

# Háskóli Íslands

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The Political Economy of Household registration system in China.

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Sages say the path (to salvation) is narrow and difficult to tread, narrow as the edge of a razor.

Katha-Upanishad

## Introduction.

This research paper, presented as a Bachelor thesis, will address few crucial aspects of function and future prospects of household registration system, hukou 户口, in People's Republic of China 中华人民共和国. Our perspective will focus on interplay, interdependence and indivisible nature of political, legal and economic aspects, underlying the scope of available policy choices leading to reform of this often contested system of institutionalized discrimination. In our perspective, hukou system has profound influence not only on labour market, dynamics of economic development and factor allocation efficiency, but more importantly it determines well-being, self-satisfaction and fulfillment of personal capabilities within polity, with profound and significant ramifications for future realities of state-society relationship and the character of social contract that would shape basis of narrative known as culture.

We will proceed from brief summary of legislative and institutional framework of household registration system, followed by outline of the Open Door Policy 改革开放 and economic reform in China from early 80's to present, in country specific context, concluding with historical overview of the process of urbanization 都市化. Declaratory in nature, yet a commitment of new Chinese leadership to abolish household registration system till 2020 (Ecns, 2013) and its prospects will be briefly summarized in concluding remarks of this paper.

### 1. Household registration system in context.

The core component of the hukou system is Household Registration Ordinance 户口登记条例, which was formally legislated at the National People's Congress 全国人民代表大会 in 1958 as Regulations on hukou registration in the People's Republic of China and is still in

force nowadays.(Wong, 2011)The system of household registration had initially been meant to monitor population movements, but as Naughton (2010) argues, the rigidity and strict enforcement grew directly out of the trauma of Great Leap Forward 大跃进, gross economic mismanagement of industrialization policies and famine, partially caused by large numbers of farmers moving into cities in search of better paying jobs. After successful agricultural reforms of 80's, accompanied with rise of productivity in rural economy administrative restrictions began to loosen.

A new willingness of political leadership to pursue reforms that dismantled the privileged status of large segments of society due to restructuring of State Owned Enterprises 国有企业 (SOE's), that provided social security and public benefits to its urban employees. The hitherto sacrosanct status of urban workers in public enterprises was substantially altered by marketization. New policies lowered barriers to migration to the cities and abolished the guaranteed employment of public enterprise workers.

What Unger (2002) calls "atmosphere of palpable tension" toward migrants became evident across whole China, not exclusively in urban setting. Decades of immobility for peasants did contribute to considerable rise of inequality between different parts of rural China, depending on great variety in local climate, quality and fertility of soil. Movement of peasants from richer areas, particularly in south China, to cities and newly established Special Economic Zones (SEZ) 经济特区 was accompanied with movement of peasants from poorer areas to replace lack of agroworkers caused by their migration. Lease of land for agricultural produce or contracting unwanted marginal land were common, however, peasants from poor areas in general formed new rural underclass for hardest and dirtiest labor in rich agricultural areas, undesired by peasants with access to jobs in cities or non-agricultural entrepreneurship.

Moreover, contrary to popular believes of general public in Western countries, empirical research (Hu et al. 2008) suggests that cultural prejudice based on ethnicity in China, became decoupled from institutional discrimination of rural population. Thus, Han migrants from rural areas become subject of class and status discrimination by members of ethnic minorities with urban household registration, I.e institutionalized discrimination of urban against rural proves stronger or at least more continuously present than non-institutionalized prejudice between members of different ethnic groups.

Although few wealthy cities could afford to moderate the costs of SOE's workers due extensive retraining and generous early retirement policies, most localities were not able to provide such ample social protection. (Rawski, 2008) Here we can find an important feature leading to opposition of local and municipal governments towards loosening barriers to migration and limiting provision of public goods for non-hukou holders.

Along with macroeconomic stabilization following in early 90's inefficiency of labour markets, in conjuncture with bundle of pro-urban provisions, the central government allowed local governments more freedom to formulate their hukou policy in 1995. Local governments could then regulate the flow of migrants by setting quotas on employment certificates. Individuals lacking the required documents could be expelled from cities. To protect urban workers from job competition from migrants, some local governments issued discriminatory employment regulations, for example, restricting migrants from working in specific occupations or imposing high fees on migrants entering the city (Cai et al. 2011). Some local governments also cashed in on the migration tide by selling urban hukou or providing urban hukou to migrants who invested a minimum amount of money or purchased commercial housing (i.e., blue-stamp hukou). (Cai et al. 2011) Practice of easing requirements for qualified workers or educated professionals was also introduced by some municipalities.

In February 2004, the central government endorsed migration as a key vehicle for increasing the incomes of farmers and demanded the elimination of all fees targeted at migrants as well as equal treatment of migrant children in urban schools. However, implementation of the new measures has been slow and uneven. (Cai et al. 2011) Thus, notwithstanding recent local hukou reforms, there remain obstacles to migration from rural areas to cities, from interior to coastal provinces, or even from city to city, because most migrants are denied access to affordable health, education, housing, and pension coverage to which urban residents have access by right. China's rising inequality is largely the result of inequality of opportunity; one's connections, place of birth, employer, and parental circumstances still play a large role in gaining access to critical social services. (World bank, 2012)

Naughton (2006) concludes that administrative barriers could be divided into two main categories by their economic origins and economic consequences. We will address those in following chapters. This on a background of indivisibility economic, social, cultural, civil and political rights as recognized in myriad of international treaties and declarations, inasmuch due to necessity of free movement of all four factors within economic union that China aims to become, I.e people, services, goods and capital.

