

Urbanization, Rural Land System and Social Security in China

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Abstract

In China's transition and economic development, temporary migration, lack of basic social security arrangements for migrants, and frequent administrative land reallocation in rural areas and abusive rural land requisition in the urbanization process are all important policy issues that have been studied intensively with lots of policy recommendations. However, these issues are closely related and need to be explored under an integrated framework that takes into account China's large size and characteristics in economic development and transition. The paper aims to establish such an analytical framework and proposes a policy package to systematically address these issues. Implications from such proposed policy package are also discussed and compared to other policy recommendations.

I. Introduction

In China's transition and economic development, temporary migration, lack of basic social security arrangements for migrants, and frequent administrative land reallocation in rural areas and abusive rural land requisition in the process of urbanization are all important policy issues both in academic research and on government agenda. Many policy recommendations have been proposed to solve these issues.

As to urbanization and migration in China, the Hukou (urban permanent residential right) system, though much less restrictive than before, still limits labor mobility and

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population redistribution across regions and between urban and rural areas. To be more specific, the current Hukou system makes the migration of tens of millions of rural labors temporary in nature. Though there have been some local reforms on the Hukou system within individual provinces, gaining a Hukou in places other than the migrant's home province is still very difficult; Though there have been huge number of migrants working at different sizes of cities and in coastal areas, permanent migration are still impossible for most rural migrants in the sense that they cannot enjoy equal treatments in social security, housing and children's education compared to the urban residents with Hukou. At the same time, the city governments are under great financial pressure to provide social security for an increasingly enlarged body of laid-off workers, SOE retirees and urban poor with Hukou. Provision of social security, housing and children's education for migrants is still not the top priority on local government agenda.

Lack of social security, housing and children's education arrangements makes it impossible for rural migrants to cut off their linkage to their rural lands. Once the migrants lose their jobs in cities, rural lands become their last resort for employment and income. The fact that migrants leaving the countryside without giving up their lands poses serious challenges to rural land tenure security. Under the current rural collective ownership, land tenure security cannot be realized due to various reasons such as demographic changes across households within villages, grain quota and tax obligations, and even local cadre's rent-seeking behavior, all of which result in frequent administrative land reallocation in many rural areas.

A more serious issue is the abusive rural land requisition by local governments in many regions. In the process of accelerated urbanization and industrialization, land requisition in which local governments purchase agricultural land from farmers and turn it into industrial and commercial uses become more and more frequent. However, since land use change from rural to urban in China can only be carried out through government requisition (monopolized purchase) under the current legal framework, insufficient compensation to farmers in land requisition has led to millions of farmers losing land, resulting in bitter complaints and even social unrests.

In this paper, we will argue that the temporary migration, lack of social security for migrants, rural land tenure insecurity and abusive land requisition are closely related issues and need to be analyzed under an integrated analytical framework and solved with a systematic solution package. In Part III, we briefly review and analyze each of the issues separately. Part III outlines the close relationships among these issues and further argues that they should be viewed with special attention to China's characteristics, i.e., a large developing county in the process of economic transition. Part IV proposes a policy package to approach these issues simultaneously with a discussion of the implications.

II. Literature Review

1. Urbanization and migration

There is a large literature on China's urbanization and migration. A consensus reached in this literature is that a set of discriminating institutional arrangements in which the Hukou system is the core has, to a large extent, limited the progress in China's urbanization. According to Au and Henderson (2003), China's urbanization lags far behind its industrialization and national economic development. Furthermore, they argue that the history of policy in China has resulted in an urbanization process where the cities are significantly undersized and agglomeration economies not fully exploited. In their empirical study, it is found that real incomes per worker rise sharply with increases in city size from a low level. Therefore, the policy implication is that removing restrictions on migration will both promote urbanization and productivity in China.

