The Potentials of Labor Supply and Policy Reactions to Lewisian Turning Point

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During 1990s, a significant labor market shocks took place in urban China due to restructuring of SOEs and cyclical factors. To deal with the dislocation of urban labor market, a bunch of policy instruments including both negative labor market policies and approaches to suppressing labor supply were employed in order to ease the tension in urban labor market. For instance, in areas with high unemployment rates, workers whose ages are close to official retirement age were encouraged to early retirement; to reduce the total number of economically active population, higher education has been significantly expanded since then, etc. However, in recent years fast economic growth and demographic transition have brought China to the Lewisian turning point, which suggests that China needs to change the direction of labor market policies; in particular, China ought to give up those temporary instruments intending to suppress labor supply . In this paper, we discuss the potentials to dig out labor supply and some related policy reactions to the coming Lewisian turning point.

I. It's Time to Exploit the Potential for Labor Supply

In most cases, actual and relative factor prices and their changes are the most important impetus to economic sector shift and industry upgrade. The economies facing industrial upgrade always display similar characteristics, including acceleration of population aging, high saving rates, fast economic growth pushing by high investment rate, transformation of consumption structure, and improving labor productivity, and in turn those features lead to upgrading industrial

structure, appreciation of currency, and rising asset prices. Those facts have been seen more or less in some East Asian economies, such as Japan and the Four Little Tigers, with some disparities depending on the specific environment and development path. In recent years, China has witnessed some structural changes experienced by those leading economies. However, when evaluating the procedure and impact of economic development and structural changes in China, we have to be cautious of its uniqueness. One of the issues we need concern here is whether structural changes and their timing conform to those of demographic transitions.

We need take care of two issues of timing here. First of all, with economic development, how long will China take to transform the economy from dominantly labor-intensive to capital-intensive? Second of all, how long will China take to turn over the trend of increasing labor age population as decreasing? In principle, if the demographic transition and industrial upgrading takes place simultaneously, the pressure of labor shortage will be resolved by price adjustment on the labor market. However, if for some reason the time for industrial upgrading is long or the period for demographic dividend is short, the outcomes of labor shortage will be serious because the shift of economic sectors does not accomplish within the period with demographic dividend.

In fact, when looking at the demographic transition and economic development in China since the Reforms and Opening up, it is easy to find a short period with demographic dividend. Meanwhile, the transformation of economic structure might take a relatively long time.

We first observe the feature of demographic transition and population dividend in China. The left panel of figure 1 displays time series of crude birth rate, crude death rate, and the logarithm of per capita GDP (constant price of 1952). With economic development, the birth rate declines very fast and TFR has dropped below 1.8. Meanwhile, we may find that the crude death rate has been controlled at very low level since 1970s thanks to declining infant mortality rate. The demographic transition is so fast that China spends a relatively short

time to achieve the transition from high fertility, high mortality to low fertility and low mortality. Because of the quickness of demographic transition, China enjoys the demographic dividend quickly, however, at the price of keeping the dividend in a relatively short period. The right panel of Figure 1 gives a picture of population prediction by age group. As shown in the figure, total amount of population at labor age will stop increasing in around 2015 and will start declining in 2020 after a few years stagnant. The prediction implies that it's better for China to be ready for structural changes of economy within decade as far as labor market constraint is concerned.