## 2. Economic transformation.

Socioeconomic process started in China after 1978 is broadly known as a reform. It had profound impact in development of polity and household registration system did play significant role in decision making process inasmuch as its framework influenced general public in broad sense of equity, equality, access to public goods and life chances. It is therefore necessary to address few issues raised by transformation of planned economy into what is being the current

state of affairs, defined differently by political actors and observers, ranging in terminology from 'socialist market economy' to 'capitalism with chinese characteristics'.

The internal migration or migration from rural to urban settings has been a central issue in theories of International Political Economy on development. In case of China, internal migration plays crucial role in efforts generally glossed as urbanization, industrialization and modernization. The relationship between internal migration and economical development reflects dynamic development we try to describe in its progressive stages. In a similar fashion than in Western societies, introduction of the market economy, modernization and mechanization of rural agriculture that was accompanied with a shift in property rights distribution from collective to household and state-led, pro- profit economy had produced large surplus labour in rural China. Vast majority of these mobile peasants are known as a 'floating population' 流动人口, because they left their domicile in search of subsistence in cities without becoming a part of registered community of city dwellers (Ballam et al., 2008).

Development of the country has been very uneven from beginning of the reforms, characterized by deliberate exploitation of the rural population, particularly in 90's, but persists as major feature contributing to big differential in quality of life between regions, provinces, but due to system of hukou, even within the administrative units themselves.

Literature generally classifies reforms into few phases or periods depending on policy choices within wider political context. As in many transitional economies, China shares a legacy of governance in which bureaucrats, technocratic and newly emerged capitalist class have great discretionary power in decision making or leverage to pursue their objectives.(Rawski, 2008) Here again, the policies of "decentralization of power and devolution of resources" that characterized the first fifteen years of reform did experience the reversal (Huang, 2011) when the different structure of political power



in the 1990s, due to partly the policy change after crushing of protests on Tiananmen square 天安门广场 in 1989 and the collapse of “elder power” in 1992, I.e generational change in leadership of Chinese Communist Party 中国共产党 resulted in a qualitatively different response to socioeconomic realities (Rawski, 2008).

Ruo (2006) summarizes different stages of reforms into six main periods. In brief, the institutional evolution in the Chinese economy since 1978 has followed a path that might be outlined by the six phases listed below:

1. centrally planned economy (before 1978);
2. economy regulated mainly by planning and supplementally by market (1978–84);
3. commodity economy with a plan (1985–87);
4. combination of planned and market economy (1988–91);
5. socialist market economy, state ownership as the main form (1992–97);
6. socialist market economy, public ownership as the main form (from 1998 onwards).

For our purposes we use simple division of policy changes between 80's, what Huang (2011) would call entrepreneur capitalism based on TVE's model, 90's characteristic for its urban bias of Shanghai leadership of CCP, its centralization effort through tax reform and leadership of Hu Jintao 胡锦涛 and Wen Jiaobao 温家宝 with their renewed attention to rural economy, reform of social system and massive stimulus package following financial crisis in 2008.

According to Huang(2011) developments after 90're-centralization efforts dramatically changed reform process. Dynamics shifted from driving force of mainly de facto privately owned explosive

entrepreneurship of Township and Village Enterprises 乡镇企业(TVE);, that helped to move rural labour from agricultural to higher value added non-agricultural activities with raising productivity levels, into state-led urban capitalist model, characterized by investment driven growth, based on high Foreign Direct Investment, massive infrastructural developments, and policy of creating 'national champions', i.e large state sponsored companies alike in Newly Industrialized Economies of East Asia. Policy rational aimed to accomplish steady agroproduce to supply cheap food for cities and industries accompanied by agricultural subsidies, favoring agro-produce and disadvantaging non-agro produce returns in rural areas.

The state in early 90's pursued highly regressive taxation system toward local governments, introduced by tax reform of 1994, combined with pro-growth policies and unclear and unenforceable system of property rights, that led to loss of land, I.e means of production, for millions of peasants. State – provided services at the same time declined dramatically, contributing to large scale of peasant migration to heavily subsidized urban centers.

The recentralization effort of central government through tax reform meant a shift from the old contract system, which gave provinces significant gambling power to direct control of centre over tax collection. Move from discretionary system to rule-based system with unified ratio of revenue sharing across provinces, which gives centre more resources for intragovernmental transfers, however also meant the loss of control over local income tax, which was a important instrument effecting enterprise behavior. (Ma, 1997) Local governments have become even dependent on enterprise income tax after 75 per cent of the newly introduced value-added tax and 100 per cent of the consumption tax were assigned to the central government under the tax-sharing system. Reform reversed local budgets from surplus to permanent deficits with opposite effect on budget of central government. Revenues of central government rose

steadily for over a decade. We are seeing a period when “agriculture supports industry” 农业支持工业.

