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| Decision Time for China |
| China’s desperate need for policy change |
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| **Neff, Joseph T.** |
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China’s economic reform in the late 1970’s early 1980’s, and the continued economic reform throughout the 1990’s until present day China has seen around half a billion people rise out of poverty, and has seemingly established itself in the world economy as a force to be reckoned with. Because of the progression in the economy, there has been a large amount of work done on the Chinese economic future. China in turn has had an increasingly large amount of research done into the why and how of the economic upturn ( Lardy, 1980).

Case in point, any lasting Chinese economic growth to be seen has been largely due to the heavy capitalist influence that it receives from emulating the early United States. This being said the Chinese economy desperately holds on to both communist government policies, and old tradition that arose from times where the emperor[[1]](#footnote-1) was the chief ruler of China. As China reformed its economy, and saw the benefits of looser regulations, it allowed for some relaxation of the policies it enacted during the Soviet rule, and Chinese imperialism.

Even with the forward economic movement it has benefited from with the relaxation of these policies, China still holds on to them like a dependent child holds on to the toy it has treasured most. Systems like the one-child policy, and the HuKou[[2]](#footnote-2) system put chains on the movement of workers, and the markets adjustment ability. Because at the same time China is incurring both the partial good, and the full bad of the American capitalist system; it will come to a point where it will have to choose to abandon these policies, or go down with the proverbial ship.

The aim of this paper is to outline the policies, their effects, and their interaction with the business cycle from the adopted inflationary tactic of the Chinese government. Ending in an analysis of Chinese economic future in either abandonment of the bad policies, or what happens if they hold on to the bad policy. Taking into account the opposing arguments for each policy; the argument will be built allowing for the fact that though China still maintains these policies, it still has made significant improvement to its economy along the coast.

#  The HuKou System:

 Family registration is something deep-seated in Chinese history[[3]](#footnote-3), designed as a solution to population growth, and to effectively plan the economy for the affected societies, it remains in place in hopes of achieving the same goal. Throughout Chinese history it has been reformed many a time; sometimes being loosened and many a time being made more restricting. In the early 20th century the Chinese government of the time had granted freedom of movement to the Chinese people, until 1950 when Shanghai started to urge the unemployed population to return to the countryside. The initiation of the current HuKou system came under Chairman Mao in 1953 as a part of the first “Five Year Plan” (Cheng, Selden). The initiation of the system was to inhibit the “blind flow” of population. Though Mao’s intent was to merge social classes, the end product was far from that[[4]](#footnote-4). The HuKou system overall requires each individual to register[[5]](#footnote-5) his or her place of residence with the local government. The registration can only be achieved through either living at the family house[[6]](#footnote-6), or moving somewhere else within the town.

 Each citizen can register either as a worker, or a peasant. If one wishes to attain a job in any city, or town, no matter how rural, they must attain HuKou or they will be penalized through government fines and restrictions. In recent times this has been used to monitor local income, this is no longer effective because of the development of the coast and those looking to migrate there in hopes of attaining a higher income. Because of the coastal development plan that was instituted in early 1988 with the help of Zhao Ziyang [[7]](#footnote-7)(Yang, 47), China saw a huge influx of foreign trade, causing profit seekers to attempt to move to these areas. This in turn created huge “floating populations” of emigrants to areas such as Shanghai.

 The profit seeking workers are unable to acquire legal work under the HuKou system would then have to either work with an income penalty[[8]](#footnote-8) or they would have to work illegally. In more recent times the residents have been allowed to work for two years with the penalties, and if they could establish themselves, in those two years, as economically capable, they could apply for HuKou. Average price for HuKou in high demand areas is about 30 times what the average resident of those places makes in a year (Wang). In the early 2000’s there was a push for reform in HuKou that would see poorer provinces use less distinction in who they granted HuKou, but up to present times only a little less than two percent of the over 100 million migrants can hope to be granted HuKou[[9]](#footnote-9). Even after all of the reforms to date there is movement towards doing away with any and all exceptions to the system in order to “increase safety”. (Wang)

 Emigration on a scale as large as this[[10]](#footnote-10) indicates a lack of work in the less urban areas. Another reason for emigration to cities is for schooling. Major Universities located almost solely in the urbanized areas. Because of this many families pool their resources and send their smartest child to as good a school as they can afford[[11]](#footnote-11). Once a degree is earned and a “special talent” is established the individual can apply and be able to pay for HuKou in a city that is in need of that talent[[12]](#footnote-12).