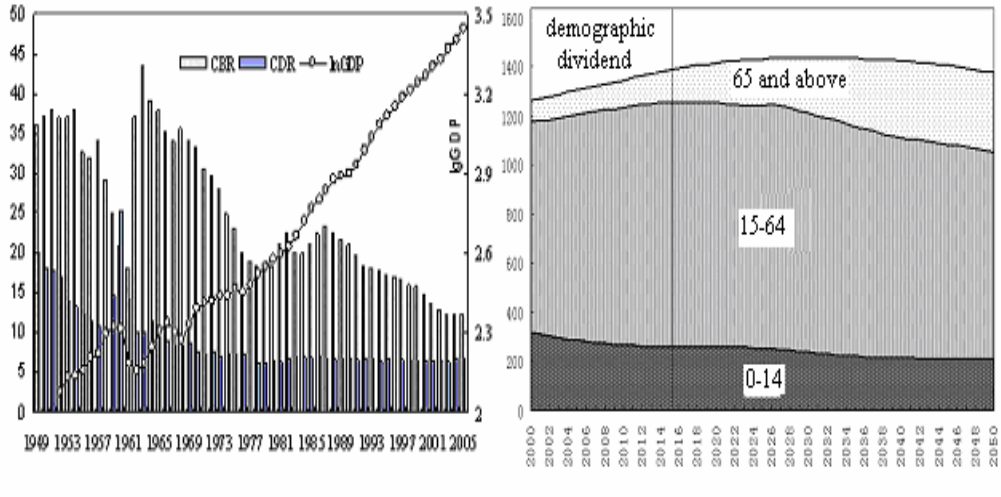

Figure 1 Demographic Transition and Period with Demographic Dividend

Source: the left panel is from China Statistical Yearbook (various years) and the right panel is from prediction from Institute of Population and Labor Economics.

Then we look on the economic transformation in the past decades. The general trend of transformation of economic structure is that the share of primary sector in GDP keeps decline. In 1996 the value added of primary sector[①] accounted for about one fifth of total GDP and the

[①] According to Chinese statistics system, only agriculture is accounted as primary sector.

proportion decreased to less than one eighth in 2006. In contrast to agricultural sector, service has been more and more important economic sector in Chinese economy. In 1996 the value added of tertiary accounted for one third of GDP and the share went up to 39.4 percent in 2006. Because Chinese manufacturing has large competitive advantages for international trade, the share of secondary sector in GDP has been stable since 1978, fluctuating around 45 percent with a small standard deviation of 2.02 percent. The economic shift of sector since the Reforms is presented in Figure 2. It is hard to find evidence indicating that the share of manufacturing will be declining in the near future. According to a national representative household survey done by NBS that investigated 68 thousand rural households, in 2005 the leading sector for migration workers who worked in off-farm sectors still was manufacturing, which accounted for 34.8 percent of total off-farm migration workers, while the number was 2.5 percent lower in 2004 and led the second employment sector 14.6 percent (NBS, 2006).

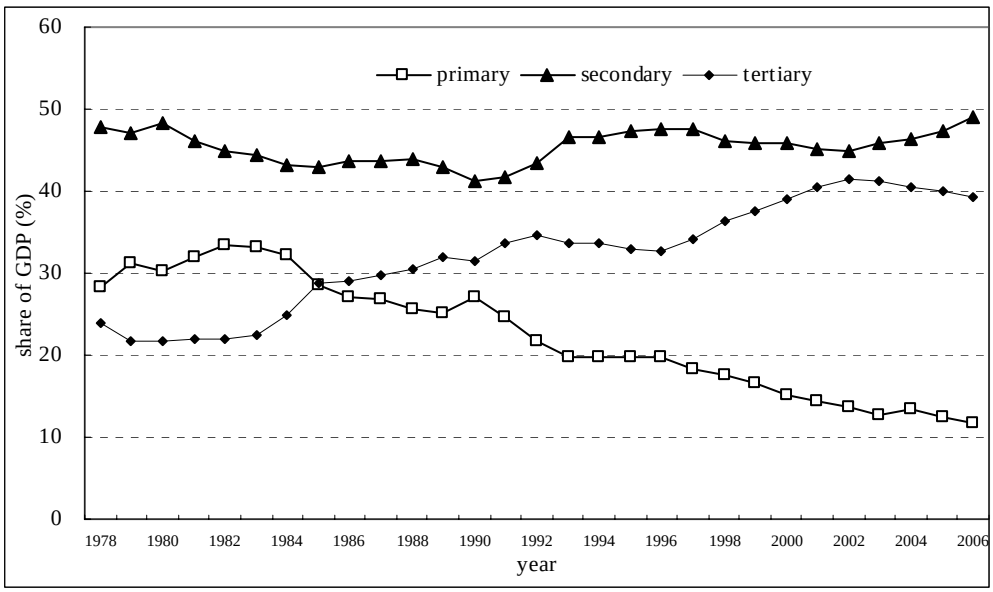

Figure 2 Sectoral Shift of GDP in China: 1978-2006

Source: National Bureau of Statistics of China (2006), *China Statistical Abstract in 2007*, China Statistics Press, Beijing.

To keep the advantage for economic development, China has to enhance the labor productivity when facing the situations of diminishing demographic dividend. However, there exists a big gap of unit labor productivity between China and the developed countries. As evidenced by Table 1, average unit labor productivity measured by value added per hour in China is one fifth of that in Japan, one sixth of that in EU countries, and one eighth of that in United States. Considering that the coming Lewisian turning point drives the labor cost increase significantly, it is hard to predict how long China will maintain the advantage of labor. For that reason, China needs to dig out the potentials for labor supply before the demographic dividend disappears and labor productivity increase substantially.