Local governments were obliged to make more expenditures, center achieves leverage through its control over of revenue collection and redistribution.(Naughton, 2006) Uneven economic performance on local level, in conjuncture with retention of income tax revenue, nevertheless gives more independence and political influence for more affluent provinces and municipalities, which as in case of Shanghai 上海, in fact significantly lowered their relative proportional contribution to national budget. Even prior to reform, the contribution of major cities was in decline, for instance in decade from 1970–1980, Shanghai gave 50% of its GDP to poorer provinces but gave only 8.5% in 1993. (Asian Development Bank, 2006)

There is even an proposed argument that suggests the household registration or hukou system together with other administrative controls on population mobility may have provided additional rent-seeking opportunities for the local authorities to raise extra-budgetary revenues from myriad of fees (such as temporary residence permits) from migrant workers. (Tsui et al. 2004, Kwong, 1997)

For understanding impacts of policy decisions on peasants, reforms of industrial sector in 90's prove illustrative. As large SOE's reorganized in attempt to rise efficiency and output, many high paid urban workers, with some degree of social and housing provisions provided for them, were replaced by low-paid migrants employed on de facto permanent basis, but classified under their temporary status to enhance cost saving effect. Due to the rising competition between TVE's in 90's, these in practice adopted similar strategy replacing locals with migrant peasants from poor areas, so their collapse in late 90's imposed highest social cost on poorest peasants losing work without appropriate compensation or safety net. After the state deliberate withdrawal from domination in countryside weakened its

hold over the conduct of rural officials, who often had a controlling stake in these 'shareholding cooperative enterprises', I.e TVE's, in conjuncture with their authority over public provisions (Unger, 2002), often left migrant workers as most vulnerable stakeholders, deprived of appropriate protection and compensation.

Members of this floating population, save for those of high educational achievement, specialization or members of military forces, become de facto illegal immigrants in their own country (Ballam et al. 2008). Often they become ruthlessly exploited by their employers with little effective recourse to protection of their rights, casually leading to strikes, riots, protests 突发性 群体 事件 and personal tragedies as suicides in modern sweatshops of foreign corporates keeping cozy relations with local officials, due to their preoccupation with both personal enrichment and economic growth.

Combined effects of crackdown on informal finance and fiscal centralization in mid 90's further worsen the situation of TVE's that faced significant liquidity restraints, which contributed to their downfall in late 90's. This events are important for us since returns from labour contribution in rural areas steadily decline in this period as relative to labour contributions from migrant labour, which together with overcrowded local rural labour markets contributed to rise of what would become a wave of labour migration unprecedented in human history, so called age of migration (Zai, 2001).

Final ban of informal finance in 1998 might be partly explained as state effort to eliminate a competition to state owned banks and preventing drawing resources away from industrial policy of central government. (Huang, 2011). The relevance of this policy shift lays in importance of informal economy, i.e. part of the economy that operates outside of direct control or regulation by the government, often a crucial factor of grass-root entrepreneurship.

In view of De Soto (2000), capital is a key to unlocking this grass-root potential for economic growth. As he articulates the problem, lack of property rights in main or only source of capital for

peasant, I.e land, prevents peasants of its efficient use and subsequently blocks movement to higher, non-agricultural productivity activities. For the poor to become capitalist, they need access to property rights to their land or micro-capital available on collateral for their property. So credit, a key to economic development, was drained from TVE's and small peasants preventing them to upgrade towards non-agricultural produce, largely due to political line of the so called Shanghai leadership of CCP. The rural entrepreneurship got deliberately disrupted by central authorities in favor of aforementioned strategy of state-led large scale industrial and infrastructural development. Moreover, central government decision accompanied another important feature of the fiscal reform, I.e introduction of fixed exchange rate regime of RMB 人民币, chinese currency (Balaam et al. 2008). The move brought about a need to significantly increase foreign currency reserves to back a set rate of RMB in world market, which furthermore intensified pressure on export industries and bias towards smaller entrepreneurship without realistic opportunities to compete on global markets.

In recognition of, inter alia, growing income inequality and danger to party legitimacy, leadership of Hu Jintiao advanced set of policies under the slogan of 'Harmonious society' 和谐社会. The objectives did include the effort to balance the policy of uncompromising high economic growth, addressing issues of growing wealth gap and improving social services for holders of non-urban hukou in cities and rural population in general. With shrinking external demand, the Chinese government has put forward a massive stimulus package targeted toward the rural and interior regions, in an attempt to boost domestic and rural demand. Consequently, the policy discourse in China on regional inequality, and on inequality generally, is very different now than even a decade ago. Not surprisingly, in the first two quarters of 2009 the inland regions have enjoyed faster GDP growth than coastal regions. (Fan et al. 2009)

Ironically, stimulus as a response to global financial crisis put China back on its road of investment driven growth from structural objective of rising household consumption. (Naughton, 2006)

On the side of legal protection, significant development in protection of sweatshop workers by new labour law and abolishing of agricultural taxation for a first time in few millennia in history of Chinese state of 2006 came to force and more importantly new social security law of 2012 became a blueprint for progressive establishment of unified national wealth-fare system.

## 2.1 Chinese economy and state.

To resume our discussion or any discussion on Chinese economy, Madison(2006) reminds us that at least two basic points should be taken into account :” (.).. first, China’s vast territorial size and the diversity of physical environments and natural resource endowments have inevitably resulted in considerable regional economic differences; secondly, China has a population of more than 1.3 billion, comprised of 56 ethnic groups. It is geographically divided into 31 provincial administrations, each of which would have been equivalent to a medium-sized country. Furthermore, all of the provinces are independent from each other in terms of developing local fiscal, tax, labor and trade policies and economic development plans which have, *ceteris paribus*, resulted in differing levels of regional economic performances in China.”

