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Urbanization, Rural Land System and Social Security for Migrants in China

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ABSTRACT *Temporary migration due to lack of social security for migrants, rural land tenure insecurity due to frequent land reallocation and abusive land requisition due to lack of functioning land markets are all major policy challenges that China is facing in its yet-to-be finished economic transition. Although there have been intensive studies and various policy recommendations on these issues, most discussions have so far neglected the close interrelationships between these issues and have failed to analyse them in an integrated framework. The paper aims to establish such an analytical framework. By taking into account the impacts of China's characteristics, that is a large developing country in transition, on the country's migration and rural land policies, we propose a policy package to address these challenges in a holistic manner.*

I. Introduction

One of the key steps in the development process is urbanisation: the growth of cities that allows for the building of factories and urban residential communities. Urbanisation shifts the population from rural to urban areas, allowing employment to shift from rural-based agricultural sectors to the primarily urban-based manufacturing and service sector, and continues until rural nations turn into urban ones and backward countries become modern (Chenery and Syrquin, 1975).

For this to happen, three conditions need to be met:

- (1) Conversion of agricultural land that allows the building of factories and urban housing and infrastructure, meaning the displacement of farmers from land around the cities in the process of urbanisation.
- (2) A set of institutions that encourage farmers to move from rural to urban, and from agriculture to manufacturing and service sectors. This would require a way to finance such migration and insure the migrating farmers throughout what is inherently a risky process (Todaro, 1969; Stark, 1991).

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- (3) Since the process of development is a gradual and long one, the system must allow those who are left behind in the first wave of migration to be able to access resources (income) that they need, in order to be able to get themselves ready to move in the coming years, either in this or even the next generation.

China, with the fastest growing economy in the world, is currently in the middle of its drive to urbanise. Sustainable urbanisation is especially needed in the case of China, given its legacy in which the expansion of cities and rural to urban mobility were artificially limited. Though economic reforms since the late 1970s have witnessed a gradual loosening of labour mobility restrictions that used to exist during the planning period to prevent urban unemployment, the old institutional arrangements that were part of the nation's *Household Registration System* (henceforth, the *Hukou* system) have not been fundamentally reformed and have remained as obstacles to permanent rural-urban migration and to movement across administrative regions (Au and Henderson, 2002)¹ When farmers moved to the city looking for work, even when they found productive employment, they mostly were treated as second class citizens. Urban officials place strict limits on permanent migration from rural to urban and across regions. Rural migrant workers cannot have access to the same level of social security benefits, housing subsidies and access to high quality education for their children, as people who are officially classified by the *Hukou* system as 'urban residents' (Wang, 2004).

Under a problematic legal framework for land use change, state-led land requisitions became pervasive in a process of faster urbanisation, which has left tens of millions of farmers under-compensated and jobless, and has resulted in bitter complaints from the displaced farmers (Han, 2005).² At the same time, rural development has been undermined by existing problems in the rural land system. Owing to demographic pressure within villages, frequent agricultural land reallocation has to be carried out (Rozelle et al., 2002).

Consequently, for China's urbanisation process to unfold in a way that will facilitate the nation's modernisation, it has to overcome the particularly challenging set of issues it is facing in the process of urbanisation. Migrating farmers need to settle down in cities on a permanent basis and obtain equal access to public services provided by city governments for their urban counterparts. The purchasing of land for urban development is also needed, and such transactions need to be carried out at market prices and in a way that obtains the approval of the rural collectives and the farmers who own land. Since the rise in land value in the rural-urban land use changes can be, at least partly attributed to urban growth and infrastructure development, there is a rationale to tax the proceeds from such land development and the collected revenue can be spent on urban infrastructure and even social security for migrating farmers from other regions, as well as locally dispossessed farmers. There is also a need for policies that will allow for the smooth shift of assets (especially land) from those that moved out to those that are staying in rural areas, so that extra lands can be released to reduce the pressures on rural land reallocation.

Surprisingly, despite the necessity of addressing these issues, there has been, up to now, very little literature that examines the policy process that would have to be put into place to ensure that China's urbanisation proceeds in a healthy way. To overcome the absence in literature of a discussion of these issues, our paper is to

analyse, under an integrated framework, the three major policy challenges that China is now facing in its economic transition and development, that is: temporary migration due to lack of social security for migrants; rural land tenure insecurity due to frequent land reallocation; and the undermining of dispossessed farmers' interests due to lack of functioning land markets in land requisitioning. Based on the analysis of the linkages between these policy issues, a holistic policy package which addresses these issues simultaneously is proposed.

The paper also aims to contribute to the literature on transition by analysing how different policy challenges facing China are inter-linked in economic transition and development, and how further reforms could be designed to realise a smoother transition. It is argued that though China's piecemeal reform approach has worked relatively well during the past two and a half decades, further reforms need a holistic approach to ensure a full transition. At the same time, reform strategies should be designed to utilise, rather than discard all at once, certain functions of the existing institutional arrangements, so that radical adjustment can be avoided and reforms are more resilient.

The rest of the paper is organised as follows. In section II, the three major policy issues are discussed separately. Section III outlines the government responses to these policy challenges so far and analyses the piecemeal and passive nature of these responses. Section IV argues for an integrated approach after exploring the linkages of the three important policy issues and analysing the implications of China's characteristics, that is, a large developing country in transition for further reforms. In section V, a holistic policy package is proposed to reform the two systems followed by some further discussions of its implications; and section VI concludes.

