

POLICY BRIEF



URBACHINA

**POLICY BRIEF: “INSTITUTIONAL FOUNDATIONS
AND POLICIES FOR URBANISATION”**

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This is a report from Work Programme 2 on “Institutional foundations and policies for urbanisation” of the UrbaChina project on sustainable urbanisation in China. It summarises evidence of the particular achievements and problems found and feasible policy solutions to these problems.

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In this document, researchers working on the first thematic workpackage of the UrbaChina programme “Institutional foundations and policies for urbanisation” list their results in a first part, and then propose possible solutions to the urban challenges China faces. This work package specifically looks at three different topics which are the patterns of urbanisation in China for the next decade, the central/local authority relationships and regional cooperation, and the urbanisation and changes in the sectoral structure of economic development.

- patterns of urbanisation

One of their main tasks was to study the patterns of urbanisation in China and the phenomenon of massive urbanisation. Researchers focused on the study of the overall urban development strategy adopted by the national and local government since the 1990's and found that priority was still given to large scale projects. The principle of “Big is beautiful” was still largely adopted by local governments.

The UrbaChina team also studied the current trends in China's urban planning and policies regarding migrants. Large cities attract the most migrants, but do not offer them enough integration mechanisms. The urbanisation model adopted in China does not provide an efficient answer to China's urban challenges. A more integrative and flexible model of urbanisation needs to be implemented in China.

-central-local relations

This theme is closely linked with the issues of regional cooperation and fiscal policies. Researchers involved on these questions first noticed that although the level of intercity cooperation is rising, intraregional competition remains an obstacle. Another important point regards China's fiscal system, which strongly influences the way Chinese cities are developed. The current tax system in Chinese cities is the cause of several major issues including urban sprawl.

-services

This theme includes research that seeks to enhance knowledge and understanding of the actual and potential contribution of producer service activities to the dynamics of urbanisation in China.

The policy problem arises from the fact that rapid urbanisation in China coincides with a stage in its economic development that requires a refinement of its manufacturing/export dependent growth model to one that incorporates a wider range of producer (and consumer) services. But the share of services in general, and producer service jobs and output in particular, in the total economy lags by some way the level in the advanced economies as well as other countries in Asia. This limits the objective of creating a more balanced, competitive economy comprising smaller labour-intensive primary and manufacturing sectors and a more modern, dynamic, and innovative manufacturing and service sector. Addressing this problem requires particular attention to cities, especially those towards to top of the urban hierarchy, since producer services gravitate disproportionately towards these locations.

Research included interviews with officials from several urban affairs department in the four studied cities (Shanghai, Chongqing, Kunming and Huangshan), and other stakeholders including architects, businessmen, academics and residents. Most of the interviewees have shown interest in this research and

One of the major challenges found by the UrbaChina team is the interconnection of China urban issues. The UrbaChina researchers strongly advise Chinese stakeholders to adopt an integrative approach to urban affairs, to abolish division between environmental protection, urban planning, fiscal policy, and urban-rural population gap. All these questions are related to each other. They cannot be answered independently. The only way to rightly do so is by promoting dialogue and active participation among all China's society actors.

I. Patterns of urbanisation

A. Migrants' integration

1. Persistence of the hukou system

The problems posed by the dual citizenship system have been widely analysed within China and abroad. In its report “China 2030 Building a Modern, Harmonious, and Creative Society” issued in 2013, the World Bank emphasises that China’s social and economic inequality has been caused in large part to the rural-urban differences in access to jobs, key public services, and social protection. The UrbaChina team also noticed that the persistence of the *hukou* system could still be considered an obstacle to migrants’ integration.

2. Migrant workers access to housing

The imperfections of a property system where the State has the monopoly of the primary land market have led to the emergence of phenomena such as small property housing and urban villages, which due to their affordability have been the preferred destination of many migrant workers. This population group has seen their access to housing hampered mainly because they lack an urban *hukou*, which have left many out of social housing programmes and mortgage schemes.

The situation of Chinese migrant workers is likely to evolve as additional reforms are implemented. The housing issues facing rural migrants result from the rapid path of urbanisation in China. These issues are exacerbated by the fact that China is in a state of transition while maintaining the dual systems of citizenship and property.

