



Hukou System Reform and Unification of Rural–urban Social Welfare

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Abstract

Using a political economy analytical framework, the present paper examines the hukou system reform in China. The potential unification of the social welfare system of rural and urban areas is discussed. The paper reviews the progress of hukou system reform since 2004. It is suggested that since China met its Lewis turning point in about 2004, and a labor shortage became a limiting factor in production, there has been stronger demand for hukou system reform. In the meantime, various levels of government have a point where incentives are compatible for carrying out reforms. The paper also explores some limitations of the currently implemented reform in certain regions and puts forward relevant policy suggestions.

Key words: hukou system reform, incentive compatibility, Lewis turning point

JEL codes: J42, O18, P16

I. Introduction

The professed function of the Chinese household registration (*hukou*) system formed in the late 1950s is to register population separately in rural and urban areas. Namely, the rural–urban distinguished birth place which is identified by the *hukou* determines the legitimate residence of Chinese citizens. The alteration of *hukou* status between rural and urban areas is conditional. The criteria for such alteration are very strict. In fact, the *hukou* system restricts the rights of free migration for rural residents. It is commonly believed that the overall economic reform has been accompanied by *hukou* system reform to some extent over the past three decades. The actual progress of the *hukou* system has not been examined thoroughly in the published literature (e.g. Chan and Buckingham, 2008; Chan, 2010). The *hukou*-related rural–urban divide is compared with the Indian caste system in Whyte (2010). Such an underrating of the progress of the reform in this area originates

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from a narrow cognition of the *hukou* system per se. That is, if the *hukou* system is merely viewed as a population registration system to distinguish between rural and urban residents, it seems that no significant change can be perceived.

However, both central and local governments have undertaken various experiments on *hukou* system reforms, and not just to eliminate the regime of regionally separated population registration. To understand the *hukou* system, we need to explore the primary motive of its initiation and resultant characteristics. First, it was introduced to serve as an invisible wall to prevent the rural labor force from moving out of agriculture, and it is closely tied to an exclusive employment system in urban sectors. Second, it was adopted to guarantee basic living and minimum social welfare for urban residents, and, therefore, an institutional arrangement should be developed to separate *hukou* residents' entitlements from migrants' entitlements. If the wider functions of the *hukou* system are taken into account, rather than viewing it only as a population registration system, one should admit that the Chinese economic marketization developed along with *hukou* reform progress, and the reform should be carried out with a much wider scope.

Like China's economic reform in other areas, the *hukou* reform has been carried out in both bottom-up and top-down ways. On the one hand, rural laborers have migrated beyond the resident and employment boundaries set by *hukou* during the reform period, seeking higher income and an improved standard of living. On the other hand, as the reallocation efficiency generated by labor mobility among sectors became more and more obvious,¹ the Chinese Government acquiesced in relation to the departure of rural laborers from farming and villages, and then gradually altered policies to encourage farmers to leave their farm work and rural areas by actively improving the policy climate for migrant workers working and living in cities. Because the *hukou* reform has involved the alteration and abolition of a series of long-standing institutions, the government's incentives and initiatives have been particularly important in driving the process. Therefore, to document and explain such reforms, it is important to explore motives, behavior and interaction of all participants (i.e. rural laborers, urban residents, and central and local governments) using a political economy analytical framework.

The Chinese economy has been subject to two transitions: the transition from a dual economy to a more integrated economy and the transition from a planned economy to a market economy. The milestones of those two transitions can be used to divide the important characteristics of the *hukou* system reform into three phases. In the first phase, roughly

¹ Cai and Wang (1999) estimate that, in addition to the conventional contributions made by physical capital, labor and education, labor mobility from low productivity agriculture to higher productivity non-agricultural sectors contributed 21 percent to China's GDP growth during the period from 1978 to 1998.

between the early 1980s and the mid-1990s, the reform was carried out under the constraints of a planned economy. Spurred by the clearer market orientation of the overall reform laid out by the Chinese leadership, the *hukou* system reform accelerated in the period from the mid-1990s up to around 2003. When the Chinese dual economy reached a new stage after 2003, the reform entered a more pivotal period. Although in each phase of the *hukou* system reform, there has been crucial progress, the latest round of reform has been more comprehensive, with the aim being to completely eliminate the *hukou* system and affiliated institutions.