II. Major Policy Issues

Temporary Migration in Urbanisation

Though the economic reforms in the past two and a half decades have witnessed a gradual loosening of labour mobility restrictions associated with the traditional *Hukou* system, the old institutional arrangements that were part of the *Hukou* system and established in the pre-reform era, have not been fundamentally altered and have remained as obstacles to permanent rural-urban migration and to movement across administrative regions (Lin et al., 2003). In the earlier period of the reform, large scale rural-urban migration did not occur because the rural surplus labour mostly flowed to TVEs (Township and Village Enterprises) within rural areas, under the state policy of 'leave the land but not the village' in the 1980s and early 1990s which continued to restrain urbanisation (Oi, 1999). Owing to a fast-growing urban economy since the mid-1990s, the pattern of labour mobility began to shift from off-farm work within rural areas to form a massive floating population primarily engaging in temporary low-end urban jobs such as street cleaning, retail services, housekeeping services and construction (Chan and Zhang, 1999). The 2000 National Population Census indicates that by 2000 there were already 121 million migrants (defined as individuals who had migrated for at least six months in the past year) in China, of which 90 million were found in urban areas and 88.4 million originated from rural areas (NBS, 2002). As Yang and Zhou (1999) observed, China's

rural-urban labour mobility pattern is rather unique with a massive floating population primarily engaged in temporary urban jobs, while in many other developing countries permanent and family migration of rural residents into urban areas has played a central role in the process of urbanisation. According to the NBS (2002), only seven per cent of rural-urban migrants move with their families. Though some richer migrants have permanently settled down in cities, an overwhelming majority of rural migrants have not obtained an urban *Hukou*.

It is a particularly interesting question to ask what an urban *Hukou* means today. In the planning period, it not only meant legal rights of residency, urban employment and job-related benefits such as housing, medical care and pensions, but also entitled urban people to 'grain rations' – rations of essentials such as grain and kerosene. As economic reforms progressed, some of the constraints that used to be associated with urban *Hukou*, such as the legal rights of residency and commodity rationing, were already abolished by the late 1980s and early 1990s. Since the mid-1990s, most urban residents began to obtain health insurance, unemployment insurance, pension through their employers as restructuring in state-owned sectors started and the traditional work unit system eroded.³ However, urban residents still receive city-provided welfare privileges largely unavailable to rural migrant workers. At present, the privileges mainly include social assistance (in China's case, the so-called 'Minimum Living Standard Guarantee Scheme') and certain forms of city level housing subsidy from locally funded public housing schemes. In addition, the children of migrants usually have no, or only very high-priced, access to urban public schools while the children of urban permanent residents are heavily subsidised in schooling (Kwong, 2004).⁴ In a word, though the urban *Hukou-linked* benefits have been declining as China's economic reforms have progressed, the *Hukou* system still limits these services to urban residents with *Hukou*, which constrains rural-urban permanent migration.

Lack of urban *Hukou* for most rural migrants has created significant economic and social problems in cities as well as in the countryside. Migrant workers are usually the most discriminated group in Chinese cities. Lack of social security, regular and 'legal' housing, as well as access to schooling facilities, are all serious challenges which confront rural migrants in their daily lives. Not only do many migrants in cities suffer from the separation of family members, various social problems also emerge in rural areas where the old and the children are left behind. As more people of working age migrate to the cities, the role of the traditional rural family in providing care for the elderly has been challenged and many old people are not well taken care of (Murphy, 2004). Many children have to attend local rural schools with their studies not being monitored by parents working in cities and poor academic performances ensue (Sui, 2005).

The *Hukou* system has negatively affected the progress of China's urbanisation (Au and Henderson, 2002). Though the official urbanisation rate already reached 40.5 per cent by 2003, China's 'urban' population in the official statistics includes not only the urban residents with an urban *Hukou* but, also, 90–95 million migrants as well as 20–25 million dispossessed farmers whose lands were requisitioned in urban expansion – neither of these groups have permanent urban residence permits (NBS, 2004; Han, 2005). In addition, problems in the definition of China's official 'urbanisation rate' statistics imply that it is biased upwards due to definitional issues

and our estimation is that such upward bias is at least 3–4 percentage points.⁵ Even if we take the figure of 36–37 per cent after correcting for such upward bias, the remaining ‘urbanised population’ still includes 110–120 million migrant farmers and dispossessed farmers who have no access to the social assistance, subsidised housing and urban public schools provided to the urban permanent residents. Excluding the rural migrants and the dispossessed farmers would make China’s urbanisation rate even less than 30 per cent in 2003. Even if we take the figure of 36–37 per cent, it is not only significantly lower than the world average of 48 per cent, but also lower than 43 per cent for all the lower-middle income countries (World Bank, 2005).

Rural Land Reallocation and Migration

In China, rural land is collectively owned at the village level. The Household Responsibility System (HRS) introduced in the late 1970s extended land-use rights to households on a fairly egalitarian basis. In principle, *all* villagers, both present and future, are entitled *ex ante* to equal access of this common property resource (Rozelle et al., 2002). This implies village officials, under demographic changes across families within villages, usually have to reallocate land on an ongoing basis. Furthermore, village leaders in China have been entrusted by the state to implement policies such as mandatory grain procurement, birth control, and agricultural restructuring. Control over land reallocations were often used as an instrument to ensure that villagers comply with the implementation of state policies (Kelliher, 1997; Turner et al., 2004).⁶ In this process, village cadres often used their power over villagers to extract rents through periodic land reallocations (Johnson, 1995).

In a survey of 215 villages across six provinces in China, Rozelle et al. (2002) found that, in the reform period, on average each village had reallocated their land 1.7 times and 53.4 per cent of all cultivated land had been reallocated at least once. Among all the 215 villages, only 60 villages had *not* readjusted land since HRS; in a small number of villages, reallocation occurs almost annually. In a quarter of all the villages land had been reallocated once, and in a fifth of the villages reallocation had been conducted twice. On average, slightly more than half of all cultivated land in the sample villages (53.4%) had been reallocated at least once.

The impact of insecure tenure on land use efficiency has been intensively studied (Rozelle et al., 2002). Though administrative land reallocation may help to move lands to households that have a higher marginal productivity, and thus be efficiency-enhancing, inefficiency still arises due to the difficulty of such an approach to efficiently allocate resources and the high transactions costs of carrying out such reallocations (Rozelle et al., 2002).⁷ Administrative reallocation also reduces land rental activities with the uncertainties and the short planning horizon it creates (Turner et al., 2004). Furthermore, if local officials reallocate lands to fulfill state policies such as grain procurement, while at the same time seeking rents for themselves, land reallocation may negatively impact local welfare (Johnson, 1995).

