

Enhancing Economic Security in Transition: Pluralism in Service Delivery

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May 2003

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ISBN 92-2-113445-8

First published 2003

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Printed by the International Labour Office. Geneva, Switzerland

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List of abbreviations

CFAPA	China Foundation for Aiding Poor Areas
CCP	Chinese Communist Party
HDI	Human Development Index
UNDP	United Nations Development Programme
SCMP	South China Morning Post
MCH	Maternal and Child Health
WHO	World Health Organization

Glossary of words in Chinese

<i>Zichou zijin</i>	self raised funds
<i>Gangwei mubiao zerenshu</i>	performance contract
<i>Minban</i>	people-run school
<i>Shehuihua</i>	socialization
<i>Paizi xiang</i>	big title
<i>Zerenda</i>	many responsibilities
<i>Quanli xiao</i>	with little power
<i>Banshi nan</i>	difficult to deal with
<i>Suzhi taidi</i>	cultural quality too low

Abstract

This paper argues that economic reform has led to fundamental challenges to the provision of social welfare. Combined with key institutional changes, the reduction in the state's financial capacity has dramatically curtailed its role as a direct service provider. While there is greater choice for those who can afford it, services have collapsed for the rural poor while migrants are shut out from existing services. This requires not only a re-think of the role of the state but also the development of a better market for certain services (e.g. housing and pension management) and an increased operational space for alternate service providers such as non-governmental organizations (NGOs) and community-based organizations.

1. Introduction

China's economic reforms have produced growth rates that are the envy of other transitional economies but they have also resulted in a significant restructuring of the provision of public goods and services. Institutional reforms combined with harder budget constraints have resulted in the dismantling of state and collective institutions in rural and urban China that have carried much of the welfare burden. Standards of living have been raised for the vast majority leading to greater choice for those that can afford better service. However, for many the costs are high while for the absolute poor there may be no service provider available. As the World Bank (1998) has noted with privatization of services, unless the field is levelled and effective redistributive mechanisms are established to compensate the poor, inequality of opportunity will increase. As in other transitional economies, China's policy-makers have found it difficult to design a new welfare system that is affordable and equitable (for other transitional economies see Kornai, 1997, and Bird and Wallich, 1993). In part, this is due to the fact that major institutional change is inherently slower and more complex than macroeconomic stabilization and liberalization measures (Nelson, 1997).

This is not to say that the Chinese Communist Party (CCP) has been inactive. Significant reforms have resulted in changed roles for the state and the emergence of new service providers, some of which are operating on strict market principles, while others are taking a more philanthropic approach (see, for example, Wong and Flynn, 2001). Reforms have also changed notions of entitlement, with access to services much more tightly tied to financial capacity than in the past. The linkage of service provision to ability to pay has produced new inequalities and exacerbated old ones. In particular there has been a dramatic rise in the disparity between welfare provision in rural and urban China and an abandonment of the old cradle-to-grave social compact for the privileged urban working-class. Not only has this led to policy challenges to devise new institutions and mechanisms for service provision but also raise more fundamental questions about citizenship and entitlement. To whom does the state have an obligation to provide welfare and at what level?

The challenge for the central leadership is to shift from a system of severely frayed safety nets for the urban working-class and official's majority to a clearer articulation of what China's citizens can expect in terms of welfare guarantees. The resultant policies should address the dualistic development strategy that privileges the urban over the rural. The literal fencing off of the rural from the urban during the Mao years made it easier for the city dwellers to enjoy their privileged position. The reforms have begun to tear down this fence and, as a result, it is increasingly difficult to justify this privilege in political terms. With increased market reliance and with the huge influx of rural migrants to the cities the two worlds are now inextricably linked and they often share the same neighbourhood. The inequity of providing education and medical services to one while denying it to the other has become a source of tension, especially at a time of economic slowdown.

China's policy-makers will have to deal with such inequities if they wish to project the image of serving the interests of the whole nation rather than a small urban elite. According to official statistics the urban population at the end of 2001 was 480.64 million (37.7 per cent) with a rural population of 795.63 million (62.3 per cent) (National Bureau of Statistics of China, 2002, p. 34). However, not all urban residents are eligible for advantageous social welfare benefits, rather only those in major state-owned enterprises and government officials (between 75 and 100 million). Even then not all enterprises can afford any longer to cover the benefits. In addition, there are between 60 and 120 million rural migrants moving from the farms in search of employment. Migrants and those who remain in the countryside need a clear indication from the central leadership as to whether

citizenship, in terms of access to social welfare, will be extended to them through a gradual increase of access to social security and insurance schemes or whether they will be left to their own devices, private sector provision and family-based support.

This paper looks first at how state capacity to provide social welfare has changed with reforms. Subsequently we look at how a greater role for the market and civil society institutions in the provision of social welfare is developing and can be developed further. The examples will be drawn primarily from healthcare and poverty alleviation. The paper concludes with a number of recommendations to improve this process and how to integrate better service providers.

2. The changing role of the State in welfare provision

China has too much and too little state at the same time (Merquior, 1993). The Chinese state is too directly involved in a number of areas that can be better left to the market or civil society and has absented itself from certain key areas where the public goods argument supports greater involvement (Saich, forthcoming "a"). A thorough re-think of the state's role in welfare provision and its relationship to other organizations is necessary.

A number of factors have weakened the state's capacity to ensure that welfare provision has kept pace with economic growth. However, this needs to be placed in context as China has ranked well in terms of the human development index (HDI) adopted by the United Nations Development Programme (UNDP) as a composite measure of social development. In fact, for its income level China has performed well in terms of welfare provision as is seen by the fact that until the year 2000, its HDI rank has always been above its income rank. However, this has declined through the 1990s. China's HDI has risen from 0.248 in 1960 to 0.566 in 1990 to 0.726 in 2000. It was ranked 96 in 2000, down from 87 in 1999. The difference between HDI and GNP has dwindled rapidly with the rapid economic growth of the 1990s and the increased per capita income. Thus, in 1993, its HDI rank was 41 places above its GNP per capita rank but by 2000, the HDI and the GDP rank were the same (UNDP, Human Development Report, various years and 2002).

This trailing off of advances is readily seen in the health sector. The World Health Report 2000 ranked China 188 out of 191 countries in terms of fairness in financial contributions, 144th for the overall performance of the health system, and 139th in terms of healthcare expenditure per capita in international dollars. While ranked above most African countries, it is ranked below other large developing countries such as India, Bangladesh and Indonesia. In terms of health quality achieved, it ranks better (61) but this may be because of the residual impact of the old collective medical system (WHO, 2001, p. 152).