Urban villages and small property housing are illustrations of the State’s lack of adaptation to the new socioeconomic circumstances. They have been home to millions of rural migrants who cannot find affordable housing within the city because of soaring real estate prices, difficulties in obtaining finance, and the lack of dedicated social housing. The emergence of these phenomena also reflects how inconsistently in the Central Government regulations are applied at the local level.

B. Urban planning

1. The steel and iron approach

Urban planners focus on infrastructure and to adopt a “steel and iron approach” to urban development, but do not pay enough attention to human centred urbanisation. Chinese smart cities are mostly about new technologies, and lack a societal dimension.

2. Priority given to economic growth

Economic growth is still the main objective of urban planners. Green development and residents’ well-being are not taken enough into account.

3. Priority to large scale projects

Researchers have noticed the preference for local governments to develop large-scale projects (eco-cities, green cities...). Municipalities usually use these projects as displays to attract further investment and build a stronger city-brand, but several of these projects do not to answer to residents and companies’ needs and remain deserted (ghost towns).

II. Central-local relations

A. Regional network

In order to better understand regional cooperation in China, UrbaChina members chose to focus on the case of Shanghai and the Yangtze River Delta (hereafter YRD); they adopted a gravity model, used methods of primacy ratio analysis, specialisation index and external functional capacity, and obtained the four following conclusions:

1. Economic relations and spatial interactions between Shanghai and other cities in the YRD have improved.

2. The YRD presented an agglomerating situation, and an influx of people moved to its first city, Shanghai. However, the degree of economic centrality of Shanghai has declined, and the trend of polycentricism has gradually emerged. In addition, regional economic integration has become increasingly apparent.

3. In the YRD, strong competition among industries has led to an improvement of the level of service offered by the region, and has strengthened connections with other regions

4. For the UrbaChina researchers, the main problems of co-opetition development between cities in the YRD are the following: the market is characterised by administrative segmentation; the coordination mechanism and system becomes a mere formality; the degree of homogeneity of the industrial structure is extremely high; competition for investment is intense; infrastructures are constructed redundantly; regional coordinated development mechanism is far from perfect.

B. Main problems of China's fiscal system

1. *The mismatch between fiscal power and expenditure responsibility*

About 85% of expenditures are made by local governments, but taxing power is still in the hands of central authorities. Local governments face financial pressure and they are not allowed to issue bonds. Currently, the Chinese central government levies taxes at three levels: national, provincial, and municipal/county. Basic public services are provided by municipal- and county-level governments. However, based on the tax sharing system, the central government only transfers the fiscal revenue to provincial-level government but not to municipal and county governments. It is for this reason that there is an imbalance of executive and fiscal power between the central and local governments. In future policy reforms, the authorities concerned should put emphasis on how to properly carry out the fiscal transfer from the central government directly to provincial-, municipal-, and county-level governments.

2. *Fiscal capacity gap between regions*

In spite of recent adjustment policies (e.g.: fiscal transfer), economic and social gap between eastern and western cities remain important. Western China is still experiencing slower development.

3. *Land compensation*

As a result of urbanisation, cities (considered as state land) absorb large chunks of rural land (collectively owned land) each year. This absorption is carried out through expropriation, as the collective's ownership rights do not include either faculty of disposal (abusus) or the power to decide on land use. Therefore, farmers are deprived from exploiting the increase in value of the land operated as a consequence of a change in its use. The Government has a monopoly on the real estate primary market as it has the exclusive legitimacy, through a sui generis expropriation, to introduce the land on the market and exploit its potential value. The compensation of the farmer is decided based on a standardised compensation and settlement price approved by municipal and county governments, which is significantly low when compared with the price of the land once it is auctioned to land developers. In short, farmers cannot truly benefit from land development and acquisition.

4. Local government's dependency on land lease fee

At present, the municipal government's income from the transfer process of land-use rights to developers in China includes the land lease fee. For local fiscal revenue, this fee is the main source of revenue. This means that local governments strongly promote land development, since they are economically dependent on land lease fees.

5. No authorisation for cities to issue bonds

Although the National Development and Reform Commission has announced that Beijing would create a financing system for local governments that would allow the sale of municipal bonds, and a pilot trial scheme has already been implemented in some cities (the city of Beijing has issued 10.5 billion yuan in August 2014), the system has yet to be implemented nationwide.

Tax sharing leads to the bulk of taxes being collected by the central government, and land-transferring fees, land value increment tax, and tax related to real estate and housing construction are left to local governments to collect. In addition, with insufficient tax revenue for local governments, the State Council announced in 1991 that local governments could not be directly in charge of local constructions. Moreover, according to Article 28 of the Budget Law of the People's Republic of China (*Yusuan fa*; 预算法), local governments cannot issue local bonds.