The current rural land system in China also affects rural labour mobility and migration decisions, since for a rural migrant to obtain an urban *Hukou* he or she has to return their land to the village and, therefore, surrender a stream of future land earnings. However, because permanent migration across provinces or into large cities are still difficult and smaller cities are less attractive due to limited jobs, lower

welfare coverage and public school quality, most migrants from rural areas are either unable, or unwilling to give up their rural land as the last resort for employment and income (Yang and Zhou, 1999). This implies that the demographic pressures for rural land reallocations are always present even when a significant number of farmers have already been primarily engaged in off-farm jobs. With tenure uncertainties created by land reallocations, the development of long-term land rental markets is undermined. Moreover, migrating farmers usually have no incentives to rent out their land even for a short term since it may send signals to village cadres and induce land reallocation (Rozelle et al., 2002). Lack of active land rental markets further reduces land use efficiency and the response of migrant workers is usually to leave their lands to relatives without charge and sometimes uncultivated.

Rural Land Requisition in Urbanisation

Another key issue in the rural land system is abusive land requisition in the process of urbanisation. Since the mid-1990s, with rapid urban expansion and large-scale transportation development, rural land requisitioning has increased significantly in suburban areas and in places that lie in the way of main transportation projects such as roads, highways and railroads (Ho and Lin, 2004). In recent years, to compete for investment and to generate more off-budget revenue, local governments across China have established a large number of industrial parks and new urban development zones by expropriating arable land from farmers. In 2000, the annual area of requisitioned land totalled over 160,000 hectares, and in the past several years it has climbed to around 200,000 hectares per year. Consequently, the Chinese countryside has witnessed a growing movement of dispossessed farmers in a disrupting, ongoing process of urbanisation. Each year about 2–3 million farmers have been losing their land to requisitions associated with urban expansion and infrastructure development (Tu, 2004). A frequently cited estimation is that during 1987–2001, legal land requisitions (that comply with the law and have been approved by higher level governments) for urban and infrastructure development reached 2.26 million hectares, with at least 34 million farmers losing half or all of their land. If the illegally expropriated land is added, the numbers of dispossessed farmers may reach 40–50 million. Among them, at least half (20–25 million) have not obtained an urban *Hukou* (Han, 2005).

The issue of land requisition has been exacerbated by the 1994 fiscal reform that centralised revenue without providing sufficient transfers (World Bank, 2002). Revenue-hungry city governments have every incentive to expropriate more agricultural land and make a profit since such land revenues fall into the locally controlled extra-budgets. As extra-budget revenues, such incomes in principle are to be used to finance urban infrastructure development. However, lack of transparency often makes it difficult to monitor and rent-seeking – involving collusion between land developers and local governments – has been pervasive and has significantly undermined farmers' interest (Zhou, 2004).

Under China's current legal framework, land use change from a rural to an urban designation can only be carried out by a government requisition at prices that are unilaterally decided by local governments (Han, 2005). According to China's Land

Administration Law, the compensation for arable land under requisition constitutes: compensation for land (6–10 times the average annual land output in the past three years) plus compensation for resettlement (4–6 times the average annual land output in the past three years). A policy document issued by the Ministry of Land Resources (2004) stipulates that the highest compensation cannot exceed 30 times the average annual land output of the past three years. For example, if the annual net output is set at RMB 15,000 per hectare, the highest compensation can only be as high as RMB 450,000. In practice, compensation for highway and railroad construction-purpose requisition is mostly set at RMB 70,000 to 120,000 per hectare while that for industrial and commercial purposes usually ranges from RMB 300,000 to 450,000 per hectare. Given that the average dispossessed farmer usually has a land holding of 0.07 hectare, a dispossessed farmer is, on average, compensated for an amount of RMB 5000–9000 for land requisition from transportation construction, and RMB 20,000–30,000 for land requisition from commercial and industrial development purposes. However, when agricultural land is sold for urban commercial uses, their market values are usually 5–10 times higher than the compensation level (Han, 2005). A survey in Zhejiang province shows that on average the revenue distribution from land requisition is that local governments receive 20–30 per cent, land developers retain 40–50 per cent and village collectives 25–30 per cent, while farmers get only 5–10 per cent of the revenue from land use changes (Tu, 2004; Han, 2005).

III. Piecemeal Government Responses

Government Responses

Both the central and local governments in China have responded to the challenges in urbanisation and the rural land system. Starting from the mid-1990s, local reforms in the *Hukou* system have been carried out on a pilot basis (Wang, 2004). In some small towns and cities where rural migrants run small business, they have begun to be able to obtain an urban *Hukou* if they satisfy certain conditions. Examples include direct cash payment for permanent urban residence permits, urban house ownership through purchase, or a certain amount of local investments in the urban locality. In a few large cities, such as Zhengzhou in the Henan Province and Shijiazhuang in the Hebei Province, local governments have begun to lower entry barriers for permanent migration.⁸ However, permanent migration into most large cities is still difficult, if ever possible for most migrating farmers.

Realising that frequent land reallocation and abusive land requisition will threaten economic sustainability as well as social stability, the government has taken various actions to promote land tenure security and to protect farmers' interest in urbanisation. The 'Rural Land Contract Law' promulgated in 2002 stipulates that farmer's land tenure security must be maintained for at least 30 years during which period no land reallocations are to be carried out. Starting from 2003, many policy documents have been sent out to local governments requiring them to constrain their abusive land requisition and raise compensation to farmers. Many industrial development zones and industrial parks set up by local governments to compete for investment have been rescinded and the land expropriated from farmers has been returned. The government also plans to centralise the land requisition power to the

provincial and central level by establishing a vertically controlled land management system with tighter non-agricultural land use quotas and stronger central supervision (Zhou, 2004; Yu, 2004).

