

What Determine *Hukou* System Reform?

A Case of Beijing

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I. Household Registration System in Pre- and Post-reform Period

Governments in most developing countries tend to adopt discriminatory policies against agricultural sector. Through price distortion, fiscal and credit policies that favor non-agricultural sectors, trade protection and overvaluation of exchange rate, the governments extract surplus from agriculture and subsidize industrial sector. This package of policy led to institutional distortion, income outflow from rural areas, and finally impedes development of agriculture and the economy as a whole. If governments do not intervene in production activities and factor markets across rural and urban areas, the labor and capital would tend to outflow from rural areas, which equalizes wages and returns to capital in the two sectors. To shape up an allocative pattern of production factors favoring industrial sector, governments usually have adopted an institutional setting. To artificially segment labor markets between rural and urban areas is one of the most unique features of Chinese development strategy in the pre-reform era.

The segmentation of labor markets between rural and urban China is a product of former planning system. Prior to the late 1970s when reform initiated, the government adopted the heavy industry-oriented strategy, making the economic relationship between rural and urban areas a component of planning control. As a result, labor mobility across rural and urban sectors was obstructed. Compared to light industry, heavy industry is capital-intensive and weak at absorbing laborers. The implementation of heavy industry-oriented strategy, thus, implied a sacrifice of many opportunities of employment. The state, therefore, had to set up an institutional arrangement to cope with the employment pressure. Household registration system (*hukou* system) catered to serve the purpose of preventing laborers from migrating from rural areas and of assuring urban residents guaranteed employment and related welfare. Issuing of *Regulations on Household registration of People's Republic of China* in

1958 marked off the complete establishment of *hukou* system and has been put into operation of restricting both migrations between rural and urban areas and across regions. By effectively excluding rural residents from enjoying universal welfare, urban welfare system was established accordingly. In addition to subsidized provision of housing, medical care, education, childcare, and pension to urban residents, the employment policy aimed at guaranteeing overall employment of urban laborers was the core of this welfare system.

Since 1980s many of the above institutions separating rural labor market from urban market have been reformed. The adoption of household responsibility system, liberalization of farm products, and maturity of factor markets are all driving forces of labor and capital mobility within rural areas and between rural and urban regions. At the same time, the relaxation of *hukou* system, the reform of urban welfare system and employment system has promoted labor mobility among regions and sectors. As a consequence, a hundred thousand migrant workers are employed by urban employers.

A host of policies is still not favored for migrant laborers from the countryside. Locally implemented employment policies give urban residents first priority to be employed and reject outside workers to be hired locally. For instance, migrant workers across regions are required approvals from governments of both sending and receiving localities. That is, to be legally eligible for work, a migrant worker is required to have 5-6 permits and documents, including an employment permit issued by municipal governments. Each piece of these papers was levied a fee. In other words, these bureaucratic procedures raised the costs of migrant labor to live and work in the cities. Furthermore, authorities of many large sized cities issue a list of jobs closed off to outside workers, which raised the costs of employers to hire migrant workers. Unfinished reform of social security prevents migrants from obtaining necessary services that are needed by living in the cities.

The institutional origin and legitimacy of all these policies deterring labor mobility lies in the *hukou* system that has been not fundamentally altered. First of all, because of the implementation of *hukou* control, majority of migrant workers and their families are not deemed legal to settle

permanently in the cities and therefore migration in contemporary China is only circular and temporary. Secondly, *hukou* identity provides a tool for municipal governments to treat people differentially in provision of employment opportunity and safety, social security and other community-based services. Thirdly, although many of the urban-biased policies have been reformed since the 1980s, as long as *hukou* system exists there is a possibility for those policies to retreat.

