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The reform of China's household registration system

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Background Briefing: The reform of China's household registration system

1. Introduction

China is an extremely geographically mobile society. As in other countries, people move to other places to study, work, or form a family. In contrast to other countries, however, freedom to pick one's place of residency is still very limited in China. People are tied to their parents' household registration by a long-term residency certificate (*hukou*), and changing residency is an extremely cumbersome affair, especially if the change involves moving from the countryside to the cities, or from a less-developed to a developed city.

The urban-rural dual registration system has its roots in the totalitarian command economy of the Mao Zedong era. One purpose was to control population flows, the other to keep two classes of people separated: urban dwellers and farmers. The countryside supported urban development by providing subsidized food without receiving benefits in return. Urban dwellers were typically state employees, enjoyed life-long employment and participated in social security systems. The life of China's peasants was far more insecure: they depended only on what their land produced, but had to deliver parts of their harvest to government authorities to pay for education, medical treatment, and the upkeep of local governments.

Living in the cities was thus far more attractive than life in the countryside, but China's registration system stemmed the large-scale migration to the cities that would have ensued if people had been able to freely choose their place of residence. One central feature of the Reform and Opening Policies implemented by the Deng Xiaoping administration since the late 1970s was that market forces gradually replaced the Party-state as the main allocator of production factors, including labour. This political change set in motion an unprecedented migration from the countryside to the cities.

Although the rigid household registration system outlived its usefulness, it has largely remained in place until today. In a landmark move, the current leadership has decided to implement reform of the system. This contribution will first outline the problems that the current system poses for China's economic and social development. Thereafter, it will sketch the contours of the change envisioned in a number of documents released in early 2014. Finally, several scenarios for future reform will be outlined.

2. Problems with the current system

China's household registration system is based on the principle that people live in one locality from their birth to their death. Moving from one locality to another was seen as the exception rather than the norm and entailed a cumbersome administrative process. **People generally moved to another locality because the authorities decided so, for example, if there was a shortage of well-educated or skilled labour in that locality, or if labour were shifted from one state-owned enterprise to another.** In the countryside, marriage was another motive for changing location. In most cases, the bride would move from her village of origin to her husband's village. If changing one's place of residence was exceptional, moving from the city to the countryside and vice versa was even more so. An obvious exception is the sending down of hundreds of thousands of educated urban youth to the countryside in the Mao Zedong era.

Fixed residency was one feature of China's registration system, the distinction between rural and urban residential registration was another. Urban registration came with entitlements that were not present in the countryside. People in the cities were employed by state-owned entities and were

able to enjoy the benefits of a basic social welfare system that entailed health insurance, maternity insurance and an old age pension. Farmers, in contrast, did not have access to an old age pension and, in case of illness, had to resort to so-called 'barefoot' doctors - unskilled medical personnel.

The period of reform and opening later rendered this system impractical. China's acceleration of industrialisation from the late 1970s, which was most pronounced in the wealthy provinces located along China's east and southeast coast, resulted in labour demand that could not be met by the local population. In addition, differing living standards resulted in labour from the central provinces being much cheaper than that from the coastal provinces. At first, increases in the movement of labour did not result in a change to the residency system. Migration to the cities was not institutionally encouraged, but local authorities did welcome it informally, because they were able to profit from economic growth and the low wage standards, which they needed to attract further investments. Later, skilled migrants could apply for a residency permit, which allowed them to live in a city without, however, enjoying the benefits of a long-term residency certificate.

Ever since, the number of people living in cities has continued to increase. In January 2012, global media reports highlighted that for the first time in China's history, more people lived in the cities than in the countryside. **Since the beginning of the period of reform and opening, the percentage of city dwellers has skyrocketed from roughly 18 percent (1978) to 53.7 percent (2014) of the whole population.** The high number of people flocking to the cities in search of work has had two major undesirable side-effects.

First, differences in employment opportunities have made migration uneven. In the developed coastal provinces, 62.2 percent of the population live in cities, but the corresponding figure for the more agrarian regions of central China is 48.5 percent; for the even less developed regions of Western China, 44.8 percent of the population is urban. In the wealthy regions, migrant workers concentrate in megacities such as Beijing, Guangdong and Shanghai. This puts great strain on the available resources in these cities, such as living space, public transport, and tap water. In addition, migrant workers are still seen as second-class citizens and are often alienated from the resident population. Migrants are often crammed together in sub-standard housing in the fringes of cities, and these slums are often responsible for increasing crime rates. Apart from these societal effects, government experts warn that the uneven distribution of migrants in China translates into uneven consumption patterns, which is harmful to the economy and might even cause China to become stuck in a "middle income trap".

