

The Changing Role of Government*

Background Note for the World Bank Report on China's 11th Five Year Plan

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The economic reforms of the last twenty-five years have been accompanied by significant changes in the role of the governing apparatus. These changes are especially clear if the state's current role is compared with that of the Maoist period, when the economy was guided by the central plan overseen by a centralized political and administrative system. Now there is far less direct involvement in the economy and people's lives, new and revamped institutions have been created to deal with law, international trade and a market economy, and the education level of administrators has improved considerably. However, while these changes are considerable, it is still the case that policy-makers are wrestling with what the correct role of the state should be in overseeing an increasingly marketized economy and pluralized society.

Despite differences in cultural and historical background, many of the trends that affect governments worldwide are also having an impact on the Chinese state. These trends are intensified by the rapid move from a centrally planned to an increasingly market influenced economy that necessitates the development of new institutions and approaches to governance. Yet the experience of Russia provides a salutary warning that it is preferable to start, where possible, with existing social and political institutions and to try to stimulate incremental transformation through the judicious use of incentives. The alternative Stiglitz denounces as an 'institutional blitzkrieg' (Stiglitz, 1996); an unregulated and ungoverned market produces chaotic results. Neither is the wholesale privatization of functions a viable strategy. Private monopolies will not necessarily function any better than those that are state-run. What matters is how the competition is regulated, with issues of 'control' more important than issues of 'ownership'.

In contemporary China, we clearly have 'too much' and 'too little' state at the same time. In the area of industrial policy, for example, government is still too interventionist and intrusive in terms of state-led development, whereas the state has absented itself from crucial areas such as rural healthcare provision. In other areas, such as fiscal policy, there is too little capacity and poor direction of the capacity that does exist (for discussion see Saich, 2003).

So how do we get better government performance with reduced resources? This background note provides some suggestions. We focus primarily on government below the provincial level and on the provision of service. It is much clearer what the functions of the national government should be, while local government provides the vast majority of public services. We begin by looking at the factors that have been driving changes in the governing structure. Second, we look at the incentives that shape the behavior of local government in China. Third, we provide some preliminary evidence on how Chinese citizens view government performance. In part four we look at the role of alternate providers that can supplement government work and we conclude with a number of policy recommendations.

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The Changing Shape of Government in China

While the Chinese governmental structure might seem far removed from that of the United Kingdom or New Zealand, the same kinds of pressures experienced by these nations, and resulting in what is termed 'new public management', have begun to affect governance in China. First, a focus on economic liberalization, with governments trying to cede more functions to the market, has combined with a push to diversify state ownership. The state's role has shrunk through devolution and *de facto* privatization while the range of state intervention in the economy has narrowed with policy instruments focusing more on macro-economic controls and less on direct administrative controls. Second, there has been a move to improve the quality of those functions that remain (see Jiang Zemin's report to the Sixteenth Party Congress, 2002). Thus, we see an emphasis on administrative reform of core state functions that seek to cut the size of government bureaucracies while trying to make its agencies more efficient, modern and responsive to citizen demand. This entails extensive experimentation with fields such as budget and financial reform, regulatory reform and customer service initiatives.

The pressures for reform have three main causes: the needs of economic reform and the increased impact of globalization; the impact of the information revolution; and the performance deficit inherited from the Cultural Revolution combined with the increasing demands from citizens for improved accountability and transparency. We shall focus our analysis mainly on the first cause.

The information revolution has not only increased the flow of information available to government and to the public but also has highlighted the distance between its adoption and creative use in the private and public sector. It has offered the potential for e-governance development but while most government agencies now have effective websites little use has been made of the possibilities that would reduce the bureaucratic processes of local government or that would significantly enhance transparency of local government transactions. By contrast the private sector has moved quickly to make use of new technologies to promote business use and customer ease and satisfaction. The information revolution has also set serious challenges for government in terms of information flows. While China, like all countries, wants to take advantage of speeded up information flows for the economy it has concerns about the flow of certain political and other types of information. New information technology makes control more difficult and contradicts China's traditional system of information flow that is hierarchical, vertically organized and cellular. New information flows are more egalitarian and thus can be shared more equitably and flow horizontally rather than vertically. The initial, poor information flows from the government during SARS in 2003 showed how the traditional system can become dysfunctional (see Saich, forthcoming). New information technology de-territorializes policy providing a challenge to China's government that is rooted in fixed ideas of location such as land rights, collectives, the workplace (*danwei*) and household registration (*hukou*).

Across much of the world citizens have become disillusioned about the capacity of government to resolve their problems (see Nye, Zelikow, and King, 1997), while citizen expectation about what government should do has continued to rise. When

economic reform began in 1978, China's leaders inherited a government system that was dysfunctional and in serious need of overhaul. There have been serious attempts to reduce the overbearing nature of government intervention not only in the economy but also in society, resulting in far greater individual freedoms. This has also resulted in the devolution of some government functions to the market or to the fledgling institutions of civil society. This is important as generally those political systems that develop better collaborations between local government and community organizations tend to deal better with progress in health, education, poverty alleviation and equity. There have also been significant attempts to enhance government accountability, the most remarked aspect of which has been the introduction and consolidation of the program for village elections.