One important feature that international undocumented migration shares with China's case is that for most migrants, they cannot find a formal work and do not expect to obtain a permanent residence permit. Because of this proximity between internal migration in China and international migration between developing and developed nations, scholars have compared the two cases, revealing a number of similarities between them (Solinger 1999; Roberts 2000). However, one should not forget while doing this comparison that there remains a fundamental distinction between internal and international migrations. That is that despite the culturally and institutionally deep chasm between rural and urban areas within a country, the two economies of sending and receiving places are still closely related and influence one another. Studying China's migration, we cannot avoid placing it in the economic and institutional context, in which trends of migration change over time. Solinger (1999) has pointed out two conditions under which a substantive change of the *hukou* system, such as any rural-urban conversion of the *hukou* status, may be possible. The first is when there is a significant increase in the urban demand for migrant labor. The second is when the jobs of urban workers are relatively secure. However, she fails to provide answers through what channels does urban employment situation impact the degree of tightness of *hukou* system and what is the basis of urban labor security under a market economy.

II. Why Is *Hukou* System Maintained?

There are primarily two analytical paradigms for explaining discriminatory policies against agriculture, countryside and peasants shared by most developing countries. One theory views this government intention as a necessary tool of implementing development strategy aimed at rapid industrialization of a state. Leaders in developing countries believe that industry is the catalytic sector for rapid economic growth and that taxing

agriculture provides the much-needed financial support for industrialization (for example Krueger 1992). Another theory is associated with the work of Lipton (1977) and Bates (1981) that finds answers in the political structure of most developing countries where agriculture, countryside and peasants are powerless because urban groups have much stronger bargaining powers. The reason why peasants lack political power is that they reside scattered and therefore bear much high costs of organizing a collective action. In many countries, the farms are small and agricultural output of each farm is only a tiny proportion of the total, so there is problem of free riding while organizing a collective action. This phenomenon characterized by more people with less power is conceptualized by Olson (1985) as paradox of numbers.

As revealed by above historical examination, artificial segmentation of labor market between rural and urban sectors before reform was an institutional measure of implementing heavy industry-oriented strategy. The economic policies at the time were made by political leaders without consideration of special interests of any interest groups and implemented by each level of the government hierarchically. Since the function of every level of government was simplified as an working procedure of the entire administrative system, lower levels of the government was only responsible for carrying out plans and strategic intention of the central government, while higher governments' main function was to supervise and evaluate the performance of their subordinates through the hierarchy. Under such a decision-making mechanism, ordinary residents needed not to do anything but express their advocacy and willingness of implementation of policies made by all levels of government. And the media was merely the tool of proving the rightness of those policies.

Under the economy of shortage and *hukou* system, rural residents were excluded from rationing of food, welfare provision such as housing and medical care, and iron-rice-bow typed employment security. Urban people enjoyed a relative privilege and therefore were beneficiaries of the *hukou* system. The migration of farmers from rural to urban areas has impinged against the privilege exclusively enjoyed by urban households, thus giving rise to their dissatisfaction and even rejection. The negative attitude of urban residents towards migrants and their willingness of seeking for protection from the governments have been expressed through two channels.

The first is through "vote". In the Chinese current people's congress system, direct election of representatives is adopted at the city district level. These representatives then elect those of the higher level. Major municipal government positions in each city have to be endorsed by the municipal people's congress. Local governments are becoming more responsive to local preferences and wishes of local residents can be reflected in policy-making process. The second means of expression is through "voice". This is mainly the media and views expressed at public meetings. On the issue of floating population, local media often have negative portrayals of migrants, giving the public the impressions that unemployment, crimes and chaotic city environment are attributed to peasant migrants from other places (see Davin 1996).

Since the economic reform initiated in the late 1970s and early 1980s, the interests of people have been diversified as the result of diversification of the economic structure and ownership. Media caters to reflect broader interests of different groups of citizens other than just government's slogans. More precisely, double goals faced by media – politically correction and economically profitability – require it functioning to be responsible for both government concerns and readers' concerns. Davin (2000) points out joint willingness of government, journalists and urban population to portray migration to be blamed on, but does not attach the issue to its institutional background, thus failing to reveal the actual incentives of urban people to be so negative toward migrants. Chinese media has long faced the dilemma of "prettifying the brightness – exposing the seamy side". That is, government requires it to be the positively propagandist, whereas massive readers require it to be the representative to their interests. In the case of migration issue, media can combine these two requirements perfectly by reflecting complains of job competition from urban residents and concerns of urban social stability by governments.

