



# EUROPEAN POLICY BRIEF



URBACHINA

POLICY BRIEF: "INSTITUTIONAL FOUNDATIONS AND  
POLICIES FOR URBANISATION"

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This is a report presenting the findings from Work Package 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 project “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, namely: 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 the 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 1990s 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 current trends in China’s urban planning and policies regarding migrants. Large cities attract 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 in these questions first noticed that although the level of intercity cooperation is rising, intraregional competition remains an obstacle. Another important point concerns 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.

## 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 by 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 in cities

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 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 they favour a "steel and iron approach" to urban development, but do not pay enough attention to the human-centred aspects of urbanisation. The concept of 'smart city' used in China mostly concerns the deployment of new technologies, without properly taking into account the 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 of local governments for the development of 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 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 compared to the past, when competition between those cities was fierce, leading to infrastructure duplication;

**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.** However, the level of coordination among local governments of the Yangtze river delta is still too low. Although regional integration has become a local policy objective, several issues still prevent the full integration of cities around the growth pole of Shanghai. For the UrbaChina researchers, the main problems of coordination between cities in the YRD are the following: the market is characterised by administrative segmentation; the coordination mechanism and system become a mere formality; competition among cities for investment is still intense; and infrastructures are still constructed redundantly.

### 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 gaps 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 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 a 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**

According to Article 28 of the Budget Law of the People's Republic of China, local governments cannot issue local bonds.

This said, 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.

Currently, tax sharing leads to the bulk of taxes being collected by the central government, whereas only 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, despite insufficient tax revenue for local governments, the State Council announced in 1991 that local governments could not be directly in charge of local constructions. Local governments need to be given access to more diversified financial resources

### **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 does not conform to international guidelines (such as ISIC Rev.4). The adoption of international standards would permit more reliable comparative analysis and interpretation of producer service statistics (GVA, employment, number of establishments etc.) across the Chinese city system and would also facilitate comparisons with trends and developments in cities elsewhere in Asia or in Europe and North America.

#### **B. Study results**

1. 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:

2. 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 larger 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.

3. In two thirds of 186 cities, 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.

4. 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. We can notice that the overall

level and diversity of producer services is lower than in cities of the advanced economies. In the majority of Chinese cities, knowledge-intensive market services remain relatively underdeveloped, and this is a barrier to the process of local and national economic adjustment of manufacturing towards technology rather than labour-intensive modes of production.

5. 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.

6. 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:

- 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).
- The principal weaknesses of the Shanghai firms derived from the shortage and range of available expertise, lack of flexibility, and marketing/promotion challenges.
- 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.
- 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.
- Weaknesses and threats to Shanghai include the high living costs, the congested infrastructure, expansion of business centres elsewhere in the YRD and the Pearl River Delta, 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. Greater 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 Chinese cities are too small in scale and have insufficient administrative resources, which results in a 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 local competition for attracting foreign investors and increasing local GDP caused by the current tax sharing system, suggests that urban policies in China need to focus more on improving cooperation networks among cities, as illustrated by the case of Shanghai and the province of Zhejiang.

#### **2. Regional institution system**

It is recommended to establish and improve a regional institutional 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**

More attention should be given to the development of the region's common markets, including consumers, capital, technology, labour force, talent and property rights.

#### **4. To construct and maintain the regional public infrastructures**

In the future, regional clusters should focus on improving public services. Priority should be given to the improvement of transport infrastructures, energy transmission information, credit network and environmental protection to improve regional integration

## **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 needs to be expanded.

## **III. Services industries in Chinese cities**

Because of 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 and depth, two principal recommendations need to be formulated:

### **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 degree of 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.

## Conclusion

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.

## 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 coming from various trades 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 interviewed local residents (e.g. beneficiaries of the land ticket system 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 the traffic regulations bureau, academics;
- Huangshan, September 2012: interview with environmental protection officials;
- Chongqing, April 2013: visit of Dazhu New Village, meeting the Village Committee and residents who used the land ticket system to recuperate arable land;
- Kunming, May 2013: visit of Dian lake and meeting with officials from urban affairs department;
- Chongqing, November 2013: visit of Lixiang lake village meeting resettled residents; 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. At this occasion, they could discuss and debate with Chinese and foreign experts on sustainable urbanisation issues.

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## PROJECT IDENTITY

<b>PROJECT NAME</b>	UrbaChina, Sustainable Urbanisation in China: Historical and Comparative Perspectives, Mega-trends towards 2050
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Instituto de Ciencias Sociais da Universidade de Lisboa – ICS –  
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Service Enterprise Research Unit, the University of Birmingham – Uob-SERU –  
Birmingham, United Kingdom

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**WEBSITE**

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**FURTHER READING**

François Gipouloux, *Gateways to globalisation. Asia's international trading and finance centres.* François Gipouloux. Cheltenham, Edward Elgar, 2011.

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Francois Gipouloux (ed.) *China's Urban Century: Governance, environment, and socio-economic Imperatives.* Cheltenham, UK: Edward Elgar Publishing.