

CHAPTER 8

The Changing Role of Urban Government

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The economic reforms of the past three decades have necessitated significant changes in the role of the governing apparatus, especially at the local level. While the challenges are many, this chapter focuses on urban governance and welfare provision.

For urban China the shedding of welfare responsibilities by state-owned enterprises (SOEs) and the intention to move millions of people from rural areas to cities by 2020 have brought new responsibilities to and put new pressures on local urban governments. This population creates new challenges as China's towns and cities strive to knit fragmented social welfare provision into a more coherent framework of support. At the same time, urban governments have responsibilities for job creation, public safety, and basic physical infrastructure. Far greater responsibility lies with local governments than is the case in most other countries.

Meeting the urbanization goals will present major challenges for the government in terms of investment in urban infrastructure and planning. It will also present significant challenges for job creation. Infrastructure programs will create some employment opportunities, but whether the service industry can be expanded sufficiently to accommodate the estimated 150–200 million surplus workers in rural China remains to be seen.

Urbanization is seen as the best long-term solution to the problems of inequality in service provision, which primarily reflect urban–rural differences. Yet the current leadership is concerned about the consequences. It is therefore seeking to restrict the expansion of large cities while encouraging the growth of small towns. In 2006, General Secretary Hu Jintao and Premier Wen Jiabao bundled policies to “build a new socialist countryside” that seek to improve conditions for those who remain behind in order to reduce the pressures of urbanization. In addition, they have promoted policies to improve the lot of urban migrants and to push more integrated social welfare programs to help those who have been disadvantaged by reforms to date, such as workers laid off from SOEs and elderly people who lack family support (see chapter 4).

It is primarily local urban governments that are charged with finding the solutions and supplying most of the funding for the promises made by the central government. The challenge is how to get better local government performance with constrained resources and competing demands.

This chapter first looks at how the role of local government has changed under reform and the incentives that shape the behavior of local government in China. It then provides some preliminary evidence on how Chinese citizens view the performance of urban government. It closes by considering alternatives for providing more effective public goods and services.

The Changing Role and Incentives of Local Government

Reforms have changed the role of local urban government in terms of economic and fiscal management, the provision of public goods and services, and the strength and structure of local administrative units. During the Mao years and the earlier phase of reforms, the capacity of local administrative units to provide public services was weak. These units primarily served people who were not employed by government agencies or SOEs and their dependents. As reforms have progressed, local governments have acquired a number of real administrative powers over planning and land use, public works, local foreign trade, and the provision of social welfare.

Local government has received greater powers over investment approval, entry and exit regulation, and resource allocation (Lin, Tao, and Liu n.d.). Perhaps the strongest expression of this increase in power was the formation of Special Economic Zones, which led to an expansion of economic decision-making powers for many coastal cities and then to other cities inland. In addition, since the 1980s, the authority over many

SOEs was delegated to municipal governments. This meant that local governments were faced with fixed asset spending on these enterprises as well as on the wide range of welfare services they provided. While this devolution of powers offered the potential to raise revenues, it added a significant and rising fiscal burden, in the form of expenditure assignments on local government, that many found hard to carry in the 1990s.

As the main providers of public services, subprovincial levels of government have had to shoulder expenditure responsibilities that are out of line with international practice (World Bank 2002). The central authorities have transferred a much larger percentage of expenditure responsibilities to local government than is normally the case. The Maoist notion of “self-reliance” reinforced the idea that each locality should minimize “dependence” on support from higher levels. In fact, with the introduction of fiscal contracts in 1988, the central government formally ended its responsibility for financing local expenditures, expanding the role of local government from simply providing services to also financing them. The move delinked expenditure assignments from revenue-sharing considerations, later regularized in the Budget Law (World Bank 2002). Unlike in many other countries, in China these transfers do not play an equalizing role; richer areas often receive proportionately larger transfers (Mountfield and Wong 2005).¹ The local level of government retains primary responsibility for financing infrastructure and providing social welfare.

This division of fiscal responsibility in China differs from that in other countries in the region (table 8.1). As a share of total public spending, subnational expenditure is much higher in China (69 percent) than in Vietnam (48 percent), Indonesia (32 percent), or Thailand (10 percent) (Mountfield and Wong 2005).

Under the 1995 Budget Law, local governments are allowed to run deficits; they are not, however, allowed to issue bonds. Unable to raise adequate resources through measures such as a property or vehicle users tax, local governments are excessively reliant on inadequate central transfers (general or earmarked) for funding, supplemented by off-budget revenues and relying on nongovernment institutions to provide many public goods and services.

1 For China as a whole, expenditures were distributed as follows in 1999: 28.2 percent at the provincial level, 30.2 percent at the prefecture level, and 41.5 percent at the county and township level. For revenues the figures were 21.2 percent at the provincial level, 35.4 percent at the prefecture, and 43.4 percent at the county and township level.

Table 8.1. Subnational Expenditure Shares and Functional Allocations in Selected Asian Countries

Country	Subnational expenditure (percent of total)	Functional allocation		
		Education	Health	Social welfare
China	69	Local	Local	Local
Indonesia	32	Local	Local	Local
Thailand	10	Central, provincial	Central, provincial	Central, provincial
Vietnam	48	Provincial, local	Provincial, local	Provincial, local

Source: White and Smoke 2005.

The funding environment became even tougher for local governments after 2004, when the Ministry of Finance shifted its macroeconomic policy to ensure greater fiscal restraint and less reliance on borrowing (Su and Zhao 2006). Borrowing had risen to cover about 30 percent of the costs of infrastructure development, from about 2.5 percent in the mid-1980s.

Most cities have set up a Municipal Development and Investment Company to deal with the funding and operation of infrastructure projects. With local governments technically prohibited from borrowing, these nominally independent companies borrow and use funds on the government's behalf (see chapter 5; Su and Zhao 2006). In addition, many cities contract out services or spin off government departments as quasi-private entities.