Being as maximizer of political benefit, all levels of government rationally weigh the costs and benefits of different policy options and chooses one that gives the largest net political benefits (Downs 1957). It is natural that local governments represent urban people's interests since local residents choose them. In particular, the evaluation system of government performance applied currently in Chinese bureaucratic system makes it true that the local urban governments have motives to care about the votes and

voices made by local residents. Currently, governmental performance at each level is evaluated annually according to a series of criteria. Of those criteria, some crucial indicators are applied to be “one vote veto”, which means if a government leadership fails to fulfill these crucial criteria, it fails to pass the evaluation. The selected criteria for “one vote veto” differ from place to place, but two of them are universally employed given their importance posed by central leadership of the party: family planning and crucial political incidence. If birth rate exceeds the controlled quota or any severe political chaos happens in a certain region,¹ the local government is considered not qualified to perform for the year and leadership is potentially discharged. In this regard, People’s Congress votes are indicative of local residents’ judgement to the leadership and voice made by press is barometer reflecting the potentially political pressure from masses. It is very high political costs for local governments that unemployment becomes serious and, worst of all, the unemployment induces any crucial political incidence. Conforming to willingness of urban residents, local governments are bounded to find an object to which the urban unemployment can be attributed and respond to urban people’s requirement positively. Correspondingly, urban governments employ a series of policy measurements to repel migrants from working in urban sector, leading to continuation of segmentation of labor market. In this regard, continuing to implement the *hukou* system and the segregation of the labor market appears as a necessary insurance of political safety during the course of transition.

III. Food, Employment, and Planned Migration: Econometric Analysis

Under the *hukou* control, urban governments arranged planned migration through *hukou* quota in accordance with the labor needed of urban development. Since the urban *hukou* was a scared resource, the planners relaxed the quota when policy environment easy, while they reduced the urban *hukou* quotas while facing a constrained economic environment. As far as the migration policy is concerned, the main determinant was productivity of grain, the bottleneck for feeding people in rural and urban

¹ Crucial political incidence refers to that workers act in unusual ways in seeking their own interests, individually and collectively, such as group appeal to the higher authorities for help, group sit-down, destruction of machinery, petition, demonstration, sabotage and strike (see MOLSS 2000).

areas at the time. The numbers of planned migrants, therefore, had to be accommodated with the supply of necessary agricultural products. As grains were the scarcest necessities at the time, their yearly production greatly determined whether or not the urban governments could meet the basic needs of urban residents and thus influenced the quota of migrants. After the reform, the labor productivity of grains has increased dramatically and supply of grains has no longer been a major constraint by which the governments decide the quota of migration. At the same time, providing basic welfare and guaranteeing a secured employment became the primary pledge for urban citizens, while *hukou* quota remains unchanged, serving the goal of limiting the numbers of people who are entitled to benefit from the welfare system. Given the changed constraints of the size of urban population before and after the reform, we can divide the whole period into pre-reform period, during which the magnitude of grain production was the main factor determining the amount of plan-approved migrants, and post-reform period when employment pressure the urban governments felt became a constraint of in-migration.

Instead of using the figures from the total floating population, we use here numbers of government controlled *hukou* migration as a proxy due to three reasons. First is the unavailability of reliable and time-series figures of market-based labor migration. Second, we believe, is that the policy intention of the government towards *hukou* migration is consistent with that one toward a wider defined floating population. Third is that the *hukou* migration can better reflect the degree to which the government loosens or strengthens the control over migration. During the time when the macro economy is in its bottom of the business cycle, both urban and rural employment suffer since the two sectors are closely correlated. The absolute number of market-based migrants may therefore not a good indication reflecting both rural employment tensions, which pressures labor to move out, and the urban policy strength against migration. An identical figure of the number of floating population tells totally different stories in different situations of rural employment, while *hukou* migration, by providing a tool to control for the situation of rural employment, can better render the government's intention over migration.