Among the various factors that have influenced a decline in state capacity to improve social welfare, changes in the financial system have been the most important. The resultant decline in welfare support has been reinforced by low incentives for local officials to take social development as a high priority and certain administrative changes. Three major factors have affected the state's financial capacity to provide adequate welfare support. First, the diversification of the economy and the abandonment of collective structures in the countryside have affected the state's capacity to raise adequate revenue. Second, the *de facto* financial decentralization that has taken place under the reforms has redistributed incentives among the different levels of the government bureaucracy and has changed their respective capacities. Third, the tightening financial constraints on state-owned enterprises

have caused them to shed their former welfare roles and shift them to under financed local governments.

Before reforms began, it was relatively easy for the central state to extract revenue from the communes in the countryside and the state-owned enterprises in the cities. Most agricultural and industrial production was sold at state-fixed prices, while the banking sector simply acted as the state's cashier for its development priorities. Twenty years later, the situation has changed dramatically with major consequences for the role of the state and its fiscal capacity. Market reliance has increased dramatically as has the non-state sector of the economy. Its share of industrial output rose from 22.4 per cent in 1978 to 73.5 per cent in 2000. The private sector grew from 2 per cent in 1985 to 16 per cent in 1998 (Yusuf, 2000, pp. 24-25).

The central state has found it much more difficult to establish a sound tax system to raise revenue from the fast-growing non-state sector. Despite its ailing situation, the state-owned sector still is the largest source for state revenues. The huge Daqing oil field in Northeast China is the largest taxpayer paying 16.62 billion *yuan*. There are two other oil companies in the top ten taxpayers and four tobacco companies (*Far Eastern Economic Review*, 10 October 2002, pp. 32-33). The importance of state-owned industry as a revenue base for all levels of government encourages investment in enterprise development and a bias against investment in social development.

Central state revenues as a percentage of GDP dropped dramatically during the reforms from a starting-point of 36 per cent to a low of 11 per cent before reviving to 16 per cent in 2001 (calculated from statistics in National Bureau of Statistics of China, 2002). In part, this rise reflects counting some provincial levies as "taxes" but also from better collection enforcement. This has severely restricted the central state's redistributive capacity and has meant that local governments have been left much more, even than in the past, to raise the funds necessary for development priorities. As is discussed below, most important has been a shift in the levels of revenues controlled by the central and local governments.

To stem the decline in central revenues, fiscal reforms were introduced in 1994 to raise the share of central revenue that had dropped from 51 to 31 per cent (Zhang, 1999, p. 120). The ratio of the budget to GDP has been raised as well as the ratio of centrally collected revenue to total budget revenue. For 2001 centrally collected revenue exceeded that of locally collected revenue; 52.4 per cent as opposed to 47.6 per cent (calculated from statistics in National Bureau of Statistics of China, 2002, p. 61), thus overcoming the initial tendency of the localities only to collect for themselves. The Centre's share of budgetary revenues grew from 2.8 per cent of GDP to 6.2 per cent in 1998 (Chung, 2000, p. 46), still one of the lowest levels in the world. This is not sufficient, however, for the central state to play a major role in redistributive policy given its other financial obligations. The original objective was to provide the Centre with a sufficient financial surplus so that it could cover both its own obligations and certain redistributive needs. It was estimated that the Centre would need some 60 per cent of collected revenues; of which 10 per cent could be used to meet the redistributive and related goals (information from Pieter Bottelier, former head of the World Bank Mission in China, July 2001). This objective of the 1994 reforms has not been met with clear consequences for the central government to meet social welfare obligations.

The move to a more market influenced economy has revealed the high costs that welfare provision has placed on state-owned enterprises and the increasing incapacity of this sector to carry those costs. In addition, the existing institutional structure inhibited the further development of a labour market. Labour mobility was highly restricted by the fact that pensions, medical care, but most importantly housing, belonged to the work-unit. The need for greater economic efficiency by enterprises has caused many work-units to cut

services, turn them over to local authorities, or adopt a fee-for-service system. At the same time, local authorities have not necessarily had the adequate funding and often not the incentive to take on these new responsibilities.

The local level of government retains the major responsibility for financing infrastructure and providing social welfare. While central state revenues may have weakened since reforms began, if one adds the revenues that the local governments gather from a variety of ad hoc fees and levies, the percentage has not changed much over the last thirty years (for a fuller explanation see Saich, 2002, pp. 78-81). There has not so much been a decline in the extractive capacity of the state under reforms but rather realignment between the Centre and the localities with the localities controlling far greater amounts of revenue than previously (Yang, 1994, especially pp. 61 and 64).

Combined with the rising income inequality, the unequal distribution of resources across local authorities and the incentives for spending priorities account for the huge variation in the provision of public goods and services during the transition. As the World Bank has shown, access to health and education services was still widely available in the 1980s but became more dependent on household incomes in the 1990s (The World Bank, 1997, p. 23). For example, in 1998 22.2 per cent of those in high-income areas were covered by co-operative medical facilities but only one to three per cent in poorer areas were covered (Zhu, 2000, pp. 41-43). In 1999 the number of rural residents not covered by any health security system was 87.32 per cent and while 82 per cent of villages reduced or exempted villages' medical expenditures, this dropped to a low of 7.6 per cent in 1993 before climbing again to 22.3 per cent (Li, 2002, p.18). In particular, as the World Bank concluded in its 1996 report, 'the downturn in China's health performance relative to its income level coincided with agricultural reform that reduced the ability of the village to tax the peasants' (The World Bank, 1996, p. 127).

Local authorities have been accorded greater control over local economic activity and the redistribution of economic rewards. However, there has been little incentive to prioritise access to social welfare. Of particular importance for the localities are the funds they raise themselves as these are discretionary: extra-budgetary funds (EBF) and self-raised funds (*zichou zijin*). If one adds the self-raised extra funds that by their very nature do not turn up in the statistics, the total sum of state revenues available were the same in the early 1990s as at the start of the reforms; 39.5 per cent as compared with 40 per cent (Zhang, 1999, p. 123).