This policy is an obvious limiter to economic improvement because it does not allow for much entrepreneurial activity on the part of the lower class citizen limiting his ability to spread income and limiting his inter class mobility. This is exemplified through observation of the floating population of the urban areas. Since a 1982 census the floating population in most urban areas has doubled. Areas such as Shanghai[[13]](#footnote-13) have as many 4.4 million of these “temporary migrants” looking to obtain HuKou. Out of the temporary migrants 71 percent of males said they were looking for manual labor or business and 59 percent of females said the same thing. Though these migrants can now get temporary housing permits, they still cannot work, enroll their kids in school, or obtain health care (Liang, Ma). This floating population also skews the unemployment numbers which causes the capitalist policy of the country to take the mainstream approach and inflate.[[14]](#footnote-14)

#  Single-Child Policy:

 The Single-Child policy was one put in place in hopes of reigning in the population growth in a centrally planned society. Initially the government only advocated the idea that each family should contain only one child, but this was short lived and very soon afterword the policy became law. The policy uses local governments to help in deciding the level of regulation it places, or how strictly enforces the rule. (Gu, Wang, Guo, Zhang)

Its most commercially broadcasted effects have been the effect on the gender ratio in the country that it has. Within China there are currently 30 million more men than there are women, that means there are 30 million men who have no hope of finding a mate within the country. The policy is argued to not only prevent the Malthusian outlook of overpopulation, but to also promote competitiveness in men, resulting in them being more successful and their parents making them more successful. (Wei, Zhang)

There are exceptions to this policy such as for minority groups[[15]](#footnote-15), those with dangerous jobs[[16]](#footnote-16) (insert citation), if the first child is disabled, and if the first child is a girl. The exception of the first child being a girl is another policy matter gained from old Chinese tradition. Only about 35 percent of the population falls under the strict one child policy. Others include 55 percent under a 1.5 child policy, 10 percent in the two Child categories, and only about 1 percent of the population is allowed to have three children.(Baochang et al, 2007)

The penalties for breaching the legal limit of the one child policy are extreme. In the occurrence of a breach, both husband and wife face up to 50 percent reduction in their income for as long as 14 years. In poorer regions where most if not all are living on subsistence wages a 50 percent reduction in income is dangerous. For this reason, most in both urban and rural areas will abort unplanned pregnancies and potentially fineable occurrences. The One-Child policy is the most effective of its kind ever to be enacted. A survey taken from urban areas indicated that better than 70 percent of the population would never even consider breaching policy[[17]](#footnote-17)

Throughout Chinese history it has been a bad thing to only have a girl as a child, before it was because the property was given to the male descendant, but it is the same way now because women in China are less likely to be successful than males are. The most recent exception was to parents who were both the only child in their family, this is still rather unlikely due to Policy rule still standing and tradition being held to as most couples who are having a girl first will either abort, or have a second child (Zhang, and Spencer, 1992).

The economic effects of this policy are apparent throughout. The amount of men versus the amount of women being so different does not allow for a level of replacement. The Chinese government has only recently made the small change of another small exemption, but it should consider disposing of the policy altogether to try and reinstate some sort of balance.

#  Chinese Education System and Its Regulations:

 The Chinese Education system is something that the Chinese government claims is one of the most substantial steps forward it has taken. Though they have increased government money spent on higher education, they still have the issue of not having very many that can afford it. The increase in specialization in China means that it is becoming increasingly difficult to find work that will pay enough to keep up with rising prices without a college degree.

 The first problem with the Chinese education systems affordability is the lack in number of schools[[18]](#footnote-18). The lack in number of schools is the barring in place on the opening of new schools that prevents school systems from developing further in rural areas (Chengping). The lack of schools causes issue for those with no money to travel, or establish HuKou in regions with schools. The lack of transportation for the lower class that lives in the western rural part of China[[19]](#footnote-19) makes it near impossible for them to travel the distance necessary to go to school.

The amount of effect government donation has on schooling has been low for as long as the government has been in place, and is still incredibly low despite the upturn in the number of students enrolling. The government investment makes up about 3% of GDP. Most of the new enrollments in China are in tertiary schools due to the role test grades have in determining where Chinese students can go to school[[20]](#footnote-20) and because most rural and small-town Chinese students do not have access to even decent elementary and middle school education.