Central government is unified around a policy that has been called “market preserving federalism.” This form of federalism limits the central government’s control over economic decision making, promotes creative competition among local governments, supposedly constrains rent seeking by officials, and provides incentives to induce creative local enterprises. It is also apparent in the design of the tax system, which has often been called “fiscal federalism,” and which is aimed at preventing taxation from stifling economic growth. In the

tax reform of 1994, the central government limited its primary administration to Value Added Tax and taxes on centrally owned enterprises. It also set up local tax bureaus under the direction of local governments to supervise income taxes (Fogel, 2007). However, indicative, terms of tax-sharing and fiscal policy, should be seen in light of control mechanism shaping the allocation of resources. Here Tsui et al. (2004) identify a key component of vertical control system, the target responsibility system, which sets a performance criteria that gives upper-level governments levers to manipulate resource allocation on lower levels along the preferences of the centre. Since its diversity and complexity of legal and fiscal arrangements within China, we are also approaching one of the most decentralized systems of governance. Along the lines of unification mantra following incorporation of anglo-american shareholder maximization capitalist model, I.e 'one country, two systems', we might claim that China today with multifarious arrangements and substantially different modes of governance on regional level, internally presents indeed a model of 'one country, many systems'.

Fiscal decentralization greatly enhanced inter-county competition and promoted economic growth (Cheung 2008; Qian et al. 1998). However, with China's hierarchical governance structure, a region's government size is proportional to the number of registered inhabitants and the responsibility of financing local public goods services, such as education, healthcare and government employee salaries, is the same across regions. Wide regional variation in economic performance and development stages cause the effective tax burden to differ greatly across regions, despite the fact that the nominal tax rate is supposed to be the same everywhere. (Fan et al. 2009) Moreover, in his provocative analysis of first two decades of economic reform in China, Young (2000) presents an evidence pointing on development leading towards a fragmented internal market, composed of regional fiefdoms controlled by local officials with economic and political ties to protected industry. His conclusion

suggests the rise in interregional trade barriers compatible with data, which show that during reform period interregional outputs converged while interregional prices remained volatile or even, in sum, actually diverged. This supported by anecdotal stories of interregional trade wars periodically mitigated or rectified by central intervention.

The new ideology of the Four Modernizations 四个现代化, adopted since the beginning of economic reforms has transformed China's local governments into the developmental state responsible for local growth. (Zhu, 2004) Performance of the developmental state is predominantly measured by economic and physical growth, but resources of local governments remain inadequate, dependent on redistribution policies of centre. In sum, Chinese economy while proceeding towards remarkable degree of international integration seems to remain fragmented internally.

## 2.2 Policy experimentation.

In a settings of decentralized and fragmented provision of public goods, policy experimentation becomes often prominent feature of institutional innovation. From well known Special Economic Zones to various pilot and model programs that are being introduced throughout the country under basic assumption of their possible, even partial implementation on higher levels, if successful or beneficial.

Though the impact of reform experiments varies between policy domains, China's experimentation-based policy process has been essential to redefining basic policy parameters. At the heart of this process, we can observe a pattern of central-local interaction, characterized as "experimentation under hierarchy".(Heilmann 2007)

Following the idea of learning through practices, Deng Xiaoping 邓小平 established an experimental ground for market economy in various Special Economic Zones, asserted that it was a brave



experiment without a predetermined end. Whether the practice was successful or not largely depends on how much the progress can make (Deng, 1985). This tradition of learning through practice endures in the post-Deng era. Upon Jiang Zemin's 江泽民 ascension to the central leadership, he continued to adhere to this time-honored tradition. He encouraged the formal institutionalization of investigation and research, presuming that it could enable policy-makers to attain up-to-date knowledge of the fast-changing situation, so as to facilitate policy coordination and its scientific analysis.(Wong, 2011) This approach became later incorporated into Chinese constitution (2007), formalized as 科学发展观, the scientific concept of development.

Heilmann (2008) found that China's unexpected capacity to find innovative solutions to long-standing or newly-emerging challenges in economic development rests on the broad-based entrepreneurship, adaptation, and learning facilitated by experimentation under hierarchy. His research highlights the widespread usage of 'experimental points' and 'experimental zones' to conduct micro-level policy experiments. The combination of decentralized experimentation with ad hoc central interference and budgetary constraints on local governments, which results in selective integration of local experiences into national policy-making, is in his view a key to understanding how a distinctive policy process has contributed to China's economic rise.

In order to gain policy adaptability the mechanism of decentralized experimentation is fundamental. Wong (2010) argues that at the local levels, indigenous wisdom is combined with rent-seeking efforts of the local officials to produce innovative, experimental policies.

To describe this mechanism, Heilmann(2007) informs us, that the central government authorizes the jurisdictions that have been selected as official experimental points to try out new policy solutions.

The center also selectively extends generous subsidies and discretionary powers to the designated pilot projects that are obliged to report regularly to higher-up authorities. If several major national policymakers support the "model experience" of specific experimental points and agree to "proceed from point to surface," a new wave of piloting based on the "model experiment" is extended to a much larger number of local jurisdictions. However, affluent municipalities, such as Shanghai, are often acting on their own initiative.