Starting from the middle of the 1990s, reforms in the Hukou system have been carried out on a pilot basis in many individual provinces where migrants can get urban Hukou easier than before. However, breakthroughs in Hukou reform are yet to be realized since the thresholds to gain an urban Hukou in large cities and across provinces are still very high, if ever possible. For example, in many cities, migrants must reach a very high income level and own a house or apartment to be eligible to apply for a urban permanent residency rights. In large cities such as Beijing and Shanghai, migrants need to invest over a million yuan to be considered. Hukou reform progressed fastest in some small towns and cities where rural migrants doing small business can be granted an urban Hukou relatively easier. However, the benefits of gaining such Hukou is quite limited and the rural migrants have to give up their rural lands and are subject to more restrictive birth control policies applied to city residents. Therefore, these reforms have not met with very positive responses from migrants. An empirical study of 88 towns in Zhejiang Province by Huang (2002) found that local government motivations behind Hukou reforms in these small towns and cities are more oriented to promoting local government administrative level and gaining extra-budget revenues from land requisition in urbanization process than to absorbing migrants and removing restrictions on migration *per se*.

2. Rural land system

Although rural households in China do not have land ownership and cannot sell lands, the use rights and residual income rights that have been provided offer direct and indirect benefits to farmers. These benefits include: first, households are entitled to the implicit return to land as a factor of production; second, in an environment of labor market imperfections and limited off-farm opportunities, land provides households an opportunity

to utilize family labor to the fullest; third, in an environment of grain market imperfections, land serves as a source of food security, and a cheap source of calories; finally, land also serves as a form of insurance in the event of loss of off-farm opportunities.

However, due to many factors such as demographic changes, rural land in Chinese villages had to be reallocated from time to time, which pose serious challenges to land tenure security. According to Rozelle *et al* (2002a), land tenure insecurity may have negative impacts on allocation efficiency and farmers' potential gain from land transactions. However, village-wide administrative reallocations may also help move land to households that have a higher marginal productivity, and thus, are efficiency enhancing. Therefore, administrative reallocation may be a substitute for market reallocation though the substitution effects are not perfect due to informational problems and transactions costs of carrying out the administrative reallocations. Yao (2000) also argues that land reallocation may be necessary since rural lands play roles of unemployment insurance and social security functions in rural China.

In explaining the regional heterogeneity of land reallocation, Rozelle *et al* (2002) found that a number of factors such as grain quota fulfillment, the desire to maintain equal access to land among villagers, missing rental markets, and rent-seeking behavior on the part of local leaders all play a role. The role of reallocations in assuring equal access can only explain a small portion of the reallocation behavior; the other explanations, all of which are linked to the incentives of local leaders, appear to be far more important in explaining decisions with respect to the timing and size of reallocations. They argued that though the impacts of current rural land system on efficiency and equity are yet to be further studied, the current government move to provide households with security for 30 years and only allow small adjustments to accommodate population changes is a step forward. In the meantime, however, keeping the door open for small adjustments may be enough to meet distributional concerns.

A more serious problem in rural land system is in the field of land use change from rural to urban. Since the middle 1990s, with the rapid development of urbanization and urban land markets, rural land requisition for urban uses significantly increased. In the context of fiscal centralization since 1994, local governments initiated a wave and another land requisition to create extra-budget revenues to fill the financial gap resulted from fiscal centralization. Lots of industrial parks and urban development zones were established in which local governments, together with local land developers, purchased lands from farmers at prices far below the market prices and gain profits. Under-compensated farmers, losing their land and usually becoming unemployed, lodged bitter complaints against local governments and social unrest are witnessed in many regions.

Zhou (2004) argues that the key reason for abusive land requisition is that there is only

one channel for rural land use change into urban uses—mandatory government requisition. Given that government is the only legal buyer of rural lands, abusive government land requisition is inevitable. Therefore, the only solution is to establish a marketized rural land use change mechanism in which rural collectives, as the owner of rural lands, can enter the land use change market directly and negotiate with land buyers. He also pointed out that in some regions, villages have begun to sell land use rights for non-agricultural and even urban development purposes and further reforms shall draw on the rich experiences and innovations from these local practices.

