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Social Welfare in China: The role of equity in the transition from egalitarianism to capitalism

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Abstract

The 'Scientific Development Concept', promulgated by Hu Jintao in 2007 articulated the increased eminence of social development in official ideology. The shift from political and economic objectives towards social factors can be explained by growing concerns over the current negative externalities of China's economic growth, the long and midterm sustainability of its economic development model and the implications thereof for social stability and political legitimacy. An immediate priority has been to formulate and implement a response to mitigate the disruptive effects of the transition to a market economy. Such a response must cover a wide array of social issues, ranging from provision of health, education and infrastructure, pension to unemployment insurance and poverty alleviation. The welfare issue is characterized by high degrees of complexity and interdependency between endogenous factors and exogenous political and economic variables. Improvements are further confounded by the high decentralization of administration, regional disparities and the sheer size of operations. Although progress has been made on most fronts, it remains to be seen whether recent initiatives will prove sufficient to meet China's social challenges. In this paper, I provide a summary of the academic literature on post-reform development of the welfare system. I will give an overview of its most salient problems, initiatives and their preliminary outcomes. Finally, I will present some concluding remarks and provide suggestions for future research.

Keywords: *China, Social Welfare, Economic Transition, Rural-Urban Dichotomy, Equality.*

Introduction

Social welfare in the broad sense pertains to all institutions, official and informal, that contribute to the wellbeing of a designated group of people. It includes a wide variety of social, economic, political and environmental factors and is subject to diverging interpretations. This study is limited to the narrow definition of social welfare which focuses on securing a ubiquitous standard of living with respect to physiological needs and social equity. This definition generally includes access to health care, education, infrastructure and a social safety net. In addition, in nations with a market economy, it includes some type of provision for retirees and the unemployed. It is generally presupposed that the state is responsible for the financing and administering of these services to a certain extent. During six decades of CCP rule, the organization of welfare in China has undergone tremendous change. These changes were brought about –partially inadvertently- with the economic reforms initiated by Deng Xiaoping in the late seventies, and signified a profound change in the CCP's thinking about issues of equality and efficiency and its relationship to society. As a result of the marketisation and decentralization of the economy, much of the fabric of the communist welfare system came undone. Moreover, these developments increased existing disparities between regions and the cities and countryside and introduced new ones. However, to a large extent, the issues that hamper the establishment of a functional and holistic welfare system are a legacy of the pre-reform era. Therefore, it is instructive to first shortly review the welfare system under communist rule.

Welfare in China 1949-1978

Under the planned economy, access to welfare was explicitly linked to employment, or more specifically, the work unit (*danwei*). A strict division between countryside and city, maintained through the household registration system (*hukou*), allowed for the implementation of a generous urban welfare program. Pensions for employees of SOEs were well in excess of 60 percent (Frazier 2004; James 2001). By contrast, the greatest contribution of the state in

the countryside consisted of the abolition of feudal arrangements through the establishment of a collective farming system (Chang 2003). Other than that, the state propagated a residual and self-reliance welfare strategy for the countryside. At its inception in 1950, the welfare program covered just about a tenth of the industrial workforce, but rapidly expanded to include over three quarters of urban wage earners by the late seventies (Selden and You 1997). The responsibility of funding lay with enterprise management. The larger portion of contributions was allocated to enterprise trade unions, and designated for the financing of pensions and subsidies. The remaining portion was pooled, and redistributed among enterprises with varying levels of performance (ibid). Welfare was extensive, comprising pensions as well as health, housing, canteens and education. The retirement age was sixty for men and fifty for women (Frazier 2004). Pension payments were about half to three quarters of wage upon retirement. By the late seventies the welfare coverage had increased to about 78% of urban wage earners, an impressive feat for a developing nation. However, since the majority of the population was still engaged in agriculture, those receiving welfare still amounted to only 19% of the total labor force (Selden and You 1997). Moreover, the quality and availability of welfare benefits differed substantially, depending on individual rank and enterprise ownership and size. Due notice ought to be given to such caveats when comparing the communist era and post-reform welfare systems. Nonetheless, the CCP managed to make significant advancements along a number of dimensions of wellbeing. Under communist rule, China had one of the world's lowest gini coefficients (Wong 2002). Comprehensive health campaigns and improvements in sanitation and water supply greatly reduced the prevalence of infectious diseases, lowered infant mortality and increased life expectancy (Dummer and Cook 2007). Marked progress was also made in decreasing illiteracy and expanding access to basic education. Whatever the merits of communist-era welfare, the system proved inherently incompatible with the focus on economic efficiency, which became the overriding principle in post-Mao China. The subsequent section will describe the new social challenges brought about by the transition to a market economy.