A recent critic by Fan et al. (2009) has provided a contrasting point of view on a phenomena of selective implementation of central policies, which is relevant for us in addressing problems of decentralized and widely different rules for household registration change and transfer of rights. Fan & Woo (2009) put forward the idea of parallel partial progression (PPP), urging that simultaneous partial implementation of reform policies must be carried out, so as to minimize the cost of incoherence. This diverges from the foregoing viewpoints by proposing that the reform goal can be clearly identified at the commencement of the entire process, which is inconsistent with rather general and broad agenda of centre. Furthermore, the implication of PPP is that it envisions a predictable future (ie. with deducible reform pathways) and thus discourages learning through practice.

Academics with contrary views disapprove this by pointing out that it is infeasible for the government to act as a super-coordinator, not to mention the fact that the ultimate goal is usually loosely defined. (Wong, 2011). This is apparent in case of household registration system, where center defines its policies loosely, thus leaving space for local officials, commonly under pressure from citizens and interest groups in their constituency, to limit their household registration regulation to economic performance and welfare provided for holders of their household registration. Despite numerous reforms and micro-adjustments, the hukou system is still reforming in an on-going process. The fundamental principle of the

hukou system, I.e different treatment of citizens based on their local registration and origin, stood firm throughout decades and rural-urban distinction persists (Wong, 2011). In summary, Heilmann(2007), informs us that China's experience attests to the potency of experimentation in bringing about transformative change, even in a rigid authoritarian, bureaucratic environment, and regardless of strong political opposition.

Large-scale experimentation, stimulated policy of learning and economic expansion are quite effectively implemented in those sectors where political elites could benefit from supporting new types of private and transnational entrepreneurial activity. Conversely, experimental programs largely failed in generating an effective provision of social goods which would require a combination of active societal supervision and strict central government enforcement to make it work. Thus, various local reforms and general trend to loosen ramification of household registration system, which is in itself a broad set of policies, laws and regulations, which outline its routine functioning, brought little to mitigate social cost on migrant labour.

Decentralized system of public goods provisions and particularly the absence of transferability of social benefits between provinces and long term residence requirements even when it comes to intraprovincial transfer, remain crucial obstacles to effective human resource allocation and more importantly to equality among the citizens.

### 2.3 Fleeing geese within?

The flying geese paradigm (Akamatsu, 1962) originally used to explain economic success of Newly Industrialized Countries in East Asia, could be used to illustrate opportunities and challenges for further development and sustainable economic growth of China; as we tried to show, in itself composed from different regions with

different endowments and developmental achievement. We could therefore apply the flying-geese theory to the scenario in which industrial transfer happens not only among countries but among regions within a country with the unique characteristics of a large economy will lead us to conclude that labour-intensive manufacturing will not shift from China to other developing countries in a general way.

Industrial transfers depicted by the flying-geese pattern are directly engendered by changes in dynamic comparative advantage. That is, as a country's per capita income increases, its resource endowment changes over time. The transformation of the economic growth pattern, which has been preached by the central government for a very long time, I.e from from investment to consumption driven model, is in its nature a process of creative destruction. (Cai et al. 2009)

One of standard explanations for failure of this model in South East Asian context, where heavy investment to manufacturing industries and infrastructure lead to Asian Financial crisis (1997) instead of gradual industrial upgrading, can be found in lack of accessible markets for produce, which however might not pose a significant problem due to large and growing domestic consumer market in China. The success of flying geese paradigm might therefore contribute to policy objective of rising domestic consumption and its share of Gross National Product and also mitigate externalities, which stem from extensive dependency of Chinese economy on export. However, due to central governments policies, most notably China Western development plan 西部大开发 of building up an production base around metropolitan administrative units such as Chongqing 重庆 or Chengdu 成都, in conjuncture to nature of migrant labour with its wage discrimination and temporary nature, price distortion of production factors lead to the separation of relative comparative advantage from the real resource endowments in those

regions. Thus, instead of what would economic theory expect as smooth process of industrial upgrading in the country as a whole, there has been an alternative pattern in which newly emerged regions have jumped to an industrial structure with higher-graded manufactures, whereas the industrial structure of the early developed regions remains little changed (Cai et al. 2009). Evidence of industrial duplication and convergence in structure of production across regions is also found by Young (2000). This obviously strikes caution in the light of reputed extensive diversification and interregional variation under the plan.

Migrants face occupational and wage discrimination (Appelton et al, 2001; Hertel et al. 2006; Liu, 2005), which contributes to lack of incentives for industries in developed regions to pursue industrial upgrading, moving labour market further towards upgrading to higher value added activities and faster development of service and administrative labour markets in cities. Unlike generally generous increase of real purchase parity of incomes earned by urban population, labour cost and wages of migrant workers in manufacturing sector changed rather insignificantly. For instance, Meng and Bai (2007) found that, on average, real monthly total earnings of rural-urban migrants in seven factories in Guangdong increased 3.3 per cent per annum between 2000 and 2004. A survey administered by the All-China Federation of Trade Unions in 2006 found that 65 per cent of rural-urban migrants were working in so-called „Three D jobs“ (dirty, dangerous and demeaning) (Tao, 2006). One study of migrant workers working hours found that nearly twice as many migrants as urban residents worked six days a week, and almost 60 per cent of migrants worked seven days a week (Gao et al., 2010). Whereas the local governments often focus mainly on maximizing the direct benefits of migration for the locality (through, for example, keeping the migrant labour wages low), the central government is often caught between the dilemma of having to prevent drastic exploitation and abuses of migrant labour in cities on

