

**The Political Economy of Urban Protectionist
Employment Policies in China**

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1. Introduction

One of the major features of Chinese development strategy in the pre-reform era was the rigid segmentation of the rural and urban sectors. This was enforced through strict control of rural-urban migration. Since the late 1970s, peasants have been allowed to move to cities, however, there remain many barriers in rural-to-urban labor mobility. Many urban jobs are off limit to rural migrants. Rural and urban labor markets are by and large segmented. The large gaps in per capita income between the rural and urban sectors and disparities in output and employment shares are indicative of the significant barriers in rural-to-urban labor flows¹. The suppression of rural-to-urban migration was part of a package of the Chinese development strategy pursued under an orthodox central planning framework (Chan 1994). It is generally expected as the Chinese economy becomes more marketized, rural-urban labor mobility will also increase accordingly. The reality, however, does not appear to be the case. While peasant migrants can now take up certain jobs in the cities, they still cannot permanently settle in the cities except the very wealthy -- those who can afford to "purchase" an urban *hukou* (household registration) status (see Chan and Zhang 1999). Despite the reforms of the *hukou* system, becoming a full-status urban citizen, i.e. converting to a full urban *hukou* status in substantive terms, is still very much a dream for the ordinary peasant.

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

¹ Statistics show that in 1998 the real rural-urban income ratio is about 1:2.5 (see Yang and Cai 2000). The rural sector has about 70 per cent of China's total employment but accounts for only 46 per cent of the GDP (SSB 1999, p.55, 133 and 412).

increase in the urban demand migrant labor. The second is when the jobs of urban workers are relatively secure. It is quite obvious that the first condition cannot act independently because while the condition of labor demand changes all the time, it takes a much longer time for any employment discriminatory policy and related institutions to change. As will be argued later, the condition for change will only come when there is a change in the type of labor associated with the orthodox, Soviet-type development strategy and its institutions. There is also some uncertainty in the second factor. Many studies have shown that even when the local urban workers' jobs (the "primary market") are secure with good benefits, labor market segmentation continues to exist. The substantial differences in labor benefits and welfare between the primary and secondary markets, ironically, speaks to the existence of segmentation (Piore 1970; Bhattacharya 1985).

This paper takes a broader perspective and attempts to seek explanations of China's current labor market segmentation from perspective beyond the *hukou* system. We will distinguish the different factors that condition the labor markets in China in the pre-reform and reform eras. Examples will be drawn from current employment policies in Beijing Municipality to illustrate the political economy of the current labor market segmentation policies.

2. Segmentation of Chinese Labor Market: Past and Present

Segmentation of Chinese labor market along the rural-urban divide was a product of the orthodox Soviet-type system and development strategy adopted in China in the 1950s. In the pre-1978 era, because of the pursuit of the development strategy based on heavy industry, rural-urban relations also became a component heavily controlled by the state. The free flows of labor between rural and urban sectors were blocked through a system of "invisible walls" (Chan 1994) based on the *hukou* system and other institutional arrangements. To pursue rapid industrialization based on heavy industry under the condition of capital scarcity, the state orchestrated to keep the costs of industrialization low. This means suppression of urban wages, and agriculture (including food) prices. The latter was done through the state monopoly of marketing of agricultural goods (the "unified procurement and purchase" system). In nature, this means that at least the initial costs of industrialization were heavily shouldered by the peasants. However, the control of commodities (and prices) could not be effective without the simultaneous control of the movements of the factors of production (including labor). The commune system setup in 1950s in the

countryside served that purpose and limited peasants' work and life only to the rural areas. In a more comprehensive way, the *hukou* system was re-employed to limit the outflows of rural labor and to protect the employment and welfare of the urban residents. At the same time, the pursuit of capital-intensive industrialization (in the urban sector) also implies that the urban sector had limited employment absorption capacity¹. With peasants effectively shut out of the urban sector, the state was able to set up an urban welfare system that included housing, medical care, education and pension for virtually all urban residents.

From the above, it is clear that (a) the various institutional arrangements described above worked in concert, not just the *hukou* system alone, to produce the rural-urban segmentation of the labor market, and (b) the various arrangements were results of pursuing a Soviet-type industrialization strategy. This is an industrial growth strategy premised on the limited supply of additional labor from the rural sector, in contrast to the Lewisian-type labor transfer based on unlimited surplus rural labor (Lewis 1954; Saith 1999). From this, one can also expect that with the abandonment of the orthodox industrialization strategy, the rural-urban segmentation of the labor market should also disappear.