These factors are of vital importance for understanding the pressures on and incentives for the local state. One inheritance of the Soviet fiscal system has been that the local government has always provided the provision of basic public goods, with very few exceptions. In addition, the Cultural Revolution reinforced the notion that each local authority should minimize "dependence" on support from higher levels (Wong, 1997, p. 11). Apart from nationally designated poor counties that receive transfers and those that receive such transfers from the province, localities are by and large on their own to raise funds. This concern with revenue generation is exacerbated by the fact that despite fiscal decentralization the central government has retained control over the policy agenda. While the accounts of localities avoiding or deflecting central policy are many, the Centre still sets many tasks that must be carried out and imposes burdens to be met. Funding for health and education are overwhelmingly a responsibility of lower level governments. Thus, an Asian Development Bank survey of five counties in Guizhou and Shandong revealed that between 40 and 45 per cent of the total outlays went to social services, by far the largest category (Wong, 1997, pp. 170-73). This is also true for townships although they often have a weaker financial base. In fact, before 1984 the equivalent of the township did not raise revenue independently. Villages, which do not form a formal level of government, have significant expenditure responsibilities even though they have no independent fiscal powers. They have inherited many of the obligations of the old collective economy such as

salary, care for the aged and even support for health and education (Wong, 1997, p. 174). This drives village leadership to seek various off-budget revenues from user fees and other unsanctioned levies to support these activities.

These financial factors account for the increasing inequality of welfare provision that we can observe across China but the disincentive to invest in social development is promoted by the functioning of the political contract system and the performance contracts (*gangwei mubiao zeren shu*) that local governments and officials have to sign (Saich, 2002, pp. 92-96). The precise nature of the contracts varies across time and place but they do set out performance expectations that provide the basis for official evaluation. Each county will set out performance contracts for the mayors and party secretaries of the townships under their jurisdiction to sign. Then contracts are signed between the towns and townships and the functional departments under their jurisdiction and then finally between the heads of these functional departments and their work personnel (Edin, 2000; Whiting, 1999; and especially Rong et al., 1998). This weakens the capacity for comprehensive development by township governments and disfavours social development.

The targets are divided into a mixture of priority, hard and soft targets. The priority targets are set nation-wide and usually are more political or policy oriented in nature. They would include, for example, the maintenance of social order, most recently including the eradication of the influence of *Falungong* practitioners, and of course meeting the targets for family planning quotas. The hard targets are primarily economic ones set by the county for the township and would include meeting tax revenues and meeting certain levels of growth. The soft targets tend to relate to questions of social development such as health and education provision and the concern for environmental protection. Clearly meeting the hard and priority targets are the most important as failure to meet them will mean that the rest of the work for the entire period will be discounted and there will be no promotions, titles or economic rewards distributed. It is especially important to meet the targets for family planning and failure to do so will annul good performance in other areas of work. This system produces a number of perverse outcomes and explains why officials will often pursue unpopular policies with such zeal. One survey of 89 villages in Fuquan county (Guizhou province) found that village leaders spent 80 per cent of their energy and 70 per cent of their time on 'the most disliked' administrative affairs, such as enforcing birth control (Li, 1994).

The urban bias of central policy has clearly exacerbated the differential access to public goods and social welfare and individuals are left increasingly to find the best support available with their own resources. This has been particularly noticeable with healthcare provision (see Bloom et al., 1995; Liu et al., 1999; and Saich, 2001, pp. 241-71). Government health spending is inadequate, 3.8 per cent of GDP as opposed to WHO recommended levels of 5 per cent for developing countries (Bland, 2000, p. 27). Spending is also heavily biased towards the urban areas and the state's financial commitment to rural health services has been declining as a percentage of the total medical and health expenditure.

Over the same period, the actual cost of care increased dramatically. The impact for poor rural households on healthcare access is particularly dramatic. Annual medical expenses per capita rose from between 2 to 3 per cent of total income around 1990 to 8 to 11 per cent of income in poor areas in 1998 and have continued to rise (Liu et al., 2000). With the loss of the pre-paid collective medical system with the disbanding of the communes in the early 1980s, some 90 per cent of rural households have to pay directly for almost all of the health services used (The World Bank, 1997, p. 47). This has hit poor areas particularly hard. A survey by Xingyuan Gu of Shanghai Medical University showed that wealthier areas such as Jiangsu and Zhejiang, the use of collective funds for rural medical expenses was 30 per cent higher than the national average (Research Group for Investigation of the Chinese Rural Medical Care System, 1991). Thus, not surprisingly,

illness has a close correlation with poverty and cost of provision is a major factor influencing utilization by the poor. One 1995 survey of 60 poor families cited major medical expenses as the most important cause of poverty (Kaufman, 1998, p. 68).

The basic problem of healthcare delivery derives from the change of the ownership structure of village networks and the nature of the incentive system that has arisen from these changes (UNDP, 1998, pp. 36 and 38). In 1981, health care facilities were informed that they would have to apply user charges to cover their recurrent costs, with the exception of staffing costs. By the mid-1980s preventive medical care facilities were also engaged in cost recovery by charging users on a fee-for-service basis (Hu and Jiang, 1998, p. 192). This caused the drop in participation in the cooperative medical schemes and the shifting of health cost burdens to the household.

The inequality of service provision between the urban and the rural, which has always been a feature of CCP policy, has become more complicated with the rapid increase in migration over the last decade. Migrant labour has been crucial to the urban economic boom, whether it be in supplying the labour to the foreign-invested factories in coastal China, providing the construction crews for the massive building expansion, or feeding the burgeoning service sector, ranging from hotel and restaurant workers to the more unseemly services of the sex trade. It has also been crucial for rural development, both in terms of remittances and also as migrants have returned to the villages and brought back with them capital, new skills and social networks that extend beyond the narrow village confines.

While their economic benefit to the urban areas has been significant, their social status is extremely low, and only in the late-1990s did some urban authorities begin to consider integrating migrants into social service provision. This shift in thinking was primarily stimulated by central leadership concerns that migrants might become a source of instability and that falling outside of urban administrative jurisdiction they might be evading family-planning regulations.

Although the wages of migrant workers are lower than those for urban residents, their main problem is the lack of access to social services and welfare facilities. Although the state enterprise system is under attack, migrants are not properly integrated into any system and it has only reached the policy-makers' attention in the late-1990s. Until the end of the 1990s, migrant children were not allowed to enrol in state schools, thus meaning that either they missed out on education, were returned to the village on reaching school age, or their parents had to pay for their education in private schools. While state regulation requires local authorities to provide education for all school-age children, urban local authorities have interpreted this to mean only those with a residence permit and thus migrant children have been excluded. Some local authorities recognized the negative effect of this policy, and in 1998-99 some Beijing districts, for example, began to accredit schools run for migrant children and issue them permits. However, even here there has been contestation. In Fengtai district, the local authorities decided to close down all schools run for migrant children, claiming that they were of poor quality. In part this derives from long running friction between the major migrant community, Zhejiang village, and the local authorities and also from the desire of the state-run schools to derive higher revenues by taking in the migrant children and charging them higher rates than those for 'legal' residents. There are signs that with Beijing hosting the Olympics and its desire to protect its own laid-off workers, attitudes towards migrant communities might be hardening again. It seems that more migrant schools will be closed because they are deemed to be of insufficient quality while restrictions have been placed on the kinds of work that migrants can undertake. In the most recent example *Beijing Youth Daily* (29 October 2001) announced that a maximum of 20 per cent of people employed in the community service sector, excluding home helps, could be migrants.