the one hand, and maintaining China's competitive edge in labour costs in the global market on the other (Wang, 2005). Moreover, due to reform of tax system, enterprise re-structuring since the mid-1990s further highlights the distortionary impact of tax-sharing scheme leaving income tax fully with local governments when these obstruct inter-regional capital mobility in order to protect their tax bases (Tsui et al. 2004). In summary, there seems to be on going debate on just how integrated chinese economy really is, but we might perceive market segmentation as a lasting problem. Tsui et al. (2004), point out that, "(..)The incentives that drive local cadres to protect local industries and obstruct inter-regional trade and factor mobility were and are still at work." Recent labor market developments include an astonishing combination of excess labor supply with steep wage increases in the urban formal sector. Although wage increases reward employees with special skills, most do not. Barriers to interprovincial trade, restrictions associated with the system of residence permits, and other policies that limit the free flow of commodities and resources limit the growth of productive employment, inasmuch as restrictions that prevent companies from using market criteria to select and compensate managers and workers. (Kojima et al., 2005) Institutional and administrative barriers imposed on non-urban hukou population that forms large portion of permanent residents in cities contributes to diminishing a comparative advantage in regions with relatively lower average labour and factor cost and effective industrial transfers between regions.

### 3. Urbanization 都市化.

Another major area of our research concerns process of urbanization and policies associated with rapid and continuous growth of Chinese cities in the reform era.

China's urbanization rate is calculated on basis of permanent residence. According to this method, China's urban population rose

from 172 million in 1978 to 690 million in 2011. Urbanization rate in same period rose from 17.95% to 51.27 % (comparable to levels achieved by the US in the 1920s and Japan in the 1950s.). If we would count only citizens with urban household registration, urbanization rate would be only around 35% (HKTDC, 2013). China's urbanization rate is expected to hit 60 percent by 2018 at the current rate of urbanization, according to a blue book released by the Chinese Academy of Social Sciences (Xinhua, 2013). Urban economic analysis has, according to Kamal-Chaoui et al. (2009) repeatedly identified three economic benefits of urbanization, often called agglomeration economies:

- 1) urbanization economies, with large input and output markets are shared between industries;
- 2) localization economies, where firms rise productivity through the sharing of inputs related to their specific industry;
- 3) economies of scale, by the size of market input unit costs of larger means of production is reduced (Kamal-Chaoui et al., 2009)

To summarize, main benefits of urbanization for economic development are connected with rising productivity by moving from primary towards secondary and tertiary industries, which have higher productivity. Moreover, due to agglomeration, urban population tends to be more productive through technology spillover and knowledge sharing permitted by interaction and proximity (Zhu et al. 2013).

Both Henderson (2003), who brings convincing econometric evidence of undersized Chinese cities and Hoffman et al.(2013) are consistent in their findings that suggest that the direction of causality runs from GDP growth to urbanization, rather than from urbanization to growth. Pettis (2013) summarizes : " Urbanization itself responds to growth. Countries do not grow because they urbanize, in other words, they urbanize because they are growing and there are more good, productive jobs in the cities than in the countryside. In that

sense urbanization is not a growth machine. It is simply a pro-cyclical process that accommodates growth when growth is rising and reduces it when it falls.”

Furthermore Hoffman et al. (2013) find positive effects of industrialization and education on urbanization, which is consistent with function of localization economies. Official sources claim that for a year 2012, every one percent of GDP growth created 1.3 million to 1.7 million jobs in urban areas. (Xinhua, 2013)

Common argument persists of under-urbanization in China, when only 35% of population has a urban status and many cities are urban only due to administrative designation, which distorts statistical data that would result from standard methodology applied in developed countries. (Kamal-Chaoui et al., 2009)

Other often cited reasons range from migration cost and restrictions, capital deepening, I.e investment in capital heavy industries that do not create urban employment, but already in China present serious issue of production overcapacity; among others low real interest rate or policy orientation on creation of small cities and restricting the growth of big cities. Policies restricting the land supply, mainly to curb resistance of rural population, might also had an impact on under- agglomeration. Therefore, China’s urbanization level has increased at a rapid pace in reform era, but, remains by international standards lower, compared to its level of economic development (Zhang et al., 2008). Despite massive labor migration in the past several decades, there are still a large number of people residing in rural areas. Policies that facilitate the relocation of labor from low-productive sectors and regions to higher-productive counterparts would have a large payoff. (Fan et al.2009)

Few policies proposed by Chinese academics interviewed by this author to address the problem of under-agglomeration thus tend to emphasize current household registration system. These policy recommendations include portability of social security benefits, linking of land reform with hukou reform, I.e land quota



exchangeability for peasants and increase of share of local governments on tax revenue. Equalization of education resources accompanied with a reform of local/central transfer for education, based not on number of local hukou holders, but on number of permanent residents is of a major concern, with result of continuing exclusion of children of migrant workers particularly from tertiary education in cities with high disproportion on quota for local student/university to officially non-local students. Policies of positive selection of candidates for urban hukou based often on their educational achievement increased urban-rural educational gap, which contributes to low cost of human capital in rural areas. Bertinelli et al. (2004) remind us that productivity, as a source of economic growth, depends on human capital.