Second, urban household registration has not kept pace with urbanisation: 53.7 percent of all Chinese live in cities, but only 36 percent hold the *hukou*. The other 17.7 percent hold short- or long-term residence permits that allow them to settle in a city, but bars them from full access to urban social security systems and public services, most notably in the following areas:

Social insurance fund

Although employers are now required by law to contribute to migrants' social insurance funds, they not always do so. In addition, migrants earn significantly lower wages than workers with a permanent urban residence, so if social security contributions are made, they tend to be lower. At best, migrants can enjoy only basic medical treatment. Despite this, as long as migrants are employed, they are required to pay taxes just like workers with an urban *hukou*.

Transferring social welfare contributions

Following the logic of the fixed residency system, social insurance funds are administered according to where a person is registered. The transfer of contributions from the place of registration to the place of employment, or from the place of employment back to the place of origin is not possible. At best, migrants can take their own, but not the employer's contribution to the funds with them when they change locality. This severely restricts their mobility.

Education for migrant children

Equally serious is the fact that migrant workers have to pay extra fees for their children to get basic education in urban public schools. This is mainly the case because they are seen to unfavourably skew student-teacher ratios, which may require the hiring of new teachers. Due to their low tax contributions and their transitory nature, the children of migrants are regarded as burdens on the local infrastructure. This is somewhat ironic because, by contributing cheap labour, migrants have often helped to set up the infrastructure in the first place.

In several cities, migrant workers have therefore established their own schools, which are cheaper, but unregulated and frequently located in unsafe, run-down buildings. This is frowned upon by the authorities who, much to the despair of migrants, have closed down several of these schools.

Tertiary education

In addition, high school students must take the National University entrance exams in their locality of origin. Hence, the offspring of migrant workers need to return to their hometown to take this exam; the content of which varies in different provinces and favours those who live where a university is located. Because of higher living costs in the city, many migrants leave their children in the countryside.

Emotional stress

Given that these children see one or both of their parents only once or twice a year for an extended period of time (e.g. for a few weeks over the spring festival), these families have to pay a high emotional price for the surplus income they receive from a city job. At the same time, the exodus of China's working-age population from the countryside has turned China's villages into places occupied by the very old, the very young and the very uneducated. In a mirror image of many European villages after World War II, this serves to further increase the already huge development gap between China's cities and its countryside.

Loss of land

A final point pertains to the agricultural land allocated to each rural household. In the course of industrialisation, many households lost their agricultural land to industry. The proceeds from these transfers have been a major source of income for many local governments, but farmers are often inadequately compensated for their loss. In this process, many farmers have lost their main source of sustenance and face dire poverty because they are not cushioned by a social welfare system.

Waste of land

Relatedly, local development schemes have not made good use of available land. Hasty development has created over-capacity in rural and urban housing, and industrial zones often take up too much space. This has led worries by the central government that there will soon not be enough agricultural land to guarantee the country's food security. There are also plans for agricultural land to be farmed more effectively – according to a recent government document on China's urbanisation, 70 percent of all agriculture is to be mechanised by 2020.

3. What are the objectives of the announced reforms?

The announced reforms have four major aims. **The first is to continue China's process of urbanisation.** As stated in the new urbanisation plan, the urbanisation rate of countries with a similar per capita income as China averages 60 percent, and China is to aim for this level until 2020.

Second, the percentage of China's population with an urban *hukou* is to be increased from 36 percent currently to around 45 percent by 2020. In effect, this means granting 100 million migrant workers a long-term urban residency certificate in the next five years.

Third, the high concentration of migrant workers in a small number of area, as characterised by the current situation, is to be remedied. In the next five years, the population size of small cities is to be increased and that of big cities to be consolidated. In particular, the following guidance is provided:

- *Cities with 500,000 to 1 million residents are called to ease the restrictions on long-term residency;*
- *Cities with 1 – 3 million residents should ease such restrictions 'within reason';*
- *Cities with 3-5 million residents should clearly lay out the conditions under which long-term residency may be granted, meaning that it should become far more difficult to migrate to a big city;*
- *China's six megacities with a population of more than 5 million residents are called on to strictly keep population size in check.*

The central authorities call on local governments to establish standards for allowing people to obtain permanent residency. Such standards are to be based on how long migrants have been employed and living in a city, and how long they have contributed to social security systems. The more crowded a city is, the more demanding the standards should be. In addition, megacities are allowed to employ a bonus point systems with flexible limits in order to regulate the scope and pace of increase of urban residents. The process for migrants to become urban citizens will involve three steps: in continuation of current practice, each new entrant to a city will be required to register with the public security organs. After a period of time, and depending on the level of integration, migrants can then apply for a temporary residency permit. In a final step, those holding a residency permit will, contingent on the conditions outlined above, be able to apply for an urban *hukou*.

Fourth and finally, the discriminatory character of the current *hukou* system is to be abolished.

Most importantly, those holding a residence permit should be able to gain access to the same public services and social welfare benefits as *hukou* holders. In particular, non-permanent residents should be able to receive training to increase their occupational skills, and should be able to enjoy accident, unemployment and childbirth insurance. The children of non-permanent residents should be allowed into local schools. A national old-age pension system will be created that allows migrants to change their place of residence without losing their entitlements, migrant workers will be entitled to basic medical insurance, and the urban and rural health systems will be integrated. Finally, the

housing conditions of migrant workers will improve, they will be granted free access to neighborhood-level health services, and measures will be taken to better integrate them into urban society.