In the followed regression model, we regard the planned in-migration rate, the share of planned in-migration persons in the total local population, as

the dependent variable and the amount of grain per person and growth rate of urban workers employed as independent variables. We use the data by province between 1952 and 1987 to run the regression. The regression model is as follows:

$$M_{i,t} = \beta' \mathbf{X} + e_{i,t} \quad (1)$$

Where $M_{i,t}$ is planned migration rate of i province in year t , and \mathbf{X} denotes the determinants affecting government's decisions which include grain per capita and employment increase in year $t-1$. $e_{i,t}$ is the error term whose nature dominates the selection of specification. The error term could be decomposed as the following form:

$$e_{i,t} = u_i + v_t + \varepsilon_{i,t} \quad (2)$$

Where u_i varies among regions but keeps constant with time, while v_t is constant among regions and time invariant. $\varepsilon_{i,t}$ is the stochastic disturbance.

The estimators are presented in table 1. The first column reports results of the basic regression regarding grains per capita and increase in employment as explanatory variables, both of which are one year lagged. In the regression, these two coefficients are all significant, which seem imply that the grain production negatively affects the migration policy and the employment increase positively works. Considering the impact of factors related to time and regions, however, the determinants can not be summed up thoroughly. Econometrically, the impact of u_i should be discussed. In fact, the implicit assumption of the first column is

$$\text{corr}(u_i, \mathbf{X}) = 0 \quad (3)$$

Table 1 Determinants of Migration Amount: Regressions of Cross-province and Time Series

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Model And Variables	Baseline regression 1952-1998	Fixed Effect Model 1952-1998	Fixed Effect Model with Year Dummy 1952-1998	Fixed Effect Model with Year Dummy 1952-1998	Fixed Effect Model with Year Dummy 1952-1998	Fixed Effect Model with Year Dummy 1952-1978	Fixed Effect Model with Year Dummy 1979-1998
Per Capita Grain in Previous Year	-.0325*** (-.0078)	-.0396*** (-.0081)	.0153** (.007)	.00083 (.0055)	.0150*** (.0066)	.0304** (.0127)	.000089 (.0031)
Employment Growth in Previous Year	.408*** (.0433)	.408*** (0.043)	.141*** (.043)	.0133 (.017)	.0249 (.0195)	.0265 (.0268)	.0237* (.0132)
Constant	33.65 (3.58)	—	—	—	—	—	—
R ²	0.046						
Observations Number of Provinces	930 26	930 26	930 26	930 26	930 26	522 22	408 26
Of Time Series							
Log Likelihood	—	-3960.13	-3578.6	-3044.76	-2982.54	-1810.54	-977.85
Wald χ^2	102.37	375.7	2036.06	1347.86	1629.41	3642.76	753.42
Prob > χ^2	0	0	0	0	0	0	0
Heterosadestic Assumption of	No	No	No	Yes	Yes	Yes	Yes
Auto-Correlation	No	No	No	Common in All Panels	Specific in Panel	Specific in Panel	Specific in Panel

Note: Standard errors are in parenthesis. * significant at 10% level, ** significant at 5% level, *** significant at 1% level.

However, the plausibility of this assumption needs to be tested statistically. An implausible assumption leads to a biased estimator and then a fixed effect model is more preferred. The statistics of Hausman test indicates that fixed effect model used from column 3 to column 7 is more befitting than a random effect model. The value χ^2 from the Hausman test suggests that a fixed effect model fits the case concerned in this study. Because of this, rest of the columns is based on fixed effect model. Since the situation has been changed from year to year and from region to region, we not only control for regional effect but also take into account the characteristics of yearly changes. Column 3 adds both region and year dummy variables. Column 4

assumes heteroscedastic panels and AR(1) of autocorrelation. Column 5 assumes specific AR(1) in each panel. In contrast, columns 6 and 7 report the results of regressions before and after the reform, respectively. The analysis should be based on columns 5, 6 and 7.

Results from the regression reported at columns 1 to 5 show that grain production did influence the government decision on migration. The coefficient is statistically significant at 1% level. From its marginal effect, one can observe that increasing 100 kilograms of per capita grain would lead to 1.5‰ increase of migrated people. Column 6 and 7 tell us that before reform when the shortage of agricultural products dominated, food was a more important determinant than employment pressure while it has cut no figure since reform. On the contrary, employment pressure has gained more and more weight in policy-making of migration. In column 7, employment variable is statistically significant at 10% level. This infers that, prior to the reform, the shortage of agricultural products constrained the migration policy, and the local employment pressure has replaced it since the reform. In brief, the results of regressions have proven the hypothesis that the situation of grain supply determined the magnitude of planned migration in the period of planned economy, while the intention of urban residents seeking for employment protection determines the pace and direction of *hukou* reform.