Piecemeal and Passive Reforms So Far

However, government responses to these challenges up to now have been piecemeal and relatively passive in nature. The *Hukou* reforms in small cities have met with little enthusiasm from migrants because these cities are not attractive. At the same time, obtaining an urban *Hukou* in many large and medium-sized cities and across provinces is still very difficult for rural migrants. For example, in the majority of large and medium-sized cities, migrants need to buy a commercial house in the city and pay a large lump-sum charge for using the urban infrastructure and facilities in order to be eligible to apply for a residence card.

Progress in providing social assistance, housing security and public schools for migrants and dispossessed farmers have been very limited. Though recent years have witnessed some development to provide social assistance and housing security for urban residents on a broader basis, most rural migrants who have already lived in cities and earned most of their incomes from urban sources, and local dispossessed farmers, are still largely ignored. For example, a social assistance programme of 'Minimum Living Standard Guarantee' (MLSG) has been set up and extended to 90 per cent of the urban population (Ministry of Civil Affairs, 2004). Urban governments also begin to provide different forms of housing subsidy to low-income urban households for housing security. In an '*Economical Housing Programme*', urban households are able to purchase housing at subsidised prices and land use fees are mostly exempted. In another '*Public Housing Programme*', beneficiaries either receive housing with subsidised rent or a cash subsidy for renting houses in markets. Nevertheless, most migrants and dispossessed in the cities are not eligible to the MLSG and the subsidised housing programmes.

The difficulties in gaining an urban *Hukou* for most rural migrants are closely related to the inter-governmental fiscal arrangements in China. Under the current expenditure assignment, city governments are responsible for providing social security for local residents who have permanent residence permits, while in most other countries, responsibility for social security provision lies at the provincial or central level (World Bank, 2002). With the fast growing body of laid-off workers, SOE (State Owned Enterprises) retirees and urban poor that has come into being since the mid-1990s, city governments are under huge financial pressure to meet their ends. Therefore, local governments lack the incentive to provide social security, housing and children's education for migrant workers from places outside their own administration. A particularly telling case is the equal access to urban public schools for migrants' children. To address the issue of schooling for migrants' children, the central government in 2004 mandated that local governments in migrant-receiving cities provide equal school access for migrants' children (State Council, 2004). However, no additional financial resources have been allocated for such purposes and in practice many local governments still limit school access to children from other regions.

In rural areas, administrative land reallocations are still being made even though the 'Rural Land Contract Law' stipulates that farmer's land tenure security be

maintained for at least 30 years. According to the authors' field investigations in different parts of China in recent years, this is because local officials claim that the reallocations are necessary to accommodate demographic changes within the village, though in practice such claims may easily turn out to be excuses for local officials' rent-seeking activities. In some rural areas where the 'Rural Land Contract Law' is followed rigidly, conflicts among farmers arise because no extra land can be allocated to the newly increased population.

With regard to the abusive land requisition in urbanisation, the government reaction of further centralisation in land administration has been a typical approach of rescuing wherever problems arise. Even if the current policies that tighten local land requisition quotas and raise compensation to the dispossessed farmers can limit abusive land requisition in the short-term, it is still unclear how such policies will last long because of their high monitoring costs. Furthermore, if compensation for land requisition is still decided by local governments instead of the market, there will be no an institutional guarantee that farmers' interests are effectively protected. More importantly, given the centre's limited information on local land demands, deciding local land supply quotas in a centralised manner may easily undermine economic development based on local needs and finally constrain the country's urbanisation progress as a whole.

IV. Towards an Integrated Approach

Policy Linkages

The three issues discussed above, temporary migration, rural land reallocation and abusive land requisition are all policy issues of top priorities on the current government agenda. More importantly, we would argue that these issues are closely related to each other and such linkages must be taken into account so that further reforms and policy responses can be designed in a holistic rather than piecemeal way.

The fact that temporary migration is becoming the dominant form of China's migration is because no social assistance, public housing and schooling arrangements have been established for migrants to enable them settle down on a permanent basis in cities. For migrants who are already earning most of their incomes in the cities and are unwilling to return to the countryside, the lack of such arrangements makes them unwilling or unable to give up their rural land, which, in turn, makes it difficult for those left in rural areas to expand their scale of agricultural production and secure their land tenure because too little extra land can be released to accommodate rural demographic changes. When such reallocations happen at the discretion of village cadres, allocative inefficiency and rent-seeking easily follows. Facing potential reallocations, both long-term and short-term, land rental markets cannot develop and migrants either leave their land uncultivated or transfer the land for short terms to relatives or friends, even though the latter may not be the most efficient farmers to use the land.

Therefore, the key to addressing these issues is to establish an effective financing mechanism that enable city governments in migrant-receiving regions to provide social assistance, public housing, as well as school services to migrants so that they are willing to give up their land in rural areas. Some extra land would then be

released in migrant-sending regions which would enlarge farm size and accommodate demographical changes within villages. This would make it unnecessary for the villages to reallocate the land that is already allocated to those staying in rural areas. More importantly, given that the value of agricultural land tends to increase significantly when such land is converted into urban uses and that at least part of the appreciation can be attributed to urban growth and infrastructure development, mobilising some revenue from such land value appreciation can be justified and the revenue could potentially form the financial basis for social security, public housing, as well as public schooling for migrants as well as local dispossessed farmers. Precisely because migrant workers also contribute significantly to economic growth in cities and thus, also, the land value appreciation in urban expansion, city governments should take some responsibilities to provide some basic public services such as social assistance and school education for migrants. As a matter of fact, a faster growing city tends to have faster urban expansion and higher land value appreciation, and thus would be able to collect more revenue from the proposed land value added tax. At the same time, faster economic growth tends to create more jobs and attract more migrants, thus the value added tax revenue and the number of migrants would tend to match each other.

