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China's *Hukou* System: Overview, Reform, and Economic Implications

What Is Hukou?

First introduced in 1951, the Chinese hukou (household registration) system is a categorization of its citizens based on both their place of residence (living in urban/rural areas) and eligibility for certain socioeconomic benefits (agriculture/non-agriculture). Hukou is issued through a process administered by local authorities and solidified into inheritable social identities that especially limits the mobility of Chinese laborers.

Why Did China Impose a Hukou System?

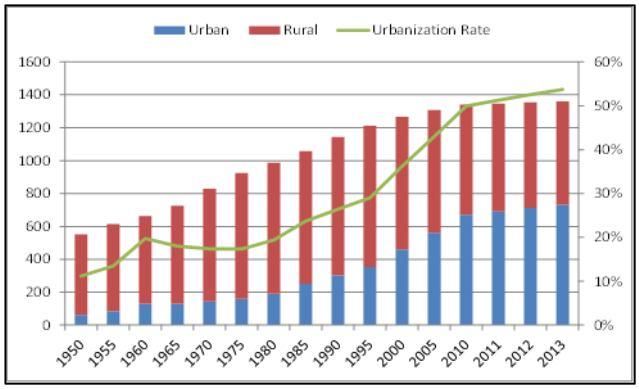
The Chinese government imposed the system to regulate population distribution, especially in large cities. Since economic reforms started in 1979, hundreds of millions of people have migrated from their home towns to work in urban areas, such as Shanghai. The number of rural laborers working in China's cities was 274 million in 2014, 36% of the total workforce. Although such workers are allowed to reside in the cities where they work, their job situations are often more difficult than those of holders of urban hukous (see **Table 1**), and they are generally denied access to social entitlements, such as pensions, medical insurance, and basic education for their children.

How Does the Hukou System Work?

Traditionally, an individual's hukou status (agricultural, non-agricultural, blue-stamp, and other types) is an inherited social identity, but in recent years it has become more complicated with the introduction of new categories of urban hukou. The differences of hukou status can be seen in terms of accessibility to urban benefits and opportunities (such as access to education, housing, and health care), and qualifications required for a hukou category. Each province or large city has its own system to obtain a local hukou registration.

Rural residents who wish to permanently move to an urban area must submit separate applications to change their permanent residence and their agricultural status. They must also obtain authorization from their current place of residence and apply for temporary registration at their destination. For example, Shenzhen's three hukou categories (Temporary, Blue-Stamp, and Regular) are based on a set list of qualifications that receive certain entitlements and benefits based on the specific categories determined by factors such as age, level of education, business ownership, investments over a certain amount, and possession of a valid Temporary Resident Certificate.

Figure 1. China's Urban Population Growth and Urbanization: (1950-2013) (in millions)



Source: National Bureau of Statistics of China.

Table 1. Comparison of Formal and Informal Employment

Characteristics	Formal Employment (Hukou for city you work in)	Informal Employment (No hukou for city you work in)
Household registration type	Non-agriculture and local	Agricultural and non-local
Urban residency status	Full legal status	Illegal or temporary
Socioeconomic sectors	Mostly state sectors and state-owned enterprises	Small and self-employed enterprises
Occupations	Managerial staff, technicians and skilled workers	Physical labor, self-employed
Employment Channel	Determined by planning or formal channels	Based on personal contacts and market information
Work status	Relatively less demanding and stable	Highly demanding and unstable
Entitlement to basic social security and benefits	Full legal status	None or temporary entitlement
Housing	Allocated by work units or self-owned	Low-cost shelters or homeless

Source: Institute of Population and Labor Economics.

Chinese Demographics

Many economists contend that China's demographic policies, particularly its one-child policy (implemented in 1979), are beginning to have a significant impact on the

Chinese economy. For example, according to a *McKinsey Global Institute* study, China's fertility rate fell from about 5.8 births per woman in 1964 to 1.6 in 2012. This is now affecting the size of the Chinese workforce.