The consequences of economic reform to China's welfare system

Under the leadership of Deng Xiaoping, China abandoned the notion of continuous revolution in order to pursue 'Socialism with Chinese characteristics'. The development of China after 1978 has been characterized by both continued high economic growth, and increasing socio-economic disparity. To an extent, this disparity might be an inevitable byproduct of industrialization. However, this disparity is also a direct result of pre-reform social economic arrangements and new preferential state policies. Economic development has had equivocal effects across regions and the various elements of social welfare. Nonetheless, it is possible to make some general observations.

First, the economic development of China has not been homogenous. In broad terms, one can make a division between the coastal provinces in the east and the western region. According to official statistics, household expenditure is 2.4 times higher in the east than in the west (2007 est.). In recent years, the government has made western development an issue of strategic priority (Lin and Chen 2004; Tian 2004). Nevertheless, indications of the effectiveness of these initiatives are equivocal (ibid). A variety of factors contribute to the disadvantaged economic position of the west:

The geography of the west

The western provinces make up 71.5 percent of the total area of China, yet comprises only 28 percent of China's population (China statistical yearbook 2008). The large degree of dispersion of the population hampers initiatives to promote economic and social development of the area. Moreover, much of the western area is composed of mountainous terrain. Only 27.6 percent of arable land is located in the west (ibid). Although the West possesses considerable natural resources, these remain unexploited due to their inaccessibility and remoteness to the industrialized areas (Lin and Chen 2004).

Discriminate economic policy

Since 1978, a host of government initiatives has contributed to a more rapid development of the economy of the coastal provinces. These policies include the establishment of special economic zones, the facilitation of FDI, government investments in infrastructure and the business sector. Tax exemptions for the coastal provinces decreased central revenues, which in turn translated into less investment in the west (Lin and Chen 2004). Industrial restructuring has been decisively more progressive in the east. The West still has a decisively higher proportion of SOEs, which tend to be much less efficient than their private counterparts. Moreover, the industrial infrastructure in the western region is comparatively outdated.

Market transformations

Because of the higher efficiency and rate of return of the coastal economy, low priced natural resources flow from West to East. The West in turn purchases high value processed manufacturing goods. Similarly, skilled laborers tend to migrate to the coastal area where wages are higher and there are more opportunities (OECD 2004). Therefore, market forces naturally exacerbate the disparity between regions.

A second division can be made between urban and rural areas. Estimates of the ratio of rural to urban income range from one third to one sixth, depending on whether urban welfare benefits are taken into account (OECD 2004). An important determinant of the persistent and increasing (ibid) disparity between cities and countryside is the dual welfare system. From the outset, China's welfare system focused on the support of urban residents (Selden and You 1997). The development of the post-reform welfare system was characterized by a further retrenchment of the central government on rural welfare services. The rural collectives were replaced by the household responsibility system, which increased farmers' revenues (OECD 2006a), but also compromised rural welfare infrastructure. After 1978 the TVEs took over many of the welfare services earlier provided by the collective. However,

increased competition with coastal industry in the 90's caused many TVEs to go bankrupt or renege on their welfare provisions (OECD 2006a).

Ruralities have responded in various ways to the lack of supply of welfare services. The state has reemphasized the principle of self-reliance (Hebel 2003). To a large extent access to support is delineated along genealogical lines. However, demographic changes have limited the extent to which the family can substitute for formal welfare institutions (Zhang 2002). Moreover, organization based on kinship ties excludes several of the most vulnerable groups of the population, such as childless elderly and orphans (Zhang 2002; Shang et al 2005). Recently, the state has taken a more active interest in rural welfare, notably by introduction of a trial rural pension system (Xinhua 2009). However, as this project is but in an embryonic stage, little can be said about its contribution to rural wellbeing. The vast size of the rural population has deterred the state from taking any comprehensive actions in establishing a rural welfare system up until now.