However, because the level of benefits received by urban *hukou* holders is not uniform, but instead depends on factors such as the size of their accumulated contributions, their place of registration and their employer, poor migrants will only receive basic services. In contrast, white-collar migrants, who have already been treated favorably by the system, are likely to have see this trend continue.

It is important to mention that it is still unclear exactly how the new policy will be implemented and financed. As always, the central government is asking the localities to come up with innovative solutions regarding how to attract investment and share financial burdens. For those familiar with local finances, there are concerns that further transfer payments and policy loans have been promised to already highly-indebted local governments, and that city-level governments are explicitly encouraged to make use of financial instruments like bonds and stocks. Leveraging actors who have not been very transparent in the past and whose investment decisions have not always been prudent poses a major risk for China's financial health.

4. Why is the system not abolished altogether?

It would be wrong to interpret the recent changes as a relaxation of the residential registration system because the announced changes really touch on two different dimensions of the present system: **the first regards the discrimination of people who are registered in the countryside. This discrimination is to be abolished.** Urban and rural residents are to have equal access to public services, enjoy the same social security benefits, and are to lose their social stigma of having been born in the countryside. **The second regards the freedom to choose one's place of residency, which will not increase, but in fact be limited further.** While the urban/rural distinction is to be abolished, the aim of controlling human resources is not: in order to facilitate even development, a more efficient use of human capital and land, and to ease strain on natural resources such as water and air, the government plans to halt the growth of mega-cities, create regional urban centers, and increase the population of small cities. One particular measure that has long be announced, but will be put into practice in the next five years, is the creation of a comprehensive database that holds basic socio-economic and employment information of each citizen. To sum up the thrust of the reform: existing discrimination between urban and rural residents is to be gradually abolished, but individuals will be encouraged to move to small- and medium-sized cities through employment opportunities and integration into urban social welfare systems. Completely abolishing the household registration system would run counter to this aim.

5. Outlook and suggestions

In the medium- to long term future, Party-state planners will continue the pace of urbanisation. **If the five-year urbanisation plan is deemed successful, then a new goal of gradually raising the urbanisation rate to 70 percent of the population by around 2030 (and in the longer-term to 80 percent), is likely.** This means that the percentage of the Chinese population with a permanent urban residency is certain to surpass 50 percent in the medium term. It is highly unlikely, however, that all urban dwellers will be allowed to change their place of residency even if they have worked in one location for a long time. Party-state planners are unlikely to fully give up the flexibility of being able to allocate human resources to where they deem necessary.

The planners follow the idea that production and consumption are correlated at a regional level: enterprises need skilled workers, but skilled workers will only settle in places where they find decent living and working conditions. This is the root cause of a vicious cycle that has caused uneven urbanisation in many developing countries. The Chinese authorities seek to break this cycle by providing incentives both for enterprises and workers to settle in certain region. **The registration system and infrastructure investments are thus complementary tools to kick-start a large number of regional development hubs.** Geo-spatial planning at this scale is unprecedented in human history, which makes envisioning scenarios difficult. Too many variables, among them (local) government finances, international and domestic economic conditions, regional and local economic policies, the skills of local entrepreneurs, the quality of China's education systems and personal preferences are likely to affect eventual outcomes. It is for this reason that the changes described in this paper will proceed gradually and on a trial-and-error basis, dependent on success and financial means.

However, one pertinent issue that is already visible concerns the reform of China's social security system. The envisioned changes require a unified social security system that covers all of China and that allows people to work in different places without sacrificing the benefits they have acquired elsewhere. Given the precarious financial state of social security funds and huge price and wage differentials across China, solving this problem will be difficult. A significant infusion of government funds will be needed to mitigate these problems. **The fact that China's population is aging rapidly and, according to data from the World Health Organization, that chronic disease is on the rise,¹ means that this will be a major challenge.**

The European Union can help mitigate these insecurities by providing expertise and facilitating communication with regard to two issues: social security and urban planning. As for how to standardise and improve China's social security system, the experience of European countries with their comprehensive and technically sophisticated social security systems is invaluable, and Chinese experts have been studying these for a long time.

The matter is different with regard to urban planning, especially in small and medium-sized cities, which still largely proceed in a top-down fashion without the consultation of stakeholders. The Chinese authorities are hoping to gain insights into how central European cities have tackled issues such as traffic, public transportation, environmental protection, green technologies, recreation, and urban governance. Their willingness to experiment in different fields and to try out new processes will facilitate fruitful interactions and mutual learning, and has the potential to improve the lives of millions of Chinese.

¹ '...the average annual increase of chronic disease cases was 10 million over the past 10 years', see <http://english.people.com.cn/90001/90782/90880/7331507.html>