



# Does economic growth affect urbanization? New evidence from China and the Chinese National Congress<sup>☆</sup>



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## ABSTRACT

Using a panel of Chinese provinces during 1985–2008, we propose an estimation strategy to study the within-province effect that per capita GDP growth may have on the urbanization rate. Our approach exploits the timing of the National Congress of the Communist Party, which is a 5-yearly meeting where national economic policies are debated. Because economic growth is a key policy objective and given that the Chinese fiscal system is highly decentralized, the recurring National Congress may encourage a systematic pattern of spending by provincial governments to foster growth. We find that per capita GDP growth is associated with the timing of the National Congress, and exploiting instrumental variables that convey this timing information, we also find that growth has a statistically significant effect on the urbanization rate.

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## 1. Introduction

Although the correlation between economic growth and urbanization (i.e. urban to total population) is a well documented phenomenon, the question of whether this relationship reflects causality from growth to urbanization has yet to receive much attention. Yet, this issue is potentially relevant to countries undergoing economic development, especially to China where growth has been an important policy objective. Over the last three decades, the Chinese economy has grown rapidly at an average rate of 9% per year (Holz, 2008) but its urban population has increased substantially as well (see Fig. 1). The rapid rate of urbanization in China, in turn, has led to environmental and social issues such as pollution (Du, Wei, & Cai, 2012; Feng, Hubacek, & Guan, 2009), overcrowding, and the proliferation of substandard living habitats known as urban villages.<sup>1</sup>

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<sup>1</sup> Song and Zenou (2012, p. 497) describe urban villages as habitats where “buildings are overcrowded; public stairways and pathways inside buildings are extremely narrow; public facilities are inadequate and poorly maintained; public roadways cannot meet the basic requirements of transportation and fire control standards; distances between buildings are well below standard and cannot meet fire control standards; and garbage is scattered and unhygienic”.

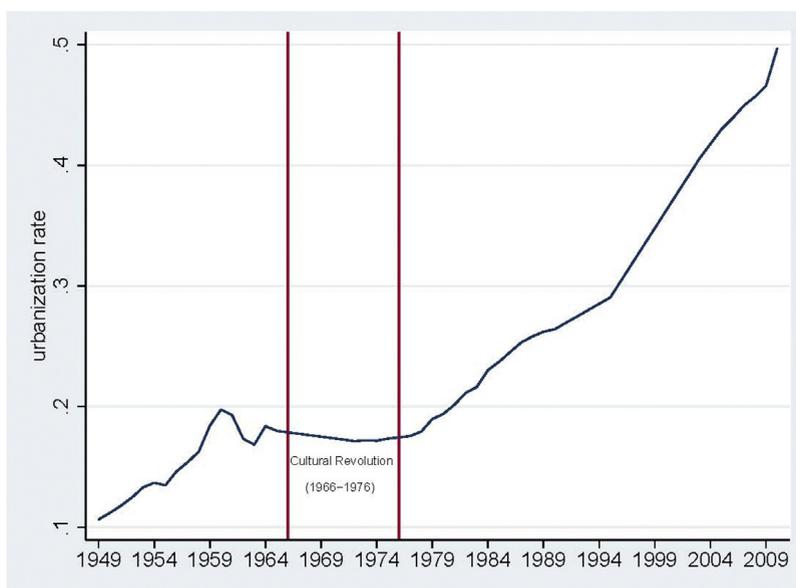


Fig. 1. China's urbanization rate (1949–2010).

Source: China Compendium of Statistics (1949–2008), the Department of Comprehensive Statistics of the National Bureau of Statistics.

At this point, little is known if, and how much, the rapid growth in China has contributed to the rapid rate of urbanization there. The purpose of this article is to examine this issue, and more generally, provide evidence on whether growth has a causal effect on urbanization. To do so, there are two methodological concerns that have to be taken into account. First, the direction of causality can run from urbanization to growth. This makes it difficult to disentangle the effect of growth on urbanization, the quantity of interest, from the reverse confounding effect of urbanization on growth. Second, our dataset, which is drawn from the National Bureau of Statistics of China, may contain measurement errors.<sup>2</sup> If these errors were classical, they would attenuate the OLS estimates towards zero and cause them to understate the true effect of growth.

To examine the effect of growth on urbanization, we propose a simple empirical strategy that uses an exogenous event – National Congress of the Communist Party of China (CPC) – to generate plausibly exogenous variation in growth. This approach appeals to two inter-related features in the Chinese political and fiscal system. The first of which is the Chinese political environment where national policies for promoting economic development and growth (typically expressed as part of a 5-year plan) are ratified during the National Congress of the CPC, which is a five yearly meeting involving the most senior leaders of the country.<sup>3</sup> The second is the decentralized nature of the Chinese fiscal system, which meant that the responsibility of implementing these policies rests on the local government (Wong, 2011).<sup>4</sup> When these two forces interact, the local government may attempt to stimulate growth before the next National Congress, since the National Congress is where local leaders may receive career advancements if their provinces have done well.<sup>5</sup> As a result, the timing of the National Congress may produce variations in growth that we hope are plausibly exogenous.

In Fig. 2, we plot the per capita GDP growth and government spending growth for each province. In principle, output can be stimulated by government spending, which seems to be the case here as Fig. 2 shows that a rise in per capita GDP growth is usually preceded by a rise in government spending.<sup>6</sup> More importantly, the peak of per capita GDP growth can usually be seen at around the year of the National Congress, which suggests that these spurts in per capita GDP growth, which are preceded by increased government spending, may be associated with the timing of the National Congress. Using the latter to generate what we hope are plausibly exogenous variations in per capita GDP growth, our 2SLS estimates show that growth is a statistically significant factor for urbanization, where a 1% point increase in growth increases the speed of urbanization by 0.4% point on average. In particular, given that the urbanization rate (percentage of urban to total population) increases by about 0.9% point per year on average, this implies that the average speed of urbanization would nearly double if per capita GDP growth across the board were 2% points higher.

<sup>2</sup> See Chow (2006), Rawski (2001) and Rawski and Xiao (2001) for a discussion on this issue.

<sup>3</sup> For instance, a key policy objective of the Twelfth Five-Year Plan is achieving an annual growth rate of 7% annual growth during 2011–2015. See [http://www.chinadaily.com.cn/china/2011npc/2011-03/05/content\\_12120516.htm](http://www.chinadaily.com.cn/china/2011npc/2011-03/05/content_12120516.htm).

<sup>4</sup> For example, the local governments have accounted for more than 80% of the national budgetary expenditures. See Wong (2011).

<sup>5</sup> For instance, Chen, Li, and Zhou (2005), Li and Zhou (2005) and Wu (2010) find that local officials who are able to generate high GDP growth for their province, relative to the other provinces, have a better chance of receiving a promotion.

<sup>6</sup> We have conducted a panel Granger causality test to evaluate the ability of government spending to forecast per capita GDP growth, and vice-versa. We find that government spending *Granger causes* per capita GDP growth, but not the other way around.

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