Since the late 1970s, many institutions inhibiting the development of a unified labor market have undergone different degrees of reforms. The full implementation of the household responsibility system in the countryside means the end of the commune system. Price reforms also finally led to the end of the state compulsory procurement and purchase system of agricultural commodities. In the factor market, labor and capital started to flow within the rural sector and between rural and urban sectors. At the same time, with the relaxations in the *hukou* system, large numbers of peasant workers now find jobs in different types of enterprises in cities. However, urban employment policies in many, and increasingly more, cities continue to be unfavorable to rural migrants and in many cases, highly protectionist.

3. Rural-Urban Labor Flows: Who gains? Who loses?

As a rule, segmentation of the labor market has distorted labor costs and contributed to inefficiencies in the allocation of labor. China is no exception. Segmentation resulted in huge losses of efficiency. The significant gains in productivity in the reform era are good indications of the inefficiencies caused by market distortions in the pre-reform era.

¹ For a detailed examination of this issue, see Feng and Zhao (1982).

Research has shown that the labor transfers from low-productivity sector (agriculture) to the higher one (such as industry) is a significant source of economic growth in the reform era. It is estimated that the rural-urban labor mobility contributed to about 16 to 20 per cent of the increase in China's GDP (Lee 1997; World Bank 1997, p.8; Cai and Wang 1999)¹. The continuing labor market segmentation indicates that there are still untapped growth potentials in labor productivity in China.

The reforms in the last two decades have changed almost every aspect of the orthodox system of the Chinese economy. The conventional industrialization strategy is no longer used. Interestingly, while the labor market is more integrated than in the pre-reform era, local urban governments (most prominently, Shanghai, Beijing, Guangzhou and Wuhan) in the recent few years have enacted increasingly protectionist labor policies, directed largely against peasant migrant labor. How can we explain these apparently opposite moves in the transformation to a market economy? In order to understand that, we need to analyze the political economy of the rural-urban mobility by examining the benefits and losses of the different interest groups in this process of marketization. In addition to studying the overall impact on China, we also need to gauge the impacts of rural-urban labor mobility on the different groups/sectors (migrants, urban workers, urban enterprises, and local governments).

The peasant migrant labor obviously has significant gains in wages by moving from a farm job to an urban job. The peasant migrant in the 1990s expected to benefit from the large wage gaps, often in the range of 1 to 3 or 4, between an urban unskilled job in a coastal city and a farm job in an inland province (Liu, 1995). Remittances are a major contribution of these outside workers to their family back home. The SSB estimates that the average wages of rural migrant workers in cities in 1997 was Y5,642 per year (*Sing Tao Daily*, 1998). Other studies have also indicated that that about 50-60 per cent of their incomes is remitted back home. If we use the 60 million figure for the size of the rural migrant workers and remittance figure of Y3,000 per year, this will yield Y180 billion a year, or roughly an equivalent of 15 per cent China's agricultural sector's GDP (SSB 1998, p.55). An earlier estimate provided by the Rural Development Institute of the Chinese Academy of Social Sciences, and the SSB, based on a total size of 41.4 million rural migrant labor, suggests a total remittance of Y83.2 billion in 1994, averaging about Y2,000 per migrant worker (RGAARE 1995).

¹ Johnson (1999) also believes that in the coming three decades, if the rural-urban migration barriers are dismantled, the intersectoral mobility can contribute to 2-3 percentage points of China's GDP growth rate.

Enterprises in the non-state sector also benefit from a more integrated labor market. The high growth of the economy in the last two decades was to a large extent due to a higher growth rates and an increasing share of the non-state sector. Because of the existence of institutional wage rates in the SOEs (which is higher than equilibrium wage rate), non-state enterprises face high labor costs in recruiting labor from the SOEs. The plentiful supply of rural labor willing to accept lower wages is a major source of competitiveness of the non-state enterprises in China. This is also crucial in maintaining China's international competitiveness (Cai 1998; Huang 1999). 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 costs¹.

The contribution of the rural migrant labor to the economy is obvious and well recognized. To the national economy, their transfers from the farm to city jobs help raise national economic growth rates and develop China's factor market. The urban economy would not have been able to achieve those impressive growth rates without the low-cost labor provided by rural migrants. Because of migrants' contribution to the economy, one would expect the government to welcome rural migrant labor mobility. Local governments of the sending regions take a favorable view and promote actively rural-urban labor mobility, but it is not true for those of the receiving regions, especially some large and super sized cities like Beijing and Shanghai. While the contribution of the migrant labor to the economy is recognized, these cities view rural migrants as a problem and have enacted increasingly restrictive policies to ban the hiring of outside workers².