Table 1 Unit Labor Cost and Labor Productivity: China and Other Economies (US=100)

	Per Capita GDP *（USD）	Unit Labor Cost	Value-added Per Employee *	Value-added Per Hour *
China	4329	21.3	13.7	12.0
India	2464	19.7	12.5	—
Mexico	8969	96.7	11.5	10.2
Japan	27101	120.1	60.1	59.2
EU-15	—	99.0	60.6	71.6
United States	34888	100	100	100

Note: * Adjusted by Purchasing Power Parity.

Source: Per Capita GDP from the World Bank, *The World Development Indicators*, others from Bart, Banister, and Guillemineau (2006), "Competitive Advantage of 'Low-Wage' Countries Often Exaggerated", China Center for Economics and Business, Executive Action, No. 212.

Hence one can see that, there are needs for China trying to keep the advantages for labor supply, which requires exploiting current potentials for labor supply. The means includes digging out the potentials for both quantity and quality in labor supply so as to gain time for the coming economic restructuring.

II. Current Potentials for Labor Supply

In general, there are two aspects of policy changes to tap the potentials for labor supply. One of them is to make good use of current population at labor age and economically activate them as much as possible. The other is by all means to improve labor quality through accumulating human capital and strengthening the linkage between human capital formation and labor market.

The Age Profile of Labor Supply

As the trend evidenced by developed economies, labor forces moving out of agriculture is the main way to make up the labor demand in non-farm sectors. In China, the major component of migration workers is young labor so far. We may indirectly estimate the available rural labor forces through demographic analysis on migration workers and rural population.

As per the rural household survey done by NBS, labor forces below age 40 accounted for 85.9 percent of total rural to urban migrants. Meanwhile, according to 1‰ Population Sample Survey, rural population whose age is between 16 and 40 is 329 million in the same year. Combining with rural household, we may calculate that 30.5 percent of those whose age are below 40 years old worked out of agriculture and migrated out of town. Among those aged below 40, migration workers mainly consist of young people whose ages are 25 or below, which accounted for 55 percent. Table 2 gives more detailed information of rural population and migration workers by age group. If we look back a few years ago, the analysis for the census data conducted in 2000 has already indicated that migration workers whose age are between 16 and 35 accounted for three fourth of total migrants, and the age group between 16 and 25 accounted for half of total migrants.

Table 2 Rural Population and Migrants by Age Group

Age Group	Total Rural Population (million)	Migration Workers (million)	Students (million)	Share of Migration （%）
16-25	122.69	5387	838	47.1
26-30	60.21	1777	0	29.5
31-40	146.28	2620	0	17.9
40 and below	329.19	9784	838	30.5

Note: According to the Statistical Yearbook of 2004, students in rural senior high school were 2.1 million while those form township were 10.45 million. Under the assumptions of 60 percent of latter are from rural areas, we got the senior high school students were 8.48 million.

Source: rural population is from *the Population Yearbook of 2004*, China Statistical Press; rural migration worker data is from *the Yearbook of Rural Household Survey of 2004*, China Statistical Press; Students number is from *the Statistical Yearbook of 2004*, China Statistical Press.

As per Table 2, we may partly understand why labor shortage appeared in 2003 and 2004 from the angel of labor supply. The first row of the table indicates there are 47 percent of rural labor forces who have already worked out of township. If we assume that the laborers below age 25 have similar distribution between migration and local off-farm work[①], then we may estimate that there are 70 percent of rural labor forces working out of agriculture. With economic development and increasing demand for labor in non-agricultural sectors, if the firms still keep strong preference to those young labor forces, it will be very possible to face labor shortage. On the other hand, to dig out the potentials of labor supply, it is essential to make good use of the labor

① According to the rural household survey (refers to *the Yearbook of Rural Household Survey of 2004*), there were 169.5 million rural labor forces who worked out of agriculture.

forces whose age between 40 and 60.

Increasing Human Capital Accumulation

In addition to quantity concerns, improvement of the quality of labor forces is another means to exploiting labor supply. Accumulation of human capital is also the necessary preparation for upgrading the industrial structure. The practice of Newly Industrialized Economies has already proved that accumulation of human capital was one of the essential drivers to push economic growth. China has the similar process of human capital accumulation to NICs. For example, in 2004 Chinese working labor forces had similar educational attainment with those in Korea in 1990 when the latter just finished the period of high speed of economic growth.