The present paper describes the efforts made to reform the *hukou* system as a response to the government policies implemented with the changing conditions. Unlike the existing literature that focuses more on the unfinished aspects of the *hukou* system reform, the present paper evaluates its progress to date and discusses the future direction of reform, which will be closely related to changes on the economic stage. We also examine changes in the intention and implementation of social welfare programs.

The rest of the paper is organized as follows. Section II depicts the *hukou* system reform in the context of the transition from a planned economy to a market economy, which has occurred in the course of typical dual economy development. Section III discusses the arrival of the Lewis turning point, representing a new stage of the China's economic development, and the implications for increased demand for migrant workers in new institutional settings and the motivation by governments for *hukou* system reform. Section IV reviews the new wave of *hukou* system reform since 2003, when the Chinese economy is believed to have reached its Lewis turning point. Section V concludes and provides policy suggestions for the future *hukou* system reform.

II. *Hukou* Reform as an Institutional Transition

China's economic reform was initiated in rural areas. In the initial stage, reform was characterized by the introduction of a household responsibility system to solve a long-standing incentives problem, which enhanced the labor productivity of agriculture and released surplus labor that had accumulated in the pre-reform period. As a consequence, Chinese farmers, after fulfilling their needs for basic living, began to seek off-farm work to increase their incomes. The intention of economic reform at that time was not abandonment of the planned system; therefore, *hukou* system reform actually took place without a clear blueprint of the overall reform, and it was characterized by labor mobility from agricultural to non-agricultural sectors in rural areas, and from villages to nearby towns.

The labor transfer entailed local relocation to township and village enterprises (TVEs)

before the urbanization policy was relaxed to allow rural-to-urban migration. The central government intended to create a pattern of “leaving the land without leaving the countryside” before the mid-1980s. TVE development, however, was confined to local villages and small towns and was extremely uneven among regions. Therefore, TVEs were incapable of creating adequate non-agricultural employment opportunities for the released surplus laborers in rural areas. In 1985, only 18.8 percent of 370 million rural laborers were engaged in TVEs (NBS, 2010a). According to Taylor (1993), in the 1980s, there were 100–150 million surplus laborers in rural areas, accounting for 30–40 percent of the total rural workforce. To tackle such a developmental challenge, farmers inevitably sought to break institutional obstacles and migrated across regional boundaries, while both central and local governments eventually responded to desires of and actions by rural laborers by relaxing the institutional constraints for labor mobility.

As reforms in urban areas began in the mid-1980s, along with the stagnation of TVE development, rural laborers began to migrate across regions, from rural to urban areas, seeking non-agricultural jobs. The gradual abolition of institutional obstacles has been crucial for increased labor mobility since the 1980s. Given the lack of opportunities for surplus laborers in rural sectors, in 1983 the Chinese Government began to allow farmers to be engaged in long-distance transportation and market their products beyond local market places. This was the first time that Chinese farmers had legitimate rights to do business outside their home towns. In 1984, regulations were further relaxed and farmers were encouraged by the government to work in small nearby towns. A major policy reform took place in 1988 when the central government allowed farmers to work in enterprises or to run their own businesses in cities under the conditions of self-sufficient staples in light of the rationing scheme that still existed. In the 1990s, both central and local governments undertook a series of measures to relax restrictions for rural migration, implying a certain degree of reform in the household registration system.

However, in the 1990s, the planned system had not yet been abandoned and the *hukou* system was taken for granted in the institutional setting. That is, any policy adjustment and any action conducted spontaneously by laborers and acquiesced by the government were still circumscribed by the strict *hukou* control.

In the 1990s, the establishment of a market economy became the goal of Chinese reform, which was also an important turning period for *hukou* system reform. Symbolized by Deng Xiaoping’s famous tour and speech in southern China and the 14th National Congress of the Communist Party of China in the early 1990s, China’s reform and opening-up entered a new era. With the accelerated *hukou* system reform, labor market development and population migration, we consider the mid-1990s as the milestone that distinguishes between the first and second phases of *hukou* system reform.

The fast growth of labor-intensive and export-oriented sectors, mostly in the coastal provinces, and the dramatic surge of non-public sectors in urban areas generated huge incremental demand for labor, which encouraged a tide of labor to migrate from rural to urban sectors, and from central and western to eastern regions. In response to these trends in labor market expansion and integration, a host of reform measures were taken to eliminate the institutional barriers deterring labor mobility. For example, the rationing system, which was initiated in the mid-1950s to limit supplies of staple food and other necessities required in cities, was abolished in the early 1990s. This broke one of the main shackles on population migration from rural to urban areas.