We believe that the negative view taken by many urban governments are related to the real and perceived impacts of migrant workers on the urban economy by urban residents. The major argument against outside labor is that migrant workers take away jobs from the locals. It is reasoned that given fixed labor demand, increases in labor supply depress wages or generates unemployment. Urban workers, after decades of almost full employment in the pre-reform era and high wage growth rates in the reform era, are now feeling the pressures of unemployment and stagnant wage levels. Naturally, they put the blame on migrant workers for causing all these. To be fair, most of the jobs taken up by rural migrants are the 3-D ("dirty, dangerous and

¹ Under the current greater economic pressures, with the autonomy of hiring SOEs have, it is not uncommon to find SOEs often illegally employing outside workers (see Wang 1995, p.351). However, SOEs also have to perform social responsibilities in order to gain the support of the government and they often have to take a position that they do not welcome outside workers.

² The central government's position is ambiguous and sometimes contradictory.

demanding") jobs shunned by urban workers (Solinger 1999). There are some overlaps of employment taken up by outsiders and locals, but the degree has yet to be systematically ascertained. In general, the competition of jobs by migrants in the urban labor market is restricted to a handful of sectors and affects only a very small group of urban workers. Though small, this affected group can still make a big noise that has an impact on policy. One of the interesting emerging urban trends in the urban political economy in recent years is that urban residents, mostly out of self-interests, are becoming more vocal and the pressures they generate are now beginning to be felt at the policy level.

4. Channels of Expression by Urban Residents and Outcomes

In the old days under the central planning, urban residents had more privileges and a higher living standard than the peasants did. Though in the pre-reform era, urban wages were hardly raised for a long period of time, and shortages of consumer goods were common, urban residents were guaranteed of the basic necessities (food, housing, and medical care) under the rationing system and "iron-bowl" employment policy. None of the peasants could enjoy the same benefits and guarantees. In many ways, urban residents are a privileged class. This is shown in the continuing large gaps of rural-urban incomes (Yang and Cai 2000). The opening of city gates to rural migrants, especially in the labor market, means that the urban privileges were to begining to be shared, even partially. This was bound to invite complaints from urban residents.

Before the reform when China was ruled by a more authoritarian government, policies were mainly decided by the political elite and were relatively immune to pressures generated by the public. Under current political system, urban social groups are more effective in expressing their preferences and voices and influence policies. Three channels, also used elsewhere in other countries, are also used in China. 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. In the post-Mao/Deng political economy, many preferences and wishes of urban residents are conveyed to various government policy levels through this way. Local governments are becoming more responsive to local preferences. In recent years, we can find in the media that the migrants are a major concern of many congress representatives. Almost uniformly, the urban

representatives take a negative position towards the incoming labor from the countryside.

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). Research institutes affiliated with local governments also produce plentiful "evidence" in support of these claims (e.g. Wang 1995, Chapter 14).

The third means is "exit". We know that the loss of skilled workers and other quality workers in the SOEs to the non-state sector is largely due to lack of incentives in the wage structure of the SOEs. But many people think that their exits are due to the low wages in the SOEs because of their positions are taken by cheaper migrant labor. People think that their "exits" are due to the competition by outside labor.

Under the assumption that the local government is a maximizer of the political net benefits i.e. it weighs 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 government will represent local urban residents' interests and institute policies that are protective of locals' jobs. In other words, local urban governments tend to favor the segmentation of urban and rural labor markets.

Of course, continuing segmentation of the labor market makes it possible for SOEs workers to hang on the institutionally determined wage levels. In China where labor supply is truly unlimited, a unified labor market will exert a downward pressure on the SOE wage levels. However, this is not happening despite the reforms in the last two decades. Even though there is significant unemployment among urban residents (which naturally weakens the bargaining powers of urban labor), SOE wage levels remain higher than the market rates (Cai 1998; Yang and Cai 2000). It is estimated that in 1998, for all industries, the average real wage of the SOE workers are likely to be some 50 per cent higher than that of the urban collectives and about 10 per cent more than other sectors¹.