To solve the problems of administrative land reallocation and abusive land requisition, many scholars argue that land privatization is the only way out. Wen (2004) argues that land privatization will make it possible not only for migrating farmers to sell their lands and those staying in agriculture expanding their cultivation and realizing economy of scale in farming, but also private lands can serve as collaterals in obtaining loans from banks to facilitate farm and off-farm development. Zhao and Wen (2000) further argues that with more young people migrating out of rural areas, the role of traditional rural family in providing for old age has been challenged, thus privatized land or permanent tenancy rights will reassume the function to facilitate the inter-temporal and intergenerational transfers within rural households. It can provide, to a significant extent, the urgently needed old age security at a time when the government could do very little financially, and many rural elderly feel particularly vulnerable after the dismantling of the commune system. Yang (2003) argues that privatized land, or private ownership in general, constitutes the basis for a constitutional rule and enables government to credibly commit not to predate, which will limit state's opportunistic behavior and bring economic prosperity.

3. Migrant's social security

The social security arrangements most related to migrants include social insurance, social assistance and housing security arrangements. As the core of social security, China's social insurance includes pension, unemployment insurance and medical insurance, while social assistance mainly includes the minimum living standard guarantee that applies to urban residents with Hukou. One key difference between social insurance and social assistance is that in social insurance, beneficiaries (or their employers) must pay a certain amount to be eligible to enjoy the program benefits, while in social assistance, benefits are granted on the grounds of eligibility and need.

In China, the development of social insurance in urban areas is closely related to reforms in state owned sectors. In the instance of pension, government efforts to establish a unified pension system across the nation and expand its coverage to private sectors have met with significant difficulties. The reason is that the pension obligations for the existing

retirees from SOEs are so huge that fees collected from existing working force are not even sufficient to cover the payment for old retirees, which makes the current pension system a typical “Pay as You Go” system (Zhao and Xu, 2000). One important reason that pension system cannot be easily expanded to people with more flexible employment (usually in informal sectors) including most of the migrants is that such a system cannot guarantee future delivery of the promised benefits. The Chinese government is now initiating a pension reform on a pilot basis to realize a transition from the current PAYG to a system more oriented to individual account. Wu and Lin (2003) argue that to realize such a transition, selling some state assets to consolidate the current social security account is necessary given the large financial shortfall existed in the current system.

If the pension for old SOE retirees can be solved, a new pension system with consolidated individual account will be established more easily, which will further promote fee collection from informal sectors and migrating workers. In this case, instead of providing funds, what the government needs to do is only to take actions to expand social insurance program coverage once the transition from PAYG to individual account is realized.

However, the government can play larger financing roles in establishing social assistance and housing security arrangements, which are much more important for low-income urban residents and migrants. In China, minimum living standard guarantee and public housing programs have been established in many cities, but limited only to city residents with urban Hukou. Therefore, expanding these programs to cover migrants will not pose great challenges given the current institutional basis and policy practices.

III. Perspectives of a Large Developing Country in Transition

We believe that to solve the issues discussed above, not only do we need to approach them under an integrated analytical framework, but also need to analyze these issues from the perspectives of a large developing country in transition.

Firstly, these issues are closely related to each other. The key reason that most of China’s migration is temporary in nature is that no social security and corresponding housing and children education arrangements have been established for migrants so that the latter can settle down permanently in cities; For these migrants already earning a life in cities and not willing to returning to the countryside, lack of such social security, housing and children’s education arrangements make it impossible for them to give up their rural lands in the face of potential unemployment risks. In most cases, they just transfer their land use rights for short terms to their relatives or friends, even though the latter might not

be the most efficient farmers to use the lands; Lack of a mechanism for migrants to give up or leave their lands permanently makes it much more difficult for those who stay in the rural area to enjoy secure land tenure rights since there are no much extra lands released by migrants to deal with demographic changes within village and minimize pressures on administrative land reallocation. Under the unclearly defined collective ownership of rural lands, the current land requisition system in which government is the only purchaser make it impossible for rural-urban land use change markets to function and inevitably lead to farmers' insufficient compensation and lack of transparency in land requisition, which not only results in social injustice, but also leads to wasteful use of rural lands and land use inefficiency in the process of urbanization and industrialization.