One emerging imperative shared by economically developed and more resource-constrained localities is the increasingly acute need each feels to enhance its own sources of revenue. The resultant fiscal inequalities that arise from this system have led to significant inequality in the provision of public goods and services. In 2005, the per capita fiscal revenue of the Shanghai municipal government (Y 7,972) was more than 16 times that of Guizhou (Y 489), a gap that is widening. Per capita fiscal expenditures also show significant inequality, with Shanghai spending Y 9,259 and Guizhou Y 1,396. Provinces such as Guizhou rely on external funding to provide services (NBS 2007).

Political incentives and the demands of higher-level local government agencies are also important in understanding local government performance. Popular expectations and those of higher administrative levels about the range and kinds of services they should provide have not declined. Financial pressures lead to the preference for a development plan that maximizes short-term revenue over longer-term needs and that pays too little attention to distributional and welfare priorities. The main

concern of government at all levels is increasing revenues rather than defining the correct role of government.

The concern with revenue generation is exacerbated by the fact that despite fiscal decentralization, the central government has retained control over the policy agenda. While localities do not always carry out central policy, the center still mandates many tasks that must be carried out and imposes burdens on lower levels of government. Most of these are unfunded mandates. Cities at the prefecture and county levels are supposed to cover all expenditures on unemployment insurance, social security, and welfare. In contrast, in most other countries, the central government covers social security and welfare, and responsibility for education and health is shared by lower levels of government and the center.

The expenditure responsibilities for townships are similar, although townships often have a weaker financial base and carry the heaviest load for social spending. Together, counties and townships account for 70 percent of budgetary expenditures for education and 55–60 percent for health (World Bank 2002). Yet the township and county levels account for only 30 percent of subnational fiscal revenue. In Xiangyang County, Hubei in 2002, budgetary contributions to education finance amount to 40.6 percent of total expenditure. Of the government contribution, townships provide 84.6 percent and counties provide 15.2 percent, with the rest coming from provinces (Han 2003). Before 1984, the equivalent of the township did not raise revenue independently.

The need to finance expenditure drives local leadership and townships to seek various off-budget revenues, from user fees and other unsanctioned levies. For example, in three counties surveyed by the Development Research Centre of the State Council, expenditures exceeded revenue, increasing the need to raise off-budget revenue (Han 2003). Nationwide, extrabudgetary funds may total 20 percent of GDP; in the three counties surveyed, they ranged from 30 percent of total income (Xiangyang, Hubei) to 69 percent (Taihe, Jiangxi). The use of these extrabudgetary funds and self-raised funds (*zichou zijin*) has clearly been rising and the 1994 tax reforms have heightened the problem.

Despite the rapidly rising social welfare demands, the two major causes of growth in government expenditures are capital spending and administrative outlays. The Organisation for Economic Co-operation and Development (OECD 2006) has calculated that between 1998 and 2003, capital expenditure contributed 31 percent of total growth in expenditure and administrative outlays contributed 21 percent. The burden of the increase in expenditure and administrative outlays falls most heavily on

local governments, which provide 82 percent of administrative spending (and less than 56 percent of capital investment) (OECD 2006).

Even in major cities, local governments have difficulty meeting their administrative expenses. Beijing and Shanghai (each of which bears 89 percent of these expenses) and other major municipalities come closest to supporting their needs from their own revenue.

This situation has led to a constant search by local governments for stable revenue sources, with Street Offices, for example, setting up small commercial ventures, and even joint ventures and services being contracted out.² In the 1980s and 1990s, financial pressures contributed to the expansion of locally owned enterprises, especially township and village enterprises (TVEs), which were seen as the most-stable sources for local income (see chapter 2). By the mid-1990s, however, TVEs had become a burden for many local governments, and large-scale privatization began.

Still needing funds, many local governments introduced a wide range of sanctioned and unsanctioned fees and levies to cover the funding gap. This practice has come under increasing scrutiny from the central government and has induced local governments to rely on the sales of land under their jurisdiction to raise more revenue, often by converting agricultural land to commercial or residential land use.

These constraints limit long-term strategic planning and investment in social development. They also force local governments to focus on short-term revenue generation, something that is encouraged further by the political contracting system.

Far more needs to be learned about the political demands placed on local officials by higher-level agencies to complete the picture of the forces shaping local government. In some areas, reforms have clearly given local officials greater financial freedom from higher levels and reduced their dependence on higher-level approval for career advancement and economic reward. However, the appointment system leaves most officials dependent on the approval of their superiors for career advancement. A number of researchers have argued persuasively that a pure political economy approach that views state agents as revenue maximizers should be complemented with an understanding of the political incentives generated by the cadre responsibility system, the political contracting system, and the performance contracts (*gangwei mubiao zerenshu*) that govern the work of local governments and officials (Rong and others 1998; Edin 2000; Whiting 2001).

2 Street Offices supervise and allocate the budgets of residents' committees and community residents' committees. China had 6,152 Street Offices at the end of 2005.

Meeting performance contracts does not discourage economic development—far from it. They are just one of a complex set of tasks that local officials are required to carry out. Other tasks include maintaining social order, delivering taxes to higher levels of government, and maintaining family planning quotas. Multiple principle-agent relationships operate between different levels of government. These relationships must be understood better in order to improve analysis of the local state, its functioning, and the incentive structure for local officials.

One problem arising from this system is that it weakens the capacity of county, district, and township governments to provide comprehensive development. The resultant system has been called a pressurized system (*yalixing tizhi*) that provides material rewards for lower-level agencies for developing the economy and meeting targets set by superiors (Rong and others 1998).