IV. Policy Dilemma: Reforming *Hukou* System or Protecting Local Workers?

The primary drive for urbanization is to gain economy of scale. However, planned system and market mechanism induces different patterns of urban development. Under the market economy, cities develop through self-financing. A more efficient investment gained by centralization of residence and production is the source of urban expansion. On the other hand, the development of a planning-oriented urban system mainly depends on redistribution. In China's case, the hierarchical ranking of a city can well represent its access to share resources from redistribution – the higher its ranking the wider its scope within which the city mobilizes development resources. Subsidy for municipal development is the revealed indicator representing a city's ability to finance itself through redistributing resources. The average amount of subsidy cities ranked differently received is shown

in Table 3. After the adoption of tax sharing system, the magnitude of local governments' fiscal revenue became an indication of ability of urban development through self-financing, and the deficit of local government expenditure exceeding revenue has to be made up by certain kind of subsidy. Budgetary deficits of local governments can well denote the degree to which the urban development is subsidized. As is shown in the table, those cities that have higher ranking receive more subsidies.²

Table 2 Subsidies Received by Each Ranking of Cities (1996)

	Municipalities directly being under the jurisdiction of central government	Cities ranked sub- provincial level	Prefectur e-level cities	County- level cities
Volume of subsidy (yuan per person)	454.66	364.39	320.35	340.44
standard deviation	246.67	460.69	354.37	327.12
Maximum	742.22	1601.01	1272.54	1987.95
Minimum	223.08	-147.34	-1306.07	-487.41
Numbers of cities	4	15	207	434

Source: SSB, Urban Statistical Yearbook of China 1997, Beijing: China Statistical Publishing House, 1997

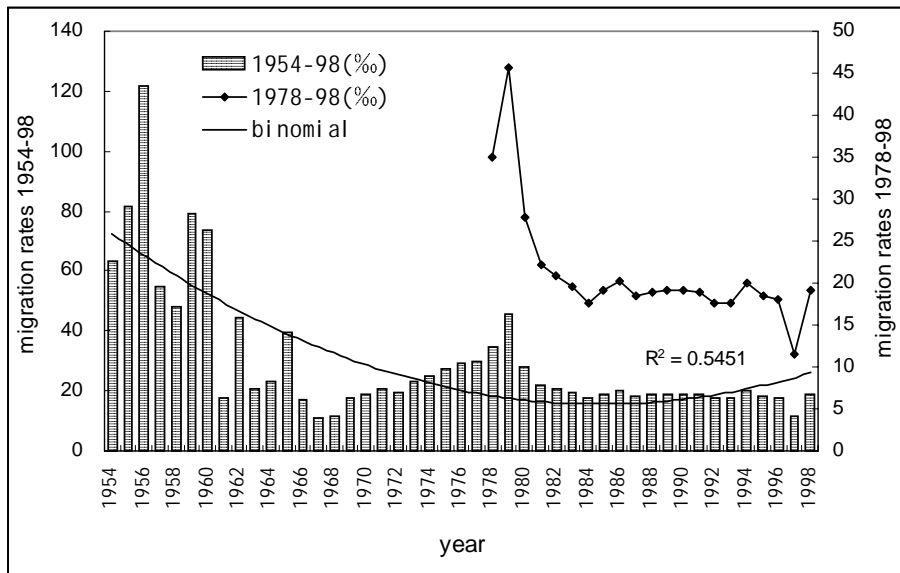
Not only the employment protection supports the continuation of *hukou* system, but the exclusiveness of urban welfare provision is also the institutional barriers preventing the *hukou* system from being abolished completely. Under the *hukou* system, residents in rural areas and in cities with different rankings are treated differently in terms of welfare provision. The reason different cities have miscellaneous attitudes towards the reform of *hukou* system lies in different welfare elements each *hukou* status contains. Self-financing typed cities treasure a booming economy higher than subsidy typed cities do. Consequently, Self-financing typed cities tend to welcome outside laborers to participate in local economic activities, while subsidy typed cities tend to seek for more subsidies from higher level governments and redistribution in larger scope of localities, worrying

² Apart from ranking, there are several other factors determining the magnitude of subsidy cities receive. Sometimes county level cities get subsidized more than prefecture level cities do, because poor areas receive poverty alleviation funds and minority autonomous regions receive special supports. More detailed analysis of links between city ranking and subsidy requires controlling for those factors.

outflow of local welfare and subsidy.