III. Services industries

A. In relation to secondary data availability:

1. Consistently comparable statistical data for all the provinces and city-level administrative areas in China is difficult to assemble. The province and city statistical handbooks are not consistently available. The classification of economic activities used in handbooks and for surveys such as the National Economic Census do not conform to international guidelines (such as ISIC Rev.4). This will permit more reliable comparative analysis and interpretation of producer service statistics (GVA, employment, number of establishments etc.) across the Chinese city system as well facilitate comparisons with trends and developments in cities elsewhere in Asia or in Europe and North America. This is a policy with benefits accruing in the medium or long term i.e. at least five years.

2. In the context of an international collaborative project, arrangements for access to and sharing of statistical data is problematical. This relates both to access to published statistical data (such as the annual statistical handbooks) and to the sharing of data that may not be available in the public domain but is held by government departments and government-supported research centres. Linguistic and cultural norms give rise to different expectations on the part of collaborators. These should be addressed before a research plan/methodology is finalized, thus ensuring that there is a reasonable expectation that the aims and objectives of research relying upon secondary data are deliverable.

3. Based on the time-series data for GVA and employment (where available) in producer services for the period 2004-2009 in a number of large Chinese cities, the policy relevant findings are:

4. Compared with equivalent cities in Europe, the share of producer services GVA and employment in Chinese cities by 2009 is lower, even in cities at the top of the urban hierarchy, but by a large margin in cities lower down the hierarchy and furthest away from the eastern seaboard. Only in a few top cities does the share of producer services in GVA or employment exceed the national average for all cities. There is a strong positive relationship between city size and share of producer services in city GVA. Provincial capital cities generally perform better than all other provincial cities.

5. In two thirds of 186 cities where employment in producer services increased, the rate exceeded 20 per cent per annum in some cases (although the baseline is often very small). The sector contracted in

some cities although there are variations linked to differences in the sector structure of producer services in each city.

6. Based on a sample of 37 major cities, the sector structure of producer services is dominated by transport, storage and postal services and financial intermediation services. The overall level and diversity of producer services is lower than in cities of the advanced economies although. In the majority of cities, knowledge-intensive market services that are crucial to the process of local and national economic adjustment of manufacturing towards technology- rather than labour-intensive modes of production remain relatively underdeveloped.

7. Although the time period examined covers just five years, there are indications that the hegemony of the cities at the very top of the hierarchy for the production of producer services is being challenged by some, albeit very slow, dispersal of these activities to the provincial capital cities.

8. A stratified sample survey of growth and competitiveness of 100 producer service firms in Shanghai (November 2013) identified their strengths and weaknesses and enabled a SWOT analysis for Shanghai as a location for these activities:

9. The strengths of the Shanghai firms are based primarily on reputation, innovation/R&D, cost/price advantages, and the overall service that they provide to clients, most of the latter located within Shanghai or the wider YRD (35 per cent).

10. The principal weaknesses of the Shanghai firms derived from both the shortage and range of available expertise, lack of flexibility, and marketing/promotion challenges.

11. Although individual firms cited problems with availability and quality of human resources, one of Shanghai's strengths is seen as the quality (perhaps relative to other places in China) of expertise available. The environment for business, transport facilities, lifestyle and locational advantages are other notable strengths.

12. The opportunities for Shanghai producer service firms are the development of an extended regional market, the emerging economy of China more generally, further opening up of domestic and international markets and the establishment of the Shanghai Pilot Free Trade Zone.

13. Weaknesses and threats to Shanghai include the high living costs, the congested infrastructure, expansion of business centres elsewhere in the YRD and the PRD, erosion of the headquarters base as a result of competition with Beijing.

POLICY IMPLICATIONS AND RECOMMENDATIONS

I. Patterns of urbanisation in China

A. Urban planning

1. For a human centred urbanisation

The "steel and iron" approach should be abandoned.

More local actors, including local companies and residents, should be associated to decision-making in Chinese cities. More attention should be addressed to smaller scale projects.

2. Forging public services and infrastructures in rural areas

UrbaChina members noticed a gap between rural and urban areas in China in terms of wealth, job opportunities, and infrastructures. These inequalities may cause increased rural-urban migrations. More attention should be paid to rural development to reduce social inequalities.