Migration in a Developing Country under Globalisation

A developing country in globalisation first implies China's migration is largely an outcome of regional redistribution of non-agricultural sectors. In the context of globalisation, China's economic development has been relatively imbalanced. Compared to the inland regions, the coastal regions in China have experienced a remarkably rapid growth of foreign investment, employment and export with their locational advantages and the preferential policies they have enjoyed (Kanbur and Zhang, 1999). As industries become more concentrated, more migrants have flown to coastal regions. In 1982, coastal regions accounted for 38.4 per cent of all migrants in China, but by 2000, the number jumped to 64.5 per cent with the majority being concentrated in the Yangtze River Delta, the Pearl River Delta and North China's coastal cities. In 1982, less than five per cent of migrant workers were in the coastal province of Guangdong, the share increased to 15 per cent in 1990 and further to 27 per cent in 2000 (Li, 2003).

The globalisation of the Chinese economy also implies the migration of younger and more skilled workers from rural areas to the export manufacturing zones in coastal cities. Utilising an almost nationally representative rural survey data set in 2000 and collected by the Centre for Chinese Agricultural Policy (CCAP survey) at the Chinese Academy of Social Sciences that covered 1199 randomly selected households distributed across 60 villages in six provinces,⁹ we find that most of the migrants from rural areas had education at or above junior high school level and were able to earn decent incomes in their off-farm employment. As shown in Table 1, in 2000, for all migrants working outside their home county (defined as long distance migrants here) and working for more than six months per year (defined as long-term migrants here), the average age was a relatively young at 25.2 years. The average education for these migrants was eight years (nine years for a junior high school degree in China). Among these long-term long distance migrants, 62.1 per cent were

Table 1. Demographics of long-distance long-term migrants

	Headcount (person)	Income per month (RMB)	Working per year per month (month)	Age (year)	Education (year)	Share of male (%)	Share of married (%)
Migrants of off-farm employment over 6 months outside home county							
Total number	348	602	10.3	25.2	8.0	63.2	37.9
Monthly income over RMB 1000	47	1339	9.9	28.6	9.1	87.2	57.4
Monthly income over RMB 800	85	1120	10.3	27.5	8.9	72.9	55.3
Migrants with off-farm employment over 6 months outside home province							
Total number	209	577	10.4	25.0	7.7	64.1	38.8
Monthly income over RMB 1000	24	1266	10.1	28.1	9.0	83.3	54.2
Monthly income over RMB 800	45	1070	10.2	27.6	8.6	68.9	62.2

Source: Data collected by the Centre for Chinese Agricultural Policy, the Chinese Academy of Sciences, 2002.

single and 63.2 per cent were male. For those with monthly incomes higher than RMB 1000, the average age was 28.6 years with the average education of 9.1 years. Male labour was the dominant group (87.2%) in high-income earners and 42.6 per cent were unmarried. The age, education and marriage patterns are similar for those whose monthly income was higher than RMB 800 and those who travelled outside their home county, as well as those migrating outside their home province.^{10,11}

The relatively young age and higher education level of the rural migrants implies a lack of both experience and interest in farming. It can be expected, therefore, that most of the young educated migrants would not value farming as much as the older and the less educated labourers in rural areas, and would tend to de-link their future to farming and the agricultural land allocated to them if they were given a chance to migrate permanently.

Migration and Rural Land Value in a Large Country

Another characteristic of China's migration comes from the sheer size of the country and the spatial imbalance between labour endowments and employment opportunities. Being a large country of imbalanced development means that a significant share of the migration is long distance in nature. This differs from the short distance migration that predominated in Japan, South Korea and Taiwan during their periods of rapid urbanisation in the second half of the twentieth century.

Still using the CCAP survey data set collected in 2000, we find that among 3445 rural labourers surveyed, 1581 labourers had off-farm employment, while 459 obtained off-farm employment outside their home county. As shown in Table 2, the labourers who had off-farm employment outside their home county earned an average of RMB 626 per month with an average of 8.6 months off-farm work per year. Among the 459 labourers who worked outside their home county,

Table 2. Long-distance migration and their annual working months

	Sample (person)	Share of sample (%)	Inferred national total (10,000 person)	Income per month (RMB)	Working month (month)
All off-farm labour					
Within home county	1122	23.2	18778	233	8.7
Outside home county	459	9.5	7684	626	8.6
Outside home province	264	5.5	4419	611	8.9
Labour with over 3 month off-farm employment					
Within home county	1007	20.9	16855	227	9.5
Outside home county	411	8.5	6880	602	9.4
Outside home province	241	5.0	4034	567	9.5
Labour with over 3 month off-farm employment					
Within home county	825	17.08	13807	218	10.6
Outside home county	348	7.2	5825	602	10.3
Outside home province	209	4.3	3499	577	10.4
Number of sample rural households	1199				
Number of sample rural population	4829				
Rural labour ^a (person)	3445				
As a share of rural population (%)	71.3				
Rural labour with off-farm labour	1581				
As a share of rural labour (%)	45.9				
Total rural population, 2000 (10,000 person)	80837				
Share of age between 15–64 (%)	67.2				
Total rural employment ^b (10,000 person)	48934				

Source: Data collected by the Centre for Chinese Agricultural Policy, the Chinese Academy of Sciences, 2002 and from *China Statistical Yearbooks*.

Notes: ^aRural labour in the sample is defined as population with age between 15–64; ^bTotal rural employment does not include rural migrant labourers employed in cities.

57.5 per cent, or 264 labourers worked outside their home province. They earned an average of RMB 611 per month and worked for an average of 8.9 months per year. If we consider the migrants with off-farm employment over 6 months, 348 had off-farm employment outside their home county and earned an average of RMB 602 per month and worked an average of 10.3 months per year. The 209 who had off-farm employment outside their home province earned an average of RMB 577 per month and worked 10.4 months per year. Given that sample is almost nationally representative, we can infer that in 2000 there were 76.84 million rural labourers who had off-farm employment outside their home county and 44.19 million who obtained off-farm employment outside their home province. If we limit ourselves to migrants with annual off-farm working period over 6 months, the corresponding

numbers were 58.25 million and 34.99 millions respectively. Apparently, this large number of long-distance migrants is unable to take care of the agricultural land.

