

Contents lists available at [ScienceDirect](#)

Journal of Housing Economics

journal homepage: www.elsevier.com/locate/jhe

Population adjustments in response to local demand shifts in China

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ARTICLE INFO

Article history:

Received 28 June 2015
Revised 2 May 2016
Accepted 9 May 2016
Available online xxx

JEL classification:

J23
J61
R23

Keywords:

Local demand shift
Population adjustment
Hukou
Urban China

ABSTRACT

In this paper, we use two nationally representative datasets to examine the population adjustment of demographic groups in response to regional demand shifts in urban China between 2000 and 2005. Using an instrumental variable strategy, we find that young and less educated workers are more responsive to demand shifts than old and educated workers, and that the population with agricultural Hukou status is more responsive to demand shifts than the population with non-agricultural Hukou status. The population with agricultural Hukou status and less educated workers also respond to demand shifts by adjusting their working hours to a larger extent. Our results suggest that China's Hukou system prevents the mobility of urban residents more than it prevents the mobility of rural residents. We propose that Hukou reform should not only abolish the agricultural versus non-agricultural division, but also change the decentralized (local vs. non-local) feature of the system.

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1. Introduction

In 2007, the GDP per capita of China's richest province, Shanghai, was 10 times that of its poorest province, Guizhou (National Bureau of Statistics, 2008). In addition, the urban–rural income ratio in China hovered above 3:1, among the highest in the world. These numbers reflect a striking regional imbalance during China's period of high economic growth in the last 3 decades. The labor market responds to local demand shifts in several ways,¹ one of which is migration. In 2012, over 160 million individuals from rural China migrated to richer areas for well-paid jobs. Meanwhile, many workers from urban areas migrate to other cities for better employment opportunities (Jason et al., 2014). The demographic characteristics of such

a large number of migrants are not only important in developing an understanding of China's urbanization patterns, but are also crucial in explaining the economic performance of different regions and income inequality both within and between regions. The labor market may also respond to demand shifts via changes in unemployment rate, labor participation rate, and working hours (Blanchard and Katz, 1992). In this paper, we ask the following questions:

First, do workers of different education levels and ages respond to local demand shocks differently? If so, how do their responses differ? This question has been raised in public and academic discussions, but it is not well addressed empirically. Take the relative responses of educated and less educated workers for example. Some argue that educated workers are more responsive to regional demand shifts than the less educated, because the former tend to have lower migration costs and higher gains in the migration process.² On the other hand, given the large pool

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¹ Such as the adjustment in working hours, labor participation rates, unemployment rates, and population.

² See Topel (1986) and Bound and Holzer (2000) for studies in the US context. In China, the household registration system (see the discussion

of rural workers and the much lower income levels in rural China, it is probable that less educated rural workers are more responsive to demand shifts in coastal cities despite the fact that most are denied permanent residency by the Hukou system (see detailed discussion of the Hukou system in Section 2). The latter hypothesis is consistent with Whalley and Xing's (2014) finding that while the wages of educated workers increased in coastal regions relative to hinterland China between 2002 and 2007, the regional wage gap for less educated workers decreased.³ As no consensus has been reached, systematic evidence and rigorous analysis are needed. The responsive pattern for populations of different ages and genders has been discussed less often, but it is of great importance for regional development.

Second, does the Hukou system restrict the mobility of rural workers more than it does for urban workers? The literature usually stresses the role of China's Hukou system in restricting rural to urban migration, but seldom discusses its role in restricting the mobility of workers with urban Hukou. Although Hukou status is a major aspect of labor market adjustment, little research has been conducted on this relationship. Finally, the labor force can respond to the increased demand for labor by working longer hours—a strategy that may differ across demographic groups.

We use a random sample of the population census for 2000 and a one-fifths random draw from the 1% population survey for 2005 to investigate population adjustment to local demand shifts in urban China. After China entered the World Trade Organization (WTO) in 2001, exports surged and trade activity was mainly concentrated in coastal regions. Between 2000 and 2005, the Chinese economy grew at an annual rate of 9%, equivalent to a 15-year growth with an annual growth rate of 3%. Thus, this period of regional unbalanced growth provides a good opportunity to answer the questions of this paper.

Following Bound and Holzer (2000), we measure the local adjustments for each demographic group with (log) changes in the employed population, average weekly working hours per employed worker, and total hours worked in each city. We use growth in total local hours (total hours worked in one city) as a proxy for unobservable local demand shifts. The OLS regression results show that changes in population of the less educated are associated with changes in total city working hours more often than the same changes for educated groups.

As changes in total hours worked also reflect supply effects, we first generate an instrumental variable (IV) following Bartik (1991), which mainly reflects the influence of national demand forces in a specific locality. The IV regressions show that young and less educated workers are more responsive to demand shifts than old and educated workers. Populations with agricultural Hukou status are

more responsive to demand shifts than those with non-agricultural Hukou status. The population with agricultural Hukou status and less educated workers are more likely to respond to positive demand shifts by working more hours. We then use the regional growth in export as an IV and obtain similar results. These conclusions hold when we consider employment in the manufacturing industry.

Our results suggest that China's labor market is flexible in terms of population adjustment to labor demand shifts, but the Hukou system still hinders worker mobility. In particular, it hinders the mobility of workers with urban Hukou to a larger extent than it does for those with rural Hukou.

This paper contributes to the literature in three ways. First, we are among the first to document population adjustment to regional demand shifts in the context of China. Existing research mainly focuses on the labor markets of the United States (Bartik, 1991; Topel, 1986; Bound and Holzer, 2000; Blanchard and Katz, 1992) and Europe (Vega and Elhorst, 2014). Second, while studies on the Hukou system mainly focus on its impact on rural-to-urban migration, in this paper we emphasize the decentralized (local versus non-local) feature of the Hukou system and its impact on the migration of residents with urban Hukou. Third, results presented in this paper help us explain the behavior of regional income gaps, which has been studied extensively (Kanbur and Zhang, 2005; Lin et al., 2004). Few studies have considered demand factors and population adjustment explicitly.

The paper proceeds as follows. Section 2 presents background information and literature on demand shifts and population adjustments. Section 3 describes our data, laying out some facts about local labor market changes between 2000 and 2005. We discuss our empirical method and report estimates of the relative mobility of various demographic groups in Section 4. Skill bias and factors that may increase the migration cost for workers in urban China are discussed in Section 5. Section 6 concludes.

2. Background and literature review

In China's reform period, different regions experienced drastically different paths of economic growth, and the regional income gap (including the rural-urban income gap) became the major contributor to sharply increased income inequality (Gustafsson et al., 2008; Chen and Fleisher, 1996). The fact that demand shifts are regionally concentrated plays an important role in shaping the regional gap.

Economic growth is often associated with changes in economic structure. A national change will have different impacts on regions, as each region has a different economic structure historically. Another reason for regional unevenness is different exposure to trade activity. The policy of opening up was first implemented in the east and led to rapid growth of exports and FDI inflows to the region. In 1995, the average share of exports in GDP in coastal provinces was 32%, while that of non-coastal provinces was below 7%.⁴ China experienced a sharp

in section two) usually treats educated workers better, which tends to increase their benefits and decrease their costs relative to migrants who are less educated.

³ However, this research uses the urban household survey, which does not include migrant workers. In addition, it does not consider demand shifts explicitly, and conclusions from that research may suffer from an endogeneity problem.

⁴ Coastal provinces include Beijing, Fujian, Guangdong, Hainan, Hebei, Jiangsu, Liaoning, Shandong, Shanghai, Tianjin, and Zhejiang. Non-coastal

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