¹ According to Cai (1998), SOEs pay workers, in addition to wages, another 33.8 per cent "indirect costs" (medical care, welfare facilities and housing) while these indirect costs are quite minimal for enterprises in other sectors. If we adjust the wage indices based on this percentage, the comparisons for urban wages are as follows: (national average urban wage=100)

5. Urban Unemployment and Anti-migrant Employment Measures

Although serious urban unemployment was not new to China after 1949, substantive reforms in the urban employment system, which is seen as the main cause of recently emerged unemployment, only began in the late 1980s (Li 1998). A major significant change first came as the non-state sector expanded. For a long time, employment in the SOEs and state-controlled urban collectives was the only channel of urban employment. This began to change in the mid-1980s. As Figure 1 show, from 1985 to 1998 SOE employment declined from about 70 per cent of total urban employment to 44 per cent. Similarly, urban collective employment dropped from 26 per cent to 9.5 per cent. The non-state sector's share, on the other hand, rose from about 4 per cent to 24 per cent. It was under this shrinking share of state employment that reforms of the traditional urban employment system began to be gradually carried out. A benchmark in the urban employment reform was the introduction of a revised form of the contract worker system. This new measure signaled the end of the lifelong employment system and sent a message to urban workers that they could lose their jobs if they did not do them well. In the late 1990s, the layoff of urban workers became more significant and serious, and the "iron-bowl" employment in China finally ended. In the same period, rural migrant workers began to enter the urban labor market at a mass scale. Urban governments reacted by enacting protectionist hiring measures. At the general level, it can be argued that the timings of the protectionist measures are correlated with the seriousness of urban employment. This can be illustrated with the example of Beijing.

Like elsewhere in China, reform of the system of permanent workers in SOEs in Beijing was experimented in 1987. The experiment was extended to a larger scope in 1988. At the same time, dismissing unneeded workers in SOEs became a possibility. However, required by the government, SOEs had to continue their responsibilities of re-employing laid-off workers and maintaining social and political stability. In the process of experimenting with the employment reform, the government required that all of the unemployed workers be well taken care of. The rate of the dismissed could not exceed 1 per cent of the total size of employment in the enterprise. Furthermore, there were stipulations that certain types of workers cannot be dismissed. Judging from the past experience and logics of economic

	<u>Unadjusted Wage Index</u>	<u>Adjusted Wage Index</u>
SOEs	103	138
Urban Collectives	71	71
Others	120	120

reforms in China, most reform measures were introduced when there was an urgency for doing that. It can be argued that the reform of the system of SOE permanent workers was introduced at a time when there was enormous employment pressure in cities and surplus workers in the SOEs. At the same time, the influx of rural migrant labor to the city only added more job pressures. Under these conditions, Beijing Municipal Government began to impose restrictions on hiring of temporary workers in cities and towns. It required all the employed to have Beijing urban *hukou* (Beijing Labor Bureau 1989, p.86). Following the central government's economic readjustment program in 1988, Beijing Municipal Government introduced more restrictions on hiring outside workers, including the introduction of quotas. This was later expanded into a system of work permit requirements for outside workers and fines on employers who violated the hiring restrictions. In 1989, Beijing even set for itself a formidable task of clearing out 200,000 to 250,000 outside workers (Beijing Labor Bureau 1992a, p.58). During this period, the central government continued to push the employment rationalization program, but it also emphasized, quite contradictorily, that the surplus urban workers could not be pushed out of the enterprises. The central government also stipulated that the use of rural migrant workers could not exceed one year in each incidence. Clearing out peasant workers from cities continued to be a major task requested by the central government.

This anti-migrant orientation in policy was moderated after Deng Xiaoping's famous tour to the South and the economic boom in the wake of that. 1992 was the year when the economic growth rate reached the highest in the post-1984 period. There was a rise in the wage levels and in the demand for labor. As a result, the attitudes of city governments and urban residents towards migrants became more tolerant. In 1992, Beijing government devolved some of the management powers and granted enterprises some autonomy to hire outside workers (Beijing Labor Bureau 1993, pp.71-72). In addition, a number of fees imposed on outside workers were taken away.

From 1995, however, the situation started to change as urban employment situation in Beijing, like many other cities in the country, started to deteriorate and as urban workers were being laid off at a higher rate. The municipal government started a re-employment program, requiring that all unemployed and *xiagang* workers be re-employed within three years. At the same time, a system of control of migrant worker intake through quota and occupation-specific restrictions was introduced. To be legally eligible for work, a migrant worker is required to have 5-6 permits and documents, including an employment permit issued by Beijing. Each

piece of these papers was levied a fee. In other words, these bureaucratic procedures raised the costs of migrant labor. In the second half of the 1990s, during which the unemployment of SOE workers was serious, the Beijing government considered that urban unemployment was caused by the competition by outside migrant labor. The government, therefore, continued to push the re-employment program to lessen SOE unemployment. On the other hand, more stringent measures were introduced to restrict the entry of outside labor to Beijing. Since 1996, Beijing government has issued annually a list of jobs closed off to outside workers. The number of these closed occupations increased from 15 in 1996, to 34 in 1997, 36 in 1998 and 103 in 2000 (Beijing Labor Bureau 1996a; 1997a; 1998a, Chan 2000). This type of discriminatory employment measures against migrants was implemented also with the help of the police. Large numbers of migrants were cleared out, for example, in 1999. The outcome is that the development of a more integrated market, as one would expect along with the increasing marketization of the Chinese economy, was seriously halted.