Another manifestation of labor market development is the reform of urban employment policies. In the mid-1990s, the Chinese Government granted state-owned enterprises (SOEs) the autonomous power of hiring and firing employees; SOE managers could then take advantage of the breakdown of the long-standing “iron rice bowl.” During the macroeconomic downturn and East Asian financial crisis in the late 1990s, which gave rise to massive lay-offs and unemployment in urban sectors, the government implemented a lay-off subsidy program, and developed an unemployment insurance system, a basic pension regime and a minimum living standard program. Although these measures were initiated to protect urban workers, an environment for labor market development and liberalized labor market regulations to encourage labor mobility across enterprises, sectors, regions and various forms of ownership was established.

In response to the improved economic conditions for labor mobility, in 1998 the Ministry of Public Security gave the green light for the entry of rural people into the cities, so that children could be registered in a household with either parent; couples who had been long separated could be reunited and obtain a change of household registration; and the elderly could obtain city *hukou* status along with their children. Although resistance to these reforms was encountered in some major cities, the further reform of the household registration system was at least given a legitimate basis at the central government level.

China was characterized by dual economy development before this phase ended: many surplus rural laborers migrated to urban sectors in coastal areas, seeking non-agricultural employment; wage rates for migrant workers remained unchanged and lower than those of their urban counterparts, partially because of the unlimited supply of labor and partially because of the existence of the *hukou* system. Even though the expanded labor mobility produced reform to a certain extent, the *hukou* system still served two traditional roles.

First, the *hukou* system has guaranteed the priority of urban laborers to obtain employment in urban sectors. Because of the coexistence of rural labor surplus and urban workforce redundancy, there has been job competition between migrant workers and urban unskilled workers. Therefore, urban governments have protected local workers and

discriminated against migrant workers in the labor market through *hukou* identification. In the 1990s, urban governments' policies towards inflows of migrants changed cyclically as employment pressures facing local governments changed over time; that is, whenever local unemployment problems became severe, in addition to the normal restrictions on migrant employment, local governments tended to take measures to supplant migrant workers. For example, in the 1990s, some large cities issued policies forbidding urban enterprises to hire migrant workers for certain jobs, to avoid competition with local workers.

Second, the *hukou* system excluded migrants from obtaining equal access to urban social welfare. In the course of tackling the employment crisis in the late 1990s, local governments built a preliminary social protection system for urban workers, including basic pension insurance, basic health-care insurance and unemployment insurance programs, and a minimum living standard guarantee scheme. Although these programs did not apply fully to all urban workers, they officially included all workers with urban *hukou* status and excluded rural migrants. In addition, migrant workers were not entitled to public employment assistance programs and, therefore, were exposed to reduced employment opportunities.

In a dual economy characterized by an unlimited supply of labor, the interests of urban residents conflicted with those of rural residents, and urban workers had strong influence on policy-making and gained a more advantageous status (Olson, 1985). The empirical study of Cai (2010a) examines the *hukou* system reform in that period. It is found that while some efforts were made by both central and local governments, such efforts proved futile. From 2000, all small Chinese towns relaxed *hukou* control by significantly lowering the thresholds for residence, and some medium and large cities, including provincial capital cities such as Shijiazhuang of Hebei Province, did the same. Owing to the lack of employment opportunities and providing equal social welfare, such as a basic pension, basic health-care insurance, access to compulsory education and entrance to higher levels of schooling for the newcomers, the reform mentioned above did not encourage many migrants to apply for local *hukou* status. In other cases, where cities announced that they were abolishing the distinction between agricultural and non-agricultural *hukou* identity, because of the unequal social welfare that remained between people living in rural and urban areas, the reform of the *hukou* system seemed no more than lip service (Wang and Cai, 2010).