The main driving force for change has been economic reform compounded in the 1990s by China's increasing integration into the world economy and the pressures that stem from global competition. China's entry into the WTO actually represents an internationalization of the entire reform process that has political and administrative consequences as well as purely economic ones. WTO regulations contain requirements that will have a significant impact on the nature of governance in China and presume a certain set of political arrangements that facilitate a market economy, including an impartial and independent judicial system to mediate disputes. The accession therefore harbors implications regarding the structure of the government, the authority of sub-central governments, licensing procedures and the administration of the trade regime. Under the stewardship of former Premier Zhu Rongji the State Council reviewed 756 administrative statutes promulgated by the end of 2000, nullified 71 and declared 80 others to be no longer in effect. The review also abolished 830 foreign-related regulations and policies and revised 325 others (see Zhu, 2003).

In 1978, before reforms began, the state controlled almost all of the output from the service sector; 94.4 percent of agricultural production and 97.5 percent of industrial production was sold at state-fixed prices (UNDP, 1999, 20-21). There was no notion of an independent financial or banking sector but rather they simply acted as the state's cashier, providing finance for state directed development projects. The situation has changed dramatically with major consequences for governance and the role of the state. The degree of market reliance has risen from 25 percent in 1979 to 63 percent in 1992 before the more dramatic reforms of the 1990s (UNDP, 1999, 39). By 1999, Professor Hu Angang estimated the degree of marketization to be almost 80 percent (personal communication). The non-state sector has experienced rapid growth and now constitutes 75 percent of industrial output, as opposed to 22.4 percent in 1978. In particular the domestic private sector (23.52 percent) and the foreign sector (15.92 percent) now account for 40 percent of industrial output, the remainder coming from the collective sector (Saich, 2004). The People's Bank of China has estimated that by the end of 1998, the private sector contributed 43 percent of GDP, 48 percent of employment and 31 percent of fixed asset investment.¹ The Chinese economy is now for all intents and purposes a mixed economy.

Despite these changes, government policies and organizational structure still do not reflect a governance approach appropriate for a mixed economy. There is still much

¹ Presentation to the conference 'Economic and Enterprise Reform in China: The Challenges for Government and Business', Wilton Park, England, November, 2001.

work to be done if government practice is to shift from 'rowing' to 'steering' future development (World Bank, 1997, 164). Preferential policies for the state-owned sector continue, there is progress in but continuing bias against the private sector, and the administrative structure cleaves too closely to that of the pre-reform era. One clear example is with credit policy, where banks essentially exist to fund SOEs that collectively receive 70 percent of bank lending.

Many observers expected that with the expansion of the market in transitional economies, the role of the state would decline. However, this has not been the case and reform has brought with it state expansion into new areas while old functions have not necessarily been terminated. In fact, a withering away of the state may not be the most suitable approach. One of the primary problems in post-communist Russia has been the lack of an effective state apparatus to guide the process of market transition. A market economy without effective rules and regulations and supported by an effective judicial apparatus results in an anarchic free for all.

First and foremost an effective, as distinct from strong, state structure is a precondition for any hope of successful reform. Certainly, the role of the state in the economy will change with a narrower set of interventions and less direct administrative interference. However, an increase in state capacity is prerequisite for an effective market to function (Polanyi, 1944). The state must adjudicate the increasingly contentious nature of economic market transactions. This means that it is the obligation of the state to establish a sound legal system. In addition, the state must manage the key macroeconomic variables and ensure that economic and investment policy is not distorted by price fixing or subsidy supports that have outlived their rational lifetime. It must deal with revenue collection and distribution, and this will help the state to provide minimum social services and welfare guarantees to protect those who are vulnerable in the shift to a market economy (World Bank, 1997, 4-5).

Far from making governance easier, the shift to less administrative interference and curtailing the direct provision and administration of services makes the process more complex. The Chinese state has added to its old monopoly functions new regulatory roles that are broader and more complex than before and that will become more complex as China further eases its way into the WTO. The Chinese government needs to dismantle old ministries and organizations and adapt the roles of others while creating new ones to serve the needs of a post-WTO entry world.

Most current administrators are less familiar in a role where they would act as an indirect provider or a regulator. These new roles will require them to acquire additional skills and capacities to manage within a markedly different administrative framework. Pension reform is a good example of the fundamental challenges of such change. The government wishes to shift responsibility for pensions of the privileged sector of the working-class from state owned enterprises to the government through a system of local collection, pooling and disbursement. Many local administrations lack the skills to manage these funds effectively and with insufficient transparency and regulation many have simply used pension funds as state assets to be invested in their pet development schemes. This is just one small example of the new kinds of skills that have to be acquired by government officials to make the new system of governance effective. Given such problems of adjustment, it is little wonder that administrative reform is resisted and

that many ministries prefer to cleave to well understood tasks and roles rather than to adapt to the new.

These trends have resulted in a change in governing capabilities, in the forms and mechanisms of governance and in the style of governance. The powers of government have been redistributed both vertically and horizontally. Vertically, some powers have been redistributed from the national government to international organizations such as the WTO, while at the same time responsibility for most public service provision has been decentralized from the national government to local governments. International markets and the decisions of international business conglomerates have also diluted the power of national governments. Horizontally, we have seen increasing numbers of government services contracted out to the private sector (both for-profit and not-for-profit). In general there is a shift from old 'command and control' forms of regulation to those characterized by contracts and covenants between public and private actors and to information management.

In turn, this creates a more complex set of government relationships, sometimes referred to as 'networked government', where decisions are made within complicated relationships with pluri-centric forms of governance. This provides a major governance challenge as states are organized in terms of hierarchy whereas markets are horizontal and multi-centric. To manage this evolving environment China will need to develop new, relatively independent regulatory bodies to oversee privatized sectors, especially for private natural monopolies such as energy supply, water, railroads, telecom, air transport, and broadcasting. Service delivery will need to be more customer focused and guided by cost effectiveness than in the past. Thus the government, while directly responsible for public policy-making, will seek to provide and deliver public services more indirectly.

