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# Approaching integrated urban-rural development in China: The changing institutional roles

(*INCOMPLETE Manuscript for 2014 ERSA conference*)

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**Note:** sorry for uploading the incomplete manuscript on 25<sup>th</sup> July due to some statistics to be updated. We will finish it quite soon and please send a request to [liyuheng@iqsnrr.ac.cn](mailto:liyuheng@iqsnrr.ac.cn) for a complete one. Thanks!

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**Abstract:** Ever since the twenty-first century, the Chinese government has been undertaking a series of rural-favored policies and measures to promote comprehensive development in rural China. The fundamental purpose is to accomplish integrated urban-rural development (IURD) given the ever enlarging urban-rural inequalities in the post-reform era. Considering the long time biased policies against the countryside, the paper aims to examine the institutional roles in approaching the IURD.

IURD at provincial level in China is measured by principal component analysis of selected variables which represent the socioeconomic integration between urban and rural areas. The institutional roles in promoting IURD have three aspects: decentralization in directing local rural development; employment, social security system and material circulation system which influence the free production factor flows between urban and rural areas; education, medical treatment and culture system which influence public services between urban and rural areas.

We use panel data analysis to investigate the relationship between institutions and IURD at provincial level in China in the period 1980-2010. The analysis also controls variables such as locational factors, population density, per capita GDP in each province. The data mainly refers to *Comprehensive Statistical Data and Materials on 60 Years of New China* and National Statistical Yearbooks in recent years. Research results show significant and dynamic roles of institution in promoting IURD at different time periods.

**Keywords:** Urbanization, dual structure, urban-rural integration, institutional roles, China

## 1. Introduction

For a long period following the establishment of P. R. China in 1949, urban and rural areas were treated separately and differently. Since 1978, China has experienced over three decades of rapid economic growth, with annual growth rates of over 9%. However, despite this “economic miracle”, the country has also witnessed ever-enlarging urban-rural inequalities across a range of indicators such as income, education, medical care, provision of infrastructure and social insurance. Whilst per capita urban household income increased from 343 ¥ in 1978 to 26955 ¥ in 2013, per capita rural household income only increased from 134 ¥ to 8896 ¥ in the same period (National Bureau of Statistics of China, 2014). Although China’s urbanization level reached 53.7% in 2013, however, restricted by the household registration system (*hukou*), peasant workers in cities are limited to gain access to the equal public services as local urban residents. That’s also why the real urbanization level was only 35.7% if calculated according to urban registered residences since there were 269 million peasant workers<sup>1</sup>. This indicates the unequal social status between urban residents and their counterparts in rural China.

Many scholars searching for the culprit behind the increasing urban-rural inequalities in China emphasized the influencing factors such as a dualistic urban-rural structure (Lu and Zhao, 2004); urban-biased development strategy (Cai and Tao, 2000; Kanbur and Zhang, 2005); market forces (Gao, 2006) and taxation (Tao and Liu, 2005). Urban-biased policies and related measures like the *hukou* system, compulsory procurement of rural commodities were initially formulated on the basis of the typical socio-economic conditions in China in the period directly following 1949. These policies and measures have, however, purposely diverted resources (capital, labour and materials) from rural to urban

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<sup>1</sup> National Bureau of Statistics of China, Stable national economy in 2013 (20 January 2014); [http://www.stats.gov.cn/tjsj/zxfb/201401/t20140120\\_502082.html](http://www.stats.gov.cn/tjsj/zxfb/201401/t20140120_502082.html)

areas, and induced greater urban-rural inequalities in China (Li, 2011).

Basically, the key to achieve social convergence while facilitating the spatial concentration of economic activity which is necessary for faster economic growth is integration (Muñoz et al., 2009). Upon the ever enlarging urban-rural inequalities, the strategy of integrated urban-rural development (IURD) was proposed in the 1980s in China (Li et al., 2013). Then, the Sixteenth National Congress of the Chinese Communist Party in 2002, stressed the importance of the countryside for achieving moderate prosperity (*Xiaokang*), and declared that China's socio-economic development must incorporate urban and rural areas alike. This declaration shifted the long-standing separation between the urban and the rural, by placing urban and rural development under the same framework. In fact, the core of urban-rural integration strategy in China indicates treating industry and agriculture, cities and countryside, citizens and peasants, as an integrated whole, instead of isolated parts (Li, 2012).