III. Lewis Turning Point and Reform Incentives

With mass labor migration from rural to urban sectors, the labor surplus in agriculture was

Table 1. Annual Growth Rates of Selected Wages, 2003–2008 (%)

Rural	Daily wages	Urban	Monthly wages
Grain production	15.1	Manufacturing	10.5
Cotton production	11.7	Construction	9.8
Large pig farm	21.4	Migrant workers	10.2

Sources: The wage of hired workers in grain production was calculated using data from NDRC (2004–2009); wages of manufacturing and construction workers was calculated using data from NBS and MHRSS (2004–2009); and wages of migrant workers were calculated using data from NBS (2004–2009).

reduced (Cai and Wang, 2008), the growth rate of the working age population began to decelerate. However, rapid economic growth has continued to generate huge demand for labor, leading to the problem of labor demand exceeding supply. Since 2003, the difficulty of hiring migrant workers, or a more general labor shortage, has become widespread and wages of migrant workers have significantly increased year by year. In addition, the wage rates of workers in agricultural sectors have also increased (see Table 1), indicating the correlation between the reduction in surplus labor in agriculture, the shortage of unskilled workers in urban areas and the induced wage rises in all sectors (Wang, 2010).

According to the definition by Lewis (1954), all these phenomena indicate that by 2003 the Chinese economy had reached at its Lewis turning point. This is the time where the wages of ordinary workers increase because the growth of labor demand exceeds that of labor supply (Cai and Wang, 2010). At the same time, *hukou* system reform start a new phase. The year 2003 saw many dramatic changes in the Chinese economy and society, such as the first appearance of a labor shortage in China’s economic development, the subsequent increase in ordinary workers’ wages, the rise of labor costs and the fall of labor input in agriculture, and the governments’ efforts to improve the conditions of migrants living and working in cities in response to these changes (Wang, 2010), and we view it as a symbolic year, indicating the Lewis turning point and the onset of the new phase of *hukou* system reform.

The essential manifestation of the Lewis turning point is the alteration of the labor market from possessing an unlimited supply of labor to frequent labor shortages. At this point a fixed wage rate can no longer maintain an endless supply of labor, and a wage rate increase alone cannot adequately satisfy workers, who also expect a series of policy reforms in accordance with economic development. The phase of reform since China started facing such challenges can be characterized as follows. First, as market orientation became the clear focus of the overall economic reform of China, the goal of *hukou* system reform has been to unify the rural and urban labor markets. Second, as an unlimited supply of labor is no longer guaranteed in the Chinese economy, and structural factors rather than magnitude

factors dominate the labor market, the direct conflict between migrant and local workers in attaining employment has eased. Third, as social welfare provisions, mainly social security programs, become socially pooled based on public finance and individual contributions, there is more compatibility than competition between newcomers and native residents in urban areas. With all these changes in the reform process, the governments' intentions and behavior in carrying out *hukou* system reform are now fundamentally different from those in the previous phase of reform.

The Chinese Government has been perceived as a developmental state (Walder, 1995; Oi, 1999), and local governments as competitive governments (Herrmann-Pillath and Feng, 2004). Local governments are highly motivated to spur economic growth using various policy measures, including legislation, public policy-making, improving the investment and development climates, helping local business to seek financial resources from domestic and foreign investors and subsidies from higher levels of government, intervention in enterprises management, and sometimes running businesses themselves. As they recognize that the Lewis turning point is reached and labor becomes a constraint to economic growth, both central and local governments begin to reorientate public policy from focusing on employment opportunities to focusing on job decency, and from protecting locals to including migrants, which leads to institutional changes.

Chinese local governments have become more and more motivated by a Tiebout-type incentive (Tiebout, 1956) and try to attract human resources by enriching the contents of and adjusting the direction of public services. In these areas, where the booming economy continues to increase demand for labor, a silent reform has been building labor market institutions and social protection mechanisms, which is compatible with the central government's objective to establish a harmonious society.

Such policy has catalyzed the establishment of labor market institutions, in which migrant workers are formally included. Symbolized by the satisfactory solution of the Sun Zhigang incident in 2003² and the government's intervention in the wages area for migrant workers in 2004, labor-related institutions have since evolved in two directions; namely, with regulations aiming to protect all workers and deregulations aiming to liberalize labor mobility (Cai, 2010b). To tackle migrant workers' problems of poor job security, poor working conditions, low coverage of the social insurance scheme, and lack of protection, since 2004

² A 27-year-old university graduate, Sun Zhigang, was detained by the police and beaten to death because he did not possess a local *hukou* or local temporary resident permit. This attracted widespread public criticism of the *hukou* system and led to the abolition of the State Council regulation *Approaches to the Custody and Repatriation of Urban Vagrants and Beggars*, which the criminal acts of the law enforcement officers were based on (see Cai, 2010b).

the Chinese Government has made various efforts contributing to *hukou* system reform.