If we define migrants who obtained off-farm employment outside their home county as long-distance migrants, we can infer that in 2000, 70–80 million migrant workers were long-distance migrants, and of these, 50–60 million worked in the cities for more than six months a year.

The large size of China and the relative abundance of arable land in migrant-sending, inland regions also implies a relatively low value and limited growth potential of the agricultural land in these regions compared to the land in coastal regions or that of other smaller Asian economies in their industrialisation. Therefore, these long distance migrants tend to have lower stickiness to their rural land and would choose to leave the countryside permanently if they could earn decent and stable incomes in cities and are able to enjoy equal treatment in urban public services.

Hukou System, Collective Land Ownership and Economic Transition

The fact that China is still a country in economic transition also has profound implications for its policy options in urbanisation and further rural land reforms. The *Hukou* system and rural collective land system were installed in the plan period to minimise rural-urban migration because the traditional capital-intensive heavy industrialisation in the plan period could not create sufficient employment in the cities. This had created a huge stock of surplus labour in rural areas even during the late 1970s when China began its economic reform. Despite increasing migration in the past two and half decades, considerable surplus labour remains in the rural areas. According to the NBS (2004), the total labour force in China reached 760 million by 2003, and of these, 256 million work in the cities, 153 million work in off-farm sectors in rural areas, and 325 million still work in agriculture. If the average GDP contribution per worker in non-agricultural jobs is used as a benchmark, rural hidden unemployment is estimated to represent around 275 million (where hidden unemployment is defined as low-productive employment regardless of working time). If the benchmark is set more modestly at one-third of the productivity of non-agricultural workers (in line with that of other Asian countries), rural hidden unemployment would be around 150 million (OECD, 2002).

Given the large stock of surplus labourers in rural China that were accumulated in the past and the limited urban employment and infrastructural capacity to accommodate migrants on a permanent basis in the short-term, any reform of the *Hukou* system and the rural land system must be carried out cautiously and incrementally to ensure a smooth urbanisation. On the one hand, although the *Hukou* system has restricted China's migration and aggravated its urban-rural disparity, it has indeed reduced the 'pull' force in China's urbanisation and helped to avoid high unemployment and the kinds of urban slums that are found in many other developing countries in South Asia and Latin America. On the other hand, though the rural collective land system that allocate lands equally according to rural household size has imposed pressures on rural land reallocation, it has indeed reduced the 'push' force in urbanisation because an equitable land allocation is able to make better use of the abundant rural labour force in agricultural sectors and,

thus, reduces the pressures on migration into cities. Even though such institutions have now begun to exert increasingly negative impacts on both urban and rural development, some of the specific arrangements in these institutions that reduce the 'pull' and 'push' forces in urbanisation can still be appropriately utilised in further reforms to facilitate a smoother transition. Therefore, the right approach in further reforms on these institutions should not be discarding them all at once.

V. An Holistic Gradualist Policy Package

Basic Elements of the Policy Package

As argued above, any policy package to further reform the *Hukou* system and the rural land system requires a holistic approach, while at the same time taking into account China's size, development stage and transitional nature. Such a policy package would incorporate several key elements that recognise the complex interrelationships between migration, land and livelihoods in China's urbanisation process.

First, the government would need to set up land offices in rural areas and issue permanent or long-term land certificates by land slots to farmers to consolidate farmers' legal rights in land use, transfer and disposal. Farmers would also have the right to collateralise land certificates. These certificates could be used for bank borrowing and could also be transacted freely on markets provided there was no change in land use designation from agricultural purpose to non-agricultural purposes.¹²

Second, city governments would define reasonable qualification criteria that may vary by locality and migrant workers who reached the criteria would be eligible to apply for an urban *Hukou*. For example, to apply for an urban *Hukou*, the migrant would need to have worked in the city for 2–3 years and would be able to verify that his or her monthly income in the past 8–12 months was at least as high as RMB 1000. City governments then would provide the eligible migrant workers with an urban welfare package that would include basic social assistance (MLSG), housing subsidy and equal treatment in children's education.¹³ If a migrant reached the criteria and was willing to give up his or her agricultural land on a voluntary basis, he or she would be granted an urban *Hukou*, and would thus be eligible for the welfare package automatically.^{14,15} Farmers could also opt not to give up their rural lands and still migrate to cities. For example, some rich migrants may not need the welfare package provided by the city governments, or they could also sell their land use certificates but continue to stay in the countryside, for example, in their old age. In either of these two cases, they would not be eligible for the welfare package associated with the urban *Hukou*.

Third, the government would reform the current land requisition system so that the rural collectives who own rural land could enter land requisition markets directly and negotiate prices with land users (either the commercial developer or the city government).¹⁶ These land use changes would have to be carried out in accordance with local urban planning and land use planning regulations so that the rural collectives and farmers would be able to reap most of the benefits from land transactions. Once the land was sold for non-agricultural uses, dispossessed farmers

would be granted an urban *Hukou* automatically and would thus be eligible for the urban welfare package that is provided to migrants who have qualified for an urban *Hukou*.

Finally, city governments would levy a value added tax on land transactions from agricultural use to non-agricultural commercial use. The value added would be defined as the difference between land sale/lease prices and the imputed land value for agricultural uses, and it would be allocated to the revenue pool to finance the urban welfare package for the eligible migrant farmers as well as the local dispossessed farmers.¹⁷

Implications of the Policy Package

From the perspective of mechanism design literature (Fudenberg and Tirole, 1991), the proposed policy package is essentially a mechanism design that fully utilises the leverage of the existing institutional arrangements of the *Hukou* system and the rural collective land system; but, at the same time, expands farmers' choices and induces farmers to reveal their private information (such as their ability to earn a life in cities and their residential preferences), and facilitates actions to improve their welfare. Since the proposed welfare package was newly created and migrating farmers had absolute autonomy in choosing between the urban *Hukou* (as well as the associated welfare package), and their rural land certificates, migrants who opt for the welfare package would have improved their welfare. Therefore, the policy package would particularly help the young rural labourers who have already found decent jobs in cities or, who were going to do so in the near future. Under the policy package, increasing the number of migrating farmers would realise permanent migration into cities and this would release more agricultural land that could be used to accommodate rural demographic changes and reduce pressures on rural land reallocation.