Priority targets are set nationwide and are usually political or policy oriented in nature. They include, for example, the maintenance of social order and the meeting of family-planning quotas. Hard targets primarily concern economic outputs set by counties for townships. They include meeting tax revenues and attaining or exceeding predetermined growth levels. Soft targets tend to cover social development, such as provision of health and education and protection of the environment. Meeting hard and priority targets is critical, as failure will mean that success elsewhere will be discounted and no promotions, titles, or economic rewards will be distributed.

This system produces a number of perverse outcomes and explains why officials often pursue unpopular policies with such zeal. Performance contracts focus on both quantitative targets and the speed of task completion. This means that less attention is paid to the quality of the finished product. The reward system encourages shoddy building and infrastructure, which has been part of China's urban and rural building boom.

The political contracting system also provides perverse outcomes for officials and lower-level governments when dealing with performance evaluation. For example, there is great pressure to juggle statistics, which are altered to match or even exceed targets. Distorted reporting is best combined with the cultivation of good social and political relations with one's superiors, who carry out evaluations. This is especially important if key targets are going to be missed. The resultant system and incentives suggest that political and vertical networks remain more important than many proponents of "market transition" would suggest.

The system does offer the potential for refocusing incentives should the leadership so desire. A new nationwide performance appraisal system is being developed that has been tested in Qingdao, Shandong Province.

The system tries to shift evaluation away from just measuring whether local officials are satisfying the demands of higher authorities to look at whether public service goals are being attained (“33 Indexes” 2004).

Citizen Satisfaction with Government

Economic reforms, distorted incentives, and ineffective administrative structures have created problems in maintaining effective mechanisms for delivering public goods and services. The costs of reform for the social transition have been higher than expected; some problems, such as sharply increased inequality and long-term unemployment, cannot be resolved by growth alone. Under Hu Jintao and Wen Jiabao, the leadership is trying to address the inequities of reform and the new challenges of providing welfare under their slogan of “building a harmonious society.” There has been a shift from immediate to long-term structural concerns. A coherent policy framework and administrative structure need to be developed that can identify and protect vulnerable groups.

To date, the main approach to resolving the challenges of local government service provision has been to improve the revenue stream. In addition to adjusting incentives for officials, this measure is important, but it is insufficient. What is needed is a thorough reappraisal of the role of government in providing services and the kinds of partnerships that can be formed to meet policy objectives.

This section discusses how urban citizens view the performance of their government. A better understanding of how citizens view government, what kind of services they expect, and how they prioritize them will clarify thinking about the changing role of government.

Like most countries, China had adopted a supply-side approach to the provision of public services. The central government sets public policy goals, such as providing nine years of compulsory education, reviving some kind of collective health system for rural areas, and providing a financial floor for urban families in distress, as noted in chapter 4. These are laudable goals, but they represent unfunded mandates, with the burden of implementation falling on local governments. Many local governments have neither the finances nor sufficient incentives to implement such policy directives effectively. The central government has begun to allocate more funding (through transfers) for its favored policies, but funding still remains far from adequate.

What do citizens think about government in general and the provision of particular public goods by local governments and how they prioritize

different needs? To find out, the author and the Horizon Research Group conducted three nationwide surveys to understand which areas of government service citizens approve of and which frustrate them (box 8.1). A simple matrix was devised that correlates the level of importance citizens attached to certain services with the level of satisfaction with local-government service provision (figure 8.1). The results suggest that continued urbanization would improve governance, as in virtually all categories, citizens in major urban areas are more satisfied than those living in small towns, townships, or villages.

Box 8.1

The Survey on Citizen Satisfaction with Government

In 2003, 2004, and 2005, the author and the Horizon Research Group conducted a purposive stratified survey of about 4,000 people, about 80 percent of whom responded.^a Respondents age 16–60 were selected at three administrative levels: the city, the township, and the village. At the city level, seven sites were chosen, based on their geographic location, average per capita income, and population. The sites varied in all three variables, representing lower-middle-income, middle-income, and upper-income individuals, as well as individuals from western, eastern, northern, and southern China. Within cities, respondents were randomly selected through the household registration lists using the Kish method.^b Because of the large average size of families, respondents at the township and village levels were selected randomly using the closest-birthday method. At least 250 respondents were identified for each city (1,850 total), 150 for each town (1,050 total), and 100 for each village (800 total). Consequently, the sample has an urban bias, resulting in respondents with higher age ranges and, in some cases, higher income levels than the corresponding regional averages. In the analysis stage, the results were weighted to compensate for both urban bias and relative population size. Thus, the final weight for cities was 0.5008. With the exception of respondents 16–19, the demographic profile mirrors reasonably well the national range.

By design, the sample does not include migrants or most ethnic minorities. Using the household registration system does not capture migrant communities. Moreover, migrants lack legal access to public goods and services; their responses therefore create bias in the survey findings. Similarly, ethnic minorities residing in autonomous regions live under varying policy frameworks, rendering a

(continued)

comparison of government performance between regions difficult at best and misleading at worst.

The questionnaire was conducted in the municipalities of Beijing and Shanghai and the cities of Chengdu, Guangzhou, Shenyang, Wuhan, and Xi'an, with Nantong (Jiangsu) added in 2005. Seven small towns (districts or counties) were covered: Beining in Jinzhou (Liaoning Province), Changle in Fuzhou (Fujian Province), Linxiang in Yueyang (Hunan Province), Pengzhou in Chengdu (Sichuan Province), Xingping in Xianyang (Shaanxi Province), Xinji in Shijiazhuang (Hebei Province), and Zhuji in Shaoxing (Zhejiang Province). Seven villages under these small towns were chosen, as well as Feng Shuling village, under the jurisdiction of Wuhan (Hubei Province), making eight villages in total.

- a. Unless otherwise stated, the details for the 2004 and 2005 surveys are the same. All surveys were conducted in the fall.
- b. Under this method, household area sampling is based on a "face sheet" or table with fractional representation of each adult (Kish 1949).