The existence of a large and underemployed labor force was a significant factor in China's rapid economic growth when reforms were first introduced. Such a large labor force meant that firms in China had access to a nearly endless supply of low-cost labor, which enabled many firms to become more profitable, which in turn led them to boost investment and production. Some economists contend that China is beginning to lose this labor advantage. China's working population has reportedly fallen for three straight years (in 2014, it reportedly dropped by 3.7 million people). The *McKinsey Global Institute* predicts that over the next 50 years, China's labor force could shrink by one-fifth. Some economists contend such factors could lead to much smaller rates of future economic growth. As the labor force shrinks, Chinese wages could begin to rise faster than productivity growth, which could make Chinese firms less competitive, shifting some manufacturing overseas.

The one-child policy has also resulted in a rapidly aging society. According to the Brookings Institution, China already has 180 million people aged over 60, and this could reach 240 million, or 20% of the population, by 2020 and 360 million, or 27% of the population, by 2030. With a declining working population and a rising elderly population, the Chinese government faces challenges trying to boost worker productivity in order to maintain healthy economic growth and expand spending on health care and elderly services. Such factors likely contributed to the government's announcement at the Communist Party's Fifth Plenum in October 2015 that all married couples would now be allowed to have two children.

Hukou Reform and Economic Implications

The central government has made hukou reform a top priority as part of its plans to increase the urbanization of its population, which is viewed as important to boosting national productivity (as labor is used more efficiently) and increasing private consumption (since urban residents generally have higher incomes and greater access to goods and services than those living in rural areas). However, hukou reform has met some resistance from urban governments and middle-income residents concerned that they could become burdened with large new financial obligations, as well as migrant workers in cities concerned that they could lose their land rights back home if they got an urban hukou.

In November 2013, at the Communist Party's Third Plenum of its 18th Party Congress, the government announced plans to "introduce new population management methods, accelerate the reform of household registration system, completely lift restrictions on new residence registration in administrative townships and small cities, relax restrictions on new residence registration in medium-sized cities in an orderly manner, lay down appropriate conditions for new residence registration in large cities, and strictly control the population size of megacities." In March 2014, the government released the National New-type Urbanization Plan (2014-2020), which stated the goal of raising the ratio of permanent urban residents to total population in China from 54% to 60% by 2020 (in comparison, the U.S. rate is currently 81%), and the share of urban residents relative to the population holding an urban hukou would increase from 35% to 45%. The plan stated that the government would grant urban residency to around 100 million people who have moved to cities from rural areas.

In December 2015, the Chinese central government outlined a broad plan for cities to provide special residency permits to migrant workers if they met certain requirements, such as residing in the city for six months, maintaining a steady job, a steady residence, or are studying at a school (and can provide certain proof, such as an employment contract or tenancy agreement). That status would grant migrants access to some public services, such as education (up to age 15) and basic health care without having to give up their rural hukou rights. They would also be allowed to register a car or obtain a passport locally (rather than back home). The Economist estimates that the plan could enable 70 million children living in the countryside to join their migrant parents in the cities, but warns that many migrant workers may lack the necessary documentation needed to obtain special residency status.

An urban hukou in cities with fewer than 1 million people might be obtained if an applicant has a stable job, a residence, and has paid into a government social insurance program for three years. This requirement increases to five years in cities with 1 to 5 million people. Cities with over 5 million people will be able to set up a complex point system for granting an urban hukou. The government states that cities can enact their own regulations based on local conditions. For example, in December 2015, Beijing released draft regulations for granting new urban hukous for migrants. Applicants would need to be under the age of 45, have a Beijing temporary residence permit, and have paid social security premiums in Beijing for seven years. Next, they would need to accumulate a certain number of points based on such factors as employment, housing, education, and tax payments to obtain a Beijing hukou.

Hukou reform could increase the allocative efficiency of the labor market by giving workers (and their families) more freedom go where their labor is needed; boost consumption (and reduce high savings rates) by those now eligible for public services; and narrow income disparities, especially between urban and rural areas. According to one estimate reported in the *China Daily*, comprehensive reform to the hukou system could add two percentage points to China's GDP growth. Such reforms could benefit U.S. economic interests if they generate higher demand for foreign goods and services in China. A major challenge for the central government will be to ensure that local governments are able to fund increases in social welfare spending.

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