Incentives Affecting Local Government Behavior

As the main providers of public services, local government and sub-provincial levels of government in China have expenditure responsibilities that are quite out of line with international practice (World Bank, 2002, ii). However, political incentives and the demands of higher level government agencies are also important in understanding local government performance.

As an inheritance of the Soviet fiscal system, local government in China has always provided the bulk 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, 11). In fact, with the introduction of fiscal contracts in 1988, the Central government formally ended its responsibility for financing local expenditures and expanded the role of local government from simply providing services to also financing them. This de-linked expenditure assignments from revenue sharing considerations, later regularized in the Budget Law (World Bank, 2002). The local level of government retains the major responsibility for financing infrastructure and providing social welfare.

One emerging general imperative shared by economically developed and more resource constrained localities is the increasingly acute need to derive one's own sources of revenue. The resultant fiscal inequalities that arise from this system have led to enormous inequality in the provision of public goods and services. At the same time,

popular expectations and those of higher administrative levels about the range and kinds of services that 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 for distributional and welfare priorities to be disfavored. The main concern of government at all levels is how to increase revenues rather than thinking about 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 the accounts of localities avoiding or deflecting central policy are many, the Center still sets many tasks that must be carried out and imposes burdens to be met. Most of these are unfunded mandates. For example, funding for health and education are overwhelmingly a responsibility of lower level governments. An Asian Development Bank survey of five counties in Guizhou and Shandong revealed that between 40 and 45 percent of the total outlays went to social services, by far the largest category (Wong, 1997, 170-73). Cities at the prefecture and county levels should cover all expenditures on unemployment insurance, social security and welfare, whereas in most other countries the central government will cover social security and welfare with education and health shared between the localities and the center.

The expenditure responsibilities for townships are similar, although they often have a weaker financial base and they carry the heaviest load for social spending. The county and the township together account for 70 percent of budgetary expenditures for education and 55 to 60 percent for health (World Bank, 2002, 34, 94 and 111). In Xiangyang County, Hubei, budgetary contributions to education finance amount to 40.6 percent of the total expenditure. Of the government contribution, the township provides 84.6 percent and the county 15.2 percent, the remainder coming from the province (Han, 2003, 12). 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, 174). This drives village leadership and the township to seek various off-budget revenues from user fees and other unsanctioned levies to support these activities. For example, in three counties surveyed by the Development Research Center of the State Council, expenditures exceeded revenue and this was increasing the need to raise even more off-budget revenue (Han, 2003). Nationwide, extra-budgetary funds may total 20 percent of GDP while in the three counties surveyed they ranged from 30 percent of total income (Xiangyang, Hubei) to 69 percent (Taihe, Jiangxi). The use of these extra-budgetary funds and self-raised funds (*zichou zijin*) has clearly been increasing and the 1994 tax reforms have heightened the problem. For example, the value added tax is split 75-25 between the Center and the localities. Prior to the reform Guizhou province had derived fully 45 percent of its revenue from liquor and tobacco. Much of this revenue now accrues to the Center.

In particular the financial pressures have led to a policy to expand township and village enterprises as a first priority as these are seen as the most stable sources for local income. This is the case irrespective of whether the locality concerned is relatively wealthy or poor. In addition to the change in fiscal stimulus, decollectivization and the return to a

household based farming system removed agriculture as a source of viable financing for local governments (Oi, 1992, 115). It has led many inland counties to try to ape the coastal areas in setting up similar kinds of industries irrespective of considerations of whether there is the necessary skilled labour force, a sufficient infrastructure and a market for the product itself.

Such phenomena are even more noticeable in the poorer areas. As Albert Park and his colleagues have noted ‘heightened pressures on revenue starved local governments may lead to over investment in revenue generating industrial enterprises, encouraged bureaucratic predation of enterprise resources and regional protectionism, and diverted attention away from long-term development strategies’ (Park et al, 1996, 751-752).² Deficit provinces and counties have also suffered from the decline in the fiscal transfers from the central state, something that the 1994 reforms were designed to reverse.

This lack of long-term strategic thinking by local governments and a focus on short-term revenue generation is also encouraged by the political contracting system. We need to understand far more about the political demands that are placed on local officials by their superior agencies to complete our picture of the forces shaping local government. In some areas reforms have clearly led to local officials enjoying greater financial freedom from higher levels and afforded them less dependence on higher level approval for career advancement and economic reward. However, it is clear that with the appointment system most officials are dependent on the approval of their superiors for career advancement. The work of a number of researchers has argued persuasively that we need to complement a pure political economy approach that views state agents as revenue maximizers with an understanding of the political incentives generated by the cadre responsibility system, the political contracting system and the performance contracts (*gangwei mubiao zeren shu*) that govern the work of local governments and officials (Edin, 2000; Whiting, 1999; and Rong et al, 1998).

Performance contracts do not discourage economic development, far from it, but make it clear that this is just one part of a complex set of tasks that local officials are required to carry out including maintaining social order, delivering taxes to higher levels of government, and maintaining birth control quotas.³ There are multiple principle-agent relationships operating between different levels of government. These 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 township governments to provide comprehensive development. One set of Chinese researchers has even referred to the responsibilities of the townships being ‘dismembered’ by the county. Most township government agencies sign contracts or receive targets from the county-level thus undermining the township’s capacity to co-ordinate work. Administrative power within the township does not reside with the township (Li, Wang and Tang, 1985,

² Their conclusions were based on research in a county without a financial surplus situated Shaanxi province. The province itself has consistently run fiscal deficits exceeding 20 percent of expenditures making local governments increasingly self-reliant in terms of meeting expenditure responsibilities.