The reforms have brought enormous benefits to China's population but they have also created new problems that need to be addressed. The state at the central and local level and its associated enterprises can no longer afford to provide the kinds of access to social welfare as in the past. With most welfare needs covered by local governments, the financial shortages and the lack of incentives for local officials to address adequately welfare issues have reduced further the state's role. In addition, new groups such as the migrants are not integrated into the existing welfare systems. This will mean that, in the future, greater use will have to be made of the market and institutions of civil society to provide social welfare. In turn, this will entail a major re-think in the role of the state in social welfare provision, with a shift from direct provider to regulator and co-ordinator. We turn to these issues in the next section.

3. The changing relationship of the State, market and civil society

Future policy will require not just a focus on increasing government revenue that has been the main concern of the Chinese government and organizations such as the World Bank but a more thorough re-think of the changing role of government in development. This will lead to an evaluation of the role that markets and the institutions of civil society can play in the provision of welfare. In recent years pluralism of service delivery has emerged with voluntary organisations supplementing the state in providing basic services and private schools and medical services being established. By 2000 there were some 50,000 private schools registered, with presumably more operating that are unlicensed. Since the 1980s people-run (*minban*) schools have become common in rural China. They draw funding from a range of sources beyond local government, including local residents and enterprises. By 1997 just over 10 per cent of funding for all primary schools in China came from funds from social organisations, individuals, or fund-raising activities (China Statistical Yearbook, 1999, p. 674).

This shift in provision has primarily been the result of the adoption of cost recovery as the main principle in determining service provision (Flynn et al., 2001, p. 9). Again this is very clear in the health sector where market principles have become dominant. In fact, China has moved further down the road of privatization, under its slogan of socialization (*shehuihua*) than most OECD countries that have adopted a conscious policy to boost the role of markets in service provision. China has shifted from an emphasis on equality in social welfare provision to one based on efficiency and cost recovery. This has resulted in further delegation of responsibility to lower levels of government and local communities to provide welfare, as well as to acquiescing in the emergence of alternative service providers. As a result, those with sufficient disposable income to afford it are enjoying greater choice than previously and signing up in the market place for a range of services covering housing, education and health. By contrast, others have to get by with reduced services or with no help at all beyond the family.

3.1 Fiscal and administrative changes

Several adjustments could be made at various levels with respect to fiscal policy. One of the central government's most significant policy challenges is how to reconfigure an industrial policy and associated fiscal policy that is premised on support to the state-owned sector of the economy. Concentration on this area has led to a relative neglect in investment in more productive assets or in the social sector (for fuller argumentation see Saich, forthcoming "b"). While there are strong political and ideological reasons for this bias, the sector is a net destroyer of assets while the rapidly growing and more productive non-state sector is penalized and starved of the necessary capital for development.

If the CCP could clear up the state-owned enterprise sector this could have enormous beneficial effects for rural China if part of the current subsidies were diverted to productive investment in the countryside. As Wong and Heady (1997, p. 324) have pointed out the “concept of a self-reliant rural public sector is no longer workable” and, as noted above, the old Maoist strategy of separate development for the urban and rural is no longer feasible. However, given the already weak government finances and other obligations that the state has taken on such as pension provision that it cannot afford, it is clear that the kind of welfare that has been accorded to the urban elite can neither be extended to other urban groups nor to the rural sector as a whole. However, this provides a dilemma that requires new policy initiatives to resolve.

Not surprisingly, to date policy has reflected the political bias of the most powerful, vociferous and visible groups. This has meant that policy has focused on the needs of state officials, has been receptive to the policy prescription of its (urban) professional classes, and has sought to soften the blows of the market transition for the urban proletariat. By contrast, it has left the rural poor, the migrants and the non-state sector employees to their own collective or individual devices and they have remained politically marginalized. If the CCP wishes to maintain social stability over the long-term this may not be the best road to follow.

The dismantling of urban subsidies has provided a good starting-point but still too many subsidies are misdirected. A key component of the Maoist development strategy was to provide an intricate complex of subsidies to urban workers to offset their low wages. Subsidies covered clothing, food, education, housing, medical care etc. but they have become too expensive to maintain in recent years. In 1988 urban residents received approximately 39 per cent of their per capita disposable income from subsidies net of taxes. By contrast those in rural China paid 2 per cent of their per capita income in net taxes (Khan et al., 1992). Urban subsidies have dropped drastically in recent years and stood at around 22 per cent in 1995 (UNDP, 1998, p. 54) but price subsidies that benefited urban residents still amounted to 104.2 billion *yuan* in 2000 up from 36.5 billion in 1995 (State Statistical Bureau, 2001, p. 283).

Further rationalization of these urban subsidies, including housing, would mark a more realistic starting-point than trying to extend them to new social categories. The attempts to commercialise housing are important, as this is clearly a case where a private good has been provided by the state or its surrogates at non-economic prices. Savings from reducing further this kind of government support and from propping up the state-owned sector could then be used to fund those areas that have clearer public goods attributes.

One clear case for disengagement is rural healthcare in poor regions. While privatisation of medical insurance might be feasible for the wealthier and most may well find means to deal with curative procedures, rural healthcare provision, especially preventative care, appears to be a clear case where the “public goods” argument applies. In practice, there has been a marked growth in private medical provision and a shift away from preventive medical care to fee-for-service with local governments in poor areas less able to provide adequate support. This increases the financial burden on the rural household that in the absence of sufficient state financing must provide the necessary social support.

The central government needs to tighten the regulatory framework to ensure that guidelines on health are followed and that in poor areas better provision needs to be provided at central government expense. The Central government would be well served to be the provider and supporter of public health, ensuring more equitable access, rather than focusing its efforts on subsidizing the salaries of those in the health system (on these issues see Saich and Kaufman, 2001). In fact, one recent Chinese study suggests that for wealthier rural areas with increasingly commoditised economies, social medical insurance

will become the norm. For the poor areas, it will be necessary for the central government to increase its transfer payments to provide medical support for those unable to afford it. For the middle areas it is suggested that the co-operative medical schemes be revived with seed funds from government and with the government providing a financial subsidy for basic public health services (Li Weiping, 2002, *passim*). Comparative research in a number of developing countries in Africa has shown that especially in the social sectors it may be better to boost direct provision of services by government agencies rather than setting up new contractual deals (Batley, 1997).

