the different stages of reforms which have affected the labor market and the determination of wages. Specifically this part emphasis the resulting consequences and the drivers for the institutional transformation.

Chapter 7 moves on to introduce the characteristics of trade unions in China by providing on overview of its structure and roles in Chinese industrial relations. Particular attention is paid to the distinct differences to the Western understanding of trade unions. In a similar fashion the role of employer associations will be explained. The chapter concludes with exploring the institutional structure of tripartite industrial relations while emphasizing the unique features of the Chinese setting.

Staying with tripartite mechanisms Chapter 8 will investigate how the institutional setting of Chinese industrial relations affect elements of wage bargaining. The section aims to show tripartite mechanisms between the government, trade unions, and employer associations affect outcomes of minimum wages, collective agreements, and wage guidelines. The chapter will include fundamental details to the institutional framework of each element.

Having introduced the institutional setting in Chinese wage bargaining, Chapter 9 utilizes data analysis exemplifying developments of Chinese wages. Resorting to official government statistics a detailed overview of average wage, minimum wage as well as wage guidelines will

be described. The analysis will further attempt to identify elements of coordination. The chapter concludes with a case study of wage determination at German companies operating in China.

Chapter 10 will provide an evaluation of the Chinese wage bargaining regime by providing an overview of the main institutional pillars. It includes a synopsis of power relations within tripartite bargaining, emphasizing the strong role of the government within the Chinese system. Finally, the chapter attempts to classify the Chinese wage bargaining regime using the theoretical context of centralization and coordination.

Chapter 11 returns to evaluating the previously defined functionality of the wage bargaining regime. The chapter employs data analysis by considering the outcome of the wage bargaining regime and its subsequent effects on price levels, inequality and consumption demand. It will also consider developments in labor productivity. The data presented in this chapter should provide ample evidence for testing the defined functionality of wages as an outcome of the institutional design of China's wage bargaining regime. Taking limits of Chinese data availability into account a wage norm band for China according to the definition of functional wage bargaining will be introduced and tested against wage developments. This will be followed by an evaluation of the wage bargaining regimes functionality. The chapter will conclude with a final evaluation of the institutional setting and obstacles for achieving a functional wage bargaining regime.

PART I: Theoretical Foundations of Economic Systems and Wage Bargaining Mechanisms

2. Introduction to Institutional Economics and Economic Systems

2.1 The theoretical foundations of institutional economics

To a large part a nation's economic performance, its output and strengths are the result of the institutional environment that define it. The underlying institutional arrangement will have significant influence on how an economy will react to various economic conditions. Every economic system relies on a certain framework within which it responds depending on the overall economic preconditions which are affecting it. In some situations the existing institutional arrangement will be favorable, resulting in development and growth while its reaction to a different set of variables might leave it more susceptible and vulnerable to stagnation, recession or decline. Much of the foundation of economic systems lies within studying the institutions comprising it. The concept of institutional economics was first introduced in the early 20th century recognizing that markets are a consequence of the sophisticated interaction of different institutions in an economy (see Veblen (1904) / Hamilton (1919) / Commons(1934). Economies are not only driven by the invisible hand of the market which stands for a system of extreme decentralization (Demsetz, 1988). Rather than being mostly concerned with pricing mechanisms, a main focal point of neoclassical theory, the institutional approach recognizes that economic activity and markets cannot function efficiently without supporting institutions, making economics far more complex than the simple supply and demand curve.

The need to analyze the ubiquitous institutional structure defining the economic system including how they evolve has been recognized by post-Keynesian institutionalists in order to develop a greater understanding (Radzicki, 2005). A key feature of institutional economics is a broader analytical approach. Neglecting other aspects of economic systems, modern economic theory favors to utilize abstract methods of analysis which do not demand detailed understanding of the entire economic system (Coase, 2005). This abstraction and strong desire to transform economics into a natural science has come at the cost of other aspects which influence how economies function. In contrast the emphasis of institutional economics is interdisciplinary to include aspects of political science, law, history, or cognitive behavior and anthropology, regarding the field of economics as a social science rather than focusing on building mathematical models.⁴ Much more its focus is on underlying structural features of an economic system to explain certain outcomes (Hodgson, 1998).

Institutional economics has several proponents with one of the most prominent currently based on thoughts of Douglass North, Ronald Coase and Oliver Williamson. The theoretical foundation of the institutional economics brought forward by these scholars does not renounce neoclassical theory, but it recognize the limitations in its explanatory capability in some areas and attempts to modify and extend the theory in order to deal with a wider range of issues (North, 1997). In neoclassical economics the economic individual is "an avaricious hermit, a super smart selfish individual without history or tradition without friends or enemies" (Biggart, 1991). The concept is used to simplify reality and how people engage in markets, but for the most is not compatible with a prominent role of institutions. Following its emphasis

⁴ The multidisciplinary approach can include political science, sociology, law, anthropology, as well as behavioral science or biology.

on individuals, while assuming that institutions and time do not matter the neoclassical paradigm focuses on the aspect of how markets operate and not on how markets or economic systems develop (North, 1994). The neoclassical paradigm disregards the role of institutions and regards individuals as sovereign, while in institutional economics institutions are considered to influence economic decision making (see Campbell, Hollingsworth, and Lindberg (1991) / Etzioni (1988) / Streeck and Schmitter (1985).

A fundamental principle of neoclassical theory is that in a world with efficient markets and rational actors, institutions do not matter. New Institutional Economics abandons neoclassic assumptions including perfect information, unbounded rationality, as well as the idea that economic transactions are costless and attempts to analyze questions that neoclassical theory does not address (Menard and Shirley, 2005). As a result it modifies neoclassical theory in a way to include institutions (North, 1997). Neoclassical theory is amended to incorporate that institutions do matter when it is costly to transact in an inefficient market (North, 1997). The total absence of any informal or formal rules would create a prohibitive threshold for any kind of economic cooperation.

There is a debate of whether institutions need be efficient to prevail or whether inefficient institutions prevail as well. Williamson (1975 and 1985) argues that institutions are tested by companies and similar to Darwin's theory of evolution, inefficient institutions will eventually disappear. This approach is consistent with neoclassical theory in shape of rational choice. In short, it is argued that the survival of institutions is influenced by firms which test their efficiency. Contrasting Williamson's argumentation, North (1990) argues that institutions "are not necessarily or even usually created to be socially efficient", much more they serve the interest of those with bargaining power while acknowledging that it does not take into account the interplay between economic and political markets. Following North's thoughts, institutions in an economic system are created by power and do not inevitably require to be efficient. Grannovetter (1985) also criticizes Williamson's argument that the institutional arrangement is viewed as an efficient solution to economic problems rather than being an outcome of legal, historical, social or political factors. Hence efficient and inefficient institutions may both exist. Institutional arrangements, shaped not strictly by the market but by political actors, are relevant to address issues which arise through the need to cooperate in economic activity (Cabellero and Hammour, 2010). As the focus of the research is China with an authoritarian regime, North argumentation will be followed in the argumentation.

Following Douglas North's (1990) definition institutions, whether formal or informal, set the rules of the game in a society by providing structure while reducing uncertainty for the different players taking into account normative, cognitive, or material reasons. It is the institutional setting which defines the "incentive structure of societies and specifically economies" (North, 1994). The definition of an institution therefore is very broad to include the legal, political, and monetary system but also items related to culture such as prevailing customs and norms.⁵ The definition brought forward by Douglas North is the most prevailing one but other authors such as Hodgson (2006), have also attempted definitions which differ in some details. Overall the various definitions agree in defining institutions as providing or establishing structure to economic interaction aiming to reduce uncertainty and to govern

⁵ The immense scope of what institutions are and how they influence economic systems has been source of some debate questioning the usefulness of institutional economics (see Hamilton (1962)).

economic cooperation. For the purpose of this research the definition shall be limited to this area.

Without going into too much detail at this level some basic concepts of institutions shall be introduced. As mentioned above an important distinction is made between formal and informal institutions. Formal institutions are mainly based on written rules and regulations such as common or statute law while informal ones include a wide variety of “unwritten rules” such as cultural devised norms or behavior, conventions or codes of conduct. Regardless of being formal or informal, they will have ways of sanctioning breaches of the prevailing norms (North, 1990). Informal rules will often originate from cultural norms while formal rules will originate in legislature. Formal rules hence can be introduced by any form of power, be it by majority in a democratic political system or by dictate in an authoritarian system. As no economic system is independent of the political system, certain institutions will be instruments for means of redistribution of powerful interest groups who succeed in influencing the institutional structure in their favor (Caballero and Hammour, 2000).

By establishing conventions, structures or mechanisms which govern how humans interact with each other, institutions govern how economic activity within an economic system occurs. On the micro level the focus is on social interactions between economic entities. Much of the work of Douglas North, Oliver Williamson, or Ronald Coase focus their work on the micro level, analyzing transaction cost economics and mechanisms of cooperation and coordination between individuals or firms engaging in economic interaction. The micro level is a fundamental component of institutional economics and a key link to the neoclassical theory. On the macro level it is analyzed how institutions create, establish and influence the outcome and performance of an economic system, but current research has much less focused on this area. Rather than focusing on social interaction between individuals the focus here is on interactions or networks between organizations, which are the individual players comprising the institutional framework in an economic system. In essence the political dimensions including the constitutional and political situation as well as legislative and regulatory actions by the governments are prominent factors for the viability of an economic system, making the political situation and the role of government’s key components in public policy (Wood, 2001). This approach focuses on explaining underlying structural features of an economic system to explain outcomes of such a system (Hodgson, 1998). The institutional approach allows for a better understanding of the complex interactions of institutions and their influence on economic change and performance. As a result, from an institutional view point, the organizations that make up an economic system are constructed within the social and political subjective realities.

Over time institutional economics has evolved with the fundamentals of New Institutional Economics and its most popular advocates, Douglas North, Ronald Coase and Oliver Williamson, evolving as the most predominant theory. Certainly there are different variants of institutional economics where some use a more heterodox approach to neoclassical economics, while others attempt to incorporate it into standard neoclassical theory by acknowledging certain components of the initial thoughts behind institutional economics. It is not the aim to go into detail of the various theoretical differences in the area of institutional economics. Much more for the aim of this dissertation is to focus on a core component of institutional economics which is that in reality market mechanisms are not sufficient to analyze

the complexities of an economic system without considering the presence of institutions such as the state which in neoclassical theory is regarded as an exogenous actor, as all economic or political institutions do not matter.

2.2 Limitations of the market as a coordination mechanism

The concept of economic systems finds its foundation in the belief that the market alone is an insufficient mechanism for healthy economic development. Pure market mechanisms have different effects on different types of markets. “Moreover, there has been increasing evidence that the market as a coordinating mechanism does not lead to the best economic performance in industries whose products have technologies that are very complex and change rapidly. In short, the basic features of most modern economic activity point to the importance of coordinating mechanisms alternative to markets.” (Hollingsworth and Boyer, 1998).

Issues such as fairness or moral hazard result in different behavior of the labor and credit markets than the market of standardized manufactured goods (Coase, 1988). Frequent market failures with undesirable outcomes costs require some form of monitoring (see Akerlof, 1984/ Benassy, 1982/ Stiglitz, 1987 / Stiglitz and Mathewson, 1986). Some vices of market mechanism calling for some form of balance include high inequality and concentration of wealth, the inability to account for externalities such as environmental destruction or poor working conditions including child labor (Coleman, 1998). As an example Manchesterism during the industrial revolution brought great economic success but in its foundations ultimately would destroy the “foundations of worthy life” (Sabel, 1998). Overall it can be said that an unregulated free market pursuing economic gain by equally commodifying all factors of production including labor, land and money will not result in a desirable outcome for a society (see Polanyi, 1944).

The invisible hand of the market is a powerful mechanism but it too is not capable of by itself to organize an economy. In reality market mechanisms are only one component of an economic system, complemented by various alternative non-market institutions (see Campbell, Hollingsworth, and Lindberg, 1991/ Hollingsworth, Schmitter, and Streeck, 1994). It is the alternative non-market institutions which counter effects of market powers, which if left uncontained, would likely result in destructive consequences or as Polanyi put it: it will lead to misery, crimes, and depletion. In Joan Robinson’s (1969) words it shall also be noted that a major drawback of unrestricted market mechanisms was that it failed to provide full employment and macroeconomic stability. Much of the 20th century history of capitalist development has created a considerable variation as to the role of the market and the complementary institutional arrangement as a coordinating mechanism (Crouch and Streeck, 1996). The variety of economic systems further demonstrates that the implementation of market mechanisms offer a wide spectrum of alternatives (see section 1.4). The positive contributions to society over economic concepts such as planned economies demonstrate that to some degree the use of market mechanisms are desirable, but that completely unregulated market mechanisms in the end will create an unjust society countering gains of overall economic efficiency (Boyer and Hollingsworth, 1998).

2.3 Institutional embeddedness and coordination

The Veblenian school of thought argues that institutions are embedded rules in prevailing shared habits within a society (see Veblen (1899), Dewey (1922), Klipinen (2000)). In line with this individual economic behavior is constrained by ongoing social relations which cannot be viewed independent (Granovetter, 1985). The focus here is less on the economic relations between individuals, nonetheless this concept of embeddedness establishes an important link as to that economic activity is not completely detached from the society. Following Polanyi this strain of thought recognizes the connectedness of institutions to an economic system and hence society as a whole. Individual institutions making up the economic system possess a certain element of autonomy, yet they will be affected by other institutions either directly or indirectly. The resulting economic system then is a complex system of directly or indirectly overlapping and interacting institution forming a sophisticated network of complementary institutions.

As Hollingsworth and Boyer (1998) stress effective organization of economic activity rests on a variety of embedded institutions and the market “should not be considered as the ideal and universal institutional arrangement for coordinating economic activity in most circumstances”. It is up to political governance to establish institutions which do not eliminate market mechanisms, but help to create a legitimate social order safeguarding people from excessive rationality (Streeck, 1998). The existence of concepts such as transaction costs implies that alternative coordination methods not only driven by pricing mechanisms may although imperfect in ways, be preferable (Coase, 2005). The market hence, is not an isolated coordinating mechanism within an economy, but is complemented by and embedded within a variety of further coordinating mechanisms (see Campbell, Hollingsworth and Lindberg 1991 / Coleman, 1990 / Schmitter, 1990).

It does not imply that markets do not have any form of coordinating mechanism, but based on institutional economics they are less dominant in achieving efficiency than argued within the neoclassical paradigm (Leibenstein, 1976). When considering the role of companies, it implies that they need to arrange themselves with a set of coordinating institutions within the economic system which are not under their control (Hall and Soskice, 2001). In most economies markets play a significant role in coordinating economic activity; however market mechanisms operate under certain limitations. First, market mechanisms are not the only institutional mechanism, but rather a component of the economic system with a wide range of different institutions. Second, governments through legislation set the rule of the game which set the conditions in which the market mechanisms may function. Consequently within an economy certain segments might find little regulation with a high prevalence of free market mechanisms. Other segments may be subject to restraints of various degrees, while on the other extreme in other areas market mechanisms are entirely suppressed. It is under the discretion of policy makers in the country, and how they can convince their constituency, by persuasion or force, what type of system well evolve and how strong market forces will be. It should however be noted, that whatever the outcome is at a given point of time, the institutional framework of an economy is not static and will be required to respond to a changing environment or various forms of structural crisis (Hollingsworth and Boyer, 1998) (see section 1.5).

The outcome is an institutional framework with countless independent institutions taking on different functions and influencing the economic interactions in different way. In sum, all institutions are embedded creating an economic system with certain individual country specific characteristics. As a result although countries may share core values of a market economy, under more scrutiny the same countries may appear dissimilar. For example although the United States, Great Britain or Australia have many of similarities and are classified as Anglo-Saxon economies, considering details of how institution constrain and influence economic behavior will result in the economic systems being similar in nature, yet very distinct in the specifics. For example the prevalence of similar legislature does imply that it will resonate in a similar manner. The impact existing rules or laws have on the institutional setting will depend on their enforcement as any rule that can be avoided without penalty will not become customary or normative. Changing, for example, the legislation alone is insufficient in affecting behavior, though some rules might have strong self-policing components (Hogdson, 2006). The examples stress that as the intuitions cannot be regarded in isolation, the entire resulting institutional settings and the resulting interactions need to be taken into account (see section 1.3). Acting within an economic system makes it nearly impossible to disregard institutional patterns which embed economic activity within society and influence the economic decisions of individuals and organizations (Biggart, 1991).

Coordination is another broad term which can take place on a variety of levels and can take on different meanings as well. On the lowest level coordination can refer to interactions between individuals. Higher levels include coordination on the company level, industrial level, regional level, national level, transnational level, global level. Hollingsworth and Boyer (1998), focusing on companies, distinguish between markets, communities, networks, associations, private hierarchies, and the state. The way the institutional framework functions within an economy very much depends on how overall coordination is organized. In terms of the political economy how coordination takes place has to do with the distribution of power. For instance under fragmented power distribution where individuals, driven by self-interest, interact will result in a different outcome compared to a situation of concentrated power constraining individual actors. Various power distributions will therefore influence the prevailing form of coordination. Naturally the role of the state will have strong implications on how economic coordination takes place and how power is distributed. Most important is to take note that pricing mechanisms are just one form of coordination, which is integrated and constraint by complementing form of coordination. Coordination then is a key element for achieving macroeconomic stability (see chapter 3).

2.4 Institutional variety of economic systems

In the strict sense a market economy would be a self-regulating system which is driven only by market prices and nothing else. The outcome then would be an “economic system controlled, regulated, and directed by markets alone; order in the production and distribution of goods is entrusted to this self-regulating mechanism” (Polanyi, 1944). Even most liberalized laissez faire economies would not qualify for such a definition and one can question if the resulting society would be a desirable one. Such ‘unrestricted’ economic systems would be prone to market failures, for instance in the area of common good such as the environment, as well as social inequalities with a high degree of external costs. Though market mechanisms are a fundamental component of modern capitalism it is not the only

institutions of an economic system. Without a complementing institutional framework markets would not be able to function making them necessary for greater efficiency and redistribution (Caballero and Hammour, 2000).

Consequently most economies choose to adhere to some principles of a market economy while constraining other principles or outcomes of a pure market. The majority of the world's economies may be clustered into liberal, social, or planned market economies which in effect are some form of a mixed economy. As a result the world's economic systems vary from fairly liberal economies such as Hong Kong to the all controlling North Korean regime, or even failed states such as Somalia. Depending on the institutional framework the element of the market will function within a predefined institutional framework. It is this institutional complexity which defines an economic system in detail, giving it the prevailing framework within which market forces are constrained. In market based economies hierarchies will be constructed to resolve problems which market mechanisms fail to resolve (Williamson, 1985). Following Polanyi's thoughts (1944), markets are subordinated by social and cultural rules. Market based systems therefore can only function when they are restricted by non-market rules. For instance different values and cultures will result in varying degrees of acceptable social inequality influencing the degree in which market forces can work. The society's perspective on social peace and egalitarian distribution will to a degree influence a firm's decision making behavior (Hage, 1980). For instance the USA or again mentioning Hong Kong with relatively liberal market economies have higher acceptable levels of inequality than would be acceptable in more social market economies such as in Scandinavia, Germany or France.

The prevailing economic systems then is the driving determinate on the industrial composition or its core competence as institutions play different roles or are integrated differently. Economic systems are comprised of financial markets, the education system, industrial relations system, inter-firm relationships⁶, customs and norms in business culture, the role of the state, legislative framework, it includes conceptions and belief systems such as the perception of fairness and justice as well as other social political factors. Economic systems are not just a result of national influences, but also need to respond to international competition which may deeply affect a nation's industrial structure as well as its social and political situation (see Streeck, 1991 / Hollingsworth and Boyer, 1998). Further with the rise of international agreements or organizations such as the World Trade Organization or the European Union, levels of economic coordination are no longer only local or national but may also be transnational or global (Hollingsworth and Boyer, 1998).

The established institutional network and the prevailing institutional interaction directly influence sectorial and national economic performance (Boyer and Hollingsworth, 1998). Complementarities between institutions in the different spheres of the political economy such as the relationship of capital market structure and employment protection are of particular interest (see Aoki, 1994 / Casper, 1997). Within this framework capitalism in different nation states has variable trajectories of development based not only due to the variation of the role of markets but also the coordination mechanisms of the institutional arrangement (Crouch and Streeck, 1996). Every economic system relies on a certain framework within which it can

⁶ For example cross shareholding or business networks.

develop and function. The various institutional players create a network that makes up the social system of production of a nation. Coming back to the definition of Douglas North, the institutions set the rules of the game in a society by providing structure and reducing uncertainty for the different players. Through their diverse network economic systems are a very complex and the driving determinate on not only how a country's economy is structured by significantly influencing a nation's competence in certain industrial sectors but also the overall society.

Depending on how the various institutions are configured will have profound implications on the resulting social system of production (Hollingsworth and Boyer, 1998). Some institutions are formal while others are informal and even intangible as certain convention are followed without any form of formality (Weber, 1978). Further the geographic location and national geographic order has implications on how economic and social systems will develop. Having a natural resource in abundance, being on an island, having many borders or having a small homogenous nation will influence the type of social system that will develop. A country's history will be another parameter in altering the system in place. Certain events will have a lasting effect on the structure of the system, especially since the institutions making up the social systems of production are not created at a certain point and time, but rather develop out of historical experience, building a set of common expectations (Hall and Soskice, 2001).

As a result despite perhaps comparable economic development, the underlining economic systems including industrial practices can differ substantially (Biggart, 1991). The institutional framework may contribute to a dysfunctional factor market as well as stagnant economic development under certain economic conditions (Cabellero and Hammour, 2000). On the other hand the same conditions might be beneficial under other conditions. For example the Anglo Saxon economic system in the 1990s and 2000s was seen more suitable for economic growth while the German economy was labeled as underperforming with slow growth rates and a relatively high unemployment. In the aftermath of the financial crisis in 2008/9 the perception of the German system changed as it was less prone to be affected by the resulting adverse effects.

2.4.1 Classification and differences of national economic systems

By exploring the diverse institutional arrangement as well as the logic that sustains them, distinctions are made between different types of economic systems (Thelen, 2001). Countries are not limited to having only one specific economic system in place. A countries geographical size or in general its diversity will increase the number of interests groups within which the institutions are embedded. Thus historically large countries, countries with different levels of economic development, or a population with a large racial, religious and ethnic diversity have greater difficulties in establishing a high degree of institutionalized economic coordination (Hollingsworth and Boyer, 1998). Consequently some economies may have different forms of economic systems present; however usually there tends to be one dominant form which influences the co-existing institutional arrangements (Hollingsworth, 1998). Hollingsworth points out that "the dominant system dictates the labor practice, finance, and the way that the state intervenes elsewhere in the society". Over time the dominant system then may result in a certain degree of convergence (Herriegel, 1995). The distinctiveness of the economic systems and its economic performance tends to limit the kind of goods it will produce and how successful it will be in international markets.

There have been various attempts to classify economic systems in the past. An important approach was related to the structure and strength of the state (see Katzenstein, 1978 / Sacks, 1980 / Nordlinger 1981 / Skocpol and Amenta, 1985). Out of this neo-corporatism analyzed the governments' coordination role on issues related to labor, social and economic policy. This approach focused strongly on trade unions and government while underplaying the coordination role of companies and employer organizations in an economy (see Soskice, 1990 / Swenson, 1991). The social system of production approach which followed in the 1980/90s uses the firm as the center of analysis and links them to the various institutional levels of the political economy while acknowledging the important influence of the state on the regulatory regime, especially that of labor market regulations (Hall and Soskice, 2001). Based on analysis on advanced economies several academics have attempted to characterize different systems by focusing on the various coordination mechanisms in place with the firm at its core. The approaches recognize that systems can contain components of various systems and recognized that within a system, certain companies may not fit the characteristics at all. These limitations should be kept in mind when characterizing social systems of production.

Following the social systems of production approach Hollingsworth and Boyer (1998) have attempted to classify countries in accordance to their present institutional framework along a range of variables which they have considered, evaluating how institutions of an economy are integrated in to the prevailing "social configuration". Center to their approach is their focus on coordination mechanisms in developed economies. In a general distinction the authors have identified systems of flexible and standardized mass production. Flexible systems of production are further distinguished between Diversified Quality Mass Production and Diversified Qualified Production. A limitation certainly is that the characterization is limited to manufacturing industries and does not include service industries. However, the differentiation does give good indicators on how economies perform. Germany, for instance is characterized as having a flexible system of mass production. Considering its strength in mechanical engineering as well as other highly customized, specialized engineering goods and its international reputation in this field, the descriptions seems highly suitable. In the United States on the other hand, which is considered a system of standardized mass production, manufacturing has been on a decline in the last decades as this form of industrial production is becoming less competitive for advanced economies. However, the national system appears to have its strength in the service industry as well as emerging sectors such as biotechnology and software engineering.

Another, similar, distinction has been made by Hall and Soskice (2001) which classify between liberal and coordinated market economies (LME and CME). Both approaches argue that a country's competitiveness and competence is highly dependent on the institutional structure that is in place. This framework will also determine how an economy reacts to a changing environment as various forms of influences will result in different consequences. Both approaches look at a similar set of variables, though Hollingsworth and Boyer take a broader look in their initial definition (see Table 1). For both industrial relations including wage bargaining are important components defining the institutional setting in an economy and they both tend to take a more micro economic perspective by keeping the firm central to their analysis.

Table 1. Comparison of variable use for classifying economic systems

	Variables Social Systems of Production	Variables varieties of capitalism
Industrial relations	Work skills	Wage bargaining
	Labor-management relations	wage coordination
	Internal labor market	Working conditions
	Degree of centralization	Representation
	Work security	Productivity
	Investment in work skills by firm	Skill level
	Institutional training facilities	Training and vocational training
	Collective action	Relationship with employees
Inter-firm relations	Degree of cooperation	Standard-setting
	Chain of production	Technology transfer
		Research collaboration
Financial markets	Modes of capital formation	financing
Legislation	Conception of property rights	Formal and informal contracts
	Anti-trust regulation	
Technology	Technology of product	Type of innovation
	Production equipment	
Market	Size and nature of market	Level of competitive market environment
	Degree of pervasiveness of market mentality of society	Wage bargaining

Source: Based on Hollingsworth and Boyer (1998) and Hall and Soskice (2001).

The varieties of capitalism or social system of production approach, in contrast to the neo-corporatist approach, tends to underestimate political dimensions of political economies and the legislative framework within which economic activity takes place (Wood, 2001). The most obvious short falling of this approach is its focus on developed economies which cannot be easily applied to the situation in developing or emerging economies (see Table 2). Emerging economies will differ largely from the political and economic conditions found in developed

and democratic nations. Research on developing or emerging markets has been rather limited and it will require a different analytical approach.

The social system of production approach should have demonstrated methods for classifying economies and providing an example on how the various institutional frameworks result in unique economic systems. Though it has major limitations for the analysis of developing nations it does provide helpful tools. For the aim of the analysis in this research the role of the government as well as the distinct role of the labor market, especially wage bargaining, will be a central point while the role of the firm will be less prominent. The analytical approach will adopt some areas of the social system approach while expanding it in other areas in order to accommodate for the special situation in China, being not only an emerging economy but also an autocratic regime.

2.4.2 Political economy of emerging economies

Classifying emerging and developing economies can draw upon findings used to classify developed economies. Doing so however has theoretical pitfalls and requires adaptations (see Nölke, 2011 / ten Brink and Nölke, 2013). Certain adaptations are necessary as the overall conditions are not comparable to those in wealthy, democratically governed, developed economies. The social system of production approach focuses primarily on an environment of liberal capitalism while the focus on analyzing the political economy of emerging and especially developing countries is still weak.⁷ This does not imply that the state does not have an influential role. Governments will also have a varying degree of influence in creating the institutional framework of the economy. The role of the state in German, France, Japan or Anglo-Saxon countries differs widely but still is substantially different than that in emerging and developing markets. However, one should keep in mind that economic history shows that for currently developed nations, state capitalism similarly has played a significant role in economic development. Most notably rising Asian economies have been prime examples on how state capitalism mixed with free market concepts and authoritarian rule, triggered rapid economic development. The Asian Tigers Taiwan, South Korea, Singapore with the only exception being Hong Kong, have all resorted to a form of state capitalism with strong government intervention significantly impacting how the economy is structured and setting the conditions for the institutional framework. China too has employed similar strategies leaving it with comparable institutional foundations of its economic systems. Table 2 illustrates some similarities of market institutions found in developed countries, but also highlights the strong position of the state. The role of the state and how controls are used to regulate the economy and market principles in order to achieve rapid growth would require more detailed research and are not the focus here.

⁷ Robert H. Bates (1983) has attempted to analyze the political economy in Africa.

Table 2. Institutional foundations of economic systems: Japan, Germany, USA, and China⁸

	Japan	Germany	USA	China
Classification	Diversified quality mass production	Diversified quality system production	Standardized mass production	Standardized mass production
Financial markets	Lead bank	Home bank	Equity market	State bank
			Venture capital	Capital controls
Inter-firm relationship	Mutual stock holding	Cross shareholding	Few business networks	Networks mediated by government
	Holding trust	Networks in part mediated by banks	Competition	Foreign Joint-Ventures
			Markets or hierarchies	Limited interrelationships
			No interlocked directorship	
Industrial relationship	Company based unions	Internal flexibility	Low level of unionization	State administered unions and employer associations
	long term relationship	Centralized unions	External flexibility	High levels of employment fluctuations
	Employment fluctuations within company	Dual system of interest representation		
		Collective bargaining		
Education	Highly developed academic systems combined with firm based training	Dual system of vocational training	Generalized skills	Basic skills
	Firm specific knowledge	Firm specific and general	High academic performance	Firm specific knowledge /low quality
	Low degree of general training		Dualistic form: high and low quality skills	Low degree of general training
Business culture	Long term relationship	Cooperation encouraged	Weak cooperation	Family networks
	Loyalty	Industry based unions	Knowledge transfer through movement of people	
	Corporate families			
State	Strong industrial development	Important role in setting rules for cooperation	Promotion of basic research	Dominant role of the state
	Fostering cooperation		Protectionist for some industries	Market protection
	Market protection		Absent in other industries	Strong industrial policies

Source: Based on Hollingsworth (1998) / China added independently.

It is typically for emerging economies to rely on a stronger state acting as a catalyst for growth or at least to protect certain key industries. Next to industrial policy it also is accompanied by elements influencing how labor and wages are organized, including issues

⁸ China has been included to highlight some main differences between the institutional frameworks found in developing and developed nations. Table 2 is only a simplified illustration.

pertaining to the role of unions, collective bargaining or for indirect influences through state-owned enterprises (see Part II). Previous rising economies, once they have reached a certain development, also experienced political change in form of more democratic structures, directly impacting the role of the state within the economy. This has been especially the case in Taiwan and South Korea, and when looking back a bit further also been Japan. The failure of the current analytical approach to catch the institutional structures during their economic ascent leaves a gap when considering current developing economies.

After the collapse of the Soviet economic system has led to the belief that democratic capitalism has triumphed (Francis Fukuyama, 1992). However, developments in Asian countries developing under autocratic systems put this into question at least for certain development stages. North (1997) acknowledged the role of autocratic states defining and enforcing the rules of the game, but also stresses that economic success can only occur in the short-run within autocratic regimes. Depending on how one defines short and long-run these conclusions might still be valid. However, developments in emerging markets, fueled by their continuous rapid expansion and crisis in more liberal structured economic systems, state capitalism has proven itself as a contender to the previously prevailing opinion in economic theory. State-capitalism seemed particularly appealing in wake of the global financial crisis mainly affecting developed countries in the US and Europe. In contrast authoritarian state-led capitalism such as China apparently proved to have the necessary capacity to act pragmatically (ten Brink, 2013). The development has let *The Economist* (Jan 21st 2012) to announce that the emergence of state capitalism appears to be the coming trend. This might especially valid for major emerging countries, and even more so for China.

The typical approach found in most of the Asian developing countries is a bureaucratic-authoritarian regime based on state autonomy, high degree on centralization and planning, large conglomerate and often authoritarian repression (Biggart, 1991). With increasing wealth and a higher degree of development, policies which were successful required adaptation in face of new realities. Taiwan and South Korea in the past and other currently emerging economies, including China, based their initial success on export led development with central banks pursuing an undervaluation strategy, merchandise exports enabled highly competitive production costs for low-skill, labor intensive products. As mentioned this process has led to the democratization in several countries. The recent strengthening of the various forms of state capitalism found in Brazil, Russia, or Brazil to name a few, in combination with the ongoing crisis in more democratic market economies in the West, provide policy makers there with strong arguments for keeping the role of the government unchanged.

Analyzing the economies of authoritarian regimes which typically hold a strong influence on the institutional framework of the economy must take the special political constellation into account. As argued above the role of the state is already important in establishing the rules of the game in democratic developed economies and the economy cannot be detached from the political economy. The prevalence of elements of market economies has allowed scholars, despite its limitations, to try an analysis based on neoclassical arguments. In an economy dominated by an authoritarian regime this becomes much more challenging if not impossible. There are two main reasons which create a unique setting for the economic development in authoritarian regimes and make it much more necessary to consider the political situation when analyzing an economy.

First, the transition of an economy requires restructuring of economic and political institutions which has been a major obstacle for many countries as the evolved belief system does not equip the economy to confront new challenges in their development path (North, 1994). Hence, institutional change is indispensable. Such change in authoritarian regimes is much harder to implement than in more democratic systems as the political constraints create severe limitations in what is possible to implement. Certain sensible changes of the institutional framework of the economic system, might, though the outcome is desired by the government, not be feasible to implement as the political constraints are too powerful to allow for such a transformation. For example representative institutions such as trade unions or employer associations are dominated by the authoritarian regime, they will face substantial credibility problems with the groups they are supposed to represent. Second, the main aim of authoritarian regimes is to manifest their political position. Of course democratic powers also try to remain in power since a party blamed for bad economic policies is hardly likely to win an election. However, the political constellation is very different. Compared to democracies, even ones with a strong government influence, an authoritarian regime possess much greater leverage in controlling the economy and can exercise its power with much less restrictions.

2.5 Transformation of economic systems

In response to political, technological or social change, every economic system experiences modifications over time. Looking at much of the developed economies, the systems in place currently are vastly different from the ones in the onset of the industrialization. To confront issues such as child labor, unsafe working conditions or low pay, different political and economic actors introduced new regulations and laws, which also contributed to establishing new organizations such as labor unions. Such new institutions come into existence due to the opportunities provided by the institutional matrix and the perception of individuals that they can improve their situation by restructuring (North, 1997). Any of such new circumstances or major disturbances to the institutional framework are subject to limitations as to what is possible or and what is not (Friedland and Alford, 1991).

Over time it is necessary for economic systems to change the institutional matrix for a variety of motives. Reasons for such change can be diverse and are not limited to economic scenarios. Most obvious catalysts for institutional change are related to competition or globalization but also include political and technical revolutions, wars, natural disasters, or changes in the beliefs of people on how their society shall be structured. If economies resist change and fail to capture new opportunities, they risk becoming stuck with the current system and “fail to confront and solve new problems of societal complexity” (North, 1994). The institutional framework in place in Western Europe when it was more dependent on manual labor (e.g. textile production) would seem ill-equipped for today’s more technological and service oriented economies. For continuous economic development, change is prerogative. Recently issues related to social injustice and rising inequality as well as economic stagnation in many western countries has set off debates on what kind of changes are needed. Depending on the political process and individual issues the relevant outcomes will differ across countries.

Institutional change can aim to achieve better economic development, but a key driver is the struggle for power between different fractions for how and what topics should be addressed. According to North (1994) the interaction between organizations, defined as groups of

individuals sharing a common purpose, such as political parties or firms, shape the evolution of an economic system (Hodgson 2006). Governments rather than companies make public policy, but to a varying degree, depending on the political situation, they will respond to different opinions. In the political economy, politicians in power, whether in a democratic or an authoritarian regime, will need to interact with their constituency, responding to the most pressing issues. Though authoritarian regimes have greater power to ignore, suppress or influence public sentiment through propaganda, they too, over time cannot avoid modifying the economic system and dealing with grass-root issues. Consequently, governments are not immune to pressures to adapt policies congruent with the production regime while at the same time they are susceptible to other pressures including ideological, political or specific interest groups (Wood, 2001).

Being the sole enforcer of rules, its ability to influence the economy on a monetary and a fiscal level as well as in some cases as an active economic actor, the state of all mechanisms has the strongest coordination mechanism (Hollingsworth and Boyer, 1998a) and influential position to induce change. A rigid institutional matrix which is inflexible is prone to fail at some point or another as history of centrally planned economies has demonstrated. Governments, hence, are not protected from change and it is in the overall interest of the economy that the institutional system is not static. Any such adjustments can also be in the interest of those in political power, as they either try to manifest or improve their power. Inducing such change then will be restrained by vested interests with the necessary political clout. Equally if nothing is changed it may mean that the opposition tries to challenge those currently in power. Politics generate structure of complex interchange in which different players attempt to secure their defined objective (Williamson, 1989). It is for this reason that the structure of an economy cannot be seen independent of its political structure as various players attempt to alternate the institutional framework for different reasons and with different aims. Consequently the political constellation cannot be seen as an exogenous factor and must be considered when analyzing economic concepts.

It has been said that intuitions are the rules of the game and organizations are the players. In certain political constellations, especially in authoritarian regimes, this exact distinction may become less clear. Interrelationships governing the institutional framework are highly complex and it should be recognized that the legal system, in many cases is strongly influenced by the political sphere, has a profound effect on the working of the economic system (Coase, 2005). As North (1994) points out, a major shortcoming of current research is “the lack of attention paid to the polity and the problems of aggregating choices through the political system.” The prevailing situation influences the type of economic cooperation feasible. For instance it will have a profound impact on how labor or employers will organize themselves and interact with each other. This in return will influence the wage determination mechanisms and labor conditions, which again influence a wide variety of issues such as industrial structure and macroeconomic conditions (see section 1.4).

2.6 Path dependency, variation in wage bargaining and implications for China

It is the ‘scaffolding’ creating the prevailing structure of rules, norms, conventions and overall economic environment constraining the possibilities for change, and a major source of path dependency (North, 1994). Following the concept of path dependency most change will take

place incremental as existing organization and institutions slowly adapt or react to new evolving perceptions within the economic system, assure a certain degree of consistency. Being interdependent, changes in one institution affect other institutions but are also restraint. This process contributes to path dependency where an economic system continues along a certain logic (see David, 1988 / Durlauf, 1991 / Krugman, 1991 / Milgrom, Qian, and Roberts 1991). These incremental changes then may contribute to preventing a revolution from occurring (North, 1997) and are substantially important for the development of the political economy. Institutionalism views an economy as open and evolving system which is affected by change within a set of embedded economic, social, political and power relationships (Hodgson, 2000). Because of the embeddedness and path dependency of economic systems, successful forms of economic coordination cannot easily be transferred to another economic system as the institutional environment in which the 'imported' policy shall function will be different from where it originated. Quoting North (1994) "...societies that adopt the formal rules of another society will have very different performance characteristics than the original country because both the informal and the enforcement characteristics will be different."

Accordingly a variety of economic systems will yield a range of labor markets and wage bargaining systems. Labor market institutions govern any type of transaction regarding employment and include wages, contractual conditions including dismissal rules, and collective action (Caballero and Hammour, 2000). The underlying institutional design will have substantial consequences on how wages are determined. Following the social system of production approach countries develop a distinct institutional scaffolding in the labor market with diverse effects. Any ambitious transformations of elements or the entire economic system desired by the government are constraint by the prevailing institutional setting. Acknowledging the relevance of the existing setting and path dependency may contribute to engaging in futile policy experiments (Wood, 2001).

The 'stickiness' is due to the stability of formal and informal factors underlying the institutional arrangement (Lindgren, 2005). Institutions, in particular their way of functioning, foster certain developments and over time accumulate assets that are specific to an institution, making it more resilient and any changes more incremental (Pierson and Townridge, 2002). Next to domestic forces, increasing global competition economic systems and their related wage bargaining systems have been undergoing an evolutionary pattern. This evolution however is not autonomous of the prevailing institutional arrangement. The theory of path dependency however is not free of criticism. Together with competitive co0nvergence the theory represents an opposing pole in how economic systems adapt (Scherrer, 2005). Some points of criticism pertaining to path dependency include arbitrary historical starting points used as a reference in explaining present situations (see Peters, 2001 / Mahoney, 2000). It also may overstate the durability of an existing path, neglecting to account for the variety of alternatives encountered in each decision making process (Scherrer, 2005), as well as not adequate accounting for political considerations in the decision making process (Thelen, 1999). Path dependency need not be overemphasized but for the purpose of deciphering the Chinese wage bargaining regime it provides useful elements for conceptualizing the institutional constraints of its transformation process.

Several country specific studies have been carried out providing evidence of the evolutionary pattern.⁹ Generally these studies, as with much of current research on wage bargaining systems, center their attention on advanced economies while emerging and developing countries are neglected. In principle path dependence induces similar constraints on emerging countries as have been observed in more developed economies. The differences in the development of formal framework of economic and legal institutions coupled with political constellations contribute to the complexity. Crucially the starting point of economic transformation of developing countries is not identical with that of more advanced economies. Poor countries could have for example a highly informal framework with weak formal institutions. Another example would be countries with a state controlled institutional system under communist rule. This is a reminder of the complexity of the political economy and its underlying institution. It is especially important to recognize this when looking at developing countries.

Although the social system of production approach introduced above has the firm at its center of analysis it does recognize the role of institutions in coordinating industrial relations. Williams (1985) identifies constructed hierarchies to resolve problems not addressed by the market, however, argues that it is firms that are the architects of this, following his argumentation that only efficient institutions prevail. His conclusion seems to be more appropriate the more liberal an economy is structured, but has deficiencies for more regulated economies with a higher degree of non-market coordination and especially will have limitations in its application to China. Although the approach neglects to encompass developing economies, the central notions remain the same. The fundamental differences when evaluating China is that its institutional framework is much more fluid. Compared to developed nations as well as stagnant developing economies the scaffolding in China's fast growing economy is faced with rapidly changing social values, shifts in economic structures, as well as the strains on the political constellation and is under pressure to quickly keep adapting the mechanisms in place regulating the economy.

Coordinated market economies typically have an institutional framework in which employer associations and unions have a more powerful position providing for a different framework compared to liberal market economies, where typically such representative bodies lack sufficient power in order to be a useful vehicle (Hall and Soskice, 2001). The two examples however again highlight that China would not fit any of the used classifications and the institutional framework will be very distinct. The social system of production approach introduces valuable methods for understanding economic system, but due to its focus on developed countries the approach requires adaptations in order to apply to rapidly developing countries like China. A fundamental difference is the approach's focus on the role of the corporations in influencing the institutional framework. While this to varying degrees will be appropriate for developed and democratic countries, it gives less weight to the strong role of the government in China in shaping the economic direction during the reform process. Throughout the following chapters it should therefore be kept in mind that the introduced concepts face limitations in analyzing emerging economies with authoritarian political systems.

⁹ See for example Elvander (1997), Pontusson and Swenson (1996), Perez (2002).

3. Labor Markets and the Role of Institutions

Much of the analysis of labor markets and more specifically wage determination finds its roots in microeconomics. Neoclassical theory will argue that the labor markets resemble any other commodity market in an economy. The basic economic inputs land, labor and money are treated equally. As these inputs have unique characteristics and are referred to by Polanyi (1944) as fictitious commodities. In the case of labor, it is human beings themselves that are considered an input. Considering them as tradable commodities would imply that humans are subordinate to market mechanisms and the price of labor would be determined in the same fashion as any other commodity. Applying the same form of unrestraint market mechanisms on the labor market would be capitalism in its purest form. Karl Marx (1867) already criticized that the consequences under such capitalism would be that everything including labor would become a commodity. To counter the negative impacts of unrestricted market mechanisms Polanyi (1944) stressed the importance to limit any commoditization of fictitious commodities and the need for a society to protect itself from excessive market mechanisms. When dealing with the labor market it needs to be noted that in many ways it is a special type of market. Since it involves human beings it establishes a direct link between society and an economy, distinguishing it from real commodities. Labor cannot be disentangled from human life and society (Boyer, 1998) and functions in a different way from standardized commodities. As a result the reality in most economies is that pure price mechanisms do not apply to the majority of employees as societies opt to constrain capitalism by introducing a wide variety of institutions.

A common neoclassic prescription to tackle unemployment has been the deregulation of labor markets. There are countless authors arguing that rigid labor market due to the existence of labor market institutions contribute to high unemployment and lower economic growth (see Nickell and Layard, 1999 / Elmeskov et al. 1998). These approaches however ignore potential endogeneity of institutions while not considering why such institutions have been established (Kim, 2007). As mentioned above unregulated market mechanisms are more likely to harm the acceptance for the general principles of a capitalist economy (Boyer, 1998). Focusing on wages and how wages are determined, one core issue is resulting wage dispersion and inequality. Humans have distinct feelings about fairness which clearly distinguishes it from the goods market (Solow, 1990) as other commodities are unlikely show any emotions characteristic of human beings. In an analogy, a particular type of orange will hardly have hard feelings and question the market mechanisms against another type of orange as its price plummets. A blue collar worker however is likely to feel resentment if his or her wage is significantly outperformed by another blue collar worker with a similar skill set, as well as towards the general society if inequality rises to unacceptable levels. This kind of resentment can trigger a wide range of consequences bringing potential instability to an economic system. It is therefore no surprise that labor markets are typically embedded within institutional scaffolding with more regulations and higher public interventions than other “commodity” markets. The result is a highly complex institutional arrangement of the labor market which is a direct result but also a shaping determinant in its interaction with the entire economic system of an economy.

Different institutional settings of labor markets will, depending on the economic environment, result in different outcomes in the labor market, including unemployment, wage levels and structure. There has not been a labor market system which has consistently outperformed

any other intuitional arrangement of the labor market while facing ever changing challenges fluctuating economic situations. Boeri and van Ours (2008) noted that the benefits of deregulating labor markets suffer from “short memory” and point out that for example that while basically the same labor market institutions in Europe performed weaker in terms of employment compared to those in the US for most the 1990s, they were stronger during the 1970s. Different economic conditions and much more individual country specific differences do not permit implementation of “the” prevailing labor market system, let alone unregulated market mechanisms, as the solution to all employment concerns in all countries of the world.

3.1 Impact of labor market institutions

The role and functions of labor market institutions in an economic system can be defined as a “system of laws, norms, or conventions resulting from a collective choice and providing constraints or incentives that alter individual choices over labor and pay. Single individuals and firms consider the institutions as given when making their own individual decisions” (Boeri and van Ours, 2008). Labor market institutions cover a wide area of relationships between employer, employee and the government. It includes labor law regulations such as retention, training and skill development; inter firm relationships, as well as hierarchies within firms.¹⁰ Laws governing the labor market, if enforced accordingly, in effect constitute the overall legal framework for industrial relations. As a focus of this research, labor laws and the resulting institutions shape the wage determination mechanisms in place. Across the world different levels of development as well as different beliefs result in labor market institutions coming in numerous forms taking on different functions within an economy, but all in effect constraining market mechanisms and the commodification of labor. Table 3 lists some legislative, fiscal, and coordinating institutions all of which are firstly dominated by governing labor laws, which in effect can be interpreted as the labor markets ‘constitution’. The institutions listed in the Table 3 are far from all-encompassing but should stress that the labor market is made up of a variety of variables, each of which will be defined by individual characteristics of an economic system. Bringing it into context of the entire economic system the impact of the resulting labor market institutions goes beyond the direct effects on issues such as wages or employment, but through their impact on for example skill levels or productivity have more far reaching consequences on the entire economic system (see Table 2).

¹⁰ Labor law can cover a wide range including regulations for hiring and dismissal, but also items such as child labor, maternity leave, limitations on working hours, holidays etc.

Table 3. Labor Market Institutions affecting wage determination

Legislative institutions	Fiscal institutions	Coordinating institutions
Labor laws	Active labor market policy	Trade unions
<i>Employment protection</i>	Payroll taxes	Employer associations
<i>Working hours</i>	Social insurance	Work councils
<i>Holidays</i>	Transfer payments	Collective bargaining
<i>Child labor</i>		Minimum wage
<i>Maturity leave</i>		Government guidelines
Unemployment insurance		
Immigration laws		
Trade union law		

Rather than exposing labor relations to pure market mechanisms, through the introduction of regulations and encouraging accompanying institutions, uncertainty in the labor market is reduced (Heise, 2005). The resulting labor relationships directly correspond to the underlying institutional framework resulting in a specific labor market classification with distinctive characteristics. Within the broad classification it will resemble elements of other labor markets, but in its entirety individual countries will still be highly unique. For instance, a weak institutional framework, typical of many developing countries, is likely to result in a dominant informal employment sector. Countries with a stronger institutional base will, under the constraints of its political economy, deliberately choose arrangements setting the foundation for a specific wage determination regime.¹¹ The outcome then can range from varying degrees of collective bargaining to an atomistic wage determination with direct consequences on levels of coordination and centralization. Once established the designated wage bargaining regime will resonate throughout the entire labor market regime, its economic system and macroeconomic functionality.

Understanding the institutional context of an economy and its labor market provide crucial insight into the interactions between the various institutions comprising the economic system and are helpful in understanding their reaction to changing economic conditions. It will further help to identify limitations and benefits of what kind of labor market reform is possible under the given institutional arrangement. It is an accepted reality that labor market institutions exist in every economy though there is little agreement on what constitutes an optimal institutional setting. The debate can take on various perspectives but the prevailing research focus is on the relationship related to employment and unemployment.¹² Veen (2006) provides an overview of some current research on the impact of various types institutions on various issues related to employment. Reflecting the notion embodied in Table 3, research focusing

¹¹ The example of North Korea highlights that a strong institutional arrangement is not necessarily dependent on the development level but can be much more dominated by the political economy.

¹² For more detailed readings and for variety of approaches see Blanchard, 2005 / Blanchard and Tirole, 2004 / Wilthagen, 1998 / Schmid, 2002 / Blank and Freeman, 1994 / Baker, Glyn, Howell and Schmitt, 2004 / Verick, 2004.

on OECD countries has shown that most countries have similar labor market institutions in place, but that the structure and impact of them differs greatly (Veen, 2006). The results show that different institutions have different significance levels on labor market developments. Despite this reality a major focal point of research on labor market institutions focuses on the questions whether if institutions matter or not, which evidently is in line with neoclassical theory. The institutional impact follows neoclassical thinking, mainly focusing on employment effects shown. There are many different ways in which labor markets are analyzed, but the prominence of institutions is often only secondary in the microeconomic approach of neoclassical theory. It does not allow a general conclusion that the impact of certain institutions is the equal in all economies and would not be compatible with the Keynesian paradigm.

In contrast to the microeconomic approach, typical for neoclassical theory, largely relying on price theory and price equilibrium, the institutional approach investigates the specific institutional context shaping labor markets (Hodgson, 2006). Taking on a broader look, it acknowledges country specific institutional fundamentals and does not only constrain itself to microeconomic analyses. By doing so it recognizing the broader role labor market institutions have within economic systems. The impact and the significance of the labor market institutions very much will depend on how they are embedded within the economic system as well as on the specific economic conditions at the time. Depending on the data set, countries analyzed, and models used, findings result in contradictory results (Auer, 2007) explaining the large variation for different research outcomes. Freeman (1998) reminds us that determining how institutions affect outcomes is extremely challenging and different approaches come with different limitations.¹³ The root of the complexity lies in the institutional embeddedness of labor market institutions and the economic system as a whole. For the remainder of the research it should be noted that there is an ongoing debate in regards to labor market institutions in general as well as how they impact the economy, and particularly employment. Wage determination is another factor when researching labor market institutions however it is mostly analyzed in a direct link to employment by attempting to establish causality with wage developments. We will return to this debate on wage determination institutions in section 2.3 and 2.4 below.

3.2 The motivation and function of labor market institutions

Recognizing the fact that the existence of labor market institutions are a reality while noting that there is an ongoing debate on the effects labor market institutions have and that there is no prevailing opinion on specific outcomes, the next focus will be on the motivation and potential functional benefits labor market institutions can have. Most existing labor market institutions found in economic systems are a result of an evolution of agreed upon arrangements between the various social parties engaged in economic activity. It is the

¹³ Freeman refers to three approaches in analyzing outcomes of institutional arrangements: A) measuring outcomes between covered and non-covered workers, however the challenge here is in regards to potential spillover effects. B) measuring before and after effects, lacks an observable counterfactual for a benchmark. C) country comparisons during the same time period, which is challenging due to the institutional differences and country specific arrangements of the economic system.

existence of these institutions which “differentiate(s) real economies from the Walrasian auctioneer model.” (Freeman, 1998).

An important function of labor market institutions is to provide some sort of insurance against social risks (Agell, 2002). It has been widely stated that for this reason and to compensate workers for their disadvantaged position that various labor market institutions have been introduced to regulate market mechanisms in the labor market (Mares, 2001). By providing a certain level of social benefits and some form of protection against other social risks associated with labor¹⁴, policy makers attempt to decommodify labor (Esping-Andersen, 1990). Uncertainty reducing institutions are a major factor influencing labor markets and attempts to create a more stable and equal society while there are of course great variations between different countries. Bringing it back into the context of the political economy, workers who make up the majority of the constituency can destabilize the political party in power, regardless of the political system in place when being exposed to a risk burden higher than society feels acceptable.

Risk reducing institutions of course is a vague term and can encompass a large variety of institutional goals. For each goal the different institutions introduced in Table 3 above may be implemented while, due to their embeddedness, they cannot be seen in isolation. However, different individual institutions aim at specific outcomes. As has been stressed above and will be shown in more detail below (see section 3.4 and chapter 4), similar labor market institutions can be found across different countries, though their role, structure, and impact varies. For this reason, and because of the ongoing academic debate on the impact of labor market institutions, it is not the aim to look at which labor market institutions can be used to achieve different policy aims at this stage. Much more the aim is to introduce a basic overview of policy goals for labor market institutions. We will return to this in more detailed when looking at wage determination institutions and functional labor markets below (see chapter 3). Generally a distinction can be made between three broad policy goals: social function, employment relations, and macroeconomic function though at the end all need to be seen in unity for forming a functional labor market.

First, goals of labor market institutions may be reflected in the aim to reducing social inequality including income dispersion. In economic history there have been several situations where an institutional push occurred to limit rising inequality, which resulted in better employee representation, improved compensation, social benefits as well as a reduction in work time (Callabaro and Hammour, 2000). As mentioned previously the accepted level of inequality differs between countries and this will have consequences on the structure of the overall institutional arrangement of an economic system. This then may also result in different functions of labor market institutions (Agell, 2003). There is wide recognition that institutions are capable of reducing wage dispersions and that countries with labor market institutions in place have lower inequality than countries relying more strongly on market mechanisms (see Card, 1996 / DiNardo et al, 1996 / Hibbs, 1990 / Manacordo, 1997 / Freeman and Katz, 1995). Several country specific case studies have further shown that changes or reduction of institutions leads to greater income dispersions (Freeman, 1998). As mentioned there are limitations in judging outcomes, but it seems safe to say that where labor market institutions are less established, inequality resulting from higher wage dispersion will be higher. However,

¹⁴ For example exploitation, child labor, work time, workers' rights etc.

judging absolute figures on wage distances or the GINI coefficient should also keep in mind the various different perceptions within countries.

Second, institutions establish how the employment relationships are structured resulting in various degrees of rigidity. A key aspect for the type of labor market institutions relate to how the dismissal and hiring of employees is structured. Without getting into the debate on which type of employment system is superior over the other, most academics will agree that the spectrum of systems can range from fairly flexible market driven ones with nearly no protection to highly regulated ones. Next to employment conditions in private enterprises it also includes the role of the public sector and the role of state-owned companies where perceived employment security is generally higher (Clark and Postel-Vinay, 2006). Under some conditions more rigid employment can lead to longer tenures and higher productivity up to a point, though there appears not to be a clear relationship between perceived job security and tenure (Auer, 2007).

Coming back to the concept of systems of social production, labor market flexibility will have an impact on the skill level and industrial output on an economy (see section 1.4). Labor market institutions relating to employment conditions also include mechanisms for dispute resolution and strike prevention. Though no clear picture has evolved on the relationship between employment conditions and strikes Veen (2006) suggests that the quality of labor institutions must be taken into account when determining their role in the labor market.¹⁵ Employment conditions are a complex framework of institutions and usually are a vividly debated topic in any economy but it again depends on the individual settings and the specific preferences in a country's society as some societies will accept a higher degree of uncertainty in their employment conditions than others.

Third, labor market institutions and their outcomes directly interact with the overall macroeconomic environment. Labor markets influence the fiscal position of a country through collected taxes of the employed or benefits paid out to the unemployed. In the monetary sphere wages are related to inflation, exchange rates as well as a nation's global competitiveness. Monetary policy, inflation and wage bargaining systems play a significant role in capitalist economies. The existence of interconnected institutions, and the political division of labor between them, create a context of strategic interdependence where decisions in each domain shape, and are shaped by decisions in other domains (Hall and Soskice, 2004). Accurate interpretation and analysis contribute to comprehending the mix of economic forces which influence economic systems and the institutional interactions. For example increasing cost of living can prompt the need for higher wages as inflation decreases real income triggering a potentially dangerous likelihood of a wage-price-spiral and creating an unfavorable economic environment. The effect of wage adjustments on the economy will very much depend on the institutions of the wage determination mechanism which will subsequently be introduced.

In economic reality institutions structure the core foundations of how an economy functions. Labor market institutions are a key element for overall macroeconomic stability. Further, they are an important part in limiting market forces affecting employees by reducing uncertainty but equally they can as well create benefits for employers. Most important institutions are

¹⁵ Quality of labor relations is measured by strike activity.

established for a reason and societies have the desire to have certain institutions in place which regulate an economy providing a form of protection against pure market mechanism in which all and everybody is reduced to a factor of production. As with economic systems there is also no globally prevailing labor market system resulting in a large variation observable in different economies.

3.3 Wage determination institutions

Before turning to wage determination mechanisms, the institutions which are part of the bargaining process shall be introduced. The embeddedness of institutions generates a framework where it is difficult to dismiss components which in one way or the other influence each other. As indicated above there are a vast number of different types of labor market institutions, not to mention the entire institutional spectrum in the economic system. Wage determination mechanisms especially are prone to being influenced by a large set of factors. As economies increasingly open and subject to global competition, they are susceptible to developments in other countries. In line with this, the development of exchange rate also affects wage determination. On the macroeconomic level wage determination is influenced of course by the general state of the economy, employment conditions and inflation. Closer to industrial relations issues related to training, education and the overall skill level play a role as do the industries in which the majority of employment takes place. Further, it is not just economic factors influencing wage determination mechanisms, as issues related to culture and ethics also play a role as does the political system in place.

