

# 5. Rural-urban Divide

ECON 211, Winter 2019-20

Yingfeng Xu

February 10, 2020

Topics

## Contents

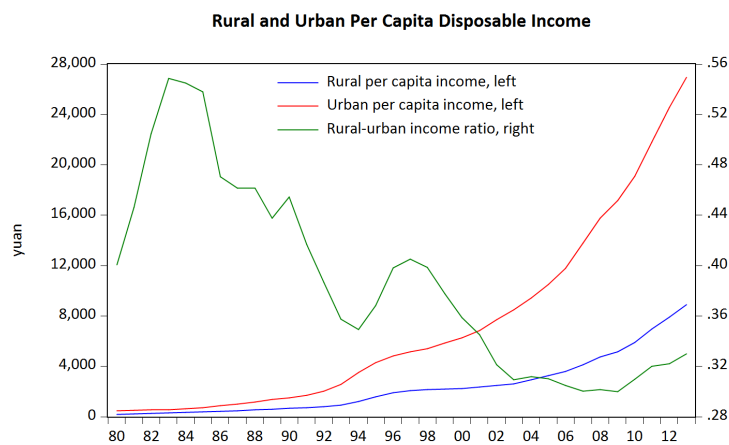
<b>1</b>	<b>The rural-urban divide</b>	<b>2</b>
<b>2</b>	<b>Urbanization</b>	<b>5</b>
<b>3</b>	<b>Implications for China's structural imbalances</b>	<b>8</b>

# 1 The rural-urban divide

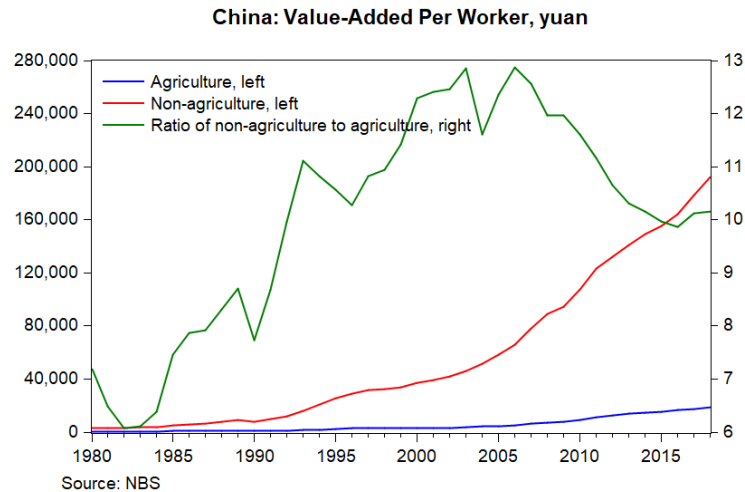
## Dualism in developing economies

- A dual social and economic structure is quite common among developing economies
- However, China has two unique characteristics:
  - Land is collectively owned at the village and farmers do not own land and cannot sell it in order to leave land
  - The benefits of local government spending is tied to the *hukou* system, which means rural residents are largely on their own