³ Contracts are usually for one, three or five years. The higher level decides on political and economic rewards and penalties for organizations and individuals at the lower levels dependent on how well they have completed the tasks. It is rare to use financial penalties for officials at the township level as their salaries are considered too low. However, a failure to meet priority targets will lead to demerits on file, possible transfer and certainly to future financial gains forgone.

5). 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. 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, 115-116). The resultant system has been called a 'pressurised system' (*yalixing tizhi*). This is defined as the 'management mode of dividing up tasks and the system of conducting assessment by giving material awards adopted by the political organization at the county or township level in order to develop the economy and attain the targets set by the higher authorities' (Rong et al, 1998, 269-70).

Targets are divided into a mixture of priority, hard and soft. Priority targets are set nationwide and usually are more political or policy oriented in nature, including, for example, the maintenance of social order and of course meeting the targets for family planning quotas. Hard targets primarily concern economic outputs set by the county for the township, including meeting tax revenues and attaining predetermined growth levels. In particular, counties are required to catch up with and outperform other counties and this is reflected in targets set for lower levels. In practice, this means setting economic targets that exceed those of the national or provincial plans and targets are set to encourage counties to compete in terms of GDP growth. Soft targets tend to cover social development such as health and education provision and the concern for environmental protection. Clearly meeting hard and priority targets are critical, as failure will mean that success elsewhere will be discounted and there will be no promotions, titles or economic rewards distributed.

Such a 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 percent of their energy and 70 percent of their time on 'the most disliked' administrative affairs (Li, 1994). Not only is the contract focused on quantitative targets but also on the speed of task completion. This means that less attention is paid to quality of the finished product, as this is not rewarded sufficiently. This encourages shoddy building and infrastructure that has been a 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 the statistics that are reported upwards to match the set targets and even to report figures that exceed the targets. Distorted reporting is best combined with the cultivation of good social and political relations with one's superiors who will carry out the evaluation. 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.

However, such a system does offer the potential for refocusing incentives should the leadership so desire. At the national level, the government has established a set of sixteen indicators by which it will measure its progress toward the target of building a comfortable society (*xiaokang shehui*) by 2020. These indicators are broader than the usual economic indicators that China uses to measure progress. Thus, for example, education expenditure as a percentage of GDP is expected to rise from 2.3 percent of

GDP in 2002 to 4.5 percent by 2020; life expectancy to rise from 71.8 years to 74; and the number of doctors per 1000 population to rise from 1.6 to 2.5. Whether these targets can be attained is open to debate but such indicators are important in alerting officials to the fact that their future work performance may not be judged solely on GDP growth, the ability to maintain social order and keep population growth under control alone.

A new nationwide performance appraisal system is being developed that has been tested in Qingdao, Shandong province. The system tries consciously 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. The assessment will comprise evaluation of 33 items that will review performance, influence and potential. In addition to evaluating economic performance the criteria will also look at the impact of policy on the environment and how well the market is regulated (*People's Daily Online*, '33 Indexes Evaluate Government Performance', August 2, 2004).

Citizen Attitudes Toward Government

To date, the main approach to resolving the challenges of local government service provision suggested by both the World Bank and the Chinese government has been to improve the revenue stream. In addition to adjusting incentives for officials, this is important but insufficient. There needs to be a thorough re-think about the role of government in providing services and what kinds of partnerships can be formed to meet policy objectives. 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 operates 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 the countryside, or providing some minimum funding guarantees to families in distress. These are laudable goals but are essentially unfunded mandates with the burden of implementation falling on local governments. As we have seen, local governments have neither the finances nor sufficient incentives to implement such policy directives effectively. As the Chinese saying goes 'the Central hosts the banquet, the Local foots the bill' (Cheng, 1995, 72).

It might be beneficial to consider also the demand side of the equation, more specifically what do citizens think about government in general, about the provision of particular public goods by local governments and how do they prioritize different needs. To answer these questions we conducted a nationwide survey together with Horizon Research Group to understand which areas of government service citizens approved of and which frustrated them. Importantly, we devised a simple matrix that correlated the level of importance citizens attached to certain services with the level of satisfaction with local government service provision (**Figure 1**).

Interestingly, citizen satisfaction with government declines the lower one moves down the institutional hierarchy (**Figures 2a, 2b**). This is important as 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, March 1998), indicating that people feel that they have greater control over the decisions of local government and may

be able to influence local policy and resource allocation. In China, local governments provide almost all public services and the fact that satisfaction levels decline as one gets closer to the people is a worrying sign. Those who reported that they were ‘very satisfied’ with government service and performance comprised 86.1 percent for the national government (with a satisfaction index of 3.16), dropping to 75 percent (2.89) for the provincial level, 52.0 percent for the county (2.54) and down to only 43.6 percent (2.32) for the township level. Satisfaction drops dramatically as one gets closer to where people have daily interactions with government. While the central government proclaims many policies to improve public service provision, it is the county and the township that has to fund and provide the service.

Similar concerns exist with citizens’ attitudes to governing ability and style of governance. Thus, while 50.8 percent of respondents deemed local government ability very competent (21.5 percent deemed it incompetent) (**Figure 3**), we see satisfaction dropping the closer one gets to the people. The view that government is very competent drops from 64 percent in major municipalities to 43.9 percent in townships and counties, while rising slightly to 47.3 percent for village officials. As for governing style, 39.1 percent feel that local officials are friendly while 38.9 percent feel that the style of local government is cool and indifferent (**Figure 4**). Again these figures vary depending on the level of government. While 50 percent feel that governing style in major municipalities is friendly (33.1 percent cool and indifferent), this drops to 35 percent in the townships and counties and 35.8 percent in the villages while the view that the style is indifferent rises to 39.5 and 40.9 percent respectively.