However, China has its unique pattern of demographic transition. As we have already noted earlier, the younger labor forces who were educated during the period of the Reform and Opening-up are not surplus anymore, while the old labor forces with low human capital seem to be incapable of working out of agriculture. Therefore, in the next decade, the focus of increasing human capital accumulation will be put on the old labor forces and the means to this group of people differs from the younger generation. For old labor forces, training and skill development are important rather than formal education. Figure 3 displays the distribution of educational attainment by age group in 2008 predicted from mini-census data conducted in 2005 by NBS, which indicates that the old labor forces have low educational attainments that mostly are below junior high school.

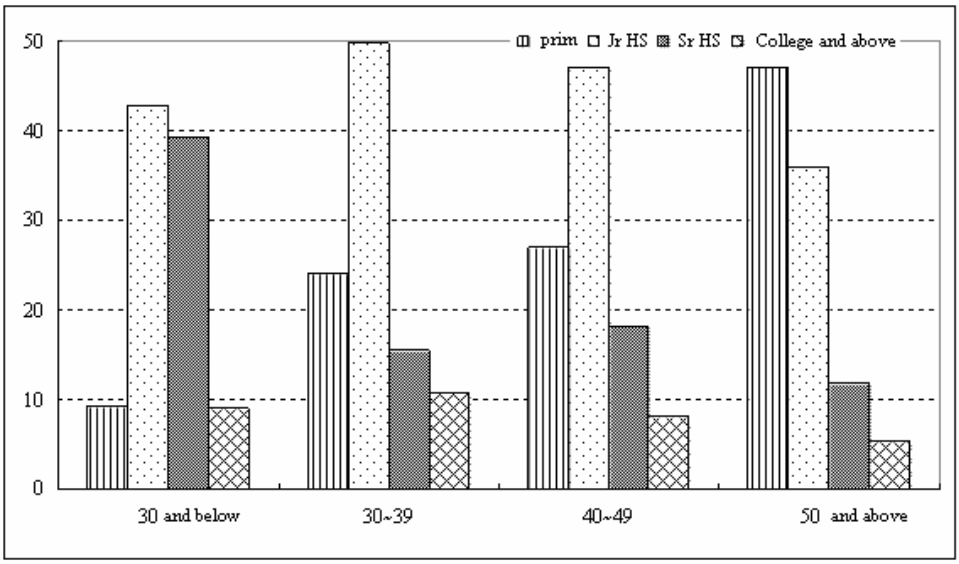

Figure 3 the Distribution of Educational Attainment by Age Group in 2008

Source: Institute of Population and Labor Economics, *The Report on Recent Trend of Employment and Social Securities*, mimo, 2007.

Given such a distribution of education attainment among labor forces, in addition to formal education, the training system plays more important and timely role in contemporary China. For those aged labors that have low level of educational attainment, as shown in figure 3, it is hard to increase their human capital through formal education system. In contrast, some appropriate skills may be helpful for them to participate into urban labor market. Considering that young labor forces in rural areas are nearly exhausted (the other paper by Cai in this book), it is more important to make good use of the old group of labor forces than ever before. According to the survey done by NBS (NBS, 2006), in 2005 the proportion of migration workers who were trained accounted for 34.4 percent of total migration workers, while in 2004 the number

was 28.2 percent. The number indicates there is a large share of migration workers who need to be trained. As far as the farmers remaining in agriculture are concerned, the necessity of training is even more urgent because they mainly consist of labor forces with low educational attainments.

Labor Force Participation

The East Asian Miracle in last century has already showed that increasing labor force participation rates and high level of human capital accumulation are two main drivers for economic development. To large extent, the economic growth pattern in China presents similarities with those economies. Before accomplishment of transformation of economic structure, high saving rates, high investment rates, and labor and human capital accumulation are necessary means to sustain high rates of economic growth. In China labor market participation rates have kept decreasing in the past decade, and this has been particularly true in urban labor market, as shown in Figure 4. The reason of why China can keep the growth pattern of factor accumulation when the participation rates keep declining is because China has large population base with desirable demographic structure. Once the demographic dividend disappears, rising participation rates will be expected as a source of factor accumulation.