3. Sustainable development

Sustainability needs to be the core objective of urban planning. Economic growth should not be regarded as the only priority of urban development. Green energy and environmental preservation need to be taken into consideration in every governing decision.

4. Reduction of functional zones

The zoning system adopted mostly in Chinese suburbs tends to increase pollution and infrastructural needs. More mixed zones (commercial and residential) need to be planned to reduce transportation costs.

B. Migrants integration

1. End of the dual citizenship system

Allowing migrant workers to enjoy urban social welfare benefits, and attain full citizenship, would remove one of the biggest obstacles to any individual's upward social mobility. It would foster migrants' identification and integration with the host city. The children of first generation migrants have different expectations than their parents regarding urban services such as education and social security. Failing to match these expectations would hamper the upward social mobility of this population group.

2. End of dual property rights

Liberalising rural construction land, and allowing farmers to become the ultimate beneficiaries of a change in use of the land from rural to urban, would put an end to the expropriation game (i.e. to the small property housing and urban villages phenomena). At the same time, it would increase tax revenues, as informal property transactions would be taxed.

II. Central-local relations

A. Intercity network

1. Urban and regional cooperation

Au and Henderson (2006) pointed out that most of the Chinese cities are too small in scale and have insufficient administrative resources, which results in the lack of job opportunities provided by urbanisation; yet, small scale cities can act as connecting points between different economic circles, and absorb excess population from big cities. This characteristic of small-scale cities, coupled with the increasing competition for attracting foreign investors and increasing local GDP among cities since the tax sharing system, suggests that the future development of Chinese urbanisation can focus on developing cooperation networks among cities, such as the partnership between Shanghai and the province of Zhejiang.

2. Regional institution system

Establishing and improving a regional institution system in order to promote and improve the capacity for interregional governance, integrate regional planning, construction and management, and cultivate all kinds of inter-administrative NGO organisations and institutions.

3. Regional common market.

Cultivate and develop the region's common markets, including consumers, capital, technology, labour force, talent and property rights.

4. To construct and maintain the regional public infrastructure.

In the future, regional clusters should focus on improving public services of the metropolitan, and start with the regional traffic, energy transmission information, credit network and environmental to construct and maintain the basic environment of regional development.

B. Financing Chinese cities

1. Better coordination between the central and local governments.

State-owned capital income should be used to safeguard and improve people's livelihood, by investing in public services and social security.

In addition, the central government needs to give key support to major projects in the central and western regions through direct investment, transfer payments and so on.

2. Fairer local compensation

Land compensation to farmers should be made at market price. The difference between the lease price and the agriculture price should be taxed. This would restrict the use of land lease sales and would therefore reduce the funding available for public investment in infrastructure. Consequently, local governments would be less vulnerable to fluctuations in land prices.

3. Tax system improvement

UrbaChina researchers found that because of the local fiscal system, city finances depend heavily on the real estate sector. The 1994 tax reform led to intense land development in and around cities, which caused increasing urban sprawl. Several cities, including Shanghai have nearly spent their entire land reserve, and so new financial sources are needed to support further economic development.

The actual local government's fiscal system is not sustainable. New taxes should be implemented to answer this issue.

- The UrbaChina consortium recommends the continuation and generalisation of property taxes in Chinese cities.
- The tax system needs to be environmentally friendly: polluting industries should bear heavier taxes while sustainable development should be encouraged with tax exceptions or reductions.

4. Promoting transparency in cities financial affairs

A standardised and transparent budget system needs to be adopted at the local level. To prevent bad debts, a debt risk early warning system should be implemented.

5. Promoting credit cooperation for rural development

Fiscal aid to cooperatives need to be expanded.

III. Services industries in Chinese cities

Given the limited findings of the research on producer services undertaken as part of WP2 and the fact that research more generally in China on these activities is very limited in scope, depth and its contribution to properly understanding how to effectively incorporate them in city, regional and national economic development policies, there are two principal RECOMMENDATIONS:

A. Providing better access to datasets

Construct, publish and make accessible consistent and comparable national datasets on employment, GVA, input-output (disaggregated down to appropriate administrative units and establishments) of producer services using international classifications such as the ISIC Rev.4. Wherever possible these datasets should be accessible to domestic and to overseas researchers.

