Zhiming Cheng · Mark Wang
Junhua Chen *Editors*

Urban China in the New Era

Market Reforms, Current State, and the Road Forward

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Introduction

In a new era of development and uncertainty after the recent global financial and societal crisis, Chinese cities and regions are facing a new series of social, economic and political challenges and turbulence caused by demographic transition, labour market changes, injustice and inequalities and issues related to natural and built environments. Consisting of nine chapters written by academics in China, Australia and Taiwan, this book aims to provide an account of recent academic understanding and reflections on some of these important issues.

Chapter 1 provides a detailed and comprehensive examination of the sophisticated relationship between outward-oriented economic reforms and income inequality at regional and sectoral levels. In this chapter, Shao-Wei Lee analyses time series data from 1978 to 2007 and finds that income inequality was to some degree caused by reforms in the trade sector and state sector. Meanwhile, foreign direct investment (FDI) and economic growth helped reduce income inequality. The eastern region, which developed much faster than the central and western regions, dominated the inequality-increasing effect of trade and inequality-decreasing effect of FDI. It is suggested that the reform package introduced in 1992 played an important role in the overall inequality-increasing effect. Lee implies that FDI and trade reforms should be further strengthened in less developed regions and sectors to boost economic growth and reduce inequality.

It is impossible to steer clear of the *hukou* (household registration) system if China intends to open up a new stage of reforms. In Chap. 2, Yeqing Huang critically reviews the continuity and changes of the *hukou* system since the 1990s. This review is timely because China plans to overhaul the *hukou* system in the coming decade in order to accelerate urbanization. Although the *hukou* system is mainly designed by the central state to control rural-to-urban migration and settlement, the local state is the most crucial player in implementing and reforming *hukou* policies in the context of decentralization and increasing local autonomy. On one hand, commodification in the *hukou* reform at the local level enables some migrants who are wealthier and better educated to gain the highly sought after urban *hukou* status. On the other hand, local governments are increasingly using market forces to guide public policy, resulting in further marginalization of rural-to-urban migrants and deprived urban dwellers.

It is widely believed that the disadvantaged *hukou* status of rural-to-urban migrants and former famers is a major reason why they are unable to fully benefit from rapid urbanization. In Chap. 3, Junhua Chen contends this observation and provides an alternative approach that focuses on land reform to assess and explain urban housing issues confronting migrants. Through an evaluation of different land pricing systems in China's agricultural land conversion, Chen suggests that the local state has dominated the conversion of farmland and the supply of urban land. The vast difference between the compensation fee paid to farmers for farmland conversion and the leasing price for converted farmland in the urban land market generates enormous land revenue for the local state. However, the majority of farmers and migrants derive limited benefits from land conversion and urban housing reform. In fact, they even have to face the risk of losing their housing land in their hometowns.

Nonetheless, some former farmers have benefited from urbanization. Chapter 4, written by Da Wei David Wang, examines the case of Shenzhen city in Guangdong province, where the spaces and functions of urban villages—the residences and collective memories for many generations of villagers—have been extensively and intensively transformed to adapt to urban expansion, redevelopment, marketization and, more importantly, a new form of local governance in the Special Economic Zone. Through a case study of Huanggang village, Wang depicts and analyses the formation and development of a village-owned company that was later developed into a successful commercial corporation in Shenzhen's city centre. However, its success, as Wang argues, was due not to the spirit of free market capitalism but to village collectivism, which proved to be very effective in the self-governing Huanggang village. Wang challenges the negative perceptions against urban villages in the eyes of some urban residents, planners and scholars. He suggests that urban villages have good potential to become vibrant and harmonious communities.

Harmony as seen in Huanggang village is not always observed during China's radical urbanization. In Chap. 5, Ying Wu and Xuezhen Dai examine two Chinese-style 'Not-In-My-Backyard' (NIMBY) protests against unwanted land uses by industrial workshops and a garbage incineration plant in Beijing. The authors find that the government is the most effective supporter for NIMBY movements in China. This is different from the circumstances in the West, where non-government organizations and the media usually play the major roles in NIMBY action. They argue that residents have strengthened their awareness of property and environmental rights and established their urban citizen identity by participating in public policy-making and pursuing environmental justice.

In Chap. 6, Wei Li extends the previous chapter's focus to urban environmental governance. Through an examination of two cases (implementation of a water abstraction policy in Benxi of Liaoning province and popularization of solar water heating in Dezhou of Shandong province), Li demonstrates the importance of considering institutional dimensions in applying environmental tools in China. She suggests that, as local institutions vary from one locality to another, local governments motivated by their own incentive mechanisms will adopt diverging policy instruments and implementing mechanisms in response to the policies of central government, resulting in heterogeneous efforts and resources devoted to environment and resource management. This chapter resonates with Chap. 2, which also examines why and how local state implements policies in a way that is different from the expectations of central government in the contexts of decentralization and reforms.