A better focus for central government subsidies should be combined with restructuring local government finance (for thoughtful analysis see Wong et al., 1995; and Wong, 1997). As in many other countries we have seen the *de facto* transfer of new responsibilities to lower level authorities without the complimentary transfer of the necessary financial resources to carry out these functions. In China this has been exacerbated by the declining capacity to tax the rural sector. As Wong and Heady suggest (1997, p.325), rural finance should be unified at one level, preferably the county as in most of China the township is too small to be redistributive. This would make planning more effective and would allow for the central authorities to provide a sufficient revenue base to carry out those functions that it deems necessary. In the mid-1990s, more than half of the 2000 counties in China could not meet their expenditure requirements from the revenues they derived (West and Wong, 1997, p. 285). One 1993 survey revealed that an average county had revenues of 57 million *yuan* but spent 74 million *yuan*, with 17 million *yuan* financed out of transfers (Wong, 1997, p. 30). The situation is even worse at the township level. One survey of 81 counties nation-wide revealed that the average debt of each township was 10.9 million *yuan* bringing them to the brink of bankruptcy (Liu, 2000, p. 74).

Local authorities could also run a deficit even when revenues were rising. For example in Xinmi Municipality (formally Mi County), the easy atmosphere for obtaining loans after 1992 provided a major boost for local revenues. As a result in 1995, Xinmi's revenue reached its highest levels at 228 million *yuan*, an increase of 76.8 per cent over 1994. This has produced noticeable benefits in terms of investment in physical and social infrastructure and in terms of per capita income growth. However, the government still actually ran a deficit. With the 1994 tax reforms for revenue sharing a greater percentage had to be handed over to higher levels and the incentive to collect taxes declined. At the same time, expected tasks were expanding and the government's administrative costs were increasing. Administrative tasks amounted to 137 per cent of the annual budget in 1994 although this was brought down to 99.8 per cent in 1995. As a result expenditures exceeded the budget in all years (Rong et al., 1998, and interviews with local officials).

Thus, a system that integrated better the capacity to raise and distribute finances would be beneficial. This would provide the central state with enhanced capacity to ensure that local authorities have sufficient funds to carry out those tasks that are mandated for them by higher levels. A particular problem arises at the village level that has to carry out many residual and mandated obligations but cannot formally raise revenues. Villages need to be provided with adequate budgets to prevent further increase in charging illegal fees and fines on farmers.

The overstaffing of local governments resulting in higher administrative expenses further undermines state capacity to provide adequate welfare. Not only do many localities have difficulty in paying staff costs but also meeting the wage bills for teachers and medical workers. Wages, entertainment allowances and transportation for local officials comprise the overwhelming majority of expenditures for local authorities. Indeed, a number of reformers have suggested that local unrest could be best tackled by drastically cutting the number of local officials who rely on illegal fees and levies to cover their salaries and benefits. One recent national survey conducted in the late-1990s showed that

in a medium-sized county with a population of around half a million and with 5,000 administrative staff, 60 per cent have their salaries covered by financial revenues. Thirty per cent had to raise their salaries themselves and 10 per cent found their salary by fining farmers directly. The situation is even worse at the township level (40,000 population with 100 staff). Here, 35 per cent collect their salary directly from farmers (Guo, 1998, pp. 34-35).

The rapid expansion of township government has been a major cause of this problem. In the early 1980s, a township of 20 to 25,000 people was served on average by less than 10 party officials and no more than 20 state officials. Now the numbers have risen to 200 to 300 with some townships having over 500 staff (Wu, 2000, p. 22; Liu, 2000, p. 74). The number of departments and offices has risen from around 40 to 80. The average number of offices in the township government rose from eight to 15 (*South China Morning Post*, 1 November 2001, internet edition, www.scmp.com). These problems have led some reform-minded officials to raise the suggestion of abolishing the township as a level of government, while others have proposed raising the level of direct elections from the village to the township (interviews with government officials and scholars, Beijing, May-June 2002).

Not surprisingly, such a situation makes it even more difficult to fund the salaries of those working in the medical and education institutions. In Guizhou, township budgets are too small often to cover teachers' salaries and this generally takes up the largest component of recurrent costs of rural basic education. The same problems operate with respect to medical care. Especially with respect to Maternal and Child Health (MCH) the government resources are too limited at the township and village level, where need is immense, and too great at the county level, where there is less need. Subsidies are being used to finance county-level MCH salaries, which are disproportionately high. The subsidies for township and village-level MCH workers are very low, creating incentives for providers to concentrate on curative care rather than on preventive care and education. Government contributions to health facilities can be as low as 10 to 15 per cent, a marked contrast to other low to middle income countries where government funds make up as much as 80 per cent of support (Bloom and Tang, 1999, p. 954).

To make local government more effective will require both restructuring and allowing a more effective role for the market and for non-state institutions in provision. Premier Zhu Rongji's intention to cut back on local government staff would help but it is more difficult to administer at the local level and any gains might be offset by the aforementioned salary increases. While provincial level cuts were pursued in 1999, those for the county and township levels were delayed and were only just beginning in 2000-01 because fears of instability with lay-offs from state-owned enterprises were already beginning to erode support. Central government estimates that around 60 per cent of county level staff is effectively redundant (*South China Morning Post*, 23 August 1999, internet edition, www.scmp.com). If this figure is correct, redundancy at the township level must be even higher.

The Farmers' Daily (*Nongmin ribao*, 9 September 1999) reported that in early 1999, Fuyang Municipality discharged all those in the county, township and village governments that were not on the regular, approved payroll. This totalled 21,829 of whom 1,151 were working at the county level, 15,903 at the township level and 4,745 at the village levels. In effect, their salaries were covered by levies on the farmers. The objective of staff reduction at all non-central levels of government is to reduce those on salary from 5.18 million, plus another 300,000 who are also paid by the government, by 2.5 million. In part the savings will go to boost salaries for those who remain; salaries are to be doubled over three years. In 2001, a basic bonus package was included that amounted to an extra month's salary (*South China Morning Post*, 16 August 2001, internet edition, www.scmp.com). Many complain that if the numbers are not cut as expected, highly likely, the result will be

increased expenditures for local governments and that this could well result in more levies on the farmers to cover the salary hikes.

It is clear that much could be saved by restructuring local authorities combined with new thinking about what kind of state structure would best serve the new economy and which tasks the state should continue to oversee and which could be delegated to the private sector or other organizations. For example, in Qindu District, in Xianyang (Shaanxi Province), local officials have decided that the administrative system is too large for the local economy. Fusing district-level party and government offices would reduce staff by 50 per cent. Restructuring the local government to reflect changing economic structure had reduced the number of agencies by 25 per cent and the staff on payroll by 20.8 per cent putting it on the way to meeting the 50 per cent cut demanded by Premier Zhu (interviews and Qindu CCP Committee, 1999).