The cost of paying for tertiary school, though the government does subsidize higher education, it does not pay for any of the tuition or class fees; instead, the family pays for that[[21]](#footnote-21). The opportunity for work is beginning to include more and more sophisticated education, and less tertiary work; along with the increase in enrollment in tertiary schools, it is becoming more beneficial to not even pay for attendance at the middle school, nevertheless a tertiary school. The lack of any ability to accumulate capital due to living on subsistence wages[[22]](#footnote-22) prevents saving in these places to take place, let alone fund a student’s way through college. (Auty)

The barriers to entry for the private schools in China make it near impossible for them to thrive. The government makes it very difficult to open one up. Even when opened up the Government still gives preference to those that attend government schools. For this reason, private Chinese schools tend to be remedial academies of sort; those who were to poor or not intelligent enough[[23]](#footnote-23) to be able to attend premier universities. The economic impact of this and the aforementioned policies can be explained in looking at the human capital contribution to China’s economy.

#  Effect on Human Capital and Industrial Shift:

 Because of the policies of China, be it HuKou or the One-Child policy, it is apparent what the intention of the government was when it began initiating the plans that it had made. The government had and still does want to foster economic growth through planned industry (Demurger et al. 2002). China did this in the late 70s and early 80s through a number of different ways.

 The amount of human capital contribution to the Chinese economy has been decreasing consistently as the country switches gears to more open foreign market policies and investment in other capital goods. This is due to the limits on education and its affordability. The amount of human capital contribution to GDP growth has been reduced by more and more since the economic reforms of the late 20th century. The reduction in human capital contribution has dropped below single digits in 2008 reaffirming the countries suspected issues with labor force (Whalley, Zhao).

 Because of the limited ability to move with the HuKou system in place[[24]](#footnote-24) the Chinese government moved to increase industry through allowing some measure of trade while offering subsidies to their own agricultural industries. The allowance of each person to manage some small plot of land that they “owned”, and the freeing up of local markets allowed for the smaller regions to create some sort of industry. The formulation of industry allowed for some small amount of capital investment to take place making minor technological advancements to take place[[25]](#footnote-25).

This advancement was soon put to an end with the emergence of new government policies that would subsidize the larger, government owned farms in an attempt to “mechanize” the agricultural industry. Because of these new subsidies the smaller farms were essentially crowded out, and forced to shut down in many cases. This began China’s soon to be much larger shift from the agricultural industry.

According to World Bank, China’s agricultural industry lies primarily in the eastern side of China (World Bank, 2012). This can be seen as a result of the government crowding out of smaller farms as the large farms that have prospered are far closer to the industrial areas crowding the eastern seaboard. Because of this slowed the growth of smaller rural communities that were not located near the major cities.

The push from agricultural to tertiary service has been prominent since the early 1980s. Agriculture has been reduced to such a small portion of the nation’s production that they are forced to import massive amounts of grain from outside sources; and yet the still remain at a level that many areas have grain rationing policies. The move toward tertiary was influenced by the governments attempted solution at fixing unemployment issues, and increasing the amount of available human capital through education (Heckman, Yi). As previously stated, that move has been largely ineffective due to other policies that are in place.

The Chinese coastal development policy also has dealt a blow to the issues of labor supply. The focus on these coastal regions: increasing openness to world markets, building massive government funded industries and the dramatic switch to the investment in capital causes the demand for the tertiary and less skilled people to decrease. The restriction of capital markets to the coastal regions also prevents the non-coastal regions from developing. The prevention of these areas from catching up has resulted in a lack of a labor force in these larger areas because of the need for more educated people (Heckman, Yi).

 The response was reform that would give a trickle down effect to lagging areas, but this was to no avail. The income gap between the provinces remained and even increased with the new reforms. As per expected the amount of government intervention stagnates the smaller economies ability to develop as rural people continue to flock to the more industrial coastal and or industrial regions (Auty).

 Bureaucratic obstacles also play a rather large role in the development of the economy as China, according to the heritage foundation, remains one of the least free countries in the world. The process to create a business in China takes longer than a month, and requires more than most can afford with a few years of wages in fees to start up (Doing Business, 2013).