Citizen satisfaction with the provision of certain public services also reveals some interesting insights that are helpful for thinking about the changing role of government. The five areas of local government work that received the highest ratings were: traffic management, religious belief, road and bridge construction, water and electricity supply and the one child policy (**Figure 5**). However, it is worth pointing out that, with the exception of the one child policy, even these services did not attain a rating of ‘somewhat satisfied’. Three of these services relate to the provision of physical infrastructure while few relate to pressing social policy concerns. There is not much variation across different levels of government, with the exception of public order and safety that ranks second in the villages. By contrast, the five areas of government work that caused the greatest dissatisfaction were: dealing with corruption, job creation, unemployment insurance, tax management, and hardship family relief (**Figure 6**). These relate much more directly to household economic and social concerns. Again there is no significant variation across government levels with the exception of medical insurance for municipalities and tax management that is an issue in both the townships and villages. These two variations are not surprising as outside of major municipalities very few people have medical insurance while there are many instances of local governments raising illegal taxes and levies to cover their costs (over 70 percent of which on average goes into covering officials’ wages).

When we apply the matrix to correlate the level of importance people attach to a particular service with satisfaction with government work we get a list that is much more closely related to the social and economic problems faced by households. Areas identified where government work is poor and that urgently need improvement are: job creation, unemployment insurance, hardship family relief, medical insurance and public

sanitation (**Figure 7**). We also find that the ‘one child policy’ that enjoys the highest level of satisfaction has the lowest level of importance attached to it. Again there is some variation between major municipalities and townships and villages but the trend is the same.

This would suggest that the areas of work citizens really wish government to concentrate on are job creation and providing basic guarantees to protect against the shocks of the transition to a market economy. Labor 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 meet objectives by reducing costs and focusing more clearly on the kinds of services local government can and should provide. In fact, the survey reveals that 54.8 percent of the respondents would not be willing to pay increased taxes in order to receive improved public services and 44 percent in major municipalities and 57.8 percent in villages would like to see a reduction in their taxes. Taxes and fees for those in the municipalities accounted for 4.9 percent of family income while it was 6 percent for those in the villages (exceeding government guidelines).

Complementing the Role of Government

To satisfy citizens’ needs, government will have to facilitate the further development of alternate service providers and form new partnerships. Local governments alone will not be able to provide the necessary services. The survey reveals one further problem. Generally, citizen satisfaction is highest with the provision of physical infrastructure and less so with the provision of economic and social services that have impact on the household. However, it is precisely physical infrastructure services such as road and bridge maintenance and the supply of water and electricity that can be, and already are, most easily contracted out. Citizens view local government as less adept at providing the kind of social support that needs to accompany the 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. In recent years pluralism of service delivery has expanded with voluntary organizations supplementing state provision of basic services and with the expansion of private education and health institutions. The shift primarily resulted from the adoption of cost recovery as the main principle in determining service provision (Flynn, Holiday, and Wong, 2001, 9). 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 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 get by with reduced services or with no help at all beyond the family (see Saich 2003a and Saich, forthcoming a).

To facilitate better use of the market and institutions of civil society, a discussion must be pursued regarding the kinds of public goods government should supply and those services that should be treated as a private good that need not be funded out of public

revenues. One illustrative example of the latter is urban housing, which has been treated as a public good and offered at highly subsidized rates by state-owned enterprises and other state agencies. The privatization of housing should be continued with profits raised used to reinvest in low-cost housing. Individual responsibility and the reduction of state provision have also occurred in the realm of healthcare. However, in such sectors, the picture is more complex and government must play a more active role. There is much to be gained from marketization of services but change has come mainly by default rather than by design. Change has also produced unexpected outcomes with a precipitous decline in rural health care provision and a clear shift from preventive to curative care. In part this 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 urban, industrialized West. What is needed is better regulation of the health sector combined with adequate government financing for curative care and for poor areas.

One of the distinctive features of reform has been the expansion of non-government organizations (social organizations) and civilian not-for profit institutions (see Saich, 2000). By the end of 2002, there were some 133,357 registered social organizations, defined as a community entities composed of a certain social group with common intention, desires and interests (Ministry of Civil Affairs, 2003, 132). 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, 26). This category includes private schools, hospitals, community service centers, vocational training centers, research institutes and recreational facilities (Meng, 2002, 10).

However, ambivalence about development of the 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 further. As a result, they prefer the sector be dominated by organizations in which the government plays a strong role. Yet 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 is eligible for welfare benefits and support from their workplace or the Ministry of Civil Affairs. But, even in the 1980s, only 3 percent of people with disabilities received state support, while 67 percent were dependent on their families for basic subsistence (Zhong, 2001). In urban areas the lack of state funding has led to efforts to develop service providers that can mobilize local resources and partner with non-governmental organizations (NGO) and local communities. Non-government funds are of increasing importance and an expanding number of NGO-run projects have emerged. The China Foundation for Aiding Poor Areas (CFAPA) has calculated that in the late-1990s between 18 and 28 percent of funds for poverty alleviation came from the not-for-profit sector (information from participants in October 2001 conference). Since its establishment in 1989, the CFAPA is reported to have 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). The China Youth Development Foundation set up by the Communist Youth League has played a similar role in providing education for poor children primarily in rural areas.