First, the *Employment Contract Law* came into effect in 2008. This worldwide legislation requires enterprises to sign labor contracts with all employees, regardless of their *hukou* status, and to include them in basic social insurance programs. The *Labor Disputes Mediation and Arbitration Law* issued in the same year encourages migrant workers to solve labor disputes by providing litigation at almost zero cost.

Second, local governments have increased the frequency and scale of minimum wage adjustments. In the early years of the 1990s, to implement this program, the minimum wage standard was low, rarely increased, and did not apply to migrant workers. As labor shortages became widespread after 2003, the central government requested local governments to adjust the level of minimum wages every year. Pressured by labor shortages, municipal authorities also increased the adjustment frequency and local level of minimum wages.

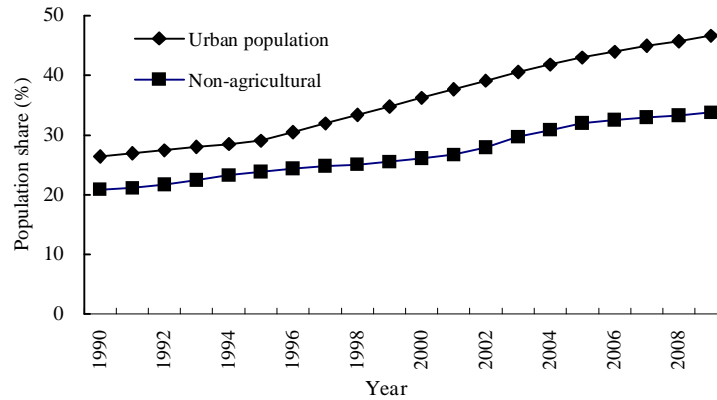
Third, the central government has attempted to enhance the coverage of participation of migrant workers in basic social insurance programs through the publication of *Interim Measures on the Transfer of Continuation of Basic Pension for Urban Enterprise Employees* in 2010, which stipulates that all workers should participate in a basic pension program; also, if a worker migrates across provincial boundaries, it guarantees continuation of their pension in both individual and pooling accounts in the new workplace. This new regulation provides institutionally guaranteed portability of migrant workers' pension entitlements.

IV. New Wave of *Hukou* System Reform

Since 2003, the proportion of the population with non-agricultural *hukou* status has increased, and *hukou* system reform has become more important. A dilemma exists in the *hukou* system reform: the more social welfare benefits associated with *hukou* identity, the more difficult it is to push forward the reform. However, without *hukou* system reform, social welfare benefits will not be detached from *hukou* status. However, the reorientation of government focus towards public service provision, spurred by the arrival at the Lewis turning point, has help to break such a dilemma and boost a new round of *hukou* system reform. In what follows, we will describe the process and progress of the reforms of the *hukou* system and related institutions since 2003.

The number of migrant workers leaving their home towns for 6 months or more increased from 114 million in 2003 to 145 million in 2009, of which 95.6 percent migrated to cities and towns (NBS, 2010). As Chinese urban residents were defined as those who live in cities for at least 6 months of the year, when the 5th National Census was conducted in 2000, migrant workers and their accompanying family members contributed to a large proportion of the increase in the urban population. In 2009, the urbanization rate (the proportion of the

Figure 1. Urban Population versus Non-agricultural *Hukou* Population, 1990–2009



Source: NBS (1991–2010a, b).

population living in cities for at least 6 months) was 46.6 percent (see Figure 1). Migrants who moved to cities but did not obtain urban *hukou* status, did not have the same access to social welfare as their counterparts with urban *hukou* status. In 2009, the proportion of the population with non-agricultural *hukou* status, which all native urban residents hold, was 34 percent, which is 13 percent less than the statistical urbanization rate for that year.

Taking the difference between the urbanization rate and the size of the non-agricultural population into account, many scholars and policy researchers assert that *hukou* system reform has not made any noticeable progress and that the level of urbanization has been overestimated (e.g. Chan, 2010; Chang, 2010). This argument is partially correct because whereas long-term migrant workers are counted as urban residents, they are still excluded from equitable entitlement to many public services provided by urban governments. For example, their participation rates in social insurance programs are significantly lower than those of local workers (see Table 2), they have difficulty in enrolling their children in compulsory schooling, let alone at a higher level of schooling, and they are not entitled to a guaranteed minimum living standard. However, migrant workers and their accompanying

Table 2. Comparison of Social Insurance Programs between Migrants and Local Workers, 2009 (%)

	Basic pension	Basic health care	Unemployment insurance	Work injury insurance	Maternity insurance
Urban workers	57.0	52.7	40.9	47.9	34.9
Migrant workers	9.8	13.1	3.7	24.1	2.0

Sources: NBS (2010a) and Sheng (2009).

family members now have much better access to public services than they did previously. Moreover, *hukou* system reform aimed at formally accepting migrants as non-agricultural residents in urban areas has been accelerated.