 Evidence from the central planning conducted in China shows that when planning, the local governments allocate the resources to what appears to be most profitable at the time. With most countries developing industry these products are things like steel, or concrete[[26]](#footnote-26)(Auty) . Because of this, what little capital that is allotted to these smaller communities is wasted on projects that must either be abandoned, or populated with more educated workers from outside of the area. If the smaller communities were allowed to use the capital they earn in the way that would benefit them it would reduce “lag time” and let them develop at a natural pace.

 The over investment in physical capital goods shows increasing diminishing marginal returns as there is too small a labor force from a lack of properly educated workers. The lack of workers once again stems from the inhibitions from the policies on education, and the prevention of smaller scale allocation of goods by not allowing entrepreneurial decision making to be done by people in direct contact with the economy.

# Chinese Inflationary Policy:

 China has emulated the rest of the world powers through inflationary policy. China continuously inflates in hopes of sustaining the constant high level of economic progress that they have seen in the recent past. However, this progression has created quite a predicament in the form of malinvestment. China has made the soviet mistake of allowing the local planning committees to attempt to make economic calculations that, because of the communist system, are based of false information anyway. The monetary inflation also inflates the problem of the malinvestment in small communities.

 The numbers that the local committees see and the expectations they receive from it all point towards industrialization. The committees responsible for planning, as mentioned earlier, are attempting to build things such as steel and cement factories that cannot be manned by the human capital available to them (Auty).

 From various article and broadcasts done on the topic, it has been revealed just how many huge cases of malinvestment are taking place. The Zero Hedge blog outlines the fact that China has invested in huge projects based in industrialization. The Chinese have funded projects like a complete recreation of Paris in western China[[27]](#footnote-27). Though the replica is full and admittedly magnificent, there is nobody living there simply because there is no opportunity to work in the area. The abandonment of projects this size shows the Chinese that they are clearly making poor investment choices on a massive scale, but you will not hear any admission of this from them (Durden, 2013).

A separate dissatisfaction in the Chinese economy is the increasing food prices. Following the agricultural movement there was an immediate increase in the price of grain. Some of the Chinese peasants were known to buy grain from the state through allowance vouchers and then sell them as farmers to state buyback programs for a profit (Lardy). This has been supplemented by the problem with inflationary prices that reach western China while at the same time receiving none of the new money. The injection points of the new inflationary money are all found along the coast. Because the west has little to no viable industry, the ripple effect[[28]](#footnote-28) never quite reaches the more rural population.

The Chinese government has another, more global reason to inflate. The Chinese RMB is inflated in order to keep the exchange rate between it and the U.S. dollar very high. This is for the purpose of selling to the United States for relatively low prices, while the rest of the Chinese country suffers (M., Catalan, 2010). The local governments took the opportunity with the inflationary effects to try to invest heavily in the industrialization, but the outside supply of capital caused nothing but further economic imbalances (Auty).

China has gotten to the point where small and necessary goods are insanely expensive relative to the United States[[29]](#footnote-29). Goods such as clothing can be up to 70% more expensive than that of other countries. A car can cost as much as three times the cost in the United States when purchased in China (Burkitt, 2013). It is safe to say the level of inflation is consistently dealing substantial damage to the Chinese economy.

# If China Maintains Current Policy:

If China continues holding on so desperately to a centrally planned system and does not allow the economy to properly adjust, they will see major problems when the market catches up with their inflationary behavior. As is the natural process of things, when a government participates in inflationary behavior, namely credit expansion, it initiates a boom bust cycle.

The United State in multiple cases has experienced multiple busts due to inflationary behavior, and during these times the accepted theory among Austrian economists is that the recovery from any of the depressions was due to government intervention in the market during the recovery process. In the case of China, the reparative process would be heavily inhibited by the typical communist policies, never mind the farther systems such as HuKou that prevent market adjustment.

Though the malinvestment is apparent in any of the cases of abandoned projects, and local government monetary allocation, the Chinese continue to ignore it. In exchange for maintaining a ridiculous level of economic growth, China is sacrificing the welfare of its people through maintaining a communist government. The currency being held at the level it is through the purposeful undervaluing of the Chinese yuan makes importing goods even more expensive (Kelly. 2011)). When the goods are too expensive to import, the government holding the responsibility must then either tax more or create more money. The Chinese governments go to in this case is to create even more money to both subsidize the government employees so they can buy food, and to actually be able to import the food themselves.