Global experience shows that, for today's leading developed countries, their urban hierarchies exhibited a high level of stability throughout their industrialisation and urbanisation processes. Their process of building density in urban areas was accompanied by a gradual convergence of living standards between different types of area with the eventual disappearance of urban-rural income disparities. This convergence occurred through the mechanism of rural-urban migration, reducing the surplus of labour on agricultural land and reducing competition in rural labour markets (World Development Report, 2009). Coming back to the China's case, the flourishing urban economy was mainly achieved on the basis of exploiting agriculture, villages and peasants (Schultz, 1978). Particularly, those rural disfavoured institutions dating back to the centrally-planned period over three decades ago, still exert various impact on the countryside's catching-up development, though there are also massive rural-urban migration and reduced peasants on agricultural land in China.

The beginning of the twenty-first century has witnessed a shift from urban-biased stage to "industry nurturing agriculture and cities supporting

countryside” when the Chinese central government endeavours to achieve an overall well-off society by coordinating harmonious economic development of urban and rural areas (Chen, 2009). Thus, from urban bias to completely supporting the countryside, such institutional change would for sure, promote IURD in China, through accelerating positive urban-rural linkages. The current studies mainly discussed the relationship between various institutions and urban-rural inequalities or disfavoured rural development. The empirical analysis and confirmation of this relationship has not, to the author’s knowledge, been clearly investigated. This paper therefore, aims to investigate the changing institutional roles in the process of approaching urban-rural integration in China in the post-reform period.

The structure of the paper is as follows: the second section provides a research background by analyzing the urban-rural dual structure and the deployment of institutions at different times in China. Then, in the third section, by using panel data, the paper assesses IURD at provincial level in China, and investigates the changing institutional roles in approaching IURD. The paper closes by discussing the research results.

## 2. Urban-rural dual structure in China and institutional deployment

Generally, institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights) (North, 1991). Throughout human history, institutions have been devised by human beings to create order and reduce uncertainty in exchange. Institutions will adjust accordingly when the social environment changes. In this process, high efficient , environment-suitable institutions will replace the inefficient ones. Lin (1990) classified institutional changes into compulsory change and induced change. Since there are the high transaction cost and ‘free-rider’ problems, the induced institutional change will not take place unless the net gains because of the new

institutional arrangement exceed the institutional change cost. Otherwise, compulsory institutional change is to be created by the government to deal with these problems. Urbanization development in China consists of both the compulsory and induced institutional changes. The former relies on the laws and governmental power which led to the top-down institutional change while the latter is initiated by the public who are to maximize their own profit and spontaneously induced the bottom-up institutional change (Li, 2000).

### 2.1 Compulsory-institution dominated era

After the P. R. China was founded in 1949, the government faced a war-torn country in which major population was living in rural areas. To pursue a quick recovery, the government strictly controlled resources allocation and put emphasis on the capital-intensive heavy industries. However, being a capital-scarce country in the 1950s, a rationing system was established in China, through distorting the prices of commodities and agricultural production factors to extract rural surplus to fuel industrialization. In 1953, compulsory procurement policy was imposed and peasants were obliged to sell certain amount of their production to the state at the government-set prices (Perkins, 1966). However, the price of agricultural products was usually lower than the price of purchasing agricultural materials (The so-called “price scissor”). An estimation of ¥ 510 billion was extracted through the “price scissor” from 1950 to 1978 when China commenced with the reform and opening up (Jiang, 2007). Nevertheless, government allocated scarce resources and funds from industry to agriculture during the centrally-planned era. By contrary, collective farming was introduced in rural China in 1956 with the aim to achieve agricultural production by collective work while not competing for resources and investment with industries. In fact, rural China was put in a disfavoured position and became the base from which materials and capital were supplied to cities and industries (Yang and Cai, 2000).

Besides the market distortion, the *hukou* system which is the basic institution for documenting population information and distributing public resources, was

established in 1958, drew a clear distinction between rural and urban areas, creating spatial hierarchies between cities and countryside in China (Cheng and Selden, 1994). Since then, only the urban citizens, who accounted for 15% of the total population in pre-reform China, were entitled to the socialist welfare, including not only the basic necessities like food and clothes, but also the social demands of employment, housing, education, health care and pensions, etc. However, the transferral of individual *hukou* status from rural to urban has been strictly controlled by the government through a rationing regime based on the *hukou* system (Wu, 2013). The *hukou* system which has generated huge welfare differences between urban *hukou* residents and peasants of rural *hukou*, actually acted as a social closure which prohibited peasants from equally enjoying the urban social sources (Liu, 2005).