This administrative restructuring reduced pressure on the budget, and to reduce this further the system of cars for most officials was abolished, with officials receiving subsidies for travel. This latter measure was estimated to save two million *yuan*. With these financial savings, the local government was able to decree the abolition of 114 administrative fees charged by the different bureaus. If more local authorities could make these kinds of savings, more funds would be released for improving social welfare at the local level.

However, budget savings will only be useful if they are directed towards productive investment and support of necessary social welfare. To help this, the incentive system could also be changed to give a higher priority to social development when appraising local government performance. The performance contracts, noted above, make it clear that economic development is one of a complex set of tasks but neglects social development. There are multiple principle-agent relationships that operate between the levels of local government and they need to be understood better in order to improve analysis of the local state, its functioning and the incentive structure for local officials.

One major problem arising from the current system is the weak capacity for comprehensive development by township governments. One group of Chinese researchers has even referred to the responsibilities of the townships being “dismembered” by the county. Most government agencies at the township level actually receive contracts from their counterparts at the county-level and this undermines the township’s capacity to co-ordinate the work of their functional agencies as the administrative power in the township region does not reside in the township (Li et al., 1985, p. 5). Others have pointed out the weak position of the township government as it lacks not only power but also the necessary finances to carry out its mandates (Duan, 1985, p. 12). With the various agencies under the direction of the county, township governments have little to no power to decide personnel arrangements, financial revenue and expenditures and the allocation of materials to the county branches in the township. For example in Laiwu (Shandong province), only five staff in 28 township governments offices were under the leadership of the township government. This had led some to dub township government as a “big title” (*paizi xiang*), “many responsibilities” (*zeren da*), “with little power” (*quanli xiao*) and “difficult to deal with” (*banshi nan*) (Dai et al., 1991, pp. 115-6). Even if the current contracting system was retained, the central government could effect a major change in local practice by amending the targets to reflect a higher priority for social development.

Thus, if finances could be concentrated at the county level this would allow for more effective funding decisions on social welfare provision and provide a more effective geographic unit for redistribution. Reduction in staffing levels, especially at the township level (even including its possible abolition as a formal level of government) would lift the financial burden on the local state and community. However, better incentives have to be provided to encourage local officials to pay more attention to social development. The

fiscal and administrative changes noted above would enable both central and local governments to play a more effective role in providing social welfare. As discussed in the next section, this will be supported by an enhanced role for alternative providers.

3.2 Alternative providers

To compliment the financial and administrative reforms, consideration must be given to how better use can be made of market institutions and those of civil society. To facilitate these decisions there is need for a discussion about what kinds of public goods government should supply and those current services that should be treated as a private good that need not be funded out of public revenues.

One good example of the latter is urban housing that has been treated as a public good by the CCP and has been offered at highly subsidized rates by state-owned enterprises or other state agencies. Urban housing has traditionally been seen as a welfare good rather than as a commodity. As in other socialist systems, this approach has brought a number of problems such as the impact that subsidies have on the national budget, the economic burden for enterprises, and the constraints on labour mobility (see Renaud, 1991, p. 29). The failure to charge full cost for urban housing has come at a high cost and while it may have been defensible in the past, it is less so now. The government has now started a major programme to sell off housing, often at significant discounts but also with significant restrictions. However, this cannot be a substitute for raising rents to an economic level. This would allow local authorities to continue with a programme of house building for the rising urban population. Should they not do this there will be a major problem for raising housing finance (see Heady in Wong, 1997, p. 139).

Not only is housing increasingly seen as a commodity with the development of attendant market structures, we are witnessing the same reduction of state provision and the rise of individual responsibility to purchase services in the marketplace in the health care sector. Following the collapse of government support, there has been a growth in private medical provision. The number of health professionals in private practice rose from 18,000 in 1981 to 172,185 by 1995 (Hu and Jiang, 1998, p. 194). Of 796,523 health clinics by 1992 already about 52 per cent had been sold to individuals or contracted out to private practitioners on an individual or group basis. There is much to be gained from an increased use of privatisation of services but most to date has been by default rather than by design. It has also produced unexpected outcomes with a precipitous decline in rural health care provision and a clear shift from preventive to curative care. What is needed is better regulation of the sector combined with adequate government financing more curative care and support for provision to poor areas.

One clear case where the private sector could play a much larger and beneficial role would be with pension management. China clearly needs to fund its pension obligations sooner rather than later, but the question is how. There are various estimates of the implicit pension debt. The World Bank (1997a) has calculated a range between 46 and 69 per cent of GDP while Wang et al. (2001) have estimated it to be 71 per cent in 2000 and Dorfman and Sin (2000) have suggested a figure of 94 per cent. This is actually low in comparative terms since the pension coverage is limited to a relatively small percentage of China's total labour force. In fact, if the central government acts soon and adopts adequate measures, the fiscal costs should be manageable (Ma and Zhai, 2001). One major proposal has been to consider the implicit debt part of the national debt and to raise funds through the sale of state assets (*South China Morning Post*, 24 February 2001, internet edition, www.scmp.com), a programme formally endorsed by the State Council in June 2001. It is unlikely, however, that especially foreign investors will be willing to buy shares in state-owned enterprises if they thought the funds would be diverted to cover pension debt. A better long-term strategy would be to open up the pension funds to a market-driven

approach and to move away from centralizing pension pool administrations and trying to reduce evasion and non-compliance by administrative means (See Zhao and Xu, 1999). Of course, for the private sector to take over management of pension funds would not only require a psychological leap for China's leaders but also would demand a proper regulatory infrastructure to be put in place. The transition costs would be reduced considerably by creating a fully funded system, with the public pillar financed out of general fiscal reserves and the individual accounts managed by a private and decentralized system.

To date one of the most successful administrations has been Shanghai, which enjoys a relatively competent administration and has been able to generate sufficient revenues. It is in the process of issuing a social insurance card for all residents that will consolidate unemployment insurance, health insurance and pension payments in a computerized system. The scheme is administered by the Bureau of Labour and Social Insurance and operates independently of all enterprises in the Municipality. This scheme is more likely to be successful than the pilot scheme running in Liaoning Province, which will rely heavily on central government handouts. Liaoning has been selected to establish provincial pooling for its social security fund in a three-year experiment. Again benefits such as pensions will be managed independently of the workplace (*Xinhua*, 8 July 2001). Neither of these is liable to provide a viable model for the rest of the country. Few would be able to emulate Shanghai's advantages and the central state will not have sufficient funds to bail out many more provinces.