With greater recognition and acceptance, the role of NGO contributions is increasingly appreciated. 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). More recently, Premier Wen Jiabao vowed to turn over to enterprises, NGOs and intermediary organizations responsibility for more activities in which the government should not be engaged (*China Daily*, English edition, March 13-14, 2004).

For alternate service providers to play a sufficiently effective role there must be a number of substantial changes made in government attitude and practice. There seems to be emerging citizen support and understanding of the sector. In our 2003 survey 56.9 percent of respondents replied that they felt that it was appropriate for NGOs to provide social welfare while only 21.5 percent thought it inappropriate. Absent state provision, increased use of the market to resolve problems is becoming commonplace, not always with positive results. Thus we see that fully 75.4 percent of the respondents had no medical insurance coverage, with the corresponding statistic rising to 88.3 percent in the villages. Yet we also see latent demand for market based services. While 9.7 percent of families with children enrolled in school were in private schools, 20.4 percent of respondents said that they would enroll their child in a private school if one were to be available.

The current ambivalence about the NGO sector and the need to register first with a sponsoring agency favors larger organizations, many of which have been set up by government itself. This preference for the larger quasi-official organizations is reflected in the regulations on social organizations that stipulate that 'similar' organizations are not allowed to co-exist at the various administrative levels. As a result, the emergence of smaller, community-based organizations that could play a valuable role in identifying and responding to social needs 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 China's preference for top-down assessment, consultation and implementation. An enabling environment is necessary that supports a more diverse NGO sector and that allows the sector 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. Yet even without this official encouragement, community-based organizations are developing and it is clear that alternate providers are emerging to take over functions that were previously considered the preserve of government. Consequently, it would be beneficial for the government to engage more actively in providing an effective enabling environment for the sector.

Conclusions and Policy Recommendations

Neither central nor local government has the financial capacity to provide the same level of public service provision as in the past. This can only be achieved by rethinking the role of the state and its relationship to the market and institutions of civil society. Government needs to do more than raise more revenue, although this clearly would help. First, it needs to re-think substantially its role in public service provision, eliminating the 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. It should be the provider of last resort for those services for which there is no market or where the market disadvantages specific groups such as the rural poor (see Moss, 2002). Incentives are needed to encourage local governments to pay greater attention to social development. Local finances should be concentrated at the county level to allow better investment decisions to be made and redistributive mechanisms to be developed. 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 allow better monitoring of local government performance and combat the diversion of resources that can be used for the public good. 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 functions of central government are fairly clear (see various World Bank publications, especially World Bank, 1997). With the devolution of responsibility for public service provision and horizontal and vertical realignments taking place, Central government should concentrate on ensuring that the basic macroeconomics are sound. It should refrain from interference in micromanaging the economy. In some areas, such as industrial policy this will mean doing less and doing what it does do in different ways through indirect mechanisms rather than direct intervention.

Of course, the Central government should manage certain basic tasks such as defense, foreign policy and the negotiation of international agreements. Most importantly, the Central government needs to sponsor a debate on the future nature of Chinese state and society relations to enable it to provide better strategic leadership. This will allow it to set policy direction in a number of key areas. First, it will need to provide a framework for the redistribution of resources within society and between different levels of government while ensuring equitable access for all. There will be considerable differences of opinion on this but this debate needs to be coordinated by the national leadership. Currently, the financial system is distorted with a strong bias towards the urban, coastal and already wealthy areas. 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, and rural net taxes are highly regressive.

Second, to facilitate more effective resource flows and to enhance equity, Central government needs to focus on a limited number of priority areas and then ensure that the financial resources are available to meet policy objectives. Currently, Central government sets too many unfunded mandates that local governments cannot implement. Development practice shows that it is better to concentrate on a smaller number of key tasks rather than setting out a long list of policy objectives. The latter approach dilutes policy impact and makes it easier for local officials to procrastinate and deflect policy intent. By focusing on a few key objectives it will be easier to mobilize resources, set indicators for progress and hold local officials accountable. For many functions, the government should only be the provider of last resort. The provision of basic rural healthcare and education should be a key focus not only for policy but also for the provision of adequate financial resources. It is impossible for the government to extend the support and benefits available to the urban elite to society as a whole. The

government will not have the fiscal capacity in the foreseeable future to adopt a model based on government delivery of an expanding range of social benefits under a system of broad-based entitlements. The government should develop public support for private responsibility (see Gilbert, 2002).

Third, Central government needs to set out a framework that will encourage new creative partnerships to flourish between government, society and market to help meet development objectives. This will require strengthening the government's regulatory functions and accepting that many development tasks can be met better by the market or by the institutions of civil society. 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. Government will play a more diverse role 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 are publicly regulated. Public funds can be used to support contracts with voluntary and for-profit organizations for the delivery of social services. This will allow scarce government funds to be deployed for the provision of essential services and support that neither the market nor voluntary organizations can provide.

For local government, reforms should be made both in the financial and administrative structures that would allow for more effective provision of services. A better focus for Central government subsidies should be combined with restructuring local government finance (for thoughtful analysis see Wong, Heady, and Woo, 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 complementary 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, 325), rural finance should be unified at one level, preferably the county level, as in most of China the township is too small to be redistributive. This would make planning more effective and would allow the central authorities to provide a sufficient revenue base to carry out those functions that it deems essential. In the mid-1990s, more than half of the approximately 2000 counties in China could not meet their expenditure requirements from the revenues they derived (West and Wong, in Wong, 1997, 285). In three counties surveyed by the Development Research Center of the State Council debts in the year 2000 ranged from 47.64 million to 79.4 million *yuan* (Han, 2003). The situation is even worse at the township level. One survey of 81 counties nationwide revealed that the average debt of each township was 10.9 million *yuan* within a lower budget figure bringing them to the brink of bankruptcy (Liu, 2000, 74).