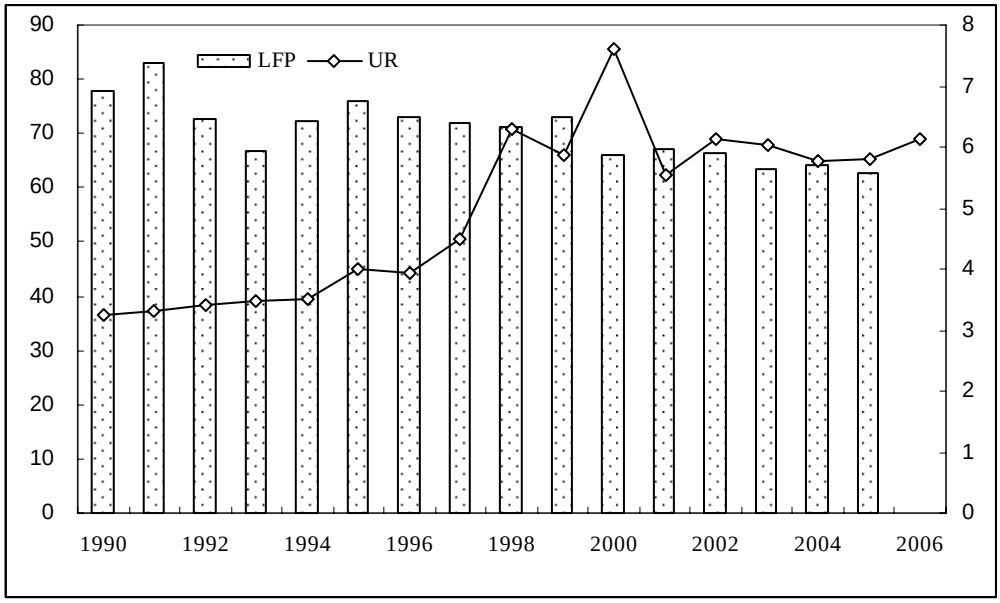

Figure 4 Labor Force Participation and Unemployment Rates in Urban Labor Market

Source: Calculation from NBS, *China Statistical Yearbook* (various years), China Statistical Press, and NBS, China Population Yearbook, *China Statistical Yearbook* (various years), China Statistical Press.

An idea of declining labor force participation rates could be understood from the following basic facts. First of all, during the era of planning economy China had a relatively high labor force participation rate in urban areas compared to other economies. At that time China has implemented an economic strategy prioritizing the development of heavy industries. As a guarantee to the strategy, a dual social structure that segmented rural and urban areas has formed in order to transfer and accumulate the agricultural residuals for supporting industrialization. In urban areas, a comprehensive employment policy was carried out, which led to high labor force participation rates in urban areas. For that reason, the trend is partly regressive to the participation rate a market economy would be.

Second of all, however, a radical economic restructuring of SOEs had taken place since the middle of 1990s. With economic depression

after Asian Economic Crisis, a shattering of “iron bowl” not only brought about laid-offs and unemployment but produced discouraged workers in urban areas. That is why we see a dramatic decrease of labor force participation rates since the middle of 1990s. In particular, women tend to be a more disadvantaged group in response to the labor market shocks. According to the evidence from China Urban Labor Market survey collecting data in five big cities, from 1996 to 2001 women’s participation rates decreased 10.6 percentage points while their male counterpart decreased 6.9 percentage points at the same period (Cai, et al., 2004).

Finally, improvement of social protection system in urban areas also has an effect to lower the labor force participation rates. For instance, since 1993 China has set up Di Bao (Minimum Income Support Program) system, a social assistance program in urban areas by subsidizing the households whose incomes per capita are below the local line. According to Ministry of Civil Affair, per capita cash benefit for urban Di Bao recipients is estimated to be 936 Yuan per year for 2006. Since the Di Bao benefit has separated from employment status, it is inevitable to create of incentives to quit from labor market.

However, the declining labor force participation rates are contradictory to current economic growth pattern in China. In particular, when the declining trend could be attributed to institutional factors, it is better to think about increasing labor supply through stopping the declining trend. For instance, population above age 16 was 933 million in 2005, which means that one percentage point increase of participation rate will increase 9.3 million of economically active persons that are a big amount of human resources.

Two factors affect labor force participation directly. One is real wage rate on labor market and the other is the reservation wage rate. By an extension of this logic, factors affecting the two rates have impacts on labor force participation rate. As the Lewisian turning point coming, the wage rate started rising, which serve as an essential precondition to increase labor force participation in the future. In addition to the basic market forces, some institutional changes, such as reforming welfare

system and public service, improving labor protection and the like, will also have effect on increasing labor force participation.