Economies have a variety of mechanism to choose from to find its institutional arrangement of the determination of wages. Theoretical wage determination regimes can range from liberal market dominated systems in accordance to neoclassical theory to rigid state controlled systems often found in planned economies to systems in which a set of institutions regulate market determination. The institutional arrangement will have varying degrees of stability, though the evaluation will be likely to cause disagreements between advocates of rivaling economic school of thought. Independent of this, most likely a country's wage bargaining system will arise out of the historical context and will develop over time rather than changing in an ad hoc manner. Any change is constrained by the linkages with other institutions shaping labor relations (Hollingsworth, 1998) (see section 1.6). Consequently, wage determination mechanisms across different economies or even within an economy can vary widely, resulting in an assortment of wage negotiation processes. Much of the behavior of the individual bargaining units will be dependent on the institutional design which has established itself over time.

It is one of the challenges in analyzing the institutional foundation of economic decision making to identify all the influencing variables. The multidimensional nature of wage bargaining systems complicates the institutional arrangement for a comparative analysis of the different constellations. One risks to not conducting meaningful research by omitting too many institutions by oversimplifying reality. On the other hand one can get caught up in the complexity of the institutional web. At this point a number of variables which influence the levels of centralization and coordination in a countries wage bargaining system shall be introduced. The target of this approach is to establish fundamental building blocks influencing the types of institutions affecting wage determination. In this overview cultural or political influences will be only touched upon, but they shall be more included when looking at country

examples and will be of greater importance where this research focuses on wage determination in China.

3.3.1 Market mechanisms

First, in any capitalist based economy market mechanisms through demand and supply will influence wage determination. That is not to say that wage determination is completely unregulated, but that capitalist economies choose between varying degrees of market forces in the labor market and the determination of wages. Demand and supply influence wage determination as they impact bargaining power of the bargaining units within the overall institutional framework. The pervasiveness of labor market flexibility does however not imply the existence of a market clearing wage level according to the neoclassical model, but depending on what regime an economy chooses the institutional restrictions on the wage flexibility will vary.

Gwartney, Lawson and Hall (2013) publish an annual index of economies in the Fraser Institute's Economic Freedom Report ranking them according to their economic freedom which includes indicators of labor market institutions.¹⁶ The index generally fits observation in advanced economies and measures the market vs. institutional orientation of an economy (Freeman, 2007). However, even labor markets in the economies considered most free are not completely based on market mechanisms. In many cases governments will be reluctant to introduce reforms of wage-setting institutions due to concerns of equity, the complexity of the structures of the economic and social fabric, as well as concerns regarding efficacy of such policies (OECD, 2004). Another key concern is the varying acceptance levels for the reliance on market mechanisms dominating labor markets in societies.

In recent years the common policy advice prescribed to countries with high unemployment was greater deregulation of labor markets (see OECD, 1999). The theoretical foundation of the advice for liberal market mechanisms is based on the general relationship between wage levels and unemployment as well as the belief that institutions create upward pressures on wages (see Layard et al., 1991 / Nickell et al. 2003). Supply and demand are an influencing component in wage determination, though it remains an academic debate whether there is a direct link to wage levels and unemployment based on the an supposed equilibrium wage level.¹⁷ The level of market mechanisms permitted to freely work will depend on the institutional framework in an economy and prescribing the same liberal strategies on all economies is unlikely to be a common cure for problems related to the economy. Further it should be noted

¹⁶ The index uses 42 data points, from external sources such as the World Bank or the International Monetary Fund to construct an index on five broad areas each with equal weight: (1) size of government, (2) legal structures, (3) access to sound money, (4) freedom to trade internationally (5) regulations of credit, labor and business. The labor market institutions considered in the ranking are: hiring regulations and minimum wage, hiring and firing regulations, centralized collective bargaining, hours regulations, mandated cost of worker dismissal, conscription.

¹⁷ For more on this debate see Howell (2004) / Teulings and Hartog (1998). For a view on Asia in particular see Stiglitz (1996).

that wage bargaining of different sectors and professions will be affected differently by market mechanisms.¹⁸

3.3.2 *Economic structure*

The economic structure of a country sets the fundamental conditions for an economic system to form. It is much less complex for smaller and more homogenous countries to reach a higher degree of both centralization and coordination than for larger economies.¹⁹ The more complex and diverse an economy becomes the more difficult it becomes to hold coalitions together (see Freeman, 1988 / Moene et al. 1993). Divisions within the workforce make it much more challenging for influential representative organizations to form and expand their influence to grass root members. Higher fragmentation then makes higher degree of centralization more unlikely, though it does not necessarily need to have a negative relationship with the level of coordination (e.g. in Japan, see section 3.4).

Equally the industrial composition can play an important role. Dominant industries employing large share of the workforce typically will make it easier for employers and employees to form influential representative bodies. For example one could expect dominant industries with mass production and a more homogenous workforce to increase the possibility of higher degrees of centralization at the peak or industry level than in an more heterogeneous and fragmented industrial structure. It is hence not surprising that countries with an emphasis on industry specific skills are more likely to organize at the industry level while economies with more general or firm specific skills typically have a lower degree of organization (Estevez-Abe, Iverson and Soskice (2001). As we will see in section 2.4 this has profound consequences as to at which level wage bargaining takes place and how wage agreements extent throughout the economy.

3.3.3 *Industrial relations and representative bodies*

In much of the academic debate regarding wage bargaining scholars are preoccupied with the role of trade unions while employer organizations' function in the wage determination process is kept at the side-line at most (Soskice, 1990). In the past years literature has increasingly noted that employer associations are equally important to trade unions, particularly for wage coordination (see Thelen, 2001 / Swenson, 1989 / Martin and Swank, 2008). Another common flaw in research is to measure trade union importance by union density, but this correlation appears to be rather weak. Empirical studies by the OECD (2004) and the European Central Bank (2008) concluded that the coverage rate of collective contracts usually surpasses that of union density indicating that employers will also apply the agreements to non-unionized employees. Avoiding some of the pitfalls is therefore very important as otherwise the country specific details will be overlooked.

As wages are not determined in a unilateral manner it is necessary to take into account the institutional framework for both employer and employee representative bodies as this will have a major impact on the level at which negotiations take place and how agreements

¹⁸ The significance of market mechanisms may vary in the various labor market segments. As highly sought after, specialized workers cannot be compared to the typical blue labor worker.

¹⁹ Centralization and coordination will be explained in more detail in section 2.4.

influence the general wage levels in an economy. The result is a complex institutional arrangement which affects the strategic interactions of the bargaining units (Franzese and Hall, 2000) as well as their willingness to extend coverage of such agreements. Much will depend on how the wage bargaining units interact with each other as this will have an immediate impact on how conflict prone negotiations are.²⁰ Coordinated market economies are typically associated with a higher degree of cooperation between employers and workers on a wide range of issues including training, wage bargaining and in some cases co-management (Soskice and Iverson, 2011). The authors further note that in liberal market economies on the other hand both parties are more likely to engage in a more confrontational way as the businesses prefer more unilateral management control and are tend to be less fond of unions. For effective collective bargaining institutions to be established the interaction between the production regime and the industrial relations system will set the preconditions for the level of centralization especially and in a more indirect way for coordination as well.

Though the government can typically influence the role and establishment of representative bodies, it still cannot detach their role from the institutional framework of the economic system. However, the independence and power of associations can be greatly influenced by the government. Legislation like the Right to Work Statute²¹ in the United States or making strikes illegal will strongly affect how trade unions can engage in wage bargaining. On the other side strong political and economic ties with a dominating political elite will strongly influence how business associations will engage as well as how they are perceived by workers and employers alike.

Type of associations will impact the degree of centralization and coordination of the wage bargaining process by establishing the necessary foundation for what kind of wage bargaining system is possible. Depending on the institutional preconditions for the establishment of associations it will determine how wages are bargained for. The outcome will set the conditions for the level of bargaining (plant level, company level, industry level, regional or national level) as well as the bargaining units (tripartite/ bipartite negotiations). Only the adequate counterpart for employee or employer associations which its members consider to be truly representing their interest can engage in the relevant wage negotiation level. Hence, different levels of wage bargaining systems require different roles and competences of the relevant associations involved. Introducing collective bargaining therefore requires a necessary supporting institutional framework.

3.3.4 Government

No sensible analysis however is possible without considering the multifaceted role of the state which sets the rules of the game in which the economic actors interact. Above all it sets the political preconditions of the economic system. The role of the government as an authority for the legislative framework of the institutional setting plays a vital role in establishing a wage bargaining system. Through labor market legislation, minimum wages, taxation and social security it sets the conditions in which employees and employers engage in bargaining.

²⁰ Relations therefore can be more hostile or more cooperative.

²¹ The right to work statute limits unions' ability to require union membership and has weakened the position of unions in the states which have introduced the statute.

Through the public sector it establishes a labor market which typically functions differently than the private sector by offering greater job security while pay for the most will be lower than in the private sector. Most certainly the government follows certain economic targets by implementing wage bargaining policies in accordance to their political agenda. However, governments need to find a balance between their strict economic goals and the preferences of enterprises and people which they govern. For example, some liberalization efforts which might work in some countries may not be accepted in the same way in another country.

Mares (2001) makes several observations of the role of the government for establishing the role of worker and employee representation. First, governments tend to be weaker in economic systems where private associations are strong, while it is stronger when representative bodies are less powerful. Second, representative bodies which are closely associated with the government risk not being perceived as authentically representing their members. Lastly, economic systems which lack appropriate mechanisms facilitating independent and powerful representative bodies will not succeed in establishing higher degrees of centralization or cooperation independent of the state. The industrial relations policies²² in place under the constraints of the political system will have a directly impact the levels of centralization and coordination by i.e. the roles trade unions and employers' associations are permitted to take on.

The indirect involvement of the government in establishing the "rules of the game" for the wage determination process often will extend to a more direct involvement. Here too the government has several ways of interacting. First, as an employer for the public sector it will directly engage in wage bargaining negotiations which to a varying degree influences negotiations in the private sector and vice versa. For private sector bargaining the government may engage in tripartite wage bargaining in which it directly participates as a bargaining unit with unions and employers. Typically this role will see the government more as a mediator between the parties and only useful in systems with higher degrees of centralization and coordination as the government may to some degree influence the outcome through its fiscal and monetary policy. In fragmented, decentralized wage bargaining systems its possibility to engage in tripartite wage bargaining and its ability to influence the level of coordination is reduced.

Second, the government can directly influence wage bargaining though it does not participate in the wage bargaining process. Typically the government can choose between two broad policies. One can be referred to the low-wage strategy in which the government makes transfer payments to reduce poverty, while the other is to establish a living wage through minimum wage (Briggs, Buchanan, and Watson, 2006). Another strategy, though usually on a subtle and non-binding basis, is to issue wage guidelines. All indirect policies affecting wage bargaining can contribute to higher levels of coordination. Via the legal framework the government directly shapes the framework for the degree of centralization. Through its influence and chosen method of engaging in the process of wage determination will affect the level of coordination as the government can set certain preconditions for the employees and employers regardless of their level of centralization.

²² Industrial relation policies include labor laws, legislation on formation of representative bodies, rule for bilateral and/or tripartite negotiations, as well as formulating a dispute resolution system.

In democracies the interaction between values, the political structure and the production regime seem to show certain patterns associated with lower inequality and proportional representation when compared to majoritarian forms of representation (Soskice and Iversen, 2011). There further appears to be a correlation with social spending and redistribution (see Bardley et al., 2003 / Lee and Romer, 2005). Other scholars however point out that the robustness of these relationships as well as the direction of the causality need to be treated with caution (see Flanagan, 1999 / Golden and Londregan, 2006). However the direct implications political institutions and the electoral systems need to be taken in consideration for understanding wage bargaining regimes (Alhquist, 2008). The government in democratic countries is not independent in its decision making process as it is accountable to its constituencies which elect them to power. Policies which the government introduces must therefore stand the test of elections and political parties need to make compromises which more authoritarian regimes need pay less attention too.

Depending on the political outcome, the government through its direct and indirect influence is in the position to act as a catalyst for higher or lower degrees of centralization and coordination. It will however be constraint by the political situation and will not be able to act completely independent in choosing its involvement and impact on especially coordination. As has been widely noted (see section 3.2), wage bargaining systems have a direct impact on inequality in the society. The level of accepted social inequality as well as the influence people have on their government will therefore impact policies put in place. Though democratic countries will be more responsive to their constituencies' demands as they need to face elections regularly, authoritarian regimes are not immune to such demands. Despite the government's potential power, wage bargaining systems can only be partly controlled and are not completely free of market mechanisms in the majority of countries, but the government is in a strong position to shape the desired wage bargaining system (European Commission, 2011). In its capacity the government can guide the establishment and role of trade unions and business associations in the wage bargaining process which will influence the amount of power various bargaining units can acquire.

After reviewing some of the influencing factors for wage bargaining systems it should have become apparent why classification and comparison of wage bargaining systems is such a challenge. The number of variables which need to be taken into consideration is highly complex and embedded, contributing to institutional variety found across economies. While some structures are more obvious, the functioning of for example informal network effects is much more opaque. This section should have demonstrated that there are certain institutional arrangements which facilitate higher levels of organization. Further, it should have been illustrated that certain arrangements make certain sets of wage bargaining regimes more difficult. In summary, the possible wage bargaining regimes are both restraint and cultivated by the existing institutional scaffolding of the entire economic system.

3.4 Theoretical foundations of wage bargaining institutions

Most of neoclassical theory directly links unemployment and wages levels arguing that only a self-regulating market under perfect competition (supply and demand) can achieve an equilibrium employment level. The theory is based on a competitive market economy with the Walrasian general equilibrium theory at its core (Kaufmann, 2009). Wage determination is

mostly regarded on the microeconomic level in which a certain real wage translates in a given supply and demand level which under perfect competition and no market interference (and no labor market institutions) should result in an equilibrium and full employment. At the heart of the wage determination theory in the neoclassical model is marginal productivity theory (see Hicks, 1963). Following this theory companies will continue to hire until the marginal productivity equals real wages. Wage determination is therefore a rather straight forward process, in which institutions are regarded as an obstruction interfering with market mechanisms.

The fundamentals of Keynesian economics take on a very different approach at labor markets and wage determination. In the *General Theory of Employment, Interest and Money* (Keynes, 1936), the Keynesian paradigm outlines the hierarchy of markets and argues that not real wages are being determined, but nominal wages. Following the hierarchy of markets, with the asset and goods market at the top and the labor market at the bottom, the paradigm refutes a direct relationship between wages and employment while stressing a relationship between wages and price levels (Herr, 2009). The Keynesian approach does not make a distinction between the monetary and real sphere and instead assumes an interaction between wages and the necessity for sound institutions as a condition for stable wage development (Herr, 2009).

Difference in wage determination theory in neoclassical and Keynesian theory is a vivid and ongoing academic debate. It is not the aim to examine the details and arguments of this debate however it is important to keep the key distinctions relevant for this research in mind. Neoclassical theory explaining wages is well developed and clearly argues against institutions interfering with market mechanism with a central role given to marginal productivity. Measuring marginal productivity objectively is for the most not possible (Herr and Ruoff, 2014). The Keynesian school of thought is more open about the interaction between various spheres and more inclined to accept the role of institutions in the wage bargaining process. Much literature focuses on the precise wage rate, most often in relation to economic performance, inflation, and most commonly employment levels while leaving the exact analysis of the institutional setting at the sidelines. Acknowledging the role institutions play in wage determination this approach will focus on the framework which is behind the wage bargaining mechanisms.

The type of labor market institutions and their influence in wage determination determine the type wage bargaining regime in place. As mentioned economic systems will not be limited to one type of system, this is also valid for wage bargaining systems. Depending on the composition of the economy several different type of wage bargaining mechanisms can be in place, though typically there will be a system which dominates the system covering the majority of employees. Market mechanisms will affect the bargaining power of different employee groups in a different manner (e.g. industrial blue collar workers vs. highly skilled professionals). Adding to the complexity of the issue, the variety of bargaining structures may take place at different levels, including recognition of several unions, closed shop bargaining, different bargaining levels and interaction between them (Hartog, Leuven and Teulings, 2002).²³

²³ See also Stewart (1987) for an analysis of the United Kingdom.

Several attempts have been made in classifying bargaining systems.²⁴ Models used, differ in the definition as well as in the number of dimensions. Most commonly classification occurs along the degree of coordination and/or centralization. Apparently no consensus has been found on which method is the most accurate as many authors choose only one dimension, either coordination or centralization, and some choose both. To add confusion, coordination and centralization are sometimes used synonymously. Though the two concepts are closely related, for a better understanding a clear distinction appears to be necessary to avoid confusion for the following debate in which both are of crucial importance.

3.4.1 Degree of centralization

The degree of centralization refers to the level at which wages determination occurs taking the number of independent bargaining units into account (Cavallari, 2004). The model developed by Calmfors-Driffill (1988) introduces this classification methodology for wage bargaining institutions in an economy and set the foundation for much of the ongoing academic debate on wage determination mechanisms (see section 3.2). Though there is no consensus on the definition of the degree of centralization, it most generally refers to where wage bargaining decisions are made. It distinguishes between the institutional level where bargaining takes place, typically on either the peak, industry or company level (Hartog, Leuven and Teulings, 2002). In general terms this is referred to the extent of vertical centralization according to Moene, Wallerstein and Hoel (1993). Additionally to the degree of vertical centralization for the bargaining partner's organizational structure, the vertical degree of geographic centralization must also be considered (national, regional, local).

Typically centralization of wage bargaining tends to focus on collective bargaining and the role of unions. Depending on at which level unions, and for this matter employer associations, are located, the degree of centralization is determined. This view however dismisses the role governments play in wage determination through measures such as minimum wage, wage-guidelines, as well as its role as an employer of the public sector (Wallerstein, 1998). Measuring the degree of centralization is not a simple task as in some cases wage bargaining may take place on multiple levels as they trickle down from higher level negotiations (see Katz, 1993 / Traxler et al., 2001). Hence the degree of wage formation may take on different dimensions which let Karlson and Lindberg (2011) to make a distinction between the dominant level, confederal involvement²⁵ and the role of the government. The degree of centralization is therefore highly complex and must capture the sophisticated underlying structure of the wage bargaining institutions involved.

The institutional arrangement of wage bargaining can result in a wide variation in the degree of centralization in an economic system. A highly decentralized system is a system where negotiations take place locally at the company level. This constellation will result in a high number of individual wage bargaining units and the absence of unions, creating an atomistic bargaining structure. On the other extreme a highly centralized system refers to wage bargaining of peak level associations on the national level.²⁶ In this system the number of

²⁴ A selection of studies is provided in Calmfors (2001).

²⁵ Defined by the authors as the negotiations of peak level employee and employer associations.

²⁶ The highest form would result in the national bodies of trade unions and employer associations.

wage bargainers is minimized. Intermediate systems usually can be best described by negotiations at industry level (Soskice, 1990). In the case of an intermediate level the degree of vertical centralization of the geographic level will impact the overall degree of centralization, but it may also include centralization on the level of occupations.²⁷ Though the degree of centralization strongly influences the level of coordination possible, though in no way does the level of centralization determine the degree of coordination which shall be explained below.

3.4.2 Degree of coordination

The level of coordination can be described as measuring the extent to which wage bargaining is synchronized across the economy (Lindgren, 2005). Specifically coordination can be distinguished between vertical and horizontal coordination (Traxler, 2003). Vertical coordination reflects the reach the wage bargaining agreement has on the employees and employers at grass root levels. It represents the concentration of power of representative bodies and their reach throughout the economy. The higher their coordination power, the less defection and deviation from the wage bargaining outcome can be expected as the results are passed on to lower levels. In contrast horizontal coordination refers to how representative bodies interact with each other. This concept is often overlooked but horizontal coordination has a significant impact on the type of industrial relation system and the relationship between the bargaining units. Coordination in a tripartite constellation will additionally include an involvement of the government and monetary authorities in the wage bargaining process. The bargaining units may engage in a more cooperative manner, which in a tripartite bargaining can include items such as social pacts, where bargaining partners in a cooperative fashion attempt to pursue a common goal. On the other hand bargaining units may engage more confrontational in pursuit of individual goals often in an environment of mistrust.

As with centralization, coordination may also vary from level to level. It can take place at the national, industry or company level. In a highly coordinated system, regardless of the level and centralization, one or very few bargaining units at the peak level influence the wage setting for other levels of negotiations. Such an agreement is taken as a lead indicator with other bargaining units using it for a point of reference, thus expanding the overall reach the pilot agreement on the wage level throughout the economy. This does not imply that it will be followed in every detail, but the key agreement provides a benchmark followed in subsequent negotiations between other bargaining units. On the other extreme uncoordinated bargaining implies that agreements of other bargaining units have no or little effect on subsequent negotiations. Summing up the different forms of coordination, a more detailed distinction is made by Traxler et al. (2001) distinguishing between state-sponsored, state imposed, inter-associational, intra-associational, state imposed, pattern-setting and non-coordination.

Especially the coordination mechanisms between non-coordination and national peak level bargaining leave room for substantial variation in the degree of coordination. For industry level wage bargaining the degree of coordination will depend on the economy wide linkages which for instance give an agreement of a leading sector the power to transmit the settlement across other sectors in the economy (Franzese and Hall, 2000). This institutional complexity makes it difficult to conceptualize the level of coordination. Measuring coordination based on

²⁷ For occupations this for example includes the role of professionals such as the Doctors Association in Germany.

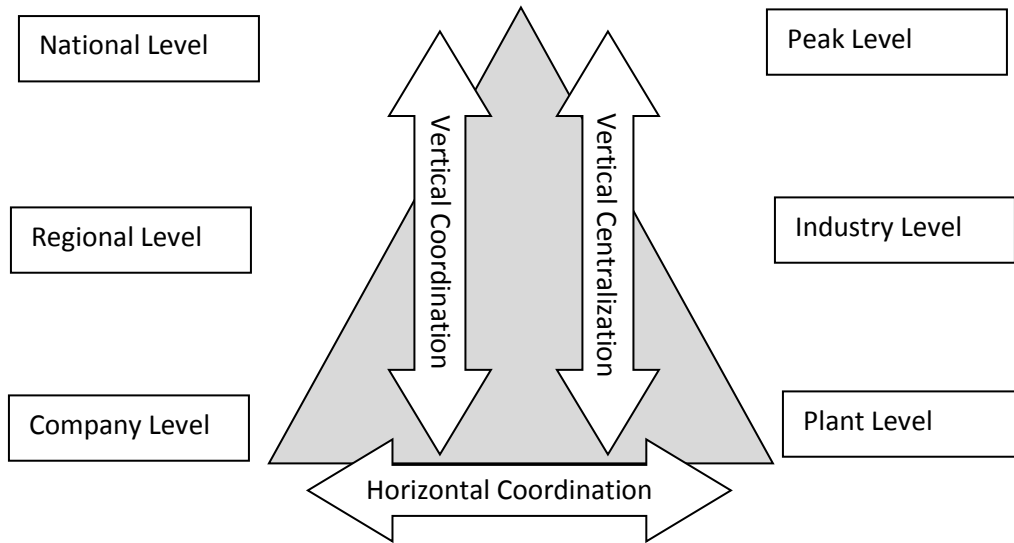
the present institutional arrangement does not appear to be sufficient as wage coordination is determined by qualitatively different institutions in different countries (Lindgren, 2005). The reach different institutions have hence depends less on the degree of centralization but on the signaling power they have over other sectors in the economy.

How the level of coordination is established depends on the individual institutional set up and the power distribution in an economic system. First, coordination can be on a voluntary basis. In this case the wage bargaining units will have agreed upon a system that has become customary though this does not mean system will not change over time. Obviously the reasons for voluntary coordination can differ widely as there is no or only a limited legal framework. Second, through government involvement and specific regulations, coordination may be imposed on the wage bargaining units although the level of involvement and forced coordination can vary strongly. Most often governments will be somewhat reluctant to get directly involved as it may cause political damage (Soskice, 1990), but in case of the breakdown of voluntary coordination it may resort to authoritative measures to achieve macroeconomic goals (Lindgren, 2005). Coordination hence is a complex and perhaps vague concept which is more difficult to determine than the degree of centralization.

3.4.3 Classification of wage bargaining systems

After having established a distinction of coordination and centralization in wage bargaining systems, next an overview of theoretical possibilities shall be introduced bringing both concepts together. The majority of studies focus on the degree of centralization (see Wallerstein and Western, 2000 / Calmfors and Driffill, 1988) while others focus more on coordination (see Traxler et al. 2001 / Soskice, 1990). Regardless of their focus most authors do consider both centralization and coordination, but the distinction is not always very clear. Over the years the importance scholars have given the degree of coordination has increased (Lindgren, 2005) though there is an ongoing debate on this topic. Before moving one it might therefore be helpful to bring both concepts together to see how they influence each other and which impact they have on an the wage bargaining system in a country. Figure 2 aims to illustrate the possible interactions of centralization and coordination and the number of bargaining units involved.

Figure 2. Levels of coordination and centralization



Source: own diagram based on Traxler (2003), Moene, Wallerstein and Hoel (1993), and Hartog, Leuven and Teulings (2002)

The diagram shows that the number of wage bargaining units decreases the higher the level of bargaining is (peak or national level). Most often peak level bargaining will also be on the national level, but it is still helpful to keep the geographic distinction in mind. It again should be stressed that the conditions of centralization influence the degree of coordination but in no way is it dependent on it as will be shown below. Overall coordination depends on the specific constellation and role of the wage bargaining units at different levels (horizontal) and how their influence transmits throughout the economy (vertical). In other words horizontal coordination refers to how bargaining units interact with each other while vertical coordination measures the impact on the economy (Traxler, 2003). To large extent wage coordination is a behavioural concept (Kennworthy, 2001) which means that similar degrees of centralization do not need to lead to similar coordination scores.

The type of economic system will influence the wage bargaining system and its degree of centralization and coordination. The wage bargaining system can only function within the institutional framework and systems lacking adequate institutions facilitating centralization and/or coordination will find its implementation difficult. Economies hence need to assess policies which are compatible with the prevailing institutional scaffolding (Culpepper, 2001). Following this line of thought Iverson (1999) notes more liberal market economies lack the strategic capacity needed for coordination. In analyzing coordination and centralization of wage bargaining systems it is hence essential to understanding the underlining economic system which sets the conditions for the institutional framework and influence what kind of wage bargaining system can evolve.

For wage bargaining to take place at a certain level, unless it in an atomistic structure, there obviously must be the appropriate organizations present representing employees and employers. These organizations mostly are representative bodies with membership on a

voluntary basis, meaning that membership cannot be forced upon them (Crouch, 1993) reflecting that its members wish to be represented by the organization. It is further essential that employees and employers have matching organizational structures of their representative bodies. A mismatch would not allow for any useful negotiations at a given level and the degree of centralization would be limited by this factor. Hence, the less organized the employers and employees are the more fragmented (low centralization) the wage bargaining units will be. Few wage bargaining units participating needs to be reflected in the organization of the representative bodies for employers and employees. The resulting degree of centralization will then set the basic conditions for the possible level of coordination. However, and this is a common misconception, the degree of centralization does not need to dictate the level of coordination.

Higher fragmentation and a higher degree of centralization results in less strategic capacity (Iversen, 1999) making it more challenging to overcome coordinating institutions (Golden, 1993). This should however not be mistaken for evidence that centralization is a necessary condition for coordination (Lindgren, 2005). Underling this are studies which conclude that that more coordinated wage bargaining is associated with lower levels of organizational representation though they do not offer clear explanations of the observations (see Wallerstein and Western, 2000 / Traxler et al., 2001). This again brings us to the challenges of measuring the degree of coordination. Whereas centralization is an easier concept to conceptualize, it is tempting to use it for analysing wage bargaining mechanisms and to explain levels of coordination. As has been outlined before coordination levels will strictly depend on the institutional framework and hence requires looking at individual details as different systems might be comparable but not equal. Comprehending the economic system as well as the political structures of an economy is therefore mandatory.

There are several different classification and quantification methods for the centralization and coordination with no prevailing definition. Rather than attempting to establish yet another independent approach a summary of the OECD (2004) which produced an overview of the different types of centralization and coordination levels as well as measuring the different degrees will be used (see Table 4). Degree 1 reflects low level of coordination or centralization, while the highest degree is 5. The table demonstrates the theoretical variety for wage bargaining systems especially in the medium range of coordination and centralization levels.

Table 4. Classification of coordination and centralization in wage bargaining systems

Degree	Centralization	Degree	Coordination
1	Company/plant level	1	Fragmented company/plant level
2	Combination industry and company/plant level	2	Fragmented industry and company/plant level with no or little pattern-setting
3	Industry level	3	Industry-level bargaining with irregular pattern-setting / moderate coordination among major bargaining units
4	Industry level with central level involvement	4a	Informal coordination of industry and firm level bargaining by (multiple) peak organizations
5	Central level	4b	coordinated bargaining by peak organization including government sponsored negotiations (tripartite and social pacts) or government imposition of wage contracts
		4c	regular pattern-setting coupled with high union concentration and/or bargaining coordination by large firms
		4d	government wage arbitration
		5a	informal coordination of industry level bargaining by an encompassing union confederation
		5b	coordinated bargaining by peak associations or government imposition of a wage schedule/freeze with a peace obligation

Source: Table based on OECD (2004) overview of various classifications.

In an attempt to bring centralization and coordination scores together Table 5 shows a matrix of the various possible wage bargaining types. While the maximum and minimum degrees (5 and 1) are relatively easy to classify, the levels in between, analogue to the summary in Table 4 above, display large diversity of the institutional arrangements. Hence very different institutional settings may still result in similar scores for coordination and/or centralization levels, while at first glance similar settings may not translate into the expected similar scores as the underlying features may be very different. This is especially the case for measuring coordination which as mentioned above is much more challenging to conceptualize.

Table 5. Two dimensional classification of wage bargaining systems

		Centralization			
		Degree	High (5/4)	Medium (3/2)	Low (1)
Coordination	High (5/4)	HH	- Few Bargaining Units - High Influence Score: 8-10	HM - Medium number of wage bargaining units - High Influence Score: 6-8	HL - Many Bargaining Units - High Influence Score: 6-5
	Medium (3/2)	MH	- Few Bargaining Units - Medium level of influence Score: 6-8	MM - Medium number of wage bargaining units - Medium level of influence Score: 4-6	ML - Many Bargaining Units - Medium level of influence Score: 3-4
	Low (1)	LH	- Few Bargaining Units - Low Influence Score:5-6	LM - Medium number of wage bargaining units - Low Influence Score:4-3	LL - Many Bargaining Units - Low Influence Score:2

Note: the abbreviations indicate the degree of coordination (first letter) and centralization (second letter) HH: high/high HM: high/medium HL: high/low MH: medium/high MM: medium/medium ML: medium/low LH: low/medium LM: low/medium LL: low/low.

Wage bargaining system with few bargaining units at the peak level which have a significant degree of influence on subsequent negotiations at lower levels impacting wage development for the economy is a straightforward case of high centralization and coordination. Lower levels of centralization, however, do not need result in lower levels of coordination. For example even constellations with many independent bargaining units are still able to achieve high coordination scores. Although less intuitive such a constellation can arise if certain key companies have significant impact in an economy. In this case negotiations take place at company level (many bargaining units), settlements of these influential companies impact the wage determination process of other players (Hancké, 2002). Regardless of the degree of centralization, wage bargaining systems with high levels of coordination are expected to result in anticipated agreements impacting the entire economy. A few bargaining units follow the pack by providing a benchmark for subsequent negotiations, regardless of the degree of centralization.

The more intermediate systems are typically associated with various forms of industry type bargaining and the relevant flexibility of such a system (Soskice, 1990). Industry level

associations can have a strong signaling effect beyond their industry. They may as well provide some flexibility reaching an industry agreement but allowing individual companies to adjust its wages for its employees after a settlement has been reached (Hall and Soskice, 2004). The lower the degree of centralization and especially the lower coordination becomes, the more fragmented wage bargaining becomes. This corresponds to a lack of influential bargaining units and an atomistic bargaining system in which the individual settlements of the numerous wage bargaining units are too small to have any significant impact on the entire economy (Franzese and Hall, 2000). No unit can expect how the other unit will react in response to any agreement, creating an environment which is difficult to anticipate. This scenario will come closest to describing the market mechanism in finding an equilibrium following neoclassical labor market theory.

3.5 Optimal wage bargaining systems

Similar to when classifying entire economic systems scholars attempt to compare the different wage bargaining systems in terms of their performance on a number of variables. A prominent variable is the relation between wage levels and employment, but also inflation or inequality. It is a daunting task to compare wage bargaining systems and judge how successful they are as economic systems may have different approaches for attaining policy goals. Most importantly they are a crucial part of the entire economic system and policies must function within the given institutional framework. As for economic systems there is no universal dominant, one-size-fits-all wage bargaining system which can be introduced everywhere yielding the same results. The following shall provide a brief overview of the academic discussion regarding optimal wage bargaining systems.

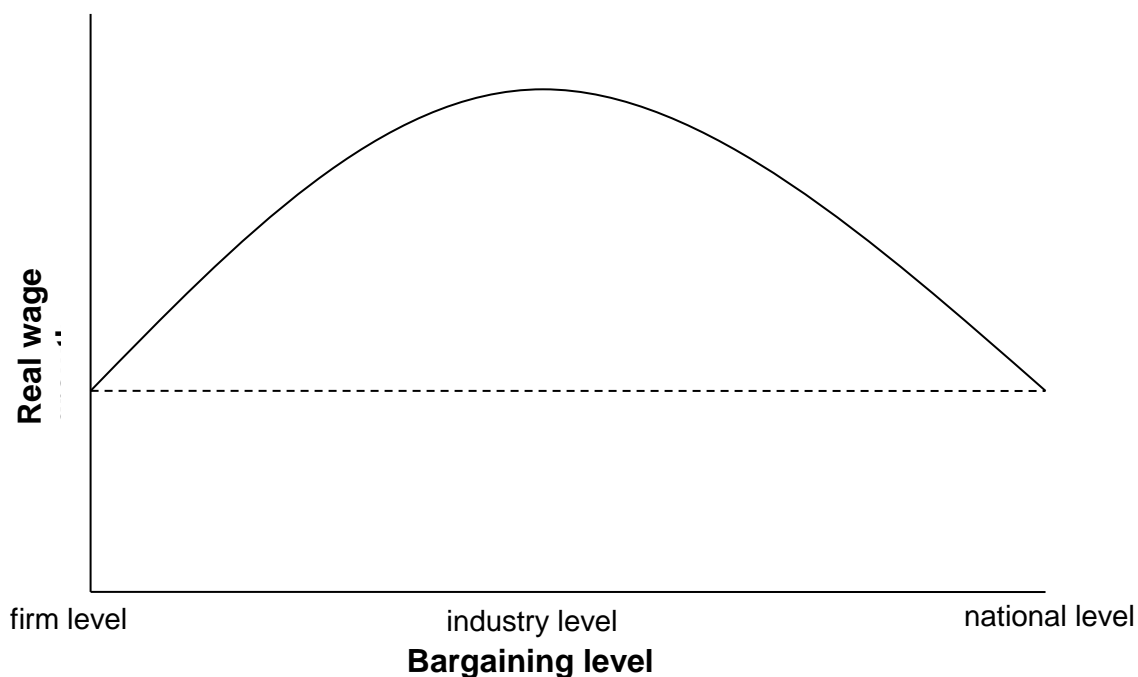
The best know study on the arrangement of wage bargaining systems was conducted by Calmfors and Driffill (1988), stimulating a broad academic discussion and vast literature. The authors establish a relationship between the type of wage bargaining system and macroeconomic performance. Based on empirical evidence they come to the conclusion that highly centralized and highly decentralized wage bargaining systems have a better macroeconomic performance than moderately centralized systems, most notably industry level bargaining.²⁸ Their theoretical model considers the role of unions and the level at which they are organized.²⁹ The theoretical approach introduced takes into account the institutional setting but it is dominated by the degree of centralization and finds its foundation in neoclassical theory. A central point in the debate is the relationship between real-wage restraint and lower unemployment (see Bruno and Sachs, 1985 / Newell and Symons, 1987).³⁰ Based on its neoclassical core the Calmfors-Driffill hypothesis claims that wage bargaining systems with high and low levels of centralization result in wage moderation and subsequent better employment compared to intermediate systems (see Figure 3).

²⁸ Though the authors do call it centralization, they did take coordination into account though it has a less important function in classifying countries. Specifically they looked at coordination within national trade unions and national employers association as well as the number of additional “central” trade unions and employer associations and the cooperation between them.

²⁹ Assumptions of the model are that all workers are union members, fixed capital stock, closed economy, goods are produced for final consumption with no intermediate goods. The model further does not consider effects on inflation or the reaction of wages during shocks.

³⁰ This follows the standard neoclassical negatively sloped labor demand curve.

Figure 3. Level of wage bargaining and effect on real wage increases in the Calmfors-Driffel model



Source: based on Calmfors and Driffill (1988).

Under the assumption of monopoly unions, unions set the wage rate, while companies set the price for their products. Hence the bargaining units' decisions depend on that of the other bargaining unit. The desire of monopoly unions with high centralization to demand higher wages is balanced by the assumption that this would also increase prices for goods workers consume, resulting in some form of wage restraint (Driffill, 2005). Similarly at the company level the wage bargaining units are price takers and under the model's assumption of perfect competition in a closed economy, which in effect has the same restraining effect as a high level of centralization. Industry level wage bargaining on the other hand gives less incentive for wage moderation as wages are simultaneously adjusted across industries producing similar products, allowing companies to shift wage increases on to consumers. The main argument therefore is that high levels of centralization result in wage restraint as trade unions fear unemployment and restrictive monetary policy due to high inflation. While at low levels of centralization, trade unions fear too high wage adjustments threatening the competitiveness and survival of companies. Following neoclassical theory in both cases this translates into a direct relationship between low wages and high employment.

The Calmfors-Driffill model is based on the assumption that other labor market institutions including social security, education and training, taxes, the structure of human capital, as well as labor law including employment law protection are held constant and are regarded as an exogenous variable (Driffill, 2005). Under these assumptions the model's prediction of the humped-shaped relationship between the level of centralization and economic performance has been observed in numerous studies (Calmfors, 2001). Recognizing that wage bargaining

has a clear effect, empirical results seem to suggest that many factors influence employment and economic performance while noting that high coordination also make a positive contribution (Driffill, 2005). The Calmfors-Driffill model has made major contributions in understanding the effects of wage bargaining structures, though it has also shown that the complexity of wage bargaining systems embedded in an institutional framework of an economic system is not easily to conceptualize in a theoretical model applicable to all kinds of different economic systems.

A major criticism of the Calmfors-Driffill model has been that it did not correctly classify countries for the empirical research. Soskice (1990) notes the issue pertaining to the distinction between centralization and coordination (see section 2.4) by pointing out that some countries with low centralization in fact achieve high levels of coordination. In his paper Soskice outlines the complexity of coordination in different countries and argues that coordination in fact is more crucial for a wage bargaining system than is the degree of centralization. This conclusion may suggest that whenever the degree of coordination is high, the degree of centralization becomes less relevant. In line with this the author is highly critical of decentralized systems and does not see clear evidence universally disapproving intermediate systems at the industry level.

Effective coordination therefore can occur in highly centralized bargaining systems but may equally occur in highly concentrated wage bargaining at the industry level or through pattern bargaining at the company level as long as they are coupled with sufficient institutional national linkages which allows the settlement to transmit throughout the economy (see Franzese and Hall, 2000 / Iverson, 1994 / Golden, 1993). Soskice (1990) further broadens the view on wage bargaining systems beyond employment and economic performance to take on a view which includes more components of the economic system by establishing an effect on training and skill levels. He points out that systems with greater employment security will be less prone to see short-term income maximization and take on a more long-term view of wage bargaining.

The prevailing wage bargaining systems in an economy is strongly impacted by its economic system. On the macro level, that is the structure of wage bargaining and the general position of labor, is influenced by fundamental differences on the micro-level pursued by employers (Thelen, 2001). Liberal market economies tend to rely more on labor market flexibility and are more prone to engage in more decentralized wage bargaining systems at the plant level (Boyer, 1988). Decentralization is often accompanied with weaker roles of unions and employer association which may further have negative consequences on the level of coordination. Coordinated market economies on the other hand, even if they have been in the process to attain greater flexibility, have been more resilient to changing their wage bargaining system due to the embeddness of institutions, are more likely to have a higher degree of labor stability and greater cooperation in industrial relations (Streeck, 1991).

Greater stability leads to what Estevez-Abe, Iverson and Soskice (2001) refer to as “wage protection” which reduces the risk of wage levels dropping dramatically and encourages investment in employees to acquire specific skills. The authors further point out that wage bargaining systems with these kind of features tend to result in wage compression and prevent poaching between companies as higher coordination limits the ability of individual firms to pay significantly higher wages. Calmfors-Driffill focus on wage restraint in their model, a more common feature of more flexible market oriented systems of production, but they do

recognize that higher levels of decentralization lead to greater wage dispersion and note that optimal wage bargaining systems need to take relative wage into consideration as well (Calmfors, 1993). The relationship of higher wage dispersion and higher decentralization has been established by numerous authors (Freeman, 1988 / Flam, 1987 / Rowthorn, 1992). Calmfors (1993) further notes that higher coordination also results in reducing inter-regional imbalances which is a central policy target for many governments.

However, as Driffill (2005) notes wage compression may also result in problems in recruiting higher skilled workers or may be responsible for worse employment conditions of the low skill sector (Davis and Henrikson, 2000). Higher degree of coordination has been found to have positive effects on macroeconomic performance though it also depends on the specific economic situation (OECD, 2004) which again makes a strong point for the non-existence of universally superior systems.³¹ Performance may vary considerably and depends on the context in which it is functioning (Traxler, 2003). As for macroeconomic performance it cannot be said that a particular form of centralization or coordination will always result the same positive outcomes. In some situations a given wage bargaining system may show good macroeconomic performance, though when facing a different set of economic variables its performance may deteriorate compared to that of other systems. This can be seen in the different performance of labor markets in the US and Europe during different time periods as noted above.

Economic systems which engage in different forms of collective bargaining usually tend have higher degrees of coordination (see Blau and Kahn, 1999 / Aidt and Tzannatos, 2002), though of course the specific frameworks for collective bargaining systems vary considerably (see Traxler et. al., 2001 / Kenworthy, 2001). It is widely noted that higher coordination and collective bargaining can reduce the volatility of wages by bringing a diverse income group together in the decision making process (Estevez-Abe, Iverson and Soskice, 2001). Compared to more market oriented systems with less coordination among the bargaining units but also in combination with accompanying monetary policy, such an institutional framework acts as a nominal wage anchor effectively reducing the volatility of nominal wages and price levels (Heise, 2005). Though other conclusion such as the effect of wage bargaining systems on employment do not always show the same results, there seems to be a consensus that higher degrees of coordination has a positive effect on inequality.

It may be futile to engage in a discussion on which wage bargaining system is overall superior. As has been noted above (see section 1.4) economic systems and wage bargaining systems will yield different outcomes depending on the specific economic situation. No system will show equally positive results for all situations and the variety of systems will have diverse benefits and drawbacks. Also more than 20 years after the Calmfors-Driffill hypothesis was introduced there are examples for and against their theory, demonstrating that it is more than difficult to obtain robust data on measuring the effectiveness of economic systems (OECD, 2004). If wage bargaining and its influence on employment and economic performance were isolated from the remaining economic sphere including the political and social sphere, perhaps it would be possible to determine an optimal institutional setting for the determination

³¹ The paper mentions research which found that wage bargaining systems with higher degree of coordination performed well in the 1970s and 80s, but less well in the 1990s.

of wages utilizing econometric models. Consequently it is a big challenge to quantify wage bargaining institutions across countries by modeling them and benchmarking their effects on economic performance as it is not only economic goals which are being pursued. That is not to say that individual analysis cannot provide for a better understanding of an economic system, it just underlines the necessity of taking the potential pitfalls into account. Despite these limitations Calmfors and Driffill (1988) must be credited for triggering an academic debate that continues to this day.

3.6 Theoretical limitations for rapidly emerging economies

The emphasis of the Calmfors and Driffill debate has been advanced economies in the Western world with the only exception being Japan. Hence applying the theoretical principles to developing and transitional economies faces some additional obstacles. Before turning to the theory of the Keynesian labor market in the next chapter, followed by specific country examples of rapidly developing Asian economies which are the focus of this research, it is worthwhile to highlight some overall theoretical limitations and conflicts in this context. In the above section it has been established that the main debate initiated by Calmfors and Driffill foremost follows the neoclassical paradigm with the firm as the basis of analysis although it attempts to include elements of other paradigms. However, as other debates trying to embrace a variety of theories have shown, they will attempt to force the underlining theory into the dominating paradigm while only making partial adjustments. As a result the debate is not enough paradigms oriented and tends to blur between various paradigms.

In line with the neoclassical paradigm the approach by Calmfors and Driffill focuses more on the relationship between wage and employment levels and less on macroeconomic functionality. Accordingly wage bargaining systems with institutions only encouraging wage moderation conflict functional wage bargaining within the Keynesian paradigm. Specifically, by limiting the analysis to the relationship between wage and employment levels, the approach conflicts the wage norm (see section 3.2) and effects on price levels. In line with the neoclassical approach it is also not clear whether the debate analysis real or nominal wages. In addition the approach of the Calmfors-Driffill debate does not consider effects of falling wages level and rising inequality (Heine, Herr and Kaiser, 2006). The theoretical debate, despite its valuable contributions, lacks the ability to clearly evaluate wage determination mechanisms.

Applying the theoretical debate of wage determination systems on developing and transitional countries then faces additional limitations. By focusing on advanced economies the debate on wage bargaining systems started by Calmfors and Driffill neglects many variables which less developed economies face during their transition. Similarly as the institutions of today's advanced economies had to develop over the past 150 years in response to the industrial revolution, massive economic crises, or wars, today's developing nations need to establish their institutional framework as well. It should also be noted that Western capitalism developed when capitalism itself was at a different development stage (Nölke, 2011). Simply applying models following a unilateral approach does not take this into account. As the examples of the Asian Tigers will demonstrate in section 4.1, it seems to be an oversimplification to credit neoclassical policies with all the credit of achieving rapid economic growth. State intervention from authoritarian regimes was used not only to develop the economy but also dismantle old institutions as well as to create new ones. Over time a new

economic system with national wage determination systems was established. An underlining assumption of the Calmfors-Driffill model is that many labor market institutions including social security, education and training, as well as the labor law are held constant. The underlying institutional framework therefore is considered as a fixed variable and not compatible with the situation in emerging economies.

At some point of economic development governments are at the critical crossroad in determining how to change the institutions in a way to adapt to the new social and economic circumstances. An important element in this transformation is industrial relations and how wages are bargained for. It also includes being faced with a more dynamic macroeconomic environment, making the establishment of functional wage bargaining ever more important. Hence the overall situation is much less stable than in advanced economies and efforts to establish labor market institutions, including better employment protection and education become more important. Amplified by, in comparison to the development in advanced economies, condensed development time period, the changes within the economic system are far more dramatic. By neglecting the necessity of institutional change this assumption faces severe limitations in general, but especially for the complexity of emerging economies.

Next to market mechanisms a mix of high degree of centralization of power, authoritarian repression and collusion with conglomerates (Biggart, 1991) during some phases of the development of developing countries was a very distinct difference compared to the current situation in advanced economies under democratic regimes analyzed by Calmfors and Driffill. Whereas the Calmfors-Driffill debate focuses on the firm level, the political dimension is only at the sideline. The strong influence of the government in shaping the evolving economic system's institutional framework and its interpretation of industrial relations hence needs special attention. As the examples of the Asian Tigers and China will show, the political dimension becomes much more important and must be considered when analyzing what kind of wage bargaining systems evolve under the institutional setting. Though governments in democratic systems will also adapt the institutional structure to maintain its power base, the pressure for change for authoritarian regimes is much greater.

That is not to say that the prevalent economic system still has significant impact on what kind of wage bargaining system will be implemented. With relatively weak unions and employer associations but a strong consent between government and businesses interest, enterprise level wage bargaining the Asian Tigers appear to have many features typical for more liberal labor market (see section 1.4.1 and 4.1). As for wage bargaining systems a common challenge in classifying them are different approaches to categorizing the degrees of centralization and coordination (see section 2.4.3). According to Soskice (1990), the degree of coordination is much more relevant to establishing functional wage bargaining compared to the degree of centralization. Identifying the institutional framework underlying coordination is however far less straightforward and requires detailed analysis. For instance institutions inducing wage restraint in the Calmfors-Driffill debate fits to wage bargaining mechanisms in flexible market oriented systems embedded in a liberal economic system, but it is difficult to derive identical conclusions appropriate for the circumstances in advanced economies compared to an environment of rapid economic growth as for example the Asian Tigers experienced. In successful expanding economies in Asia, economic growth was accompanied with rapidly growing wages levels.

The Calmfors-Driffill debate is more suitable for relatively established economic systems in advanced economies, although there too it faces limitations as the scope of analysis appears too narrow. For fast developing nations with a volatile institutional structure it is ever more important to include the underlying economic system while considering how it is changing. Economies which are catching up and rapidly developing will experience different challenges as they do so and will need to make different tradeoffs during different developmental phases. There is neither a dominant economic system nor a wage bargaining mechanism which will result in the same outcome. Much more it depends on the individual constellation and situation of the economy. When analyzing wage determination systems in developing and transitional economies it is therefore essential to identify the drivers of institutional change including the political and social sphere to comprehend the effects the implementation of specific wage determination institutions can have. Elements of the Calmfors and Driffill are valuable assets in analyzing wage bargaining systems, but they are constrained by neoclassical understanding of labor markets and the role of institutions. In contrast the theoretical foundations of the Keynesian paradigm are much more open to the importance of wage bargaining institutions as part of a macroeconomic functionality.

4. Ordnungspolitik for a Functional Wage Bargaining Regime

4.1 *The Keynesian paradigm and wage bargaining*

The most fundamental difference between neoclassical and Keynesian understanding of wage determination is that the former assumes that real wages are bargained for while the latter assumes nominal wages are bargained for (Keynes, 1936). Within the Keynesian paradigm nominal wages are determined during the wage bargaining process and not real wages as “these cannot be known until after the worker is paid” (Chick, 1987) as inflation is not predetermined. Another although simplified distinction between the paradigms is that the former has more microeconomic roots assuming a relationship between employment levels and wages while the latter has more macroeconomic roots. As has been outlined above wage determination according to neoclassical theory treats the labor market as a goods market, arguing for a competitive and decentralized wage bargaining system. In such a deregulated neoliberal system wages are determined by market mechanisms, leading to higher income dispersion which affects equality and disposable income. A key argument in the Keynesian paradigm is determined that employment is determined by aggregate demand and not by wages. Wages are recognized for their stabilizing role on overall macroeconomic development. By incorporating the role of social, psychological, political and historic facts, the Keynesian approach provides a framework which has brought economics back into society (Skidelsky, 2010) and clearly distinguishes between the goods and labor market.

Within the Keynesian theoretical framework labor markets are at the bottom of a hierarchy of markets, dominated by the capital market on top as well as the goods market (Herr, 2002). The Keynesian paradigm (see Keynes, 1930) unlike the neoclassical does not argue that wage levels directly and solely determine employment level as in itself the labor market lacks mechanisms for employment effects (Herr, 2008) Within the hierarchy of markets wages have a macroeconomic function, mainly by affecting price level. Wage increases only affect employment in the context of monetary policy targeting inflation or deflation. Wage setting in line with the macroeconomic dimensions of the Keynesian paradigm are open for bargaining within an institutional framework. The theoretical openness is in contrast to the neoclassical outcome of market determined wage bargaining. Neoliberal wage bargaining are more susceptible to contributing to a more volatile macroeconomic environment with risks of cost inflation or deflation as well as affecting the goods market through inequality caused by higher wage dispersion. Although Keynes himself did not clearly outline specific wage determination mechanisms, his macroeconomic approach favors a form of coordination requiring an institutional arrangement limiting market mechanisms and its potential market failures.

Elements of unregulated market mechanisms were common features during the Western industrialization as well as in the industrialization of emerging and developing countries. Some countries might have implemented more neoliberal components in their policy mix, but these then become a source of instability. At a certain point of economic, social and at times political development, market failures induced by neoliberal policies will deteriorate the positive effects of an economic growth model based on unsustainable policies. Herr and Rogall (2011) point out the importance of social safety nets as key elements of democratic systems and that market failures cause instability and inequality threatening the sustainability

of the democracies. Changing wage structures have profound effects on society by the level of inequality they induce (Herr and Ruoff, 2014). This thought is not limited to democracies, but any type of political system (see section 1.4.2). Authoritarian regimes certainly have different tools to their disposal, but once a certain level of economic development has been achieved, often based on liberal economic policies in the labor market mixed with strong government controls as well as policies pursuing rapid and unsustainable growth policies, these regimes were forced to change (e.g. of Asian Tigers, see section 4.1). The underlying argument for this position, as has been outlined in chapter 1, is that neoliberal economic systems do not regulate themselves, leading to unstable economic and social development. Economic policies (*Ordnungspolitik*) create the institutional boundaries for the economy to follow a sustainable development path (Herr and Rogall, 2011) regardless of the political system in place (see also section 2.2).

While keeping in mind that the labor market is at the bottom of the hierarchy of markets, three macroeconomic functions can be derived from the Keynesian paradigm. First, changes to the nominal wage which are out of line with productivity growth create inflationary or deflationary pressure. Price levels are influenced by unit labor costs which decrease with improvements to productivity and increase with nominal wage increases (Keynes, 1930). Increasing unit labor cost of companies, can lead to cost push inflation, threatening a wage-price-spiral. This in return, assuming a non-accommodating position, induces restrictive monetary policy of the central bank by increasing interest rates, which in return has consequences for investment and production. For central banks pursuing an official or unofficial inflation target, this interaction becomes even more important. Productivity oriented wage increases are therefore at the heart of Keynesian wage determination as wage increases in line with productivity increases will not cause inflationary pressure. Such a macroeconomic environment permits for less restrictive monetary policy by the central bank keeping lower interest rates which increases the likelihood of higher investments, growth and employment, though of course it is no guarantee (Herr, 2002). Herr further notes that “income policies can be a force for stabilization only when the other macroeconomic markets are in a stable constellation..... (which) shows (the) limited role of labor markets in the hierarchy of the Keynesian paradigm”.

Second, income inequality leads to insecurity within a society which directly causes instability in the entire economic system. Polanyi (1944) noted market failures in the labor market and the socially undesirable outcomes of the commodification of labor (see also section 1.2). In the Keynesian paradigm the system of wage bargaining is of fundamental importance to the wage structure as “the relative (bargaining) power of different fractions of the working class is of key importance for wage dispersion” (Herr and Ruoff, 2014). Current research mostly agrees that the more unregulated wage bargaining is, the higher inequality becomes. Liberal economic systems are accompanied by a weaker institutional framework setting the preconditions for wage bargaining systems with low levels of centralization and coordination whereas the Keynesian paradigm is associated with higher degrees of both. In order to counter negative consequences of high wage dispersion and inequality, the Keynesian theory can accommodate active wage policies targeting the distribution of wages.

This directly leads us to the third point, that the more unequal income distribution becomes the greater the problems for consumption based on incomes becomes (Dullien, Herr and Kellermann, 2012). High wage dispersion is regarded as a main driver for income distribution potentially affecting consumption demand as higher income groups have a lower propensity

for consumption (Herr and Ruoff, 2014). Herr and Ruoff further point out that high wage dispersion “can become an obstacle for prosperous economic development or even prevent it”. In an empirical study of OECD countries Cingano (2014) found evidence that higher inequality negatively impacts economic growth. Given the substantial importance of consumption as a share of GDP for most economies lower wage dispersion becomes imperative for sustainable economic development.³² Establishing an institutional setting which reduces wage dispersion and inequality is therefore vital for consumption demand growth. Such a development does not automatically develop under neoclassical oriented economic policies which will lack a necessary institutional framework (Dullien, Herr and Kellermann, 2012).

Unregulated markets as the neoclassic model would suggest, eventually lead to market failures and instability. The Keynesian paradigm does not clearly outline a specific institutional structure for an economic system. However its underlining emphasis on macroeconomic stability will require an institutional framework to counter market imperfections. A lack of institutions encourages a dysfunctional labor market with the potential of disrupting macroeconomic stability. The macroeconomic dimensions of Keynesian wage determination therefore entail an institutional framework to facilitate functional wage setting.

Table 6. Macroeconomic effect of weak institutions on price level, demand and wealth gap

	Price levels	Inequality	Consumption demand
Macroeconomic cause	Wage developments out of line with changes in productivity and inflation	High wage dispersion due to differences in bargaining power	Unequal income distribution and lower propensity for consumption by higher income groups
Macroeconomic consequences	Risk of increasing inflation and deflation pressure	Changes in wage structure of the society with a large low-wage sector	Lower consumption demand and less sustainable economic development

The three macroeconomic effects summarized in Table 6 are a consequence of a lack of strong institutions reinforced by a resulting uncoordinated and decentralized wage determination process. The weaker the institutional framework in the economic system is, and for the purpose of this research specifically the wage determination process, the more important coordination and centralization with all the outlined macroeconomic consequences will become. To counter these consequences an institutional framework must be implemented which can “provide for the economic preconditions for a good society based on stable growth, equality and sustainability” (Dullien, Herr and Kellermann, 2012). One of the underlining results of a weak institutional framework are company based negotiates confined to the

³² Consumption in economies with high levels of wage dispersion and inequality is possible, but it is likely to rely on credit. As the example of the financial crisis 2008/9 has shown, this is cannot be regarded as a sustainable development.

microeconomic logic of individual companies. Lacking extension mechanisms the subsequent wage agreements are unlikely to go beyond individual company motives. By focusing on individual needs overall macroeconomic conditions will not be taken into consideration.

In absence of coordinating institutions, the macroeconomic risks of unstable price levels, increasing inequality and weak consumption demand increases. To counter such effects in order to achieve a more macroeconomic based wage determination in line with the Keynesian paradigm requires an appropriate institutional framework. Such a framework is however unlikely to establish itself under unregulated market mechanisms as the neoliberal framework would oppose market intervention. To be implemented it must be imposed on the market as can be observed in more balanced economic systems (Streeck, 1998). Controlling market mechanisms through legislative and fiscal methods as well as the utilization of coordinating institutions (see Table 3) requires a targeted economic policy (*Ordnungspolitik*) associated with forming the economic system and the resulting wage determination mechanism. The Keynesian paradigm is far more open to various forms of interventions by the state limiting market failures and by taking on a more macroeconomic approach to economic issues. Driven by the overall macroeconomic impact of wages on price level, inequality and consumption demand, Keynesian *Ordnungspolitik* emphasizes greater significance to institutions in the wage determination process. Strengthening the levels of coordination as well as centralization is fundamental to establishing the necessary institutional framework for productivity oriented wage increases in line with the macroeconomic dimensions of the Keynesian paradigm.