Villages need to be provided with adequate budgets to prevent further increase in charging illegal fees and fines on farmers. Extra budgetary 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. 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, townships and villages. For example, social security and unemployment insurance provision should be shifted to provincial government (if not the

national level) so that the benefits of risk pooling could be attained (see World Bank, 2002, 27, 41 and *passim*).

Local government in China is too large and overstaffed. Overstaffing results in higher administrative expenses that further undermine government capacity to provide adequate services. Not only do many localities have difficulty in paying direct staff costs but also in meeting the wage bills for teachers and medical workers. Many have suggested that local dissatisfaction 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. A late-1990s national survey revealed that financial revenues covered only 60 percent of the salaries in a medium-sized county with a population of around half a million and with 5000 administrative staff. Thirty percent had to raise their salaries themselves and 10 percent did so by fining farmers directly. The situation is even worse at the township level (40 000 population with 100 staff) with 35 percent of the staff covering salary from direct levies on the farmers (Guo, 1998, 34-35).

The rapid expansion of township government is 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, 22 and Liu, 2000, 74). The number of departments and offices has risen from around 40 to 80 (*South China Morning Post*, 1 November 2001, internet edition, www.scmp.com). The agencies that are expanding most rapidly are those that can bring in extra-budgetary funds such as health facilities that can charge fees, family planning agencies and public security organs that can levy fines and fees. This situation has led to calls to abolish the township as a level of government or to raise the level of direct elections from the village to the township (interviews with government officials and scholars, Beijing, May-June 2002). Townships do not need to maintain the full governmental apparatus of staffed line agencies and the people's congress and people's political consultative congress systems. If the township was abolished as a formal level of government, the county could retain and oversee administrative offices for necessary, clearly defined services.

Finally, there should be some basic criteria for evaluating whether tasks should be performed by government or tasked out. Obviously, in practice there can be considerable variation from locality to locality. Two basic questions can be asked (Kennedy School of Government, 1995, 2). Does the task involve the making of public policy or the implementation of policy? Is the service a 'core' one that must be provided by government (*e.g.* the courts or public security) or a service function (*e.g.* trash collection or providing utilities) that could easily be provided by the market? If a service does not involve policy-making and is not a 'core' function then it should be considered for contracting out to the market or civil society organizations.

The fiscal and administrative changes noted above would allow governments at all levels to play a more effective role in providing social welfare. Concentrating finances at the county level would permit more effective funding decisions on public service provision and provide a more effective geographic unit for redistribution. Reduction in staffing levels, especially at the township level (even its possible abolition as a formal level of government) would lift the financial burden on the local government and community. 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

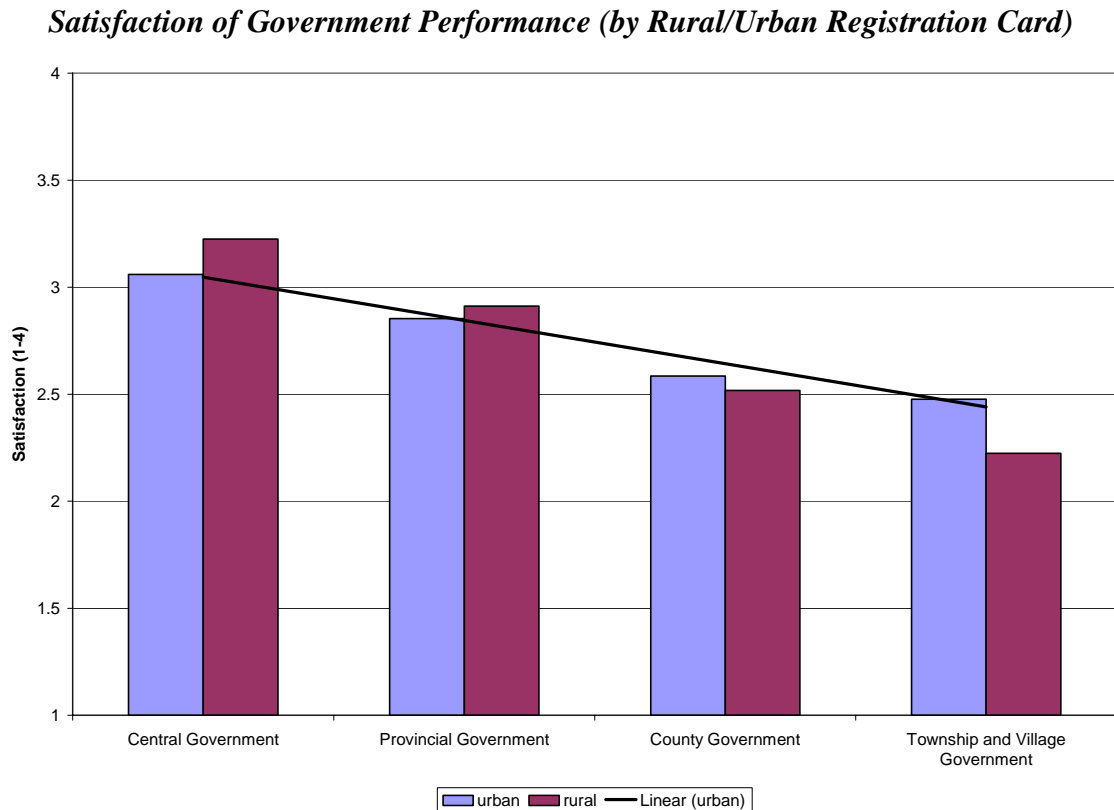
better understanding of what kind of services citizens expect from the government and how they prioritize them. Government cannot provide all services and they should allow an enhanced role for alternate providers. This process of restructuring would allow China to develop an enabling governing structure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

TABLES

Figure 1.