Treatment to Structural Unemployment through Flexible Labor Market

In recent years, shortage of migration workers and unemployment of colleague graduates have taken place simultaneously, which implies the coexistence of robust labor demand and structural unemployment. According to the concept of labor statistics, the human resources will not be employed efficiently, even with high participation rate, when facing high unemployment rates. For that reason, it is a good way to dig out the potentials for labor supply by reducing current structural unemployment.

At present, two factors contribute to the unemployment of college graduates. First of all, labor market information is not delivered efficiently between supply side and demand side. For instance, some emerging industries have strong demand for skilled labor whereas the educational system can not respond to the changes effectively. Therefore, governments take efforts to passing on labor market information that will be helpful to reduce structural unemployment. Second of all, more importantly, it is urgent to change current educational system that is supply oriented into one that is demand oriented.

There are two implications for demand-oriented educational system. First, in terms of education input, directions of educational investment ought to be determined by labor market demand. Second, arrangement of what to be taught and adjustment for educational structure ought to rely on the signals on labor market. Therefore, a desired education system is able to allocate the public resources efficiently and guide the direction of private investment into education effectively. Meanwhile, it is necessary to have flexible structure within the system so as to adapt labor market and economic development.

III. Policy Reactions to Labor Shortage

As described before, some institutional barriers restrict labor supply through affecting real wage rates or one's reservation wage rates. Meanwhile, policy may have different impacts on different groups of people even for those who work in the same labor market. For instance, the segmented welfare system, public service system, and hukou system may have more impacts on rural migration workers while some other institutional arrangement like retirement and contents and benefits of social security could influence local workers more. The following part describes possible policy reactions that could be helpful for digging out the potentials of labor supply.

1. Unification of Welfare and Public Service Provisions between Rural and Urban Areas

In recent years, the voices of reforming *hukou* system arise frequently and the reforms have been practiced at local level. However, it turns out that unification of the welfare system between rural and urban areas that is based on the hukou system is not an easy work. The current welfare system relies on hukou to identify the locality of citizens. From that point of view, in spite of the positive effects of reforming on hukou system, it still has a long way to go if China wants to bridge the gap of welfare system between rural and urban areas. Through reforming current welfare system, migration workers real wage will increase. In addition, the reservation wage will be decreased by removing some institutional barriers. As a result, the labor supply will increase. We will analyze some policy reaction in details as follows.

Urban Housing System

Housing const consists of a large fraction of living costs for migrants. In the past decade, China has reformed the previous housing system in urban areas dramatically. Although the reform took emphasis on increasing efficiency of distribution of housing, the plan rarely considers rural migrants demand for housing during the era of rapid

urbanization. Therefore, migrants' demand for housing in urban areas is difficult to be satisfied, which becomes a constraint for them to provide labor supply.

At present, the housing system has been highly marketised. When facing with the housing demand driven by high income group, the developers have low incentives to meet the demand of low income people who mainly consists of migrants. Since the migrants can not afford the housing in the system, they tend to live in suburb or shanty town where the housing price is low and lack of necessary facilities and social service. However, many cities are in the process of new construction, which is a movement demolishing the shanty town and in turn increases the living costs of migrants. Experiences in other developing countries suggest that reducing the possibility of access to low-priced housing would not stop the migration flows into the cities. Instead, the decreased provision of low-priced housing would raise the living density of current living areas. Combining with the bad infrastructure and low level of social service in their living areas, the migrants' living conditions would be even worse (Alain et al.， 2006).

In fact, the housing market in urban areas consists of both rental market and buying market that are complementary to each other. For migrants, development of rental market is very important to meet their demand for housing. Because the tenants do not have to pay a big lump-sum payment, the expansion of rental market ought to be directed to alleviate rural migrants' economic burden, which required the government to help develop private rental housing so as to meet the housing demand of migrants.

As shown in Figure 5, in the most market economies, the rental market accounted for 25 percent to 40 percent of total housing. In China the share is only 15 percent while 3 percentage points are private. It is helpful for solving the housing problems of migrants by encouraging the development of private rental market in urban areas. The other thing that requires governments' efforts is provision of social service in migrants living areas, including clean drinking water, heal service in communities, public safty, and so on, which lower down the living costs of migrants in

the cities.