The share of the population with non-agricultural *hukou* status has increased since 2003. The annual growth rate in the size of the non-agricultural population increased from 3.4 percent in 1991–2002 to 4.3 percent in 2002–2007.³ Given that the natural growth rate of both rural and urban populations in China declined to very low levels (the natural population growth of the country as a whole decreased from 1.3 percent in 1991 to 0.5 percent in 2007),⁴ the increase in the size of the non-agricultural population is mainly attributed to mechanical growth, namely, the growth associated with rural-to-urban migration. Although the expansion of university enrolment might contribute to the increase, because enrolled rural students can change their agricultural *hukou* status to non-agricultural *hukou* status, the proportion of the total number of enrolled students of rural origin declined dramatically, which means that the two factors offset each other.⁵ Therefore, the majority of the new non-agricultural *hukou* population includes those who have been officially accepted in migration destination cities.

After the Chinese economy recovered from the 2008–2009 financial crisis, unprecedented labor shortages were encountered. Many provinces and cities have initiated a new round of *hukou* system reform, different from previous reforms in the following respects:

First, the motivation for the new round of reform is endogenous and strong. In terms of governments' incentives for *hukou* system reform, two facts are worth noting:

1. The shortage of migrant workers, which first appeared in 2003 and became severe after the recovery of the economy from the financial crisis in 2010, has affected enterprises' ability to fully utilize their production capacities. As a response to this, local governments in coastal areas, where enterprises struggle to recruit workers, have included *hukou* system reform among policy measures to stabilize labor supply.

2. With the strict control over arable land use, the only way that local governments can exploit land to boost urbanization is to reclaim the plots of contracted arable land and house sites left behind by those who have migrated away and to use the quota of those plots elsewhere to balance the reclamation and exploitation of land.

Second, the measures of the new round of reform are more feasible. Since the beginning of this century, many regions have announced and piloted *hukou* system reform. Although

³ Calculated using data from NBS (1991–2010b).

⁴ Calculated using data from NBS (1991–2010a).

⁵ Among currently enrolled university students, the proportion of those of rural origin is 17.7 percent, a large reduction from over 30 percent in the 1980s (see Li, 2009).

the effects differ from place to place, all reform has been initiated locally to conform to the actual needs of individual localities. Because the objective of the reform is the change of institutional format of the dual societal structure, the *hukou* system, the reform shares some common features wherever it is implemented. The reform must equalize public service provisions and this is helped by easing entry criteria for migrants. Reform will not be successful if migrants are unable to obtain local *hukou* status or if there is discrimination in social welfare between migrants and natives. As local governments become more aware of the importance of *hukou* system reform in driving urbanization, they tend to ease the criteria for accepting new residents.

Guangdong, a coastal province of southern China, initiated *hukou* system reform in response to labor shortages in its export-oriented sectors. The pilot reform in Chongqing, a more agrarian municipality in south-western China, is a typical example of an attempt to obtain necessary land for urban expansion. As a less developed region, Chongqing is constrained more by land than by labor shortages in its efforts to catch its developed counterparts. Because any reform needs to be boosted by incentives, and because the reform of *hukou* policy must be initiated by governments, linking *hukou* reform with land development can motivate a municipality to initiate reform.

The *hukou* system reform initiation in Chongqing involves relocating the plots of land vacated by urbanized rural families. According to policies issued by the government, land relocation involves three steps. First, the local governments compensate for the plots of contracted arable land and house sites based on land expropriation regulations and the current price of land vouchers.⁶ Second, as returned house sites are required to be reclaimed in their original localities, their land use quota is traded within the municipality, and the quota may be used as construction land in other localities of the municipality. Third, the claiming rights for the land are held for the transferred households for 3 years in case they return as a result of employment problems or the like. The unified utilization of the quota of land vacated by official migration from rural to urban areas is the motivation for Chongqing municipal government implementing *hukou* system reform.