4.2 Defining functional wage bargaining

Different schools of economic thought define a variety of wage determination systems able to achieve functional wage developments. However, determining functionality based on market driven income and employment levels does not take into account the broader role wage determination systems have on the economic system. Typically neoclassical definition of functionality strictly focuses on the relationship between wages and employment levels, discounting the greater scope of wage bargaining.³³ Functional wage determination derived from the Keynesian paradigm needs to achieve stable price levels, limit inequality, and facilitate consumption demand. All of which in a way are interdependent with each other and have a macroeconomic effect on the overall economy.

It is not the aim to enter a debate on functional labor markets or what constitutes functional wage determination. Much more the Keynesian approach to functional wage determination shall be outlined and used as a foundation of this research. As has been argued above, within the Keynesian paradigm functionality requires labor market institutions, recognizing that the market is mostly inadequate to achieve a stable macroeconomic and social development. For the purpose of this research functionality will focus on the role wage determination has as a wage anchor for macroeconomic stability and its role as an instrument of reducing inequality though both are related. A weak institutional framework in the wage determination system, yielding mostly to market mechanisms, makes economic systems more susceptible to market failures. The negative macroeconomic impact of uncoordinated wage bargaining may still allow ways to control or limit the overall impact on price levels and demand through a mix of

³³ A key concept in this relation is that of marginal productivity.

monetary and fiscal policies. However, it is nearly certain that the weak institutions and uncoordinated wage bargaining result in higher inequality. This in itself creates a danger, unless this inequality is culturally accepted, of threatening the functionality and sustainability of the entire national economic system as social mobility is reduced and elites become increasingly entrenched.

A cornerstone of Keynesian wage determination with macroeconomic functionality are wage increases according to changes in price levels and productivity as well as limiting inequality in the wage structure (Herr, 2009b). This approach concerns itself with limiting large fluctuation of wages in times of high or low employment, creating a wage anchor against inflation or deflation (Heine, Herr, and Kaiser, 2006). Unlike neoclassical theory this echoes the greater influence wages have on price levels than on employment (Keynes, 1930). Functional wages are hence defined as inflation target plus trend productivity³⁴: $w^* = i + \Delta p$. If for example the inflation target (i) equals 4% and trend productivity increases (Δp) by 3%, nominal wages (w^*) may increase by around 7% following the productivity oriented wage theory in the Keynesian school of thought (Herr, 2002). Creating necessary labor market institutions is a prerequisite of any such productivity oriented wage determination which goes beyond the interests of individual employees or companies.

Influential wage bargaining units provide the central bank, which is independent in most industrialized countries, a clear communication channel through which it can directly signal its response while monitoring negotiations. The institutional arrangement helps to create a relatively homogenous environment, where consequences can be anticipated to a greater degree. The multiple interactions between the institutional arrangements are a strong demonstration that economic developments, in this case specifically inflation, monetary policy and wages, do not depend on just one single institution but “on the broader configuration of the set of relevant institutions and structures characterizing the political economy” (Franzese, 2001). In a more atomistic wage bargaining system achieving this kind of functionality is much harder to achieve.³⁵

Wage bargaining systems additionally have a direct effect on wage dispersion, a major reason for inequality in a society. Generally it can be stated that the less coordinated wage bargaining is the higher wage dispersion will be. A key reason for this outcome is the lack of an institutional framework as has been illustrated above. In spite of the many differences in opinion there is a consensus on the positive effects institutions associated with higher degrees of coordination have on reducing wage dispersion and effectively inequality. Because societies have different tolerance levels for inequality it makes it challenging to quantify functionality of wage bargaining in this regard. Despite the individual differences, inequality is an important component which needs to be taken into consideration when analyzing the functionality of wage bargaining systems. Stabilizing the wage structure is an essential element to controlling inequality but it also has broader consequences for macroeconomic stability. Increasing the rigidity of wages by creating a wage anchor at the expense of flexible wages has a stabilizing function not only on inflation (Herr, 2002). By reducing wage

³⁴Wage developments are only one component of an economic regime and inflationary pressure will further be influenced by foreign trade, currency value, fiscal and monetary policy (see Heine, Herr, and Kaiser, 2006).

³⁵ Institutional arrangements giving incentives to the bargaining units to cooperate may be helpful in achieving favorable macro-economic environment (Heise, 2005).

dispersion and subsequently inequality, a productivity oriented wage policy following the wage norm should contribute in strengthening consumption demand.

Table 7. Establishing functional wage bargaining through *Ordnungspolitik*³⁶

Institutional framework	Ordnungspolitikal effect
High level of centralization	Peak level bargaining taking macroeconomic issues into account
High level of coordination	Strong reach of collective agreements throughout the economy
Bargaining following the wage norm	Wage increases according to trend productivity and inflation targets
Labor market and income policies	Limit wage dispersion, create wage floor and implement redistribution policies

In conformity with the Keynesian paradigm and in contrast to the neoclassical model strengthening, labor market institutions are an important element in establishing functional wage determination defined as above. Establishing *Ordnungspolitik* constraining market mechanisms are hence crucial (Herr and Rogall, 2011) in creating the necessary institutional framework for functional wage bargaining, limiting a complete deregulation and market dominated system of wage determination (see Table 7). In contrast the paradigm would argue for stronger labor market institutions, shifting the level of wage determination away from an atomistic structure in favor of a system with a higher degree of centralization and especially coordination. Organizing labor unions and employers associations at the peak level and equipping them with sufficient political support to increase coordinated wage bargaining are key elements (Herr, 2009b). In extension *Ordnungspolitik* also encompasses labor market regulations targeting income inequality and redistribution policies (Dullien, Herr and Kellerman, 2012).

4.3 Institutional foundations of functional wage bargaining

As has been demonstrated above, economic systems come with great variation in terms of its institutional framework as well as society's expectations. Given the sophistication of economic systems there are many ways to organize the wage bargaining system. The institutional framework will determine the position of market mechanisms, associations as well as the role of the government (see section 2.3.4) all of which of course are connected. First, implementing institutional constraints on market mechanisms does not imply its complete absence. It has been acknowledged by Keynes that there are different degrees of bargaining power with some type of employers in a better bargaining position than others (Keynes, 1936). The institution's aim however is to reign in on uncoordinated laissez-faire wage determination by rebalancing bargaining power. Second, the government, through its legislative power, has significant power to influence wage bargaining mechanisms directly and indirectly. Most of all its political will is possible the utmost important component in achieving greater a functional wage bargaining by strengthening institutions. Lastly, the organization of employees and

³⁶ Own table based on Heine, Herr and Kaiser (2006).

employers and their relevant position will directly determine the level at which wages are determined (degree of centralization) and how agreements transcend (level of coordination) through the economy.

Depending on the roles of the various labor market institutions within a national economic system's wage bargaining mechanisms (see Table 3) significantly different systems can evolve. This debate also highlights the importance of clearly distinguishing between the level of centralization and coordination (see section 2.4) when comparing different wage bargaining systems. As has been pointed out earlier, it is the level of coordination which dominates over the level of centralization though both complement each other. However, the higher the level of centralization is, the more likely the level of formal macroeconomic coordination will be.

The then established wage bargaining system is an important component of economic systems with extensive interaction with other institutions. Industrial relations and outcomes of the wage determination process influence wages and equality, influence employment patterns, domestic consumption, the industrial structure and national competitiveness, and through its impact on price levels, affects monetary policy and interest rates with far reaching effects for the overall economy (see also chapter 3). Classifying wage determination systems is however a challenging task and some research is inclined to jump to conclusions especially if the basis of analysis is the direct relationship between wages and employment as the neoclassical model would suggest. For example, compared to labor markets regulation in Anglo-Saxon countries, European regulations have often been attributed to result in a persistently high unemployment rate (Cabellero and Hammour, 2000). However, this evaluation has had a stronger argument in the 1990s and 2000s.

In the direct aftermath of the financial crisis starting in 2008, unemployment rates in Europe performed similar or in some cases better than in the US. The change in evaluation illustrates that the institutional matrix of labor markets is relevant in understanding how, e.g. employment and wage, react under a certain economic situation and time. There is abundant literature on classifying wage bargaining systems in advanced economies (see OECD, 2004 / Kenworthy, 2001 / Nickell and Nunziata, 2001 / Hall and Soskice, 2001/ Hollingsworth and Boyer, 1997). In this context it needs to be recognized that there is no overall accepted superior characterization of wage bargaining systems. Taking the sophistication of the institutional arrangements into account, any quantifiable comparison of different indicators of the degrees of centralization or coordination becomes very challenging (Schettkat, 2003). However, some countries are consistently classified in similar ways, while others are classified differently depending on the approach used.³⁷

One of the most comprehensive overviews of classifying wage determination systems has been conducted by Kenworthy (2001) who based his summary on approaches utilized by other researchers (see for example Traxler, Blaschke, and Kittel, 2001 / Iversen, 1999 / Golden, Lange, and Wallerstein, 1997). Kenworthy identifies four sources of coordination: bargaining centralization, state-imposed centralization, informal centralization, and pattern-setting. This is similar to the classifications used by the OECD (see Table 4), although the

³⁷ For example there have been different categorizations been made for Japan's wage determination mechanisms. Calmfors and Drifill (1988) classify it as decentralized while Soskice (1990) classifies it as coordinated.

distinction between centralization and coordination can lead to confusion. As has been pointed out above, low levels of centralization can still achieve high levels of coordination with the support of extension mechanism through strong informal coordination and pattern-bargaining.

Classifying countries' wage determination systems is easier when the level of formal coordination and centralization is either high or low. The stronger informal coordination or pattern bargaining becomes the greater the ambiguity becomes (Kenworthy, 2001). Table 5 shows that low levels of centralization can be compensated by high levels of coordination increasing the overall coordination score of the wage bargaining system. Low levels of coordination cannot be compensated by higher degrees of centralization alone as it basically implies that the high degree of centralization has no power to implement any agreements throughout the economy. With abundant classification methods in place, it is not the aim to introduce an alternative approach for classifying wage determination systems. However, after this more general overview of wage determination systems in the developed world, the following section will attempt to identify specific institutional settings of wage determination mechanisms observable in a variety of advanced and developing economies (Chapter 4). This should also contribute to a better understanding in identifying coordination and centralization mechanisms. Starting with systems with low levels it will continue to systems with increasingly higher levels in advanced economies. The aim here focuses on identifying mechanisms facilitating the degree of coordination and centralization and not necessarily to get an accurate picture of how wages are currently determined in these countries.

4.4 Wage determination systems in developed countries

Anglo-Saxon countries consistently are classified with low levels of centralization and coordination. Representative of these countries, the US wage bargaining process is strongly atomized and uncoordinated at the same time (Ganßmann and Haas, 1999). Labor unions and employer associations are relatively weak when it comes to wage determination.³⁸ Historically employers are rather reluctant in accepting collective bargaining and unionization and industrial relations between the representative bodies tend to be hostile. As a result collective bargaining only plays an important role for certain sectors. For example the automotive industry engages in more centralized wage bargaining with some form of coordination across the industry (Lange, Wallerstein, and Golden, 1993). However, overall wage bargaining has strong neo-liberal roots and can be attributed to a set of political and political-economic conditions as well as the American mentality of individualism. A minimum of formal (e.g. minimum wage, labor laws etc.) coordination mechanisms exist next to more informal arrangements, but these generally are very weak. This picture is consistent with classifications of British, Australian or Canadian wage bargaining.

Despite having a low degree of centralization with theoretically many individual wage bargaining units, other countries' economic systems achieve higher levels of coordination through informal means. Japan for instance has low level of centralization, similarly to that of the US, but coordination similarly to that of Germany. Whereas Germany's wage bargaining system is coordinated in a formal context of trade unions and employers' associations, the

³⁸ Unions and especially employer associations do exist, but their role is stronger comparable to that of an interest group trying to influence politicians.

Japanese model achieves its coordination through wage settlements conducted by management, worker's as well as government representatives at a small number of dominating and influential companies (zaibatsus) which form quasi wage cartels influencing outcomes at other companies throughout the economy (Soskice, 1990). The Japanese wage bargaining has been synchronized in all areas during the so called Spring Offensive (shunto) further contributing to informal coordination (Dore, 1987).

France too lacks clear formal institutions for centralization or coordination but achieves a form of informal coordination by mixing a quasi-pattern bargaining (Kenworthy, 2001) with government influence. The influence of large nationalized industries in France "has dominated the economy and the wage setting-process" (Soskice, 1990). Employer and employee representations in French industrial relations are divided with several organizations representing their constituency on a national level and several strong unions in the public sector (Vigneau and Sobczak, 2005). The agreements establish a form of quasi-pattern bargaining which effectively translate into extension mechanisms for a general minimum standard which then however leaves individual enterprises, which are technically not bound by the agreements, with a high degree of autonomy for the individual details (Ferner and Hyman, 1998). Additionally, with minimum wage levels relatively high compared to average income, minimum wage legislation directly influences wage setting (Bazen, 2000 / Traxler and Kittel, 2000). In the French case, generally identified with a strong role of the government, within the coordination efforts in the wage bargaining system the government also plays a vital role in setting wage levels (Vigneau and Sobczak, 2005).

Germany on the other hand has stronger formal institutions with relatively powerful representative associations. German wage bargaining units engages in a wage determination system which has a higher level of centralization and coordination with wage bargaining taking place primarily at the (regional) industry level and secondarily at the company or plant level (Soskice, 1990). Due to strong national representative bodies at the peak level, regional agreements (pilot agreements) transmit across the economy on a national level, increasing the level of centralization and formal coordination. Employers' associations organizing companies at the national level (DGB) as well as the accepted influence of regional agreements by the IG Metal extend through different industries nationwide. Aware of its far reaching impact, the labor union is forced to conduct its wage bargaining in a macroeconomic context, which is further strengthened by the DGB representing a wider share of employers including blue and white collar workers in the private and public sector which contains any competitive bargaining (Streeck, 1994). This constellation has been supplemented by extension laws allowing collective agreements to extend to non-union companies (Kenworthy, 2001). Since the 1990s the German wage bargaining system however has been transforming in which the reach of institutional agreements has been reduced. By weakening extension mechanisms of bargaining agreements this has effectively contributed to establishing a dual labor market.

Without going into too much detail, identifying some key coordinating elements of Scandinavian wage bargaining seems useful to highlight the institutional variety found in wage bargaining systems with medium to high levels of centralization and coordination which is especially prevalent in Europe. Denmark, Finland, Norway and Sweden all scored relatively high on coordination, although over the past years there has been some deterioration of the

high degree of centralization and coordination (see summary of Kenworthy, 2001).³⁹ Based on the summaries of several authors (Lange, Wallerstein and Golden, 1993 / Martin, 1995 / Regini, 2000 / Golden and Wallerstein, 1994 / Ferner and Hymann, 1998) the following coordination mechanisms can be identified. The direct influence of peak level labor and employers' representative bodies has declined and for the most part bargaining is referred to. However, the Scandinavian system in the past and to some degree still has elements that mix national bargaining with industry wide bargaining. Peak level organizations negotiate recommendations, although these are usually non-binding, to provide a general basis under which lower levels can then negotiate wages. In the case of Denmark and Finland wage bargaining takes place in a tripartite setting giving the government the power to impose wage schedules. Lastly, in Denmark and Norway wage bargaining is synchronized according to a schedule (typically every 2 years) during which all bargaining takes place. Similarly to Germany a formal institutional framework with peak level organizations does exist, while the role of the government is in part stronger.

One country which has been consistently attributed with high levels of coordination has been Austria. According to Kenworthy (2001) and Traxler and Kittel (2000), the country's wage determination system was dominated by informal industry-level centralization by a monopolistic Austrian Trade Union Federation (ÖGB) and the Austrian Federal Economic Chamber (WKO) with support of a coordinating commission by the government (Parity Commission) until this system was replaced by pattern bargaining of the metal workers' union, which is the biggest of the seven affiliated unions, whose leading role is recognized by other unions. Key drivers for achieving high levels of coordination in wage bargaining is through the status given to trade unions and employers associations. The ÖGB's authority exceeds that of other unions in Europe, giving it special legal rights and power to "make binding wage agreements" (Golden and Wallerstein, 1994). Golden and Wallerstein further note that the ÖGB itself does not engage in bargaining process which is left to its affiliate trade unions at lower levels. In other words, despite the strong position of the ÖGB, wage bargaining is not directly conducted at the peak level. However, the ÖGB must approve and sign all agreements and de facto has monopolistic power for the negotiation wage bargaining with employers. Similarly, all enterprises with the exception of agriculture and independents (*freie Berufe*) are obliged to be members of the WKO and collective agreements extend to all of its members. Lastly, all bargaining demands are initially discussed within the Subcommittee on Wages of the Joint Commission between the ÖGB and the WKO providing for peak level framework within which lower level bargaining can take place (Lange, Wallerstein, and Golden, 1993).

4.5 Institutional mechanisms for wage bargaining systems with macroeconomic functionality

The above examples of the institutional frameworks in advanced countries reveal how wage determination systems can greatly differ. Even though some institutions may be present in one country, this does not imply that they have comparable positions or power within the wage bargaining process. Despite the differences there are certain institutional patterns which make greater formal or informal coordination and centralization more likely. The various

³⁹ Lane Kenworthy makes a data set with coordination scores available on his website.

institutions, despite some similarities, are unlikely to have the same impact or function within the wage bargaining system. For instance while an institution might be formal in one country, it might be informal in another country while the effect on wages and macroeconomic stability is similar. Having a more stable and mature institutional framework the following section shall contribute to identifying mechanisms and institutional features which strengthen coordination and centralization using the examples previously introduced.

Table 8. Factor affecting levels of coordination and centralization in wage bargaining

Associations	<ul style="list-style-type: none"> - Monopolistic peak level association - Subordinate regional/industry associations - Binding agreements for members - Mandatory membership - Regular wage bargaining schedules
Government	<ul style="list-style-type: none"> - Wage commissions participating in wage bargaining process - Minimum wage legislation - Wage schedules - Large public sector - Supplemental legislation (Extension laws to non-union companies)
Industrial structure	<ul style="list-style-type: none"> - Few dominate industries - Large state-owned companies - Limited industrial diversity - Small, homogeneous country

The most important mechanisms in establishing higher coordination are by strengthening formal or informal institutions which expand the influence of relevant wage agreements throughout the economy. Centralization is a tool of concentrating power and potentially strengthening overall coordination. The level of coordination is determined by the power of bilateral or tripartite wage agreements to extend to different levels of the economy. In order to achieve higher level of coordination, the institutional framework needs to establish and strengthen the power of the negotiating parities while at the same time regulate market mechanisms and individual agreements. Table 8 lists mechanisms identified in countries with high levels of coordination with the most important institutional features belonging to the role or associations, the government as well as the industrial structure.

The existence of representative associations for employers and workers is a tremendously supportive institutional feature in establishing creating greater coordination and centralization. The more powerful and monopolistic the peak representative bodies are on a national level, the greater their impact on the wage bargaining outcome. The more power they have on lower level or alternative representative bodies, which in the strongest form would be direct subordinates, the stronger the institutional framework can affect the wage bargaining process. Passing down any agreements to other levels of the economy, depending on the level on which negotiations take place, can be achieved by making all agreements binding for all the members of the employers' and employees' representative bodies. How influential

associations become will vary and depend on historical development of the economic system. Their importance can be amplified by providing a legal framework for the wage bargaining process including regular wage bargaining schedules as well as the mandatory membership for companies and employees.

The government most certainly is the most influential element in establishing the institutional frameset for the national wage bargaining system. Through its legislative power it has the power to lay the foundation for the power bargaining units have and how and on which level the wage bargaining process should be organized as well as to which areas the agreements extend to. Next to establishing the rules of the game, the government can also directly and indirectly influence wage bargaining. When the government participates within wage commissions in tripartite wage bargaining it can participate in the wage bargaining process between the representative bodies with directly, as an equal bargaining party, or indirectly, as a mediating bargaining party, influence the outcome of the agreement. Other supplemental legislation such as minimum wage legislation can be used to set signals by raising the income levels of lower income groups, which if set effective can directly impact wage bargaining and increase coordination. The government also has the possibility to establish wage schedules which in extreme cases of government power would be mandatory to follow. Similarly a large or influential public sector puts the government in the role of a major employer whose bargaining outcome will have signaling power on other bargaining units. The government is hence in a position to facilitate higher degrees of centralization by providing bargaining units the required legal framework eventually translating to increased coordination.⁴⁰

Lastly, the industrial structure sets important prerequisites for the ability to establish higher levels of coordination and centralization. The larger the country and regional differences are, the greater the diversity of its industry, the less dominate the public sector or some key companies are, and the more heterogeneous a country's economy is, the more challenging it appears to achieve higher levels of coordination as well as centralization. For the most countries with high degree of formal coordination and centralization tend to be relatively small, homogenous economies with a few dominant industries. The more sophisticate the economic system become the less likely it seems to be that a wage bargaining system with national representative bodies extending its peak level agreement throughout the economy becomes established.

Any economic system based on capitalism will have certain elements of market mechanisms in the labor market and the determination of wages. In itself it is an influencing factor on wage determination, however an element increasing the degree of coordination and centralization. In this context market mechanisms are less a mechanism for coordination or centralization. Naturally with higher levels of centralization, meaning that peak level associations negotiate on a national level, the higher one would expect the level of coordination to be. However, as has been pointed out above, high levels of coordination can also be achieved in absence of high levels of centralization. Informal coordination mechanisms or a form of artificial or informal centralization can compensate for the lack of formal institutions in the wage bargaining process (e.g. key companies, dominant sectors etc.). These however would seem to be less stable than wage bargaining institutions with stronger

⁴⁰ It can also strengthen its own position as a coordinating power by directly signaling wage developments to the overall economy.

formal mechanisms. Coordination can be achieved in many ways although the underlining element will always remain the same.

High levels of coordination are only possible when certain institutions have the necessary power and scope to influence the overall wage bargaining process. This can be achieved by providing representative bodies the required signaling power of wage agreements to carry beyond their actual range. Alternatively or complementing this, government policies can achieve similar signaling power by implementing minimum wage adjustments, wages increases for the public sector or wage schedules. Similarly the level of centralization will much depend on the organization of the economic system, but low centralization can still be compensated though wage bargaining taking macroeconomic elements into account, although this approach is likely to be more prone to instability. Lastly, it is important to keep in mind that successfully achieving higher levels of coordination will need to take into account the entire complexity of the economic system, including cultural, political, geographic, as well its industrial diversity (see section 1.4).

5. Wage Bargaining Systems in Developing and Transitional Countries

In the above sections it has been established that the majority of research on the classification of wage determination systems as well as economic systems in general has focused on advanced economies with far more established institutional structures having been established over time. Similarly they have been at the core of the Calmfors-Driffill debate. Academics as well as international organization related to economic development such as the World Bank have not studied developing nations with the same vigor (Freeman, 2008).⁴¹ However, the institutional setting found in non-Western emerging as well as in the advanced economies differs from those in developed Western economies (Chui, So and Tam, 2008). Though some crucial lessons can be learnt from the situation in advanced economies, no framework exists which can be simply applied to developing countries. Prior to extending the theoretical discussion to China, it appears helpful to highlight some key differences in the institutional settings of developing and transitional countries with a focus on Asia.

Developing economies will typically have a rural based economy, a large informal sector, and a mainly unskilled workforce as their starting point. The role of the state and major private industries will vary depending on the individual pre-growth structures. Overall, supporting political and legislative institutions will be weak, requiring structural change and reforms during the progression of economic development. As developing nations evolve to emerging economies and ideally reach developed nation status, the countries go through periods of rapid economic growth fundamentally altering the underlying structure of the economic system. In its course the rapid economic development is accompanied with changing attitudes and expectations of its people which eventually challenges the established institutional setting. In its course reforming and advancing the economy requires changing or abolishing old institutions while establishing a new institutional framework capable dealing with the new economic and social reality. In doing so, path dependency (see section 1.6) will constrain and influence how the new institutional framework evolves. The variety of institutional settings as well as wage bargaining systems in advanced economies highlights the many possibilities, all of which need to take national circumstances into account. There is no one fits all approach in reforming an economy and establishing a specific set of institutions as has been clearly demonstrated by the failure of the Washington Consensus. However, by defining policy goals it is possible to construct an institutional framework which may be inspired by other countries' examples but still require adjustments taking local factors into account.

Countries can choose different paths for development and policies will differ widely. In some countries reforms may lead to the collapse of the old institutional framework, while others, typically ones with stronger governments, keep some elements of the old economic structure intact during the transitional period (Yudaeva, 2002). The transition of for example East Asian economies and Eastern European economies happened within a different institutional context (see also Nölke, 2011). Experience in some transitional economies has provided evidence that experimenting with the institutional design is more beneficial for development than simply copying Western style institutions (Mukand and Rodrik, 2002). To say the least, less developed countries face a daunting task of changing their economic system and establishing a functioning institutional framework. In some cases these changes are simultaneously occurring with political change which further complicates the tasks at hand.

⁴¹ One contributing reason for this may also be the difficulty of obtaining reliable data.

Returning to labor market institutions, the settings vary greatly across regions. Fields and Wan (1989) grouped developing countries with primarily market wage determination and those with institutional wage determination.⁴² Developing economies in Latin America, Africa, and South Asia are classified as having an institutional driven wage determination while the wage determination process of the Asian Tigers sees a weaker institutional framework with wages predominately market determined. However this observation should note that literature on the degree of centralization and coordination in developing countries is very rare. There are some indicators though that in most developing economies, without a system based on communist structures, company level bargaining seems to be predominant (see Visser, 2000). One explanation for this lies in an overall weak institutional structure of the economic system. Information on the levels of coordination which would require a more detailed study of the institutional interaction is nearly non-existent for developing countries. Excluding elements under communist structures, which currently are with the exception of North Korea, relatively uncommon, a highly decentralized wage bargaining appears to be the most characteristic for developing countries. Given the weak institutional structure it seems that this would also be associated with low coordination. Although the institutional structure is far less sophisticated compared to industrialized economies, a dominant state, cooperation between key industrial sectors or a combination of both can contribute to higher levels of coordination.

Despite some similarities of the institutional structure, developing countries will already have very distinct differences in how its labor market and wage bargaining are structured which will affect how its institutional framework will continue to evolve as it reaches higher levels of development. As the economy enters periods of high growth the existing institutional framework becomes weakened, if it has any substantial influence to begin with. With higher levels of economic development the transformation of the institutional framework will be accompanied with changes to the coordination or centralization of the countries wage bargaining system. A challenge in analyzing or even categorizing developing and transitional countries is the rapidly changing economic and political institutional structure which economies undergo in the transformation process before establishing a more durable structure. Accounting for individual differences and finding classifications for emerging economies or for ones that recently rapidly developed is hence much more difficult.

5.1 Experiences of the Asian Tigers

For a better understanding of the institutional setting of wage bargaining systems in countries having undergone rapid transformation the following part will focus on the Asian Tigers (Hong Kong, Singapore, South Korea, and Taiwan). All of these economies achieved remarkable success from transforming rapidly into high income and developed economies. Whether free market principles, authoritarian government policies, or a mix of policies was the driver for their rapid success remains debated. There is abundant literature on the theoretical debate for the success factors of the Asian Tigers (see Radelet, Sachs, and Lee, 1997 / World Bank, 1993 / Page, 1994 / Stiglitz, 1996 / Krugman, 1994). It is not the aim to go into the detail of

⁴² Institutional wage determination is measured by the role of non-market forces, including minimum wage, the role of unions, pay in the public sector, labor law as well as multinational corporations which the authors argues can sometimes come under political pressure to pay higher wages.

the complexity of detailed policies behind the developing strategies applied. Rather this section will briefly outline some underlining factors in the labor market resulting wage bargaining mechanisms within the Asian Tigers as their economies developed. Share cultural and geographic similarities looking at Asian Tigers should provide a better overview of the starting point for China's transitional labor market and its wage bargaining system.

5.1.1 Hong Kong

Hong Kong has long been regarded as one of the most laissez-faire economies in the world. Its government is considered to have limited interventions on the labor market. Hence the labor market has been highly unregulated with minimal statutory employment legislation and although interventions have increased over time, the starting point is very low (Chui, So and Tam, 2008).⁴³ Although unionization was not legally suppressed, membership and collective bargaining remained very weak (World Bank, 1993). Hong Kong's experience is hence an example for that unions do not need to be aggressively repressed (Freeman, 1992). The presence of trade unions has been mainly confined to the public sector and at the enterprise level of large corporations although there is no legislation requiring employers to engage in collective bargaining (Hsieh and Woo, 2005). As a result trade unions remained relatively weak in Hong Kong and furthermore politically divided, acting more as political lobbying groups.⁴⁴ Employer associations, most notably the General Chamber of Commerce, sway considerable political influence, lobbying for keeping the laissez-faire tradition in place. However, some authors such as Wade (1990) argue that due to the prevalence of a small business elite which controls significant portions of the economy across nearly all industries, they may influence wages in a cartel like fashion. The General Chamber of Commerce does not engage in collective bargaining, but does issue non-binding wage guidelines to its membership (Lingnan, 2011).

As has been typical for East Asian Tigers, Hong Kong initially specialized in labor intensive, low skill manufacturing, but quickly moved up the value chain and on to services, requiring a more skilled labor force (see Berger and Lester, 1997 / Findlay and Wellisz 1993). Employers could hire and fire workers as they needed while offering wages in competition for increasingly better skilled workers. In this dynamic and fast growing economic environment, employees, given they had the necessary skills, could easily switch employers trying to improve their employment situation and wages through individualistic means, not seeing the need of any collective action by unions (World Bank, 1993). Although Hong Kong still enjoys relatively low unemployment levels, the situation is now less favorable for employees as the power balance has shifted more in favor of employers (Hong Kong Institute of Human Resource Management, 2004).

Modifications reigning in the flexible labor market or even establishing collective bargaining face intense opposition by employer organizations. Consequently changes have been slow and usually in a top-down manner. "Intense popular political mobilization of labor that elsewhere has been associated with political democratization has been absent in Hong

⁴³ For example minimum wage legislation was introduced as of May 1st 2011, set at HK\$28 for all sectors.

⁴⁴ The Federation of Trade unions is considered pro-China, while the Confederation of Trade Unions is seen as pro-democracy. This constellation causes friction between the party, but in some cases both unions managed to cooperate on lobbying on labor issues together (Chui, So and Tam, 2008).

Kong's case" (Chui, So and Tam, 2008). Chui, So and Tam note that labor market condition as well as wages are employer driven. As a result wage bargaining in Hong Kong was and continuous to be highly fragmented with little government intervention. The level of coordination is low, as is the degree of centralization. Coordination efforts by the government are particularly low despite the recent introduction of minimum wage.⁴⁵ The politically influential business associations' impact on coordination appears to be higher, but is not measurable and opaque at best. The majority of wage bargaining therefore takes place at the individual level. Especially for lower skilled workers employers can dictate wages, while competition for more skilled workers is high. It may therefore be no surprise that Hong Kong has one of the highest levels of inequality, which increased from 0.43 in 1971 to 0.54 in 2011.⁴⁶ Hong Kong's wage determination is dominated by its weak institutional setting and its lack of significant coordination and centralization. Most notably during the process of its rapid economic development its wage bargaining mechanism has only see miniscule changes.

5.1.2 Singapore

Being a city state with limited resources, Singapore has many similarities with Hong Kong. Singapore however chose a path of greater government involvement during its industrial development. Prior to its period of rapid growth which began in the 1960s, the city state had unharmonious industrial relations which resulted in social unrest and high numbers of strikes (Fashoyin, 2010). Identifying the industrial relations as a key to establishing a framework for future economic growth, a variety of labor market institutions were introduced.⁴⁷ With the concurrent establishment of national peak level labor and employers' associations, the National Trades Union Congress (NTUC) and the Singapore National Employers' Federation (SNEF), basic foundation for more cooperative industrial relations and wage bargaining was introduced.

Rapid industrialization within a tight labor market brought concerns that "irrational wage negotiations would lead to an increase industrial dispute, which might discourage investment and hamper economic development" (Fashoyin, 2010). In an aim to safeguard cooperative industrial relations and enhance rational wage increases, the government established the tripartite National Wage Council (NWC) in 1972.⁴⁸ The NWC is comprised of representatives of the government, labor unions and employer associations, notably the Ministry of Manpower, the NTUC and the SNEF as peak level organization with other members providing additional

⁴⁵ The minimum wage introduce in Hong Kong currently does not have any coordinating function as it has not been increased since its introduction in 2011. In 2013 there are ongoing discussion to increase it to HK\$30, an increase of 7.1% over 2 years, far below the CPI increases of 5.3 and 4.7 for 2011 and 2012 respectively. In how far agreements from corporate trade unions as well as the wage guidelines issued by The General Chamber of Commerce influence wage developments needs to be further investigated, but it would be expected to generally low.

⁴⁶ Data taken from Half-Yearly Economic Report 2012 released in August 2012 by the Economic Analysis Division, Economic Analysis and Business Facilitation Unit, Financial Secretary's Office, Government of the Hong Kong S.A.R.

⁴⁷ This includes the Industrial Relations Ordinance and the introduction of the Industrial Arbitration Court (1960), Industrial Relations (Amendment) Act (1968) and the Employment Act (1968).

⁴⁸ Detailed overview of the NWC can be found here: <http://www.tripartism.sg/> (accessed March 10th, 2013)

representation (see Table 9). In its annual meetings the NWC in a consensual approach issues national wage guidelines taking productivity, inflation, overall labor market conditions as well as key macroeconomic indicators into account (Fashoyin, 2010).

Table 9. Composition of the Singapore National Wage Council 2013/14⁴⁹

Employers' associations	Government representatives
Singapore National Employers' Association	Ministry of Manpower
Singapore Chinese Chamber of Commerce and Industry	Ministry of Trade and Industry
Singapore Business Federation	Public Service Division
Singapore-German Chamber of Commerce and Industry	Economic Development Board
American Chamber of Commerce	Singapore Workforce Development Agency
Japanese Chamber of Commerce and Industry	Chairman
Singapore Indian Chamber of Commerce and Industry*	Lim Pin, National University of Singapore
Singapore Malay Chamber of Commerce and Industry*	
Employees' associations	
National Trade Union Congress	
Singapore Industrial and Services Employees Union	
Singapore Insurance Employees' Union	
Food, Drinks and Allied Workers Union	
Amalgamated Union of Public Employees	

Source: own table based on National Wage Council Annex 2013/14

Though NWC wage guidelines were of non-binding nature they were used by member companies of the employer associations or which are unionized, but it also has a significant signaling function for non-member companies as these companies use the agreements as a reference point. The non-mandatory nature allowed for individual flexibility based on the business situation of the individual company. Prior to 1986 the NWC would issue qualitative wage guidelines with precise wage increase, but this was changed to qualitative wage guidelines as the flexible wage system was gradually introduced. The new interpretation of the wage guidelines was to allow greater flexibility of enterprise level wage bargaining linking it closer to a company's performance, although it does attempt to establish some key

⁴⁹ The wage council also includes alternate members' organizations. For employers: Singapore Indian Chamber of Commerce and Industry, Singapore-Malay Chamber of Industry and Commerce. For employees: Building Construction and Timber Industries Employees' Union, Chemical Industries Employees' Union, Singapore Manual and Mercantile Workers' Union, Singapore Port Workers' Union, Metal Industries Workers' Union.

principles and recommendations.⁵⁰ ⁵¹The NWC had a key role in the transformation of Singapore's economy and established high degrees of centralization and coordination when it was first introduced in the 1970s. It had an important role in moderating wage increases when employment was at near full employment, as well as periods of deliberate high wage increases aimed at increasing productivity by "discouraging intensive use of labor and instead going in for higher levels of automation and mechanization to achieve higher value added activity in the capital-intensive production" (Hing, 2003). With the introduction of the flexible wage system however the degree of centralization and especially coordination as quantitative wage guidelines negotiated at the peak level with a high degree of signaling power where replaced by qualitative wage guidelines with actual wage increases determined at the enterprise level.

Singapore's institutional framework has some unique features highlighting government intervention in industrial relations especially when the economy was in its transitional stage of development. First, the NTUC, as the de facto peak level trade union, had close political ties to the ruling People's Action Party (PAP) which has been in power since Singapore's independence under its hybrid political regime. Under this constellation labor movements in the city state was expected "to subordinate its sectorial interests to the advancement of national interest" but at the same time it remained credible to its workers as well as employers within a government system which is widely considered as non-corrupt (Hing, 2003). It is however also apparent that as Singapore became developed, it began to slowly tilt towards greater labor market flexibility undermining the direct government involvement, though there is no doubt that it still can significantly influence the outcome if it wishes to do so under the current institutional setting.

5.1.3 South Korea

Korean labor markets during the early industrialization were modeled after the Japanese model with seniority-based wage schedules (*hobong* table) regulating employees wage schedules, though this system was mainly limited to regular employees at one of the five conglomerates (*chaebol*) (Hwang, 2006). This contributed to a dual labor market in which employees at other enterprises faced a highly competitive labor market and less privileged employment conditions (Lindbeck and Snower, 1986). Under the authoritarian regime of Pak Chung-Hee, who modeled the economic development policies after Japan's (Woo, 1991), labor movements were generally suppressed. Although unions were legal, they were ineffective in representing workers and much more a tool of the government (Lee, 2005). During the Pak regime rule, close links between the government and businesses, mainly the chaebols, were established. In terms of labor relations the government ensured favorable business conditions while it expected the companies to provide life-long employment and ridged wage structure for its employees (Kim, 2000). With the forceful introduction of the productivity wage system under the authority of the Economic Planning Institute it would seek

⁵⁰ The nature and details of the NWC are outlined on the councils website: <http://www.tripartism.sg/page/National-Wages-Council/> (last accessed 10th March, 2013).

⁵¹ For an overview of principles see Fashoyin (2010) and Thoong (1998).

to repress wages in the public and private sector (Inagami, 1998).⁵² In an authoritarian environment with capital controls in place to facilitate export oriented growth, on the labor market levels of coordination and centralization were achieved to a limited extent driven by the government's target of contributing to maintaining international competitiveness via relatively low wages, but still remained low.⁵³

It was not until Korea's democratization starting in 1987 the government's suppression of independent labor movements and the current industrial relations system began to disintegrate. Independent trade unions were established fighting for substantial wage increases often through "militant shop-floor activities" (Grubb, Lee and Tergeist, 2007). During its democratization period Korean economic policy appears to have lacked any form of planned institution building to replace the industrial relations system under the authoritarian regime (Lee, 2005). Attempts by employers, now equally less dependent on the government, to expand labor market flexibility were matched by attempts of the newly independent labor unions to maximize benefits for its members, while at the same time the government did not have any useful social safety net in place (Haagh, 2001). As a result labor relations under the democratic regime in Korea became highly confrontational, with the labor movement itself being highly fragmented (Lansbury and Wailes, 2005). The confrontational situation between workers and employees has let the later attempting to avoid unionization and is seen as a major reason for the increasing duality in the labor market (Chun and Lee, 2004). Consequently the post-authoritarian system of wage determination became highly decentralized with low degrees of coordination and wage bargaining mainly being limited to enterprise level collective bargaining.

The government has taken steps to establish labor market institutions by establishing a legal framework regulating labor relations and collective bargaining (Lee 2005 / Inagami, 1998). In its aim to modernize industrial relations steps have been taken to introduce industry-level collective bargaining though these efforts are limited to some sectors and face resistance by employers which in turn favor labor market flexibility over tripartite wage bargaining (Grubb, Lee and Tergeist, 2007). Korean industrial relations face sever obstacles in establishing a trusting working relationship and current legal reforms in the labor market have not yet been able to address all of the short comings of the current industrial relations (Lee, 2005). As the Korean economy developed its institutional framework was only slow to adopt and remains driven by hostile industrial relations with little coordination and centralization. Initial efforts have been implemented as the government attempts to formulate its labor market policy, but for the time being the lack of trust between bargaining units, the fragmentation of bargaining and the lack of strong peak level organizations appear ill-equipped to change the confrontational and dualistic industrial relations.

⁵² There is however a debate on whether Korea repressed wages during this time (see World Bank, 1993), while there is a consensus that independent labor unions were repressed.

⁵³ The OECD Wage setting institutions and outcomes) consistently ranks levels of coordination and centralization at the lowest level from the 1970s throughout 2000.

5.1.4 Taiwan⁵⁴

Taiwan is somewhat of a special case, as it shares many similarities with China. In many ways its economic, social, political and cultural similarities with China make it a good point of reference to developments in China. As the other Asian Tigers, Taiwan, launched its economic development through relying on strong growth in export oriented, labor intensive manufacturing within a stable macroeconomic regime with capital controls in place to limit exchange rate appreciation. Relying on an abundance of labor previously employed in agricultural, tightening labor markets, and rising productivity lead firms to quickly adjust wages and more capital investment (Fields, 1985).⁵⁵ Sharing a colonial Japanese past and sharing several similarities, Japan has been a role model in many regards prior to the economic reforms (Singh and Trieu, 1996), including items such as life-time employment and benefits.⁵⁶ In regards to the labor market key elements of the Japanese model such as paternalistic employment become less relevant during its economic development.

On paper Taiwan did have sophisticated labor laws in place, but the implementation was miniscule and companies faced few actual restrictions. Especially during the onset of the Taiwanese economic development labor market institutions in general were deliberately held very weak by an otherwise dominant government. Wage setting focused on companies' competition for workers and was united by companies' demand for low labor costs. However labor markets began to transform as the economy further developed and some production began to shift to China in the 1980s (Fields and Wan, 1989). Although over time employment regulations including employment protection and benefits improved labor relations, the legal framework and government restricted voluntary employer-worker bargaining including collective bargaining (Pan, 2005). Independent unions were repressed by the government (Lin, 1989), but at the same time employers were pressured by the government "to mend their ways, if any other course might lead to labor unrest and social instability" (Fields and Wan, 1989). Fields and Wan however point out that in the mid-1980s labor laws underwent reform, increasing the rights of workers while at the same time increasing the practical implementation. Similar to the labor law, minimum wage was practically ignored by companies (Chang, 1989) and well below the market wage rate (Fields and Wan, 1989) experienced a similar development. Overall for much of the Taiwanese economic development, the institutional framework and position of workers in the wage bargaining process was weak but within the context of an interventionist and strong government which desired stability by all means. It only began to change after higher levels of economic development was accomplished that growing social pressure forced the government to reconsider policies.

Taiwan remained an authoritarian regime with martial law in place for vast periods of time during much of its economic transformation until its first democratic elections in 1996. Under this regime its labor relations experienced significant state control; the purpose was less for economic but more political reasons (Pan, 2005). During the reform period, rapid economic

⁵⁴ I would like to sincerely thank I-Wen Wang 王怡雯 for introducing me to Taiwan and getting a firsthand understanding of this proud country which over the course of my research I have come to admire.

⁵⁵ According to Fields real wages in Taiwan increased by 300% between 1954 and 1979.

⁵⁶ The authors mention similarities in ethnic and linguistic homogeneity, Confucian tradition as well as compact geography with low population growth.

growth following the slogan “progress and stability” was the main power justification of the authoritarian Kuomintang (Fields and Wan, 1989). After the democratization process Taiwan’s labor relations had to evolve from the previous state dominance (Chen, Ko, and Lawler, 2003) which contributed to stable labor relations but also prevented a natural evolution of institutions. The establishment of independent unions was a process which accompanied the democratization process (Lin, 2010). Changes continued to transform the Taiwanese labor market as the democratically elected parliament made significant changes to the Labor Union Law, the Settlement of Labor Disputes Law, and the Collective Bargaining Agreement in 2010. This process has also been driven by more assertive employees and higher unionization levels (Baker and McKenzie, 2009).

Table 10. Labor market scores of Taiwan, Germany, USA, and Japan, 2013

	Taiwan	Germany	USA	Japan
Minimum wage	2.23	6.67	10.00	8.90
Hire and firing	4.52	3.49	6.73	3.04
Centralized collective bargaining	7.54	3.60	7.33	8.01
Hours regulation	10.00	8.00	10.00	10.00
Mandated costs of dismissal	2.52	6.26	10.00	10.00
Conscription	3.00	10.00	10.00	10.00
Total score labor market	4.97	6.36	9.01	8.33

Note: The higher the score, the more market forces can freely work in the labor market

Source: Gwartney, Lawson and Hall (2013)

Table 10 contrasts the ranking of the Taiwanese labor market with those of Germany, the USA and Japan. Taiwan’s labor market is ranked similarly as Germany by the Gwartney, Lawson and Hall based on their 2013 evaluation. A high score for centralization of wage bargaining, places Taiwan closer to the USA and Japan, indicating that most wage bargaining takes place at the company level. Minimum wage and high compensation costs which have been implemented by the authoritarian regime to improve workers’ rights remain in place, explaining low scores in the ranking according to the parameters used in the index. Overall there is little literature on coordination in Taiwan, but there are strong indications that other than coordination effects through national legislation including minimum wage, there is little coordination across the economy. Taiwanese wage bargaining remains highly decentralized at the enterprise level. Lin (2010) however points out that on a local level the role of local unions contributes to some form of coordination has been taking place. Trade unions in Taiwan are generally still weak but at some local levels they are gaining power and trying to extend their regional reach.

The Taiwanese example demonstrates that authoritarian regimes legitimizing their power through economic growth need to be responsive to demands by workers by introducing policies such as minimum wage and improving labor laws in general. It however also

demonstrates the reluctance and fear of introducing independent unions and meaningful collective bargaining. The changes in industrial relations were carefully administered in a way that any changes appeased demands by workers but at the same time did not threaten the political regime. Any economic or institutional reform was restricted by its compatibility with the authoritarian political system. Only with the onset of democratization in Taiwan were industrial relations able to begin to adjust freely. The changes in the Taiwanese labor market during its authoritarian regime and rapid economic growth phase as well as its continuous transformation after the democratization in Taiwan deserve special attention prior to looking at the institutional change taking place in China.

5.2 Institutional features of wage bargaining mechanisms

The Asian Tiger's development exemplifies the limitations of classifying their economic systems during their transitional phase using categorizations for developed countries as has been outlined in chapter 1. They achieved comparable economic success employing similar growth policies achieving unprecedented rapid economic development. In this process the previously underutilized and low skilled labor force transformed to a highly skilled one which along with productivity gains translated to rapid growth in income levels. Especially in the onset of their rapid growth period the wage-setting institutions in Hong Kong, Korea, Singapore and Taiwan were weak if not absent (Starr, 1981). It is widely recognized that introduction of market mechanisms were vital for the economic development of the Asian Tigers (see World Bank, 1993 / Fields and Wan, 1989 / Fields, 1994 / Freeman, 1993). Though government intervention in key areas of the economy were at times, and depending in which area, strong.⁵⁷ Market intervention in the labor market was generally limited or involved suppression of independent labor market institutions. Singapore was the only exception during periods when the government directly influenced wage increases and Hong Kong was the exception of not directly suppressing independent unions.

Generally the governments of the Asian Tigers maintained substantial control over the wide areas of the economy with strict regulations on the capital market as well as through industrial policies while at the same time the development model strongly relied on the government cooperating or even depending on large industrial players. Labor markets and wage determination however as the examples above had shown, had little regulation or enforcement was given little emphasis in the initial phases of development. In the onset of their rapid economic growth during the 1960s, the Asian tigers had low level wages, but also low levels of productivity, so it is not necessarily an indication for a low wage strategy. Over time all countries massively invested in education and moved into more sophisticated industries requiring higher skill levels. This then resulted in higher productivity which corresponded in increasing wages. For the most this all happened within a weak institutional framework dominated by authoritarian regimes with close ties to businesses. Government intervention varied and was stronger in Singapore and Korea than it was in Taiwan or Hong Kong (Scitovsky, 1986). The regulatory environment (including minimum wage and collective bargaining regulation) was either absent or not adequately enforced, labor unions were

⁵⁷ Hong Kong being the exception. For further readings on state intervention in the economies of the Asian Tigers see Amsden (1989) / Wade (1990) / Young (1992).

suppressed or weak, and enterprise level wage bargaining was encouraged. The rapid economic growth, the subsequent tight labor markets, and increasing productivity not only helped push up wages but also contributed to keeping wage gaps between skilled and unskilled workers remarkably low (World Bank, 1993 / Ranis, 1993).

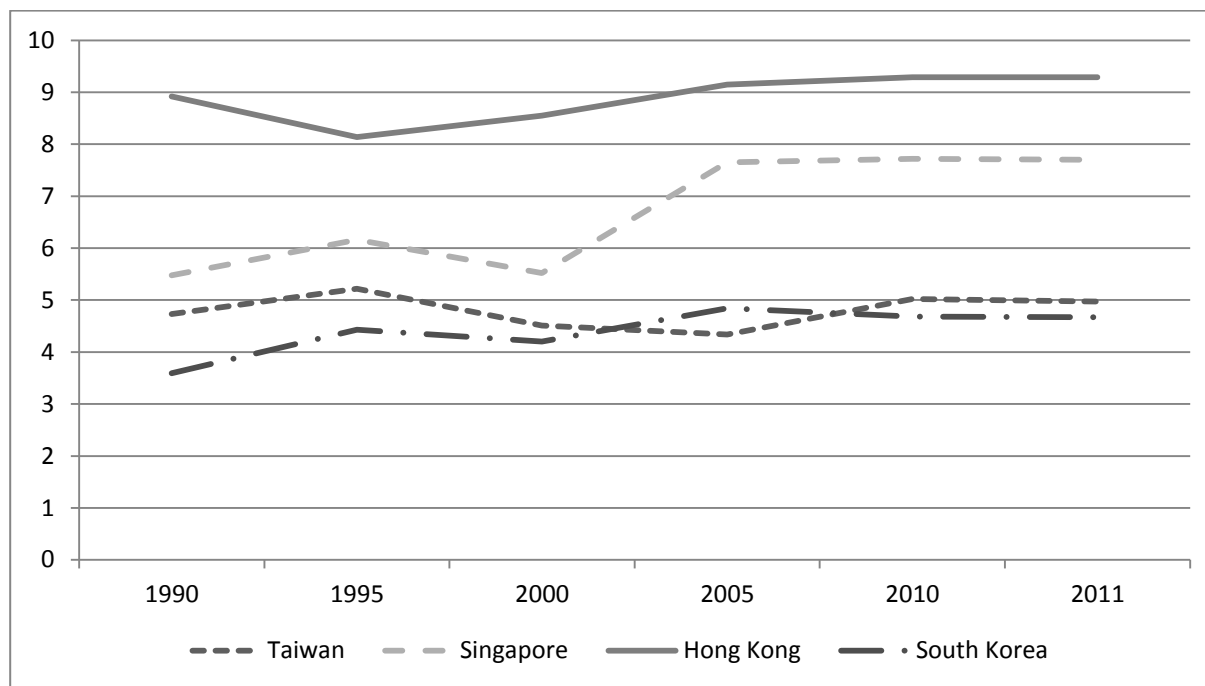
In the initial phases of the reforms directed by authoritarian regimes (with the exception of Hong Kong) peak level organizations were discouraged. Low levels of employer and employee representation for the most under the authority of the political regime limited coordination and clearly favored enterprise level wage bargaining. Increasing productivity resulted in higher income contributing to political stability and cooperative relations between workers and employers (Stiglitz, 1996). Any kind of coordination was directed by government involvement which could influence major business sectors though this was exercised differently in the four countries. Not surprisingly levels of centralization and coordination in the Asian Tiger's economies remained low. Over time as the economies grew richer and in part more democratic the institutional framework began to strengthen with the introduction of stricter legislature and independent employee and employer representation.⁵⁸ This process, however, was slow and the resulting labor markets differ across the Asian Tigers' economies. The index calculated by Gwartney, Lawson and Hall certainly has its limitations, but it does highlight the differences in the regulatory framework in the labor markets of the Asian Tigers. As Figure 4 illustrates Hong Kong and Singapore have higher scores indicating lower labor market regulation, while Korea and Taiwan have lower scores indicated more regulation.⁵⁹ Higher regulation scores in the economic freedom index correspond to higher wage dispersion: Hong Kong has a GINI coefficient of 0.537, higher than in Singapore, Taiwan and Korea with GINI coefficient of 0.463, 0.342 and 0.311 respectively.⁶⁰

⁵⁸It should however be noted that during the Asian Financial Crisis most economies resorted to more flexible labor markets to maintain their international competitiveness (especially Korea, Singapore and partially Taiwan).

⁵⁹ It should be noted that Fraser's Economic Freedom Report regards any market interference as negative and does not consider coordination scores.

⁶⁰ Data taken from CIA World Fact Book based on 2011 levels, except for Singapore which is based on 2013.

Figure 4. Index of Asian Tiger's labor market regulation, 1990-2011



Note: 10 indicate highest low level of regulation / 0 indicated high level of regulation. The labor market institutions considered in the ranking are: hiring regulations and minimum wage, hiring and firing regulations, centralized collective bargaining, hours regulations, mandated cost of worker dismissal, conscription.

Source: Gwartney, Lawson and Hall (2013)

It should also be kept in mind that the labor market is just one element of the entire economic system, but industrial relations had a significant impact on what type of economic system could evolve. Just as with wage determination mechanisms, there have been limited attempts to classify economic systems of developing nation (see 1.4.1). Claims that much of the success during beginning and transitional phases of the Asian Tigers' development labor force was due to flexibility in employment and wage setting not only discards the relevance of strict macroeconomic controls, it also does not account for the diversity of the transformation of the labor market on a national level. Although weak labor market institutions were a policy tool in the beginning of the economic reforms, even the most authoritarian regimes had to loosen their political control, introduce policies allowing wages to increase as productivity rose, and improved employment conditions in order to retain public approval (Freeman, 1993). Limiting the continuous success of the Asian Tigers' purely to neo-liberal policies would discount the many modifications of the institutional frameworks as the economies re-engineered their entire economic systems.

The widely acknowledge failure of the Washington Consensus has clearly demonstrated that economies driven mostly by market mechanisms are doomed to fail and there is no one-fits all development strategy. Similarly it also seems highly unlikely that despite some similarities, one could prescribe a success strategy which equally fits for Hong Kong, Korea, Singapore and Taiwan. Freeman (1993) points out that "institutions and policies that unleash or restrain sustained growth differ across settings and periods depending on country idiosyncrasies,

initial institutional structure, and the world economic environment“. It is hence important to understand the entire situation and to consider the variety of institutional alternatives from which countries can choose from (Coase, 1992). Despite the successful contribution of market mechanisms, the individual institutional framework of the labor market must be analyzed as well. More importantly for developing countries, their institutional structure will change over time as they must adapt to changes in the country's economic and political situation.

As has been outlined in section 1.5, economic systems are not stable systems. This is especially true for developing countries which are in need to fundamentally change their institutional framework as they need to experience rapid growth in order to catch up to other developed nations. Although there are institutional differences between all four economies, there are some patterns which have been similar in their institutional development path. The starting point for all the Asian Tigers' have been authoritarian regimes of different degrees which were determined to develop their economies. Hence the first phase of institutional restructuring is motivated by economic motives under authoritarian regimes for which in many cases economic success is their sole claim to legitimacy. Hong Kong, Singapore, Korea and Taiwan all, though there are differences in the political constellation, chose a form of collaboration between the government and local as well as international companies to create a business friendly environment. Most importantly this meant that a stable macroeconomic environment needed to be established in order to develop market mechanisms under varying degrees of state-capitalism.

Despite stringent regulations in other parts of the economy, the adopted development policies meant to establish fairly flexible labor markets and optimizing the use of the labor force which for the most meant shifting rural, unskilled, and relatively unproductive workers into manufacturing sectors. During this transition the previous institutional framework becomes less relevant and a dismantling process is initiated. Nonetheless any type of reform is influenced by path dependence regardless whether there was a weak or strong institutional framework in place before. Undoing the previous institutional framework is accompanied with conditions favoring employers while the protection of workers is kept to a minimum. The main effort of loosening labor market regulations and weakening institutionalized wage bargaining is to contribute to creating an environment favored by business interest groups. In many cases, as has been outlined above, this sets the ground for decentralized and uncoordinated wage bargaining systems.

Initial economic success and an overall good macroeconomic situation translate to improved living standards. The booming economies quickly were faced with a tightening labor supply which along with productivity increases pushed up overall wages to the benefit of the majority of workers in absence of strong institutions or trade unions which were not needed to improve their relative bargaining power. Rapidly rising GDP and income puts governments in a comfortable situation to counter macroeconomic problems, however when faced with slower growth this becomes more complicated and unstable. As outlined above dysfunctional wage bargaining negatively impacts macroeconomic performance in several ways. The rapid economic development also meant that the economies quickly had to adopt their policies as they moved up the value chain requiring a better educated and better skilled workforce. This also meant that during the transitional phase labor market institutions needed to adapt creating a new institutional framework.

The new institutional framework needs to deal with changing economic conditions but also needs to accommodate political realities. A better educated workforce with higher skill levels of a middle class society is more likely to demand better labor market legislation and social protection which goes beyond merely securing a job. At this stage the governments' business friendly policies come under pressure to adapt and consider the needs of the newly established middle class. Faced with this question, authoritarian regimes can opt to suppress their requests, but this is more likely to negatively affect economic development. Suppression is likely to cause instability ending rapid economic growth leaving the country's development progress stuck in its tracks. By implementing policies accommodating the peoples' concerns, the institutional structure is strengthened while the elements of unregulated capitalism within the labor market are restrained to an increasing degree. In this process Korea and Taiwan became democracies while Singapore and Hong Kong are not full-fledged democracies, but are considered hybrid political systems. Luckily in all countries the regimes opted to change the political system during their transitional phase.⁶¹ With greater economic development limitations to the initial growth model as well as the political system become apparent. The authoritarian resilience introduced by Andrew Nathan (2013), referring to the ability of authoritarian regimes to maintain in power appears to become harder once the initial economic success slows. The fairly stable industrial relations in the Asian Tigers did not begin to change until political democratization began (Yoon, 2009).

Since becoming industrialized countries the institutional framework in all four economies has changed, but for the most they have maintained a high degree of market mechanisms in the labor market.⁶² Although all four economies have developed different systems of wage bargaining during their development process, they share strong elements of enterprise level wage bargaining with low levels of centralization or coordination. Government intervention varied across regions and development stage, but has been regressing at the current stage with a rather weak institutional setting. Flexible labor markets and wage determination however are prone to cause dysfunctional effects (see section 1.2) on the economy as its growth slows. Especially the lack of coordination mechanisms of the wage bargaining process are a threat to the wage structure, social equality, demand as well as price levels. It then too depends on what kind of social effects are accepted by the society whether there is political pressure to increase coordination levels in order to counter these effects. The Umbrella movement in Hong Kong which started in August 2014 and the Sunflower movement in Taiwan in May 2014 are examples how mindsets and preferences change. Though the political motivations differed, both movements have in common that large parts of the younger, better educated generation have a different perception on social justice than older generations. Less willing to accept high levels of inequality and a perceived collusion between government and businesses have contributed to students becoming disillusioned facilitating their desire for change. The developments in the Asian Tigers underline that economic systems and their principal institutional framework change over time. Their relevant impact of

⁶¹Hong Kong's experience certainly is somewhat special, but it too emerged with stronger democratic features after the handover to China.