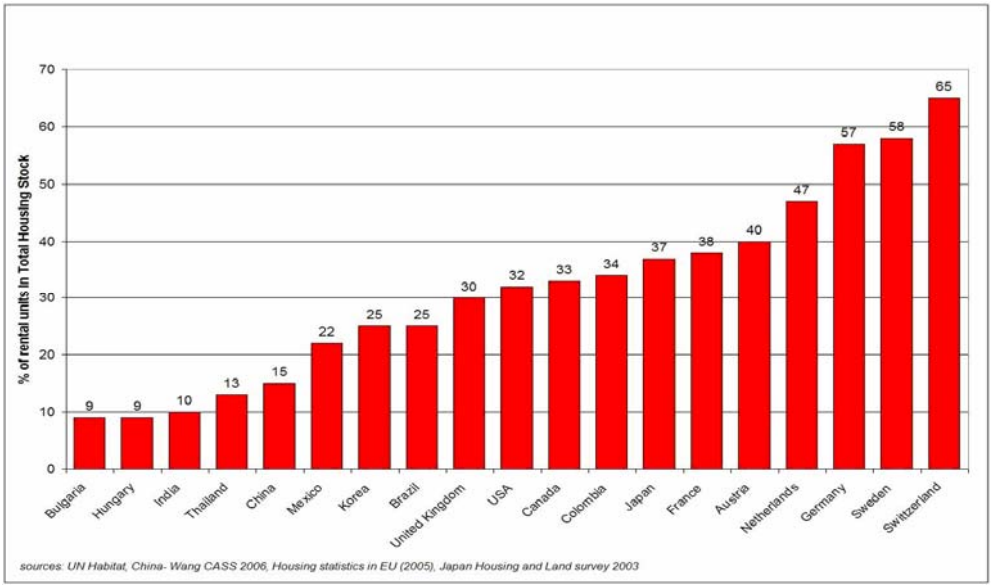

Figure 5 Share of Rental Units in Total Housing in Selected Countries.

Source: Cite from Alain Bertaud, Jan K. Brueckner and Yuming Fu (2006), "Managing Urban Development in Chinese Cities", Working Paper Submitted to CERP.

Stable and affordable living conditions will be helpful for rural migrants to increase their labor supply in urban labor market. On the one hand, the decreased living costs and improved quality will attract more rural labor forces into urban labor market, which will increase the labor supply in urban labor market. On the other hand, improvement of living conditions will decrease the frequency of job turnovers increase the actual working time.

Education Service for Migrants' Children

Once the cities can not provide enough opportunities for migrants children or the costs of education is too high for them, migration

workers tend to reduce their labor supply in urban areas because high education expenditures actually reduce their real wage rates. In recent year, education service for migrants' children has been an issue that is widely discussed by the public and academic circle. The central government has carried out policy that helps migrants have access to compulsory education in urban areas and increase the equity of education system. For example, in 2003 the State Council issued document that clarifies the destination regions should subsidize the schools that accept migrants' children. In some provinces with large number of migration in-flow, governments have already included migrants' children into local compulsory education system. However, because the segmented education system between rural and urban areas has been implemented for a long time, it takes time to bring into better balance the relations between areas, in particular the obligations of compulsory education and fiscal accountability. Before formation of a suitable education system, a mixed compulsory system including formal public schools and temporary schools for migrants' children will be helpful to meet the demand for education.

Although the urban facilities of education have already been opened to migrants in general, the migrants rarely utilize them due to their limited affordability. Therefore a large proportion of migrants still need some affordable education service in the cities. Migrants schools are such facilities that an effective complementary to current system. However, as per current regulation on education, migrants' schools have to reach the minimum standard of running school that is actually too high for migrants. As a result, the regulation limits the provision of education service run by migrants themselves. For example, in 2006 there were 350 migrants' schools in Beijing and most of them did not hold license. Among 40 migrants' schools in *Haidian* District, *Beijing*, only three of them were issued license. In July of 2006, the District closed the rest of migrants' schools that did not own licenses, which leaded to about 10 thousand migrants' children with difficulty to find other schools (Liu, 2007). In fact, as complementary to urban education system, schools run by migrants themselves have positive effect on

meeting migrants' education needs. Simply closing down those schools is not right way in administration.