## 2.1 Policy development.

China has three main levels of local administrative entities: province 省, prefecture 地区, and county 县. Cities can exist at any level. For example, a province and a municipality directly under the central government are both at the provincial level; a prefecture and a prefecture-level city are both at the prefecture level; a county and a county-level city are both at the county level. (Fan et al., 2009)

Main feature of Chinese national urbanization policy is a strategy of small town development that supported motto of "leaving the land but not the villages, entering the factories but not cities". China's national urbanization policy evolved into three pillars: "controlling the big cities, moderating development of medium-sized cities, encouraging growth of small cities". (Kamal-Chaoui et al., 2009) This as we show forms a persistent trend of central planning of urban development.

Underlying Chinese government policy objectives, on purely speculative basis, we might at least partially confirm to finding of

Hoffman et al.(2013) that : "Political representation and access to power of the rural population are virtually nonexistent. Autocratic governments are able to make decisions without consideration of a spatially dispersed wider population. Instead, they rely on the support of small wealthy elites to stay in power. As a consequence, they will tend to strongly favor urban elites in the allocation of public resources. Such urban favoritism has implications both for consumption of public goods (e.g., health and education services) as well as for investment and economic growth (rural areas will receive less investment in infrastructure, which further deters private capital flows and impedes economic growth of these regions)."

Constraints of the hukou system, prohibitive to migration have decreased significantly during last years. However, even if rural migrant workers are entitled to work in cities, they have no access to the "five major social insurances" (old age pension, medical, unemployment, worker's compensation and maternity) which are all currently reserved for registered urban residents. Even the "Minimum Living Standard Insurance"(MLSI), which was introduced in the late 1990's, and now serves as the principal mechanism for alleviating poverty within the urban districts of cities is exclusive for urban dwellers. (Kamal-Chaoui et al., 2009) Similarly, the Unemployment Insurance Fund 失业保险金 and the Basic Living Expense 基本生活费 provided by the state, do not cover migrant workers.

This system, however proves to be an unsatisfactory motivation for migrants in smaller cities that lack resource base of large metropolitan cities, and therefore does not provide incentives for peasants to change their rural status to urban, where urban status does not hold much benefit. In contrast rural hukou brings variety of tangible entitlements, including a courtyard house, farming subsidies and proceeds from lease or rent of farm land. Moreover, well documented struggles of peasants with land rights near expanding city suburbs, which in itself is among main strategies of government to urbanize, confirm plausible chance and relatively high

compensation for land seizure that they might accomplish. Here hukou system plays central and consistently strong hurdle in plans of central government for urbanization throughout whole reform era, including current urbanization agenda, which expects China's urbanization rate is to hit 60 percent by 2018 at the current rate of urbanization.

Policy developing at central level might be summarized on basis of OECD report (Kamal-Chaoui et al., 2009) into four main periods: 1988-2000 – Unanticipated urbanization, 2001-2005 – Town-based urbanization and 2006-2010 – “Balanced development”: emergence of metropolitan regions. 2011-2020 “New Urbanization”.

## 2.2 Unanticipated urbanization

Unanticipated urbanization resumed in 1988 after decision of the central government to introduce the current system of long-term lease for state owned land, allowing municipalities to retain most of revenue, which contributed to large-scale, residential and industrial, urban development. Urban land is owned by the state through municipal governments. The policy was consistent with long-term agenda outlined in the Sixth Five Year Plan (1981-85); I.e control growth of large cities and permit migration to small towns and cities through relaxing hukou-related restrains. Henderson and Au ( 2003) in their analysis of development of urbanization, “find that a large fraction of cities in China are undersized due to nationally imposed, strong migration restrictions, resulting in large income losses...” and furthermore that, “..Evidence suggests that this planning combined with China’s long-term aversion to large cities has distorted the size distribution of Chinese cities compared to other countries.”

Major feature of this period of urbanization was process of upgrading, I.e changing county to city administrative status. Li (2008) informs us, that : “The creation of a large number of cities through so-called “county-to-city upgrading” has changed China’s basic

administrative structure, making the Chinese city system unique. City status gives localities both political and fiscal benefits, thus providing the center with an effective tool to reward counties.”

From 1983 to 1997 when process of administrative upgrading was called off, the central government granted city status to more than 400 counties and prefectures. Although the central government set some minimum requirements to regulate the upgrading process, these formal requirements were not enforced in the practice (Li, 2008). Instead, the most important determinant of city status—and the associated political and fiscal benefits— was local economic growth rate. Thus, upgrading mainly served as an incentive mechanism for local officials to develop the local economy (Fan et al., 2009).

### 2.3 Town-based urbanization.

Town-based urbanization came as a policy shift along with the tenth five year plan, which stipulated three main objectives of urban policy, I.e 1) allowing conversion of agricultural to non-agricultural hukou for rural residents permanently relocating to towns within their counties; 2) land reforms designed to create secondary markets in farming rights by allowing farmers to permanently sell off their rights to other farmers to encourage economies of scale in production; and 3) promotion of industrialization in towns with implied approval of conversion of agricultural land to town construction land (largely for industrial parks).