Government Service Satisfaction/Importance Matrix Template

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

Figure 2a.**Figure 2b.**

Chinese Resident Satisfaction with Government Service and Performance
(Comparison by government level)

	Central government	Provincial government	County government	Township government
Percentage of residents reporting a high level of satisfaction	86.1%	75.0%	52.0%	43.6%
Satisfaction index	3.16	2.89	2.54	2.32

Note: The “high level of satisfaction” category includes both those who responded with “very satisfied” and “somewhat satisfied.” The satisfaction index was measured according to the following scale: an answer of “very satisfied” received a rating of 4, “somewhat satisfied” a rating of 3, “not very satisfied” a rating of 2, and “very unsatisfied” a rating of 1.

Source: Horizon Research Group Survey, p. 3

Figure 3.*Chinese Resident Impression of Local Governing Ability*

	Number of respondents	%
Incompetent	851	21.5
Very competent	2015	50.8
Not stated	70	1.8
Undecided	1031	26.0
Total	3967	100.0

Source: Horizon Research Group Survey, p. 40

Figure 4.***Chinese Resident Impression of Local Governing Style***

	Number of respondents	%
Cool and indifferent	1543	38.9
Warm and friendly	1550	39.1
Not stated	52	1.3
Undecided	822	20.7
Total	3967	100.0

Source: Horizon Research Group Survey, p. 39

Figure 5.

***Government Service Categories Receiving the Five Highest Satisfaction Ratings
for Quality of Service and Management***

(Comparison by type of location)

City		Town		Village		Total respondents	
Government service	Satisfaction index	Government service	Satisfaction index	Government service	Satisfaction index	Government service	Satisfaction index
One Child Policy	3.07	One Child Policy	2.99	One Child Policy	2.95	One Child Policy	2.98
Water/ electricity supply	2.98	Water/ electricity supply	2.94	Public order and safety	2.72	Water/ electricity supply	2.81
Religious belief	2.96	Road and bridge construction	2.9	Water/ electricity supply	2.71	Road and bridge construction	2.77
Road and bridge construction	2.96	Traffic management	2.85	Traffic management	2.67	Religious belief	2.73
Attracting business and investment	2.87	Management of primary/ middle school education	2.81	Road and bridge construction	2.66	Traffic management	2.72

Note: The index uses the following scale: an answer of “very satisfied” received a rating of 4, “somewhat satisfied” a rating of 3, “not very satisfied” a rating of 2, and “very unsatisfied” a rating of 1.

Source: Horizon Research Group Survey, 2003, p. 46

Figure 6.

***Government Service Categories Receiving the Five Lowest Satisfaction Ratings
for Quality of Service and Management***

(Comparison by type of location)

City		Town		Village		Total respondents	
Government service	Satisfaction index	Government service	Satisfaction index	Government service	Satisfaction index	Government service	Satisfaction index
Punishing corruption	1.96	Punishing corruption	2.09	Punishing corruption	1.98	Punishing corruption	1.99
Job creation	2.15	Job creation	2.28	Unemployment insurance	2.25	Job creation	2.25
Unemployment insurance	2.27	Unemployment insurance	2.32	Job creation	2.29	Unemployment insurance	2.27
Hardship family relief	2.39	Tax management	2.45	Tax management	2.3	Tax management	2.36
Medical insurance	2.43	Hardship family relief	2.47	Hardship family relief	2.35	Hardship family relief	2.38

Note: The index uses the following scale: an answer of “very satisfied” received a rating of 4, “somewhat satisfied” a rating of 3, “not very satisfied” a rating of 2, and “very unsatisfied” a rating of 1.

Source: Horizon Research Group Survey, 2003, p. 46

Figure 7.

Government Performance Matrix (all respondents)



Source: Horizon Research Group Survey, p. 47

Appendix

Resident Satisfaction Survey - Methodology

The findings and analysis of the survey are based on the results of a purposive stratified survey of 3,967 respondents, conducted by Horizon Research Group in the spring of 2003. Respondents, aged 16 through 60, were selected from three administrative levels: city, township, and village. At the city level, seven sites were chosen based on their geographical 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 western, eastern, northern and southern populations of China. At the seven town and eight village sites, respondents were randomly selected through neighborhood committee lists using the KISH method.⁴ No fewer than 250, 150, and 100 respondents were identified for each city, town, and village, respectively. 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. SPSS and STATA software programs were employed to analyze the data.

Using 50 question survey forms, one rural and one urban to address minor discrepancies in income measurements and employment responses, interviewers recorded multiple choice, binary, and free-response answers. Care was taken to record respondent demographic data when available, such as profession, gender, age, hukou, educational attainment, employment status, private/public enterprise or NGO employer, income range, etc. All interviews were conducted by professional staff trained and employed by Horizon Research Group.

The sample, by design, does not include migrants or the majority of ethnic minorities living in China. In most cases migrants lack legal access to public goods and services and their responses therefore create bias in the survey findings. Similarly, ethnic minorities residing in autonomous regions live under varying policy frameworks, rendering a comparison of government performance between regions misleading.

⁴ Household area sampling according to a “face sheet” or table with fractional representation of each adult (Kish, 1949).

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