⁶² Although, with the exception of Hong Kong, the Asian Tigers established a form of state capitalism, the labor market institutions are left relatively weak even at higher levels of economic development. The resulting centralization and coordination is therefore low (see section 1.4.1). An exact classification would require more detailed research on this topic.

these changes depends on the macroeconomic environment as well as their development stage. Clearly the institutional framework most suitable for rapid economic development is much less suitable for when the economies have reached higher levels of development. This also applies to the wage determination system as the economic systems faces not only economic but also political challenges to which it must in some way or the other adapt.

5.3 Theory lessons for the analysis of China's wage determination

From the theory outlined above and the practical experience of the Asian Tiger's there are some areas which will need special attention when analyzing China's wage bargaining system. It is important to understand the starting point of wage bargaining system and how it has been changing during phases of rapid economic growth. The examples of authoritarian regimes of the Asian Tigers has also shown specific, often repressive, features which strongly influence industrial relations including the role of labor unions and business associations can have. The examples however also showed that as their economies rapidly developed the government was in need to adjust its institutions. Labor market institutions were strengthened and the role of unions also changed in most countries although the flexible market mechanisms remain the most dominant wage determination mechanism.⁶³

Based on the lessons outlined above, one would expect China to also have endorsed an economic system resembling mixing policies of state-capitalism with a relatively unregulated labor market. The examples of Singapore, Korea and Taiwan (to a lesser extent in Hong Kong) have shown us that despite the market orientation the state still maintains a strong position not only in terms of economic development but also in terms of what kind of wage bargaining systems is introduced. The brief look at the wage bargaining systems of the Asian Tigers had three main features which should be considered when analyzing China's system of wage determination. First, its wage bargaining system during rapid growth phase is expected to be highly decentralized with wage bargaining taking place on that enterprise level. Formal and informal coordination can be expected to be similarly low. Second, as the economic system changes the institutional framework evolves in reaction to the changing economic and social situation in the country. Recent experiences of protests in Hong Kong and Taiwan exemplify this. Facing new challenges and expectations, the institutional structure of China's wage bargaining is expected to equally adjust. Strengthening labor market institutions as well as pushing the introduction of coordination mechanism is to be expected. Third, the government is an important catalyst for the institutional change which needs to balance economic policy. The brief examples of wage bargaining systems in the Asian Tigers have already indicated different roles the government took in influencing wage bargaining. Despite the initial impression of highly flexible market based wage bargaining and given the overall influence of the government, it is important to clearly identify the more subtle coordination mechanisms of the wage bargaining system. Most important however, the government will attempt to experiment with different mechanisms (see chapter 1), ideally in a way which causes as little economic disruption as possible.

China is a large country with a highly diversified industrial base. Its economic structure is very unique and certainly different from the relatively small Asian Tigers. Compared to Hong Kong,

⁶³ A reason for this may also be the Asian crisis in 1996/97 which hit most of the Asian Tigers hard prompting them, at the advice of the IMF, to strengthen such wage bargaining systems.

Korea, Singapore and Taiwan its rapid economic development is also much less harmonious and regionally less equal, causing a different set of challenges to its institutional framework. The following analysis will attempt to identify institutional features and their effect on the degree of coordination and centralization of wage bargaining in China. Next to the specific features of China's economic system, it will be of essential importance to consider its political structure. Under its current political setting, the authoritarian regime of the Communist Party of China (CPC) acts as the dominant power orchestrating any institutional changes to China's economic system. Identifying the institutional constraints of the political system will contribute to comprehend what kind of system of wage bargaining can be achieved. As the examples of the Asian Tigers have shown, with a higher degree of economic development the old political structure which was successful in the initial and transformation phase may transform into a severe restriction to the further economic development as it becomes an obstacle for institutional change to overcome.

Figure 5. Process of institutional change in transitional economies

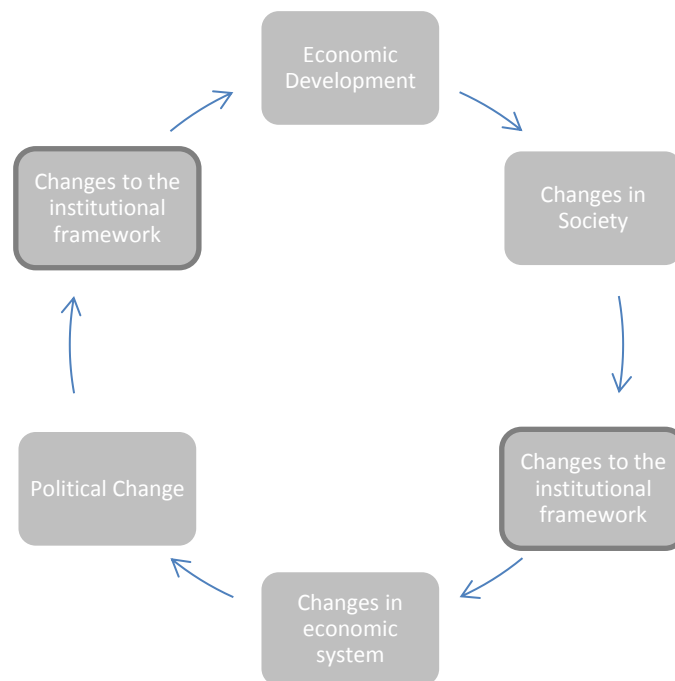


Figure 5 outlines the developmental changes the institutional structure of developing countries undergoes. The old institutional structure needs to change prior to triggering economic development, often this may also be triggered by preceding political change, as for example the willingness of the CPC to end its isolation from the world. Ideally the economic development triggers (rapid growth period), translating into higher standards of living, higher education levels with significant implications on how the society functions. This again will require adaptation of the institutional framework as well as changes to the economic system as higher levels of development (transitional period) are reached. Hence institutional change

will be foregoing and preceding economic development. Once rapid growth slows (developed period) the country faces a different set of challenges with a more sophisticated economy and higher income levels. Less tight labor markets, a moderation in GDP growth accompanied with a slowdown in wage increases bring a whole new set of challenges. During this process the political sphere will not be able to isolate itself from the economic and social development taking place; however the term political change is a flexible one. It can mean that the political structure is reformed to various degrees or at some point gives way to a new political order.

Another lesson of the Asian Tigers has been that economic systems of rapidly developing economies change several times as they continue to face new challenges due to their own economic success as illustrated in Figure 5. The transitional period can take on several rotations as the economy continues to develop. Similarly industrial relations and the wage determination mechanisms will change as the institutional arrangement adapts to new economic, social and political circumstances. As of 2015 after undergoing over 30 years of economic reforms, China's economic system continues to undergo major changes as it faces new challenges to its economic model. A core issue in this continued transformation is the labor market and wage bargaining system, which provides a direct link between the economy and society. The process of institutional change is clustered with ongoing choice which of course are not only limited to the economic sphere. This results in necessary compromises and the occasional change of policy direction. Naturally what may be economically functionally then may not be politically functional as at the end, depending on the target, what is functional lays in the eye of the beholder. In the following section the focus will shift on China's evolving labor market attempting to identify the direction its institutional framework is heading to and whether China can achieve a functional wage determination system focusing on the targets defined within the Keynesian paradigm. Understanding the theory behind economic systems and wage bargaining mechanisms as well as the special circumstances of developing countries should have established a foundation of the coming analysis of China's wage bargaining system.

PART II: Chinese Wage Bargaining System

6. China's Evolving Labor Market Amid Institutional Transformation

Classifying economic systems is a daunting task due to the institutional complexity of individual economic systems. This task becomes even more difficult for developing nations as their institutional arrangements undergo massive changes during their transformation period. The limitations of existing theories focused on developed countries in this context has been illustrated (see e.g. ten Brink and Nölke, 2013). In the case of Asian Tigers and for the development of East Asian economies the importance of state capitalism as a catalyst for growth has been widely noted. Typically the economies would follow the Lewis model transforming from agricultural based economies to more industrialized ones based on low skill and labor intensive production. This development would be accompanied by a rural-urban shift in the population. Another important similarity are bureaucratic-authoritarian regimes with high levels of centralization, planning and repression of unwanted developments. Within its economic transformation the CPC has adapted to alter how it governs shifting from coercion to domination (Hui, 2014). Economic reforms focusing on growth and development as the prime policy goal are accompanied by political constraints and the ruling elites' desire to manifest its power position (see also ten Brink and Nölke, 2013).

The magnitude and transformation speed of China's economic system has had substantial effects on its institutional framework. Particularly, labor market reforms have had far-reaching implications not only for the economy but for the Chinese society as a whole. Over time Chinese industrial relations have substantially changed from governmental paternalism to a more market oriented system for large portions of the labor force. In this process previous labor market institutions have either been transformed or abolished while new ones have been slow to develop. Since reforming its economy China's labor market has vastly transformed a rigid wage determination system to one with a higher degree of flexible: First, government institutions which used to allocate jobs, guaranteeing income and social security ("iron rice bowl"), have been for the most part abolished. Second, the unified grade wage system (wage grid) which ensured fairly small wage dispersion disappeared. Third, the household registration (hukou) system which created a major obstacle to labor mobility has been reformed unleashing a tremendous shift from rural to urban areas.

The institutional embeddedness of economic systems has strong influence on their possible transformation. However, it was pointed out in section 1.5 that economic systems are not rigid and will need to change for a variety of reasons over time. This incremental change has been referred to as path dependency. Even in the most radical revolutions, the newly emerging economic system cannot instantly replace old institutions. The interdependence of institutions translates into that if one institution is changed, it will affect the entire system which also makes the issue of sequencing reforms important. Reforms in the labor markets hence are intertwined with other reforms and there is a danger that marketization efforts advance too fast for other institutions to adapt (Knight and Song, 2005). Within authoritarian systems such as China these institutional modifications will be more tightly controlled trying to strike a balance between economic development and maintaining political power, as economic development is the CPC's sole source of political legitimacy. This also means that institutions which could emerge freely in democratic systems are not able to develop without the consent of the party. The CPC is preoccupied with containing any potential discontent to the economic sphere with in an industrial relations regime it can control (see Hui, 2014). By hindering labor

market institutions from developing freely, most notably independent unions or the welfare state in democracies, the CPC is in need to engineer institutions as the economy transforms.

Knight and Song (2005) however are right to point out that the government has given the priority to rapid economic growth while labor market reforms “lagged behind other market reforms”. Only in recent years have government initiated experiments been observable in the labor market and its system of wage determination. This approach however, also shows that there is no clear policy on how the labor market should evolve. Labor markets everywhere are made up of different types of labor markets based on different geographic locations, skill sets, professions or other specific characteristics (Knight and Song, 2005), with individual features in terms of wage determination. The current Chinese labor market has several competing, yet interdependent, segments as it continues its transformation process. At its current transformational path it is not yet clear which destination it is heading for, but as part II below will show, the government is vigorously experimenting. China’s current labor market is an evolving and tremendously crucial component of the Chinese transformation process. Naturally institutions are changing and evolving during this process. Their institutional interdependence in some cases will facilitate certain policies, while in other cases it will obstruct them.

China’s reform process has been of great interest to the world and its progress has been carefully monitored and analyzed. Much of the attention has focused on special economic zones, foreign direct investment, international trade, and financial markets. However, external openness also requires an internal institutional transformation process (Qian, 2002). According to Fleisher and Yang (2003b) “labor market reform has been both the source and a major limitation - perhaps the major limitation of China’s economic transition since 1979”. Within the labor market, wage determination is crucial to establishing a wage norm for the price level as well as to an effective wage distribution. Current literature related to the labor market has monitored reform developments including agricultural reform and the establishing of Town and Village Enterprises (TVE), reform of State-Owned Enterprises (SOE), the evolution of the household registration system, as well as different wage reforms which have originated since the “iron rice bowl” (see Zhao, 2005/ Saha, 2006/ Meng, 1994 and 2000/ Hope, Yang, and Li, 2003). Empirical studies on different issues of the Chinese labor market have been conducted, such as rural-urban issues and migration (Meng, 2000/ Meng and Zhang, 2001/ Yao, 2001/ Jalan and Ravallion, 2001/ Zhao, 2005), the rural industrial sector (Meng 1994/ Yao 1999), SOE industrial sector (Larus, 2005), as well as public and private sectors (Weinhold and Zak, 2005).

The overall consensus of academics finds that the Chinese labor market is segmented (see Zhao, 2005/ Fleisher and Yang, 2008/Qian, 1999/ Meng and Zhang, 2001). Often this segmentation is simplified into the rural-urban dichotomy and analysis focuses on empirical analysis of wage developments while limiting the role of institutions in the wage determination process to a supporting role, if it is taken into consideration at all. Some authors recognize a more detailed segmentation within the two-tiers itself in their analysis, but an explanatory analysis of the interactions is omitted. For example Qian (1999) further classifies the urban area into SOEs, collective enterprises, private firms, foreign owned firms, stock listed companies, and joint ventures, whereas the rural area consists of TVEs and the private sector. When only addressing aspects of the fragmented Chinese labor market, it becomes difficult to

comprehend its complexity and interdependence. Often the explanation of short comings and development may lay in the underlying institutional design. Some authors such as Meng (1994 and 2000) will argue that the Chinese labor market has become increasingly flexible with evidence of a neoclassical labor market with an evolving market mechanism, whilst others will reject the competitive hypothesis and argue that administrative controls on wages and employment continue to exist (Yao, 1999) and that there is no evidence of regional or sector wage conversion (Yang, 2005) as the neoclassical model would predict. Other studies (Fleisher and Yang, 2008/ Cai, Park and Zhao, 2004) identify no major developments which have led to an improvement in the functioning of labor market mechanisms. It has however become clear that China has inherited several institutions from the pre-reform era which in the post-reform era interact with the newly emerged labor market (Cai, Wang and Du, 2005).

Regional experimentation rather than the “big bang” approach has been a notable feature of Chinese reforms. Policy makers did not prescribe to the mainstream economic formula of development (Cao, Qian and Weingast, 1999 / Qian 2002). The results are reflected in regional differences in the pace of economic reforms (Knight and Song, 2005). Parallel to economic reforms similar developments are apparent in the evolution of the labor market. Though China is an authoritarian regime with a high degree of centralization, the central government has and continues to give provincial governments substantial leeway to test new policies.⁶⁴ Historically the Chinese approach to reform has shown laboratory federalism under which selected regions or cities implement various policies (Oates, 1972). Reflective of this, regional experimentation of modern reforms demonstrate a relatively high degree of regional decentralization (Qian and Xu, 1993). Failure of the Washington Consensus and the distinct complexities in China underline that no precise road map for institutional reforms which countries can prescribe to was at hand for the Chinese leadership. Lacking such a blue print make regional experimentation ever more useful as it allows minimizing costs through structured learning during the implementation of reforms (Qian, 1999). For a diverse and large country such as China, this experimentation may prove even more vital than for smaller and more homogenous countries. Next, an overview of major developments in the Chinese labor market should provide the basic fundamentals for understanding the institutional design of the Chinese labor market and its wage determination system.

6.1 Institutional change during the stages of labor market reform

At a first glance the Chinese labor market and its system of wage determination seems unrecognizable from the founding of the People’s Republic of China in 1949. However, it too has followed an evolutionary pattern and the development of its labor market has gone through three stages (Cooke, 2008). At a starting point it is important to note that transitional economies generally are faced with a weaker formal framework and legal institutions compared to more developed countries during the reform process. It has already been stressed that institutions cannot be changed or replaced at once, regardless of the political or revolutionary will behind the reform efforts. For the purpose of this section the influence of pre-reform institutions will define path dependence within which the labor market is emerging as it is crucial to emphasizing the institutional constraints within China needs to transform its institutions. Within this context a brief introduction of the major changes in Chinese industrial

⁶⁴ The administration under Xi Jinping has however given indications that it aims to centralize power stronger. How these policies would precisely alter the political condition is not yet clear as of December 2014.

relations and the institutional environment in which its wage determination mechanism has evolved shall be provided. The first stage was a highly regulated, paternal system. Under this concept workers were assigned to a work unit (*danwei*) which provided a wide range of social benefits, including lifelong employment, housing, schooling and basic health care. The second stage saw a period of unprecedented growth and deregulation accompanied by the destruction of many former labor market institutions, resulting in social imbalances. The third and current stage aims at reducing social inequalities through a series of regulative measures and experimentation in building modern Chinese industrial relations.

6.1.1 Socialist pre-reform labor Market (1949-1978)

Prior to 1978 the organization of labor was centered on the work unit which was at the core of the Chinese iron rice bowl.⁶⁵ Under this concept workers would be assigned to a work unit functioning as a sort of community within the society, providing its workers and their families with a wide range of social benefits.⁶⁶ Generally, these benefits included lifelong employment, a high degree of income equality, and additional benefits such as housing, schooling, and health care.⁶⁷ Such extensive welfare, however, was only granted to members of the work unit, and variations between different enterprises were notable. The system did not exempt workers from all kind of hardship (e.g. during the Great Leap Forward), but for the most provided basic care for its members. Notably, the rural population did not have access to such industrial welfare provisions, having their basic needs provided through rural people's communes instead (Shen, 2007). The basic concept between the urban and rural forms of organization is similar in nature while differing in quality. Because of this it is common to use the term work unit for urban as well as rural areas in current literature; the same will be done in this text.

Wages were determined by a centralized wage grid system which was detached from most performance indicators any profit-oriented organization might pursue. Instead, the wage grid system was a government-set wage rate, mostly determined by seniority and formal qualification. Regional differences were taken into consideration as well, but normally wage differentials across the country were limited (Meng, 2000). Essentially, it detached wages and employment from company performance, establishing nearly complete security (Saha, 2006). Due to its robustness the system was referred to as the 'iron rice bowl'.⁶⁸ Institutional arrangements resulted in severe limitations on labor mobility, since income and social security were usually directly linked to the work unit (Fleisher and Yang, 2008).

⁶⁵ There is abundant literature on the work unit system as well the development of the Chinese labor market since 1949. More detailed studies of the different reforms are provided by e.g. (Qian, 1999/Cooke, 2005/Lee, 2000/Korzec, 1992).

⁶⁶ Next to the economic role, the work unit system was also a tool for political control of the population (see Heilmann, 2004)

⁶⁷ The wage grid system did have variations with seniority and qualification being the most important determinants. Regional differences were taken into consideration as well, but generally wage differentials were limited (Meng, 2000).

⁶⁸ Not all workers were part of the work unit system as it was accessible only to urban residents based on the relevant household registration status. Rural residents had access to more limited benefits through rural communes (Shen, 2007).

China's pre-reform institutional setting thus created an extremely rigid labor market in which the state occupied a significant part in the welfare system undermining any type of flexible markets. Using paternalism to shield the working population by guaranteeing social welfare and at the same time limiting widespread inequality the government maintained tight control.⁶⁹ The socialist Chinese economy created a dualistic, but egalitarian society, reflecting a significant urban-rural divide, although incomes within each sector as well as between the sectors were fairly equal (Naughton, 2006). Despite the limitations on the labor market, the complimentary institutions including the wage grid, kept wage dispersion and inequality in check. Another factor for this egalitarian society, however, was also the fact that in the socialist, agriculturally-based economy anyone other than the elite was more or less equally poor. Under the socialist economic regime the majority of China's labor force was employed either in rural communes or in urban state-owned enterprises, but the distribution of jobs was about to significantly change with the onset of economic reforms and the opening up of the Chinese economy (Fleisher and Yang, 2003a).

6.1.2 Economic reforms and deregulation (1978-2003)

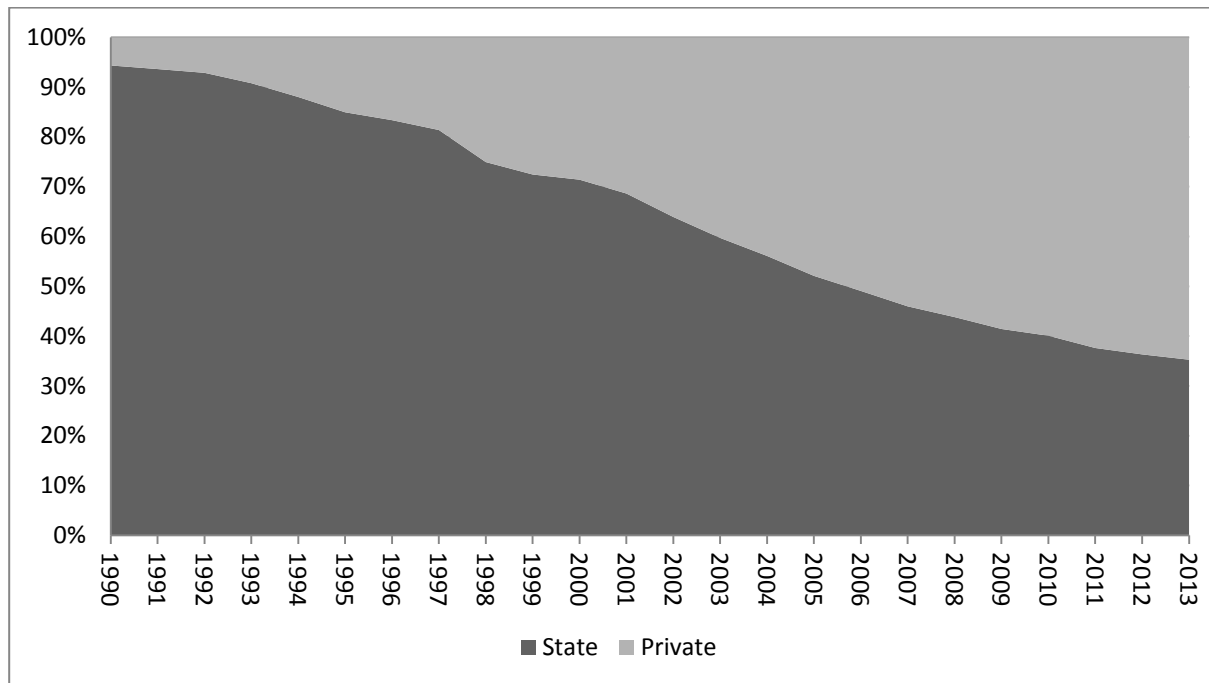
A crucial factor in the initial reforms was the labor market, although this was more implicit and not a central point to any reform efforts. During the process of shifting from a planned economy to a market based one, the government significantly reformed the labor market, gradually dismantling the government controlled system to form a more competitive market. As the Chinese government continued its marketization efforts of the Chinese economy, benefits provided for by the work unit have gradually disappeared. During the massive deregulation period one of the main priorities of the reforms was the breaking up of the paternal government employment system including the wage grid system. Reforming these institutions had an immediate impact on the workforce. Despite not being at the center of reforms, according to Fleisher and Yang (2003a) "labor market reform has been both the source and a major limitation - perhaps the major limitation of China's economic transition". The reforms however got off to an uncertain start and it was not until the aftermath of Deng's southern tour that the pro-reform fraction within the party's elite was able to establish its power and facilitate deeper reform.

During the 1990s the government increased pressure on SOEs to increase productivity and to transform themselves into profitable companies. Initial reforms limited exposure to market mechanisms, but continuous privatization efforts reforms began to specifically target the labor market affecting a higher proportion of the labor force. Correspondingly labor market reforms entered their most radical phase as well when the government significantly down-sized the public sector, putting an end to "cradle-to-grave" socialism and lifetime employment (Dong, 2004). While few had been previously employed in private enterprises, the distribution significantly changed during the reform process (Fleisher and Yang, 2003b). Whereas the process was relatively slow to pick up pace, the proportion of employees working in state-owned enterprises rapidly decreased during the early 1990s (see Figure 6). Continuous marketization efforts of China's industrial relations, specifically related to the determination of hiring, dismissal, and wages, transformed the paternal employer-worker system to an

⁶⁹Although wage inequality may have been limited, hidden inequality can be assumed to have been present as party officials have had better access to non-monetary income and benefits. However, current inequality is much more widespread and substantial.

exchange of labor services for wage payments (Rawski, 2003). Consequently, as has been the case in other post-communist countries, a major employment and welfare institution was reformed, significantly influencing the labor market but also fundamental values of the Chinese society under the CPC's rule.

Figure 6. Development of share of urban private and state-owned employment, 1990-2013



Source: own calculations based on NBS data.⁷⁰

In the process of marketization private enterprises became increasingly important for employment, while at the same time government controlled enterprises laid-off workers, significantly reducing their social benefits. The changing composition is illustrated in Table 11, presenting how the various forms of private ownership types were crucial in job creation enabling the government to reduce employment in the state-owned sector.

⁷⁰State-owned includes SOEs, cooperative units, collective owned units, and shareholding companies while private is compiled by joint ownership, limited liability corporations, private enterprises, foreign owned (including Hong Kong, Macau, and Taiwan), and self-employed). Please note that some joint ownership might be majority state held, while some shareholding companies might be majority private owned. Therefore, the exact figures should be treated with caution. Data here should rather be seen as an indicator of the basic privatization trend.

Table 11. Chinese employment structure, 2001-2012*
number of employees in million

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Change 2001- 12
Total number of employed persons	730.3	73.7	744.3	7.5	758.3	749.8	753.2	755.6	758.3	761.1	764.2	767.0	5.0%
Primary industry (in %)	50.0	50.0	49.1	46.9	44.8	42.6	40.8	39.6	38.1	36.7	34.8	33.6	-16.4
Secondary industry (in %)	22.3	21.4	21.6	22.5	23.8	25.2	26.8	27.2	27.8	28.7	29.5	30.3	8.0
Tertiary industry (in %)	27.7	28.6	29.3	30.6	31.4	32.2	32.4	33.2	34.1	34.6	35.7	36.1	8.4
Urban employed persons	239.4	247.8	256.4	264.8	273.3	296.3	309.5	321.0	333.2	346.9	359.1	371.0	55.0%
SOEs	76.4	71.6	68.8	67.1	64.9	64.3	64.2	64.5	64.2	65.2	67.0	68.4	-10.5%
Urban collective-owned units	12.9	11.2	10.0	9.0	8.1	7.6	7.2	6.6	6.2	6.0	6.0	5.9	-54.4%
Cooperative units	1.5	1.6	1.7	1.9	1.9	1.8	1.7	1.6	1.6	1.6	1.5	1.5	-2.6%
Joint ownership units	0.5	0.5	0.4	0.4	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.4	-13.3%
Limited liability corporations	8.4	10.8	12.6	14.4	17.5	19.2	20.8	21.9	24.3	26.1	32.7	37.9	350.3%
Share-holding corporations	4.8	5.4	5.9	6.2	7.0	7.4	7.9	8.4	9.6	10.2	11.8	12.4	157.3%
Private enterprises	15.3	20.0	25.5	29.9	34.6	39.5	45.8	51.2	55.4	60.7	69.1	75.6	394.9%
Hong Kong, Macao, Taiwan funded	3.3	3.7	4.1	4.7	5.6	6.1	6.8	6.8	7.2	7.7	9.3	9.7	197.2%
Foreign funded	3.5	3.9	4.5	5.6	6.9	8.0	9.0	9.4	9.8	10.5	12.2	12.5	261.2%
Self-employed	21.3	22.7	23.8	25.2	27.8	30.1	33.1	36.1	42.5	44.7	52.3	56.4	164.8%
Rural employed persons	490.9	489.6	487.9	487.2	484.9	453.5	443.7	434.6	425.1	414.2	405.1	396.0	-19.3%
Urban unemployment (in %)	3.6	4	4.3	4.2	4.2	4.1	4.0	4.2	4.3	4.1	4.1	4.1	0.5

*Please note that employment data by enterprise type are based on the annual population sample survey. As a result, the sum of the data by ownership and by sector is not equal to the total.

Source: NBS

The demolition of the work unit system and the establishment of a mix-economy conveyed an increase in private held enterprises, entrepreneurialism, and profit orientation. But unlike in many Western or post-communism European countries where capitalism and workers' rights were able to develop themselves during the industrialization process within a less controlled society, any such developments remained under tight orchestration of the Chinese government. In order to please the country's desire for industrialization and economic development, output, investment and profits were given strategic priority. Lacking explicit labor market reforms this often came at the expense of workers' rights and the environment. Whether deliberate or not, elements of neoliberal labor market mechanisms were deemed necessary to generate employment for a massive number of laid-off state employees in an effort to reform highly unproductive government enterprises. If this apparent economic policy

path chosen by the Chinese government was necessary for job creation remains debatable.⁷¹ It did however establish the foundation for establishing a market driven modernization process of the economic system solely controlled by an alliance between political and business elites (ten Brink, 2013b).

6.1.3 Consequences for a labor force in transition

The marketization of labor markets naturally also had profound consequences for wage determination in China. While job security and centralized wage scales were removed, SOEs were granted more freedom in setting wages (Yueh, 2004). SOE personnel departments subsequently implemented performance-based wage schemes (Saha, 2006). They thereby contributed to the wage drift between high and low-skilled workers. While scarce skilled labor was enjoying rapid wage increases, the enormous pool of unskilled labor in combination with the intense rural-urban divide resulted in low wages for the majority of the workforce (see Rawski, 2003 / Chan, 2005). Consequently, though China's growth has been exceptional and improved the lives of the vast majority, it was at the same time highly unbalanced, between urban and rural areas, coastal areas and hinterland, skilled and unskilled labor. Given the size and complexity of the China, this however can be expected during a process of economic reforms.

Despite of the reform efforts towards a more market oriented labor market, industrial relations continued to remain under tight government orchestration. Neither the discriminatory household registration (*hukou*) system nor the political control over the workforce was relaxed. Due to major deficiencies in the social safety net, the household registration system, continued to be a barrier to labor mobility, particularly when a worker wished to change the workplace to a different type of ownership or to another geographic location (Fleischer and Yang, 2003a). Fear of evolving into a political movement, prevented any non-governmentally-endorsed worker's voice from establishing itself in this process (Luo, 2011). In combination with a weak legislative framework this put the workforce into a disadvantaged position to their employers. The initial reform outcome let management in public and private enterprises gain the upper hand in post-reform industrial relations (Cooke, 2008). With increased privatization of its economy, China labor market became notorious for poor working conditions, default on wages, low wages, forced labor and other forms of abuse (Luo, 2011). A situation mostly tolerated by government officials in order to achieve high GDP growth rates.

Breaking the iron rice bowl, hence, brought dramatic changes to the Chinese labor market. First, over time the state controlled enterprises increased worker lay-offs. As outlined above these workers were reliant to find subsequent employment in the newly established and highly unregulated private sector. Younger generations entering the workforce found themselves confronted with a very different scenario from previous generations. Criteria determining employment and ensuing working conditions of a more flexible labor market had changed dramatically. Searching for job opportunities, portions of the population began to migrate within the country; typically from rural to urban areas. However, constraints due to the household registration system (household registration) put migrant workers in a difficult legal

⁷¹ Theoretically and empirically it is highly contented whether such economic policy, often relying on low wages, is needed to increase employment.

situation, making them susceptible to exploitation.⁷² Millions of unskilled and semi-skilled workers entered the underdeveloped labor market (Cooke, 2005). Commonly these private sector jobs were described as “three-D-jobs”: dangerous, dirty, and demanding. Usually they are attributed to little job security or benefits as the usually informal nature of such jobs made it easy for employers to evade formal rules regulating the labor market (Cai, Wang and Du, 2005).

Second, wages have become increasingly determined by the market and profit orientation leading to an increase in wage dispersion along the different segmented sectors of the labor market. The lack of labor market institutions filling the large gap left by the demolition of the iron rice bowl set condition for establishing a flexible labor market with an uneven employer-employee power relationship. Third, the work unit system at SOEs in itself was a complex institutional arrangement which not only affected employment and wage determination mechanisms (Frazier, 2002), but embedded its employees in a social security system including health care and retirement as well as additional individual privileges. The sophistication of the work unit system underlines the dramatic changes that workers were faced with as many components of the previous institutional arrangement began to crumble while new institutions were too weak or slow to evolve. Taken together, the reform process of the 1990s resulted in a dramatic change in Chinese industrial relations.

Public attention on high profile cases of labor and environmental maltreatment have been cause of much discussion in China.⁷³ In the reforms aftermath China’s labor market has been in the press internationally and to an increasing amount domestically for poor working conditions, default on wages, low wages, forced labor and other forms of abuse, not to mention the depletion of the environment which is contributing to health problems within the population while keeping production costs low. Official data from 2004 reveal that 145 million workers did not have any kind of formal contract (IHLO, 2008), with actual figures are expected to be much higher. The informal nature of many private sector jobs and the lack of institutions substituting the previous industrial relations arrangement let employers evade rules (Cai, Wang and Du, 2005). Unpaid wages and violation of employee rights became an apparent problem within the labor market and were an indicator that the labor market has become highly unregulated. A survey conducted by the Standing Committee of the National People’s Congress (NPC) in 2005 found that 80% of private firms violate employee rights.⁷⁴ This is reinforced by figures for defaulted wages. Considering many cases of unpaid wages are not reported, an exact figure on default wages during that time can only be estimated as official data may only be the tip of the iceberg. However, national data on defaulted wages from the state regulated construction industry may illustrate the enormity of the problem:

⁷² The household registration system (hukou) was established in 1951 and did not originally intend to control movement. However, since the failure of the Great Leap Forward it was used to control movement due to food shortages. In this sense it took on a more macro oriented function. Since 2000 the household registration system has been reformed, but certain aspects still limit mobility without constraints as accessibility to education and other social benefits may be restricted. As with many Chinese policies the household registration system has local variation (see eg. Zhao, 2005).

⁷³ There is equally abundant literature on the negative consequences for the labor force especially prior to 2008 (see e.g. Chan, 2001).

⁷⁴ Reported in the China Daily, on Dec. 29th, 2005 http://www.chinadaily.com.cn/english/doc/2005-12/29/content_507514.htm

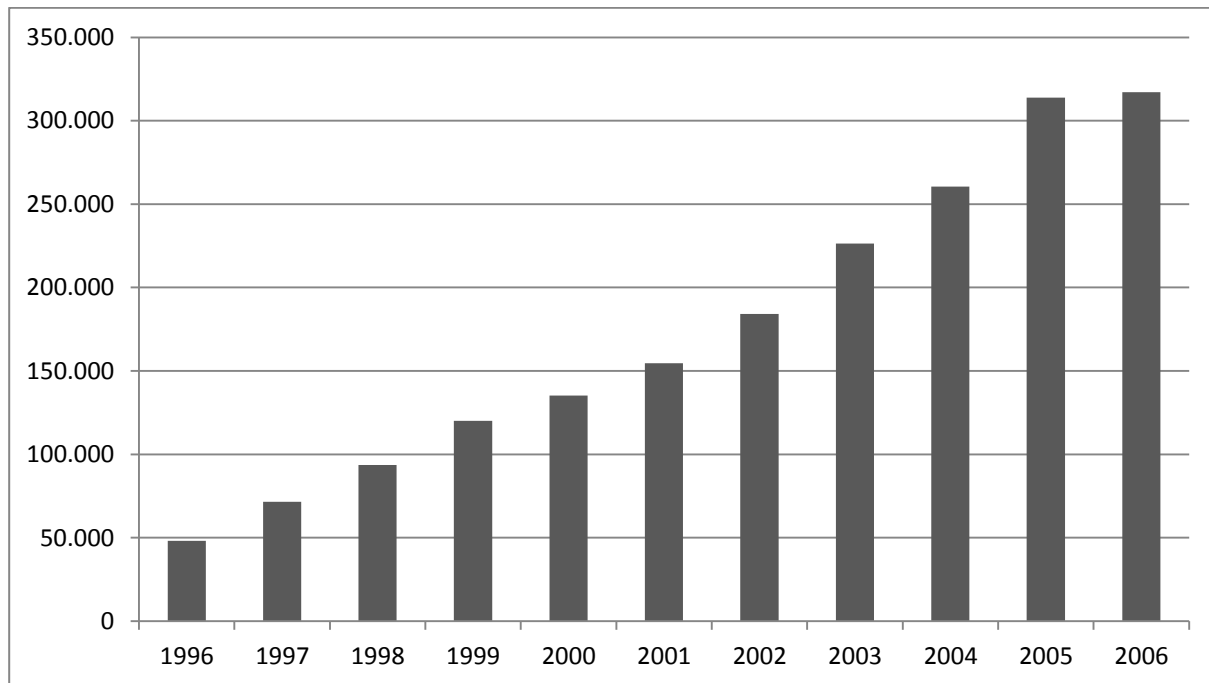
RMB278 billion (2001), RMB336.5 billion (2002), RMB367 billion (2004) (Chan, 2005).⁷⁵ Data for 2001 indicates that private companies were especially prone to disputes, being involved in far higher numbers than state-owned companies (Cai, Wang and Du, 2005). The negative trend of rising labor disputes (see Figure 7) increased over the years indicating that the Chinese labor market faced significant challenges and discontent among its labor force. As with figures for defaulted wages, the official data may only be an indicator for a much greater national problem at the time.

Though in aggregate terms China's massive population has enjoyed significant benefits during the government reform efforts, it has become clear that the rapid GDP growth has come with a price-tag and that workers' rights were not being adequately protected. As inequality grew and benefits of the reform effort became unevenly distributed among the population, discontent about unfair treatment rose. Official data shows that the number of labor disputes rapidly increased during the reform process potentially creating a problematic scenario for the one party system. Without policy action continuous exploitation of natural resources and labor could otherwise backfire threatening the country's tremendous economic development.⁷⁶ During Chinese rapid growth period many economic costs were externalized by the industry at the cost of the public. In how far this policy has contributed to the enormous growth and impressive development of the Chinese economy would require further detailed research. Perhaps other economic policies would have been more suitable and sustainable, but a full discussion of this topic is beyond the scope of this text (see e.g. Stiglitz, 1996).

⁷⁵ These figures are taken from new conferences or press releases quoting government officials.

⁷⁶ Economic development at the expense of the environment may inflate actual GDP and enable short-term growth. However, this degradation comes with significant long-term costs, and therefore it is not a recommended strategy. The Chinese government has reacted to international and more important, domestic pressure identifying environmental protection and sustainable development as a desirable goal. Just recently it was announced that the State Environmental Protection Administration (SEPA) will be upgraded to a ministry.

Figure 7. Number of labor disputes, 1996-2006



Source: China Labor Statistical Yearbook 2006

Regardless of this debate, this policy influenced initial economic reform and labor market policies. After achieving first milestones, these policies have not been able to adapt to challenges related to dissatisfaction and uncertainty in society. China's current social problems become apparent when considering the growing income and wealth gap in the country as well as the speed at which this has happened. Certainly the vast majority of the country has benefited from the country's development in terms of living standards, but as the wealth gap rose and workers' rights were being violated further change seemed indispensable. Abolishing the iron-rice bowl under the work unit system were important steps in the marketization efforts, but the government has not established labor market institutions effectively protecting worker's rights, while at the same time private enterprises have had the opportunity to exploit a wide range of opportunities with little regulation creating a significant power imbalance.

The lack of supporting social institutions following the initial reforms might be a threat to the continuous transition to private employment (Fu and Gabriel, 2001). The move from a socialist paternal labor relations system has been implemented without providing the labor force neither much possibility to adjust nor supplying it with necessary support providing institutions. In a sense the Chinese labor market flexibility became so prevalent that when there was less demand for work, workers often had no income, while during busy periods overtimes reach levels in violation with national laws (Chan, 2005). The government has relied on the private sector for job creation as it was downsizing the state-owned sector and perhaps for this reason has provided management much leeway in establishing an industrial

relation system best suiting their needs. In this process the government has shifted from a system where it had complete control over labor, benefits and wages to a system where its influence has significantly been reduced. From an enterprise's perspective these conditions might be favorable at first, but this kind of capitalism cannot be sustainable in the long-run. Uneven institutional evolution of labor markets including their regulation had profound economic, social, and political consequences for China. Dealing with the challenges of the transformation of the labor market is an essential task the Chinese government had to tackle (Fleisher and Yang, 2003b).

Adding to the complexity, a new generation of workers emerged. The present generation of workers, born in the mid-1980s or 90s, is less willing to accept the kind of hardship and grim working conditions in combination with living in dull dormitory camps within crowded industrial clusters (see Li and Feng, 2011). Additionally, today's workers are better connected via mobile phones and the internet and far better educated about their rights. Nonetheless, for the majority it won't be feasible to truly bridge the urban-rural gap, as even many urban residents are struggling and social pressures continue to intensify. The desire, amplified by social expectations, of owning living space, a scooter or even a car, will remain unattainable, whereas the successful, lucky, privileged (and not to seldom corrupt) are living the Chinese dream. This might have been accepted in silence under previous generations, but resentment in China's overly hard-wearing labor force has been slowly building up. At this stage it has become evident that enterprise reforms have far outpaced social reforms (Fleisher and Yang, 2003b).

6.1.4 Rebuilding China's industrial relations (since 2003)

At this stage of the Chinese labor market reform, the evolution of institutions regulating the now more flexible market were slow to evolve, often providing employers with far more leverage over the average worker. Amplified by negative developments on the labor market in 1990s and 2000s, perhaps convinced the government to introduce stricter rules and regulations. Faced with increasing social unrest, the leadership of the party began to realize that its prior strategy of achieving rapid economic development at all costs was not sustainable. In pursuit of the party's goal for building a harmonious society, the leadership under Hu Jintao (in office 2003-2013) introduced policies to improve the situation of workers and limit disparities. Labor market regulations became central to the government's efforts in building new industrial relations as they have an important redistributive role and can provide vulnerable categories of workers with necessary insurance from adverse market outcomes (Cooke, 2008). A process of balancing an employer-friendly environment into a more employee-friendly institutional setting began to emerge. Requirements to enter contractual agreements with workers, attempts to utilize unions, experimentation with collective agreements and tripartite consultation, tripartite arbitration, wage guidelines, a wage information system as well as the implementation of minimum wages (see Table 12) indicate that the labor market became a central issue to government policy.

Table 12. Changes in Chinese labor law legislation

1992	Trade Union Law
1993	Industrial Relations Regulations
1994	Collective Contract Provisions
1995	Labor Law
	Provisions of Labor Law Establishing Minimum Wage System
1999	Labor Market Wage Guidelines
2000	Decree on Collective Wage Negotiations
	Regulation on Labor Market Management
2001	Revision of Trade Union Law
2004	Promotion of Collective Bargaining and Collective Agreements
	Minimum Wage Regulation
	Revision of Provisions for Collective Agreements
2005	Anti Discrimination Regulations
2008	Labor Contract Law
	Law on Mediation and Arbitration of Labor Disputes
	Employment Promotion Law
2015	Changes to Regulation on Collective Contracts ⁷⁷

Source: own table based on information from MOLSS.

A milestone was the Employment Contract Law of 2008 which granted employees improved protection and legal rights. The new Employment Contract Law taking effect January 1st, 2008 was intended to provide employees with improved protection and rights. A core component of the law requires employers to enter into a contract with an employee within 30 days of fulltime employment. Further, the law sets out to provide improved protection of employees' rights. In the process opinions were publically consulted with several foreign chambers of commerce vocally expressed opinions on first drafts of the China Contract Law in in favor of watering down the legislation (see Freemann and Li, 2011). It is likely that Chinese employers' associations expressed concerns, but due to their close relationship with the government, the

⁷⁷ The changes affect Guangdong province only. They were passed as a law by the Standing Committee of the People's Congress of Guangdong Province in September 2014 with the law taking effect on 1. January 2015.

process would be less public (see also section 6.2).⁷⁸ Shortly after coming into effect, the Labor Contract Law has made a positive contribution to strengthening workers' rights. Together with the complementary Law on Mediation and Arbitration of Labor Disputes, legislation has proven itself an effective tool to advance workers' rights.⁷⁹ The move can be seen as a step to pursue more sustainable economic growth by establishing certain minimum standards, all intended to contribute to a more harmonious relationship between workers and employers.

The persistent increase of unequal income distribution was recognized as an eminent threat to macroeconomic stability, which has always been a paramount goal of policy-makers in China (Priewe and Herr, 2005). To ameliorate the negative side effects of unregulated markets, the government has been trying to implement a new framework to regulate labor relations, specifically targeting the private sector. Labor market legislation is usually issued by the central government, however, given China's vast geographic and development differences, implementation is highly decentralized by giving local authorities more room for interpretation. Under Xi Jinping reforms have been further announced mainly focusing on redistribution, but also including experimentation of collective bargaining (see section 7.2).

6.2 The institutional transformation of Chinese wage bargaining system

The brief outline of major developments affecting the Chinese labor market provide a basic overview of the institutional structure and how it is transforming the old labor system in an attempt to establish a unique Chinese labor market. A major limitation of current theory behind institutional economics strongly influenced by neoclassical theory has been that a clear understanding of the institutional requirements which would be essential for establishing market mechanisms is lacking, while the necessary institutions, which are much more established in developed economies, are taken for granted (North 1997b). Qian (1999) notes that "the gap between conventional economic thinking and the realities of transition shows that our knowledge about institutional change in general and transition in particular is quite limited". China's huge economy and political structure will further limit the applicability of current theory.

The example of the experiences of the Asian Tigers (see section 4.1) reveals much of these limitations. The common experience for most of the Asian Tigers has been that in the initial reform stages the existing institutional structure underwent severe transformation. A fixation of rapid economic growth was accompanied by a rapid marketization of the labor market. Wage determination in particular was mainly determined by supply and demand within a weak or absent institutional time period. A rural-urban shift provided abundant low skilled workers to a labor market dominated by the employers, resulting in increasing wage dispersion. Most importantly these developments were orchestrated by a strong state trying to re-engineer the

⁷⁸ It is difficult to attribute respective changes to the draft to specific lobbying groups.

⁷⁹ Prior to the introduction of the new Labor Contract Law, employees had far fewer rights and often never entered a formal contract. The new rules require a contract be signed after 30 days, max. In case of dispute, arbitration channels are now accessible free of charge, whereas prior to 2008 employees had to pay a fee of RMB300 upfront. Consequently, reported labor disputes have been on the rise, and according to the NBS data more than doubling with the introduction of the new legislation.

institutional framework of the economic system. Driven by high growth ambitions the government attempted to formulate favorable conditions for employers', strengthening market mechanisms within a state-capitalist regime. For the most part economic reforms preceded reforms of building new or transforming existing labor market institutions which would have improved workers' bargaining power. A regulatory framework remained absent or was not enforced in order not to threaten growth target. At the same time labor market institutions which would appear to have been natural to appear, such as independent unions, were suppressed in most of the countries. The conditions for a classic sweatshop with bad working conditions and increasing wage dispersion were set.

As these countries developed, productivity and skill levels increased, so did the sophistication of the economy and the workforce. Once countries reached this part of the reform process strengthening the institutional framework and beginning to control market mechanism became a bigger focus in economic policy. Referring to transitional economies Ronald Coase (1992) noted that "without the appropriate institutions no market economy of any significance is possible". Undeniable the growth model chosen by the Asian Tigers achieved tremendous economic growth and one can say successfully managed to quickly develop their originally predominantly agricultural and backward economies. However, at a certain point an institutionalization of the market mechanisms began to set in. Most governments began to introduce stricter legislation and enforcement shifting the power balance in a more favorable position for workers.

The example of China for the most part followed precisely the same path of development compared to the economic development of Hong Kong, Taiwan, Korea and Singapore. Once these economies reached a certain stage of economic development as they entered more moderate growth periods, differences in economic policies began to emerge. The differences include the role of the government, establishment of independent unions and employers associations, as well as wage bargaining mechanisms and very importantly the political environment. Korea and Taiwan emerged as democracies while Hong Kong is considered a semi-democratic territory and Singapore has its political system under a de-facto one party rule with democratic elements. The important point is that the transitional economies reached a decision point where next to economic reform, political reform also become more pressing in order to remain compatible with economic and social development.

The political outcome after this crucial development stage in the different countries however has significant differences. For most countries the role of the dominant government was weakened and policy differences became stronger. With an ethnically homogenous population of 50 million, 23 million, 7 million, and 5 million in Korea, Taiwan, Hong Kong and Singapore respectively, achieving more balanced economic development throughout the country/territory is far less challenging compared to achieving the same for 1.3 billion people.⁸⁰ Comparing China's development with the Asian Tigers thus has its limitation as China most likely is not comparable to any other country. Although the better developed coastal areas may have reached the point of development where the state would be expected to retreat its influence in the development process and launch political reforms, the lesser developed interior of China still leaves the country as a hole at a lower level of development.

⁸⁰ At this stage I just wish to clarify that the term territory reflects the political status of Hong Kong as a Special Administrative Region of the Peoples Republic of China. Taiwan (Republic of China) is a de-facto independent country and not a territory. After getting to know the proud Taiwanese people, I feel obliged to make this clear.

The country therefore faces an economy at different levels of development which makes classifying the Chinese economic system ever more challenging. However, during the fourth plenary session of the CPC' Central Committee in 2014 announced strengthening the rule by law (not of law). This can be seen as a first small step, though it has also been made clear that the authority of the CPC is above the law and that no political reforms are impending.

6.3 Fundamentals of shaping Chinese wage bargaining system: market mechanisms and government policies

As has been demonstrated above classifying economic systems and wage bargaining regimes has theoretical limitation as it mostly focuses on developed economies (see section 1.4 and 2.4.3). The underlying economic system sets the foundation for the wage bargaining system, however applying existing theory on transitional economies will need some modification. It has been demonstrated in chapter 1 that economic systems are influenced by a wide variety of factors including industrial structure, culture, political environment or diversity and size of the country. This has lead Hollingsworth and Boyer (1998) to conclude that more diverse countries also have different levels of economic development and consequently typically will have a lower degree of institutionalized coordination. With about 20% of the world's population, with many ethnic groups, vast geography as well as different regional development stages ranging from highly developed to under developed, this certainly applies to the Chinese economy.

It is very tempting to assume that the Chinese growth model fit the neoclassical theory with a liberal market-orient system. This assumption would translate having one expect an institutional setting in favor of an atomistic wage bargaining system dominated by enterprise level wage bargaining and weak employee and employer associations resulting in low centralization and coordination (see Table 5). Classifying the economic system as neoclassic would however discount the strong influence and controls the authoritarian governments have. When the old institutional framework is being reformed, it cannot be instantly be replaced by another. The development of the Chinese labor market as well as similar experiences in Hong Kong, Singapore, Korea and Taiwan all paint a similar picture. Higher levels of coordination or centralization require a stronger and more developed institutional structure. It is therefore no surprise that during the initial economic reforms that a liberal-market oriented economic system, which however is under strong influence of the state, and an atomistic wage bargaining system evolves. From an institutional perspective such a wage bargaining system will be the most simplistic.

As the economic system develops this approach needs change and market regulating institutions have been introduced. The development in the Chinese labor market since shows that in the mid-1990s first efforts were undertaken to start building a new institutional foundation replacing the former labor system. These efforts accelerated over time and began to progressively establish themselves. China's transition must be seen as a series of incremental changes in which it is has been dismantling its previous labor system and is on a path to establishing an urban labor market. Given the complexity it is only natural that the Chinese labor market at this stage remains imperfect and incomplete (Knight and Song, 2005). One can only imagine how Chinese wage bargaining system would evolve without the dominance of the CPC. With a high degree of industrial production with massive number of

unskilled and semi-skilled workers one could expect that these would be the perfect preconditions for independent unions to evolve. However, as the government continues to engineer the institutional foundation for wage bargaining at this stage of economic development it will require a closer look at some crucial institutions in Chinese industrial relations.

Market mechanisms

The influence of market mechanisms are not the core focus of this research, however, based on the historical developments of the Chinese labor market some key points shall be introduced. A key element in breaking up the iron rice bowl was reducing employment at SOEs and boosting employment at private enterprises (see Figure 6). Reforming the rigid wage determination system translated into having a growing portion of wages being non-regulated and increasingly market driven. Ideally pay should then be based on qualification and performance, and regional disparities would attract migration from low earning regions to regions with higher pay reducing wage differentials over time (Yang, 2005). Elements of a competitive market did begin to establish themselves while the institutional framework regulating the market had yet to develop. At the bottom of the labor market were unskilled workers from rural areas which were flocking to the factories in the rapidly developing coastal cities.

Since the onset of Chinese economic reforms the influx of migrant workers from the rural areas to the rapidly developing coastal areas has been a notable feature during the transformation of the labor market. The enormous pool of relatively unproductive unskilled and semi-skilled workers looking for jobs and better lives in the cities, initially resulted in increasing wage dispersion, poor working conditions and job security during the marketization process (see also section 2.1). While blue collar workers in the expanding private sector faced an employment market dominated by employers with little legal security and wage bargaining power, the skilled workers were in a far better position to bargain for higher pay and opt for better positions and conditions under this competitive environment. On average real wages increased for all Chinese employees, with even the SOEs which at the time were massively laying-off workers increasing wages (Rawski, 2003).⁸¹ Wage dispersion however also dramatically increased as skilled and highly skilled employees were in a better position to exploit opportunities in the private sector. Similarly some parts of the labor market, in particularly migrant workers, and in some sectors particularly women, wages remained stagnant and in real terms declining (see e.g. Rawski, 2003 and Chan, 2005). The increase in flexibility and a higher share of unskilled workers compared to the share of skilled workers created a challenging situation for the majority of the Chinese workforce. As a result this development has contributed to high income disparities and inequality increasing pressure on the social and political system in China.

According to Fleisher and Yang (2008), major issues contributing to problems within the labor market could be contributed to legislation during the reform period often not being “incentive compatible with the goals of local governments”, which mainly focused on rapid GDP growth at all cost, neglecting sustainable development. Efforts to privatize and let market forces take

⁸¹ Although average real wages did increase, it does not account for the loss of social security or health care provided particularly to urban employees of SOEs.

over have paid-off, enabling the evolution to a more market based economy, but at the same time other parallel institutions contributing to a labor market with fair treatment of labor did not seriously evolve until 2008 with the introduction of the Labor Contract Law. This however has been consistent to developments in the other Asian Tigers (see 4.1). Additionally it is debatable in how far the government actually remained in complete control of the privatization efforts during the onset of economic reforms. Heilmann (2004) argues that due to bureaucratic confusion regarding how to control the private sector, combined with a general underestimation of the developments, growth of the private sector was fairly unnoticed and uncontrolled. This led to the point where the private sector had gotten too large to enforce a “conservative counter-strike” leading to a bigger emphasis on strengthening non-market institutions, including welfare and social security.

Compared to the labor market situation during the inception of the economic reforms, the overall market situation has dramatically changed. First, a new generation of ‘migrant workers’ no longer define themselves as migrant workers and instead have become quasi permanent residents in the urban areas. Second, the pattern of migrant workers has been shifting. Rapid economic growth in traditionally labor exporting regions in central and western China has allowed for improved job opportunities closer to home. Third, fewer workers are entering the overall labor market of which a higher percentage of the new generation are shunning labor intensive work (see Li and Feng, 2011 / Elfstrom and Kuruvilla, 2012) contributing to the labor market demand for lower skilled workers to remain tense. Not surprisingly the situation for skilled workers remains unchanged, with it consistently being one of the major employment concerns companies are facing with (GCC, 2013).

Unlike in the past where there was abundant supply of unskilled and semi-skilled blue collar workers, vacant positions have become increasing difficult to fill (GCC, 2014b). Employers therefore are in competition for blue collar workers as well as skilled employees who now enjoy better legal protection and are better educated about their rights. Despite the strengthening of labor market institutions, market mechanisms will of course continue to influence wage bargaining. Market mechanisms are a fundamental principle of any economic system other than purely planned economic systems. In a market based economy elements of varying degrees will always influence the bargaining power of the parties engaged in the negotiation process regardless of the level at which the bargaining takes place. It is however institutions which limit the impact of market mechanism and the dysfunctional pressure they cause (see chapter 1). The Chinese institutional framework and its continuously evolving economic system must be evaluated against this background.

Government

In any economic systems governments determine the rules of how wage bargaining is conducted. Though the importance of government employment and regulation of wage bargaining has become less relevant to the majority of the working population, the government still retains a tight regiment over many elements of the labor market including wage determination. The reform efforts over the past decades have eroded the wage-grid style government control previously known in China and the labor market has continuously shifted from a planned economy to a market based economy. The latest rounds of economic

reforms announce at the Third Plenum of the CPC under the leadership of President Xi Jinping in November 2013 saw further marketization efforts of the state sector by 2020, although specifics have not yet been outlined in detail. Despite continuous liberalization of the labor market, several government institutions still directly or indirectly influence wage determination in the Chinese labor market. Indirect tools mainly include the System for Guidance of the Labor Market, and the Information Guide System of Labor Cost by Industry (Du, Wang, and Lee, 2009) which are supposed to provide improved information on developments in the labor market. Direct measures include employment in the public sector and at SOEs, wage guidelines and most prominently, minimum wage guidelines.

SOEs/Public sector

With the initial marketization of the Chinese labor market, traditional employment and the wage payment mechanisms under the work unit system substantially declined. Certain components of the work unit system remained in place in the SOEs although the government has gradually withdrawn from its extreme intervention of the pre-reform area (Knight and Song, 2005). Initial reforms in the 1990s forced SOEs to lay off a significant part of their labor force and become more productive. In line with this the companies were also granted more freedom in setting wages according to market mechanisms (Yueh, 2004). Accordingly wage structures in SOEs have been reformed during the 1990s, subsequently implementing performance based schemes and a reduction of regulations (Saha, 2006). However, employment and wages remained to enjoy elements of protection and have contributed to growing inequality (Appleton, Li, Song, and Xia, 2013). Employees of the SOEs were hence able to retain some of their privileges, shielding them from the effects which employees in the more unregulated private sector endured. As the employment in the SOE sector continued to decline it did not have the ability to reduce wage dispersion but rather contributed to it.

Wage guidelines

Despite increasing liberalization in wage determination for SOEs, the government established policies to influence market conditions as government and party officials establish wage guidelines mostly for, but not limited to, SOEs. Typically, their influence may pertain to regulating total wages and increases of the total wage bill, leaving internal wage distribution to the management (He, 2003). The concept of wage guidelines was introduced 1999 and are issued by local governments. Usually they are non-binding recommendations, suggesting three different wage increases for companies which are performing above average, average, or below average compared to other companies. How wide spread government wage guidelines are and to what degree they are actually enforced remains unclear. Most likely its implementation will vary widely. Rawski (2003) expects that the overall influence for the majority of the labor force remains negligible as these guidelines most likely are only applicable for executive or mid-level management positions (Rawski, 2003). Recent developments have however seen wage guidelines given a more prominent role in wage determination (see also section 7.2).

Minimum wage

Next to collective contracts minimum wage regulations, in theory are another element of greater tripartite negotiations directly influencing wage developments in China. Regular adjustments can be a powerful tool for adjusting and implementing economic policies affecting the cost of labor as well as general social policies and redistribution. At present minimum wage provisions are the most prominent measure for the government to influence wage structure. Establishing minimum wage legislations across the economy underwent considerable evolution during the past decades, considerably strengthening over time.