The hukou reform in over 20,000 small towns has been characterized as “requiring minimum conditions and complete opening-up.” After years of experimentation in some regions, in 2001 the Ministry of Public Security (MPS) initiated reform of the hukou system in small towns. In most cases, the minimum requirements for obtaining a local hukou were a stable source of income and a fixed

place of residence in the locality. This was considered the most significant step in the hukou reform since the system was put into place in 1958. (Cai et al. 2009)

These policy measures did not have their desired effects of stimulating any significant town- based urbanization. Farmers did not take up resettlement since their rights to collectively-owned land , guaranteed by Chinese Constitution, were regarded by peasants as inviolate, secure and beneficial. The permanent change to non-agricultural hukou was too uncertain, and the still limited, relatively insecure and marginal hukou-related public services in towns were not enough to persuade (Kamal-Chaoui et al., 2009). In effect, Chinese urbanization process was a result of a large increase of the number of cities rather than increasing the size of existing cities. (Huang, 2010)

#### 2.4 "Balanced development"

"Balanced development" and emergence of metropolitan regions follows the Eleventh Five Year Plan (2006- 2010) emphasis on the development of metropolitan regions across the country, including measures to better integrate strategic towns into metropolitan economies. The government hopes to more effectively address China's growing rural-urban disparities. In part, this is being pursued through the strengthening of suburban towns in metropolitan regions. For example, Shanghai, Beijing, and Chongqing are now implementing development strategies to foster the growth of "strategic" towns into satellite cities with strong connections to their respective metropolitan centers. The future of the Chinese city seems to be a continuous growth and in some cases the emergence of a Mega City or Megalopolis. A Megalopolis/Mega City is defined as a cluster or chains of cities in close proximity with more than 10 million inhabitants. A possible future for the Chinese cities seems to consist in these Megalopolis-styled cities that are connected together through

transportation corridors, including highways, rail, HSR, and possibly subway systems as well. Mega Cities can already be seen prominently along the shoreline predominantly in the delta areas of the Pearl River, The Yangzi River and to a lesser extent in the Bohai corridor around Beijing and inland at the Chongqing municipality. (Petursson 2012)

## 2.5 “New urbanization”

With the new leadership, the process of urbanization entered a new phase coined as “new urbanization”, comprised as 'The National Plan for Promoting Healthy Urbanization (2011-2020)'. It provides for shift in focus from expansion speed to quality of upgrade and construction of 20 city clusters, some 180 cities above prefecture level and more than 10 000 cities and towns. Priority on building small and medium sized cities remains (HKTDC 2013). With many details still to be determinant, Zhu et al. (2013) anticipate “new urbanization” to differ from previous policy mainly in focus on social development, I.e safety net and consumption areas with more selective and targeted investment demand. Here they reference speech of Premier Li Keqiang, who has said that urbanization ‘is not simply increasing urban population ratio, nor expanding urban square footage,’ and that we should not simply ‘build more cities.’ (January 15th, New Beijing Daily 2013)

The government plans to help 260 million migrant workers to gain urbanite status and become integrated city residents by 2020. Policy keeps with commitment to fully remove hukou restrictions in towns and small cities, gradually ease restrictions in bigger cities and set reasonable conditions for settling in big cities. (Xinhua, 2013)

Centre issued guidelines of a new policy of chengzhenhua 城镇化.

The use of 镇 to describe urbanization indicates that the new policy is focused on towns 镇. Administratively, towns fall under the rural government system in China and are therefore subjected to rural institutions, which might cause significant complications, particularly with planned conversion of collective landownership to state ownership that faces opposition from locals defending traditional collective land distribution system. Approach of the centre is the legal relaxation of collective land transfers 集体土地流转 and experiments are currently in progress to both deregulate and marketise collectively owned land. Furthermore, few experimental programs were already launched in various parts of country (Guandong, Anhui), granting rural population living permanently in city for certain time right for conversion of their hukou status or even program granting rural hukou holders urban privileges without losing their entitlements from rural hukou. (Mi Shi 2013)

General urbanization strategies of “new urbanization” include four main transfers as outlined by central government: converting collective land ownership to state ownership; converting the rural household registrations of villagers into urban registrations; re-assigning social services provided by village collectives to selected municipal bureaus; and redeveloping villages according to the urban spatial planning regime. Here can only agree with Mi Shi(2013) that wholesale transfers are unlikely.

#### 4. Concluding remarks.

To conclude, future direction of hukou reform might be in principle settled by commitment of central government to abolish the system altogether (Xinhua, 2013), but combination of political and fiscal restraints might, to mention just few, render the process intrinsically complex, I.e not only gradual, but by no means linear. Opposition from large, politically influential cities that host relatively high proportion of migrants is real, inasmuch as fiscal strain imposed by hukou conversion on already heavily indebted medium and small municipalities. In conjuncture with general preference of central government for disconnected, politically benign population, preserving cozy support of urban elites in dominant cities, might lend us healthy skepticism over capacity of centrally planned urbanization to achieve its declared objectives of becoming future engine for Chinese economy. Moreover as Zhu et al.(2013) further remind us, "with daunting costs (up to Rmb 100,000 per head, as estimated by China Development Research Foundation) and resource limitations, a balanced hukou reform approach must be decided upon." Cost estimates of dismantling hukou system vary, however, as we tried to show, social equity and inclusion might not be inevitable prerequisites for economic growth, but with further progress towards higher value added and knowledge based economy, could nevertheless become indispensable.



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