The last three chapters examine different aspects of the urban labour market in southern, eastern and northern China, respectively. In Chap. 7, Zhiming Cheng examines the emergence of new-generation rural-to-urban migrants who were born in 1980 and thereafter in cities of the Pearl River Delta in Guangdong province. Cheng presents a portrait of migrant workers that differs from previous research, because getting urban jobs and a wage income has become a means to embrace urban life for many new-generation migrant workers, rather than the sole or major purpose of migration. New-generation migrant workers are younger, better educated and trained, less connected to the countryside and have a broader urban dream than their predecessors. However, they are experiencing difficulties and confusion caused by a long-standing rural–urban divide, thwarted by institutional barriers and market forces.

In Chap. 8, Reza Hasmath studies the relatively less revealed experience of ethnic-minority workers and jobseekers in Beijing, implying a hidden dimension of labour market segregation in addition to the *hukou*-induced segregation as discussed in Chaps. 2 and 7. Ethnic minorities are found to be at a disadvantage relative to the dominant Han ethnic group, particularly when it comes to their employment in high-wage, skilled jobs. This may be attributable to gaps in the institutional framework that encourage reliance on social network capital for the job search, hiring and promotion process. Another potential reason for ethnic disadvantages in the labour market is the difference in education attainment between ethnic minorities and the Han ethnic group. The next chapter provides some more hints.

In Chap. 9, Vinod Mishra and Russell Smyth use matched employer-employee data for Shanghai to estimate the private returns to education. There were low rates of return to education in the pre-reform period and the initial stages of the post-reform period because China's long-term allocation of labour resulted in a relatively equal distribution of income. This is consistent with Lee's findings in Chap. 1. Their estimates suggest that the returns to schooling in urban China have increased over time due to relaxation of administrative controls over wage setting and that the returns to an additional year of schooling for females were higher than those for males. In addition, this chapter discusses some important methodological issues in relation to the study of the urban labour market in China.

Zhiming Cheng, Mark Wang and Junhua Chen

Chapter 1
The Impact of Outward-Oriented Economic Reform on Income Inequality in China: 1978–2007

Shao-Wei Lee

Abstract China initiated economic reform in various sectors from 1978 and since the early 1990s has drawn a great deal of attention to its outward-oriented economic reforms. The economic transition from a centrally planned to a market-oriented system accompanied fluctuations in income distribution. The main objective of this chapter was to examine the impact of China's outward orientation (globalisation) on income inequality from 1978 to 2007 by using the cross-sectional and time series approach. The major results show that (1) income inequality was widening in the 1990s, especially in the eastern region, which coincided with the period of all round economic reform and accelerated outward-oriented reforms; (2) the reforms of trade and state owned enterprises lead to income inequality, whereas, FDI and economic growth improved income inequality; (3) the eastern region dominated the inequality-increasing effect of trade and inequality-decreasing effect of FDI; and (4) the reform package introduced in 1992 played an important role in the overall inequality-increasing effect. The policy implication is that FDI and trade policies should be strengthened in those regions and sectors that are less developed and/or concerned.

Keywords Foreign direct investment • Trade • Reform • Income inequality

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Dr. Shao-Wei Lee is a Research Fellow at the Taiwan Academy of Banking and Finance, Taipei, Taiwan. This research project is originated and re-written based on her unpublished PhD thesis which was completed in Nov. 2010 at the University of Wollonging in Australia.

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Abbreviations

ADF	Augmented Dickey-Fuller
FDI	Foreign Direct Investment
FIEs	Foreign-Invested Enterprises
GDP	Gross Domestic Product
HOS	H-O model and Stolper-Samuelson theorem
IPS	Im Pesaran, and Shin
LLC	Levin Lin, and Chu
LM	Liquidity preference Money supply
SEZs	Special Economic Zones
SOEs	State-Owned-Enterprises

1.1 Introduction

China introduced economic reform in 1978 where government's attention was initially given to the agricultural (rural) sector and then extended to state-owned-enterprises (SOEs), non-SOEs, and globalisation characterised by international trade and foreign direct investment (FDI). The outward-oriented economic reforms (globalisation) were accelerated in the 1990s and a large amount of inward FDI and foreign trade became the source of the nation's wealth over time and the increased income helped move a population away from poverty[1] in the past three decades (Jalilian and Weiss 2002; Winters et al. 2004; Zhang 2006; Warr 2006).