7. Institutional Structure of China's Evolving Tripartite System

7.1 Trade unions

7.1.1 Organizational structure and function

The All-China Federation of Trade Unions (ACFTU), the governing body for all unions in China, has not much changed in terms of its basic organizational structure, although its responsibilities have dramatically changed with the demolition of the iron rice bowl where unions' main duties were related to social welfare and leisure activities (Heuer, 2004). Between 2008 and 2013 the ACFTU increased its membership by an average of 14 million annually, to reach a membership of 290⁸² million, covering more than a third of the total labor force, and about 70% of the urban workforce. A breakdown of unionization by ownership type is a difficult task, as figures cannot be confirmed by official ACFTU data. However, Shen (2007) provides own estimations as well as figures used by other authors (see also Traub-Merz, 2011). Generally, SOEs are likely to have a high degree of unionization, with as much as 90% of enterprises having a trade union. Figures for private enterprises and foreign owned enterprises vary by author, ranging from under 10% to about 50%. These figures are to be treated with caution, but it can be assumed that non-SOEs are significantly less likely to unionize voluntarily. Large foreign companies have however been more in the public spot light as the government likes to use them to emphasize its strength. Accordingly it has been reported that 91.9% of the individual investments of Fortune 500 companies have been unionized as of October 2013.⁸³

The ACFTU's current structure is a top-down, hierarchical organization. As outlined by Chinese Trade Union Law grass-root unions can be established at the enterprise level if so desired by workers, which would then represent the lowest organizational level. Competing enterprise unions are not tolerated by the law and all established grass-root unions are subordinate to the local, provincial and industrial levels of organization, with the national ACFTU on top. Grass-root union representatives usually have been appointed by party officials and as a result one could expect that union leadership has been more likely to side with management than to fight for its members' interests. This situation however may be slowly changing or at least becoming less obvious. However, for the vast majority, union leadership is not chosen by workers, their interest can be easily ignored. Contributing to this, local governments are in competition for foreign investment domestically as well as with other rising regional economies such as Vietnam, and may prefer to keep trade unions tame (Chan, 2000). Consequently interaction between union officials and members is nearly non-existent and it may be argued that Chinese unions are likely to operate more on behalf of government and management (Metcalf and Li, 2005). There have been small numbers of enterprise level elections of union officials potentially contributing to provide workers with improved representation, but in how far this mechanism is suitable and supported by the government is yet to be determined (Chan, 2005). As with many policies in China, much depends on the

⁸²Figure reported by Xinhua News Agency in December 2013: http://news.xinhuanet.com/english/china/2013-12/24/c_132993047.htm

⁸³ As reported by Xinhua News Agency In October 2013:
http://news.xinhuanet.com/english/china/2013-10/21/c_132817780.htm

sentiment of local officials. Since local and provincial governments are expected to deliver high growth of output and exports, official sentiment can easily tilt towards employers (Rawski, 2003). The dependence on local governments' preferences can reduce unionization efforts, and, if they are established, their effectiveness and bargaining power.

An important historical role for trade unions has been to keep the government in touch with its workers, having them functioning as a "transmission belt" (Dong, 2004). The top-down function is the mobilization of labor for means of production and serving the government's interest. The bottom-up transmission then is the protection of workers' rights and interest. However, workers have little room to communicate their interests as much bottom-up transmission is suppressed (Chan, 2000). In this sense, its core activities have little to do with Western understanding of trade unions. This historically limited role may have, among others, two reasons. First, the concept of the iron rice bowl, the wage grid system as well as the a non-market economy with non-profit oriented enterprises administrated by the government meant that most traditional trade union activities were occupied by the government, leaving trade unions with a limited role associated to providing for welfare issues. Second, all people, workers and management, were (supposedly) pursuing a common goal which due to the ideology made any further union activity futile. Another factor which contributes to the stagnant organizational structures and tight government association are political fears owing to the association of parts of the ACFTU and especially autonomous trade unions with events during the 1989 Tiananmen Square incident (Sek and Warner, 1998). As a result Chinese trade unions remain under the same strict government control as it has in the past thirty years. Nevertheless, due to the increasing marketization of the Chinese economy, the ACFTU has been confronted with a rapidly changing environment. With reform efforts drastically transforming the previously planned economy, the formerly homogenous Chinese workforce has become increasingly diversified, creating problems of representation for such a centralized organization as the ACFTU (Howell, 2003).

The tripartite between government, management, and trade union may cause legitimacy to be questioned by employers and workers for different reasons. Workers' trust in the state controlled union are limited for fear that it does not represent its interest but rather that of management and/or the government as the union is caught in the dilemma set out by the rules and regulations governing its existence. Management, on the other hand, next to the standard reservations against unions, may fear close ties to the government and worry about potential state interference (Ge, 2007). Several authors such as Metcalf and Li (2005) argue that the interaction between unions and its members is practically non-existent, while unions tend to operate on behalf of the government and management instead. Accordingly most workers will not know the function of a trade union nor of their union membership. Data in this area is scarce, but some studies confirm these expectations. A recent student-led study, though very limited in scope, concludes that within the sample only 16.6% of workers had knowledge of what a trade union is and only 15.2% were aware of their union membership.⁸⁴ These circumstances put unions in a situation which is prone to a conflict of interests making it difficult to truly represent its actual constituency when bargaining with management.

⁸⁴ The report is published under http://www.xingongren21.com/show_15257.htm (in Chinese). Parts of its can be found in English at: http://www.hkctu.org.hk/cms/article.jsp?article_id=1150&cat_id=12

7.1.2 Role of grass-root trade unions

When exploring the current of role Chinese trade, this section will first highlight the tasks outlined by legislation and regulations set out by the ACFTU itself, followed by a critical evaluation of its present role as well as the limitations set out by the conditions influencing the current situation on Chinese wage bargaining.

In the past decade the Chinese labor law as well as the role of unions has been transforming. But a serious gap of what trade unions are entitled to do and what they do in reality persist as this text will try to demonstrate below. Today, as the ACFTU constitution states, the union's basic responsibility is to protect workers' legal rights and interest. This then is reflected in the union's core activities outlined in Article 28 of the constitution, including assistance in mediation of labor disputes, education programs, legal supervision, and workers' representation during collective contract negotiations. The majority of the activities include dealing with malpractice in employment and poor working conditions which have been recognized as factors contributing to unstable labor relations (Dan, 2003). Basically, a core function of Chinese trade unions is to act as a watch-dog for the implementation of labor laws and to provide workers a pressure valve to which they can turn in the event of unfair treatment in violation of current laws. Very much in contrast to Western unions, wage negotiations are not a core function for Chinese unions at this point (see also section 4.3). On the national level the ACFTU has been pushing on the legislative front to improve the legal status of the workforce, most notably the new Employment Contract Law. Certain parts of the law were under criticism by European and American lobbyist groups representing Western business interests in China and have been watered down. Worried about wide spread discontent, the government, in a recent push, set quotas to unionize foreign owned enterprises and in a high profile case successfully unionized Wal-Mart in 2004 which elsewhere refuses its workers to organize (Chan, 2005).

When it comes to evaluating what Chinese unions are actually doing one could have a vivid discussion. Arguments could be as far as that unions are practically non-existent to that unions are doing their very best, given their current status. Perhaps everyone would be able to agree that Chinese unions currently function very different compared to Western unions, both in terms of their organizational structure as in the role they have representing workers' interests. For this reason it may not be appropriate to compare them with each other. Certainly the working conditions of Chinese unions are very challenging as they have multiple objectives to keep in mind involving government, enterprises, and the interests of workers. It is only naturally that conflict of interest will arise leading to unstable implementation of policies. The dilemma of unions may question its legitimacy of representing workers. As a result, workers tend to continue to regard trade unions less associated with their representation, as personal linkages between management, government, and union leadership continue to be assumed (Heuer, 2004).

Even if grass-root unions are willing to protect its members' rights, they still have very little bargaining power over employers. Some authors such as Chen (2003) will argue that after smashing the iron rice bowl the government is "sacrificing workers interests for the sake of restructuring the economic system". Local officials' preference for rapid GDP growth might also contribute to side with the enterprises' desire for a union free labor relationship at the expense of protecting workers' legal rights. The government has discovered the potential of unions, but at this stage might still be experimenting on what exact role they should be given

even as they are pushing for higher unionization rates. As the paternal role of the government has been abandoned, this vacuum might be filled by unions (Metcalf and Li, 2005) and lead to a revised form of state paternalism. In an effort to please workers' needs and to prevent confrontational labor issues its new role may be to appease discontent workers (Chan, 2000). Of course this assumption might conflict with workers' limited trust in trade unions itself. Union activity has been controversial and it might be questionable if workers' interests are truly being represented. Any changes must be supported by the government, limiting the possibilities of even the best intended union officials. But changes in the Employment Contract Law and apparent strengthening of union activity are first steps in helping workers assume their legal rights which have and continue to be violated in many cases; developments underlined by increasing numbers in official labor disputes, keeping in mind that these might be dwarfed by actual violations.

At its current stage Chinese labor unions are to take on a role to protect workers legitimate rights outlined in the country's labor laws and to enable workers to communicate grievances in their employer relationship. But Chinese trade unions traditionally, have had a collaborating role with the CPC as well as management and it might seem unlikely that workers will turn to unions for any support. The improved legal situation since 2008 routinely sees workers bypassing the trade union by workers demonstrating, striking or directly turning to government or the legal system as well as the media (CLB, 2009). In order to improve their ability to represent workers' interests the ACFTU would need to change their organizational structure (Ge, 2007).

7.1.3 Independent unions

An indicator that Chinese workers are increasingly facing frustration are the now frequent occurrence of spontaneous strikes and unrests, which have led the CPC leadership to identify labor related unrest as one of the most worrying threats to Chinese stability (Sheehan, 2000). As illustrated above grass-root trade unions under the governing body of the ACFTU are to defuse this threat. At the same time trade unions should help prevent the emergence of independent trade unions, especially out of fear of the prospects of a Polish Solidarity union uprising (Metcalf and Li, 2005). These fears were underlined by events around the Tiananmen Square events in 1989 and have increased party control over any union activity, as well as the determination to undermine independent trade unions. In many cases trade unions have failed to resolve labor disputes or to represent workers' interests increasing the perception among workers that its interest are not effectively being represented (Howell, 2003). Studies confirm low approval ratings: only a fraction of unionized workers would turn to the trade union for assistance (see e.g. Chen and Lu (2000) and Yao and Guo, 2004). Needless to say, that this refers to unionized enterprises only, and does not consider the discontent among workers where unions have not been established, whether the reason is management or government refusal.

Limited legitimacy and strong linkages with management and government, and as a result ambiguous union activity, are harmful in establishing any trust among its members. Considering an employment population of 769 million in 2013, 38.5% of the workforce were unionized and assuming that only a fraction of these see any benefits of unionization, a the majority of the labor force is not effectively represented. Representation is for the most only

masked by impressive growth figures for membership focusing on quantity and not quality of representation. One can only estimate the proportion of discontent workers which have no effective way of having their interests protected as the power balance in the employer-employee relations is completely off-balance. Officially labor disputes have been on the rise and wild strikes as well as unrest are not uncommon events in China. In order to make their voices heard the desire to form independent trade unions truly representing their interest in face of weak government protection is only natural.

Despite immediate suppression, attempts to establish autonomous trade unions have occurred in the past including the Beijing Workers Autonomous Federation, migrant workers of Guangdong 1995 and 2002, the Beijing taxi drivers in 1998, and the Free Labor Union of China (see Howell, 1997 and 2003). The existence and actual work of independent unions is negligible as authorities are quick to step in. Autonomous union involvement during the Tiananmen Square events of 1989 have contributed to creating a nearly impossible environment for setting up independent unions in the near future, but as Howell (2003) says: "such attempts are a constant reminder to the ACFTU at both the national and local level that its claim to represent is questionable and its power to defend the interest of workers (is) weak." Ironically, at times the government gave in to demands, sometimes enforced by illegal strikes, organized by autonomous unions or labor activists only to then imprison the responsible people (Heilmann, 2004). Other authors (Bai, 2001 / Lau, 1997 / CLB, 2009b) report of local groups or brotherhoods representing workers with a similar regional background, in some cases resembling gangs, to protect their members' interests. These attempts underline the current frustration of many workers and reservations against the ACFTU. In their usually short-lived formations independent trade unions can only play one role: remind the Chinese leadership, that for the majority of the workforce the current role of ACFTU affiliated trade unions is insufficient and the government should attempt to improve and enforce its duties as outlined in the legislation.

7.1.4 Evaluating Chinese trade unions

As mentioned above Chinese trade unions by no means fit any Western definition. However, when evaluating Chinese trade unions one needs to consider the inherited institutional structure in which national trade union practices need to be constructed (Clarke, 2005). At this stage it would be unfair to judge Chinese unions on the basis of understanding of trade unions in advanced economies. Despite all its advances China remains an emerging economy and it is far from having completed its transformation from a planned economy. The newly developed labor market is little more than a two decades old. Additionally, the size of the Chinese economy and having the world's largest labor force creates additional challenges, perhaps calling for a different approach than seen in the much smaller Asian Tigers. Potentially trade unions may have a balancing effect in the increasing marketization of the Chinese economy after rapid economic growth has been the driving force behind much of the economic policy during initial stages of economic development often compromising the labor force. Increasing environmental degradation and social inequalities are now a source of discontent; current economic policy and unions may provide the necessary instruments to appease these developments during the economies transition to more moderate growth. At this stage of reform wage bargaining, a core function for Western trade unions, is not at the center of attention. Much more it is the instruments protecting workers' rights. However, an

important obstacle which ACFTU affiliated trade unions must overcome is their limited credibility with its members (see section 11.1). Limited credibility will result in failure of this pressure valve and the threat to release itself in another way, potentially causing political and social unrests which cannot be in the interest of any government. It remains an open question whether the current trade union structure can achieve the goals the government has in mind without further reforming the organization and powers of trade unions. In sum, Chinese trade unions currently are facing a significant number of limitations including problems of representation, close management and party ties, deficiencies in the rule of law, and the desire for continuous attraction of investment and growth by local governments. Though their overall position is weak, trade unions are a potential tool in improving protection of workers' rights. In order to develop into a powerful balancing labor market institution it will be necessary to build on its current, in comparison to Western unions limited, objectives and further evolve from there. At this stage protecting the legal rights of workers has become a central issue for the Chinese government and trade unions have the potential to be successful. A study based on the Chinese Economic Census Yearbook 2006 conducted by Ge (2007), while highlighting trade union's weak position, the weak enforcement of laws, as well as the limited scope of collective contracts, concludes that unions do contribute to the protection of workers' rights. He further finds that in an employer dominated environment with frequent violations of the law, trade unions might be the only institutions which currently can improve workers' working condition and legal status. Most importantly, unionized enterprises provide workers with the necessary channels to protect their legal rights, whereas in non-unionized enterprises workers interest might be significantly less protected.

7.2 Employer associations

Equally important for any tripartite industrial relations system is the representation of employers. Just as the representation of workers, the CPC keeps close control over employer organizations. Given the revolutionary communist setting provided by the founding of the People's Republic of China in 1949, establishing employers' organizations would appear contra to ideological beliefs. The All-China Federation of Industry and Commerce (ACFIC) was established in 1953 to give non-public enterprises a form of representation. As China began its economic reforms in 1978 the Chinese Enterprise Management Association (CEMA), renamed China Enterprise Confederation (CEC) in 1999, was formed, followed by the Chinese Enterprise Directors' Association (CEDA) in 1983. Both organizations merged in 1988, with both names having been retained, although there seems to be no apparent distinction in the organizations. The predecessor of the CEC, the CEMA, was originally established by the State Trade and Economic Commission (STEC), now part of the Ministry of Commerce, aimed at functioning as a transmission belt between enterprises and the government, and specifically the CPC, similarly to the role of the ACFTU.⁸⁵ Just as the ACTFU both main employer associations are national organizations with regional chapters in each Chinese province which then administer smaller chapters at the county and city level. Both organizations, with greater importance to the CEC/CEDA, are peak level employers'

⁸⁵ More information on history and background can be found online (in Chinese): <http://cec-ceda.org.cn/china/aboutus/aboutus.htm>

associations to which lower organizational levels are associated with regardless of region or industry.

There is no official distinction between membership in the ACFIC and the CEC/CEDA, but while the former is more associated with non-public enterprises (including Hong Kong and Macau invested companies), the latter is associated with representation of SOEs (Huang, 2013). According to Unger and Chan (1995) the creation of all Chinese associations of any significance owes to the government's initiative and is not seen as independent organizations desire to freely associate. Although both organizations are independent, they must be seen as similar organizations with the one linking the non-public sector employees to the government and the CPC while the other does the same for public companies. When China re-entered the International Labor Organization (ILO) in 1983, the CEMA was established as the official employers' association funded mostly by government funds, but remained mainly passive in this capacity until the end of the 1990s when first tripartite experiments were launched, limiting itself to providing enterprises with information and trainings (Clarke and Lee, 2002). Although the CEC/CEDA over time has attempted to transform itself, developing its representative capacity aims "to best serve the interests of enterprises and entrepreneurs..... assist(ing) them in making their voices heard in the development of economic, business and labor-related laws to support the creation of regulations and policies that will enable a favorable business environment,"⁸⁶ these ambitious goals face significant limitations.

Similarly to the ACFTU the CEC/CEDA is recognized as the sole legitimate representative body by the government and hence is strongly associated with the government. In line with this it is subordinate to the CPC, closely adhering to its policies. Clarke and Lee (2002), while recognizing that steps have been undertaken to establish a more functional role, note that the advancements are constraint by the organizations limited funds, domination of SOEs and overall weak organizational structure. Interviews conducted by the Clarke and Lee (2002) in their respective research, as well as own interviews during the current research underpin the notion that the employers' organizations are more closely linked to the government than as representatives of companies. Despite the obvious limitations, according to Clarke and Lee the CEC/CEDA did contribute strengthening the rule of law in employment relations as well as first steps to encourage collective bargaining.

Trade union and workers representation certainly will be in a better position to lobby workers' rights in a political regime established by a CPC, whereas the 'class enemy' will need to treat more carefully and employer association were less developed due to China's socialist heritage since 1949 (Chan, 2011).⁸⁷ In terms of employer organizations the large SOEs often lead by high ranking members of the CPC are in the strongest position to lobby for their interests, although this will focus on individual interests unlikely to be expressed publically. The State-owned Assets Supervision and Administration Commission of the State Council (SASAC) is the key organization overseeing the 117 central government's SOEs, many of which are the largest in China, but rather than an interest group, it is an organization administrating SOEs following direct orders of the central government. In order to gain credibility as a national representative body of employers, the CEC/CEDA is under similar pressure as the ACFTU to truly represent its constituents. This includes lobbying their

⁸⁶ Retrieved from the CEC/CEDA "about us" section (retrieved January 24th, 2014): <http://www.cec1979.org.cn/english/about.php>

⁸⁷ Capitalists' for that matter were not officially permitted to become members of the CPC until 2001.

interests as well as expanding the representation beyond SOEs to include private enterprises independent of the CPC and the central government. Equally there are a variety of associations and professional organizations dealing with more specific industries or sectors which are at best regarded as intermediary organizations with the capacity to administer industrial development plans or regulations (CeCC, 2012). These, however, are for the most under the direct leadership of either the ACFIC or the CEC/CEDA and hence cannot be considered independent.

Many foreign nations with foreign direct investments in China have for the most established private or quasi-official chamber of chambers. The majority of these however will only have limited clout on a national level. Employer organizations including the American Chamber of Commerce and the European Chamber of Commerce are the most vocal, but their activities are limited to lobbying and communicating their members' opinions (see also section 5.4.1).⁸⁸ Though in principle most foreign chambers of commerce attempt to represent their members' interests, their main focus is more in providing companies with business relevant information, HR tools including training and recruitment, as well as networking or marketing channels. Overall their respective position, though independent, appears to be relatively weak (see Li, 2008 / Karindi, 2008). The government will consult their opinions and at times also make adjustments, but in general their political clout on the national level is insignificant. In areas with a strong local presence there might be more far reaching influence, this however will strongly depend on the specific individual constellation.⁸⁹

Employer organizations representing Hong Kong, and to a lower degree Macau, invested companies, which in principle are regarded as foreign investment, have a special role in Chinese industrial relations. As a major source of investment, especially critically to initial reform efforts, Hong Kong based companies are major players in China, especially in Guangdong, but also in other coastal regions. As part of the one country, two systems policy Hong Kong companies, though considered foreign investment, are part of China. Employers' organizations thus have greater access to political decision makers and several key business figures are part of national institutions such as the NPC or National Committee of the Chinese People's Political Consultative Conference (CPPCC). Organizations such as the Hong Kong General Chamber of Commerce or the Hong Kong China Chamber of Commerce are in a better position to represent their respective members in China, but their role including those of delegates from Hong Kong in any national assemblies is limited only (Fu and Choy, 2007). According to Cheung (2011) their appointment is much more recognition of status than real power.

Foreign employer organizations despite being independent organizations will at best be limited in their overall impact on Chinese industrial relations and even if they are successful in doing so, only represent a small fraction of the total number of enterprises in China. Chinese

⁸⁸ National European chamber of commerce have in principal agreed to leave lobbying activities to the European Chamber of Commerce. Nonetheless other chambers, most notably the German Chamber of Commerce and the French Chamber of Commerce maintain a strong independent position in China representing more members than the European Chamber of Commerce.

⁸⁹ For example regions with major investments from Taiwanese companies will through close personal ties with local governments try to represent their companies' interests in a subtle way, due to political concerns. Similarly due to historical reasons Japanese interests groups will face difficulties in expressing opinions.

employer organization are peak level organizations with the CEC/CEDA being the more dominant employer association under direct subordination to party-state which define themselves as a direct link between employers and the government. In a diverse country as China there may as well be regional variations, with individual pushes to foster a more independent representation, but in general it can be said, that despite the initiated transformation, employer organizations remain weak. Beyond officially recognized organizations, the corporatist approach of the CPC will limit, or in stronger words, not tolerate, significant influence by any other independent employer organization. The CEC/CEDA hence is the most important because uncontested employer organization. Equally to the ACFTU the CEC/CEDA has made limited organizational advances, but remains a weak organization with little scope to truly defend and represent employer's interests, mirroring the weaknesses of the ACFTU in representing workers' interests (Clarke and Lee, 2002). Judging Chinese employer associations however, must always been seen in its historical context. Just as the Chinese state imposed trade union initially occupied a very different range of responsibilities vis-à-vis the workers, employer associations come from a very similar position further complicated by the ideological limitations within a CPC state. Despite not resembling Western employer organizations, they do have an important role in Chinese industrial relations, which includes implementing government policies as well as strengthening the rule of law in an aim to improve industrial relations. In this context they are an important vehicle for the government, which is eagerly, and in order to protect its own political system, trying to build a 'harmonious society'.

7.3 Tripartite consultations and the roles of government, employers' associations and trade unions

According to the ILO Tripartite Consultation Convention of 1976 consultation on equal footing shall take place between freely chosen representative bodies. In principle any tripartite bargaining system in industrial relations will include some form of bargaining units representing the government, workers, and employers. Following a very basic text book example, tripartite relations in industrial relations will involve the three representative bodies mutually engaging in bargaining independently, creating a triangular relationship between all parties involved. The government will take into account particular policy goals and macroeconomic issues such as employment and inflation⁹⁰, the unions will bargain for wages, employment, working conditions and a like while employers will be driven by the desire to maximize their investment and business interests. The actual power balance as well as the composition however will very much influence how the tripartite system will function. It has been illustrated above in the brief descriptions of industrial regimes of developed as well as emerging countries, that there will be a significant amount of variability based on the specific relations of the bargaining units. The underlying institutional framework then is a result of the power balance between the bargaining units as well as their interrelations. Bargaining systems can range from strong to weak government involvement, from peak level negotiations to enterprise level bargaining, all of which determines the degree of centralization and coordination of a countries wage bargaining system, and in the end its overall macroeconomic functionality.

⁹⁰ Whether the central bank is independent or not will further influence the bargaining. For simplification this is not further explored here. A good reference for this particular topic is Iverson, Pontusson, and Soskice, (2000).

Prior to the economic reforms the Chinese economy was a planned economy under total domination of the CPC and its government. Industrial relations naturally were equally dominated by the government including significant of political ideology that accompanied authoritarian rule under the CPC and the cult surrounding Mao. When discussing the evolution of the Chinese industrial system one cannot depart this historical context and must take this post-revolutionary institutional framework into account in order to understand the current and the past.⁹¹ The various stages of reform impacting industrial relations and wage bargaining have been outlined briefly above (see section 4.3). After a period of total government domination, the reform process shifted the power balance to individual employers and market mechanisms while retaining supervisory power (see e.g. Han and Morishima (1992) / Ip (1995) / Warner (1996)). In either case the institutions required for tripartite industrial relations were non-existent. Though there were small step in beginning in the 1990s, momentum for rebuilding industrial relations with a stronger institutional foundation did not take shape until be 21st century.

Modeled to a great degree on familiar Western concepts and legislation, the Chinese leadership has been progressively strengthening the institutions necessary for tripartite relations. Though the authoritarian government certainly never was lacking power, it has made efforts to curtail the power of market mechanisms in labor relations and has reclaimed a greater amount of authority. Whereas the government had complete control of labor relations as well as wages at the enterprise level prior to economic reforms, the newly found authority on these issues is based on its more regulatory role and by means of legislations (see e.g. Chang (1995) / Ip (1995) / Qi and Xi (1995) / Taylor, Chang and Li (2003)). The ACFTU has been at the forefront of promoting tripartite industrial relations on behalf of the government, slowly evolving from its historical functions but significantly lacking independence. Regardless of its shortcomings in comparison to Western trade unions in the area of representation of workers, the ACFTU is a strong peak level organization with a considerable amount of political clout in the CPC system. As the third bargaining unit, the employers' organization can undoubtedly be labeled as the weakest bargaining unit, lacking independence as well as a strong organizational structure. When considering the starting point of the Chinese tripartite system, it becomes clear that building the necessary institutional foundations is a formidable task which takes a considerable amount of time and is complicated by the limitations of the authoritarian Chinese political system.

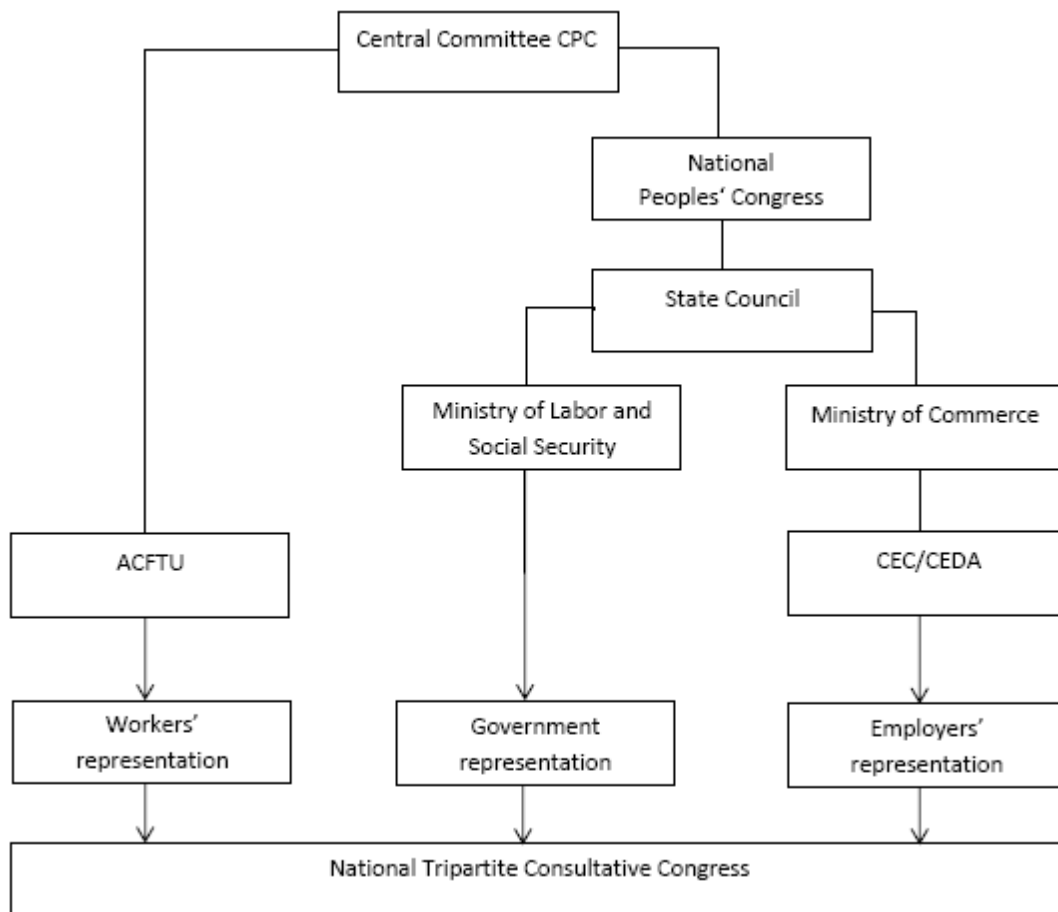
7.3.1 Formulation of institutional mechanisms: the National Tripartite Consultative Committee (NTCC)

Current literature will agree to the fact that the Chinese labor market institutions and its system of wage bargaining underwent a period of rapid marketization during the reform era while in the early 2000s the government focused on strengthening non-market institutions. Following initial experimentations starting in 1986 and a first tripartite consultations system introduced in the early 1990s under the assistance of the ILO an explicit effort to further formalize institutional mechanisms for tripartite consultations and more 'harmonious industrial relations' at the enterprise level was introduced in August 2001 with the establishment of the

⁹¹ A good summary of China's pre-reform industrial relations system can be found in Walder (1986).

National Tripartite Consultative Committee (NTCC) (Shen, 2007). The NTCC effectively functions as the peak level tripartite mechanism at the national level under which Tripartite Consultative Committees (TCC) on the provincial and the municipal level follow. The NTCC comprises of the three official representative bodies for the government, labor and employers which are directly or indirectly linked to the CPC (see Figure 8). The government is represented by the MOLSS, labor by the ACFTU and employers by the CEC/CEDA. Similarly at the lower levels the three parties are represented by the corresponding lower levels of representation. All decisions, mostly of consultative nature, are taken by consensus (Clarke and Lee, 2002).

Figure 8. Structure and political association of tripartite institutions



According to Clarke and Lee (2002) the main intention of the TCC at the various regional levels are to cover four dimensions. First, establishing a legal and regulatory framework for industrial relations at the enterprise level. Second, advocating 'democratic management' and 'collective consultation' to all types of enterprises. Third, creating a "framework for the consideration of the government's substantive social, labor and welfare policies" (Clarke and Lee, 2002). Lastly, to establish a conflict resolution framework. Given the limited scope, most prominently omitting explicitly mentioning wage bargaining, Lee and Clarke are left with the impression that the TCCs are rather a consultative body for the different social partners rather

than a decision making body. The authors point out that policy statements and discussion of proposed laws and regulations typically will dominate the agenda at the national and provincial level with the aim of issuing instructions to the municipal level which directly deal with issues at the enterprise level.

8 Tripartite Consultations in the Chinese Wage Bargaining System

After having provided an overview of the institutional setting of the Chinese tripartite industrial relations, the next section shall look at two areas where the tripartite system outlined above should be implemented. First, the process of determining minimum wages in China will be analyzed. Second, the role of the various bargaining units in the collective bargaining process shall be introduced. Within the context of collective bargaining, the role of wage guidelines will be further explored. Both collective bargaining and minimum wage are a classical area for tripartite negotiations, allowing for a better understanding of the Chinese wage bargaining system. The examples intend to provide an overview of the institutional setting and the implications on the Chinese tripartite industrial relations regime, providing a basis to understanding the system in a more comprehensive manner.

8.1 Minimum wage regime

Understanding the underlying legislation and the mechanisms in its determination and implementation are vital in understanding minimum wage as an institution for the overall Chinese wage determination mechanism. The first regulations on minimum wages were introduced in 1994 within the Labor Law. Chapter 5 of the document is entirely devoted to wages and Articles 48 and 49 (see Table 13) are specifically devoted to minimum wages. The national legislation does not outline any unified national standards but stipulates that lower level governments, typically at the provincial level, are required to implement a minimum wage standard and specifies basic guidelines which should be followed in determining a minimum wage rate. Given the overall transitional institutional setting of the labor market and limited enforcement of legislation for much of the reform period prior to 2008, the initial minimum wage provisions remained, for the most part, insignificant as a policy tool (see Chan (2003) / Du and Pan (2009) / Meng (2001)). It carried little power as a wage bargaining institution and widely remained irrelevant for the wage determination process.

Table 13. Overview of Chinese Labor Law on minimum wage 1994

<p>Article 48</p>	<p>The State shall implement a system of guaranteed minimum wages. Specific standards on minimum wages shall be stipulated by provincial, autonomous regional and municipal people's governments and reported to the State Council for registration.</p> <p>The employer shall pay laborers wages no lower than local standards on minimum wages.</p>
<p>Article 49</p>	<p>Standards on minimum wages shall be fixed and readjusted with comprehensive reference to the following factors:</p> <p>(1) The lowest living costs of laborers themselves and the number of family members they support;</p> <p>(2) Average wage level of the society as a whole;</p> <p>(3) Productivity;</p> <p>(4) Situation of employment;</p> <p>(5) Differences between regions in their levels of economic development.</p>

Source: Labor Law of the People's Republic of China

In an attempt to strengthen the significance of the legislation the Ministry of Labor and Social Security (MOLSS) issued specific Minimum Wage Regulations in 2004.⁹² The revision was more specific and broader in scope following then President Hu Jintao's aim for a more "harmonious society". Unlike the previous provisions, it clearly defines supervision (Chapter IV) and legal responsibilities (Chapter V). Further, the MOLSS has advised enterprises, especially profit-making ones, to pay workers more than the minimum wage (CLB, 2007b). The legislative changes to minimum wage regulations have progressed slowly since 1994 and it was not until the Labor Contract Law 2008 (see Table 12) coupled with a stronger political determination that its implementation made significant advances. Building and strengthening minimum wages as an institution to a level that they evolved in to one of any significance in the Chinese wage bargaining system therefore took nearly 15 years.

Minimum wage regulations constitute a national law governing minimum wages adjustment process throughout the country. It encompasses a framework detailing the mechanisms on how minimum wages should be determined on the local level across China's jurisdictions. As with other labor related policies issued by the Central Government, local administrations at the provincial level, municipalities under the direct supervision of the central government as

⁹² In 2008 the MOLSS was combined with the former Ministry of Personnel to form the Ministry of Human Resources and Social Security (MHRSS). To avoid confusion and as the majority of the relevant regulations are prior to 2008, this article will use MOLSS throughout the text.

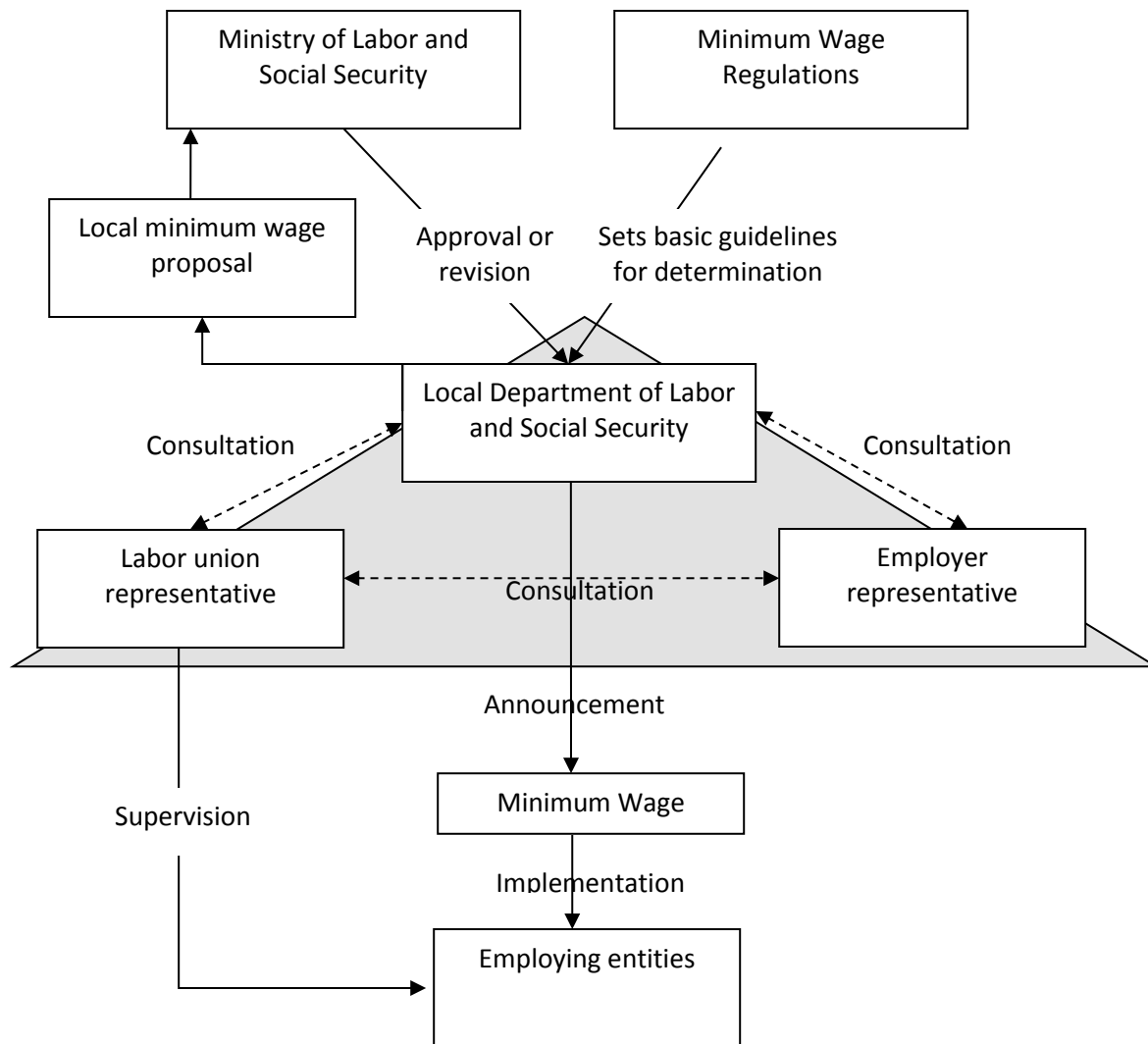
well as Shenzhen, can set a minimum wage rate at their own discretion.⁹³ Although there are no official differences in the minimum wage setting mechanism, the actual process as well as the outcome may therefore differ regionally (see section 8.1). Local authorities are advised to enter consultations with the labor union and employer representatives following the regulations outlined methodology to determine a local minimum wage standard. Despite local variations the legal process should resemble the process outlined in the TCC with involvement of the provincial government, as well as the ACFTU and the CEC/CEDA. Minimum wage does strengthen tripartite consultation at the provincial level with peak level organizations bargaining for the adjustments before MOLSS has the final word on approval of the agreement proposed by the bargaining units.

The bargaining units representing workers and employers of course lack the same issues in regards to independence. There are no clear regulations on how national policies are taken into account, but it seems more than likely that the bargaining units will take into account national policies (see section 8.2) when adjusting minimum wage rates. Although the negotiation process perhaps is not introduced by fiat, any bargaining will be constrained by national policy goals set by the Chinese leadership. Some authors (Qiao, 2011) argue that there are heated debates and a significant media attention of the consultations. This claim appears to be overblown. In 5 years of monitoring minimum wage debates in China, it was rare to find any public discussion of the ongoing tripartite negotiations. Usually minimum wage adjustments do not follow a public debate, but rather through closed door consultations where the actual constellation and roles of the participating parties remains opaque. One to two months prior to the introduction of the new minimum wage level, the new minimum wage rates are then announced to the public. Not surprisingly the characteristics of tripartite consultation for minimum wages follow a similar pattern seen in other areas in China: the government retains the dominant position in the consultations while the other bargaining units' power remains weak.

Once a minimum wage rate is agreed upon, a proposal for a minimum wage adjustment is submitted to the MOLSS, which may further consult with union and employer representatives before it either grants its consent or it is required to submit a revision within 14 days of reception. Following approval the local authorities are obliged to publish the new minimum wage while supervision at the enterprise level is the responsibility of the ACFTU or one of its affiliated unions as well as labor authorities (Luo, 2011). An overview of the process and roles of the different organizations in the minimum wage determination process are outlined below in Figure 9. Though the rules outline a tripartite consultation, the actual determination lacks transparency and varies strongly depending on the region. Further the national regulations governing the minimum wage-setting process leave much room for regional interpretation, much in line with the policy of regional experimentation.

⁹³ Currently China has 4 cities (Beijing, Shanghai, Tianjin, and Chongqing) administered as direct-controlled municipalities by the Central government with a status equal to provinces. Shenzhen as a starting point of many economic reforms enjoys special privileges and determines its own minimum wage levels independent of Guangdong province, although it is not under the direct control of the Central government.

Figure 9. Overview of minimum wage determination process



Source: own graph based on Regulations on Minimum Wage by the MOLSS.

8.1.2 Minimum wage setting method and impact on wages levels

As for the actual calculation, the MOLSS sets out two universal methods within the Minimum Wage Regulations: the proportion method and the Engel coefficient method. Both methods are based on minimum living expenses and a coefficient for people supported by each employee. First, the local minimum monthly living cost for persons living in the minimum income group is determined (C_{\min}). Fixing the minimum monthly living costs should, but is not limited to, taking average living costs of urban residents, social insurance premiums and public accumulation of funds for housing, average local wage, rate of unemployment, and level of economic development into consideration. Second, the coefficient of the number of family members supported (P_{sup}) is determined. For the Engel Coefficient, the proportion (E_{pro}) and absolute value (E_{AV}) of the minimum monthly living cost spent on food is then calculated ($E_{\text{pro}} = E_{\text{AV}} / C_{\min}$). Each formula then permits for adjustments (a) based on public social programs such as pensions. Although there are two formulas they both derive an identical minimum wage rate as $C_{\min} = E_{\text{AV}} / E_{\text{pro}}$. Essentially, C_{\min} must first be set in order to make any use of the Engel Coefficient Method.⁹⁴ The computation of C_{\min} however is not made transparent. Calculating the local minimum wage (MW_L) then leaves the following formulas:

$$\begin{aligned} \text{Proportion Method:} & \quad MW_L = C_{\min} \times P_{\text{sup}} + a \\ \text{Engel Coefficient Method:} & \quad MW_L = (E_{\text{AV}} / E_{\text{pro}}) \times P_{\text{sup}} + a \end{aligned}$$

Finally, the regulations set out that the prevailing minimum wage rate should be equivalent to 40-60% of the average monthly wage. Along with the adjustment variable (a), this stipulation leaves policy-makers a certain degree of flexibility necessary in the relevant jurisdiction before fixing the minimum wage rate. Next to the monthly minimum wage, an hourly minimum wage (or a piece rate) is also introduced. The legislation also sets out a calculation method to reduce the disparities between full- and part-time employees.

Though minimum wages were introduced in 1994 a significant number of cities did not implement regulations. Enforcement and coverage therefore were difficult to judge but considering the weak legal framework, it is considered to have been generally weak during the 1990s and early 2000s. Since then great improvements have been made over the years and by 2006 more than 286 cities reported to having minimum wage policies in place (IPLE, 2007). Prior to the introduction of the 2008 Labor Contract Law as well as the Law on Mediation and Arbitration of Labor Disputes (see Table 12) the legal position for enforcement was much weaker. The improvements notably improved the position of migrant workers at the bottom of the income scale and the main recipients of minimum wages. Thus, when considering the issue of coverage and enforcement, a distinction between pre and post 2008 is necessary.

As mentioned above, data on coverage is scarce; however prior to focusing to the current situation, this section will attempt to provide a summary of some findings prior to the legislative changes in 2008. In 2007 migrant workers were estimated at 136 million workers,

⁹⁴ Example: Minimum monthly living cost set at $C_{\min}=600$, absolute amount of which is spent on food is determined to be $E_{\text{AV}}=240$, equivalent to a proportion of $E_{\text{pro}} = E_{\text{AV}} / C_{\min} = 240/600 = 0.4$. Let's assume people supported is determined to be $P_{\text{sup}}=1.8$ and the adjustment $a=20$.

Proportion Method: $MW_L = C_{\min} \times P_{\text{sup}} + a = 600 \times 1.8 + 20 = 1100$

Engel Coefficient Method: $MW_L = (E_{\text{AV}} / E_{\text{pro}}) \times P_{\text{sup}} + a = (240/0.4) \times 1.8 + 20 = 1100$

of whom over 80% were attributed to the informal sector (Cai, Du and Wang, 2009).⁹⁵ By the authors' estimates up to 46% of the urban workforce was engaged in informal employment by 2005. The authors further show that wages in formal sectors were higher than in the informal sector with the wage dispersions being stronger for hourly wages than for monthly wages and migrant workers generally earning less than local workers (see also Table 14). It can further be estimated that a substantial portion of the local household registration holders were employed in the informal sector. With an abundant labor supply and little legal protection before 2008, workers were commonly confronted with employers who violated regulations including holding back wages (Chan, 2005/ Cooke, 2005). During the period of deregulation informal employment experienced strong growth, leading to a significant informalization of Chinese employment (see Cooke, 2008 / Park and Cai, 2009). The resulting employer-dominated environment and ease of replacing one unskilled worker with another encouraged workers to tolerate any violations of the law, of which workers were generally ill-informed anyway. A challenge to the implementation of minimum wages is that it primarily applies to the worst employers of an economy, making effective enforcement a crucial element determining its impact (Rubery, 2003). Taking this into account, it is generally understood that minimum wage regulations prior to the introduction of the Labor Contract Law did not significantly improve the conditions for informal workers, though supporting data is hard to obtain. With no formal employment contract, any legal steps demanding minimum wage payment proved difficult, resulting in an overall weak enforcement. Since then minimum wage enforcement has made great strides, significantly improving workers' payment situation.

From the onset China's minimum wage regulation aimed at universal coverage in urban areas, i.e. all locally implemented minimum wage rates are meant to cover the entire workforce within a city. In practice it is mostly relevant in urban areas as rural areas, i.e. employees in the primary sector, are excluded (Herr and Kazandziska, 2010). In an ideal case the informal and the agricultural sector will benefit from spillover effects through improved minimum wage regulations in the formal urban labor market. Better compulsory education and the now strict enforcement of the Labor Contract Law will also contribute in a reduction of the informal sector, albeit do little for the rural sector.⁹⁶ This fact contributes to a major rural-urban divide and is a major challenge authorities still need to face, although this will not be further explored here.

The scope covers all employees with formal contracts at enterprises, community-run and non-enterprise units, private industries and individual businesses, state organs, institutional units and social community units with no limitations on age, gender, job or industry in urban areas (Du, Wang, and Lee, 2009). The Peterson Institute for International Economics (PIIE) (2007) reports that figures for Beijing showed that workers earning minimum wages covered only 2.4% of workers in 2002. Given the higher average wage the share of workers actual earning minimum wages appears to be small (PIIE, 2007). Reports for 2004 concluded that in Shanxi province a quarter of the rural migrant workers earned below the minimum wage (Cooke, 2008). Other studies find that 11% (2001) and 16% (2005) of migrant workers were paid

⁹⁵ Other estimates put the figure between 150-300 million.

⁹⁶ Improving conditions for the rural poor can be achieved through rural development rather than setting a minimum wage (Saget, 2001).

below the minimum wage (IHLO, 2008). Using 2005 data from the Urban Labor Survey 2 Cai, Du and Wang (2009) found that 84.4% of all full-time migrant workers and 85% of local workers earned incomes above the minimum wage, while 15.6% of migrants and 15% of household registration holders (i.e. people holding citizen rights in the city) received earnings below the minimum (see Table 14). According to an ILO study (ILO, 2010) migrant workers, usually with no household registration, in urban areas are the most likely to be paid minimum wage as they have a higher likelihood of working in low-paid employment. In 2007 64% of migrant workers were engaged in low-paid employment compared to only 28.2% for local workers. These workers in general will be younger, with an overrepresentation of females and a lower level of education. The ILO study points out that in 2007 the incidence of remuneration below the minimum wage was 29.8% of local workers (i.e. household registration holders) and almost twice as high for migrant workers.

Table 14. Average monthly earning and minimum wage coverage in five selected cities, 2005⁹⁷

	Average monthly earnings		Minimum wage coverage	
	Migrant	Local*	Migrant	Local*
	in RMB		in %	
Men	1.140	1.282	88.6	88.9
Women	879	963	79.1	80.0
Total	1.022	1.144	84.4	85.0

* local = local household registration holder⁹⁸

Source: Cai, Du and Wang (2009)

Looking at the different findings with regard to minimum wage coverage, there are no conclusive figures for coverage in China as data varies depending on the study cited. It should be kept in mind that all these figures are pre-2008 and prior to the new Labor Contract Law which aimed to force employers to enter into contractual agreements substantially increasing the share of employees eligible for minimum wage coverage. Typically, minimum wage recipients in urban areas are rural migrant workers working in enterprises that perform poorly (Carley, 2006). The minimum wage is a significant component of low income workers

⁹⁷ The five cities included in this survey are Shanghai, Wuhan, Shenyang, Fuzhou, and Xi'an.

⁹⁸ 'Local household registration holders' refers to people with local citizen rights in the relevant city. For example, a worker with Shenzhen household registration will enjoy access to certain government services and privileges in Shenzhen but not in another city. Any person who does not have a city's household registration will normally only enjoy limited access or at higher costs and will be required to return to the household registration issuing city for some services (e.g. passport or identification card renewal). Currently the household registration system is undergoing reforms and some municipalities have implemented legislation which aims at reducing some of the resulting discrimination.

in urban areas, i.e. few workers will only receive the base rate, because for many workers minimum wages are only just one component of their wage (see Table 22).

While the above paragraphs in this section have mainly focused on the situation prior to the introduction of the new laws in 2008, below we will attempt to illustrate the situation after the changes, although data for the post-2008 period is often scarce and premature. The first studies after implementation of the Labor Contract Law (see Herd, Koen, and Reutersward, 2010 / Cai, Du and Wang, 2009) indicate that fixed-term contracts are the norm after the introduction of the Labor Contract Law, resulting in a higher degree of regulation. A survey of 300 workers in Shenzhen found that workers from larger companies will typically have contracts, though smaller domestic companies will still try to limit the impact by avoiding resulting obligations (Dangonzhe Migrant Worker Center, 2009). Based on a survey conducted by the Institute of Population and Labor Economics, Park and Cai (2009) make a similar observation in Shenzhen and Shenyang. The policy shift in the early 21st century and new legislation has given workers improved access to the legal system and workers are generally better informed about their rights which has resulted in increased regulation of the labor market. Minimum wage adjustments are usually made public a few months prior to implementation. As a result, workers are well-informed of changes and employers will find it difficult to avoid the changes without workers taking action. With ubiquitous knowledge of the current minimum wage in urban areas, the role local unions play in actual enforcement (see Figure 9) is unclear. Given the limited trust in unions and the atomistic nature of Chinese trade unions (Zenglein, 2008), its actual role in supervising minimum wage implementation can be assumed to be minimal. Whereas issues such as paying below the minimum wage or back wages were a severe problem prior to 2008, employees are now more prone to fight for their rights leveraging their improved legal standing. A development which certainly also increases the coverage of minimum wage payments. In short, the improved legal situation, enhanced knowledge of legal rights, and the public announcement of minimum wage adjustments have resulted in a de facto self-enforcement independent of any apparent union supervision.

Minimum wages are a fairly simple policy to implement; its impact however will strongly depend on effective enforcement, its policy design, and the institutional setting. According to Rubery (2003), minimum wage regulations make a positive contribution to improving social norms with respect to wages in developing countries if the following circumstances apply: 1) greater importance of working poor in formal employment 2) absence of welfare system or effective taxation providing for an alternative system of redistribution 3) simple and readily available regulations 4) existence of excess labor 5) high inflation potential 6) importance of stimulating social dialogue, including involvement of trade unions.

Minimum wage has become one of the government's most visible policy tools in influencing wage developments across China and over time has evolved into a formidable institution. Though the central government gives provincial governments freedom in the determination of any increases in general they follow policies set out in the central government's economic policy. As with many legislation or policies in China, the central government often only roughly outlines its policy goals, giving provincial governments room for interpretation but also for regional experimentation. Uniformly minimum wage regulations have become a stronger policy tool, as its enforcement has dramatically improved since 2008. However, there is and

has been no official data as to what percentage of the workforce is covered by minimum wages, or which industries or occupation levels are covered. While conducting this research several interviews with senior management identified operators and other low skilled blue collar workers (especially cleaning, security personnel, etc.) as the major recipients of minimum wages.⁹⁹ Though in urban areas the minimum wage seems to have contributed to higher incomes especially after the policy shift since the beginning of the new millennium, it is most likely to affect employment in urban areas, greatly having improved the situation of workers at the bottom of the pay scale. A closer statistical analysis of minimum wages in China will follow chapter 8.

8.2 Collective agreements

Collective agreements technically have been present in China since the early 1980s and its legal position has been changing over time (Sek and Warner, 1998), while the most meaningful developments in terms of establishing a new legal framework for tripartite collective bargaining did not take place until the mid-1990s (Warner and Ng, 1999). Prior to approaching to understand collective contracts in China, one must understand the Chinese characteristics of it. Just as with the definition of trade unions in China, many foreign scholars are prone to attest the same content because of how something has been labeled. At a first glance collective contracts in China would fit the ILO's Recommendation No. 91 from 1952 which stipulates that collective agreements are defined as "all agreements in writing regarding working conditions and terms of employment concluded between an employer, a group of employers or one or more employers' organizations, on the one hand, and one or more representative workers' organizations, or, in the absence of such organizations, the representatives of the workers duly elected and authorized by them in accordance with national laws and regulations". This observation however would be misleading as will be shown below.

Over the past 20 years China has dramatically reformed its legal framework governing its industrial relations regime and has introduced comprehensive regulations governing collective agreements and collective bargaining. The new Employment Contract Law of January 1st, 2008 can be seen as a commitment by the government for further the development of collective contracts. Revisions and additions to the old law outline that "labor unions shall assist and guide workers in the conclusion of employment contracts with their employer and the performance thereof in accordance with the law, and establish a collective bargaining mechanism with the employer in order to safeguard the lawful rights and interests of workers" (Article 6). As has been illustrate above, despite the advances Chinese industrial relations the tripartite system remains entrenched in a complicated power relationship finding its roots in its pre-reform, planned economy era (Walder, 1986). Anything involving collective consultations hence must be evaluated against this backdrop.

There are a variety of laws and regulations which govern collective consultation in China. All agreements will need to be in accordance with the Labor Law, Labor Contract Law, as well as

⁹⁹ These interviews were conducted in numerous discussions with senior management of mainly foreign-owned enterprises in and around the Pearl River Delta between 2010 and 2013.

the Trade Union Law.¹⁰⁰ Details of collective contracts are governed by the Provisions of Collective Contracts taking effect in 2004 with additional regulations outlined by the Measures of Collective Wage Consultation issued by the MOLSS in 2000. The latest step in strengthening the legislation has been initiated with Guangdong province issuing its own revision in 2014.¹⁰¹ Earlier versions of the law limited collective agreements to the plant level, but this has since been expanded. Although the national law, just as Guangdong's 2014 revision, does not mention national consultations at the peak level it likewise regulates industry-wide and regional collective agreements (Article 53 of the Labor Law). Previously there have been unclear regulations to which agreement shall prevail in case of overlapping jurisdictions (Traub-Merz, 2011). Huang (2010) adds that agreements were not legally binding for the employer to implement. These legislative weaknesses have since been reformed, though not completely abolished. Guangdong's provisions regulate the legally binding nature (Article 4) of agreements for employers and employees alike. Article 5 states that items stipulated in individual contracts may not be lower than in collective agreements, and that details of collective agreements at enterprise level may not be lower than industrial or regional agreements. Legislation governing collective bargaining and collective consultation has over the years become more comprehensive, greatly improving its legal standing and contributing to establishing a tripartite industrial system compatible with the political constraints in China.

Collective negotiations can be requested by both employers and employees (Article 25) with details regarding the procedures regulated under Section III of the Provisions. There have been examples of industrial or regional collective contracts which have been highly propagandized by the authorities but these type of contracts still remain rare (Luo, 2011 / Lüthje et. al, 2010). Representation at this level is regulated in Article 17. In such a case negotiations at this level would take place within the context defined by the Tripartite Consultative Committees (TCC) with the corresponding trade union, employers' representative and responsible government department as bargaining units.¹⁰² Generally the government prefers more decentralized consultation at the enterprise level, at least to some degree, out of concern for the possibility of larger scale labor disputes which would be more difficult to contain (Taylor, Chang and Li, 2003). Avoiding similar movements such as the Polish Solidarity movement in the 1980s is clearly a major concern for the CPC leadership. Political rather than economic matters are a significant element for the level of wage bargaining for collective contracts.

8.2.1 Processes behind formulating collective agreements

At the enterprise level negotiation workers will be represented by the enterprise union representatives or if this has not been established by worker representatives elected for this purpose (Huang, 2013).¹⁰³ Technically workers could be represented by the workers congress,

¹⁰⁰ As stated in Article 1 of the Guangdong Province Regulations on Collective Negotiations and Collective Contracts for Enterprise.

¹⁰¹ If not mentioned otherwise references to the regulations will refer to Guangdong province's provisions.

¹⁰² Should there be no representative body at that level, employers "shall democratically elect" a chief negotiator while in the absence of such a trade union, the local branch of the ACFTU may assume this task.

¹⁰³ Representation at the enterprise level is regulated under Article 16 of Guangdong's Provisions on Collective Bargaining.

however their role within the quickly transforming governance structure lacks clear regulations as to what their specific roles could be in tripartite bargaining (Taylor, Chang and Li, 2003).¹⁰⁴ Article 17 states that the workers congress shall appoint other representatives, next to the chief representative (the chairman of the enterprise trade union, who can authorize another representative), but does not mention workers congress in the absence of a trade union. The employer is to be represented by the legal representative or any representative with the authorization of the legal representative. Each negotiation party shall appoint between 3-9 additional representatives and may include observers (Article 15). Once there has been a mutual agreement the draft needs to be submitted to the local labor bureau for verification, potential revisions and final approval before it becomes legal binding after 15 days. The process hence in many particulars resembles that of minimum wage.