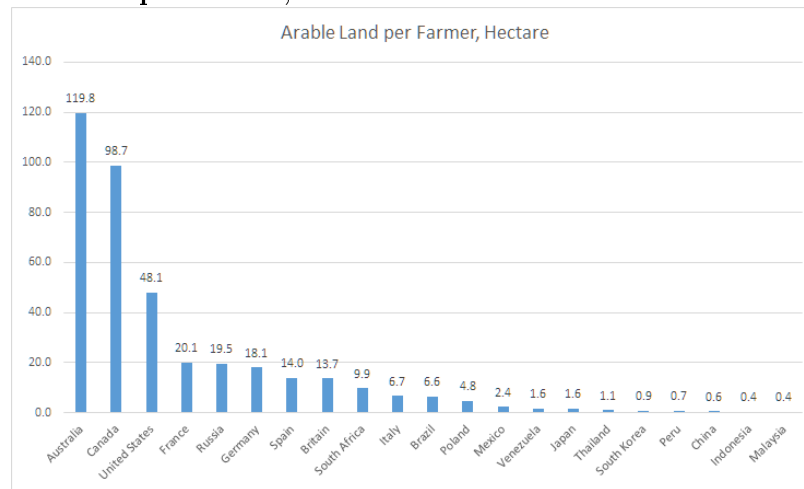
## Rural-urban income gap



## Value added per worker/farmer, yuan



### Arable land per farmer, hectare



### China's rural-urban divide

- First, the divide is reflected in the income gap caused by low labor productivity in small-scaled household farming and high labor productivity in the modern urban economy
- Second, the income gap is perpetuated by highly decentralized fiscal system, reinforced by the *hukou* system
- Finally, the income divide is further accentuated by labor market discrimination and barriers for non-local residents

### **When the divide started**

- The rural-urban divide was institutionalized after the late 1950s
- The urban sector was covered with state ownership
- In the rural sector, collective ownership in the form of the commune system prevailed
- A critical distinction is that rural residents are responsible for their own food, while urban residents get rationed food

### **The urban sector**

- The social and economic system based on state employers
  - Food rations Employment Health care and pension
  - Free or subsidized education
  - Subsidized housing
- Urban property rights
  - All land and properties belong to the state
  - Land use rights (50-70 years)

### **The rural sector**

- Characteristics of the rural sector
  - Self sufficiency in food Income and employment are based on production team (village level)
  - Collective provision of pension, health care, education
  - Local taxes and fees to fund local government
- Property rights
  - Land was owned collectively at the village level
  - Household responsibility system gives households only use rights

### **Obstacles for removing the divide**

- The huge cost to merge the rural social system into the urban system
- Urban residents lack incentives to share their privileges with migrants
- The profit motive to exploit migrant workers
- More fundamentally, the current local tax system lacks property tax as a major source of revenue
- Ridiculously, it is politically incorrect to consider the abolition of the current rural land tenure system, which is really a relic of central planning

### Key points

- The rural-urban divide is an entrenched gap in productivity, income and living standards
- It is further aggravated by the land tenure system, which was installed in the early 1950s as a core component of communist revolution
- It is frozen by the *hukou* system, in effect, one country with two social insurance systems and two classes of people
- It is a fundamental source of poverty and social injustice
- And it is also the root of cheap labor and the Chinese advantage

## 2 Urbanization

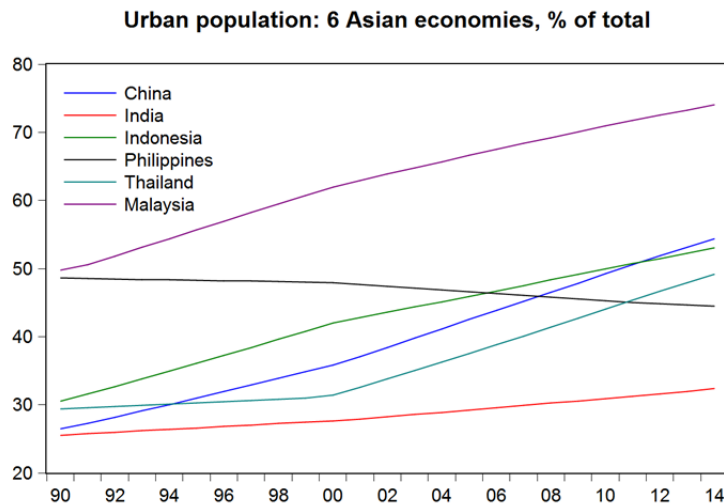
### The role of urbanization

- Urbanization is essential for moving rural labor out of low productive activities
- Urban jobs come from, on the one hand, the external demand for goods and services and, on the other hand, the local demand, especially for public and personal services related to the size of local population
- A salient feature of the past mode of urbanization is that migrant workers work in cities, but not consume fully there

### Urbanization

- The level of urbanization is low relative to other comparable countries due to:
  - town and village enterprises
  - discrimination against migrant workers
- Urbanization is now the main driver of domestic demand. Land appreciation has become a major source of local government revenue
- Compensation of farmers have been a critical issue