However, there are some positive signs and economic necessity will probably force a faster pace of market driven change. In 2000, it was reported that the pension system ran a \$4.3 billion deficit. Partly in response, the Ministry of Labour and Social Security together with the Boshi Management Company announced that perhaps as much as 15 per cent of pension funds could be invested in stocks with another 10 percent in treasury and corporate bonds (*China Daily*, 25 May 2001). This marks a significant shift away from current practice that only allows investment in bank deposits and government bonds. This would aid further the attempts to separate social welfare payments from enterprises.

With declining financial capacity and the need to reduce the number of government workers, there will be a need to expand further the non-governmental sector to take on many functions that will be shed or that are not covered at all. Indeed government policy intends that organizations that are being separated from the state should become independent financially within three years. In fact, one of the features of the reforms has been the expansion of non-government organizations, or social organizations as they are referred to in China, and civilian not-for-profit institutions (see Saich, 2000). By the end of 1998, there were some 165,600 social organisations, defined as a community representative composed of a certain social group with common intention, desires and interests. Examples would include professional associations, academic societies, research associations and foundations (Deng, 2002, p. 26) This is a 12 per cent drop from the 1996 figure of 186,666 social organisations, of which 1845 were national-level organisations (1,800 in 1998) (*Zhongguo falu nianjian 1997*, p. 1077). This drop was caused by an extensive review of registered organisations in the late-1990s that caused many to lose their official registration. In addition, there are 700,000 civilian not-for-profit institutions, which are set up by enterprises, social groups or individuals to provide not-for-profit social services (Deng, 2002, p. 26). This category includes private schools, hospitals, community service centres, vocational training centres, research institutes and recreational facilities (Meng, 2002, p. 10).

However, senior CCP leaders have remained ambivalent about the development of the sector and while keen to mobilize the resources that they can raise are concerned to keep strong control over the sector. Rather they prefer that the sector be developed within a highly restrictive legislative and organizational framework that ensures CCP and state control. This is driven in part by the party's Leninist organizational predisposition that

creates suspicion of those organizations that are outside of its direct organizational control. In addition, it stems from the awareness that the next phase of reforms will shrink the role of the state in people's lives even further. As a result, the sector is still dominated by those organizations in which the government plays a strong role often having set the organization up as a way to mobilize funds more effectively.

It is clear that the state is unable to meet many of the obligations that it claims for itself. Thus, for example, anyone with a disability should be eligible for welfare benefits and support from their workplace or the Ministry of Civil Affairs. The fact is that even in the 1980s, 67 per cent of people with disabilities received basic subsistence from their families and only 3 per cent from the state (Zhong, 2001). For those in the urban areas the lack of funding has led to interest in developing service providers for rehabilitation that depend more on mobilizing local resources and partnerships with Non-Governmental Organizations (NGO) and local communities.

Such problems have also led to greater tolerance for alternative funding sources such as the welfare lotteries that provide a key financial resource for the Ministry of Civil Affairs at both the national and local levels. Such non-government funds are of increasing importance and an expanding number of NGO-run projects have emerged. A meeting convened by the China Foundation for Aiding Poor Areas (CFAPA) in October 2001 calculated that incomplete statistics suggested that resources mobilized by the sector amounted to between 18 and 28 per cent of the total funds for poverty alleviation in the second half of the 1990s (information from participants). Since its establishment in 1989, the CFAPA has raised more than \$60.4 million in cash and kind to help the rural poor in central and western China (*China Daily*, 4 August, 2001). Similar organizations with close party and state ties have also been important in fund-raising for welfare projects. Perhaps the best known was the Youth Development Foundation set up by the Communist Youth League, which launched Project Hope to build primary schools and provide scholarships for poor children. Over a ten-year period, Project Hope raised around \$215 million from domestic and overseas donations, providing assistance to over two million children and building and renovating 7,549 elementary schools (Xu, 2000, p. 8). Project Hope had provided aid to all the officially designated poor counties in China and 74.7 per cent of the total counties. In 1996, the Project Hope fund for primary school construction accounted for 8.8 per cent of the county-level budget for capital construction for education (National Research Centre, 1998, pp. 3 and 5).

There is also growing official recognition that NGOs have a role to play in welfare provision broadly defined. CCP general Secretary, Jiang Zemin and Premier Zhu Rongji recognized the necessity of further development of NGOs at the party and state congresses of 1997 and 1998. In his speech to the 15th Party Congress, Jiang stressed the need to "cultivate and develop" what he termed "social intermediary organizations" as the reform programme proceeded (Jiang, 1997). The 1998 plan for restructuring the State Council stated that many functions appropriated by government organs be given back to society and handled by new social intermediary organizations. It mentioned several times the important role that such organizations could play. In introducing the plan State Councillor Luo Gan complained that many problems that should have been dealt with "by legal means" or through social intermediary organizations had been taken on by government. Luo stated that "government has taken up the management of many affairs that it should not have managed, is not in a position to manage, or actually cannot manage well". This overload detracted from the government's capacity to carry out its work effectively. As a result, Luo called for social intermediary organizations to be expanded (Luo, 1998). However, all were clear this was not to be a free-for-all but would be a closely managed process.

Subsequently, more ground has been marked out for such organizations to develop. In a major departure from past practice, the current 10-year plan for poverty alleviation

explicitly states the need to bring NGOs on board to help implement government development projects in poor areas (State Council, October 2001). The NGO meeting sponsored by the CFAPA called for the government to set up systems for bidding and tendering to ensure fair competition and to break-up government monopoly over the implementation of such projects.

Indeed there is ample evidence to show that NGO-run projects have been more successful in meeting their goals in alleviating poverty than similar government-run programmes. In fact former vice-Minister of Civil Affairs, Yan Mingfu, who now heads the China Charity Federation has stated that he believes government should delegate most social services to NGOs and volunteer organizations in order to deliver better help to people (*Toronto Star*, 5 September 2001). This has certainly been the case in the field of micro finance. Pilot micro finance institutions were set up in 1994 and have expanded rapidly. Most of these were small-scale and often were joint local-international organization programmes. As a result of the initial success a number of provinces set up micro finance programmes to replace their subsidized loan programmes that had formed the staple of government approaches. However, as in other countries, the government-run micro finance programmes have experienced greater difficulties than those run by NGOs. Park and Ren (2001) have concluded that in a number of respects government-run programmes have differed little from the failed subsidized loan programmes they replaced. In the areas of targeting, sustainability and impact, the NGO projects have been faring better.