Although it appears that at the enterprise level bargaining, the government appears to stay out of the negotiations process, this would be a misconception. Quite in contrast, the government retains a dominant position in the Chinese style collective bargaining process (Huang, 2013). While in theory employees as well as employers can request collective consultations, the crucial first step will be defined by a directive of the superior authorities, most often trade unions and local party officials (Li, 2000). More importantly, as has been outlined above, trade unions are not independent organizations and the state can project their policies directly through them. Workers and employers alike will, in one form or the other, remain dependent on the government's influence (Traub-Merz, 2011). The role governments have in the negotiation process will vary in China leaving a wide range in industrial labor regimes or implementation of policies (Lee, 2007). Technically, the government has a considerable share of control over collective agreements as they remain subject to approval by the local labor authorities. Given the sizable influence the government can have on limiting market mechanisms, its influence on the private sector and SOE sector (including mutual business interests) will depend on local government's preferences and abilities, and may be more enforced on a case-to-case basis rather than on a large scale basis. The process of collective bargaining therefore is not uniform and may have local variations. The legal structure however has improved and one can expect the situation to progress over time leading to greater uniformity. Despite the variation in collective bargaining, the government will remain in direct or indirect control over the content and process of collective negotiations at the enterprise level in China.

8.2.2 Evaluating the contents of collective agreements

The CPC's anxiety about disharmonious industrial relations has aided advocating a greater focus on collective contracts. The emphasis has however been on collective contracts which in effect are much more limited in scope than collective agreements resulting from collective bargaining following common Western definition. In order to avoid confusion and to maintain a clear distinction the term collective contracts will be used for the remainder of the text. The agreements described above do not emphasize a true bargaining process between

¹⁰⁴ Workers Congress were established to provide workers with a voice within management decisions and is often regarded as a reaction following the Solidarity Movement in Poland (Sheehan, 1998). Their scope, among others does include wages, but they are generally considered a weak organization with a close alignment to senior management mainly there to approve decisions already made by the management. Taylor, Chang and Li (2003) provides a brief introduction of Workers Congress in China.

management and unions. Confrontational bargaining is not welcomed as the main policy goal is to create ‘harmony’ and ‘stability’ within society (CLB, 2007). Clarke, Lee and Li (2004) refer to collective contracts as a self-regulatory collective institutional mechanism to secure ‘harmonious’ labor relations”. The ACFTU’s perception of collective contracts and agreements is in a similar fashion¹⁰⁵:

“Practice has shown that under the conditions of developing a socialist market economy in China, implementing the system of collective consultation and collective contract has played a very important role in protecting workers’ legitimate rights and interests, establishing harmonious and stable labor relations and promoting economic growth.”

Legislation (Article 7) in theory leaves room for a wide scope of topics to be included in the collective contract: agreements could include issues related to pay, holidays, health and safety, training, sanctions, layoffs among others. Article 8 outlines contents of collective wage negotiations in more detail (see Table 15).

Table 15. Content of collective wage negotiations

1. Wage distribution system and wage standards	6. Wage during probation, sick leave and absence of leave
2. Wage payment method and time	7. Duration of collective wage contract, procedures of change and termination of collective wage contract
3. Annual total wage and average pay level of employees	8. Condition for termination of collective wage contract
4. Wage rates and methods of adjustment	9. Liability for the violation of collective wage contract
5. Allowances and subsidy levels, bonus distribution method	10. Other mutually agreed upon wage related items

Source: Guangdong MOLSS

Wage bargaining of course is a thorny issue which, next to political concerns, might as well be contrary to the governments ambition of creating more ‘harmonious’ labor relations. Being a problematic matter, collective wage bargaining in effect will not include wage bargaining but is more likely to be similar in content across companies taking the government’s instructions into account (Huang, 2013). The grass root labor union is set to avoid confrontational bargaining, effectively opting not to bargain for more challenging topics (Taylor, Chang and Li, 2003). Focusing more on workers’ welfare and working regulation, the agreement resembles more work council’s agreements than collective bargaining agreements (ten Brink, 2013). As a result there is in effect little bargaining in Chinese collective contracts (Feng, 2006) and hence little effect on the power distribution of employees in the bargaining process. A study of collective contracts at SOEs confirmed that the vast majority of content are merely copied from labor laws (Taylor, Chang and Li, 2003). Other studies confirm these findings noting that there are no actual wage figures within the agreements and that there are only few cases of

¹⁰⁵ Retrieved the ACFTU’s website under: from <http://english.acftu.org/template/10002/column.jsp?cid=77> on March 10th, 2008

real individual agreements (Lüthje et al, 2010). Most frequently collective contracts ‘agreed’ upon by management and workers representatives will be sample contracts with nearly identical content issued by local authorities or higher level trade unions (Luo, 2011). In a top down approach the content of collective wage bargaining within the structure of collective contracts at the enterprise level hence do little more than to reflect current labor legislation and government wage policies. Bottom up initiated agreements, usually after a labor dispute, are exceptional and most likely only to be tolerated at foreign companies (see for example the cases at Honda in 2010 (Hui, 2011)).

8.2.3 Coverage and impact

According to the ACFTU, “with painstaking promotion and positive participation by trade unions at various levels in China, by the end of 2006, 305,000 special collective wage contracts had been signed across the country, with 526,000 enterprises and 37.15 million workers involved; and 23,900 special regional and industrial collective wage contracts were signed, with 281,000 enterprises and 11.138 million workers involved”.¹⁰⁶ Assuming these numbers are not inflated, coverage of 6.3% of the total workforce would have been achieved. By 2010 this figure was to have reached 185 million workers covered by collective contracts in 2.439 million companies, reflecting a coverage rate of 24% of the employed population.¹⁰⁷ Data released by the ACFTU in 2013 states that in the first 6 months 1.2 million collective contracts in 3 million enterprises were signed and that its target is to sign collective contract at 80% of unionized companies by 2015.¹⁰⁸ The figures however must be regarded with caution. First, as has been previously illustrated the quality of the content of the collective contracts must be questioned. Second, how many workers actually are aware of the existing collective contracts is debatable at best. Lastly, data on the quantity of collective contracts, as with much official data in China, is notoriously unreliable. This issue will be explored further below in section 8.4.

Data on the ACFTU’s website as well as data found in official news reports are likely to provide different details. Regardless of the exact figures, the trend of collective contracts signed and workers covered has been clearly rising. Data available also confirms that the focus is on enterprise level negotiations while regional agreements appear to be less relevant than industrial agreements.¹⁰⁹ With rising wage dispersion and inequality the increase in collective contracts in recent years has been a policy reaction of the government instructing the ACFTU to increase collective bargaining. The ACFTU has been keen on increasing unionization and collective contracts at foreign companies, particularly Fortune 500 ones since 2000 (see CLB, 2006 / Chan, 2005 / Graver 2008 / Hui and Chan, 2011). According to the ACFTU 80% of the 4100 companies of Fortune 500 companies set up in China introduced collective contracts in 2011 and this figure was to increase to 95% by 2013.¹¹⁰

¹⁰⁶ Retrieved from the ACFTU’s website under: <http://english.acftu.org/template/10002/file.jsp?cid=81&aid=232> on March 10th, 2008.

¹⁰⁷ ACFTU report: acftu.people.com.cn/GB/13771665.html last retrieved February 9th, 2014.

¹⁰⁸ Reported by the IHLO in June 2013 at <http://www.ihlo.org/LRC/W/081013c.pdf>

¹⁰⁹ Retrieved from ACFTU news reports under: acftu.people.com.cn/GB/196955/index.html last retrieved February 9th, 2014.

¹¹⁰ Retrieved from China Daily under: www.chinadaily.com.cn/business/2012-08/20/content_15687094.htm last retrieved February 9th 2014.

These advances in collective bargaining appear highly impressive when the quality of the content is ignored. Rather than reflecting advances in genuine collective bargaining the advances are a product of policy targets set by the government implemented by the ACFTU (Pringle, 2005). Following a high profile case of Wal-mart, which attempted to keep its global anti-union policy in place (Hui and Chan, 2011), most foreign companies will not resist. Wanting to avoid political confrontation with the local CPC employers, once approached, will usually just sign collective contracts (Guo, 2004). The impressive numbers of collective contracts are hence a direct result of a top-down administrative task of the ACFTU implementing policy goals of the CPC (Taylor, Chang and Li, 2003). Recent developments however do stress the importance the government has put on advancing collective contracts. The increasing numbers of collective contacts, though lacking true bargaining and content at present, also underline the government's ambition to gain direct foothold into wage bargaining at the enterprise level.

8.3 Understanding the role of wage guidelines

In a similar function to minimum wage adjustment several municipal, and less so provincial, governments issue separate wage guidelines indicating wage increases. Wage guidelines are issued by local labor bureaus with a baseline as well as a minimum and maximum adjustment, depending on the economic condition of the company compared the average performance in the region.¹¹¹ These adjustments should not be confused with wage guidelines for wage levels, which are based on surveys carried out by the local labor bureau of local companies for many different specific occupations. Rather than being a reference for wage levels, wage guidelines, similarly to minimum wages, provide a guidance to wage growth. The guidelines are parallel to minimum wage adjustments, and were initially introduced to regulate wage growth at SOEs (Rawski, 2003). However, unlike minimum wage adjustments, wage guidelines function as a reference and are not legally binding, although for some SOEs its implications are stronger.¹¹² Mostly wage guidelines have been limited to municipal level, but in a new development wage guidelines have also been issued at the industry level (catering industry) in China, for the first time in 2014.¹¹³

Overall the process of how wage guidelines are determined remains vague and unclear, most likely with regional variations similar to those seen in the collective contracts and minimum wage. As the example of the industry wide wage guidelines show, the agreements may be based on tripartite consultations between industry groups, trade unions and the government. Other reports however have indicated that the representative bodies remain at the sideline leaving the adjustments to the labor bureau (Clarke and Lee, 2002). Equally, the impact on wage developments may be very different and difficult to evaluate. Depending on the region, the issued wage guidelines can be of indicative nature to having a "fairly interventionist ton" (OECD, 2010). Despite this wage guidelines are an often overlooked concept in the Chinese wage determination system. Both in terms of how the increases are determined, as well has

¹¹² Based on interview with Arthur Kroeber and Janet Zhang from Draconomics in September 2010.

¹¹³ Reported at the ACFTU's website (Wage guidelines issued for the Catering Industry) under: <http://acftu.people.com.cn/n/2014/0128/c67502-24247981.html> (in Chinese, retrieved January 27th, 2014).

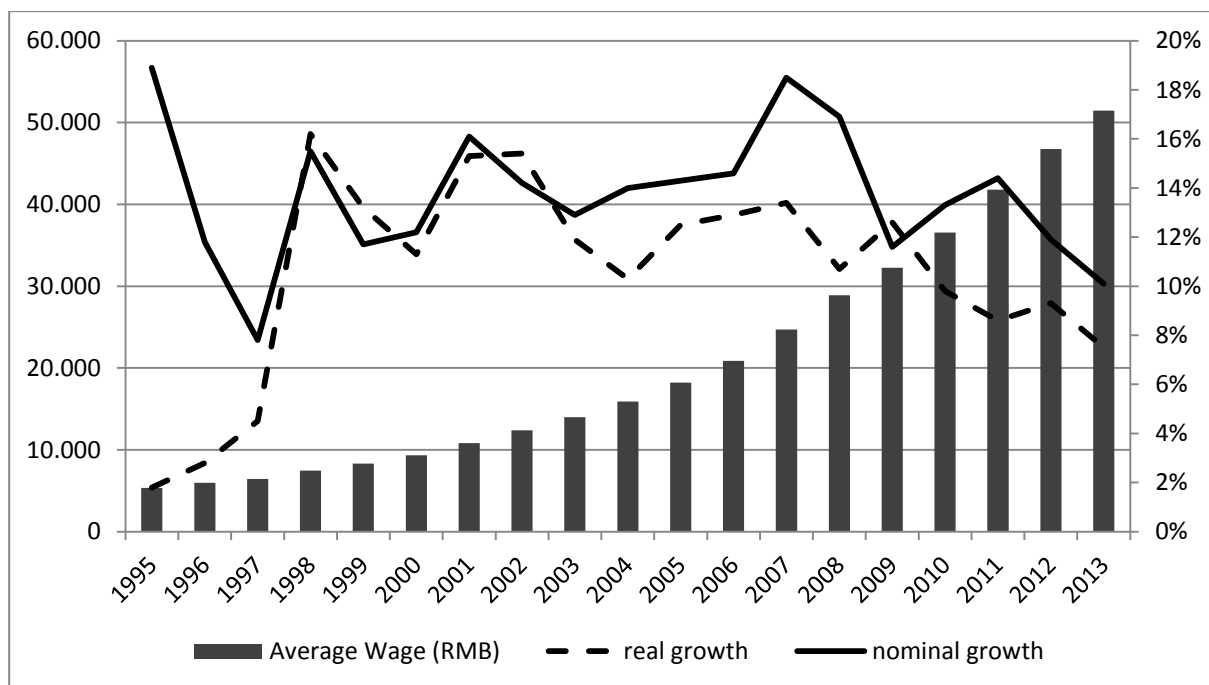
their actual impact on the wage determination process varies. As of 2014 experimentation as to how to evolve wage guide lines and tripartite bargaining are ongoing. At this stage wage guidelines still appear weaker compared to minimum wage guidelines, but they may become stronger as China policymakers continue to experiment with collective contracts and eventually collective bargaining agreements.

9 Wage Developments of the Chinese Wage Determination Regime

9.1 Wage growth in China

Since 1978 economic success has been overwhelmingly positive and the vast majority of the population was able to experience significant personal gains in terms of wealth and income. Rapid double digit growth has also contributed to rapidly rising average wages. Data of the National Bureau of Statistics in Figure 10 illustrates that between 1995 and 2013 average urban wages increased from RMB5.348 to RMB51.474, increasing more than nine-fold in nominal terms. According to the official data real average wage growth was 10.7% during this time period, while nominal growth was 13.9%.

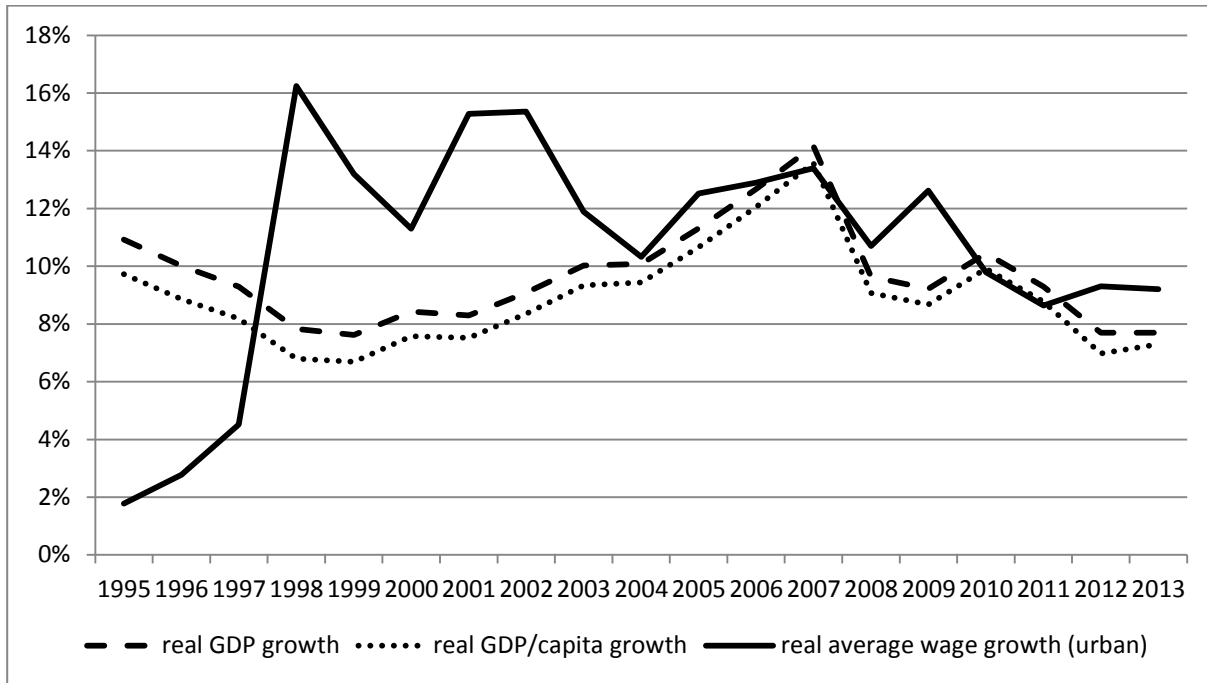
Figure 10. Average wage growth, 1995-2013



Source: NBS

As Figure 11 below shows, real GDP and real GDP per capita have been growing in a similar way, with GDP growth slightly outpacing the later. Real wage growth by comparison developed less homogenously. Since 2003 it has however, been growing more in line with GDP and GDP per capita while there seems to be a lag when adjusting to slower growth rates as seen in 2008/09 as well as in starting in 2012.

Figure 11. Development of wage growth, GDP, and GDP per capita, 1995-2012



Source: NBS / own calculations based on NBS data

Wage growth across all of China's regions has been experiencing exceptional growth. Table 16 lists nominal wage growth rates between 2004 and 2012. The average growth across all provinces during this period ranged between 9.3-17.8%. Economic reforms were centered in China's coastal regions, making them the most developed and wealthiest provinces. Provinces in central and western China did not equally benefit from the reforms, mainly because of being landlocked, making access to major export markets. In 2000 the government began to formulate growth strategies to develop western and central regions in an aim to push for a more balanced development across China. Ideally the less developed regions should then experience faster growth and narrow in gap to the provinces with higher levels of development.

China officially distinguishes its provinces into three regions: East, Central, and West.¹¹⁴ The geographical categorization at the same time provides an adequate representation of different development stages as ranking and categorizing the provinces according to GDP per capita, with few exceptions, yields similar results. Over the past 10 years this strategy has so far not translated into wage growth in the less developed regions high enough to close the gap. Figure 12 illustrates the nominal wage growth in the three areas between 2004 and 2012. The eastern provinces, which include most of the coastal areas at the center of initial economic reforms including Guangdong in the south, have recorded the lowest nominal wage growth, expanding 13.8% on average during this time period. Growth in central regions, which are in

¹¹⁴ The National Bureau of Statistics defines the provinces and municipalities in China as follows: East (Beijing, Tianjin, Hebei, Liaoning, Shanghai, Jiangsu, Zhejiang, Fujian, Shandong, Guangdong, Hainan), Central (Shanxi, Jilin, Heilongjiang, Anhui, Jiangxi, Henan, Hubei, Hunan), West (Inner Mongolia, Guangxi, Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Qinghai, Ningxia, Xinjiang).

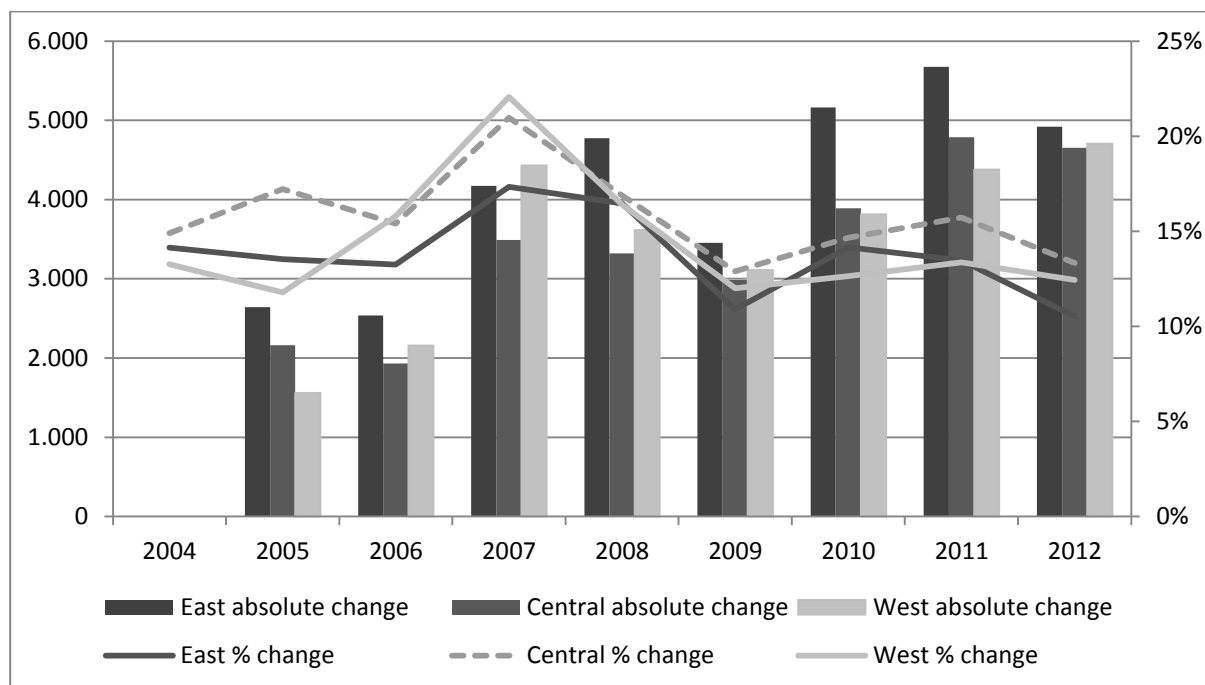
direct proximity to the coastal powerhouses around the Bohai Rim, the Yangtze Delta and the Pearl River Delta, was 15.8%. The least developed western regions meanwhile saw real wage growth of 14.4%. Wage growth rates in the less developed regions were slightly higher than in the East; however coming from a higher base, the lower growth still translated into higher absolute wage growth in the most developed regions (see Figure 12).

Table 16. Ranking of average urban nominal wage growth in Chinese provinces, 2004-2012

	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average
Anhui	22.2%	18.6%	17.3%	23.6%	18.9%	11.8%	16.1%	18.0%	13.3%	17.8%
Shanxi	20.6%	20.9%	17.0%	17.6%	20.0%	10.1%	17.8%	18.7%	12.8%	17.3%
Inner Mongolia	18.1%	20.0%	15.5%	18.5%	19.3%	17.5%	15.5%	16.8%	13.2%	17.2%
Hubei	10.9%	21.6%	15.0%	23.5%	14.7%	18.6%	19.8%	13.6%	10.3%	16.4%
Hainan	21.7%	13.9%	10.2%	21.8%	13.0%	13.9%	24.1%	17.8%	8.9%	16.1%
Shaanxi	13.6%	13.6%	14.3%	25.9%	21.8%	16.0%	12.9%	14.3%	12.9%	16.1%
Guizhou	12.6%	15.4%	17.0%	22.9%	19.0%	14.4%	10.9%	18.6%	14.0%	16.1%
Ningxia	12.6%	17.7%	23.1%	23.4%	17.2%	9.5%	12.9%	14.9%	11.1%	15.8%
Jiangxi	12.7%	15.4%	13.6%	18.0%	14.1%	17.3%	17.4%	17.2%	15.9%	15.7%
Chongqing	15.5%	15.8%	15.6%	20.2%	16.8%	14.5%	13.9%	13.5%	12.9%	15.4%
Henan	12.7%	17.9%	18.9%	23.3%	18.5%	10.1%	10.8%	12.8%	11.0%	15.1%
Hebei	15.5%	13.8%	12.8%	20.0%	24.3%	14.4%	13.2%	12.3%	9.5%	15.1%
Tianjin	16.7%	16.2%	14.5%	21.8%	19.5%	9.9%	17.2%	8.1%	10.5%	14.9%
Heilongjiang	13.8%	15.1%	13.7%	17.5%	18.9%	14.0%	11.8%	12.9%	16.3%	14.9%
Jilin	12.2%	15.9%	14.0%	23.7%	14.5%	11.4%	11.8%	15.9%	14.3%	14.9%
Sichuan	13.0%	12.5%	12.6%	19.4%	17.5%	13.8%	15.7%	14.6%	13.4%	14.7%
Beijing	17.2%	15.2%	17.9%	15.9%	21.1%	3.5%	12.8%	15.8%	12.3%	14.6%
Xinjiang	9.3%	7.4%	14.2%	20.3%	15.2%	11.9%	15.9%	19.5%	16.6%	14.5%
<i>China Average</i>	14.0%	14.3%	14.6%	18.5%	16.9%	11.6%	13.3%	14.4%	11.9%	14.4%
Shandong	14.0%	15.9%	15.5%	18.8%	15.6%	12.1%	13.3%	12.9%	11.4%	14.4%
Hunan	14.0%	12.4%	13.7%	20.6%	15.5%	9.9%	11.8%	16.6%	12.7%	14.1%
Liaoning	14.7%	16.1%	12.9%	18.2%	19.5%	12.3%	12.8%	10.8%	9.7%	14.1%
Jiangsu	15.8%	15.1%	13.3%	15.1%	15.7%	12.5%	12.9%	14.4%	11.3%	14.0%
Guangxi	13.6%	13.9%	16.5%	21.2%	17.2%	10.2%	12.3%	7.7%	10.2%	13.6%
Fujian	9.0%	9.9%	13.0%	15.3%	15.3%	11.0%	14.0%	19.3%	15.4%	13.6%
Gansu	10.7%	9.7%	15.9%	21.7%	14.4%	13.2%	8.8%	10.3%	17.4%	13.6%
Shanghai	10.2%	14.2%	19.0%	19.7%	14.7%	11.9%	13.3%	14.3%	4.1%	13.5%
Qinghai	12.2%	10.8%	18.5%	15.4%	18.4%	7.9%	11.2%	14.5%	12.4%	13.5%
Yunnan	13.3%	10.7%	16.1%	9.5%	17.3%	12.3%	11.6%	16.5%	10.7%	13.1%
Guangdong	10.7%	8.3%	9.4%	12.4%	12.5%	9.6%	10.9%	11.4%	11.6%	10.8%
Zhejiang	10.0%	10.2%	7.3%	11.7%	9.8%	8.7%	11.2%	11.1%	11.1%	10.1%
Tibet	14.6%	-6.2%	10.1%	46.3%	2.6%	2.9%	10.0%	-0.9%	4.5%	9.3%

Source: NBS

Figure 12. Growth of annual average wage in percent and absolute terms in East, West, and Central China, 2004-2012



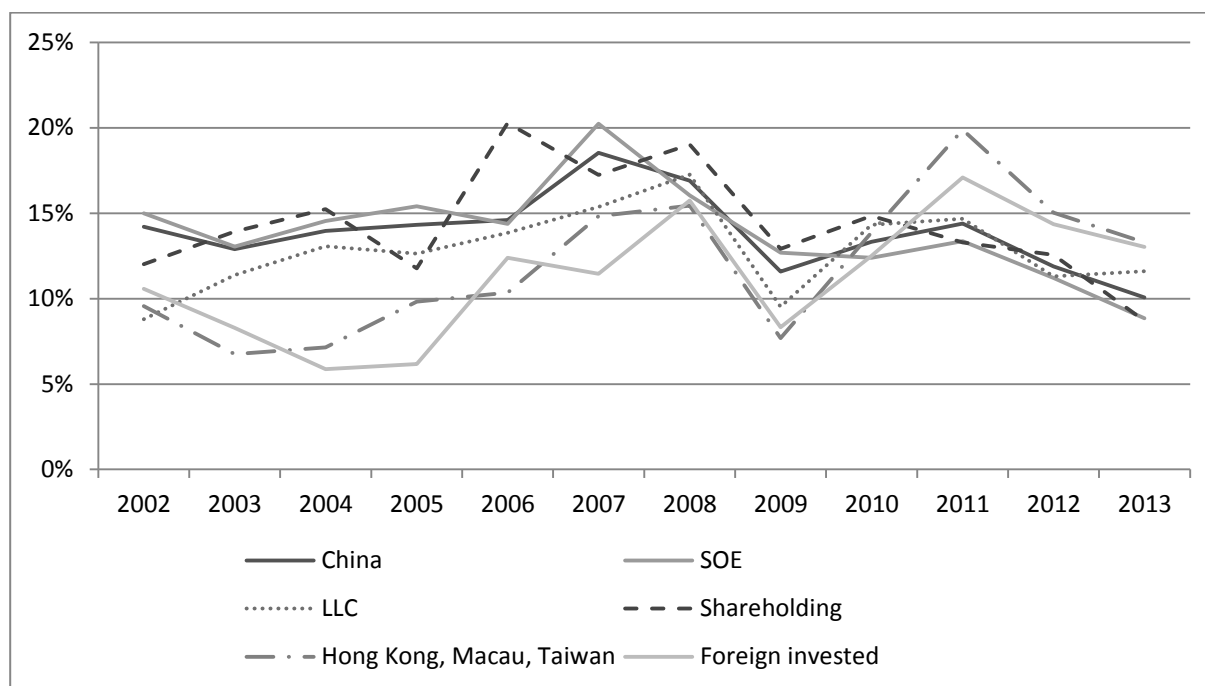
Source: own calculations based on NBS data and definitions.

Considering the heterogeneity and complexity of the massive Chinese economy as well as the significant differences in economic development, nominal wage growth in China has been relatively homogenous. Over the past 10 years wage growth generally has been moving in a similar manner within a relatively narrow bandwidth. With the exception of 2005 and 2007 wage growth in all three areas was within a bandwidth of approximately 2 percentage points.

9.2 Elements of coordination in wage developments

Nominal wage developments based on type of company registration highlight some noticeable differences. SOEs and shareholding companies, which often have a strong government ownership as well, closely match the overall nominal average wage developments. Though their employment share has been strongly falling (see Figure 6), they still employ over 1/3 of workers. It is the SOEs in particular which deviate no more than 1 percentage point from the average wage growth, while shareholding companies have a slightly higher variations. Limited Liability Companies, foreign invested companies as well as Hong Kong, Macau, and Taiwan invested companies show higher fluctuations in wage development. Industry, business purpose, export dependence, company size are among the many factors which can influence wage developments and it is not the focus to further explore the underlying reasons behind the individual variations. Much more Figure 13 does indicate differences in the periods before and after 2008 when the government began to change labor relations. The data suggest considerable advances in coordination especially of wage growth at Chinese SOEs and LLCs with the average wage development, but also, although to a lower degree at, non-Chinese owned companies.

Figure 13. Nominal wage growth by type of company registrations, 2002-2013



Source: NBS

Stronger labor legislation and enforcement of minimum wage were key elements of the governments push in rebalancing industrial relations. Fluctuations prior to 2008 were greater than after 2008 when wage increases at the various company types began to move within a narrower bandwidth. Despite the rising number of collective contracts signed, the lack of data makes it nearly impossible to evaluate any potential signaling power, which is further complicated by the differences in content of the individual agreements. The ACFTU has not yet published data of collective contracts which would allow the calculation of a wage premium (Traub-Merz, 2011). Although this would require further research individual empirical research by Lee and Liu (2011) lets to believe that prevalence of trade unions and collective contracts do not have a significant impact. Data on wage guidelines may however act as a substitute in this matter. Although their nature and composition is very different to collective contracts, they can be a helpful to utilize. The most important pillar, with the best data availability are however minimum wage levels. As they are adjusted regularly and across all provinces, and most importantly being widely enforced its impact on the overall development of Chinese wages can be evaluated best.

Table 17. Minimum wage rates across China, 2014

Region	Category						Valid since	Increase
	A	B	C	D	E	F		
Shanghai	1,820	-	-	-	-	-	1. Apr. 2014	12.3%
Shenzhen	1,808	-	-	-	-	-	1. Feb. 2014	13.0%
Tianjin	1,680	-	-	-	-	-	1. Apr. 2014	12.0%
Zhejiang	1,650	1,470	1,350	1,220	-	-	1. Aug. 2014	12.5%
Beijing	1,560	-	-	-	-	-	1. Apr. 2014	11.4%
Guangdong	1,550	1,310	1,130	1,010	-	-	1. Mai. 2013	-
Xinjiang	1,520	1,320	1,240	1,160	-	-	1. Jun. 2013	-
Shandong	1,500	1,350	1,200	-	-	-	1. Mar. 2014	10.2%
Inner Mongolia	1,500	1,400	1,300	-	-	-	1. Jul. 2014	12.1%
Jiangsu	1,480	1,280	1,100	-	-	-	1. Jul. 2013	-
Shanxi	1,450	1,350	1,250	1,150	-	-	1. Apr. 2014	14.2%
Yunnan	1,420	1,270	1,070	-	-	-	1. May 2014	12.4%
Henan	1,400	1,250	1,100	-	-	-	1. Jul 2014	13.7%
Sichuan	1,400	1,250	1,100	-	-	-	1. Jul. 2014	9.7%
Jiangxi	1,390	1,300	1,210	1,060	-	-	1. Jul. 2014	11.8%
Gansu	1,350	1,300	1,250	1,200	-	-	1. Apr. 2014	15.0%
Jilin	1,350	1,220	1,120	-	-	-	17. Jun. 2013	-
Hebei	1,320	1,260	1,150	1,040	-	-	1. Dez. 2012	-
Fujian	1,320	1,170	1,050	950	-	-	1. Aug. 2013	-
Ningxia	1,300	1,220	1,150	-	-	-	25. Mar. 2013	-
Liaoning	1,300	1,050	900	-	-	-	1. Jul. 2013	-
Shaanxi	1,280	1,170	1,060	970	-	-	1. Feb. 2014	11.5%
Qinghai	1,270	1,260	1,250	-	-	-	1. May 2014	18.9%
Anhui	1,260	1,040	930	860	720	680	1. Jul. 2013	-
Chongqing	1,250	1,150	-	-	-	-	1. Jan . 2014	20.1%
Guizhou	1,250	1,100	1,000	-	-	-	1. Jul. 2014	18.3%
Tibet	1,200	1,150	-	-	-	-	1. Sep. 2013	-
Guangxi	1,200	1,045	936	830	-	-	7. Feb. 2013	-
Hunan	1,160	1,050	950	870	-	-	1. Jan. 2013	-
Heilongjiang	1,160	1,050	900	850	-	-	1. Dez. 2012	-
Hubei	1,300	1,020	900	-	-	-	1. Sep. 2013	11.5%
Hainan	1,120	1,020	970	-	-	-	1. Sep. 2013	9.2%

Source: Provincial Labor and Social Security Bureaus.

In total, as shown in Table 17, China has 32 minimum wage regimes in place of which 19 adjusted their minimum wage in 2014 by October. Next to China's 28 provinces the four municipalities with quasi-provincial status under direct control of the central government, Beijing, Shanghai, Tianjin, and Chongqing as well as Shenzhen issue minimum wage rates. In theory their determination are all based on the stipulations outlined in the Minimum Wages Regulations (see section 7.1). Stronger growth in minimum wage adjustments is especially apparent since labor relations have been given greater priority since 2004. For instance the loosely enforced minimum wage for areas outside the special economic zone in Shenzhen grew 62.5% from RMB286 in 1993 to RMB465 in 2003 (MacDonald and Marshall, 2010), while between 2004 and 2014 it nearly quadrupled from RMB480 to RMB1,808.¹¹⁵

Within provinces different wage rates are primarily set to account for variations in the cost of living (C_{min}). Only the municipalities Beijing, Shanghai, Shenzhen, and Tianjin have unified their minimum wage regimes in 2010, meaning that minimum wage rates are uniform for the entire jurisdiction. All other 28 provinces, depending on variations within a province, wages rates will be set for different tiers of development. Different minimum wage rates are then set for different cities within the province resulting in some provinces like Guangdong having four different minimum wage rates. Including Shenzhen, which enjoys much economic autonomy from the provincial government in Guangdong and sets its rates independently, the province has five tiers (see Table 18). Minimum wage rates are fixed separately for each of the different tiers. In the case of Guangdong, contrary to what would be expected, minimum wages at the lower tiers do not necessarily have higher increases.

Table 18. Minimum wage rates across Guangdong province, 2014

Region	Minimum wage	Effective Since	Increases by year in %			
	in RMB/month		2014	2013	2012	2011
Tier 1 Guangzhou	1,550	May 2013	-	19.2	-	26.0
Tier 2 Zhuhai, Foshan, Dongguan, Zhongshan	1,310		-	19.1	-	20.0
Tier 3 Shantou, Huizhou, Jiangmen	1,130		-	18.9	-	17.0
Tier 4 Other Guangdong ¹¹⁶	1,010		-	18.8	-	20.0
Shenzhen ¹¹⁷	1,808	Feb 2014	13.0	6.67	13.6	20.0

Sources: Guangdong and Shenzhen Labor and Social Security Departments

Minimum wage growth has been trailing that of national wage developments for the most. Between 2004 and 2013, national average earnings in urban units more than tripled from

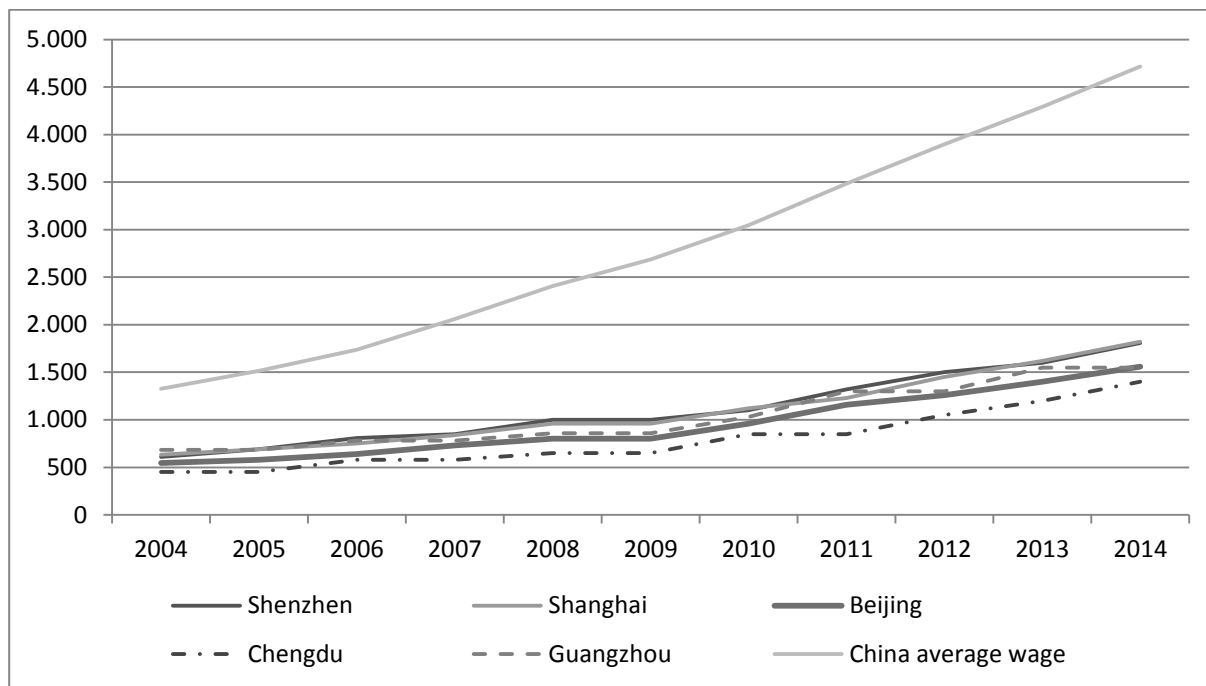
¹¹⁵ Until 2010, Shenzhen had one minimum wage rate for areas within the special economic zone and for those districts outside of it. Hence, when a single minimum wage rate was introduced in 2010, districts that were covered by the lower minimum wage rate experienced a larger wage increase.

¹¹⁶ Shaoguan, Heyuan, Shanwei, Yangjiang, Zhangjiang, Maoming, Zhaoqing, Qingyuan, Chaozhou, Jieyang, Yunfu.

¹¹⁷ Although a part of Guangdong province, Shenzhen enjoys higher level of economic freedom and adjusts its minimum wage independent.

RMB15.920 to 51.474, while for example Guangzhou’s minimum wage did not quite double (from RMB684 to RMB1,550) during the same time. Figure 14 shows that growth rates in the selected cities increased on average between 9.9% and 11.4% annually between 2004 and 2013. Despite the strong growth of minimum wages during these years, it appears to have been outperformed by the overall average wage developments, which increased 14.1%. While the income gap between the minimum wage and average wages in the cities has been growing, minimum wage adjustments in Chengdu, in one of China’s poorest provinces, was not able to close the wage gap to its richer cities in the east and south of the country. However, according to Lee (2009) minimum wages have significantly increased after the introduction of the 2004 changes. Whereas prior to the changes minimum wage grew at about 8% per year, the annual rate following the revision has accelerated to 14%. Further research by Xu and Lam (2010) point out several studies that designate increases in minimum wage have not been able to reduce growing disparities (see also chapter 9). The authors point out that, nationally, average workers’ wages increased annually by 13.5% from 1996 to 2006 while the minimum wage increased only by 9.9% annually during the same time period. Development of average wages to minimum wage levels illustrated in Figure 14 for Beijing, Chengdu, Shanghai, Shenzhen, and Guangzhou show that the gap continued to widen between 2004 and 2014.

Figure 14. Development of average wage in China and minimum wage levels in five cities, 2004-2014*

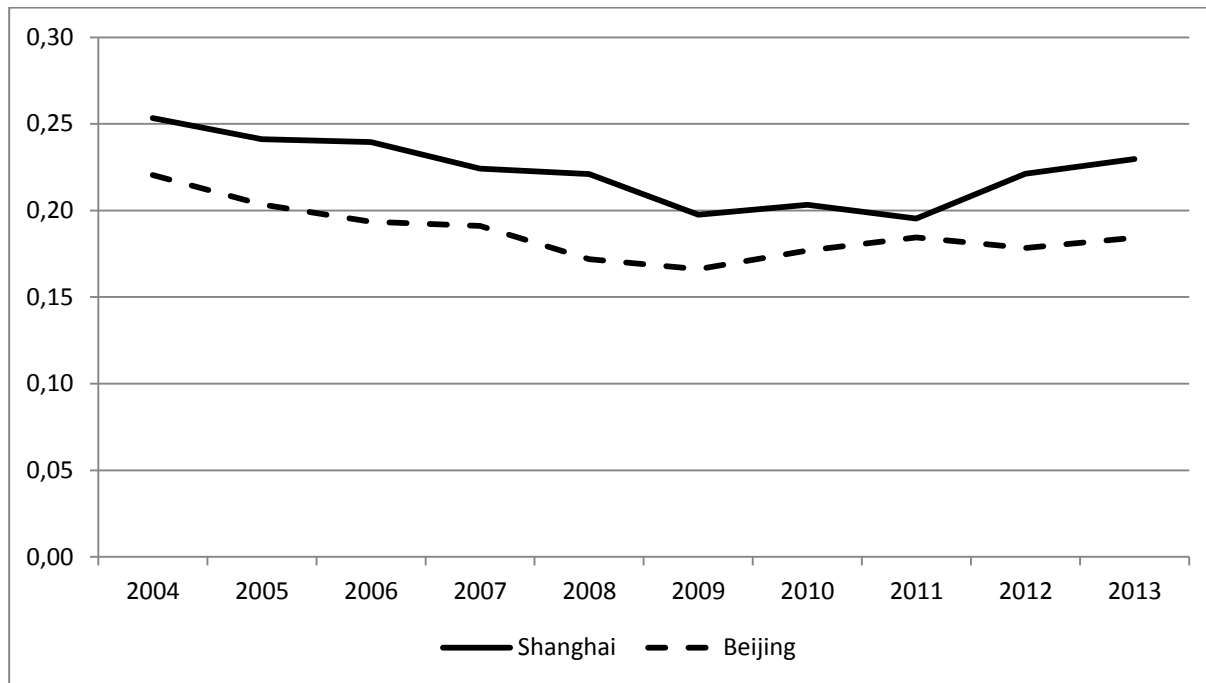


Source: NBS / Provincial Labor and Social Security Bureaus / *China average for 2014 is an estimation only.

A closer look at developments in Shanghai and Beijing using the for the same time period confirm these findings. The Kaitz index illustrated in Figure 15 has fallen from the 2004 levels in both cities. Better legislation and enforcement in the post-2008 era may have contributed in

stopping the drop, but has not been able to significantly improve the situation with the Kaitz index not being able to recover even to the 2004 levels. Wage dispersion therefore has been increasing between the lowest and average wage earners. Taking into account the government's policy goal of creating a harmonious society, wage development would be in violation of their own target and highly dysfunctional.

Figure 15. Kaitz index development in Shanghai and Beijing, 2004-2013



Source: own calculations based on NBS and Shanghai and Beijing statistical bureau.

The impact of minimum wage had on China's wage determination regime should not be underestimated despite its apparent weakness in contributing to greater coordination. Its most important contribution has been to set a wage floor for employees which otherwise would be left more valuable. Following its intentions of a policy tool minimum wage effectively establishes a base wage but it performs poorly on limiting wage dispersion. In chapter 7 the calculation of the minimum wage was previously explained, noting that C_{min} represents the most important variable in calculating the minimum wage rate but is only governed by loose guidelines. Lacking a national poverty line and any guidance in regards to the calculation within the Minimum Wage Regulations, the central government leaves the interpretation of a minimum standard of living to local authorities. Next to efforts to remain competitive against other provinces in China, local governments in an effort to limit payments to low income groups have an incentive to fix C_{min} at relatively low levels.¹¹⁸ This finding however remains

¹¹⁸ Looking to the regulations for the Minimum Living Standard Scheme (MLSS) might be helpful in providing a better definition. Aimed at urban residents, MLSS was first introduced in 1993 providing a social safety net for low income residents. This system, too, does not provide a precise calculation rule, leaving details to local authorities. By no means can it be assumed that the MLSS basis is also used in calculating C_{min} but it is used here to provide a basic reference for minimum consumption. Since the smallest variations in the minimum living standard have potentially significant implications for a number of beneficiaries, local authorities have an incentive to keep this figure relatively low (Chen and Barrientos, 2006).

speculative as it is difficult to validate due to the lack in transparency in the process. Some support of these findings can be found using data from the Guangdong Statistical Yearbook (2010) as an example. Table 19 shows that average monthly per capita consumption expenditure for urban residents in the province for low income, lowest income and poor households is 43%, 31.5% and 28.5% of the average.

Table 19. Average monthly per capita consumption expenditure, 2009

	Average	Low income households	Lowest income group	Poor households
Guangdong	1,405	607	443	401
Guangzhou	1,902	818	609	542
Shenzhen	1,794	771	574	511

Source: own calculations based on Guangdong Statistical Year book 2010¹¹⁹

Continuing in determining the variables of the minimum wage formula with the example of Guangdong, (see chapter 7), according to the Guangdong Statistical Yearbook (2010) each urban employee has 1.97 dependents which is equivalent to P_{sup} . Knowing the minimum wage rates for 2010, which should be based on data of the previous year and using the proportion method, allows the 2010 minimum wage rate to be evaluated and better understood. For this example minimum wage for Guangzhou and Shenzhen will be used which in 2010 was RMB1,030 and RMB1,100 respectively. Hence, the only unknown variable in the formula is the adjustment variable (a). Table 20 provides an overview of all of the proportion method's variables. Assuming that the adjustment variable $a=0$ should then result in the lowest possible minimum wage rate MW_{min} .

Table 20. Assumed variables of the proportion method calculating 2010 minimum wage

	MW^{2010}	C_{min}	P_{sup}	a	MW^{min}
Guangzhou	1,030	542	1,97	0	1,067
Shenzhen	1,100	511	1,97	0	1,007

Source: own calculations.

Under these minimal conditions, using the lowest possible consumption expenditure levels (poor households) and assuming $a=0$ Shenzhen's minimum wage fares slightly better than Guangzhou's, surpassing MW_{min} using minimal variables based on 2009 data. Adjusting for

¹¹⁹ The Guangdong Statistical Yearbook provides annual data only. Data for other income groups is only available for Guangdong. Data for other income groups for Guangzhou and Shenzhen have been calculated based on official data for Guangdong province resulting in the 43% for low income, 32% for lowest income and 29% for poor households.

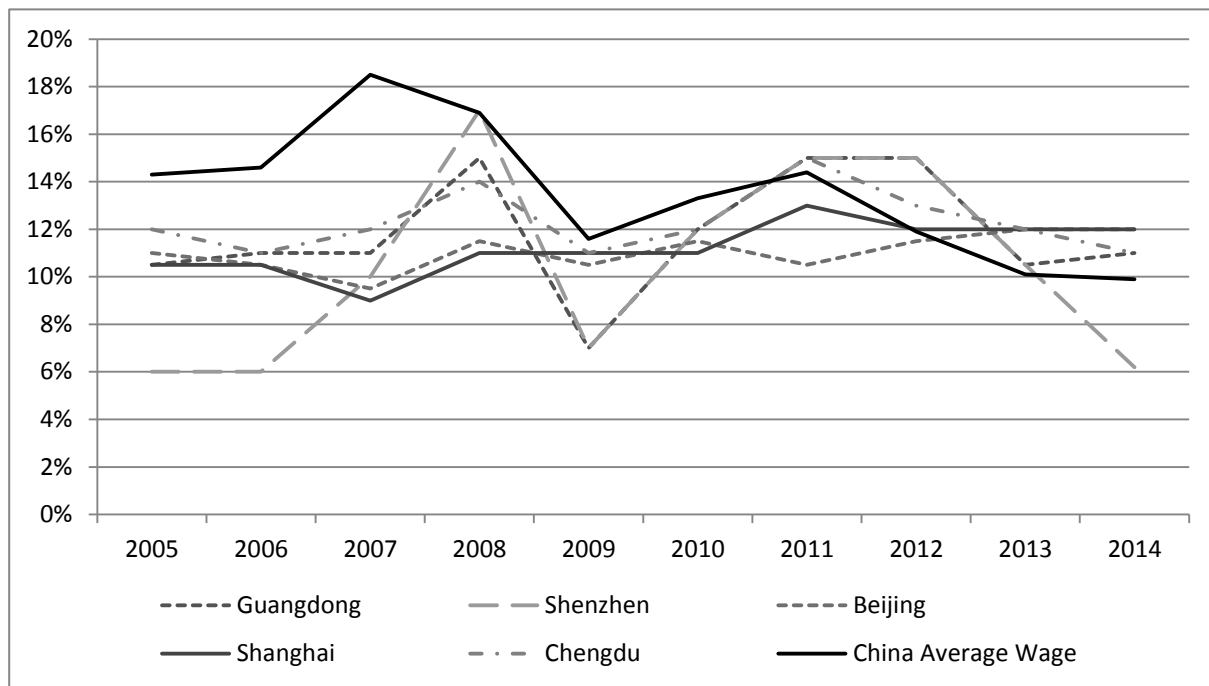
inflation in 2010 would however increase C_{\min} and therefore MW_{\min} . Comparing any inflation adjusted MW_{\min} to the actual MW_{2010} would consequently result in an even less favorable picture. Data for Guangdong strongly suggest that minimum wages there do not achieve the government's aim of establishing a sufficient minimum living standard, as even by the government's own definition recipients of minimum wages would qualify as poor or belonging to the lowest income bracket. By this benchmark set out in the Minimum Wage Regulations, the established wage floor appears too low. It is clear that there are large local variations within the nation, but initial research indicates that overall minimum wages are set according to a very low minimum standard of living contributing to higher wage dispersion.

Compared the national average in Figure 14 as well as in strikes that have been highlighting workers' dissatisfaction with them, increases in the minimum wage rate seem to be perceived as too low because, for most operators or low-skilled workers, minimum wages contribute a significant share of their income. Minimum wage adjustments are further valuable to economic shocks. In wake of the economic crisis minimum wage rate adjustments were suspended in 2009.¹²⁰ The suspension contributed to a wave of wildcat strikes by disgruntled workers, and notably outside the scope of the ACFTU, particularly centered in Guangdong. In response Guangdong authorities announced minimum wage adjustments in May for June 1st 2010 with rates rising on average over 20%, depending on the tier. Shortly before the official implementation, despite communicating the adjustments in May, several high profile strikes broke out. The first strikes were reported on May 17th at a Honda plant in Foshan, with the China Daily reporting 36 strikes by July 12th in Guangdong alone. Similar events were reported in Shenzhen, where a string of suicides at Foxconn put pressure on the company. Both companies, Honda and Foxconn, resolved the strikes by agreeing to pay rises of 47% and 66% respectively for the minimum basic wage, exceeding the previously announced minimum wage increase for Guangdong and Shenzhen (see Hui, 2011 / Hui and Chan, 2011).

The often overlooked wage guidelines are another policy element with the potential for increasing coordination of wage bargaining. Tracking wage guidelines does prove difficult, especially as there are wage guidelines issued at different levels and their frequency is inconsistent. They can be issued at the provincial or municipal level, but more recently guidelines for industries in some jurisdiction including Shanghai and Beijing have been issued. Understandably there are numerous wage guidelines which are announced throughout the year, but for the sake of better comparison, just as for minimum wage, only wage guidelines for Guangdong, Shenzhen, Shanghai, Chengdu and Beijing will be considered at this point. This is due to good data availability as well as the comparably advanced institutional setting in these high profile regions. Though most areas are well developed, Chengdu should highlight developments in lesser developed regions.

¹²⁰ As signs of continuous strong growth in China persisted in 2010, Jiangsu province was the first minimum wage authority to announce a rise in the minimum wage rate by the end of February. Guizhou and Gansu province, Guangxi autonomous region and Chongqing municipality were the last to follow suit towards the end of the year. Most adjustments were around 20% while Hainan province announced the largest increase of 37%.

Figure 16. Base line wage guidelines in selected cities compared to national average wage increases, 2005-2014



Source: NBS / Local labor bureaus, own calculations

With the exception of Guangdong (2004 and 2007) and Shanghai (2009) wage guidelines were adjusted annually.¹²¹ As mentioned wage guidelines will typically involve three different levels of wage adjustments depending on the economic condition of the individual enterprise. Under normal circumstances the base line provided is the most prevailing recommendation for wage increases. Figure 16 tracks the base line adjustments for the five areas since 2005 comparing it to the average wage developments in China. Average wage increases outpaced most wage guidelines by between 2-6 percentage points until 2009/10 when the increases across the different regions started to narrow the gaps and more closely tracked the overall average. The latest increases in 2014 were, with the exception of Shenzhen, especially similar.

¹²¹ Though no official statement could be identified, it appears that Shenzhen adopted Guangdong's wage guidelines since starting 2008.

Figure 17. Development of nominal growth of average wage in China and averages for wage guidelines and minimum wage in Beijing, Chengdu, Guangzhou, Shanghai and Shenzhen, 2005-2014



Source: NBS / Provincial Labor and Social Security Bureaus / own calculations

Figure 17 compares the average minimum wage adjustments as well as the average base line wage guidelines of the five provinces and municipalities with the average wage increases in China over the past 10 years. Minimum wages in particular display the higher fluctuation levels with all jurisdictions withholding minimum wage adjustments during the height of the financial crisis. In an effort to support companies using wage restraint, the central government in fact instructed all local governments to refrain from adjusting minimum wage in 2008 (Jia and Zhang, 2011). Although average wage growth did decrease, the decrease is not particularly significant, further hinting at very limited coordination power of minimum wages. After a recovery and an attempt to compensate for the suspension, increases in 2010 where nearly 20%, significantly higher than wage guidelines or average wage increases (for accounts of the strikes wave in 2010 see also in Hui, 2011). Since 2011 all three average have begun to move within a narrow bandwidth of below 2 percentage points.

Wage guidelines as well as minimum wage in theory should have components of tripartite wage bargaining similar to the provincial level TCC. Some wage guidelines specifically mention that the recommendations are based on consultations between the government, trade union and employers association at the provincial level which in would point to a relatively high level of centralization of the wage bargaining process. In the past three years there appears to be some consolidation and accommodation of wage increases for the average wage, minimum wage and wage guidelines. This may be an indication for higher level of coordination, though it is too early to evaluate the level of significance. Strengthening the tripartite elements within the Chinese wage bargaining system mainly in the form of

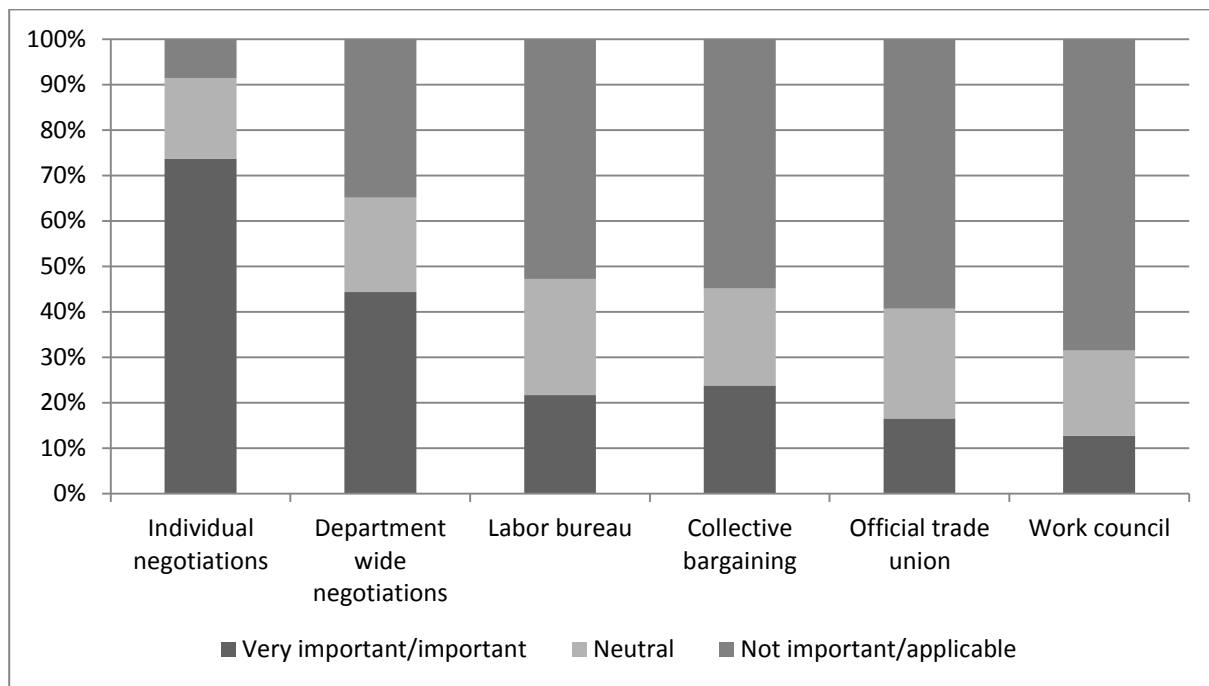
minimum wage and wage guidelines are with no doubt the most promising developments for improving coordination of wage increases in China under its current political structure.

9.3 Case study: wage determination in German companies

The basis of the data used for the case study is the German Chamber of Commerce annual wage survey, which is explained in greater detail in the methodology (see section 1.4). Both the most recent reports of the Business Confidence Survey (GCC, 2014) and the Labor Market and Salary Report (GCC, 2014b) compiled in 2014 are referred to for illustrating developments at German companies. The results of the study on wages are in line with slower GDP growth and overall development in China illustrated above. Wage growth at German companies began to continuously slow in over the past three years observed. Average increases for the 36 different job categories of German companies mainly located in the industrial centers along the coast provinces increased on average by 10.2%, 8.9% and 8.8% in 2012, 2013 and 2014 respectively with companies expecting increases to slow to 8.1% in 2015.