## Urbanization in Asia

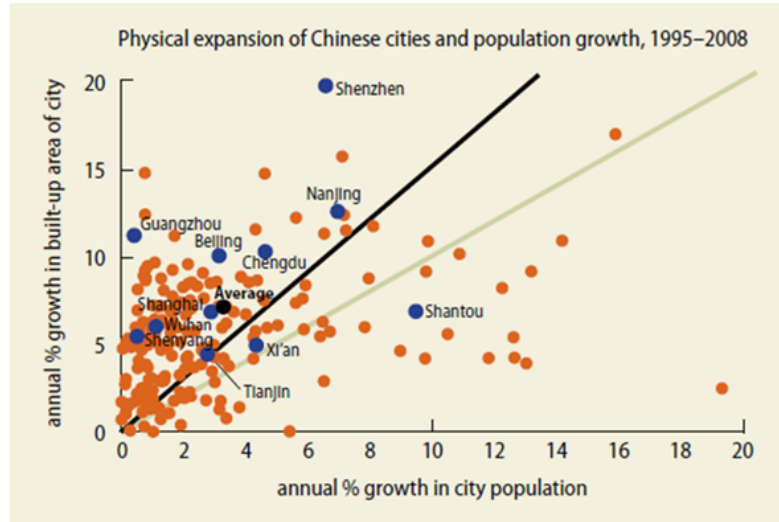


### Main challenges for China's urbanization

- Municipal governments are under-funded for their spending responsibilities, so the *hukou* system becomes an excuse to keep out migrants
- Rural-urban land conversion is hugely profitable, so there is an urge to build new ghost towns under the illusion of ever rising house prices
- House/land-centered urbanization moves much faster than people-centered urbanization
- As a result, much of GDP growth in recent years is in the shape of a huge pile of empty or scantily used roads and buildings mirrored by ever rising load of debt

### Spacial and people urbanization

**FIGURE 4 Urban land has expanded faster than urban population**



### People-centered urbanization

- The current body of migrant workers (260 million at the latest count) need to settle down permanently
- Local governments need additional source of fiscal revenue to fund their spending responsibilities
- Wages need to rise, but permanent jobs need to be created
- Real estate prices must be prevented from shooting through the roof, resulting in a destructive financial crisis

### Key points

- Urbanization remains uncompleted
- Current mode of urbanization is geared to conversion of rural land to urban use and to building empty houses and ghost towns
- The finance of municipal governments is precarious:
  - On one hand, municipal governments greedily sulk in one-time revenue from land sale
  - On the other hand, they do not have adequate recurrent local revenue for providing public services such as education and health

- Ever-rising local government debt is secured against ephemeral bubble house prices
- To avoid a pending crisis, it is imperative to switch to a people-centered mode of urbanization

### 3 Implications for China's structural imbalances

#### Why are there too many factories?

- The rural-urban divide results in a huge pool of cheap labor, at least in the past
- Chinese labor is hard-working, and does not complain much because of low human rights and tight Party control
- Migrant labor is cheap because:
  - low opportunity cost in farming (small scale of family farming)
  - Institutional discrimination of rural *hukou*
- Low wages make high profits possible, which attract foreign investment via globalization

#### Why external surplus used to be large?

- External surplus reflects that domestic consumption falls short of domestic production/income
- When foreign investors open a factory in China, output and profits are part of China's GDP
- But they do not typically consume in China, though for a while, they may re-invest part of their profits in China
- As a result, profits from foreign investment would contribute to external surplus
- Empirically, estimated foreign profits match China's external surplus, though reported foreign profits are much lower

#### Why is private consumption share so low?

- The rural-urban divide implies that rural residents/migrant workers consume only 1/3 of urban residents
- Migrant workers (1/3 of urban population, or 260 million) only work in cities, but do not consume fully there
- Inadequate social spending on education, health care and old-age income, especially for rural residents and migrant workers



**Why is investment rate so high?**

- It is hugely profitable to turn rural land into urban land because of the land tenure system
- Plentiful money supply and rising house prices adds fuel to the fire
- Infrastructure investment aggressively undertaken by governments
- Profitable export production, at least before 2008

**Review questions**

- What differentiates rural and urban residents?
- What are the major issues concerning urbanization?
- What are the economic consequences of the rural-urban divide?