Fluctuations in income inequality are sensitive to government policy, which is why the economic reforms that accompanied the increased/decreased income inequality in China were obvious. Winters et al. (2004) noted that while an open economy tends to increase opportunities for economic activity it can very easily increase income inequality while simultaneously reducing absolute poverty. A number of Chinese studies have shown that overall income inequality decreased initially when agricultural reforms were launched, but it worsened when globalisation policies were enhanced (Lu and Wang 2002; Keng 2004). The outward-oriented economic policies and greater market competition may explain this increased income inequality during the reform period, however, reforms of differing sizes and magnitudes across regions and sectors also worsened the overall distribution of income in China (Liu 2001; Kanbur and Zhang 2005; Owen and Yu 2008).

How would globalisation affect a country's income inequality? Existing theories and empirical studies about the impact of globalisation on income inequality remain inconclusive. The HOS model (a combination of the HO model and

[1] Based on the poverty headcount ratio of $1.25 a day, the aggregate absolute poverty decreased from 60 % of the population in 1990 to 16 % in 2005 in China (World Bank 2009).

Stolper-Samuelson (1941) theorem) argues that free trade and higher labour-intensive exports raises the income of the unskilled worker due to unskilled workers being an abundant resource. Given the fact that unskilled worker is a more equally distributed factor than skilled worker in China, and China is the world's major manufacturer/exporter of labour-intensive goods, the HOS theory can be used to predict that China's open door policy is associated with a more even income distribution. Unfortunately, the HOS model has some limitations. For example, imperfect competition and tariffs still exist among trading partners which may lead to a failure of the prediction. Other than that, globalisation benefits those who are already well off because rich people gain most of the advantages offered by trade expansion (Spilimbergo et al. 1999). Therefore, the limitations of HOS theory leave room for an argument regarding the relationship between openness and income inequality.

A number of international studies have emerged that examined the linkages between outward-oriented economic reform and income inequality. The fact that trade and/or FDI is associated with widening income inequality was found by Savvides (1998), Bhandari (2007), Breau (2007) and Silva (2007), whereas an argument that trade and/or FDI narrows income inequality was found by Reuveny and Li (2003), Ashby and Sobel (2008), Ahmad and Daud (2008), and Barlow et al. (2009). No relationship between FDI and/or trade with income inequality was found by Bhatta (2002), Sylwester (2005), and Roine et al. (2009).

In China, the relationship between economic globalisation and income inequality is also mixed. The fact that international trade and/or FDI is associated with increased income inequality was found by Xu and Zou (2000), Zhao (2003), Li and Xu (2003), Kanbur and Zhang (2005), Lu (2008), and Jin (2009), whereas Tian et al. (2008), Owen and Yu (2003, 2008), He and Tan (2003) and Liu (2001) found that trade and/or FDI were linked to a decrease in income inequality.

China is an important case study because the use of a longer historical time series data covers a significant period of economic transition which offers a model of future tendencies that may be experienced by other developing countries who undertake economic globalisation. Furthermore, China has one of the largest populations in the world and vast geographical disparities in terms of the distribution of resources and living standards, for example. Therefore, investigating whether those factors can be associated with changes income inequality worthy of deeper examination. Importantly, this chapter is different from many previous studies because it computes its own Gini coefficient (proxy for income inequality) which is based on reliable and consistent sources of data. Second, this research considers several important econometric issues, including the panel stationarity of variables, the endogeneity of explanatory variables, and a censored (truncated) regression model. These issues are rarely discussed in existing empirical studies.

The remainder of this paper is organised as follows. Section 1.2 discusses China's outward-oriented reforms and performances; Sect. 1.3 presents the methodology procedure and descriptions of data; Sect. 1.4 shows the empirical results; and Sect. 1.5 resumes and concludes.

1.2 China's Outward Orientation Reforms and Performances

1.2.1 International Trade

From early 1949 to 1971 China's economy was self-reliant and isolated from the outside world. Even though trade strategy for import substitution was carried out from 1972 to 1978, the purpose was not to open its markets but to spur industrialisation and protect the shortage of foreign exchange. Imports of intermediate and capital goods were used to produce final goods, and exports were carried out to pay for imports (Chai and Roy 2006, p. 110). Therefore, foreign trade was low before trade reform. From 1978, a combined strategy of import substitution and export expansion was implemented. China exports labour intensive goods where China has comparative advantages, and develops capital and technology intensive industries where China is relatively disadvantaged. Trade strategy became fairly export-oriented from 1992 after a number of export assistances were introduced to promote exports.

Importantly, the establishment of special economic zones (SEZ) since 1979 is a most notable strategy because of its function in attracting FDI in the industrial sector, which was producing and exporting labour -intensive goods. It is worth noting that all the SEZs were established in the eastern region, particularly along coastal line cities, because the eastern region is the strategic site for economic development and geographically, the eastern region directly faces the world markets. Enterprises in SEZs enjoy, for example, tax exemptions, advanced and convenient construction of infrastructure, and services. Under a successful operation of SEZs, foreign trade (particularly exports) and FDI increased rapidly, which were considered the driving forces of China's economic growth (Berthelemy and Demurger 2000).