The vast majority (73.7%) of German companies participating in the survey report that wage bargaining takes place on the individual level, followed by department wide negotiations (44.4%) (see Figure 18). The findings emphasize the findings of the atomistic nature of the level of wage bargaining and a wage bargaining system with a low level of centralization. Higher level bargaining including the involvement of trade unions, work councils, collective bargaining or the government are relevant for less than 25% of the companies. The study does not allow a conclusion if the involvement of trade unions or the government pertains to a higher level of centralization or if the negotiations take place at the enterprise level. Results of the survey however underscore the structural weakness of trade unions. 67.8% report that they have no enterprise level trade union and 92.5% do not have work councils indicating a low level of involvement beyond the individual negotiations. Even in companies where trade unions have been established, collective bargaining is weak, with 65.1% of companies reporting no form of collective bargaining. Interviews with German managers yielded that not one participated or was involved in any form of tripartite negotiations and that no substantial bargaining took place. Accordingly any involvement of the trade union or the labor bureau was extremely weak and limited to the company level. The reports (see chapter 6) of major advances of trade union penetration as well as collective contracts, has not materialized at German companies in China. Although the share of companies which has been forced to join the ACFTU has doubled compared to 2013 (13.5%) this did not translate into a wider use of collective contracts. The findings therefore support other conclusions that advances published in these areas focus on quantity not quality at best, and would require careful scrutiny.

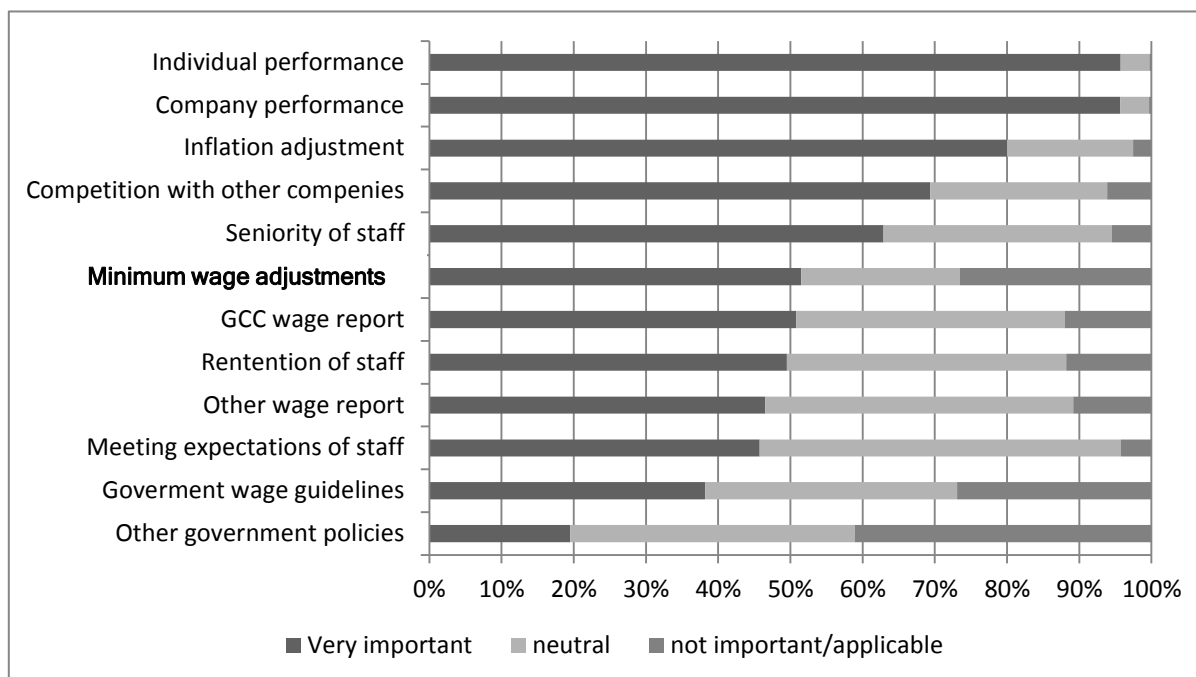
Figure 18. Importance of institutional drivers in wage bargaining at German companies



Source: GCC (2014b)

When asked for the main drivers for wage adjustments, company and individual performance are the most significant, with inflation the third most important factor (see Figure 19). For 69.4% of the companies, competition for staff on the market is an important driver for wage increases. According to the GCC's Business Confidence Survey 2012, 2013 and 2014, labor increases, as well as finding and retaining qualified staff have continuously been the biggest business challenges for companies operating in China. These results reflect tight labor market conditions and competition for employees. Interviews over the past five years with managers at German companies show that they all face competition for workers and are under pressure to react to the wage increases to retain especially highly skilled workers. Other managers have noted that the use of social media and modern communication results in workers quickly sharing their wage increases, contributing to false expectations as workers, especially the lower skilled, are prone to only compare wage increases and wage levels irrelevant of industry, region, company size or other influencing factors.

Figure 19. Importance of factors impacting wage increases



Source: GCC (2014b)

In many cases surrounding companies will cluster in nearby industrial park with similar products and skill requirements. The interviews indicated that communication between the companies is scarce, with little cooperation between the enterprises and a mistrust of companies with different national background. Lacking an enterprise association which could in effect facilitate coordination in wage development, each enterprise attempts to set wages on their own. In areas with a higher concentration of companies from a certain nationality, there have been attempts of German companies to communicate and make some kind of gentleman's agreement at best (examples can be found in the Zhuhai Free Trade Zone, Suzhou Industrial Development Zone, Taicang, or within Shenzhen). Other companies report of communication between HR staff and attempts to collude between potential employers.¹²² Given the small amount of companies involved, the positive impact on effective coordination can be seen marginal. It does however increase the effectiveness of enterprise wage bargaining at the lowest level. Wage surveys including the GCC's wage report must be seen more as an information sharing tool rather than an active element in the wage bargaining process. Much more these are attempts by companies to compensate for the limited role employer associations have in the wage determination system.

Government instruments aiming at wage developments do not fare much better in their influence at setting wage levels at German companies. Minimum wage adjustment are only an important driver for about half (51.5)%, while wage guide lines (38.2%) and other government policies (19.5%) are among the least important drivers further pointing to low

¹²² In one individual instance a highly specialized company provided a training program in order to supply enough skilled workers for its own use as well as the needs of its competition in order to keep wages in check.

levels of coordination in the Chinese wage bargaining system. Both government policy tools are further regarded as not important or applicable for nearly a third of companies, the highest shares of all items. The direct impact of wage guidelines was expected to be minimal on foreign-owned companies as its main focus at present is SOEs and its institutional capacity is only just being experimented with in order to affect broader wage developments. Minimum wage increases however, have been well established since 2008. They are the government's most visible policy tool aiming at controlling wage developments across China. For German companies surveyed minimum wage adjustments are only of limited importance, being the 7th most important driver.

Wage levels at foreign companies, and also German companies in China, are generally higher than the national average according to NBS data and findings of the GCC's wage survey, resulting in minimum wage rates having less of an impact on the general pay structure as minimum wages only represent a part of total compensation for workers. Other components in the wage structure can reach 50% and more of total salaries especially for lower skilled positions.¹²³ These components can include a wide variety (see Table 21 below) which will be very company specific while others such as mandatory social insurance payments are of a more general nature.¹²⁴ The wage structure typically becomes more complex the more senior an employee becomes while the impact of minimum wage diminishes accordingly. For most blue collar workers the basic wage is just one component of the actual income, although items including overtime pay, legal allowances and benefits may not be counted as part of the wages when determining the minimum wage (Du, Wang, and Lee, 2009). As expected interviews conducted while researching this paper showed that, while minimum wages impact workers' income, current minimum wages are only paid to unskilled support staff such as cleaning and security personal at foreign owned companies and represent their basic salary without other wage components.

Table 21. Example wage components for blue collar workers

Basic wage	usually equivalent to minimum wage rate
Overtime payment	Limited to 80h per month
Allowances	Food, housing, position/hardship, phone, skill, attendance, other allowances
Performance bonus	Based on Key Performance indicators / bonus payments for major public holiday ¹²⁵
Social insurance	Payments exceeding regulations
Year-end bonus	13 th salary common practice, usually based on base rate

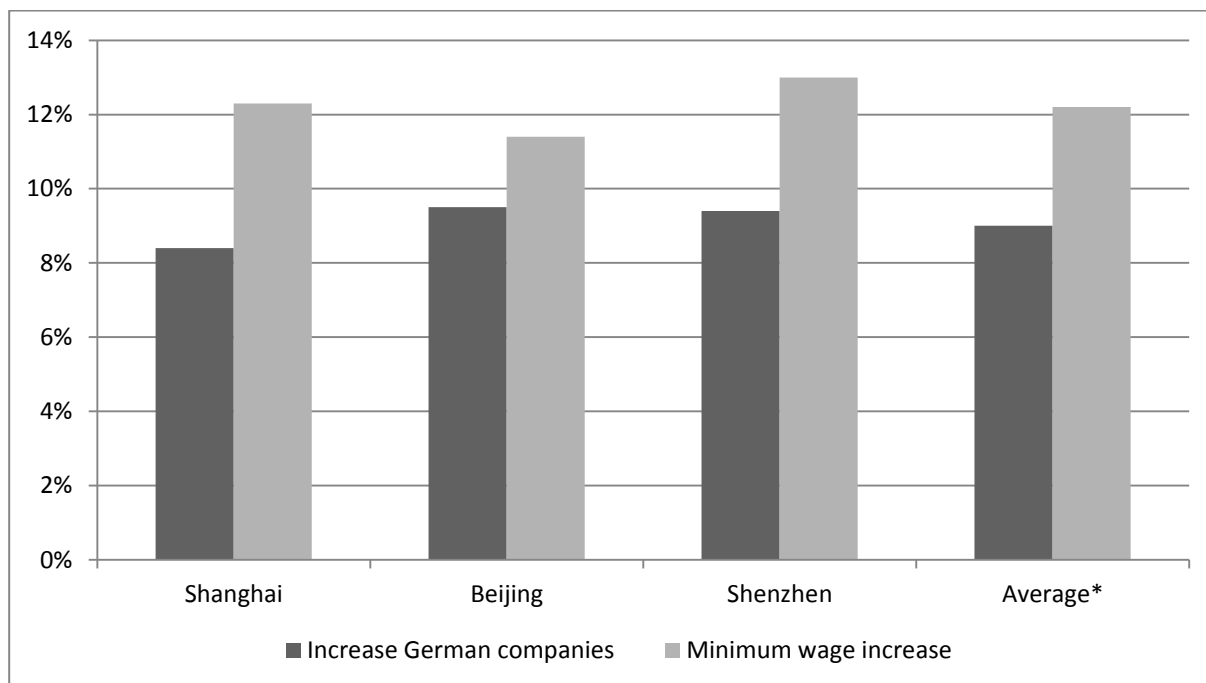
¹²³ For the relation of wage bargaining system and wage structure see Hall and Soskice (2001)

¹²⁴ Companies for instance can determine the share they contribute to the housing fund.

¹²⁵ According to the GCC's 2013 wage survey 72.2% of companies pay a bonus for the Chinese New Year holidays, while 61.1% pay a bonus for the mid-autumn festival.

Minimum wage adjustments do therefore impact wages of blue collar workers most and average wage increases for blue collar positions at German companies were the highest and closest to provincial minimum wage adjustments. Increases to the provincial minimum wage however do not fully raise wages at their nominal rate. Interviews confirm that the impact of minimum wage adjustments is highest for staff at the bottom of the pay scale, but companies further have the ability to adjust wage components illustrated in Table 21 to compensate for some of the increases, dampening the direct effect on the basic wage. A more complex wage structure means that minimum wage is not the overall determining factor for wages. By making adjustments to the other wage structure components or for example by increasing the requirements for receiving bonuses (effectively increasing productivity) companies have ample opportunities to compensate for changes in minimum wages. In an another example, companies can make adjustments to other fringe benefits, effectively compensating for all or at least portions of the minimum wage adjustments which in effect reduces the real wage increase for workers. An important income source for workers is and has been overtime pay. Even though long working hours are considered stressful and will depend on the individual working circumstances, overtime is generally welcomed by blue collar workers as the pay rate is 150% of the daily or hourly wage rate. Limiting overtime and increasing productivity targets are just two examples of what companies could employ to at least reduce the impact of basic wage increases due to the introduction of a minimum wage.

Figure 20. Minimum wage adjustments compared to average wage increases for blue collar positions at German companies, 2014

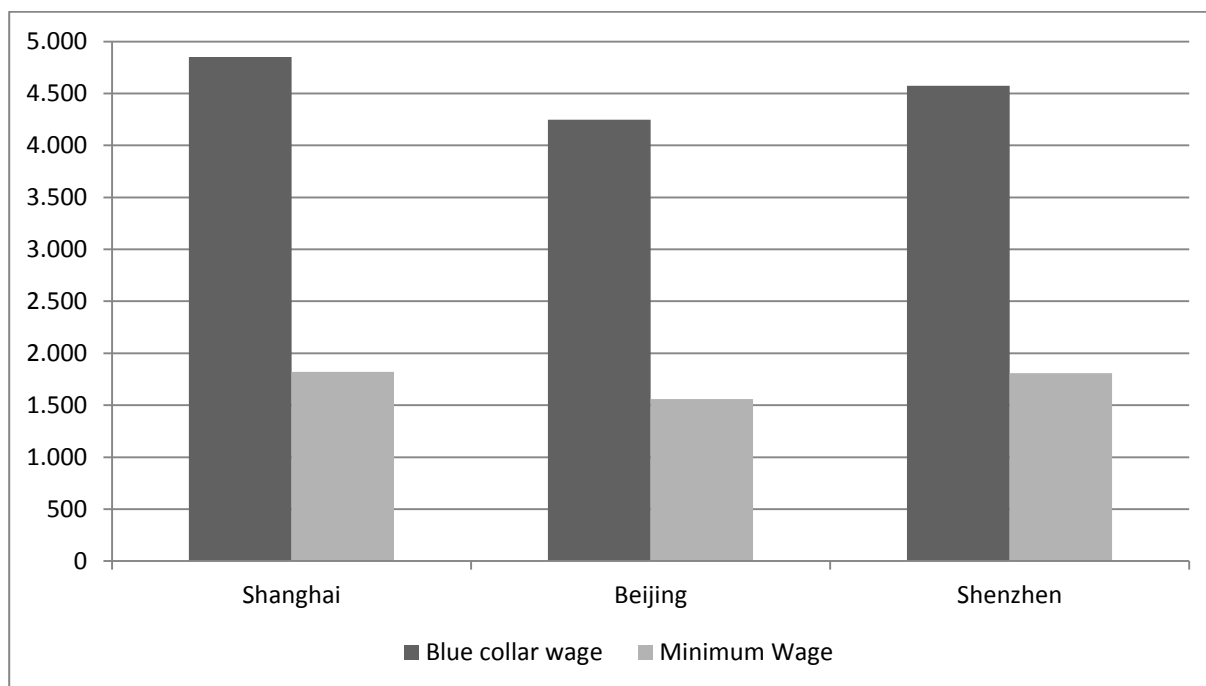


* Average of 2014 minimum wage adjustment for Shanghai, Beijing, and Shenzhen.
 Source: own graph based on GCC (2014b)

Wage increases for blue collar workers on average were 9.0% at German companies, while the average minimum wage increases was 12.2% in the three covered cities, which have a

strong German presence (see Figure 20).¹²⁶ With the exception of Beijing, wage increases for blue collar staff were lower than the minimum wage adjustments. A reason for the limited effect of minimum wage increase can be found in the relatively high wage levels at German companies. Several managers of German companies interviewed, stated that it was not uncommon for blue collar workers or operators to earn more than double the local minimum wage when overtime pay, bonuses and other allowances are included.¹²⁷ Data of from the GCC's wage survey confirms these statements. Figure 21 compares the 2014 minimum wage rates in Shanghai, Beijing, and Shenzhen to the median blue collar wages paid in these cities by German companies. The ratios then are 2.7, 2.7, and 2.5 for Shanghai, Beijing, and Shenzhen respectively when basic pay, allowances and overtime pay are taken into account. When only considering basic pay, the ratio drops to 1.6 for all locations. Although less dramatic, basic wages excluding variable compensation are still considerably above the prevailing regional minimum wages.

Figure 21. Blue collar wages at German companies in relations to local minimum wage, 2014



Source: own calculations based on local labor bureaus / GCC (2014b)

According to follow up interviews minimum wage adjustments do push up labor costs for employers and affected the entire pay matrix. As a result, workers and staff earning above the minimum wage demanded higher wages as well, resulting in a complete upward shift of the labor cost base. Higher salaried employees use minimum wage adjustments to demand higher wages themselves in order to maintain the pay distances to lower qualified or more

¹²⁶ Over 90% of German companies are located in Shanghai, Shenzhen, Beijing, Guangdong, Tianjin, Jiangsu, Zhejiang, Shandong.

¹²⁷ The collected data showed, that overtime and allowances make up around 35% of the wage for blue collar workers in equal parts.

junior staff. Although blue collar workers at German companies record the highest overall wage increases (+9.0%) in 2014, the increases are less than one percentage points higher than for senior white collar positions with a median monthly salary that is around 6 times that of blue collar workers. The higher increases are hence too small in order to narrow the wage dispersion. Interviews with managers of foreign-owned enterprises confirmed that minimum wage increases do little or nothing to reduce wage disparities between workers and staff at their companies.

According to the GCC's Business Confidence Surveys wage increases in China have consistently been the most important business challenge and companies are under pressure to increase productivity. In 2013 29.1% of companies report that wage increases outpaced productivity increases, while in 2014 this figure jumped to 40.7% of the responding companies. Personal interviews and yielding insights from discussions confirm increasing worries about wage increases exceed productivity. A main reason for this are the expectation of ever increasing wages based on previous wage increases but also the increasing cost of living, housing in particular. Several managers have stated that rapidly increasing housing prices are a significant driver for staff demanding for higher wages in order to afford purchasing apartments. This is complicated by younger generations being affected stronger by skyrocketing housing prices, whereas older generations were able to buy real estate at much lower prices. Though concerns are increasing, feedback from the companies also shows that most companies believe that over the next 3-5 years they see sufficient potential for increasing productivity through automation, process optimization and improved training.

10. Tripartite System, Market Mechanisms, and Government Policies in China's Transitional Industrial Relations Regime

10.1 Markets and government control: institutional pillars behind wage developments

As has been introduced above the Chinese wage bargaining rests on four institutional pillars, each of which providing the government ways of experimentation (see Table 22). First, market mechanisms are a cornerstone of any economic system based on capitalist fundamentals. With the abolishment of a planned economic regime, the Chinese government progressively introduced and strengthened wages determined by supply and demand of labor. While taking different regional (national, provincial, municipal, industrial area) factors into account wages are determined at the enterprise level. This creates a basic underlying environment within which wages are determined and, to varying degrees, will be present in any economic regime. From the perspective of institutions, it becomes relevant how the institutional framework limits market forces.

Second, a system of minimum wages were the first effective pillar which was introduced and enforced by the Chinese government, after beginning to strengthen institutions in wage bargaining. As has been illustrated, minimum wages are introduced at the provincial level by local authorities after some form of tripartite consultation. In effect minimum wage increases are a policy tool of the central government with certain regional flexibility, allowing for limited negotiations between the representative bodies on the provincial level in a, at least by Western standards, flawed tripartite consultation system. Regardless, minimum wage adjustment are the most powerful tool, which in a top down approach, dictate wage increases for the lowest income group in urban areas. The third pillar is the Chinese style collective consultation mechanism involving tripartite consultations. As has been illustrated in more detail above, although the contracts are signed at the enterprise level, major decisions or consultations take place at higher levels. At last, the fourth pillar is based on government issues wage guidelines, following a similar process as minimum wages.

Table 22. Pillars of Chinese wage bargaining system

	1	2	3	4
	Market mechanisms	Minimum wage	Collective consultation	Wage guidelines
Regional coverage	National level with regional variations	Provincial level	Enterprise level Exception: Industry/regional level	Municipal level Exception: Industry/regional level
Bargaining units				
Government	weak	strong	Strong	strong
ACFTU	weak	medium	Medium	weak
CEC/CEDA	weak	weak	Weak	weak
Employers	weak	weak	Weak	Weak
Employees	medium	weak	Weak	Weak

With little legal protection and abundant numbers of unskilled labor, employees in the initial phase of the economic reforms were in a weak bargaining position. Lacking an institutional framework, employers were in a strong position to dictate wage levels at the enterprise level while taking market trends into account. As western and central provinces experience faster growth than the richer coastal regions, the traditionally labor exporting provinces, and fare better in retaining its employee population. This development underlines how the shortage, especially of skilled, workers has put employees in a far better bargaining position. It is however also a source of growing wage dispersions. In combination with improved legal protection the government has contributed to strengthening the position of employees in the wage bargaining process. While employees and employers were the most significant bargaining units after the breakup of the iron rice bowl, Chinese policy makers are progressively establishing an institutional framework; steps that are crucial to establish functional wage bargaining targeting not only inequality but stabilizing inflation and consumer demand. Within this framework it aims to strengthen the position of the ACFTU and to a significantly lesser degree the CEC/CEDA. By strengthening the institutional framework the government is in a result also strengthening its position in the wage determination system. The next section will have a closer look at the power relations and links between the various bargaining units.

10.2 Power balance in the Chinese tripartite consultation regime

Similar to the implementation of other economic policies the government is opting to experiment with different wage determination institutions. Within the evolving institutional structure, many elements resemble that of a tripartite system. However, there are some distinct differences in its composition and interaction. In this sense the Chinese system is often referred to as a tripartite system with four parties, recognizing the roles of the government, trade union, individual employers and employers (see Lüthje, 2011/ Lee, 2006 / Shen and Benson, 2008). This extension of tripartite system highlights some of the system's short comings. Tripartism with four parties focuses on decentralized wage determination between employers and employees with some involvement of the government and trade unions. The wage bargaining regime is a good illustration for the period prior to 2008 when significant institutional changes took effect. However, this approach has deficiencies in adapting to the transformation of the emerging Chinese wage bargaining system. Clearly, China's framework does not fit the definition of tripartite consultation in a Western sense. Using this term in the Chinese context is misleading as it significantly under represents the power of the government while it over represents the role of unions and their interaction with employees or employer organizations.

In the post 2008 era the government has reinforce and transformed minimum wage, collective consultations, as well as wage guidelines directly influencing wage determination by shifting the power balances significantly. The established pillars underline the government's determination to regaining a foothold within the wage bargaining process while at the same time reducing direct negotiations between employers and employees. The CPC since has been keen on rebuilding its ability of direct intervention and to fill the institutional vacuum after its initial reforms in the 1980s (Warner and Ng, 1999). With the pillars came a stronger intuitional framework which includes components of a tripartite system. However, rather than

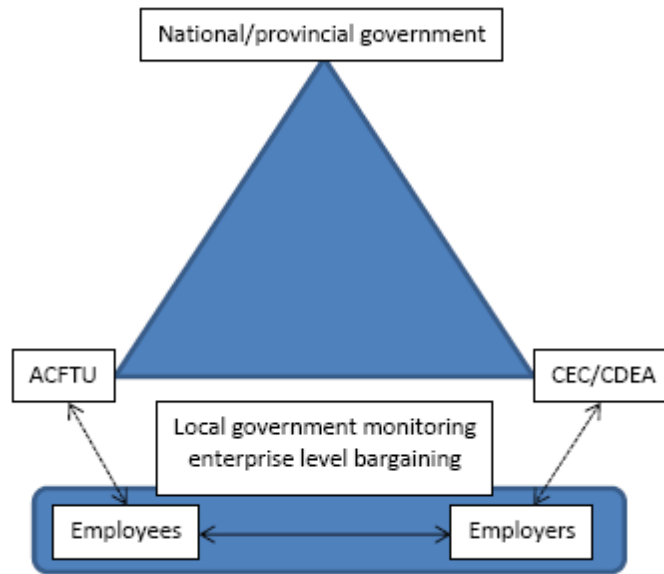
being a single tripartite system, the wage determination regime is a web of relations between the bargaining units with the government at its center. Further, the introduction of the different pillars can be seen as experimentation of the different system within the context of the Chinese political economy. It has been outlined above, that institutional change comes by slowly. While post reform era institutions continue to exist (e.g. the household registration system indirectly influencing wage determination), the enterprise level wage determination now coexists with the government's attempt to introduce a stronger institutional framework with tripartite elements.

Although elements of tripartite wage negotiations have been progressing at the will of the Chinese government, the still transitional system encompasses a more complex institutional framework as the experimentation of different wage determination systems continues. Depending on the pillar, different wage bargaining units engage in bargaining with the government maintaining a prominent position. At the national peak level, through the NTCC, a formalized tripartite system has been established which in theory should negotiate wages developments for the country. It remains an opaque system and unclear how the power relations within the system are. Given the constellation of the individual bargain units the bargaining power of the ACFTU, and to a much larger extent the CEC/CEDA, are weak relative to that of the government. The results of these peak level negotiations in effect communicate the governments wage policy acting as a transmission belt. Effectively the policy will influence wage developments at the provincial and municipal level from the top down. Although minimum wage rates are set at the provincial level¹²⁸, wage guide lines typically at the municipal level, as well as collective contracts at the enterprise level, from an institutional perspective, the policy determined by the central government in Beijing remains the most dominant policy guide in the wage determination process.

At the provincial level minimum wage, wage guidelines and collective contracts will similarly, on the basis of the decisions of the central government, be negotiated allowing for a certain amount of regional flexibility. At the enterprise level trade unions have a certain amount of influence on wage bargaining within the authority given to them from higher level organizations. At various regional levels an institutional framework for tripartite bargaining between the government, trade unions and employer associations has been established. Given the dominance of the government in the bargaining, it remains questionable as to how far there are actual negotiations between the trade unions and the employer organization. The institutional constellation much more appears to that the government uses information of the other bargaining units to facilitate its own decision on wage developments though regional variations in the independent bargaining powers can be expected. In order for top down decisions to reach the enterprise level, enterprises with collective contracts will engage in direct consultations with the trade union while the remains CEC/CEDA secondary with very limited influence at the enterprise level. This then represents the second institutional wage determination system taking place between the ACFTU, the employer at the enterprise level, and local governments. In companies without trade unions and collective bargaining, negotiations take place directly between employers and employees while the government through minimum wage as well as the authority of the local labor bureau (including wage guidelines) is in a position to strongly influence the bargaining process.

¹²⁸ As well as municipalities directly under the control of the central government as well as Shenzhen.

Figure 22. Institutional relations of ‘tripartite’ bargaining mechanism



These institutional relations in the wage determination process hence represent the different frameworks of post 2008 and pre 2008 (see Figure 22). The top triangular relation with the government is the most dominant element representative of the NTCC approach already illustrated and currently being experimented with (post 2008). The bottom represents the enterprise level, market determined wage bargaining system lacking an institutional framework with the local government as a regulator, intervening only in emergencies. While within the NTCC issues related to minimum wage, collective contracts, or wage guidelines are discussed the illustration emphasizes that there the ACFTU and the CEC/CEDA have little connection with their relevant constituents at the enterprise level. The gap between the pre and post 2008 arrangement represents the institutional void which the government is attempting to fill (see section 11.1)

Figure 22 further illustrates the transitional stage of the Chinese wage determination system resulting in a web of various relationships. The institutions in the Chinese tripartite system are still too weak to truly refer to it as tripartite following a Western definition. Departing from the tripartism with four party's concept, Ma (2011) introduces a six party taxonomy in her evaluation of Chinese industrial relations. The author identifies the distinct roles of the party-state, the ACFTU, grass-root unions, employer's organization, employers and employees. While widely agreeing with the findings, for the grass-root unions will be omitted for this research as according to own findings made, the impact at this level is equivalent to actions by individual employees at the enterprise level and not an organized effort (see section 6.1.3). Figure 22 illustrates the different institutional relationships exemplifying a wage bargaining system with elements of tripartite wage determination, but also the weak power base of the ACFTU and even more so the CEC/CEDA. The evolving institutional framework has several key elements. First, the government is the by far most influential bargaining unit. This is

especially the case within the tripartite negotiations process and more indirect when bargaining takes place at the enterprise level. Second, the weak representation capacity of the ACFTU and CEC/CEDA for the most disconnects them from the employees and employers, effectively leaving the latter as independent bargaining units.

The illustration above can only be a rough guide to understand the different relations in the Chinese wage determination system. It does however highlight that currently there are different wage bargaining systems in place. Lüthje (2011) identifies five different labor relations, each setting the stage for a different type of wage bargaining.¹²⁹ Each of the different production regimes has a different set of labor relations. Most important unionizations rates depend strongly on the type of company, being highest at SOEs as well as large MNEs, while its presence is weak at the other levels. This in return has a direct impact on the wage bargaining system, as stronger union presence more often translates into collective contracts (see below). In companies with no union, individual performance based bargaining is the norm.

Naturally under these circumstances many scholars are critical of a tripartite system in China (see Taylor, Chang and Li, 2003/ Guo, 2004 / Clarke, Lee and Li, 2004). The current system of tripartite bargaining whether it is within collective bargaining, wage guidelines or minimum wage setting remains dominated by the government. At a first glance tripartite bargaining in China involves similar actors and processes as by Western standards, but in fact the entire system functions in a very different manner within a regulatory framework dictated by the CPC. Under these rules the actual bargaining between the bargaining units is likely to be lacking (Feng, 2006). The government dominates the tripartite system while trade unions and employers are limited to offering suggestions (Qiao, 2011). The tripartite process outlined for collective contracts, minimum wage adjustments and wage guidelines will only allow for limited actual bargaining.

Any actual bargaining will be limited given the institutional and political constraints. It has been shown above (see section 7.2) that the content of collective contracts is often prearranged with limited room for individual enterprise adjustments. The absence of actual bargaining of collective contracts belittles their actual value, with the most notable effect of reminding employers of their legal responsibilities (Clark, Lee and Li, 2004). In an attempt to increase the number of collective contracts, a significant share of collective contracts are signed under political pressure without further bargaining (Guo, 2004). Large leading companies or SOEs further feel obliged to implement collective contracts to avoid further scrutiny (Luo, 2011).

Given the limited bargaining power within the tripartite system the actual significance may need to be put in perspective. It should be noted that, very much in line with previous Chinese reform efforts, a certain amount of experimentation is being carried out at a regional level. Most notably collective wage bargaining is being carried out to a limited extent, but wage negotiations do not belong to the core activity of the ACFTU or the CEC/CEDA. Chinese trade unions are highly unlikely to become as confrontational as in many Western countries any time soon, but the government has taken steps to increase their power base in protecting

¹²⁹ Lüthje (2011) categorizes state bureaucratic (mainly SOEs), corporate bureaucratic (MNE, JVs) companies, corporate high performance companies, flexible mass production, and low wage classic.

workers legal rights and providing them a pressure valve in case of violations. The role of the CEC/CEDA is less developed and at present less relevant for the Chinese government. Current Chinese conditions are not favorable for any form of tripartite wage bargaining of significance as without a functioning power balance between independent parties a process on equal terms is not feasible.

10.3 Obstacles to a tripartite system

The pillars of the Chinese wage determination system make ample reference to tripartite consultations involving government, trade unions and employer representations. The Chinese institutional structure is evolving from an industrial relations system in many ways is very different from the Western definition of tripartite wage bargaining. Consequently the Chinese framework has its own characteristics and most will agree that it does not comply with ILO standards for tripartite consultations (Qiao and Applebaum, 2011). Nonetheless since the 2000s advances have been made in order to establish the necessary tripartite institutional foundations as well as process needed for tripartite bargaining. The tripartite system in China however has and will continue to be constrained by several obstacles which will define what kind tripartite system can evolve.

First, independent bargaining requires representative organizations for employers as well as employees which bargain in the best interest of their constituency. The peak level organization representing labor, ACFTU, and employers, CEC/CEDA, both were established by the government and remain a policy instrument. As a result the state is the most dominant player while workers and employers alike are not independently represented by the quasi-governmental organizations. The ACFTU on a national and a regional level has made great strides in improving its representative capacity, though it continues to be a far cry from being independent representative organization. Independent representational organizations require voluntary membership (Crouch, 1993) and the members expressed desire to be represented by the organization. In China neither employees nor employers have a legal choice of representation outside the ACFTU or the CEC/CEDA as all organizations are subject to the peak level organizations. With the policy shift towards a “harmonious society” the purpose of the ACFTU has become more prominent, providing it with greater flexibility and scope beyond the traditional role as a transition belt.

Fractions within the organizations are willing to pick a fight with government bodies on union related issues including representation and collective contracts. At the peak level the ACFTU’s voice can at times be reminiscent of a union attempt to advance workers’ rights and union causes. In this process it has been able to strengthen its position mostly as a lobbying body vocally pushing for advances in unionization as well as collective contracts at the national level. In October 2013 its position as a lobbying group was underscored in the amendment of the ACFTU’s Labor Union Charter in which it calls for greater participation in the legislative process and advocating collective contracts. There have also been attempts to increase representation by advocating democratic grass-root elections (Pringle, 2011). These advances are however only possible because there are not only accepted but encouraged by the government and not subject to independent momentum. Advancing social causes and workers’ rights has been in line with recent government policies and has greatly helped to advance the standing of the ACFTU as long as it complies with the government’s accepted

principles. On the enterprise level the ACFTU has, with more limited success, been promoting and advancing employees' interests, but as wild cat strikes, independent of the official trade union, show, it continues to face representational issues and pressure from below (Zhu, Warner and Feng, 2011). The CLB recorded 1,171 strikes and protests between June 2011 and December 2013, which are more likely to be tolerated at foreign or Hong Kong, Macau or Taiwanese companies. In some cases representatives of worker participating in wild cat strikes have been reported to have publically condemning the official ACFTU for failing to represent their interests (Baker and McKenzie, 2010). The government has a general fear of strikes (Sek and Warner, 2000) and strikes at SOEs or other high level Chinese companies are less likely. There have been reports that in some recent strikes the local ACFTU branch in fact used violence against striking workers (see Baker and McKenzie, 2010 / Lin and Ju, 2010). Tripartism in a Western sense is based on independent representation of the three bargaining units and integrated in a pluralistic political system (Trebilcock et al., 1994). Despite the advances the institutional framework remains political contained.

Advances of the CEC/CEDA, already coming from a far less strong representational standing, by contrast have been minute if not irrelevant. Its representation mainly focuses on SOEs, and has less standing within private enterprises, less to speak Small and Medium sized enterprises. Though it may have a limited, and possibly increasing, role as a lobbying organization at the peak level, significant share of senior positions in key industries are held by children of leading CPC cadres (Holz, 2007). Individual SOEs are mostly well connected and part of the political power structure. It is admittedly difficult to judge the true impact the CEC/CEDA has as a lobbyist group, as it will be less likely to publicly voice its opinion as strongly as the ACFTU. China has in principle a basic tripartite corporatist structure and employer organization plan to include private companies in the future (Chan and Unger, 1995), though the advances until 2014 have been frail.

Second, tripartite bargaining regimes require corresponding representational bodies. The CEC/CEDA appears especially weak positioned to form a matching organization to the ACFTU. Enterprise level bargaining in combination of absent employer associations undermines collective bargaining and trade union activity (Hall and Soskice, 2001). The tripartite structure would presently best function for SOEs, in which trade unions as well as CEC/CEDA are best positioned. The structure however is far weaker or non-existent at the private enterprise level other than regional experiments. Consequently the independent representation of workers and employers alike are a massive institutional barrier for any tripartite mechanism (see Clark Lee, and Li, 2004 / Huang, 2013). While much focus has been on strengthening the position of the ACFTU, the advances will do little to establish more substantial tripartite structure without a corresponding employer's association.

Third, the political manifestation of the CPC autocratic rule sets the rules in which any tripartite regime can evolve. Limits to reforms in the political sphere in China will simultaneously confine the economic reforms possible, directly affecting the Chinese system of industrial relations and its related wage determination system. China, be it in its political, economic, intellectual, or cultural sphere, has over the past 30 years made phenomenal advances in individual freedoms. Many first time or infrequent visitors will be positively surprised how free Chinese society appears to be. Modern China has indeed developed into a relatively free society, as long as one golden rule is adhered to: anything can be done in China, but don't get in the way of the government. The CPC is panicked by anything

perceived as a threat to its leadership, and quickly will brand anything outside its opaque rules as subversive (see also Hui, 2014). Any advances in independent representation of workers or employers are confined by these restraints. Recent crackdowns, which have increased under the leadership of Xi Jinping, underline this tough stance acting as an effective deterrent.

The Chinese political system has severely restricted or prohibited institutions independently establishing itself in response to particular issues including labor related issues. Recognizing this weakness and reacting to growing discontent at the grass-root level, the government reacted to strengthen the institutions already in place. However, the Chinese state is trying to control the institutional safeguards between society and the state, defending the hegemonic position of the state (Jessop 1990, also see Hui, 2014). The CPC is shifting the traditional institutional power relations, but any changes are limited by ideological restraints and cannot exceed a politically accepted framework (Esser, 1982).

10.4 Theoretical context of the Chinese wage bargaining regime

The Asian Tiger's labor markets periods implemented a decentralized labor market with limited coordination mainly due to weak institutions during their phases of rapid growth. Their governments maintained a strong position acting as a catalyst for experimenting with institutional change. The non-democratic systems at some point of economic development became a restriction on the type of institutions which were able to evolve and required political adaptation as well (see section 4.3). The CPC under Xi Jinping has initiated the most significant round of reforms with a strong focus on wage growth, inequality and tripartite systems in the economic sphere while political reform remains distant. First, China has not yet reached the overall development level at which political change was induced at Asian Tiger economies. Though development level in the coastal areas has reached middle income level, the western and central regions remain underdeveloped. The differences in development level and associated institutional requirements contribute to a complicated scenario with the CPC is confronted with. It needs to identify policies which are adequate for regions with significantly different levels of development. Second, the CPC while continuing a path of economic liberalization in terms of strengthening private companies, (slowly) breaking up SOE monopolies, and financial market liberalization, it has tightened its grip on other areas such as internet freedom or advocate groups. Any policies adjustments in the economic sphere are therefore subordinate to the political constraints imposed. Strengthening tripartite system and the roles of unions (and business associations) should therefore not be mistaken for loser policies, but rather as an attempt of the CPC to preserve control within these institutions.

Many of China's policy shifts resemble the experiences made in the economies of the Asian Tigers. China's size, sophistication, and diversity however limit the lessons to be drawn from these comparatively small economies. Applying theory on wage bargaining mechanisms faces further constraints resulting in a relatively weak theoretical framework. Elements of present theory can provide useful tools, but it also shows that the theoretical framework for transitional countries has drawbacks. The Calmfors-Driffill debate, being the most prominent theoretical in the context of wage bargaining systems appears not applicable to China or other transitional economies (see section 4.3). First, the focus on developed economies with

a relatively established and stable institutional framework does not apply to the transitional period in Chinese economic development. Whereas the model assumes many variables in the labor market constant, in China institutions are adjusting on a wide range. Second, the Calmfors-Driffill debate is based on a neoclassical theoretical regime exemplifying real wage restraint and lower unemployment arguing that wage moderation is best achieved by high or low levels of centralization. Wage restraint is not compatible with rapid economic growth of developing countries. Rather it is in the government's interest to facilitate wage increases as its power is legitimized by economic development. As long as this occurs following the wage norm the development can be functional. Once growth slows and wage increases require constraint this poses not only an economic, but also a political threat. Third, focusing on wage restraint the theory underestimates the significance of macroeconomic functionality. For a sustainable development and a functional wage bargaining regime, wage increases should follow the wage norm by taking inflation target and trend productivity into account. In economies with high wage growth and high levels of employment stable wage development, following the wage norm increases the likelihood of long-term growth (Herr, 2002). Expanding on this thought a recent study by the Cingano (2014) found that inequality has a negative effect on economic growth. These findings are fundamental elements for a functional wage bargaining regime according to the definition of the wage norm. It should further be noted that in China rising income dispersion and resulting inequality have been among the strongest proponents for implementing institutional change in the wage bargaining process.

It is challenging to apply existing theory on China and to classify its economic regime or system of wage bargaining. Though China's economic system contains elements of LMEs, the government also curtails liberal elements. For instance labor market flexibility has been reduced since 2008 reducing companies' flexibility, while the tight labor market has retained a higher degree of flexibility for employees. Similarly China's economic system does not match CMEs as labor is not stable and relations are not cooperative. The theoretical limitations mostly are due to the transitional nature of institutions as well as a neglect of the political sphere. The Chinese economic system and its wage bargaining regime are a hybrid system with unique country specific elements. Though every economic system will include country specific elements, the significant in China is of greater importance. Theory hence will need to embrace the transitional arrangements of as well as the autocratic nature of the political regime to apply it to China.

10.5 Classifying the wage bargaining regime: centralization and coordination

Classifying the Chinese wage bargaining system needs to consider some special features of the institutional arrangement which is further complicated by its transitional nature. After having introduced the institutional framework of the Chinese wage determination system, a closer look at the degree of centralization and coordination shall allow a better understanding for its classification. As a reminder, the degree of centralization considers the number of independent wage bargaining units, and the level at which wage bargaining takes place (see section 2.4.1). Measuring the degree of centralization is challenging and different dimensions need to be considered to grasp the systems complexity. Often classifications limit their focus on collective bargaining and the role of trade unions by omitting the various roles of the government (see Wallerstein, 1998 / Karlson and Lindberg, 2011). Other authors have pointed out that wage bargaining may take place at different levels, trickling down from higher to lower levels (see Katz, 1993 / Traxler et al. 2001). Further adding to the complexity is the

fact that many classification systems are derived from classifying developed economies making it difficult to project them to developing and transitional economies.

Most wage bargaining in China takes place at the enterprise level hence the system is often classified as highly decentralized with many independent wage bargaining units. Institutional weakness of trade unions and especially employer associations obstruct higher level bargaining at the peak or industry level. Especially the representational weakness of the CEC/CEDA does not provide the ACFTU with an adequate bargaining unit at the peak level, resulting in the need to conduct bargaining at the enterprise level. Additionally the political as well as the geographical situation of China hinder this kind of peak level wage bargaining. As a result, although the number of collective contracts has been rising, the majority of employees are still covered by individual contracts. The example at German companies underlines its relative insignificance (see Figure 19). Even in the presence of collective contracts these are conducted at the enterprise level due to reasons explained previously. This constellation translates into a low degree of centralization, but is also limited to the pre-2008 era when the institutional framework was weak.

As the Chinese industrial relations began to transform resulting in better enforcement of labor laws and strengthening the institutional framework, the government influence in the bargaining process has also made an impact on the degree of centralization. By introducing and strengthening tripartite mechanisms, minimum wages, wage guidelines the government employed tools to implement its political agenda. The central government at the peak national level has employed mechanisms enabling it to define wage developments which from an institutional perspective should directly impact lower level wage bargaining. As a result wage bargaining at the enterprise level needs to take into account higher level wage decisions. In how far these peak level decisions transit to the lower level (vertical centralization) will much depend on the individual factors including region, company type, and industry. The constellation does however show that wage bargaining in China takes place at different levels in a mixture of government dominated peak level consultations and enterprise level bargaining.

Coordination of wage bargaining measures the impact wage bargaining has across the economy (see section 2.4.2). Traxler (2003) made a further distinction between vertical and horizontal coordination. The weakness of peak level representational bodies is often identified as translating into a lack of coordination above the enterprise level. It is however a misconception that a low degree of centralization will always result in low levels of coordination. The institutional framework of Chinese wage bargaining system established a weak foundation for voluntary coordination. This weakness results in weak horizontal coordination between the bargaining units. Tripartite bargaining, though the technical processes have been established, is limited by the weak institutional structure on the one side and the dominant power of the government, through which effectively every bargaining must pass through.

Informal networks between companies strengthened with an alliance with local governments, but mostly excluding workers' representation, remain contained on a local level. Focused on reacting to local labor market particularities and affected by regional competition these networks have only limited capacity to contribute to coordination (ten Brink, 2013b). Any effective coordination requires the government's direct involvement by imposing rules and

regulations contemplating the existing framework. The reforms efforts regulating labor relationships which effectively improved the situation of workers in the early 2000s not only helped to maintain social stability but also established the government as a coordinating factor in industrial relations and has increased its capacity to exercise authority of over the industrial relations actors (Taylor, Chang and Li, 2003).

In theory this gives the government tools to implement high level of vertical coordination over the wage bargaining process. Minimum wage decisions, wage guidelines as well as collective contracts potentially have strong signaling power on overall wage developments in China. With its universal reach minimum wage adjustments are equipped with the strongest coordinating power, while the roles of collective contracts as well as wage guidelines are currently still undergoing regional experimentation. Additionally, the government has made explicit advances in increasing the data availability of wage levels by conducting wage surveys with data for a large number of occupations. The Guangzhou Human Resource and Social Security has made strives to integrate the guidelines in other tripartite agreements, stating that levels and increases of issued wage guidelines should be utilized in collective contracts.¹³⁰ Guangdong in particular is taking on a key position in experimenting with increases of coordination (OECD, 2010). From an institutional perspective the potential level of coordination in China is much stronger than one would initially expect, though it must be seen in how far this actually translates into reality of wage developments.

It remains a challenging task to bring the concepts of coordination and centralization together in order to characterize a wage bargaining regime. The transitional nature of the Chinese system further can only provide a snapshot of the current situation, but it nonetheless helps to identify what kind of system will evolve in the future. For the most wage bargaining in China takes place at the enterprise level resulting in a highly fragmented and atomized wage bargaining structure. Minimum wage as well as decisions pertaining to collective contracts do however take place at higher levels, effectively increasing the level of centralization. Referring back to Table 4, centralization in China is a mix of enterprise and central level bargaining. A much clearer picture evolves by also adding coordination into the equation. The government can wield massive influence on wage bargaining outcomes in which decisions of the central government trickle down to lower levels of government before reaching the enterprise level. The institutional setting hence is designed in a way in which the government can project its power through different policies directly controlling minimum wage adjustments, wage guidelines, and collective contracts.

Combining both concepts leaves China's institutional setting with a low level of centralization which is slightly cushioned by the higher level bargaining for minimum wage as well as wage guidelines and to a lesser degree collective contracts (see Table 5). In terms of coordination China has been moving from low coordination to medium level of coordination. It should however be clear that coordination is merely established by decree under disguise of tripartite mechanisms expecting companies to comply. In effect the Chinese institutional framework has been shifting as it has been increasing its coordination level moving from low centralization and coordination (LL) to low centralization and medium level of coordination (ML). In the process of reforming the Chinese economy, the government gave enterprises

¹³⁰ http://www.hrsgz.gov.cn/tzgg/ldjy/ldgz/201206/t20120618_186770.htm (in Chinese, last accessed December 28th, 2013).

significant autonomy in wage setting resulting in a low level of centralization and little capacity for coordination. Threats to social stability however forced the government to take steps to reclaim some of the autonomy by ways of positioning itself as an influential player in the bargaining process, effectively increasing its coordination power while at the same time, though to a lesser degree, increasing centralization.

The Chinese example exemplifies that wage bargaining systems come with great individual variety with similar institutions taking on different roles (see section 3.4). Certain mechanisms tend to facilitate coordination and centralization (see Table 8). China in theory has peak level associations with regional and industry subordinates, while the trade union is far stronger in terms of membership and clout than the employers' organization. The biggest limitation here though is the different roles that the representative bodies have in Chinese industrial relationships. These short coming can at present only be compensated by the government and reflect policies strengthening its current positions in the wage bargaining process. Under the current political constellation with the limits on the institutional capacities increasing as well as the highly complex and diversified economy, only the government can achieve higher degrees of centralization and coordination by strengthening its own position in the process. An authoritarian regime with a large state-owned sector does provide it with the possible tools to achieve this goal.

A look at emerging or developing economies has shown some institutional differences, though there has been evidence that low level of centralization and coordination appear the most prominent wage bargaining regime (see chapter 4). Much of this has its roots in weak institutions which however strengthen as an economy advances. Within this process the institutions will contribute to achieving higher levels of coordination and centralization, but in a transitional period in which the country continues to reinvent itself (see Figure 5). Returning to the experience of the Asian Tigers, wage-setting institutions were nearly absent during the onset of their rapid economic rise. Similarly most countries, just as China, suppressed independent representative bodies as the government identified them as threats to economic growth and political stability. As China has achieved a higher level of economic development, it is entering a period of institution building directly affecting industrial relations and its system of wage bargaining. Many factors resemble experiences made in the Asian Tigers signifying that the government has reached a critical crossroad in adapting Chinese industrial relations.

11. Assessing China's Wage Bargaining Regime: Inequality, Price Levels and Consumption Demand

11.1 Government policy adjustments

Indisputably China has experienced tremendous economic development since it began its reform efforts in 1978. In many areas its economy employed similar policies which successfully propelled the Asian Tigers from developing nation status to developed nation status. This unprecedented growth in many ways has successfully been replicated in China. Between 1979 and 2013 real GDP growth expanded on average of nearly 10% annually, resulting in the economy doubling in size nearly every 8 years (Morrison, 2014). China has already advanced to the second largest global economy and a global manufacturing powerhouse although its GDP per capita remains comparably low. Rapid economic growth was complemented by rapid wage growth, lifting hundreds of millions of Chinese from poverty. Initially low wage levels and abundant labor, but also low skill and productivity levels, were a key contributing factor leading to an expansion of industrial capacity especially in areas of in labor intensive manufacturing, relying on foreign investment and exports as a catalyst for growth. Despite the resemblances with the Asian Tigers any similarities should not be overstretched as the Chinese economy in terms of size and complexity is greatly unique in its own way. The experience of the Asian Tigers has however shown that initially successful economic policies cannot be maintained forever and need be adjusted accordingly in order to cope with the changing economic constellation and to avoid structural stagnation.

Whereas rapid economic growth was paramount to defining success for much of the post-reform period, these policies have also led to unsustainable development with dire consequences for the environment, parts of the workforce which were seen as mere means of production, as well as increasing inequality within the society. With increasing wealth attitudes within the society change and policies acceptable in the past become less viable. Just as the examples in the Asian Tigers has shown, after a certain stage of development has been accomplished, changes to the industrial relations regime become necessary. Improved labor legislation and building necessary institutions for a wage determination regime become important tasks for policy formulation. Economic progress acts as a major catalyst for policy change, leading to strengthening of the industrial relation regime put it also confronts policy makers with crucial choices to make. On the one hand higher labor costs have the potential to undermine labor intensive manufacturing, requiring a shift in the industrial structure by moving up the value chain. On the other hand increasing wage disparities impact consumption demand harming economic growth while changing attitudes within the society, if left unattended, have the potential for social unrest.

The Chinese leadership has been well aware of these developments and has introduced policies focusing on the labor market as well as wages after previously leaving it largely unattended. A turning point in China was 2003 when efforts to rebuild industrial relations become more prominent in direct response to growing social tensions. In the context of rising inequality and social injustice the leadership under Hu Jintao proclaimed its dogma of a 'harmonious society' in 2005. This was the first notable policy departure from the previous 'growth at all cost' approach, and a stronger commitment to greater sustainability including a greater focus on social advancements. Although there is no official guideline on what this concept incorporated at the time, official policy statements provide an idea of what was

behind it.¹³¹ Key elements include improvements in living standards, fighting poverty, reducing the income gap as well as poverty, all intended at creating a more fair society by spreading the gains of China's economic achievements more equally. For the most policies however do not put lower wage dispersion in the context of macroeconomic functionality, with policy details remaining equally ambitious in its aims and vague in specifics. They did however establish a direction for new policies and can be understood as the principal ideological driver for several policies introduced later on.

In its aftermath a variety of specific legislative changes were introduced and overall enforcement of the labor law made considerable progress. Subsequent policy addresses of the political leadership gradually outlined more measurable targets. The Hu administration was the first to establish GDP per capita as an official growth target during the 18th National Congress of the CPC, whereas previous targets merely focused on GDP contributing to fierce provincial competition. Specifically a target was set to double the 2010 GDP per capita level by 2020. Further pledges were made to increase individual incomes in line with the overall economic development and to reform China's income distribution system. The policy directions initiated by President Hu have been reconfirmed after the power transfer to President Xi Jinping in 2013 who was quick to establish the slogan of the 'Chinese dream'. This idea included a pledge to 'human centered urbanization' which effectively should increase peoples' livelihood and social welfare.

In one of his first major policy announcements, while only in the capacity as the General Secretary of the CPC¹³², the income policy reform, though long delayed, was approved by the State Council in February 2013. The reform reiterated the goal to double per capita income by 2020 from its 2010 levels. In an aim to reduce inequality poorer income groups should experience faster wage growth which also should contribute to reducing poverty and strengthening the middle-income group. Minimum wage levels should also reach 40% of average wages by 2015.¹³³ The entire reform agenda is massive and includes additional ambitious plans related to social welfare and security, pensions, the household registration (hukou) system, as well as rules affecting SOEs, including an increase in returns used to finance social welfare programs and rules aimed to narrow the income gap.¹³⁴ As with many reforms, however, the policy details remain vague about many specifics as well as the actual implementation at the lower level. Often reforms act as a guideline for policy directions with a significant level of flexibility at the lower levels of administration, making it difficult to identify the precise direction.

It has become apparent that recent policy direction over the past 10 years has shifted their focus to establishing more sustainable fundamentals. The complexity is similar to policy adjustments of other developing nations with a stronger focus on social policies and income distribution. Overall the recent changes are an adaptation of China's economic policies as it is

¹³¹ Retrieved from People's Daily under: <http://english.people.com.cn/90002/92169/92211/6274603.html> (last visited Aug 1st, 2013)

¹³² He did not assume the presidency until March 2013, which was the final step during the power transfer.

¹³³ This already has been a guiding principle of minimum wages in China, though it has been weak in its implementation and the target is likely to be missed.

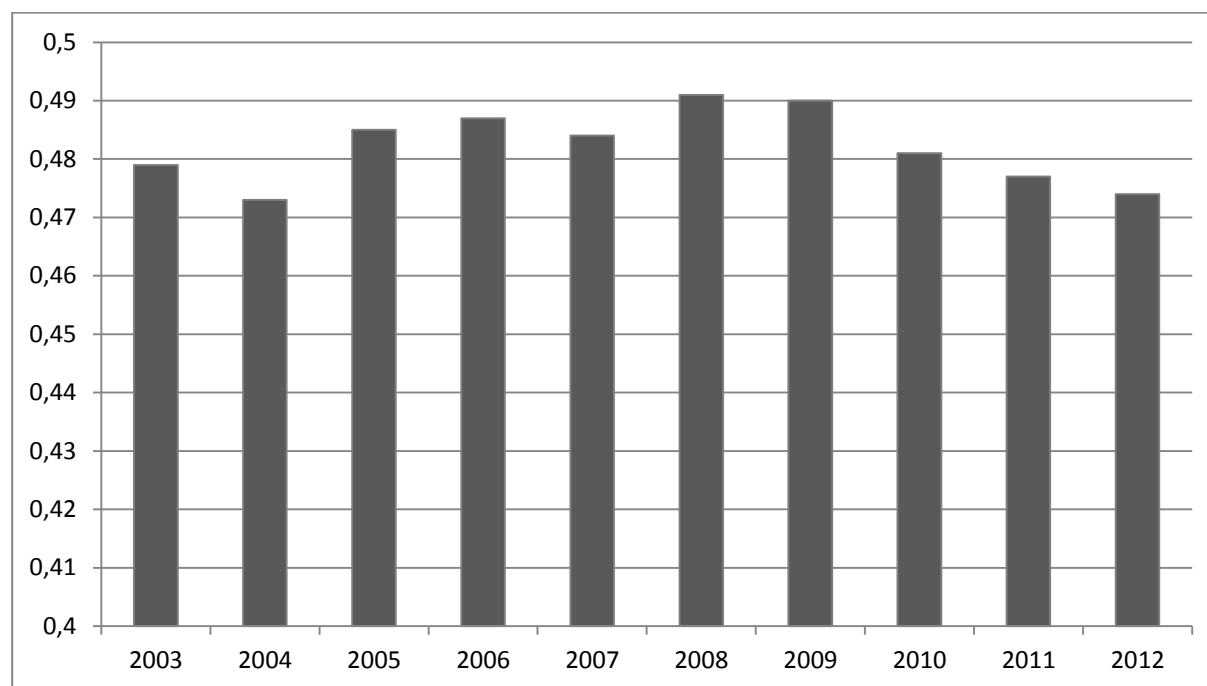
¹³⁴ Rules at SOEs include pay ceilings and slower wage growth for senior management compared to average employees.

in the process of adjusting to new economic realities with moderate economic growth. It has been a long road from breaking-up the iron rice bowl and there has been much talk introducing Xi Jinping as an able reformer. The new reform agenda however has its own challenges and will require much fine tuning in the future. Policy addresses during Third Plenary Session of the 18th Central Committee of the CPC in November 2013 and the 12th National People's Congress in March 2014 committed deeper reforms, some of which may be painful in order to rebalance the economy and test the political structures. China's macroeconomic environment has changed significantly over the past decades, experiencing rapid growth, but also indicators for elements contributing to dysfunctional developments. Keeping this in mind, the next part will have a closer look at developments related to wages, inequality, inflation and consumption demand.

11.2 Rapid wage growth and rising income inequality

Without doubt the China's rapid economic development has benefited the Chinese society as well as the world as a whole by lifting hundreds of millions out of poverty. Livelihood improved greatly and income levels increased across the board. Though growth has been overall positive, it has also been highly unbalanced fueling rising inequality. These developments are reflected in the unprecedented rise of the Gini coefficient from 0.160 in 1978 to 0.473 in 2006, as World Bank and Asian Development Bank data suggests. Official data of the NBS in Figure 23 have the GINI peak in 2008 reaching 0.491, well above the 0.4 level generally considered as a warning threshold to social stability. The official data show positive signs and could be interpreted as government policies taking affect and that the Chinese society is becoming more equal. However, official inequality data remains at extremely high levels with only few countries recording higher levels of income inequality. Findings from a study by the China Household Finance Survey suggest that the official data, despite its already high level of inequality, is too low. According to its findings, the study puts the Gini coefficient for 2010 at 0.61 (Li, 2013).

Figure 23. Development of Gini coefficient, 2003-2012



Source: NBS

Similarly, China's wage share of GDP has consistently been declining, dropping to 36.7% in 2005.¹³⁵ Wage disparities between rural and urban areas, especially in developing countries, are not particularly noteworthy. However, the magnitude of China's income gap is substantially larger than anywhere else. A study by Yang and Cai (2003) analyzed the ratio of non-agricultural income to agricultural incomes for standard workers in 36 countries. In recent years China has been fluctuating between ratios of 2 to 3, with few countries showing higher marks. The ratio measuring the urban-rural income gap has consistently been on the rise (see Chi, 2008 / Liu and Wang, 2011). More notably, the countries with similar high marks were some of the world's poorest economies. Rural residents attempting to bridge the gap by searching for better opportunities in urban areas could expect to be disappointed. A survey by Meng and Zhang (2001), based on two data sets of individual information, concludes that migrants faced discrimination and lower pay compared to their urban counterparts. China's inequality has been on the rise not only across regions (e.g. urban-rural, provinces), but across industries and occupations as well (see Lee, 2009 / Chi, 2008). Social inequality increases the risk of unrest and turmoil; much to the worry of the CPC. Responding to the high levels of inequality before it becomes a threat to its authority was therefore imperative. As has been outlined above, a main driver for the changes in labor market policies and its institutions have been due to the functional weaknesses in the wage determination contributing to high levels of inequality.