The new round of *hukou* system reform represented by the experiences in Chongqing and Guangdong in 2010 meets the two criteria for reform: low entry threshold and equal application of social welfare. In Chongqing, migrant workers who have worked and

⁶ The land voucher program, an innovative institution in Chongqing, is intended to unify land use and land development on a citywide basis. The administration issues vouchers for the increase in land area generated by reclaiming house plots and collective construction land vacated by people migrating from villages and trades them in the government-run land exchange. Those who buy the vouchers receive a quota of land use for non-agricultural development within the municipality.

undertaken business for a certain period of time, bought a house, invested, or who pay taxes of a certain amount in the destination cities are eligible to obtain local *hukou* status and to receive equal access to employment assistance, such as social insurance, subsidized housing, education and medical care. In Guangdong, the government converts various criteria, such as schooling, working skills, contributions to social insurance, volunteering and blood donation, into credit points, which accumulate to obtain urban *hukou* status. Because of these initiatives, becoming an urban citizen is no longer a random prospect but involves an assured procedure.

V. Conclusions and Policy Suggestions

During the process of China's transition from a planned economy to a market economy, *hukou* system reform has driven labor mobility from rural to urban sectors, helped to increase the efficiency of allocation of economic resources and contributed to the unprecedented rapid growth of the economy. Under conditions of unlimited supply of labor and scarcity of public service resources, competition for employment opportunities and welfare provisions between migrant and local workers in urban areas hampered *hukou* system reform and urbanization, and prevented migrant workers from contributing to a stable labor supply and becoming regular consumers. When the Lewis turning point was reached, economic growth could no longer be assured due to low-cost labor and high saving rates brought about by a demographic divide. This created incentives for both central and local governments to implement *hukou* system reform and created incentive compatibility between central and local governments, and between migrant workers and urban native residents. As a result, *hukou* system reform pushed ahead.

In different regions, local governments have their own motives for initiating *hukou* system reform. For example, some might want to implement reform to attract and keep human resources in coastal areas, tapping domestic demand in central and western regions, and breaking through the bottleneck of land in the economic growth of less-developed regions. These different motives lead to dissimilar institutional designs and different ways of implementing reforms.

Like the previous rounds of reform, the ongoing reform has its limitations, which involve the consensus between central and local governments. To initiate *hukou* system reform, local governments not only need incentives, but also need the support and approval of the central government. As is evident from the experiences of Chongqing and Guangdong, some shortcomings need to be overcome.

First, the main concern of central and local governments is to accelerate urbanization

and to retain the designated amount of arable land. Because of the extreme scarcity of arable land in China, neither industrialization nor urbanization can proceed at the expense of a land shift from agricultural to non-agricultural utilization. The land voucher program coined by the Chongqing Government requires that all plots of vacated land reclaimed for cultivation are approved by the central government. The central government often disputes the reclamation of land declared by local governments because there have been many cases of failed commitments in the process of new village construction.

Second, both central and local governments are concerned about building labor market institutions and social protection mechanisms that help avert urbandiseases caused by urbanization. Migrant workers have become an indispensable source of labor for urban sectors; there is a constant demand in non-agricultural sectors for migrant workers, and agriculture has become rapidly mechanized so that it no longer provides a pool of surplus labor. Although most migrant workers cannot go back to agricultural production, individual migrant workers face the risk of joining the urban poor. *Hukou* system reform has to provide a comprehensive package to tackle all such risks, from inclusive social protection policy in urban areas to flexible relocation policy for arable land.

Third, the coordination of policy measures by local and central governments affects the overall impact of *hukou* system reform. Policies developed in Chongqing and Guangdong to assist migrant workers to officially reside in cities benefit only the residents of those particular provinces and cities. In 2009, of the 145 million migrant workers (and their 22 million accompanying family dependents), 51 percent migrated across provincial boundaries (NBS, 2010). Because it is difficult for these interprovincial migrants to benefit from *hukou* reform underway in many provinces, half of the migrants, whose ancestral homes are mostly in the poor central and western areas, are still excluded from the urbanization process.

The *hukou* reform has so far been initiated by local governments that are motivated by breaking through constraints to local development. As a public policy reform, *hukou* reform requires nationwide harmonization. In addition to encouraging various reform initiatives by local governments, the central government should put forward general guidelines regarding the content and coverage of social security programs, methods of managing plots of vacated land, and the nexus between practical policies and overall objectives of the reform based on domestic and international experiences and lessons.

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