Paradoxically, the urban-rural divide has been perpetuated in the cities. This is because the relaxation of restrictions on migration has not been matched with a relaxation of the household registration (*hukou*) system. The vast majority of migrant workers are not eligible for urban residency, which prohibits them from making any claims on the urban welfare system. Because of their marginal status, migrant workers are generally restricted to risky, low-paying and physically demanding labor (Liu and Wu 2006, OECD 2006a). Observers note that many migrant workers retain their farming plots to substitute for social security. This in effect hinders the efficient allocation and use of scarce farm land and undermines the viability of the agricultural economy (ibid).

A third divide runs along ownership structures. China's welfare system systematically emphasizes the rights of public sector employees over those of non-state workers (Saunders and Shang 2001). This is by and large due to the legacy of the centrally planned economy, under which welfare provision was the responsibility of the work unit (*danwei*). The practice of tying access to welfare to public employment was perpetuated during the economic transition. Developments in the SOEs and social welfare policies introduced since the

nineties have mitigated the duality of the urban rural welfare system. Mounting concerns over the poor performance of SOEs and the excessive burden of welfare obligations led the state to initiate a rigorous restructuring of the public sector. The practice of providing lifetime employment was terminated in 1986 (Wong 2002). Under Jiang Zemin, the majority of small and medium sized SOEs were disbanded, and the SOE workforce was downsized by some forty percent between 1995 and 2000 (Giles et al. 2006). Under the new *xiagang* arrangement, laid-off worker's social benefits were limited to three years of basic living subsidies, health care and pension contributions (ibid). In concurrence with the reduction in public welfare, the state made efforts to expand welfare coverage to include the other sectors of the urban economy. The three-pillar pension system was promulgated in 1991 (Yu 2007). In 1999, the state introduced universal urban unemployment insurance. Both initiatives (nominally) included the private sector (Giles et al 2007). However, non-compliance rates for both programs are high (Yu 2007). Although the scope of welfare has increased, the link between contract employment and access to welfare persists (Liu and Wu 2006). The public-private dichotomy has become more permeable, but institutional and economic obstacles to both a more equitable welfare system and greater economic efficiency remain. The welfare system continues to favor the relatively well-off (OECD 2004). Labor mobility between the public and private sector is constrained because most welfare benefits are non-transferable. Also, reorganization of the public industry has given rise to new social economic issues, such as urban unemployment.

A fourth general observation can be made in regards to the shifting responsibilities of the central state, localities, enterprises and individuals. Devolution of responsibilities has been taking place both in the funding and the administration of welfare (Wong 1994; Wong 2002; Guo 2003; Dummer and Cook 2007). The devolution of the funding of welfare services was a consequence of the economic and fiscal decentralization initiated in the late seventies. Because of these reforms, central government's share of GNP declined drastically, and deficits accrued (Wong 1994). The 1985 Joint Circular rendered local authorities responsible for the financing of welfare services. The

intent of central government was to limit its role to that of regulator and supervisor (Mok 2005,) focusing instead on the establishment of a social safety net (Liu and Wu 2006) and assistance to selected regions (Gustafsson and Zhong 2000; Tian 2004). In theory, decentralization ought to improve the responsiveness to local circumstances, and thereby, the effectiveness and efficiency of public spending (OECD 2006). However, empirical evidence paints a less encouraging picture. As local governments aren't responsible to an electorate, there remains a significant risk of misallocation of available funds. Perhaps a more salient issue is that the increased responsibilities of local governments have not been met by a corresponding increase in revenues. Moreover, local governments have limited discretion to increase revenues through taxes or levies. In order to cope with structural shortages, many local authorities engage in dysfunctional and/ or illegal practices, or renege on their duties altogether (ibid). A concurrent development is the increasing privatization of welfare services. The lack of public funding has placed greater demands on both welfare institutions and individuals. Fees for healthcare and education have been rising steadily (Wong 2002; Bai 2006; Hannum and Wang 2006). In consequence, access to welfare services has become increasingly contingent on individuals' ability to pay for them (Wong 2002).

Problems also persist on the central level. The reorientation of central government and intended retrenchment is undermined by the size and inefficiencies of the administrative apparatus, which is characterized by high levels of overlap and redundancy (OECD 2006b). This impedes attempts to lower expenditures and improve transparency and accountability. Moreover, state expenditure is unbalanced; while spending on key areas such as education is already low by international standards (ibid), a disproportionate part of government budget is allocated to salaries for administrative personnel. Initiatives aimed at downsizing and reorganizing the state bureaucracy have been under way since the late nineties (Brødsgaard 2002). Nonetheless, the pervasiveness of the state remains an impediment to the envisioned restructuring of central-local relations.