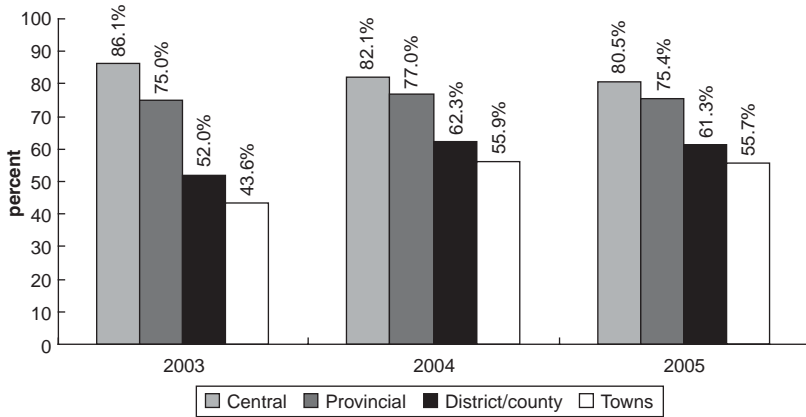
Figure 8.1. Government Service Satisfaction/Importance Matrix

Area D	Area A
High level of importance, low level of satisfaction (Work is of poor quality and urgently needs improvement.)	High level of importance, high level of satisfaction (Work is of good quality and should remain a policy priority.)
Area C	Area B
Low level of importance, low level of satisfaction (Work is of poor quality but does not require immediate attention.)	Low level of importance, high level of satisfaction (Work is of good quality but is of limited importance.)

Source: Author.

Across categories, citizen satisfaction with government declines as one moves down the institutional hierarchy (figure 8.2).³ This finding is important, because it is distinct from many developed economies, where satisfaction levels tend to rise as government gets closer to the people (see, for example, Pew Research Center 1998).

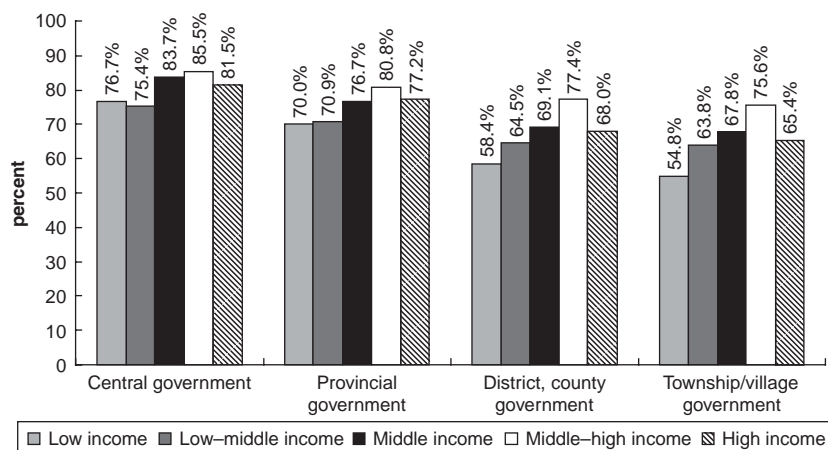
³ These figures include respondents who are extremely satisfied and those who are relatively satisfied with government performance.

Figure 8.2. Citizen Satisfaction with Different Levels of Government, 2003–05

Source: Survey conducted by author and Horizon Research Group.

Local governments in China provide almost all public services. The fact that satisfaction levels decline as government gets closer to the people is therefore a worrisome sign. The percentage of respondents indicating that they were “very satisfied” or “relatively satisfied” with central government service and performance was high, although it dropped slightly between 2003 and 2005, from 86.1 percent to 80.5 percent. Satisfaction with each lower level of government was lower, but satisfaction with the county/district level and the village or residents committee rose between 2003 and 2005. The same trend is evident among urban respondents. In 2005, 83.6 percent of urban residents expressed satisfaction with national government, while just 66.9 percent expressed satisfaction with residents committees. Respondents with higher and lower income levels tend to be the least satisfied (figure 8.3).

Satisfaction with government competence rose between 2003 and 2005. In 2005, 72.2 percent of respondents from municipalities viewed their local government as very competent in implementing policy (up from 64.0 percent in 2003), while only 9.9 percent found it incompetent (down from 14.9 percent in 2003) (table 8.2). In addition, 60.7 percent viewed local officials as friendly (up from 50.0 percent in 2003), while 23.8 percent found them cool and indifferent (down from 33.1 percent in 2003). The new policies of the government and attempts to encourage local governments to be more responsive and take care of those in need may be having an effect, as indicators across the board have improved.

Figure 8.3. Citizen Satisfaction with Different Levels of Government, by Income Level, 2003

Source: Survey conducted by author and Horizon Research Group.

Table 8.2. Urban Residents' Attitudes toward Government Behavior, 2005

Issue	Number of respondents	Percentage of respondents
Concern for ordinary people		
Raise fees in line with the law	553	56.9
Adopt the method of helping the masses	470	48.4
Care about masses in hardship	458	47.1
Solve real problems	426	43.9
Bring benefits to ordinary people	417	42.9
Think about looking after the masses	406	41.8
Bureaucratic behavior		
Act in line with slogans	389	40.0
Move close to their superiors	373	38.3
Remain aloof from the people	340	35.0
Take care of their own interests	336	34.6
Close to those with money	332	34.2
Raise fees in an arbitrary manner	193	19.8

Source: Survey conducted by author and Horizon Research Group.

While indicators improved, respondents' attitudes about the way local governments implement policy should still raise concern. Irrespective of place of residence, the general view is that when implementing policy, many local officials and governments are concerned with their own interests; are more receptive to the views of their superiors than those

of ordinary people; favor those with money; and implement policies formalistically rather than dealing with actual problems. Among rural dwellers, majorities of respondents had negative perceptions in all categories; even in major cities, about a third held negative views of the ways local governments implement policy (table 8.2). The one exception was whether local governments raise levies in accordance with law: only 19.8 percent of respondents felt that local government officials raised fees arbitrarily.