6. Concluding Remarks

It is common for developing countries to have urban-biased policies, including the protection of urban workers in the labor market (World Bank, 1984). This kind of distortion in favor of urban interests can be attributed to two sources. One is the development strategy based on rapid industrialization at the expense of agriculture. This strategy discriminates the rural sector and uses it to generate financial resources for industry (Lipton 1977; Bideleux 1985; Krueger 1992). This type of skewed approaches generates extreme rural-urban imbalances and often also necessities strong policies to keep the rural-urban separation. The other one is the imbalance in political power between rural population and urban population. The urban population is more organized and has greater political bargaining power (Lipton 1977; Bates 1981). Because of one or both of the above factors, government policies in many developing countries tend to be urban biased and reinforce rural-urban disparities.

In pre-reform China, the distortions in the factor market and the resulting segmentation of rural and urban labor markets is inherently linked to the industrialization strategy (Chan, 1994; Lin et al, 1996). Those distortions were part of the strategy and system used by China. As argued in the paper, the distortions in the factor market and labor segmentation continue to exist in the reform era. In fact, they have become more serious in the last few years due to various new urban protectionist policies. The

direct cause of these distortions, however, is quite different from that in the pre-reform era. It comes from the political pressure of urban residents, reflected in the policies of local urban governments. Of course, the impacts of the orthodox development strategy and political pressures from urban interest groups are intertwined and are not totally separable, but it is likely that the development strategy has a decisive role. Even in the reform era, China's development strategy has not totally detached itself from the orthodox one. The structure of the Chinese economy still does not reflect China's comparative advantage (Lin *et al* 1996). In other words, China has not exploited fully the employment potential possible given its endowments. Urban residents, through lobbying, have pressured local urban governments into instituting protectionist policies. This type of distortion in the factor market further inhibits the rationalization of the economic structure, hence resulting in low allocative efficiency of resources.

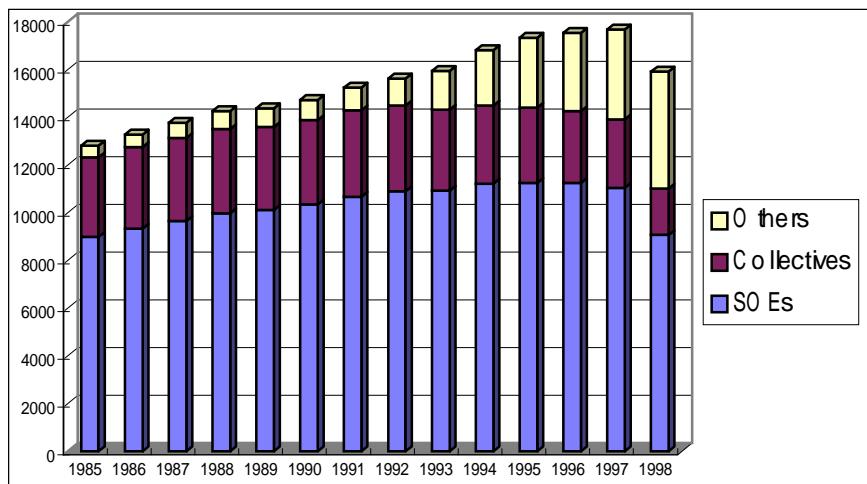
It is clear that while urban protectionist employment measures may appease local urban residents' concerns and bring social "stability" for the present, it is obviously against China's drive to develop a market economy. Instead of continuing the current protectionist policy, one way out of this difficult situation, based on the above political economy analysis, is to provide compensation for those who lose out in this transition to a unified labor market. An integrated labor market, which will allow China to be more efficient and in turn generate economic growth and enlarge the economic pie, should be the goal. To achieve this, the government may want to consider compensating urban workers who lose jobs in this reform and so that they can accept a non-discriminatory labor market. In other words, if one cannot achieve "the Pareto improvement" in which everyone gains, one should follow Kaldor's (1939) approach to maximize the net gains and use the additional gains generated to compensate those who lose in the process. This "Kaldor improvement" is probably a more generally acceptable and realistic way in the current Chinese context as recent reforms in China are bound to create gainers and losers.

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Figure 1 The composition of urban employment by ownership



Source: State Statistical Bureau 1999, pp. 136-7.