Within such dual structure, the provision of public services is also made differently between urban and rural areas in China. During the centrally-planned era, the provision of public services in the countryside followed the principle of “Stand on its own feet, Supplemented by state support”. Thus, the village committees and the peasants became the main boy of supplying themselves with the public services, with the minor support from the government (Han, 2007). However, the Chinese government invested great finance which mainly comes from rural surplus into the provision of public services for urban residents.

## 2.2 Induced institutional change since 1978

The opening-up and reform since 1978 marked a significant change from centrally-planned economy to market-oriented economy in China. A distinct feature is the decentralization of decision making from central government to the local municipalities. Traditional institutions, such as collective farming, state ownership of means of industry production, the central planning system, and the labour employment and remuneration system are considered to be the root causes of poor economic performance during the pre-reform era.

Initiated by 18 peasants from Xiaogang village in Anhui Province in 1978,

allocating land to each household, instead of farming collectively has induced the most important reform in rural China. In early 1980s, the collective farming was replaced with household responsibility system in which peasants are responsible for both the profits and loss of their own household plots. This policy which enabled peasants to deal with their agricultural surplus had greatly increased peasants' enthusiasm in agricultural production.

After gaining the autonomy in managing their own land, more and more peasants began to undertake non-agricultural work in cities for more incomes. Although their rural *hukou* still prohibits them from accessing urban public services, however, peasants' such motivation has received positive response from the Chinese government. In 1984, released migration policy allowed peasants and their families to get permanent registrations in towns and cities if they were engaged in industrial or commercial activities. In consequence, huge amount of rural labourers migrated to cities and such human mobility contributed to the major urbanization growth in China in the 1980s and 1990s (Table 1).

Table 1 Urbanization and its constitution in China, 1978-1998

Year	Urban population (10,000)	Urbanization		Natural growth		Net migration	
		Level (per cent)	Growth in population (10,000)	Growth in population (10,000)	Share (per cent)	Growth in population (10,000)	Share (per cent)
1978	17250	17.9	582	144	24.8	438	75.2
1980	19139	19.4	645	158	24.5	487	75.5
1982	21479	21.1	1305	228	17.5	1077	82.6
1984	24017	23	1746	210	12	1537	88
1986	26366	24.5	1272	281	22.1	991	77.9
1988	28656	25.8	982	313	31.9	669	68.1
1990	30191	26.4	651	306	47	345	53
1992	32372	27.6	1829	255	13.9	1574	86.1
1994	34301	28.6	950	269	28.3	681	71.7
1996	35949	29.4	776	264	34	512	66
1998	37942	30.4	953	310	32.5	643	67.5

Source: National Bureau of Statistics of China (1999)

As the core of strategy of urbanization from below, the development of



Township and Village Enterprises (TVEs) was highly encouraged by the government to accommodate more peasants. The TVEs achieved rapid growth as a response to the reform of resource allocation mechanism and a way of mechanizing agriculture (Lin, 2004). In 1992, 106 million workers (52 million in collective enterprises and 54 million in private enterprises) were employed in the TVEs comparing to 145 million in the state and urban enterprises (National Bureau of Statistics of China, 1993). In this process, the development of small towns and medium cities act as the interface for promoting urban-rural linkages. This has actually broken the once prevailed economic divisions between urban and rural areas. Besides selling the agricultural products, peasants also benefit a lot from selling TVEs-manufactured commodities at market prices.

The flourishing rural economy and higher non-agricultural incomes have contributed much to peasants' decision making in undertaking non-farming work and migrating to cities. According to the National Bureau of Statistics, there were 269 million peasant workers, of whom 166 million were migrant workers in cities<sup>2</sup>. This type of people unlike those who are still living in the countryside has strong desire to completely settle in cities. The reality has been challenging the current urbanization policies which used to discriminate the peasants. Firstly, the policy of settling in cities became loose in late 2013: completely remove restrictions of settling in towns and small cities, orderly open settlement in medium cities, reasonably make conditions of settling in big cities, and strictly control population size in super cities<sup>3</sup>. Further, in mid-March 2014, the Chinese Central Government released the <National New-type Urbanization Plan (2014-2020)>. This strategy emphasizes to respect people's willingness of settlement in the future, and to provide even public services to people residing in cities.