Secondly, China is a large developing country under globalization. To bring China's comparative advantages into full play, China's cities, industries and population all need to be redistributed across space, which necessarily results in large scale migration, especially the migration of relatively young and skilled labors into coastal regions and large and medium-sized cities. As a large country, long distance migration plays a significant role in urbanization, as compared to the dominant form of short distance migration in Japan, South Korea and Taiwan during their rapid urbanization and industrialization periods in the second half of the 20th century. According to Rozelle *et al* (2002b), in 1990, less than 30 percent of rural migrants move outside their provinces, while in 2000, the share reached over 40 percent. Therefore, the stickiness of China's long distance migrants to their land is much lower than those in other smaller Asian economies. At the same time, the land rights of the Chinese farmers under the collective ownership are less protected than those of other Asian economies with a private ownership

At the same time, globalization of the Chinese economy requires younger and more skilled migrants. According to Cai (2000), the working ages of China's migrants are mostly within 20-35 years range, which are much lower than the average of China's labor forces. Not only these migrants are younger, but also they are better educated with education at or above junior high school level. The young age and relatively high education of the migrants means they lack both experiences and interests in farming.

Finally, it must be realized that China's economic development is a process simultaneous with its economic transition. The urban-biased policies have been in place since the planned period and are largely sustained up to now, which have led to abnormal urban-rural divide and huge stocks of surplus labor in rural areas. Freer and permanent migration is definitely an effective approach to reduce urban-rural divide since migrants usually earn less incomes than urban residents, but much more than the rural farmers. However, given the large stock of surplus labor in rural China and the limited capacity of cities in absorbing migrants in short terms, the Hukou reform must be carried out in a cautious way so that more farmers

can gradually, yet permanently move to cities. If the urban Hukou can be regarded as a threshold for the migrants to overcome, a reform of the Hukou system is to lower it step by step instead of removing it all at once.

What does an urban Hukou mean in China now? For migrants, an urban Hukou now means equal access to social security, housing and children's education. If some breakthroughs can be made in these aspects, real progress in Hukou reform can be achieved.

In the current policy debates, land privatization is regarded as the best approach to avoid frequent rural land administrative reallocation and abusive land requisition by local governments. However, land privatization might not be the best policy choice from the perspective of income redistribution given the current system. For the low and middle-income regions, the people migrating out to cities and coastal regions on average earn much higher incomes than those who stay in the countryside. Land privatization means the migrants will enjoy all the benefits entailed through land privatization and the lower income farmers who stay in the countryside have to buy or rent lands from the migrants to expand their agricultural production. Furthermore, if many migrants' main income sources are urban-based and they can gain permanent urban residency with further Hukou reform, what should be protected is the land rights of those who stay in the countryside. In addition, in further reforms of rural land system, a realistic question is the political feasibility of land privatization. If there is other policy package that can realize the targets of protecting farmer's interests and raising land use and transaction efficiency, and at the same time can do even better in income distribution without entailing radical reforms lacking political feasibility, such a policy package should be considered.

IV. Hukou-Rural Land Choice with Marketized Land Requisition: An Alternative Policy Package

We propose here an alternative policy package to solve the issues of urbanization, rural land system and migrant's social security simultaneously.

First, the government needs to set up land offices in rural China and issue long-term land user rights certificates to farmers. Second, local city governments need to define a reasonable entry criteria for gaining urban Hukou for migrants (for example, the migrants have worked in the city for 2-3 years and earned a monthly income of above RMB 600 or 800 Yuan for the past 8-12 months). At the same time, the city governments can establish a welfare package for the migrants who are granted urban Hukou. The package includes basic social security (minimum living standard guarantee), public housing and children's education arrangements. Third, if a migrant reaches the entry criteria as defined above and are willing to give up his or her rural lands on a voluntary basis, he or she can be granted a