As the nation's capital city and one of the four municipalities directly being under the jurisdiction of central government, Beijing holds the advantage of traditional welfare provision and strictly controls inflow of migrants through planning mechanism. Since the late 1950s after adopting the *hukou* system, the rate of planned migration in Beijing has been dramatically dropped and remained at a low level at which its population mobility cannot meet the requirement of urbanization during the economic development of the country as a whole. Figure 1 shows that in the entire period between 1950s and late 1990s the rate of in-migration with *hukou* status has remained low with an exception during the late 1970s when the sent-down youth returned to the city from the countryside of all parts of the country. It has even further dropped in the late 1990s due to the increased employment pressure in the city. Such a dynamics implies a lagged reform in this area comparative to other areas of reform. If *hukou* system can be said to be the last stronghold of the centrally planned economy, municipalities like Beijing are most likely to be the last stronghold of the traditional *hukou* system. Even the National "Tenth Five-year Plan" in which the reform of *hukou* system in all cities and towns is scheduled still gives an exception to cities like Beijing that are said to have special status (See SDPC 2001). Once the city of Beijing continues to hold this position, it is pretty logical for it to carry out a policy strictly controlling over migration in order to keep the institutional consistence. Since the city of Beijing is characterized by both of specialty and generalization, it can be viewed a good example for us to examine the political economy of urban employment protection and migration control.

Figure 1 In-migration Rates of Beijing between 1954-98 (%)



Note: For better observing the change in in-migration after reform, we plot the trend after 1978 shown by the scale of right hand.

Source: Data before 1993 from Zhuang (1995) and after 1993 from MOPS (various issues)

In order to serve its policy objective, the *hukou* system is not alone enforced. Apart from controlling the amount of migrants, municipal governments also implement a host of policy measures to restrict the inflow of migrant workers. Taking Beijing as an example, we can observe the conceptual links between discriminatory employment policies against migrants and the seriousness of unemployment in the city. Following both the historical and theoretical logic, we summarize and describe the policy evolution below, dividing it into three periods. First is the period from mid 1980s to 1991, during which the municipal government enacted a variety of policies to regulate and restrict migrant inflows. Second period is between 1992 and 1994 when the restriction was relatively relaxed due to the economy boomed. Since 1995 the policy direction has been retreated. Figure 4 summarizes the major measures in the period of policy evolution.

Table 3 Policy Measures Restricting Migrants by Beijing Government

	Amount Control	Permit Requirement and Fees	Procedure of Approval and Management	Restriction of Sectors and Posts
Period of regulation and restriction (1989-1991)	Local hukou required while recruiting; expelling 200-250t thousands migrant workers; strict restriction of employing migrant workers	Employers of migrants are required to apply for "Permit of Work in the City" for their employed migrant workers		
Period of policy relaxation (1992-1994)		Stopping charging administration fees from migrant nannies	Issuing system of employment contract; granting autonomy of hiring rural migrant laborers	
Period of strict restriction (1995-2000)	Strictly restricting enterprises to employ migrants; for whose enterprises where layoffs exceed 10% of total workers, hiring migrants is not allowed in principle; formulating both a total magnitude of employing migrants and a proportion between layoffs and migrants to be recruited	Permit for residing and working is required; for some posts, special permit is asked to apply for; regulating the procedure of applying for various permits; according to their length of stay, work type and social appearance, migrants were identified as types A, B or C and treated differently	Regulating administrative management of migrant workers; expelling those outsiders without holding various IDs permitting staying and working; making conditions under which enterprises can employ migrant workers	Restricting industries and posts for employing migrants: 14 in 1996, 32 in 1997, 34 in 1998, 103in 1999