Based on the above analysis, the relationship between institutions and

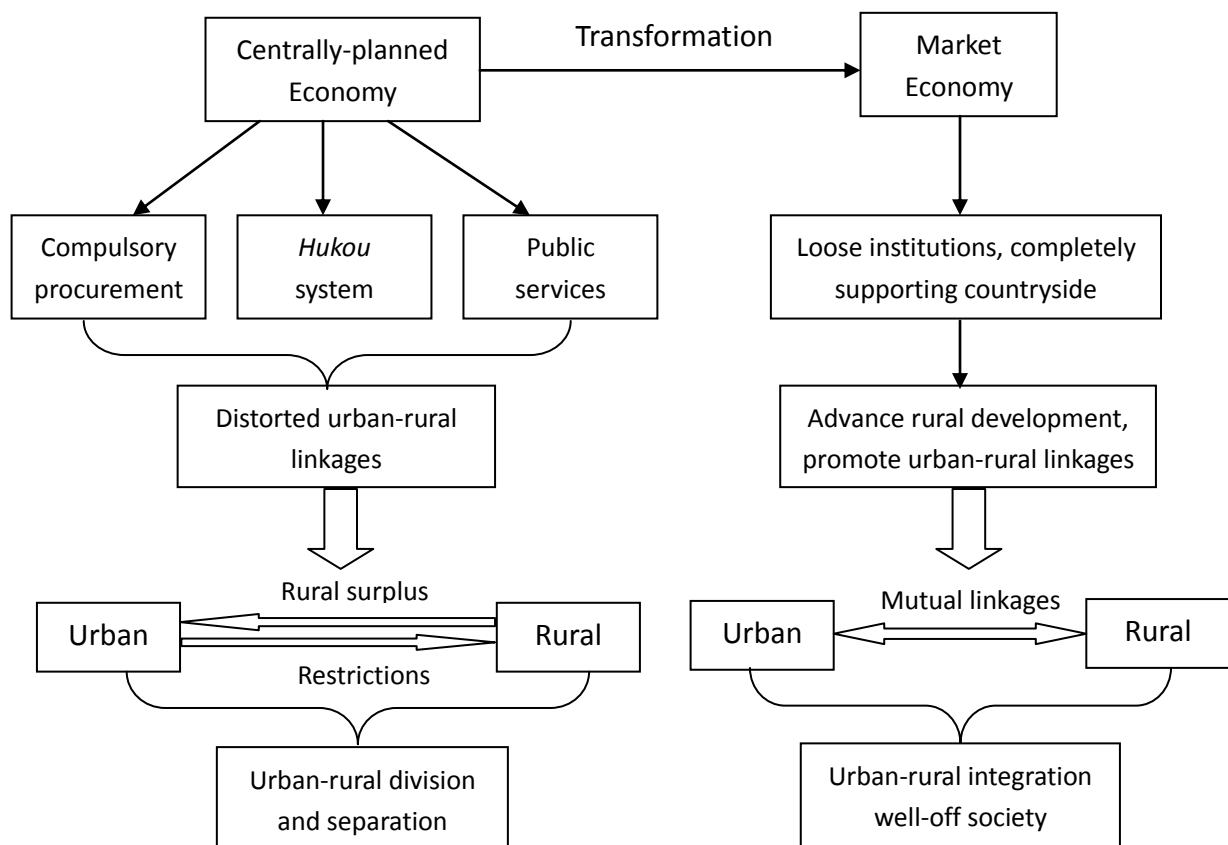
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<sup>2</sup> [http://www.stats.gov.cn/tjsj/zxfb/201405/t20140512\\_551585.html](http://www.stats.gov.cn/tjsj/zxfb/201405/t20140512_551585.html)

<sup>3</sup> <http://theory.people.com.cn/n/2013/1215/c49154-23842834.html>

urban-rural development in China could be described in the following sketch (Figure 1). The compulsory institutions which are of urban bias were intentionally deployed, distorting the urban-rural linkages and causing enlarged urban-rural inequalities. Ever since the reform and opening-up, peasants' initiatives of undertaking non-agricultural work and settling in cities have induced the institutional change which finally shifted from urban bias to completely supporting the countryside at the beginning of the twenty-first century. Then, rural development was advanced and mutual linkages between urban and rural areas were promoted. As a result, the ever enlarging urban-rural inequalities tend to approach IURD.