The Chinese government, in attempt to control the rising prices, has placed price controls on consumer goods, have attempted to slow loaning by increasing the interest rate, and have finally been letting the currency move closer to its natural market rate. This allowance will end in a recession (Bouzou, 2004), but because of the heavy government hand on every aspect of the economy, this recession should stretch out over a very large period of time.

A stretched out recession in China’s case would be very damaging to their population with so many restrictive regulations in place as far as health care and movement for work. The spread of infectious disease in China is already damaging the elderly population as most do not have the immune system to survive things that wouldn’t normally kill them.

 Even the Keynesian analysis of the current Chinese economic tendencies is very grim. The Chinese are assumed that they will not be able to continue the growth necessary to continue on with their expansionary goal of 10 percent. Instead they believe that if current policies are maintained[[30]](#footnote-30), they will begin to see a somewhat rapid decrease in returns (Haltmeier, 2013). The fact of the matter is that the Chinese can either hold strong to their traditionalist, and communist ways. Or they can adapt to the current needs of the country, and accept a free market like the ones they allow for in special administrative regions, and remove the archaic and ridiculous policies like the HuKou system.

#  If China Embraces Capitalism:

 More freedom is good for everybody. In China’s case this would mean a complete and total overhaul. The government being the supreme power in the country has been commonplace for most if not all of the countries existence.

 If China were to revoke the HuKou system it would allow for the movement of workers to where they were demanded. This would allow the labor contribution to the production structure much more flexibility. No longer would the Chinese face the issue of not being able to find workers to do even menial work.

A compound of this would be the removal of one of the larger barriers to education. The removal of the HuKou system would allow for increased competition among schools in both the students and the institution. Children from poorer families would gain access to some class mobility and be able to find work much easier than before.

The removal of the One-Child policy would allow for the decrease in the difference in the sex ratio within the country. Though the Chinese have begun to loosen this up[[31]](#footnote-31), the elimination of the policy would help properly distribute the potential for a labor market such that the economy could begin to expand in a sustainable way.

If the Government were to cut the subsidies to the coast, it would allow industry to spread at a normal rate. Along with the removal of the HuKou system and the hoops one needs to jump through to start a business, Chinese businessmen would be able to gain access to new working population. The new freedom found through this would benefit even further from the release of the school system from the heavy government regulation, this would allow the work force more flexibility in how they could study giving the new Chinese businesses labor to match the current technology and capital.

The malinvestment hole that came from years of inflationary recklessness will eventually catch up to China. The boom in China has been going on for quite some time, seeing the highest points in their economic history, but that will eventually end in a bust. If China chooses to forego their current communist policy, and embrace freedom and capitalism, they will still have a difficult time adjusting but will the blow will be made much softer (Kelly, 2011).[[32]](#footnote-32)

The Chinese allowing competition and removing the government subsidies to the much bigger corporations, will allow for the corporations that have invested poorly to just fail and reap the losses they have sown.[[33]](#footnote-33) From this the economy will be allowed to bounce back. New companies will be allowed to rise from the newly found economic freedom, and old companies that can survive will merge if they are too weak, or will continue on in their growth.

#  Conclusion:

The matter of the policies China has maintained cannot be attributed to their economic progress. Rather, the relaxation of these policies has been what has allowed them to move forward as a country (Case, Wang. 2013). The inflationary tendencies of China have created a fog that allows for the improvement of their appearance in the global economy while those in their country suffer (Skular, 2013).

 Though China is not the only country with problems similar to this, they do take all of the policies to an extreme[[34]](#footnote-34). They also desperately cling to the policies because of how long they have been in place. If China were to do away with all many if not all of the policies listed above, they will be able to expand their economy even more, to the point where they can take advantage of much of their unused land, and population.

 The elimination of the heavy government regulation would do away with much of the corruption found in local and large government structures. It would allow China to become a bigger presence in the world, and let them move to a position that would encourage foreign trade along all of its borders; not just the land bordering the United States.