For alternative service providers to play a sufficiently effective role there must be a number of substantial changes made in government attitude and practice. Most recently the rise in lay-offs in urban China, the number of protests in rural China over illegal levies, and the activities of the *Falungong*, (an organisation based on a particular type of breathing and exercise regime that Beijing outlawed in July 1999 as a dangerous sect) have caused the central authorities to be cautious about pushing ahead in this area of regulation. Indeed a much more cautious approach has been discernible since the crackdown on *Falungong*. It appears that legislation to make tax deduction for NGO gifts and to distinguish charities better from profit-making organizations have all been put on hold. Wang Ming, head of the NGO Research Centre at Tsinghua University, anticipates that the growth of China's NGO sector will be set back by at least two years (*South China Morning Post*, 15 October 2001, internet edition, www.scmp.com).

This current ambivalence about the non-governmental sector and the need to seek approval through registration with a sponsoring agency favours the larger organizations, many of which have been set up by government itself. Further, the confusing Public Welfare Donations Law that took effect in September 1999 also favours those organizations that are close to government. The Law does acknowledge tax relief for corporate and individual donors but is not specific about the levels and circumstances for this. This means that the environment will remain uncertain for giving and that for the most part the outcome will be a result of negotiations between the donor, the recipient and the local tax authorities. This will favour those large organizations with senior ex-officials in leadership positions over grass-roots organizations. In fact, this is also presumably the intent as the central government has been continually concerned that any tax relief for donations to NGOs could result either in money laundering or a reduction in the funds available for its own coffers. Also, given the difficult financial circumstances of many local authorities outlined above, many are likely to resist tax reductions unless it is for an organization with powerful local connections.

This preference for the larger quasi-official organizations is also reflected in the regulations on social organizations that stipulate that "similar" organizations are not allowed to co-exist at the various administrative levels. This helps to control representation to a smaller number of manageable units and has been used to deny registration for some

groups. It ensures that the “mass organizations” such as the All China Women’s Federation and the All China Federation of Trade Unions enjoy monopoly representation and cannot be challenged by independent groups seeking to represent the interests of women and workers (Saich, 2000, p. 131). The emergence of smaller, local organizations that could play a valuable role in identifying and responding to social needs within the locality is restricted.

Again this is not surprising as the kind of grass-roots participation that has proved successful in many other developing countries runs counter to the CCP preferred model of top-down assessment, consultation and implementation. What is needed is an enabling environment that supports a more diverse NGO sector and that allows them greater independence. A simpler process for registration and greater transparency would reduce official intervention in the process and would make it easier for organizations to be established.

Before turning to the conclusions one last issue needs to be addressed. To provide effective social welfare it is necessary to have a better understanding of the needs and wants of those who are considered the objects of development. Participation needs to be improved not only to ensure that governments deliver the kinds of services people desire but also for NGOs to improve performance. Current policies tend to be constructed and implemented by different vertical bureaucratic hierarchies with little attempt to integrate them effectively. Further, there is very little consultation with people about what they might want in terms of help and little effort to build with them sustainable participatory institutions. This is particularly apparent with poverty alleviation work in rural China. The paternalism of CCP rule is evident with many local officials convinced that the farmers do not know what is in their best interests. The phrase “their cultural quality is too low” (*suzhi taidi*) is frequently used by local officials to justify why they do not ask farmers for input on the projects they are cooking up. This kind of mentality also informs the work of a number of NGOs whose leaders feel that they know best what is in the interests of local people.

There is a need for better research on poverty in China that is participatory. A good start has been made in Yunnan, for example, by the participatory research network that has developed through the 1990s and provides training and advice in addition to its own research work. Well-intentioned government poverty alleviation and social welfare programmes more broadly have been hampered by inaccurate assumptions about poverty, and by the fact that poor people themselves have had little to say in the design and implementation of such programmes. In the uplands, some local governments have squandered scarce resources in failed attempts to mimic the development strategies of wealthy coastal areas without regard to local conditions and capacities. Others have over-emphasised the need for subsidised credit and relief, undermining local initiative while deepening dependency. Local people’s ability to utilise the most valuable natural assets in upland areas, the forests, is restricted or denied by laws and regulations that give the state a dominant role in the management of natural resources.

In addition to increasing the effectiveness of design and delivery of government programmes, it is also necessary to create conditions that enable the poor to cast off poverty on their own, which is often a matter of insuring that they are able to secure access to and control over productive resources. Strengthening the rights of farmers and rural communities to manage and derive benefits from the natural resources on which they depend is one of the keys to securing sustained improvements in the lives of the rural poor. This could be achieved both by improving the existing village election program to provide more control over the election and behaviour of village leaders but also through allowing greater capacity for organisation and associations of local groups. Last but not least, regulations needs to be provided that clarifies use and access rights and that protects local

communities from arbitrary intervention by authorities to appropriate land and or other resources for their own use.

4. Concluding comments

This paper has argued that economic reform over the last 25 years has led to fundamental challenges for the provision of social welfare. Neither the central nor the local state has the financial capacity to provide the same levels of social welfare as in the past. It suggests that better social welfare provision can be achieved by rethinking the role of the state and its relationship to the market and institutions of civil society. Crucially, social development needs to be integrated better with economic development plans rather than being considered something that can be dealt with once sufficient economic growth has been achieved. While it may appear appealing to go flat out for high economic growth first and then think about other issues later, historical experience shows that this is mistaken and proves extremely costly over the long-term.

There are a number of things that the government needs to undertake beyond simply improving its revenue streams, although this would help. First, it needs to re-think substantially its role in welfare provision eradicating the remaining subsidies and distortions left over from the centrally planned system. Government at all levels needs to complete its transition from the sole provider of services to that of regulator and coordinator. That said it needs to be a funder of last resort for those services for which there is no market or disadvantages specific groups such as the rural poor. Local governments need to be provided with greater incentives for their officials to pay greater attention to social development. Local finances should be concentrated at the county level to allow for better investment decisions to be made and redistributive mechanisms to be developed. Given that so much funding goes on wages and benefits for personnel, the programme to trim staff should be pursued vigorously and serious thought should be given to eradicating the township as a formal level of government. Transparency of local government work should be increased further and the role of democratic, competitive elections should be expanded beyond the village level. This will help monitor local government performance and combat diversion of resources that can be used for the public good.

These reforms of government should be accompanied by an enhanced role for the market in areas such as housing and pension management and an expansion of the not-for-profit sector as service providers. To facilitate this expansion, the Chinese government needs to make substantial adjustments to its attitude and practices. The government should encourage more small, community-based development organisations to accompany the larger state-sponsored NGOs. Last, more channels need to be developed for, and implementation of social welfare policies. Implementation of these kinds of measures will help the Chinese authorities to construct a social welfare structure that will produce results that will not be so far behind its impressive economic achievements.

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