Figure 1 The sketch of changing institutions and urban-rural development in China



### 3. Empirical analysis

#### 3.1 The assessment of IURD in China

Mainland China includes 27 provinces and 4 provincial-level cities (Beijing, Tianjin, Shanghai and Chongqing) (Figure 2). These administrative units are

grouped into eastern, central and western regions.

Figure 2 Provinces and the Three Regions in China



The fundamental purpose of promoting IURD is to break down institutional barriers, and to achieve coordinated urban and rural development by strengthening urban-rural linkages (Chen and Li, 2004; Luo and Li, 2005). Ye (2009) lists three main rubrics of IURD in China: deployment of key factors between urban and rural areas; supply of primary public goods and services (infrastructure, compulsory education, health care and social insurance) in urban and rural areas; allocation of public resources between urban and rural areas (this subsumes the previous two rubrics). Basically, the IURD covers many aspects in the socioeconomic and environmental fields and the data availability challenges the feasibility of assessing IURD. In the paper, we try to investigate the urban-rural differences which can, from the opposite side, indicate the level of IURD. If there is big/small urban-rural difference of a certain province, then, the level of IURD of this province would be low/high. We believe that the deployment of key factors, provision of public goods and

various policies would finally cause the differences of people's income and living standards between urban and rural areas. Thus, we select two variables to assess the level of IURD, as follows:

(1) *The ratio of average household income between urban and rural areas (INCOME)*. This variable describes the income difference between peasants and urban citizens because of the various dual development policies during past decades. The higher ratio indicates the bigger urban-rural difference, and lower level of IURD.

(2) *Engel coefficient*. The Engel coefficient is an observation in economics stating that as income rises, the proportion of income spent on food falls, even if actual expenditure on food rises. This coefficient is widely used to indicate people's living standards. High Engel coefficient indicates more expenditure on food, but low living standards. We use  $X$  to describe the difference of people's living standards between urban and rural areas, as shown in Formula 1. The higher  $X$  means bigger urban-rural difference and lower level of IURD.

$$X = (1 - \text{Urban Engel coefficient}) / (1 - \text{Rural Engel coefficient}) \quad \dots\dots 1$$

Thus, the level of IURD of a certain province can be assessed by conducting the Principle Component Analysis of the above two variables.

### 3.2 The institutional roles

Generally, the influence of institutions on urban-rural integration mainly lies in three aspects: the deployment of economic factors e.g. capital, flows of laborers and provision of public goods. Thus, we hereby list three main institutions. They are institution of investment in villages and agriculture; *hukou* system and institution of supply of public goods.

(1) Institution of investment in villages and agriculture (*Investment*). Basically, the decentralization of authority by allowing provincial governments to keep part of the tax revenues remaining, has given provincial governments more autonomy in directing local development. With respect to the rural

development, we assume that provinces, according to their own socioeconomic conditions, would exert different measures to boost rural economy so as to promote urban-rural integration.

*Investment* is measured by the share of budgetary expenditure on agriculture in the total budgetary expenditure (BEA). BEA shows rural inputs from provincial government beside the support from the central government. Higher *Investment* reflects more decentralized power in boosting rural development.

(2) *Hukou* system. It is not so easy to measure the influence of *hukou* system. Sun et al. (2011) sets 1 for years when there were *hukou* reform while 0 for years when there were no *hukou* reform and then, measures its influence on China's urbanization development. However, this way of quantifying *hukou* couldn't sufficiently show the changes of *hukou* system over time since the restrictions of *hukou* in the provinces are different at different times.

In the paper, we use the urbanization level to proxy the influence of *hukou* system in a certain province. In the period before 1990, the urbanization level shows only the proportion of non-agricultural population with urban *hukou*. The influence of *hukou* during this period was also firmly prohibiting peasants from migrating in cities. Ever since 1990, the statistics of urbanization level were adjusted according to the permanent urban population who are residing in a city for at least half a year. This way of measuring the urbanization level actually shows the changes of *hukou* influence on controlling peoples' mobility.