Figure 1.1 shows the pattern of aggregate foreign trade, export, and import as a percentage of GDP from 1978 to 2008. There were some intersections between exports and imports before 1994 that stemmed from a combination of import substitution and export expansion policies. Overall, the import substitution strategy was to stimulate domestic industrialisation, which led to higher imports from 1985 to 1990. The trend of imports exceeding exports ceased in the 1993 when China decided to emphasise export expansion. In addition, international trade (exports plus imports) was increasing over time with an obvious drop during the Asian financial crisis in 1997. Trade as a percentage of GDP accounted for 15 % in 1978 and increased to about 45 % in 1994. It then decreased to about 32 % in the late 1990s as a result of the global economic recession. The trade performance recovered from 32 % in 1998 and increased to 71 % in 2008.

1.2.2 FDI

FDI involves a complementary shortage of domestic capital, a transformation of advanced skills and technology in production, and additional income sources for a great number of unskilled labourers. Hence, FDI reform is also considered an

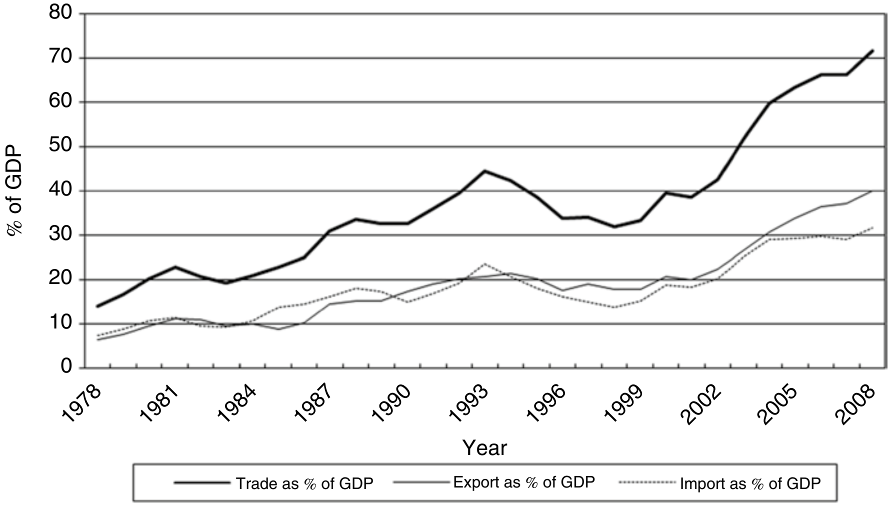

Fig. 1.1 Foreign trade (total, export, and import) as % of GDP (Source: *China Statistical Yearbooks*, various years)

important factor in China's fast economic growth. Overall, the progress of FDI reform moved gradually but accelerated in the 1990s. 1978–1983 was the "Experimental Stage" where FDI reform was experimental and carefully regulated, with preferential treatment allocated to four special economic zones (SEZs) that were established in 1981. Restraints on FDI outside these SEZs were rigid.

The second period from 1984 to 1991 was the "Speed-up Stage". A formerly lengthy process of approving FDI was simplified, restrictions on FDI were further relaxed, and more investment channels were given to FDI than other regions outsides the SEZs. More precisely, 14 coastal line cities[2] were opened up to foreign investment, and they enjoyed, for example, more autonomy in making economic decision compared to SEZs. In 1987 regions such as the Yangtze River Delta (surrounding Shanghai) and the Pearl River Delta (surrounding Guangzhou, Fujian, Liaoning, and Shandong) were also opened up to FDI.

The period from 1992 to 1993 was the "Peak Stage" where high technology, established manufacturers, and financial companies were encouraged to set up their operations in Shanghai. Importantly, overall economic reform and the openness of FDI moved much further in 1992 after former leader Deng's inspection tour of South China. Export-oriented FDI and FIEs with advanced technology were especially promoted during this period. In comparison to earlier stages, more geographic regions and sectors such as financial, banking and insurance, wholesale and retail,

[2] Fourteen coastal cities are including Shanghai, Tianjin, Dalian (Liaoning province), Qinghuangdao (Heibei province), Yantai (Shandong province), Qingdao (Shandong province), Lianyungang (Jiangsu province), Nantong (Jiangsu province), Ningbo (Zhejiang province), Wenzhou (Zhejiang province), Fuzhou (Fujian province), Guangzhou (Guangdong province), Zhanjiang (Jiangsu province), Beihai (Guangxi province).