In 2003, only in one category—whether officials helped the masses as opposed to remaining aloof—was there a majority of respondents in favor: 42.4 percent against 41.9 percent. In 2005, there were positive views on all comparisons, but in no category did those replying favorably top 50 percent. The urban respondents who felt that government behaved bureaucratically dropped from 40.7 percent in 2003 to 33.7 percent in 2005, while those who felt government showed concern for the people rose from 40.3 percent to 46.8 percent. Among respondents from small towns and townships, the respondents who indicated that government behaved bureaucratically dropped from 45.1 percent to 38.6 percent; the respondents who indicated that government showed concern for the people rose from 27.3 percent to 34.8 percent.

Satisfaction among urban citizens with the provision of certain public services provides some insights that are helpful for thinking about the changing role of local government. The five areas of local government work that received the highest ratings among residents of municipalities in 2003 were family planning, water and electricity supply, oversight of religious worship, road and bridge construction, and attracting business and investment (table 8.3). In 2005, traffic management and middle and primary school management replaced religious belief and attracting business and investment. However, respondents rated their satisfaction with only one of these services in 2003 and three in 2005 as at least “somewhat satisfied.” These services relate to the provision of physical infrastructure and key state priorities; few relate to pressing social policy concerns. In contrast, the five areas of government work that caused the greatest dissatisfaction in 2003 were dealing with corruption, job creation, unemployment insurance, hardship family relief, and social safety. In 2005, tax management replaced social safety. These areas of dissatisfaction relate much more directly to household economic and social concerns and they derive from the new problems and social challenges the reforms have brought with them.

Table 8.3. Highest- and Lowest-Rated Categories of Government Service by Urban Residents, 2003 and 2005

<i>Service</i>	<i>Highest</i>				<i>Lowest</i>			
	<i>2003</i>		<i>2005</i>		<i>2003</i>		<i>2005</i>	
	<i>Satisfaction index</i>	<i>Service</i>	<i>Satisfaction index</i>	<i>Service</i>	<i>Satisfaction index</i>	<i>Service</i>	<i>Satisfaction index</i>	
Family planning	3.07	Family planning	3.06	Punishing corruption	2.45	Punishing corruption	2.09	
Water/electricity supply	2.98	Water/electricity supply	3.04	Job creation	2.60	Unemployment insurance	2.32	
Religious belief	2.96	Road and bridge construction	3.01	Unemployment insurance	2.62	Job creation	2.38	
Road and bridge construction	2.96	Traffic management	2.91	Aid for hardship families	2.59	Tax management	2.45	
Attracting business and investment	2.87	Management of primary/middle school education	2.91	Medical insurance	2.74	Aid for hardship families	2.47	

Source: Survey conducted by author and Horizon Research Group.

Note: Very satisfied = 4; somewhat satisfied = 3; not very satisfied = 2; very unsatisfied = 1.

When the level of importance people attach to a particular service is correlated with satisfaction with government work, the list is much more closely related to the social and economic problems faced by households (figure 8.4). Areas identified where government work is poor and that urgently need improvement are job creation, unemployment insurance, hardship family relief, medical insurance, public sanitation, medical services, and market management. Family planning and religious belief evoke the highest level of satisfaction and the lowest level of importance. In the 2005 survey, the topics of corruption, social safety, and environmental governance evoke the lowest satisfaction and the highest level of importance, while market management drops out of this category. Among people living in towns and townships, corruption, employment, hardship family relief, unemployment insurance, medical insurance, medical and drug services, and social safety all fall in the category of lowest satisfaction, although they are the items to which citizens attach the highest level of importance.

These findings suggest that citizens want government to concentrate on creating jobs and providing basic guarantees to protect against the shocks of the transition to a market economy. Unemployment and medical insurance are high priorities for all residents.

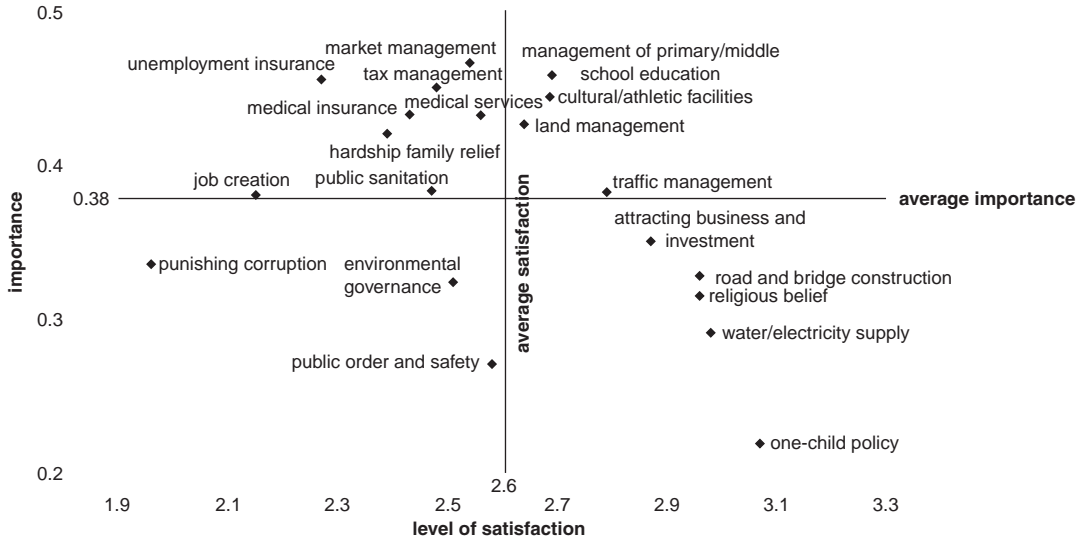
Given that it is unlikely that governments will be able to raise significantly more revenue to finance the provision of public services, it is necessary to reduce costs and focus more clearly on the kinds of services local government can and should provide. The survey reveals that 55.4 percent of respondents in 2005 would not be willing to pay higher taxes in order to receive improved public services; 23.1 percent would be willing to pay more, while 60.2 percent in major municipalities would like to see a reduction in their taxes (up from 44.0 percent in 2003).