Health Care for Migrants

Health care is one of the important components of public service. Due to the legacy of rural and urban segmentation, there exists a huge gap of health care service between the rural and urban residence. In recent reform, Urban Basic Health Insurance for Employees has become the main solutions to health care issues for urban workers. However, there is no arrangement of health insurance for migrants who work and live in the cities. Migration workers work on jobs with risks or high intensity that will probably damage their health[①]. The only choice for those whose health was harmed is to return their hometown. Health issuance for migration workers not only will be good for their human development but for sustainable labor supply.

In recent years, New Collective Medical System has been introduced in rural China. Central government, local government, and the households share the input. Although the NCMS is still in the process of experimental, it expands very fast over time. In 2006, 40 percent of counties have implemented NCMS and the proportion is over 80 percent in 2007. The NCMS significantly increased the rural residents' welfare in terms of health care. However, as per current design of the system, migrants who work and live in the cities have to go back to hometown for using the system. Due to lack of portability between regions, the system could not play role on encouraging labor mobility.

Labor Protection

① Study on relationships between health status and working intensiveness refers to Yang Du, Gregory R. and Meng, X. (2006), "The Impact of the guest-worker system on poverty and the well- being of migrant workers in urban China", in *The Turning Point in China's Economic Development*, Asia Pacific Press, Australian National University.

Protection for effective labor supply should not solely rely on ex-post health insurance, but on beforehand protection. Compared to urban workers, the occupational distribution of migrants is more concentrative in dangerous ones. If no relevant means to protection, migrants are possible face with high occupational risks. It is necessary to have strict regulation on working safety in some risky sectors. Meanwhile, passing on the information of occupational risks among migration workers is also essential.

2. Increasing the labor supply of urban labor forces

As we have already seen in the previous part of this paper, labor force participation in urban China has been declining, which means that reforming current institutions could be a source of increasing labor supply in urban areas. During the period with fast economic growth and strong labor demand, the declining is not driven by shrinking demand for labor but by rising reservation wages. It is evident that an increase of non-labor income leads to growing reservation wage. So the following areas should be concerned when China face Lewisian turning point.

Retirement and Labor Supply

As noted earlier, with aging, China will more and more rely on the old labor forces. However, the institutional arrangement for retiring can not meet the challenges brought about by the aging society and economic development. The following reasons indicate that improving retirement system will be helpful to make use of urban labor forces.

First of all, China need raise the official retirement ages that are pretty low compared to other economies. According to current regulation, the official retirement age is 60 for male workers and 55 for female. In some sectors or occupations, the official retirement ages are even lower than the criteria. In the case of increasing life expectancy, the criteria are not appropriate for using of old labor forces.

Secondly, China need eliminate the differentials of retirement age between male and female. The gap is not in conformity with the principle of equity in labor market and not good for making use of female labor forces whose life expectancy is actually longer than male. It is obvious that the regulation limited labor supply of female workers.

Finally, China need control early retirement as much as possible. Since the official retirement age is set up at low level, early retirement is going to decrease labor supply further. As Table 3 presents, the actual retirement age in China is lower than other developed economies. Based on urban household survey conducted by Institute of Population and Labor Economics in 2005, the average actual retirement age for male workers were 55.4 years old and 49.3 for female workers. Hence, there still exist potentials for labor supply in urban labor market if relevant institutional arrangement is applied.

Table 3 Aging and Actual Retirement Age in Selected Countries

	Total Population in 2005 (million)	65 and above (%)		Old Dependency Ratio in 2005 (%)	Age of Actual Retirement (2005 for China and 2004 for others）
		2005	2030		
China	1307.6	7.2	15.8	12.7	51.0
EU-25	459.5	16.6	24.7	24.8	60.7
United States	295.1	12.4	19.6	18.5	60+
Japan	127.6	19.9	29.6	30.0	60+

Source: data for China come from China Urban Labor Survey II, conducted by Institute of Population and Labor Economics in 2005, others from http://www.europopulation.org.

The Level of Benefits

To deal with labor market shocks in economic restructuring, some negative policies have been implemented. As the means to maintaining

the stability of society, the policy instruments are indispensable. However, the implantation of the policy is simply through income transfer to the unemployed or who quit out of labor market, which increase non-labor income and in turn raise the reservation wage. Once the level of income transfer is not designed correctly, it will have negative impacts on labor supply. Study on non-working duration and income transfer has already indicated that some policy tools did reduce labor supply (Cai, et. al, 2005).

The social security is the same case. To ensure that the social security system does not have negative impacts on labor supply, the focus is on increasing coverage, unification of the system between the rural and urban areas, higher level of pooling, and improving the portability instead of raising the level of benefits.

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