urban Hukou and are eligible to the welfare package automatically; Farmers can also opt not to give up their rural lands and still migrate to cities to work, or they can sell their land certificates and stay in the country side. In neither case are they eligible to the welfare package associated with the urban Hukou. Fourth, the government reforms the current land requisition system so that rural collectives can enter land use change markets directly and negotiate with buyers (land developers and city governments) on land sale prices given that the land use change conform to local urban planning and land use planning, so that rural collectives and farmers who sell their lands can enjoy most of the benefits from rural land sales and land use changes; Once their lands are sold to land developers and /or city governments for non-agricultural uses, farmers are granted urban Hukou automatically and also eligible to the welfare package defined above. Finally, city governments levy a value added tax on the land sales by rural collectives (value added is defined as the difference between land sale prices and the calculated land value in agriculture) and use the created revenue to finance the welfare package for migrants newly granted urban Hukou.

We believe that such a welfare package can bring a breakthrough for China's urban Hukou reform and at the same time solve all the major problems in rural land system. Establishing basic social security, public housing and children's education arrangements for migrants can make it possible for the current floating population to migrate from rural to urban on a permanent basis. Permanent migration by giving up rural lands on voluntary basis will help to release some extra lands to deal with demographic changes within village and reduce the pressure on rural land administrative reallocation. At the same time, marketizing land requisition and taxing on land use changes by city governments will not only protect farmers' basic rights in land requisition and enhance land use efficiency in urbanization, but also provide the financial basis to accelerate permanent migration in China.

As to land tenure security, though the newly promulgated Rural Land Contract Law stipulated that farmers must be granted secure land tenure for 30-50 years, administrative land reallocation is still going on in many regions. Besides the demographic changes within villages, rent-seeking behavior by local cadres also play an important role. Therefore, restricting such rent-seeking activities by issuing land use certificates directly to farmers will help to alleviate such problems. Even for land reallocation resulting from demographic changes across households, issuing land certificates may still be advisable, because even if such land reallocation may bring both efficiency gain and better equity across household at the same time, it may also lead to other inefficiencies such as low motivation of farmers' in agricultural investment.

Therefore, if permanent migration of some farmers to cities can be achieved and the lands thus released can be used to accommodate demographic changes, a secure land

tenure system can be achieved. Experiences in many other developing countries such as Vietnam shows that creating land offices in rural areas and issuing land certificates to farmers is a feasible approach with low costs. Once land use certificates are issued to farmers, administrative reallocation will be very difficult unless farmers give up their land on a voluntary basis.

We also believe that now it is the best time to issue land certificates. The timing is also related to another two important factors for land reallocation, i.e., grain quota and agricultural taxes. Village cadres often reallocate lands across households to ensure the state grain quota delivery and agricultural tax collection. However, since 2000, grain quota in China has been gradually removed in most provinces. Starting from 2002, rural tax reforms in China also witnessed great progress and the government plan is to remove all agricultural taxes within five years, which apparently have and will continue to reduce the pressure on administrative land reallocation.

Establishing basic social security, public housing and children's education arrangements for migrants will promote permanent migration and release lands to deal with rural land reallocation. If we consider that migrants on average earn less incomes than the city incumbents and work mostly in informal sectors not well covered by pension, medical insurance and unemployment insurance programs, social security arrangement for them should be mainly oriented to the social assistance system, such as the minimum living standard guarantee, so that the migrants can be assisted in case of emergencies such as loss of jobs and working ability. At the same time, migrants should also be encouraged to participate in the existing pension, medical and unemployment insurance programs and enjoy the program benefits if they fulfill payment obligations. As to children's education, migrants' children should enjoy the same treatment as those of urban incumbents at least in the period of nine-year compulsory education. In the cities, a public housing system should also be set up to provide migrants and low income urban residents with decent housing at cheap rents.

Marketizing land requisition and liberalizing land use change markets accompanied by value added tax on land use change will not only protect farmers' interests in land sales, but also provide the financial basis for establishing welfare package for migrants who give up their rural lands voluntarily and participate in urban sectors fully. Such value-added taxes on land use change are justified in both efficiency and distribution terms. Theoretically, the source of value added in rural-urban land use changes is mainly the "positive external effects" created by urban infrastructure development and industrial growth, instead of farmers' efforts and investments, thus there is a rationale for such taxation.