Complementing the Role of Urban Government

Local governments alone will not be able to provide the necessary services. To satisfy citizens' needs, government needs to facilitate the further development of alternate service providers and form new partnerships, as noted in chapter 4.

The survey findings highlight a key problem. Generally, citizen satisfaction is highest with the provision of physical infrastructure and lower with the provision of economic and social services that affect households. However, it is precisely physical infrastructure services, such as road and bridge maintenance and the supply of water and electricity,

Figure 8.4. Urban Respondents' Rating of Satisfaction with and Importance of Various Government Functions, 2003



Source: Survey conducted by author and Horizon Research Group.

that can be—and already are—most easily contracted out. They are also the kinds of projects for which more funds are available from higher levels of government.

Citizens view local government as less adept at providing the kind of social support that needs to accompany economic transition. To resolve the problems of service provision, government will have to make more-effective use of the market and not-for-profit organizations. This need by government and the impact of reforms have also led to the need for administrative restructuring in urban areas to deal with new challenges, such as the influx of migrant workers or those laid-off from SOEs.

In recent years, pluralism of service delivery has expanded, with voluntary organizations supplementing state provision of basic services and private education and health institutions expanding. The shift resulted primarily from the adoption of cost recovery as the main principle in determining service provision (Flynn, Holiday, and Wong 2001). China has moved farther down the road of privatization under its slogan of socialization (*shehuihua*) than most OECD countries that have adopted policies to boost the role of markets in service provision. It has shifted from an emphasis on equality in social welfare provision to one based on efficiency and cost recovery, something that the current leadership, under Hu Jintao and Wen Jiabao, is trying to address. Those efforts have resulted in further delegation of responsibility to local governments and communities to provide welfare, as well as an acquiescence regarding the emergence of alternate service providers. Effectively, those who can afford it enjoy greater choice, while others have to make do with reduced services or no help at all beyond the family (Saich 2003, 2006).

A public discussion needs to be pursued regarding the kinds of public goods government should supply and those services that should be treated as private goods that need not be funded out of public revenues. One example of a private good is urban housing. It has been treated as a public good in China, with SOEs and other state agencies providing housing at highly subsidized rates. The privatization of housing should be continued, with the profits raised used to reinvest in low-cost housing.

Individual responsibility and the reduction of state provision have also occurred in education and health care. In these sectors, the picture is more complex, and government must play a more active role. There is much to be gained from market-based provision of services, but change has come mainly by default rather than design. Change has also produced unexpected outcomes, with a clear shift from preventive to curative care.

In part, the shift to more-expensive curative care is understandable, as, with the exception of HIV/AIDS, communicable diseases have declined significantly and earlier immunization programs have been successful. With the population now living longer, the diseases to be confronted are beginning to resemble more closely those of the urbanized and industrialized economies. Better regulation of the health sector is needed, together with adequate government funding for preventive care and support of the poor.

There have been interesting experiments to increase citizen choice and the role of markets with the use of education vouchers. However, unlike in the United States, where experiments have sought to improve accountability by allowing citizens to exert their influence directly on suppliers, experiments in China have used vouchers to deal with the issue of equity in education access by targeting vulnerable groups or sectors of education. This is the case in Changxing County, Zhejiang Province, which introduced education vouchers in May 2001. Vouchers have prevented children there from dropping out of school because of financial reasons, and they have guaranteed full attendance at the primary-school level. Some 40 counties in Zhejiang are now using vouchers, which the provincial education bureau is promoting (Center for Comparative Politics and Economics 2006).

One of the distinctive features of reform has been the expansion of social organizations and civilian not-for-profit institutions (see Saich 2000 and chapter 4 of this volume). By the end of 2006, China had some 192,000 registered social organizations (defined as community groups composed of a social group with common intentions, desires, and interests) (Ministry of Civil Affairs 2007). Many of these organizations (95,263) were registered at the county level (Ministry of Civil Affairs 2006). In addition, enterprises, social groups, and individuals had set up about 700,000 not-for-profit institutions to provide social services. This category includes private schools, hospitals, community service centers, vocational training centers, research institutes, and recreational facilities.

Ambivalence about development of the NGO sector remains. The framework for development remains highly restrictive, but leaders are aware that the next phase of reforms will shrink the role of the state in people's lives even farther. As a result, they prefer that the sector be dominated by organizations in which the government plays a strong role. The state is unable to meet many of the obligations that it claims for itself. In urban areas, the lack of state funding has led to efforts to develop service providers that can mobilize local resources and partner with

nongovernmental organizations (NGOs) and local communities. With greater recognition and acceptance, the role of NGO contributions is increasingly appreciated. In March 2004, Premier Wen Jiabao vowed to turn over responsibility for more activities in which the government should not be engaged to enterprises, NGOs, and intermediary organizations (“NGOs, can become,” 2004).

For alternate service providers to play an effective role, substantial changes must be made in government attitude and practice. Public awareness of the NGO sector and its potential role also needs to increase. The survey results indicate that in 2005, only 36.8 percent of urban residents had heard of NGOs, although 47.5 percent thought that it was appropriate for NGOs to be involved in social welfare work. Without state provision and with an insufficiently developed civil society, increased use of the market to resolve problems is becoming common, not always with positive results. The survey results indicate that 34.6 percent of respondents had no medical coverage in 2005; and there is a marked increase in the use of commercial insurance in one form or another. Although only 13.4 percent of respondents had purchased commercial insurance in 2005 (9.2 percent in 2003), 6.1 percent had jointly purchased such insurance with their employer, and another 38.4 percent (8.6 percent in 2003) had a commercial insurance purchased for them by their employer.