B. Improving research on producer services

Commission a national-level research programme on producer services (operating in prescriptive and responsive mode) that will provide rigorous and systematic insights on some outstanding issues that include: current development trajectories for the various categories of producer services and how and why these vary between cities etc.; the awareness within the business community (micro-enterprises to TNCs) of the actual and potential role of producer services to their business strategies, goals and competitiveness; whether or not city/province authorities incorporate producer services in their plans and policies for economic development and what determines their inclusion/exclusion; the relationship between the physical infrastructure provision and the needs of producer service firms; the hard and soft impediments to the growth and performance of producer service firms, especially at the interface between them and manufacturing firms (knowledge acquisition, innovation, product enhancement, logistics, marketing etc.); how to tailor policies and initiatives for education, training and skills to include provision for outputs that will better match the human resource requirements of a growing and diversifying portfolio of producer services, including firms from outside China.

RESEARCH PARAMETERS

I. Objectives

The main tasks of this work package on “Institutional foundations and policies for urbanisation” consist in defining the dynamics shaping the urban hierarchy, investigating on the process of city creation and identifying the scale of service producers in urban China.

During its research, UrbaChina adopted a broad definition of the concept of sustainability. The UrbaChina members not only looked at the environmental aspect of urban planning, but also at financial sustainability, citizens’ integration and regional cooperation.

II. Methodology

Methodology includes both quantitative and qualitative analyses.

A. Macro analysis

The UrbaChina members established a literature review on the urban strategies adopted by China at the national level.

Special focus was given to the change in China's fiscal system and the fiscal relationship between central and local governments.

Data sets were used when available to compare Chinese cities.

B. Micro analysis

1. Case studies

Four Chinese cities were selected to gather data and conduct extensive case studies in order to illustrate the diversity of China’s urbanisation patterns: Shanghai, Chongqing, Kunming (Yunnan province) and Huangshan (Anhui province). The rationale behind this choice is as follows: a variety of cities with different sizes, statuses, regions (coastal and inland China, West, southwest) and historical backgrounds.

2. Fieldtrips

Between June 2011 and August 2014, several field trips were conducted in the four selected Chinese cities of the project. In these cities, researchers met Chinese stakeholders with various activities and backgrounds, including academics, officials and businessmen.

Research methodology included open-ended interviews with real estate developers, architects and officials from urban planning departments and other departments.

The UrbaChina participants also paid attention to talk to local residents (e.g. beneficiaries of the land ticket reform in Chongqing). Both formal questionnaires and informal talks were used to gather information.

Major fieldtrips include:

- Shanghai, June 2011: interviews with architects, land developers, officials from road traffic regulation, academics;
- Huangshan, September 2012: interview with environmental protection officials;
- Kunming, May 2013: visit of Dian lake and meeting with officials from urban affairs department;
- Chongqing, November 2013: visit of Lixiang lake village, and meeting residents who used land ticket system; interview with officials from Chongqing Rural Land Exchange Centre;
- Shanghai, April 2014: meeting with Party Member Service Center at Central Huaihai Road Sub district.

Other fieldtrips and interviews were conducted by the Chinese partners.

3. Sharing experiences

Members of the UrbaChina consortium attended numerous conferences on urbanisation in China such as the 2013 EU-China Urbanisation Partnership forum where they exchanged and explored new tracks with Chinese and foreign experts.

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PROJECT IDENTITY

PROJECT NAME	UrbaChina, Sustainable Urbanisation in China: Historical and Comparative Perspectives, Mega-trends towards 2050
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CONSORTIUM	Anhui Academy of Environmental Science Research – AAESR – Hefei, China Centre National de la Recherche Scientifique – CNRS – Paris, France East China Normal University – ECNU – Shanghai, China Enterprise Research Institute of Development Research Center of the State Council – DRC – Beijing, China Institute of Finance and Trade Economics, Chinese Academy of Social Sciences – CASS – Beijing, China Institute of Geographical Sciences and Natural Resources Research, Chinese Academy of Sciences – CAS – Beijing, China Instituto de Ciencias Sociais da Universidade de Lisboa – ICS – Lisbon, Portugal Istituto di Studi per l'Intergrazione dei Sistemi – ISIS – Rome, Italy London School of Economic and Political Science – LSE – London, United Kingdom Renmin University of China – RENDA – Beijing, China Service Enterprise Research Unit, the University of Birmingham – Uob-SERU – Birmingham, United Kingdom
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FURTHER READING

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