If China chooses to hold on to its communist government it will most likely hit a recession so long that there will be little chance of full recovery. The population will be damaged through possible starvation[[35]](#footnote-35), or would revolt. The Chinese government would have to try and maintain an army without having the food to feed it; because they have no non-government funded agricultural businesses of any size that would survive the collapse, and the devaluation of the yuan would be high enough that they would be hard pressed to afford the rest of the world’s prices[[36]](#footnote-36)(M., Catalan)

 In the end, if China does not decrease the insane government policies, if not dispose of them altogether, it will begin to decline. Worst case scenario, China goes under and cannot bail themselves out. Best case scenario, China fully adopts a free market policy as it has begun to allow in the special administrative regions like Hong Kong and the market will be allowed to adjust as necessary.

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1. Chinese government was ruled by 皇帝，translated is roughly the same as emperor. [↑](#footnote-ref-1)
2. The HuKou system or 户口is Chinese for “permanent residence” [↑](#footnote-ref-2)
3. The first recorded family registrations in China date to times B.C. [↑](#footnote-ref-3)
4. As are most policies created in a communist setting. [↑](#footnote-ref-4)
5. There is a fee for registration. [↑](#footnote-ref-5)
6. Yet another Tradition stemming from Chinese history. [↑](#footnote-ref-6)
7. The coastal development plan was developed to give Zhao more power. [↑](#footnote-ref-7)
8. In some cases, even with a penalty they would still make more money than they were in their old residence. [↑](#footnote-ref-8)
9. This of course bars anyone with ideas opposed to the nations ideals. [↑](#footnote-ref-9)
10. Migration to cities makes up 70% of the migration in China, the rest is foreigners moving into business centers or intra-community movement. [↑](#footnote-ref-10)
11. Because of the Chinese testing system most people end up in trade school whether they like it or not [↑](#footnote-ref-11)
12. Students have to return to where they originally had HuKou to take their standardized graduation exams. They cannot take the exams in the school they are at unless they have HuKou. [↑](#footnote-ref-12)
13. Shanghai is ranked fourth on the list [↑](#footnote-ref-13)
14. Will talk about inflation later in the paper [↑](#footnote-ref-14)
15. Mongolians among some others [↑](#footnote-ref-15)
16. For the sake of a worker being able to replace the father if he should be rendered unable to work. [↑](#footnote-ref-16)
17. Urban areas being the lightest enforced due to the higher income. [↑](#footnote-ref-17)
18. Schools in this case being 重点学校, or the Chinese premier universities; these are the schools that receive the government subsidies and are given preference in all government job choosing. [↑](#footnote-ref-18)
19. The western rural part of China makes up for most of the country. [↑](#footnote-ref-19)
20. Determination relies almost entirely on test scores unless you have some sort of government relationship [↑](#footnote-ref-20)
21. The average cost is around 10,000 RMB per year and the average rural resident makes a little less than 6,000 per year. [↑](#footnote-ref-21)
22. This is assuming the average income in the average 1 worker, 2 peasant HuKou household. [↑](#footnote-ref-22)
23. As deemed by test scores [↑](#footnote-ref-23)
24. And rather than just remove the HuKou system [↑](#footnote-ref-24)
25. Minor meaning that some communities could afford horse ploughs or maybe even a tractor [↑](#footnote-ref-25)
26. Much like the large cement factories made by the Soviet Union [↑](#footnote-ref-26)
27. There was another reported project in which they leveled 700 small mountains in order to build a city. The city had the same issues as the Paris model, but was much more expensive. Since then development has ceased and been left half done. [↑](#footnote-ref-27)
28. Or Cantillon effects [↑](#footnote-ref-28)
29. If a country manages to out-inflate us in the last few years something is very wrong. [↑](#footnote-ref-29)
30. Expansionary policies included [↑](#footnote-ref-30)
31. Very recent relaxations as mentioned previously [↑](#footnote-ref-31)
32. The blow will still be heavy, but it will not be so devastating that they cannot recover from it. [↑](#footnote-ref-32)
33. The United States could also do with some relaxation of government intervention, but that is a different topic. [↑](#footnote-ref-33)
34. For instance, the HuKou system has been present in many Asian countries, but many have long since given it up. [↑](#footnote-ref-34)
35. Has happened more than once in the years leading up to the reform [↑](#footnote-ref-35)
36. As the rest of the world will probably side with the idea of freedom and the spread of democracy [↑](#footnote-ref-36)