Urban China’s administrative system has been unable to cope with the consequences of the changes that have affected the urban landscape for providing public goods and services. The two most significant changes have been the shedding of social welfare and other obligations by the workplace and the influx of large numbers of migrants into the cities in search of work, as described in chapters 2 and 3. Employees of SOEs, and particularly workers laid off from SOEs in the process of restructuring, have lost many of their benefits and receive inadequate coverage from state institutions. Migrants, as noted in chapter 3, do not receive most benefits and are not effectively integrated into those urban services for which they are eligible.

Given that most services used to be provided through the workplace, the infrastructure of government was relatively weak at the local level, especially below the district. Street Offices and residents committees were not set up to deal with major welfare support or the provision of public goods and services.

Experiments have been conducted to create new organizational forms at the grassroots level that can provide better social infrastructure. The most important is the program of community construction (*shequ jianshe*),

which the Ministry of Civil Affairs (MOCA) has been promoting since the mid-1990s (figure 8.5).⁴ The need to develop a more universal and comprehensive welfare system to replace the fragmented workplace-based system led the ministry to put forward different models of communities for experimentation.⁵ This need for experiment was put forward in November 2000 and was supported by a joint document of the Office of the Chinese Communist Party Central Committee and the Office of the State Council, which called on all government and party committees to set up these new structures. The call was a clear acknowledgment that the old administrative system could not meet the new demands.

The *shequ* were formed out of the residents committees that were under the Street Offices, but they are geographically larger than the old residents committees and have a wider scope of obligations. They are asked explicitly to take over the social welfare tasks that had previously been the domain of the workplace, the residents committees, or the Street Offices. The MOCA favored a model developed in Shenyang, a city that was home to many SOEs and was thus hard hit by the reforms of the mid- to late-1990s.⁶ It was felt that the residents committees were too small to operate effectively and the Street Offices too large to function as effective grassroots organization. The MOCA referred to the new organizations as community residents committees (*shequ jumin weiyuanhui*).

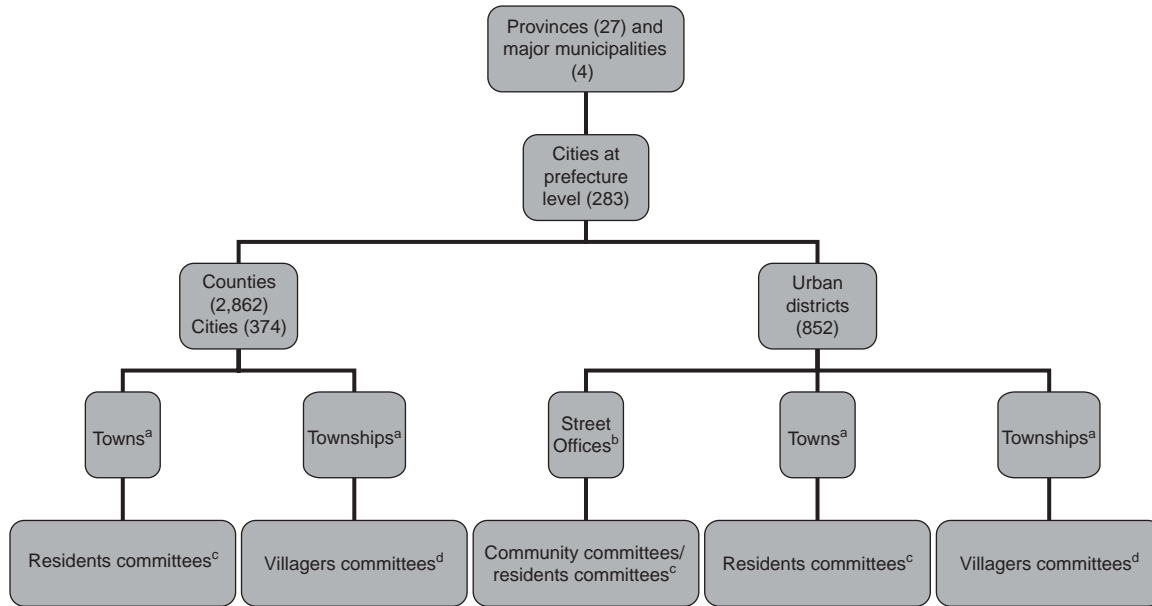
The party has acted to replace one form of collectivity with another, as Bray (2005) notes. Rather than allowing people to interact individually with government and the market, the government has created new organizations to take over the collective aspects of work and service provision that had been provided by the workplace. These organizations, which fall under the authority of the Street Office, are responsible for implementing the state's guarantees to provide minimum support to those in need; taking care of vulnerable populations; managing urban sanitation and health care; enforcing party policy, such as family planning and the maintenance of social stability; and helping with public security work. They are also expected to liaise with other key organizations. While the *shequ* can raise some funds from services it provides, it is essentially dependent on budget appropriations from the Street Office.

4 This account draws on Derleth and Koldyk (2004) and Bray (2005).

5 Eleven communities were originally designated; another 15 were added in 2000.

6 Other models described by Derleth and Koldyk (2004) are the Shanghai, Wuhan, and Qingdao models. The degree of autonomy and control of government and party over the communities varies across models.

Figure 8.5. Organization of Urban Government



Source: NBS 2007.

a. There were 34,673 towns and townships at the end of 2005, comprising 19,522 towns (a decrease of 331 from 2004) and 15,151 townships (a decrease of 2,300). In 2004, 956 towns and townships were merged or cancelled.

b. There were 6,152 Street Offices in 2005, an increase of 248 over 2004.

c. There were 79,947 urban residents committees at the end of 2005, a decrease of 70 from 2004.

d. There were 629,079 villagers committees at the end of 2005, an increase of 3,932 from 2004.