¹³⁵ China Daily (May 12th, 2010). Official: Wage share decreases 22 years in a row. Retrieved from www.chinadaily.com.cn/china/2010-05/12/content_9841109.htm on February 26th, 2011.

Reducing income inequality were the central governments' main goal when minimum wages were introduced and further strengthened after 2008. Regulations governing minimum wage suggest the minimum wage level to be equivalent to 40-60% of average monthly wages, though this is not mandatory and widely ignored. According to Chan (2003), the only year that all of China's regional minimum wage rates met the government's criterion of reaching at least 40% of the average local wage, was 1993. Since then, there have only been a few exceptions, while for the most part minimum wage rates declined as a percentage of average income: from 36.7% in 1994 to 27.0% in 1999. Similarly, in Shenzhen the rate fell from 40% in 1993 to under 24% in 1999 (Chan, 2003). This trend is supported by findings of the Institute of Population and Labor Economics (IPLE) of the Chinese Academy of Social Science (IPLE, 2007) who conclude that between 1995 and 2006 the ratio dropped from 44% to 28% (see Figure 24).¹³⁶

Figure 24. Ratio of minimum wage to average wage and development of average minimum wage, 1995-2006



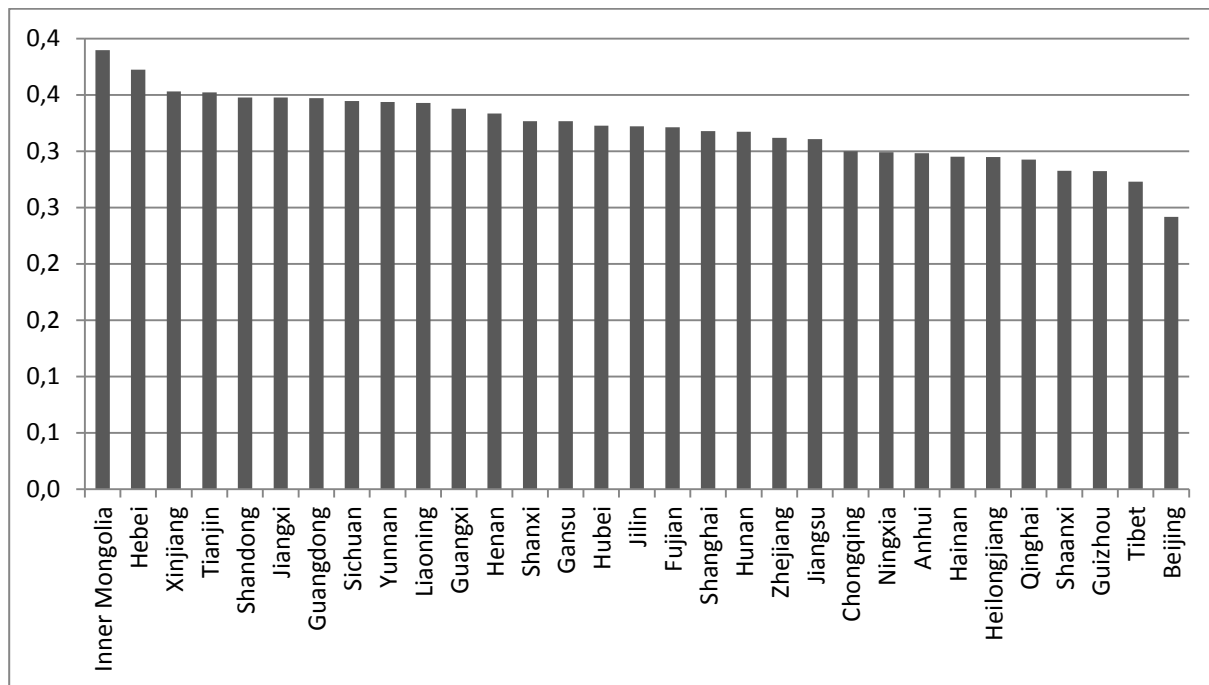
Source: Du, Wang and Lee (2009) based on IPLE (2007)

Most recent data for 2013 further confirm the previous observations with strong evidence that the target of reaching 40-60% of the average wage is currently not being met. Using official data for average income in China's provinces as well as the relevant average minimum wages, none of the provinces, municipalities, or autonomous regions reached the minimum target Kaitz index of 40% even if using the highest prevailing provincial minimum wage and

¹³⁶ The study included data from 130 cities implementing minimum wage policies in 1995. This figure continued to rise until the survey included 286 cities for the years 2002-2006.

comparing it to the overall average income in the province (Figure 25).¹³⁷ On average minimum wages only reach 32.1% of average wages, and are far off the official target with Shanghai and Beijing, among the richest cities in China, performing particularly poorly. However, as Shanghai and Beijing are provincial level cities, with one uniform minimum wage rate across their jurisdiction, their low Kaitz score maybe more reflective of the actual situation. The violation of minimum wage regulations has not gone unnoticed by policy makers. Reaching the minimum 40% target by 2015 was one of the 35 points within the income distribution reform which was issued by the State Council in February 2013. The specific target and date provide the guidelines with more weight, they are however still not mandatory.¹³⁸ In order to reach the targets minimum wage increases would need to outpace average wage increases considerably to reach the ambitious target within just 2 years. Taking the economic slowdown of 2014 and 2015 into account, it seems more than unlikely that there will be any significant improvements.

Figure 25. Kaitz index: percentage of highest provincial minimum wage to average provincial wage, 2013



Source: own calculations based on data from the provincial Labor and Social Security Bureau¹³⁹ data / Data for Tibet and Xinjiang based on 2012

¹³⁷ The Kaitz index is a common measure to quantify the significance of minimum wage by using a ratio of the minimum wage to median wages. For China, median wages are not available, so most research will substitute it with average wages.

¹³⁸ Other problems are the typical vague language used. For instance the definition of average wages remains unclear (IHLO, 2013).

¹³⁹ Provincial data is not identical to data from the National Bureau of Statistics. This explains a difference in the Kaitz index for Shanghai and Beijing in Figure 15. One explanation for the difference is that local governments have an incentive to underreport average wages as average wages are used for issues including social insurance benefits.

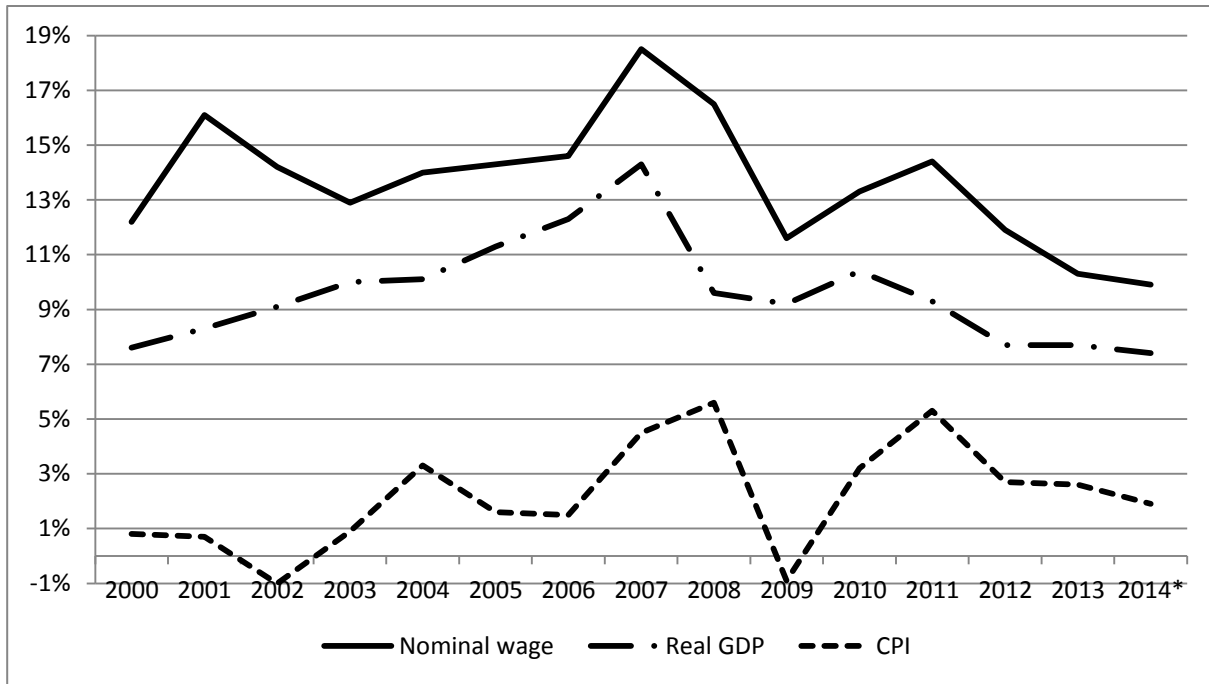
Some authors such as Du and Pan (2009) argue that the official average wage data does not include migrant workers and informal employment resulting in an overestimation of average wages. Although this might be more suitable to the pre-2008 changes in the Labor Contract Law, it still raises questions about what average wages actually are and casts doubt on the statistical fundamentals of minimum wage calculations.¹⁴⁰ Despite concerns regarding data reliability, there are strong indications suggesting that China's minimum wage rates do little for reaching the government policy goals and it can be seriously questioned whether the minimum wage levels help to achieve a more fair income distribution.

11.3 Price levels, productivity and wage growth

Most data points into the direction that overall productivity and wage growth in China have been increasing without causing macroeconomic instability through high inflation or deflation during its high growth period (see Figure 26). However, when the economy was confronted with critical situations, spikes are noticeable. During the financial crisis 2008/9 nominal wages plummeted, resulting in deflation in 2009. Following a massive stimulus by the government to stabilize GDP growth, nominal wage growth, minimum wage adjustments as well as inflation rebound sharply. Increasing price levels were a particular concern to policy makers and are regarded as a contributing factor for more restrictive stimulus in the following years. Since 2011 GDP growth has been exiting its rapid growth period, settling at more moderate growth. Latest data for 2014 saw GDP growth dropping to 7.4% and it is widely expected to further fall in 2015. As the economy has been slowing, wage growth and inflation have consistently been falling as well. As for price levels, they have fallen to such low levels, that deflation concerns are mounting. The development demonstrates that China's macroeconomic stability has become under increasing pressure as its economy enters a 'new normal' at more moderate growth.

¹⁴⁰ According to the explanatory notes of the NBS's China Statistical Yearbook, average wage figures are only available for staff and workers, which only includes employees at units of state-ownership, collective ownership, joint ownership, share-holding ownership, foreign ownership, and ownership by entrepreneurs from Hong Kong, Macao, and Taiwan, and other types of ownership and their affiliated units. They do not include 1) people employed in township enterprises, 2) people employed in private enterprises, 3) urban self-employed persons, 4) retirees, 5) re-employed retirees, 6) teachers in schools run by local people, 7) foreigners and people from Hong Kong, Macao and Taiwan who work in urban units, and 8) other people not to be included by relevant regulations. While the statistical appendix provides details of how average wages for staff and workers are calculated, less information about the computation of average earnings at urban units is given. In general the differences between the average wage of staff and workers and the average earning at urban units is small with the average for wage and staff slightly higher.

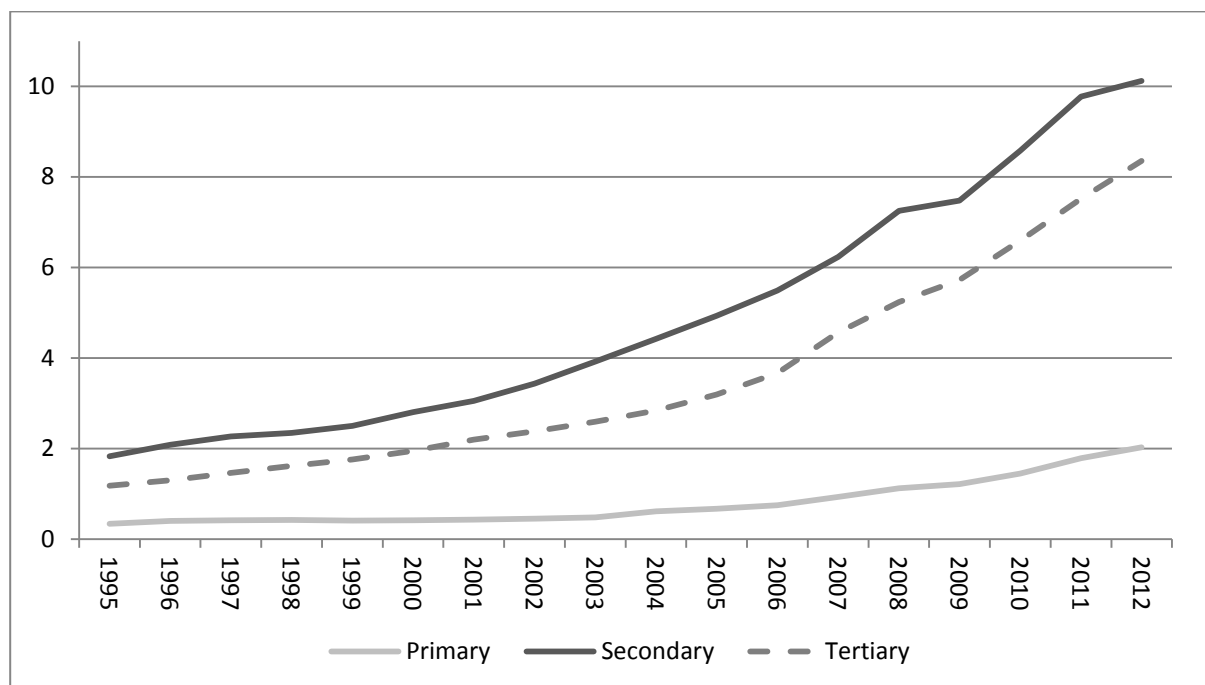
Figure 26. Wage, GDP and CPI development in China, 2000-2014



Source: NBS /*2014 estimates based on latest available data November 2014

Measuring China’s productivity remains a challenging matter, complicated by the lack of available data. China does not publish official figures for labor productivity or unit labor costs, making it necessary to derive conclusions from data that is made publically available. Productivity being a key factor for economic success has nonetheless been of interest to researchers. Not surprisingly there has been a variety of research on the topic using different methodologies to analyze Chinese productivity development since its economic miracle began with the early reforms in 1978. Most of these studies conclude that China has made tremendous advances in productivity helping to propel it to one of the world’s most important manufacturing economies (see Chen, van Ark, and Wu (2009) / Liu (2011) / Schucher and Kruger, 2010/ Brandt, Van Biesebroeck, and Zhang (2009) / Nabar and Yan (2013)). On a much grander scale than has been the case in the relatively small Asian Tigers, China exploited its labor surplus combined with a massive investment boom, all of which contributed to strong growth in productivity.

Figure 27. Labor productivity: Development of GDP per employed person, 1995-2012



Source: own calculations based on NBS data.

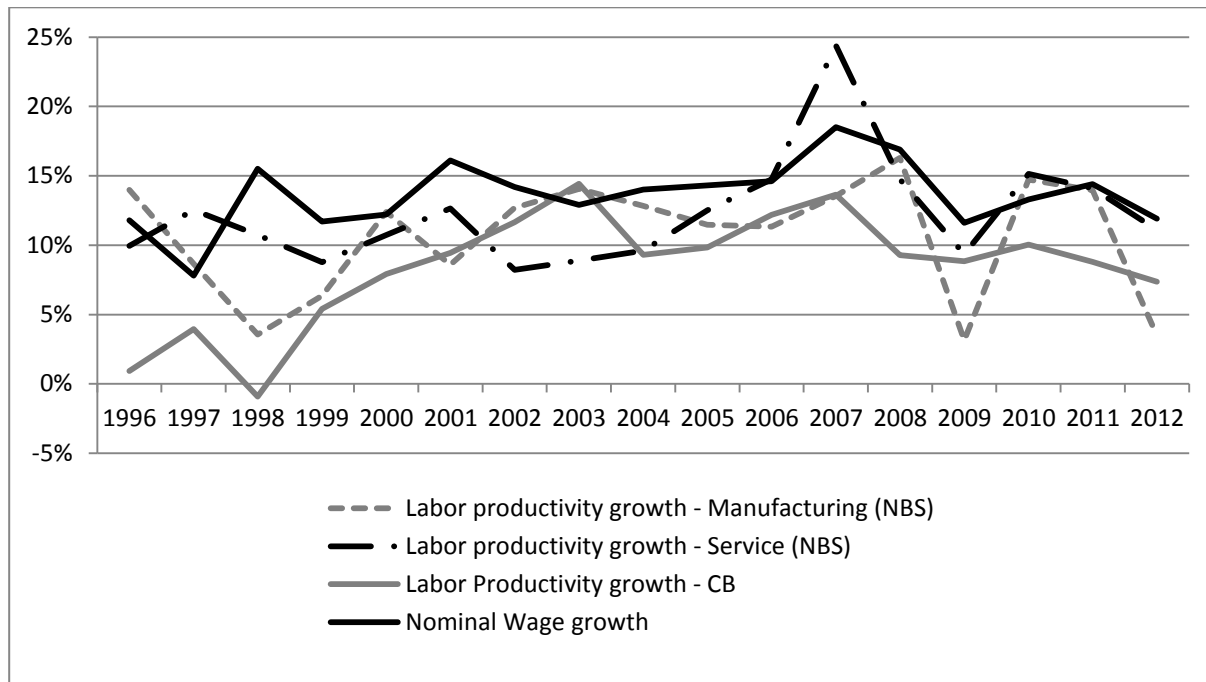
The development is reflected in Figure 27 where GDP per employed person is calculated based on official NBS data for the different economic sectors. Between 1995 and 2012 productivity measured as output per employed person in the manufacturing sector grew 5.5-fold, the service sector 7.1-fold and the agricultural sector 5.9 fold. The data further reveals that the manufacturing sector is the most productive sector, far ahead of the service sector. Behind by a large margin, the highly unproductive agricultural sector, still employing nearly 1/3 of the working population while contributing only 10% to GDP in 2013, follows. In terms of productivity development, the secondary sector benefited most from the transition of surplus rural working age population into labor intensive manufacturing, where an influx in foreign direct investment and technology acted as an additional productivity catalyst.

Productivity gains and wage growth will continue to be a macroeconomic concern as China needs to implement a new growth model focusing on domestic consumption. China's manufacturing remains highly reliant on labor and will be able to make productivity gains through a higher degree in automation. Despite growth of the employment population stagnating (growth was 0.4% in 2012), the shifts from the agricultural sector to more productive areas of the economy as well as a looming increase of the retirement age, provide ample room for employment growth. This is also reflected in the Chinese urbanization rates which for the first time reached more than 50% in 2012. As a result, despite the employment population having reached its maximum, China in the foreseeable future will see a continuous influx of the population from rural areas to urban areas. The resulting population shift comes with a greater share of the workforce employed in the secondary and tertiary sector. Surely this task was much easier to achieve with the first generation of migrant workers who readily

took on low-skilled work at fairly low levels. As the new generation flocks to the urban areas, their attitudes towards work have changed, minimum salaries have increased sharply, while their skill sets have not increased in a similar manner. In terms of productivity, a major challenge will be to match the wage levels of the unskilled segments of the labor force and integrate them in the urban areas productively without further fueling wage dispersion.

Focusing on labor productivity of the secondary and tertiary sector official NBS data shows that it increased by an average of 11.3% annually between 1996 and 2012. An alternative measure by the Conference Board (CB) suggests an increase of 8.4% during the same time period. Nominal wage during this period grew on average 13.6%. The data plotted in Figure 28, shows average wage growth mostly outpacing labor productivity measured using data from the NBS as well as the Conference Board. NBS data further shows that recent productivity increases in the service sector have been greater, growing on average 12.2% compared to 10.6% for the manufacturing sector, although productivity levels measured as GDP per employed person still remain significantly below those in the manufacturing sector. A study on the competitiveness of manufacturing in China by Ceglowski and Gloub (2012) finds that while unit labor costs fell between 1998 and 2003, they have increased between 2003 and 2008.¹⁴¹ Other studies by the World Bank conclude that wage increases have been offset by productivity growth, reporting a fall in unit labor costs in the mid-1990s and mid-2000s and has remained unchanged until 2010 (World Bank, 2010). Using GDP per employed person surely is just one indicator and has its limitations for accuracy. Studies on productivity therefore must be regarded with caution.

Figure 28. Development of labor productivity and average wage, 1996-2012



Source: The Conference Board / NBS / own calculations

¹⁴¹ The authors conclude that most of the increase in unit labor costs is contributed by the RMB's appreciation.

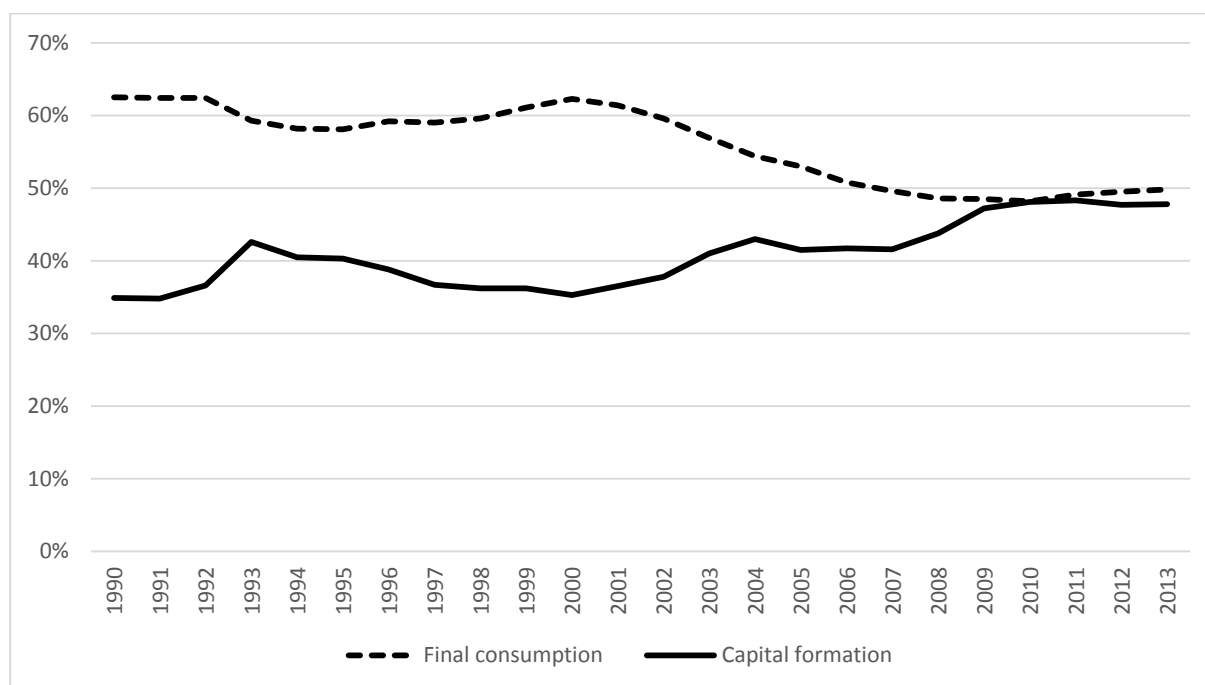
Most research agrees however that productivity growth in the past years has been slowing. For instance average growth of GDP per employed between 2008 and 2012 has slowed by 1.9 percentage points using NBS data, and 3.0 percentage points for CB data compared to the previous five year period. As with economic growth in general, increasing productivity from a low base is far easier compared to after a higher level of development has been achieved. This development is also in line with productivity levels in the manufacturing sector. Having been at the core of the Chinese economic growth model accumulating massive investments, it is more developed and therefore growing slower than the service sector which is now increasing its importance as share of GDP. Accordingly, the World Bank (2012) also expects labor productivity growth to slow continuously in the future. Productivity issues have, however, become a greater focus in China. Its relevance has been identified as a major policy concern as China fears losing its competitive advantage, but also for its effects on macroeconomic stability.

11.4 Development of consumption demand

China's rapid economic growth has in large part been fueled on investment and export, a proven development strategy of East Asian economies. Such rapid growth however cannot be sustainable and overtime contributes to substantial imbalances within the economy. Figure 29 plots the development of final consumption against capital formation measured by share of GDP. Since 1990 final consumption fell from a share of 62.5% to 49.8% in 2013, with a substantial decrease taking place after 2000. While some authors (see Zhang and Zhu, 2013) suggest that consumption rate is understated, there seems to be a strong consensus in current literature that final consumption has been declining.¹⁴² The fall of the consumption share corresponds with the drop in state-owned employment during the dismantling of the iron rice bowl (see Figure 6) when an increasing share of households experienced a reduction of all-encompassing benefits previously granted to them. Lacking these benefits household propensity to save income would be expected to increase.

¹⁴² See also section 1.4.3 on data reliability in China.

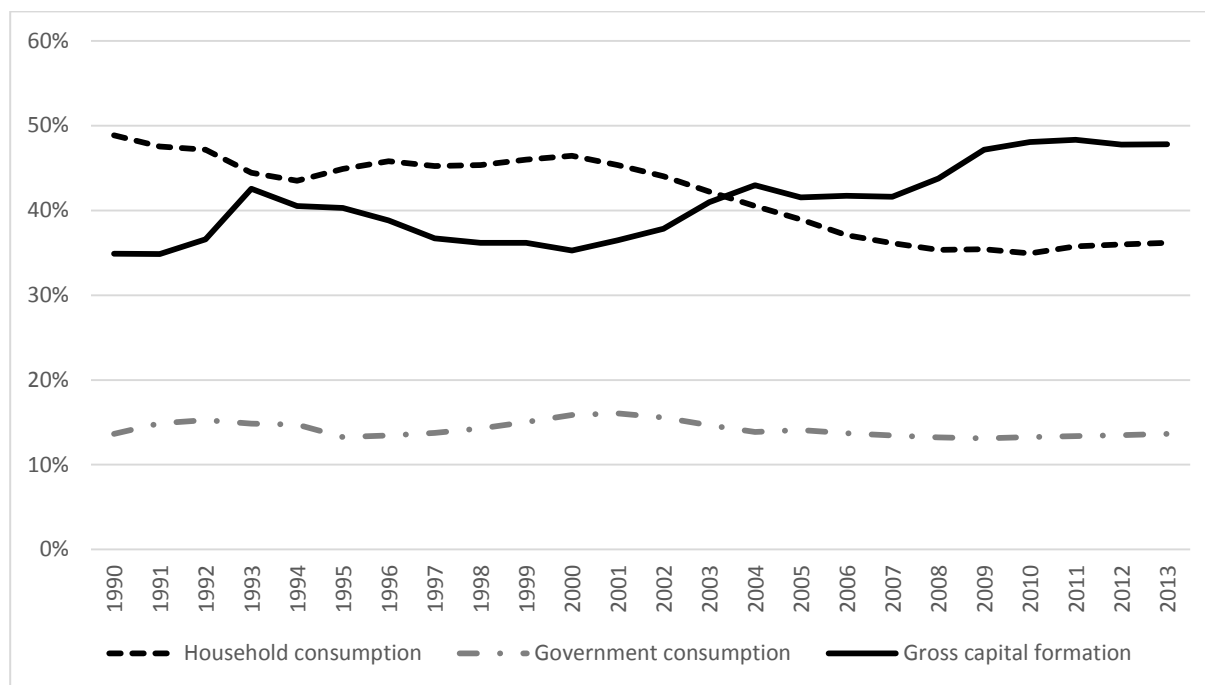
Figure 29. Final consumption and capital formation share of GDP by expenditure approach, 1990-2013



Source: NBS

Additionally, as part of the rural-urban shift to man the factories in the coastal regions a higher share of migrant workers emerged. Faced with the restrictions of the household registration (hukou) system their access to public services was particularly restricted, providing further evidence of a negative effect on household consumption (Dreger, Wang, and Zhang, 2013). The development is confirmed by a closer look at the components of final consumption depicted in Figure 30. Between 1990 and 2013 government consumption remained unchanged at 13.6%, peaking at 16.0% in 2001, but for the most of the period staying flat with minimal fluctuations. Household consumption meanwhile fell from 48.8% to 36.7%, solely attributing to the fall in final consumption. The share of capital formation in the time period observed increased from 34.9% to 47.8%. Since 2009 the relevant shares have largely remained stable with final consumption only making unremarkable gains.

Figure 30. Components of final consumption and capital formation share of GDP by expenditure approach, 1990-2013



Source: NBS

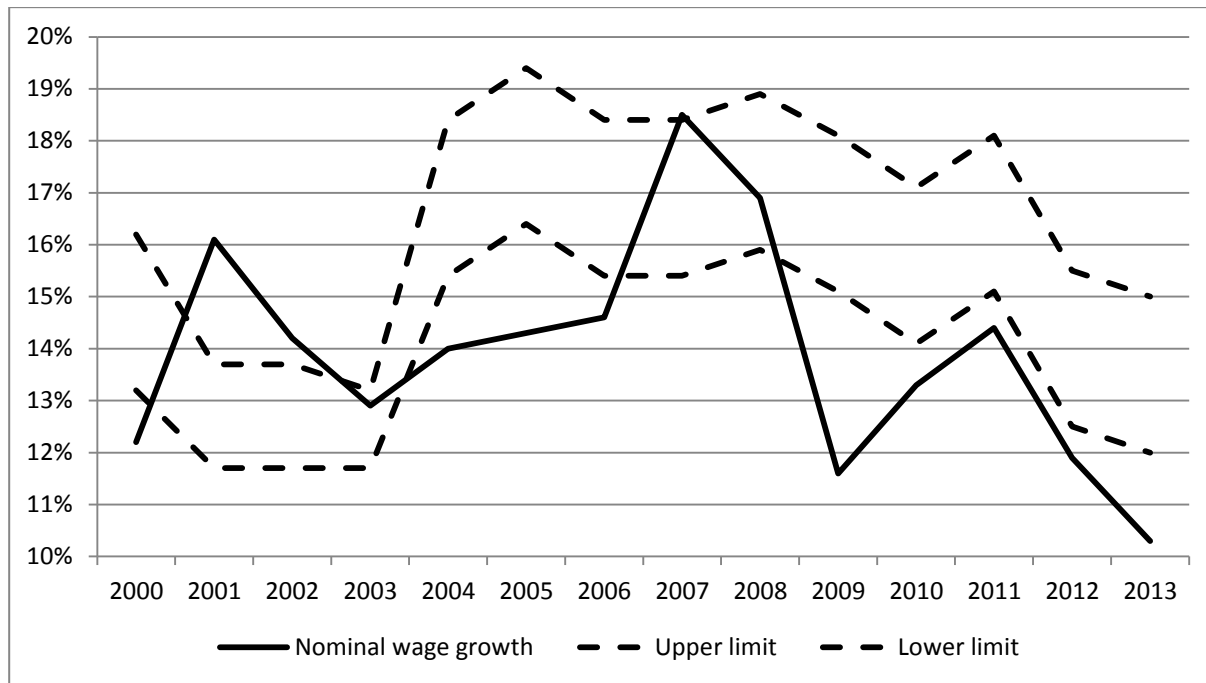
The negative ramifications of unequal income distribution on consumption and subsequently sustainable development have been noted above (see also Herr and Ruoff, 2014 / Cingano, 2014). Li (2013) in his China Household Finance Survey provides further evidence of how inequality contributes to lower consumption rates. The author's study concludes that low income households have a larger propensity to consume, but face liquidity constraints barring them from doing so due to liquidity constraints. The data further suggests that despite China having relatively high savings rates, most of the saving is attributed to high income groups. The development of final consumption share of GDP suggests that despite policy changes, China's economy remains highly dependent on investment.

11.5 Defining a wage norm for China

A key element of functional macroeconomic wage policy within the Keynesian paradigm is to consider trend productivity increases and target inflation to determine nominal wage increases (Herr and Horn, 2012). As has been defined in section 3.2 the wage norm is defined by $w^* = i + \Delta p$. Despite the data limitations (see section 8.4) for the purpose of consistency, data from the NBS will be used for defining the wage norm here. The Peoples Bank of China (PBOC), China's central bank, does issue inflation targets, but it appears evident that the target is not an explicit one driving monetary policy. The inflation target is of secondary importance to monetary policy as the central bank needs to find a compromise between price levels and economic growth. It should further be noticed that, as with many key policy institutions in China, the PBOC is regarded as one of the most opaque central banks in

the world. To account for the data limitations rather than using an explicit inflation target, a band with an upper (i^U) and lower (i^L) limit will be introduced. The bandwidth is defined as between ± 1.5 percentage points of the corresponding inflation target of the PBOC.¹⁴³ For trend productivity (Δp) average productivity increases of intervals of 4 years starting in 2000 are calculated using NBS data based on GDP per employed person.¹⁴⁴ The resulting wage norm (w^*) for China is then defined by an upper and lower band within nominal wage growth should fluctuate according to the functional wage development defined above.

Figure 31. Nominal wage growth and wage norm band, 2000-2013



Source: own calculations based on NBS data.

In effect this approach allows calculating two sets of wage norms with different estimations of functional wage developments taking into account the data limitations at hand. Plotting nominal wage growth between 2000 and 2013 as illustrated in Figure 31, shows that wage growth was rarely within the calculated range and has generally not been following the wage norm. Of the 14 years analyzed, nominal wage growth was within the defined only range three times. With few exceptions nominal wage growth was lower than the lower limit. The resulting Figure 31 depicts that nominal wage development for the most was dysfunctional between 2000 and 2013 and that the Chinese wage bargaining system is especially vulnerable at periods of economic slowdown. In 2009 affected by the global downturn, nominal wage growth fell considerably below the range, contributing to deflationary tendencies. Since then nominal wage growth has been able improve but has not been able to penetrate beyond the lower limit of the wage norm. Quite in contrast with Chinese economic

¹⁴³ For 2001-2003 the lower limit would have been deflationary, an unrealistic monetary target. The minimum of the lower limit is therefore defined as 1%.

¹⁴⁴ For 2012 and 2013 a simple average was used.

growth slowing further since, nominal wage growth is again dropping further below the lower limit, suggesting that there is no wage anchor in China's wage development.

11.6 Evaluating functionality of the wage bargaining regime

Despite some progress in recent years the institutional structure of the Chinese wage bargaining system remains deprived of considerable coordination and centralization (see section 10.5). Within the past 10 years some efforts in strengthening the institutional framework began to transform the atomistic wage bargaining system with some evidence of improvements to increasing levels of coordination, while the level of centralization remains at low levels. Prevailing institutional patterns especially due to weak representative bodies, a heterogeneous industrial structure in a large and diverse country set preconditions which do not favor higher levels of coordination and centralization (see Table 8). Under the current institutional design and the characteristics of China's economic system, the theoretical context outlined in Chapter 3 would anticipate that such an arrangement would obstruct the development of functional wage bargaining following the Keynesian paradigm.

Although the Keynesian paradigm does not outline a detailed institutional structure for a functional wage bargaining regime, it does provide the pretext for a stronger institutional framework preserving macroeconomic stability as illustrated in Table 6. The institutional limitations (see section 10.3) of the Chinese wage bargaining regime hinder achieving functional wage bargaining as it has previously been defined by contributing to macroeconomic stability. The data analysis presented previously in this chapter suggests that the subsequent outcome of the Chinese wage bargaining system scores low on all accounts when considering its effect on price levels, inequality and consumption demand.

First, we will start the evaluation with inflation and productivity development. Compared to other emerging economies, China's price levels developments have been relatively stable, only fluctuating within a relatively narrow band during its high growth period. Nonetheless, the time periods observed suggests that there are spikes in price level development in either direction reacting to the changes in economic conditions. While China has been experiencing high levels of growth, with equally rapid productivity growth, since 2011 its economic growth is shifting from high levels to more moderate levels. Lacking a wage anchor following the wage norm according to the Keynesian paradigm, Chinese wage growth appears ill-equipped to cope with future changes as China is entering a new period of more moderate growth. Lower GDP growth will be accompanied with lower productivity gains further complicating future wage developments. Though the impact on macroeconomic stability caused by high inflation or deflation has been moderate so far, the outcome of the wage bargaining system has shown to be vulnerable to deflation or inflationary spikes.

Second, income inequality has been widely accepted as being an outcome of an unregulated atomistic wage bargaining system. It is equally recognized that the wage dispersion in China is multidimensional across skills and regions. In large part this has been a consequence of weak coordination and centralization of China's wage bargaining regime. Official data has shown slight improvements in the past years, but income wage dispersion has contributed to affect the overall wage structure. The government's policy changes targeted inequality with a variety of measures since 2003, indicating that the tolerated level of inequality in the Chinese society has been exceeded. The institutional framework has improved with policy attempts

focusing on reducing the atomistic wage bargaining regime, but, while recognizing that it is not solely responsible for inequality, the institutional framework and differences in bargaining power in the labor market seem ill-equipped to contribute to making any significant progress in reducing pervasive inequality in China.

Third, the outcome of wage bargaining contributing to unequal income distribution directly affects consumption demand. Here the evidence is most striking as unequal income distribution constrains lower income groups' ability to consume. It underlines China's reliance on capital investment and its struggle to shift towards a more sustainable development path. Rather than contributing to boosting consumption as a new growth driver, the current institutional framework of the wage bargaining system facilitates low consumption demand. It hence still needs to be recognized that tackling inequality as part of a functional wage bargaining regime is imperative to transforming China's economy in order to facilitate higher consumption demand and establish a more sustainable development pattern (Li, 2013).

The results considering the effect on price levels, inequality, and consumption demand contemplate the institutional weaknesses apparent in the Chinese wage bargaining regime. Of course the wage bargaining system is not exclusively at the center of all these developments as particularly addressing inequality needs to be contemplated with relevant redistributive policies and social benefits (see Li, 2013 / Chapter 3 and section 2.1). The wage bargaining system in place, however, displays imperfections when evaluated against variables of a functional Keynesian wage bargaining regime. Some of the institutional flaws have been acknowledged and are being addressed by policy makers with improvements to the framework of future wage bargaining regime. At present, and despite the gradual improvements, Chinese wage bargaining however remains dysfunctional. The institutional features of China's wage bargaining regime hence may prove an obstacle to establishing a sustainable development regime under the authority of the CPC.

11.7 Wage bargaining with Chinese characteristics

Adjusting its economic growth model away from export oriented low cost manufacturing and heavy reliance on investment towards a stronger reliance on services, higher value added manufacturing, and domestic consumption confronts the party-state with crucial institutional choices in order to realize these goals. The success over the past decades will be challenging to repeat without setbacks as the potential headwinds are picking up. Still an emerging economy, far from reaching developed nation status, a success the Asian Tigers were able to reach more easily, China's economic system will continue to undergo substantial changes. With over 100 million rural workers anticipated to move into urban areas in the next few years, a massive number of unskilled workers will enter the urban labor market but at a significantly higher wage rate than two decades ago. Faced with a highly different economic environment from when economic reforms began, absorbing the new entrants to the urban labor market will be a formidable task requiring a barrage of policies, including improvements in education, redistribution and social policies. The necessary adjustments to China's growth model will necessarily be accompanied by institutional changes critically determining the outcome of its economic system.

The industrial relations arrangement is a crucial part of the economic system with far reaching implications (see section 1.3). It has been illustrated above that for a variety of reasons countries will transform their economic systems and that there is no dominating economic system which can simply be transferred to other countries (see section 1.4). Over the past 30 years the Chinese economic system has experienced a dramatic transformation subsequently rendering it unrecognizable from when reforms first began. The initial success however is in need of further substantial adaptations as China faces new challenges. The changing environment of course has immediate implications for its labor market and wage determination regime. While during the initial reforms Chinese labor relations were mainly affected by the use of surplus cheap labor accompanied by radical changes of the institutional structure of the planned economy. In its process of economic development and the dismantling of the iron-rice bowl the Chinese system of wage bargaining has and continues to go through substantial modifications and has emerged in a more prominent role for future change. However, during the transformation the state mainly preserved its ability for direct and indirect intervention although it has also been alternating and adjusting the way it influences the industrial relations regime.

Conceding much of its power in industrial relations to market mechanisms during initial economic reforms left the government with less direct control. Over time attitudes and labor relationships changed, becoming less compatible with the established system while lacking a comprehensive institutional framework (Zhu and Warner, 2000). After the Chinese government's policy shift the overwhelming majority of litigation and arbitration cases has seen employees prevail (Brown, 2008), a situation which especially in urban areas has continued to rise in the post-2008 era. Resolving the growing labor disputes peacefully by granting employees more rights has become a top priority for the government (CLB, 2009).¹⁴⁵ This shift has been the first and crucial policy adjustment transforming the Chinese legal system from being employer-friendly to being more employee-friendly. It is part of a strategy of the government to reign in on the threat of a potentially evolving militancy among workers (see Hui, 2014 / ten Brink and Butollo, 2012). The preliminary adjustments directly aimed at the labor market by reigning in weak regulations slowly progressed to affect the general industrial relations regime including the roles of its representative bodies.

The ACFTU was originally designed as a transmission belt between workers and the government at the enterprise level. Its recent strengthened position at the political level has effectively contributed to advancing the legislative environment for workers including the Labor Contract Law and initiatives advancing collective contracts contributing to improved legal provisions and a strengthening of institutions (Lee, 2009). In this process the representation of ACTFU officials within national and provincial standing committees has increased as well (Feng, 2008).¹⁴⁶ Lee refers to this development as a political incorporation of trade unions which “enhance(s) trade unions’ political influence over the legislative and decision-making process”. He further points out that although the lobbying position of the ACFTU is strengthened, incorporating the ‘labor movement’ into the structure of the party-

¹⁴⁵ According to the China Labor Bulletin (CLB), an NGO, official figures show that the workers win far more than 50% of all cases with large regional differences and some areas reaching a 95% success rate for workers.

¹⁴⁶ Strengthening the role of the ACFTU within the political framework has been repeatedly reiterated by the new leadership. See for example a report by Xinhua from Oct 18th, 2013: <http://english.cntv.cn/20131018/105128.shtml>

state sustains the CPC's direct control. The current institutional restructuring and its focus on tripartite elements is at the same time a redesign effort of the traditional transition belt function.

The recent focus on strengthening the tripartite system has further improved the standing of the ACFTU, while the CEC/CEDA has not been equally developed. The adaptations aim to appease social pressures and strengthen the position of workers previously having been susceptible to exploitation, making changes to the CEC/CEDA more difficult to communicate to the public. Establishing stronger business associations will be further limited by political issues and the representation of capitalist within the CPC's framework. However, the CEC/CEDA's position is not necessarily comparable, as especially SOEs have and had significant political clout. Following rapid marketization the adjustments aids the party-state to regain stronger control of the wage bargaining mechanism. The combination of minimum wage, wage guide lines and collective contracts provide the government with greater leverage in influencing wage growth, which in effect theoretical also increases the level of coordination possible in the Chinese system.

From the government's extreme intervention in the economy prior to 1978, it has progressively endeavored to build a new form of capitalism. During the transformation the Chinese government continuous to increase its role as a regulator by establishing a new legislative framework (Cooke, 2005). During the latest reform agenda announced in 2013 during the 3rd Plenary Session of 18th CPC Central Committee, President Xi vowed to further reduce the role of the state by strengthen market mechanisms, while it pledged to strengthen the rule of law during the 4th Plenary Session in 2014. Strengthening of market mechanisms however does not necessarily imply that it will apply to the labor market as such a development would be in contrast to the ongoing institution building efforts within a stricter regulatory framework in the labor market and its system of wage bargaining. In contrast, as has been pointed out above (see Table 12) the labor market is experiencing the introduction of measures aiming to limit market influences by building a stronger institutional framework.

Improving the legal environment set the groundwork of changing industrial relations in a similar manner seen in the economies of the Asian Tigers. The experiences of several of the Asian Tigers highlight that authoritarian regimes are not immune to social pressures building up, requiring adjustments to the economic system in order to manifest the political power regime. Examples in the Asian Tigers, after having reached a higher degree of economic development, in a first step have strengthened the rule of law. China has also responded by building up institutions and fostering law directly affecting industrial relations. In Korea and Taiwan the strengthening of the legislative framework ultimately led to democratization and the government reducing its direct influence on the economy including labor relations (see section 4.1).¹⁴⁷ Hong Kong and Singapore, with their semi-democratic regimes, have chosen a different path but with many similarities, especially in areas related to the rule of law. The developments seen in the Asian Tigers emphasizes the prominence of the political context of the individual countries in which the revolving process of economic transformation takes place (see Figure 5 and also Qian, 1999).

¹⁴⁷ It should be noted that GDP per capita in both Korea (1987) and Taiwan (1996) was substantially higher than in present day China. If this is any indicator at all, any such speculative pressure for political reform would still be 5 to 10 years in the future.

The CPC is eager to construct an institutional design which can contribute to appease pressure at the grass-root level while at the same time securing its control. Attentive in identifying and reacting to destabilizing elements the party-state has taken steps to respond to pressures venting themselves through wildcat strikes and other displays of discontent usually contained to local issues. The party's responsiveness over the past 10 years has contributed to making labor issues much more prominent in Chinese policy making. Improvements in labor rights, rising income levels as policy targets, enforcement of minimum wages, as well as experimentation with collective contracts and tripartite bargaining have contributed in shifting attention on industrial relations. The CPC has however also refrained from introducing bold reforms pertaining to industrial relations. Much more, in order to appease bottom-up pressure from building up, the government, in an attempt to suppress demands for independent interest groups, opted to enhance its existing institutions in a top down approach in an effort to control how industrial relations transform.

It is a stark reminder that the evolution of an economic system is the outcome of a complex set of variables, including the political and social situation of a country. Through experimentation China is cautiously moving from an extremely decentralized wage bargaining system by means of strengthening its existing institutional framework. In countries with established representative bodies the power rebalancing between workers and employers resulted from a class struggle at the bottom of the system. In China the process developed very contrary to that. In an attempt to regain control and alleviate social tensions which potentially could threaten the political system the CPC, the government initiated tripartite industrial relations, including minimum provisions and collective contracts (Warner and Ng, 1999). Change therefore was initiated and enforced from the top down (Taylor, Chang and Li, 2003) and can be best described as a form of enlightened authoritarianism (Roscher, 1847).

Confined by its political system the Chinese tripartite system is undergoing gradual transformation towards a new institutional framework. It has been outlined that many of the introduced rules and regulations resemble those found in developed market economies by establishing a consultative system between representatives of the government, employers, and workers at different levels (Clarke and Lee, 2002). In its reform efforts for economic development Chinese policy makers were keen, yet vigilant, to embrace Western capitalist ideology. Within industrial relations frequent references to trade unions, work councils, tripartite consultation, collective bargaining and agreements as well as minimum wage or social dialogue are elements present in Western economies, especially European ones. Consequently provisions within China's legal framework appear familiar to Western scholars (Rudden, 2012). Deriving a similarity based on these superficial similarities however would be a fallacy (see also Holz, 2007 / Taylor, Chang and Li, 2003).

Just as the Chinese CPC encompasses little elements of communist ideology, the face value of trade unions or tripartite consultations need to be reinterpreted according to distinctive Chinese characteristics. Often when referring to the Chinese economy the country's uniqueness is exemplified by amending issues by the addition of 'with Chinese characteristics'. The phrase encompasses the Chinese interpretation of specific matters and is most commonly used when referring to capitalism with Chinese characteristics. Applying the supplemental term recognizes the individual differences in China by hinting that the definition of terms used in China has their own country-specific connotation. This in itself is not necessarily worth mentioning as all economic systems retain a certain degree of

individuality. However, in China's case the term specifically reflects the prerequisite that any institutional reforms need be compliant with the CPC's ideological doctrines. Under these preconditions the CPC has progressively been building a compatible institutional framework. Inevitably the restrictions limit how institutions can evolve, affecting the system of wage bargaining which needs to function within tight boundaries.

In an authoritarian political regime the CPC commands close control over all elements perceived as a threat to their power base. Chan and Unger (1996) suggest the corporatist framework in China is similar to that found in other East Asian economies, including the Asian Tigers described previously. They identify that under a state-led corporatist system only one representative body for workers and employers will be officially recognized. This corporatist constellation between the government and representative organization resembles a double edge sword (Huang, 2013). While there is a problem of autonomous, independent representation, the government has the power to establish and expand a tripartite system with increased levels of coordination and centralization. If necessary this also includes forcing employers' acceptance and compliance (Taylor, Chan and Li, 2013). In order not to cross the opaque as well as clear rules set by the CPC, any union or employers' organization leader will implement a form of self-censorship. The implicit and explicit restrictions aim to contribute in advancing the CPC's own agenda.¹⁴⁸ For industrial relations the term 'Chinese characteristics' then translates to restraining control of the bargaining units' independence. Workers as well as employers and their relevant representational organizations recognize the containment with the occasional outburst of protest mainly limited to the grass-root level and independent of the official institutional structure. Any person or organization stepping out of the boundaries however can anticipate a severe clampdown by a hyper-vigilant party-state.¹⁴⁹

Institutional experimentation takes place under the hierarchy of the one-party state (ten Brink, 2012). The top-down approach has effectively contributed to advancing workers' rights, unionization, and collective bargaining according to principles of 'Chinese characteristics' (see Huang, 2013 / Lee, 2009). After 2008 the strong position of business interests was restricted, with more regulations forced on employers, shifting the power balance. Establishing a tripartite system such as the NTCC is similarly orchestrated by the party-state. It is highly unlikely that these rapid improvements would have been possible outside of the corporatist relationship between the state, workers and business interests. The tripartite institutions however are all under the direct control of the CPC executing policy targets within the party's responsive authoritarian regime. Any shift within the power balance hence reflects a policy response within the established framework. The top-down, state-led control of the institution

¹⁴⁸ Document No. 9, forbidding to speak about 7 topics, leaked in 2013 highlights the opaque rules.

¹⁴⁹ An example of a strike at a German factory exemplifies the limitations. After a non-union wild cat strike broke out in the summer of 2013 local authorities did not respond to the company's request for mediation, pointing out that the company needs to solve the problem bilaterally. However, being a wild cat strike, the local trade union proved useless bringing the "negotiations" to a halt, mainly due to lack of a negotiations partner representing the union. The authorities kept a watchful eye as the strike went on for more than a week. Riot police did intervene however, as soon as the striking workers began to carry their demands outside the company's premises onto public streets, effectively ending the strike. Mediation efforts then took place with the government dictating the terms and making clear that this is what the company needs to offer, and also making clear to workers that the offer needs to be accepted. It should also be noted that under the leadership of Xi Jinping restrictions on NGOs as well as the detentions of outspoken individuals has been on the rise.

building of Chinese wage bargaining on the one hand contribute to establishing a tripartite system and advancing reforms, on the other hand the close relation between 'representative' bodies and the government also jeopardizes any significant advances due to a lack of representation (see Huang, 2013).

Strengthening the institutional framework in the post-2008 era appears to have had some effect on wage developments. On the national scale Figure 16 and 17 show evidence of recent trends in which overall wage increases are increasing at a more similar rate. Although it is not possible to evaluate the impact of any tripartite system, from an institutional perspective it would appear to be too weak to have a significant impact. However, under the current structure, at the regional level wage development technically need to consider wage developments dictated from the top down while also being affected by local factors of overall labor supply of skilled and unskilled workers. Minimum wage were the first tool implemented by the government though at present it can achieve little more than establishing a simple wage floor, while it has little coordination power for overall wage increases. A persistent strengthening of tripartite institutions, unions as well as collective bargaining does however underline the government's ambitions for the Chinese wage determination regime. However, coming back to the concept of 'with Chinese characteristics', collective contracts are not to be compared to collective bargaining in a Western sense (see chapter 7), but as of 2014 the government's remains committed to extend the pervasiveness of collective contracts, but it remains unclear what precisely will materialize. Scuttled by flawed representation no Western style representation is about to evolve.

By Western standards the Chinese institutional arrangement of its tripartite system might seem badly designed and flawed. This however disregards the intentions of the CPC. Above all, any institutional design is subordinate to the CPC's primary goal of maintaining an authoritarian one-party rule in China. Tripartite wage negotiations only play a limited role, but as Chinese industrial relations are in the making, experimentations compatible with the rigid political system are ongoing. The institutions for effective tripartite wage bargaining are still premature, with experimentation only beginning in the 1990s (Howell, 2003). Chinese style tripartite bargaining remains at its infancy.

Over time it seems likely that the position of representative bodies will continue to be reinforced, but any independence will be limited by a type of self-censorship in which the representative bodies will not threaten the CPC' regime. Any tripartite bargaining will need to adjust itself to the Chinese institutional framework, dominated by the CPC and authoritarian rule which will not tolerate charismatic leaders nor will it wish for anything causing 'disharmonious' labor relations, meaning that confrontational public industrial relations will not be tolerated. In a pragmatic approach further improvements in the area would seem acceptable to the CPC as long as any criticism and debates pertaining to issues directly affecting party rule are voiced behind closed doors. The Chinese wage regime under the CPC's rule will hence be preoccupied by the political sphere with political functionality dominating economic functionality.

Generations of workers have become accustomed to rapidly rising wages and living standards mostly absent of a strong institutional arrangement for wage bargaining. Though China's economy has successfully avoided major economic shocks during its rapid development, its wage bargaining regime has shown vulnerabilities. Equally the regime is susceptible to react to social demands fueled by a perceived injustice, also because China

lacks the necessary political institutions to resolve such issues. A lack of true representation complicates the situation as employers faced with potential confrontation cannot identify a proper employee representative. In the worst case the result can be wildcat strikes and unrealistic wage demands threatening macroeconomic stability which with the proper institutional framework could be avoided or dealt with. This only leaves the government to intervene either by mediating a solution or by cracking down on the demands. In recent years the government so far has been prone to at least partially giving in to local, factory level demands in order to maintain social stability. Through tripartite bargaining the government is becoming more actively involved on a broader scale, and therefore may increasingly becoming held accountable for wage developments. While some argue that the state, after a partial withdraw from labor relations, has taken on a more regulatory role by means of legislation (see Taylor, Chang, and Li, 2003 / Ip, 1995 / Qi and Xi, 1995), the current direction goes beyond that, towards more active involvement through the direct control of labor market institutions. The result is a potentially dysfunctional wage bargaining regime ill-equipped to deal with macroeconomic realities in which wage increase are determined by political policy. It is yet to be seen how the system will cope with a significant economic slowdown accompanied by slower wage growth or even negative real wage growth.

Adapting an institutional framework is a complex endeavor and takes significant time. Unlike quick fixes to immediate problems, building institutions follows long-term decision-making and resembles maneuvering a massive ocean going vessel. Economies, however, need to adapt or otherwise remain trapped in the past, not fully exploiting their true economic potential. China has become accustomed to uninterrupted progress, with ever increasing prosperity and is on track to becoming the world's largest economy soon, though by far not the wealthiest one. The CPC has been very successful in implementing long-term policies and is attempting to redesign its institutions to execute its policy targets. Rebuilding industrial relations and its wage bargaining regime with tripartite elements is a direct response to social pressure and changing expectations. It is also a precaution in dealing with slower GDP growth rates and inevitably slower wage growth in the future as the Chinese society needs to prepare for potential necessary pains during the readjustment to lower growth rates. The institutional framework not only supports long-term policies, but also contributes to balance competing interests within society. Rather than relying on bottom-up interest groups, in China a top-down approach aims to appease interests enough by incorporating it into the party-state controlled institutional mechanisms with its explicit limited representation.

The CPC is faced with mounting challenges as economic growth is slowing, especially since rapid economic success has been the core source of its political legitimacy. Korea and Taiwan chose a path of democracy and political reforms contemplating economic reforms. Hong Kong and Singapore, though not comparable, evolved into hybrid-democratic regimes. Hong Kong, now a special economic region of China, has since the handover in 1997 experienced a progressive stronger intervention by the central government. Although China continues to learn from Hong Kong's economic system, focusing on selected individual elements, and adjusting them accordingly, it is tightening political control. It therefore appears to be an illusion to believe that China will become more like Hong Kong by loosening its political control. The Singapore model with a tighter control on the country's institutions seems to be a more attractive example on how to maintain power. At present China does not appear

to plan for any political reforms, much more policies regarding the institutional design of its wage bargaining regime aim at securing its control. Any institutional economic reform therefore needs to be evaluated for their impact on the political sphere. Policy aims constitute a fine line between progressive economic reforms and political stagnation (Taylor, Chang and Li, 2003), and prevent a functional wage bargaining regime that is independent of strict government control.

The CPC has been determined to unleash the economic potential of China, but following its initial success, it is increasingly being confronted with more complex policy targets in which economic and political targets are not compatible. In the words of Cao Yaxue this may result in suboptimal policies in which China's right foot wants to head north, while its left foot wants to head south, yet both feet share the common target of preserving the one-party rule.¹⁵⁰ Its willingness for future political reforms will set the pretext under which Chinese wage bargaining will develop. Under current developments China's evolving economic system is setting the ground for a dysfunctional wage bargaining regime posed to compromise a smooth transition to a more sustainable economic development pattern.

¹⁵⁰ Quote taken from article 'Chinas peinlichstes Ministerium' published in the Süddeutsche Zeitung online on March 13th 2015.

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Institutional Framework and Dysfunctionality of the Transitional Chinese Wage Bargaining Regime

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Max J. Zenglein

This book examines the institutional building blocks of China's transitional wage bargaining regime taking into account the macroeconomic and political framework. Special attention is paid to the more volatile institutional setting in emerging economies. The approach enables an evaluation of how China's wage determination mechanism is developing.

China's economic reform process launched in 1978 had far reaching consequences on the institutional setting of its economic system. This resulted in substantial re-arrangement of its industrial relations. In an attempt to better understand the changes, this book draws on extensive empirical data, including a case study of wage developments at German companies in China and an analysis of the macroeconomic functionality of Chinese wage bargaining system according to the Keynesian paradigm focusing on inflation, nominal wage growth, productivity as well as the development of consumption demand and wage dispersion.

The analysis suggests that the functionality of the Chinese wage bargaining system performs poorly and that the current transitional system lacks a strong institutional structure. Although China's current wage bargaining system has seen some elements of strengthening its institutional structure, particularly in the area of more coordination, its design remains subordinate to the Communist Party of China's primary goal of defending an authoritarian one-party rule. Under these conditions China is unlikely to establish a more functional wage bargaining regime.

Key words: China, industrial relations, economic systems,
institutional economics, wage bargaining, wage determination,
emerging economies

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