In terms of income distribution, political feasibility and even economic efficiency, the proposed policy package has several advantages over the pure land privatisation as proposed by some scholars (Sachs et al., 1999; Zhao and Wen, 2000). In the proposed package, one key feature of the present rural collective land system is retained: that the village collective would still be able to allocate some land to accommodate demographic changes within the village since there would be some land to be released by out-going migrants. If rural land were to be fully privatised, there would be no such transfer mechanism that was able to bring about such a desirable income redistribution favouring the poorer farmers left in agriculture. Land privatisation would imply that the migrants would enjoy the monetary benefits from their privatised land ownership, and that the relatively low-income left-over farmers would have to buy or rent land from the migrant workers to expand their production scale. If rural lands were to be privatised, there would be no extra land released to accommodate demographic changes within villages, and this would create undesirable income distributions favouring the richer migrants rather than the poorer farmers left in agriculture. In fact, one significant obstacle to land privatisation in China is that the government fears it would deprive the village collective of any re-distributional power in land allocation and could even potentially lead to large number of landless farmers (Yao, 2000).

More importantly, land privatisation is politically unacceptable to the ruling Communist Party at least in the short term because not only it is inconsistent with the Party's claimed ideology, but also has the potential to destroy the Party's power base in rural areas. The proposed policy package, by keeping some land in the hands of the village collective, would help to ease such worries. At the same time, because the land certificates can be freely transacted on agricultural land use markets or used for mortgages in bank borrowing (if farmers choose not to apply for an urban *Hukou*), it would be able to realise all the efficiency gains that a pure land privatisation can bring about.

In addition, financing the urban welfare package by means of a land value added tax would also promote economic efficiency in land use and development since it would help to correct for externalities from land value appreciation in urban expansion. Finally, given such a policy package would not impose further financial pressure on China's existing urban social security system, it would make the proposed policy more resistance-proof. With faster urban expansion that can be foreseen in the coming decades, the land value added tax would make significant contributions to urban public service provision in the short, or even the medium term. In the longer term, considering the potential of such land value added tax would be constrained by the physical limits of urban expansion. The local revenue base ought to be gradually shifted to a property tax levied on urban commercial and residential properties, and could also be used to finance urban public services to migrants, dispossessed farmers as well local infrastructure development.

VI. Conclusion

China's economic transition in the past two and a half decades has been praised because it has adopted an experimental approach of 'crossing the river by groping for stones' (Lin et al., 2003). However, China has reached a stage where such an approach, though still useful, will not be sufficient. To realise a full transition to market economy, further reforms need to be carried out in a holistic rather than a piecemeal manner. In the case of *Hukou* and rural land system discussed in this paper, further reforms necessitate a national initiative and full coordination from local governments.

In this process, specific institutional frameworks would need to be in place to avoid the potentially excessive dependence on urban welfare provisioning and inequity in allocating the released land in villages. However, the difficulties that may arise should not be viewed as excuses for piecemeal responses or even delaying reforms if establishing the social assistance, housing and school arrangements is a necessary means for China to urbanise and is an end in itself in the country's modernisation drive. It is precisely because that the *Hukou* and the rural collective land system inherited from the plan period are all artificially designed institutions and that radical reforms may lead to undesirable consequences, that it takes artificially but well-designed policies to dismantle them gradually.

While an integrated approach is essential to address the serious challenges confronting China, the past experiences in China's economic transition have also told us that considerable progress is still possible with sensible but not perfect institutions, and that some 'transitional institutions' – rather than the best practice

institutions – could still be utilised for a period of time because of the second-best principle (Qian, 2000). Successful reforms at this current stage may need policy makers to utilise, rather than discard all at once, certain arrangements in the existing institutions. With regard to the *Hukou* system and the rural land system in China, it may still be necessary at this stage to set certain entry criteria and utilise the *Hukou* as a leverage to induce migrants to give up their land on a voluntary basis; and it may also be necessary to leave the released land in the hands of village collectives to accommodate demographic changes. Even if the final targets of such reforms are to realise free migration and full land ownership, the policies adopted in the short and even medium term should still be oriented to lower barriers to permanent migration, and to create conditions for better protected land rights on a gradual basis. As more farmers become fully urbanised and rural land tenure better secured, the best practice institutions would be easier to achieve.

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Notes

1. The *Hukou* system in China is similar to an internal passport system. A person's local 'citizenship' and residence is initially defined for a child as a birth right, traditionally by the mother's place of legal residence. Legal residence in a city entitles one to local access to permanent jobs, regular housing, public schooling, and public health care in that city. To permanently migrate and be eligible for local benefits, one needs to change citizenship (Chan, 1994).
2. Though in a few large cities such as Beijing and Shanghai, farmers and villages often have considerable power in negotiating settlements for land take, under-compensation in land requisition has been pervasive in many regions in recent years where the hardships and grievances of these ill-treated farmers have contributed to local social unrests and political instability. The issue became so serious to the extent that central government had to take strong counter-actions to limit local governments' abusive behaviour in 2004. By the first half of 2004, the central government already ordered local governments to pay an arrear of RMB 87.4 billion to farmers for underpayment in land requisition. For further reference, see Yu, 2004; Zhou, 2004; Han, 2005.
3. The high level of subsidy in pension, medical insurance and housing that used to be part of urban privileges, is now no longer associated with urban *Hukou* anymore. The question now, therefore, is to further clarify and adjust the urban rights to an economically sustainable level so that a reasonable level of public services can be extended to more of the floating population, rather than transfer the previous high level of urban rights to rural migrants.
4. It must be noted that one of the positive sides of China's liberalisation is that a market sector has been allowed to grow alongside the state sector and in some cases, some unregistered high-income migrant workers have generated market-based social services such as schools, clinics (Xiang, 2005). However, owing to their relatively low income, most rural migrants still cannot afford such market-based services, which may render a certain form of government involvement necessary.
5. Since the 1990s, many counties surrounding the prefecture and higher-level cities have been turned into districts directly under city administration. Although in the regulation for collating urbanisation rate statistics, only the population in such districts with a population density over 1500 person/square kilometer should be all included into the 'urbanisation rate' statistics. In practice this rule has not been