The development of these new organizations has not taken off as planned, in part because the agenda is too ambitious for the staff involved. Most *shequ* have just three to six full-time workers, who are not particularly well paid, and the work is not considered prestigious. In addition, the government expects the organizations to undertake many functions but does not provide the budget for them to do so. In Qingdao, 160 functions of the Street Office are divided among the *shequ*, government-funded service centers, and charitable organizations (Derleth and Koldyk 2004). Bureaucratic inertia is also a factor: urban administrations have a complex set of organizations, which it is difficult to restructure to integrate the *shequ*. As a result, Derleth and Koldyk (2004) conclude that “active” *shequ* are the exception rather than the rule.

Conclusions and Policy Recommendations

With increased burdens inherited through decentralization and new vulnerable populations to deal with in urban areas, most local governments lack the financial capacity to provide the same level of public services provided in the past. Service provision can be maintained only by rethinking the role of the state and its relationship to the market and institutions of civil society. Government needs to move beyond simply raising more revenue, although raising revenue would clearly help. Four main areas of reform would improve local governments’ capacity to deliver more effective public goods and services.

Rethink the Government’s Role in Providing Public Services

Government needs to rethink its role in public service provision, eliminating remaining subsidies and distortions left over from the centrally planned system. Government at all levels needs to complete the transition from being the sole provider of services to being a regulator and coordinator—“steering” rather than “rowing” the boat, as the World Bank says. Government should be the provider of last resort of services for which there is no market or where the market disadvantages specific groups, such as migrant workers or the new urban poor (Moss 2002).

Incentives are needed to encourage local governments to pay greater attention to social development. Local finances should be strengthened at the district level in urban areas and the county level in rural areas to allow better investment decisions to be made and redistributive mechanisms to be developed. The strengthening of local finances would be aided by more

rapid financial development and deepening, as proposed in chapter 5. Transparency of local government work should be increased, to allow better monitoring of performance and to combat the misuse and diversion of resources. Reforms of government functions 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.

The central government needs to provide a framework for the redistribution of resources within society and between different levels of government while ensuring equitable access to public goods and services for all. Currently, the financial system is distorted, with a strong bias toward urban, coastal, and other areas where SOEs are strongly represented. China's investment patterns and fiscal policies have favored the coastal regions at the expense of the interior; formal credit access is highly biased in favor of capital-intensive SOEs, as described in chapter 5; and rural net taxes are regressive.

Focus on a Limited Number of High-Priority Areas

To facilitate more effective resource flows and enhance equity, the central government needs to focus on a limited number of priority areas, as proposed in chapter 1, and then ensure that the financial resources are available to meet its policy objectives. Development practice shows that it is better to deliver results on a smaller number of key tasks than to pursue a long list of policy objectives. Pursuing too broad an agenda dilutes policy impact and makes it easier for local officials to procrastinate and deflect policy intent. Focusing on a few key objectives will make it easier to mobilize resources, set indicators for progress, and hold officials accountable.

Create New Partnerships with Society and the Market

Creating new partnerships will require strengthening the government's regulatory functions and accepting that the market or civil society institutions can perform many development tasks better than the government. Government officials need to recognize that the state is no longer, if it ever was, the sole development actor and that in some areas it may no longer be the most important actor. The emerging mixed economy model for delivering social welfare needs to be legitimized and regulated effectively. In this model, the role of government changes, with less emphasis on direct public financing through taxing and spending and more emphasis on enabling the development of private arrangements that are indirectly

subsidized through tax expenditures and publicly regulated. Public funds can be used to support contracts with voluntary and for-profit organizations for the delivery of social services. Doing so would allow scarce government funds to be deployed on essential services and support that neither the market nor voluntary organizations can provide.

For local governments, reforms should be made in both the financial and administrative structures that would allow for more effective provision of services. Better-targeted central government subsidies should be combined with the restructuring of local government finance (for thoughtful analysis, see Wong 1997). Like many other countries, China has witnessed a de facto transfer of new responsibilities to lower-level authorities without the complementary transfer of the necessary financial resources to carry out these functions. Extrabudgetary and off-budget revenues should be incorporated in a unified transparent budget, with a realignment of expenditure and revenue assignments for the various levels of government.

Reducing the reliance on off-budgetary sources and achieving transparency are long-standing policy objectives; meeting them requires some fresh approaches. One option would be to allow local governments to retain a higher percentage of specific taxes collected to cover education, health, and public infrastructure. The burden of service provision should also be reduced for counties, districts, townships, and villages. For example, provision of social security and unemployment insurance should be shifted to provincial governments (if not the national level), so that the benefits of risk pooling can be attained (World Bank 2002).

Establish Basic Criteria for Evaluating Whether Tasks Should Be Performed by Government or Outsourced

In determining which services government should provide, two basic questions need to be answered (Kennedy School of Government 1995). First, does the task involve the making of public policy or the implementation of policy? Second, is the service a “core” one that must be provided by government (for example, the courts or public security), or could the service (for example, trash collection or providing utilities) easily be provided by the market? If a service does not involve policy making and is not a core function, contracting out to the market or civil society organizations should be considered.

The fiscal and administrative changes noted above would allow governments at all levels to play a more effective role in providing social welfare. However, better incentives have to be provided to encourage local officials to pay more attention to social development. These

reforms should be supported by a better understanding of what kind of services citizens expect from government and how they prioritize them. Government cannot provide all services; it should allow an enhanced role for alternate providers. This process of restructuring would allow China to develop an enabling governing structure that would provide good guidance to further the impressive economic reforms achieved to date.

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