(3) *The supply of primary public goods (GOODS)*. Generally, urban and rural areas in China differ a lot in the supply of primary public goods and services due to the over decades biased policies. We use the ratio of per capita hospital beds between rural and urban areas to represent the supply of primary public goods and services in China. The higher ratio of *GOODS* indicates better provision of public goods at the countryside.

We collect data of 30 provinces in China from 1981 to 2010. The Appendix 1 reports the descriptive statistics for the main variables. Following the literature, after controlling for a series of explanatory variables that may influence the

economic conditions of a certain province, we specify our regression model as:

$$IURD_{it} = \alpha_1 Investment_{it} + \alpha_2 Hukou_{it} + \alpha_3 Goods_{it} + \alpha_4 X_{it} + \beta_i + \gamma_t + \varphi_{it}$$

Where  $IURD_{it}$  is the measurement of the level of urban-rural integration of province  $i$  at year  $t$ .  $Investment_{it}$  is the share of budgetary expenditure on agriculture in the total budgetary expenditure of province  $i$  at year  $t$ .  $Hukou_{it}$  is the assessment of *hukou* system proxied by the urbanization level of province  $i$  at year  $t$ .  $Goods_{it}$  indicates the supply of public goods to the countryside, proxied by ratio of per capita hospital beds between rural and urban areas.

$X_{it}$  is a vector of control variables that influence the economic conditions of a certain province, including: economic openness, measured by the ratio of export and import to GDP (TRADE) and the ratio of utilized FDI to GDP (FDI); government expenditure, GOV, measured as the ratio of government budget expenditure to GDP; state ownership, measured by the share of state owned enterprises in total industry output value (SOE).

We also control fixed effects:  $\beta_i$  is the province-specific effect,  $\gamma_t$  is the year effect. Finally,  $\varphi_{it}$  is an unobserved error term that changes across time and among provinces. Appendix 2 reports the definitions of variables and data source.

Appendix 1 reports the definitions of variables and data source. We collect data for 29 provinces in China from 1981 to 20102. Almost all the data are from National Bureau of Statistics (NBS). Appendix 2 reports the descriptive statistics for the main variables.

#### Appendix1

Variable	Source	Variable Description
GGDP	NBS	Per Capital GDP Growth
INV	NBS	Investment ratio
HUMAN	NBS	Ratio of university students to total population
SOCIAL	PBOC	Number of associations possessed by per 10 thousand persons
SOE	NBS	Ratio of industrial output of state owned enterprises to total industrial output
Government	NBS	Government expenditure to GDP ratio
TRADE	NBS	Import and export at current price
FDI	NBS	FDI inflow to GDP ratio

#### Appendix2

Variable	Obs	Mean	Std.Dev	Min	Max
GGDP	870	0.098	0.043	-0.097	0.39
LNGDP	870	7.311	0.963	5.279	10.296
INV	870	0.435	0.124	0.153	0.982
HUMAN	870	0.007	0.008	0.0004	0.064
SOCIAL	609	1.37	0.625	0.42	4.210
GOV	866	0.144	0.063	0.048	0.548
SOE	870	0.606	0.198	0.107	0.938
TRADE	860	0.239	0.347	0.006	2.203
FDI	870	0.024	0.033	0.000005	0.243

In contemporary China, decentralization has characterized the fiscal system reforms since the 1980s with the fiscal contract system (1980–1993) and the revenue assignment system (1994–present) (Jin & Zou, 2005). Meanwhile,

China's sub-national governments have received corresponding decentralized responsibilities to address social service provision with an increasing share of public expenditure (Wu, 2013).

Since the late 1990s, massive regional migration, triggered by state's export-oriented developmental strategy, has seriously posed a threat to the urban-centred welfare provision. It is against this policy context that the central government has kept urging local governments to improve working conditions of migrant workers. However, when being exposed to the territorial competition under economic globalization, local governments usually have less incentive to provide welfare services for migrant workers, who move frequently between regions (Mok and Wu, 2013).

Although welfare provision is significant for promoting nation-building and social citizenship, welfare delivery is dependent, to a large extent, on the capacity, resources and incentives of the local states/governments. For local states/governments, they are in better position to assess and identify the welfare needs of citizens and come up with welfare/social policies/measures appropriate for matching people's welfare demands (Cook, 2011; Greer, 2010a, 2010b).

#### 4. Conclusion and discussion

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