closely followed. Furthermore, this rule itself is difficult to defend because even for districts with a population density over 1500 person/square kilometer, a significant share of the population within a district may still be farmers and so are excluded from calculations of the urbanisation rate. Our estimation is that there are at least 40 million pure farmers that are included because of such problems in statistical definition.

6. In China, a grain procurement policy was implemented in which the state required farmers to sell a share of grain output to the state grain sector usually at below market prices. Through the grain quota system and the national agricultural tax system, the state exercises a claim to agricultural output. In practice, local cadres usually deducted the state agricultural taxes and local fee charges before paying farmers for their grain quota delivery. The grain procurement has been gradually removed starting from 2000 and a rural tax reform has been initiated in recent years to reduce tax burdens on farmers.
7. Compared to the pure market transaction case, administrative reallocation is costly in terms of efforts and administrative expense. It may also lead to conflicts between local cadres and farmers and amongst farmers. According to Rozelle et al. (2002), administrative reallocation and a decentralised system of exchange based on land rental among individual households, however, are imperfect substitutes because of informational problems and because the high costs of reallocation prevent reallocations from being carried out frequently.
8. Take Shijiazhuang, the capital city of Hebei Province as an example. In 2001, the city government adopted a policy that would grant *Hukou* to migrants who either had been employed in the formal sector for one or two years depending on technical qualification, had a college diploma, had purchased local housing or had invested in the city. However, Shijiazhuang is exceptional in the sense that it was a city with only 5.07 per cent migrants in the total population, the lowest share in large cities in coastal regions and lower than those in most capital cities in inland provinces. Cities with a higher share of migrants in the local population still lag far behind in reform (Li, 2003).
9. The provinces are Hebei, Liaoning, Shaanxi, Zhejiang, Hubei, and Sichuan. The data collection effort involved students from the Centre for Chinese Agricultural Policy, Renmin University, and the China Agricultural University. To reflect accurately varying income distributions within each province, one county was selected randomly from within each income quintile for the province, as measured by the gross value of industrial output. Two villages were selected randomly within each county. The survey teams used village rosters and our own counts to choose 20 households randomly, both those with their residency permits (*Hukou*) in the village and those without. For further information of the data set, please refer to De Brauw et al. (2002)
10. Using the same CCAP data, as well as data covering earlier years, De Brauw et al. (2002) found that the age structure of migrants became younger over time. In 1981, the off-farm labour participation rate (LPR) in rural areas for all age groups was in a small range of 18–19 per cent. In 2000, the off-farm LPR for the age group of 16–20 was as high as 75.8 per cent, twice as much as that in 1990 (23.7%). Off-farm LPR for the age groups 21–25 and 26–30 doubled from 1990 to 2000. Off-farm LPR for those above 30 also increased to 37.6 per cent from 20.6 per cent between 1990 and 2000. For all rural migrants less than 30 years old, off-farm LPR increased from 31 per cent to 45 per cent.
11. Migrants with relatively high incomes (over RMB 800 and 1000 yuan per month) are listed since we consider that they are the groups of rural migrants who can afford to settle down in cities permanently earlier than other low-income migrants. In our policy package proposed in Part IV, some qualification criteria, such as certain periods of local working experiences and a relatively high and stable salary, would be set up for migrants from other regions to obtain an urban *Hukou*.
12. Issuing land certificates to farmers would effectively minimise local cadres' rent-seeking in administrative land reallocation since land certificates would make the protection of land tenure security legally enforceable.
13. It must be noted that such qualification criteria are by no means to limit any temporary migration and labour mobility but are used as a screening device to absorb migrants who are truly willing to stay in cities and, at the same time, not using the urban welfare system. Therefore, setting up certain qualification criteria would not only smooth the urbanisation process, but also promote the work incentives of potential migrants to reach the qualification criteria. This, in turn, would limit the growth of expenditures on the urban welfare package. More importantly, if the criteria were set in a way that they did not increase over time (or did not grow as fast as the urban average income grows), it would imply an actually declining barrier for potential migrants to overcome as the economy and income grew.

14. In China, every rural household is also allocated a residential land plot for housing construction (Rozelle et al., 2002). The policy package could be designed so that migrant farmers only need to give up their agricultural land plots to apply for the urban *Hukou*, but their residential land can in principle be retained (or fully privatised). This is because farmers' investment in rural housing tend to be more intensive and privatising residential land and housing would facilitate the move of migrating farmers into cities since they can sell their housing before leaving for cities permanently.
15. In practice, the expenditure for children's education for permanent migrants can be provided by migrant-receiving city governments. However, the proposed policy package does not imply that the state should not cover the expenses of the children's education for temporary migrants. In principle, some fiscal transfers from the central government can be considered to cover such costs.
16. According to Zhou (2004), in some provinces such as Jiangsu, Guangdong and Hunan, villages have moved beyond state regulation in land use change and begun to lease out long-term land use rights for non-agricultural development purposes directly under the implicit endorsement from local governments. However, under the current legal framework, such actions are illegal. He further argues that further reforms in land requisition should draw on the rich local experiences and innovations, which has proved to be successful in China's past reform experiences.
17. Of course, land use changes from agricultural use to infrastructural development such as roads and highway would not be subject to the value added tax since there was not a market for such changes, therefore compensation for such land still needs to be set by the state.

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