In distributional terms, the essence of the proposed policy package is that city governments first establish a welfare package and use it to "purchase" the land rights of

rural migrants, and then subsidize the land rights to those who stay in the countryside. It must be pointed out that such a welfare package are newly created, and that farmers have absolute autonomy in choosing between the welfare package and their rural lands. Therefore, it means migrating farmers who opt for the welfare package must improve their welfare in making such choices; if such a welfare package can be set up by taxing value added on land use changes from rural to urban, it implies all the migrating farmers who opt for urban Hukou will enjoy the benefits of land value increases in the process of urbanization and industrialization.

If it is appropriate to consider the fact that the migrating farmers who voluntarily give up their rural lands and opt for urban Hukou on average earn higher incomes than those who stay in rural areas, but have lower wealth than those who sell their lands for urban and industrial developments under a marketized land requisition system, our policy package will have a desirable function of income redistribution, but at the same time will do no harm on efficiency grounds. This is true especially when we consider the rationale for levying value-added tax on land use change and that land certificates issued to farmers can be sold and also used as mortgages in banking borrowing. Comparatively, land privatization alone may not have such a function of income redistribution. In addition, financing migration and urban welfare package by value added tax on land use changes will not put any pressure on the already very tight budgets of the current urban social security system, which makes it financially more acceptable.

Such a policy package is to realize a gradual efficiency improvement and social equity through well-designed policy measures taking advantage of the existing Hukou and rural land system. From a perspective of game theory, the proposed policy package is essentially a mechanism design that fully utilizes the Hukou and rural land system, but at the same time expand farmers' choice set to induce farmers to reveal their private information (such as the ability to earn a life in cities and residence preferences) and facilitate them to take welfare improving actions. The policy package will help those young rural migrants who already found decent jobs in cities or plan to do so to realize permanent migration. The lands they give up then will be redistributed to rural households that experience population increases or rented out by rural collectives with the rents either used to deal with inequity created by demographic changes or used to provide rural public goods.

In realizing such a policy package, the center must take policy actions across the nation and also need the coordination from local governments. Some fiscal incentives such as transfers based on the number of newly received migrants' children in local city schools may need to be created to motivate local governments to adopt such policies. Some pilot programs can also be carried out in two or three provinces across which there are lots of migrations going on.

There may be some objections to the proposed policy packages. For example, is it wise to accelerate urbanization by large-scale public programs (such as setting up the welfare package for migrants)? Is it possible that certain adverse effects will be induced by implementing such an artificially designed policy package? If the marketized land requisition reform infringes the interests of local governments that benefit from extra-budget revenues through abusive land requisition, will it be feasible to carry out such a policy?

We believe that since any government policy, especially these large scale public programs, may create new problems by themselves, concrete measures must be designed to avoid their potential adverse consequences, such as the migrants' excessive dependence on urban welfare packages, the distributional issues in newly released lands by migrants giving up their rural lands. However, if establishing the basic social assistance, housing and children's education arrangements for migrants are themselves justified and commendable in China's urbanization and modernization drive, such a policy package should be promoted. It is just because the traditional plan system and its residual Hukou and rural land system are all artificially designed systems to realize resource mobilization in a period of heavy industrialization that it is appropriate to take artificially, but cautiously designed policies to dismantle them. If land use change marketization cannot be realized so that local government can still draw revenues for their extra-budgets, abusive land requisition will not stop and will finally lead to social and political unrests.

We believe that in China's economic and social development, reforms must be carried out taking into account of the real economic and political conditions and the existing institutional arrangements so that a smoother economic and political transition can be realized. However, breakthroughs in key aspects should also be planned and implemented when necessary. Regarding the rural land system and Hukou system discussed in the paper, even if the final outcomes of current reforms is land privatization and free migration, what can be done now is to promote permanent migration and protect farmers' land tenure and land sale rights through a less radical and well-designed policy package. Permanent migration will finally enhance the human capital for both migrants and their children, which finally create demands for better political and economic institutions.

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