Source: Beijing Municipal Bureau of Labor, various issues

Until mid 1980s when labor mobility was not significant phenomenon, the employment administration in Beijing had been typical planned regime. As the reform of urban employment system initiated and rural laborers started moving to the cities, labor force in urban sectors has been no longer allocated solely by government plan. At the same time, municipal government of Beijing began to regulate floating population and migrant workers. In the period, basic orientation of the policies was still to restrict labor mobility. Controlling the numbers of migrant workers allowed to move in the city and implementing a system requiring work and resident permits for outside workers were the major tools though which the municipal administration restricts labor mobility when it first appeared. This policy package rejecting migrants was relaxed after Mr Deng Xiaoping made his famous tour to the south followed by an economic booming and high expectation of income increase. While the high growth

rate increased the demand for labor force, the attitude of urban residents and government towards migrant workers became relatively positive, the policies of population control experienced a short period of relaxation. Although the policy orientation was not to be fundamentally changed, the relevant policies conveyed messages that outside laborers were welcomed by local economy.

Like what happened in the country as a whole, Beijing has experienced a severe pressure since 1995 and an unprecedented number of urban workers have become laid-off and unemployed. Viewing the outside workers as job competitors of local workers, the government implements the reemployment project by taking a series of measures more strictly restricting migrants to work in the city and preventing migrants from moving in. Heretofore the city of Beijing has still taken the lead of implementing most discriminatory policies against migrants, impeding the maturity of labor market. First of all, the system of permit requirement even for temporary work and short residence, which is expensive in terms of both direct and transaction costs shouldered by employers and migrant workers, has been implemented in a rigid way. Secondly, the municipal administration issued a host of regulations setting obstacles preventing migrant workers from working in a number of industries, types of work and posts in a way that is not consistent with the era of reform and opening-up.

Under the current economic system of China in which market mechanism plays major role in allocating resources among sectors and regions, enterprises and individuals often try to avoid the government regulations that are against their economic rationality. So, those discriminatory employment policies against labor mobility is not necessarily implemented effectively. Despite the restrictions placed by local government on hiring outside labor, many non-state enterprises have found ways to circumvent the restrictions because of the lower labor costs. With the autonomy of hiring state-owned enterprises have, it is not uncommon to find those enterprises often illegally employing outside workers. However, the consequences of behaviors enterprises and individuals act under different policy constraints are different. Provided the unfavorable policy references against labor mobility, both enterprises that hire migrants and migrant worker employed in the city faces much higher costs than it would be the case if the restriction does not exist.

V. Conclusion and Policy Implications

The segmentation of rural and urban labor markets legitimized by *hukou* system was given birth to by heavy industry-oriented strategy and attendant institutions and has been maintained during the reform period due to the strong powers urban residents hold in decision-making of urban development policy. By the logic of China's ongoing reform, the complete abolishment of institutional deterrents to labor mobility depends on three conditions. First, municipal governments find that the policies deterring the development of a labor market cannot help solve the unemployment problem and implementing these policies no longer has legitimacy. Second, urban residents and workers find no evidence that migrants are a threatening competition force in employment opportunities in the long run and they realized that their employment situation is independent from the existence and size of migrant workers in the city. Third, the sources of urban welfare provision come from self-financing rather than from fiscal redistribution. In a perspective of political economy of reform, one can clearly see a relationship between welfare implication of *hukou* and the willingness of *hukou* reform. That is to say, the *hukou* reform will follow a logic under which the governments intend to implement the reform when local *hukou* no longer contains welfare element. In practice, the current reform of *hukou* system has been sequenced from small towns, middle-sized cities and large cities, though cities like Beijing and Shanghai may remain as the last forts. A progress of *hukou* reform worth mentioning is that the planned distribution of *hukou* quota has been replaced by a selection mechanism through which more migrants can settle in the cities as they meet the criteria set by the municipal governments. A continued reform of urban welfare system and transformation of urban development pattern from subsidy-typed to self-financing-typed will finally eliminate welfare element in *hukou* and therefore greatly reduce obstacles of the reform.

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