At the same time, decentralization and a top-down structure have impaired the effectiveness of central efforts to alleviate poverty. Earmarked funds for poverty alleviation are distributed according to regional and ethnic criteria rather than on a need basis. This gives rise to both problems of undercoverage and leakage (Gustafsson and Zhang 2000). Weakened central local ties also give rise to agency issues. Recent efforts to ensure a basic level of subsistence such as the Minimum Life Security system (MLS) employ more relevant criteria and have accordingly achieved better results. However, coverage is still insufficient (Liu and Wu 2006).

The above issues are by and large symptoms of an archaic state structure, and confound developments across the whole spectrum welfare service. General improvements in government organization and administration ought to significantly alleviate these problems. Yet a multitude of issues particular to specific welfare services remain. The subsequent section will expound the developments and challenges related to the main constituents of the Chinese welfare system.

Unemployment

Although unemployment is a phenomenon concomitant with the market economy, there is a general consensus that unemployment constitutes a sizeable and serious problem in China. Employment in the state-owned sector alone fell by 40% between 1995 and 2000 (Giles et al 2006). However, no consensus exists when it comes to estimates of the number of unemployed. Obfuscation arises first from the official taxonomy employed by the government. The government distinguishes between furloughed (*xiagang*) and unemployed (*shiye*) workers. The former category is officially defined as those laid-off workers that started employment before the establishment of the contract system in 1986, have not yet officially terminated relations with their former employer and have not yet found other employment (Solinger 2001). It does not include furloughed from the collective sector. The predicate of unemployed on the other hand, only applies to workers from bankrupt firms. Naturally, official statistics do not include the floating population, nor do they take into account

the large group of 'early retirees' from the state firms. Problems are compounded by pragmatic issues such as underreporting by firms. The hidden unemployed retain their official association with the firm, but receive reduced or no pay (ibid). This allows enterprises to refrain from dispensing unemployment benefits. Due to the above factors, the extent of unemployment is anybody's guess. What is obvious is that the official figure (4.0% in 2007, China Statistical Yearbook 2008) is structurally deflated.

For the higher skilled and younger workers, the release from the SOEs has been a welcome change, as it allows them to pursue better opportunities in the private sector (Solinger 2002). For most discharged SOE workers, the redistributive function of the free market has proven inadequate.

Far from being a mere taxonomical exercise, the government's overly strict classifications deny benefits to many of the jobless (Solinger 2001). Under the *xiagang* arrangement introduced in 1993, laid-off workers were entitled to three years of basic living subsidies, health care and pension contributions (Giles et al 2006) as well as reemployment service. Funding came from a combination of central and local budgetary expenditures as well as enterprise contributions. The SOEs were responsible for establishing and running re-employment centers. The *xiagang* arrangements were designed as a temporary mechanism to facilitate the restructuring of the overburdened state owned sector. However, it soon became clear that they fell short of achieving this objective. Less than half of the workers considering themselves to fall into the *xiagang* category received formal certificates. And even then, the majority of the select group holding formal proof of their furloughed status didn't receive the benefits they were entitled to. Leakage is also a problem, with some 17% of workers receiving both unemployment and *xiagang* benefits, and 20% receiving these benefits while working (ibid). Results from the reemployment centers were no more encouraging. According to Giles et al (2006) a survey held between 1996 and 2001 indicated only 29% of the discharged were reemployed within a year. In response to the unsatisfactory performance of the *xiagang* arrangements, the government introduced its unemployment insurance program in 1999. This program has -nominally- extended coverage to all urban workers. Funding is

secured through a diversified scheme that includes state, enterprise and individual contributions. Local authorities have the prerogative to determine the duration and size of the assistance (Vodopivec et al 2008). The unemployment insurance abrogated the relation between the furloughed and their former employers. No more reemployment centers were established after 2001 and as of 2005 the number of people registered in such centers equaled a mere 3% of the seven million enrolled in 1991 (ibid).

The minimum living security program was established in 1998 (MLS) to complement unemployment insurance. The former is an attempt to improve coverage and consolidate insurance funding and administration. The MLS isn't directly targeted at the unemployed, but rather intended to provide people with a minimum level of subsistence. However, since many unemployed are ineligible for insurance, they comprise a large part of MLS recipients. Although the reorganization has expanded the scope of unemployment assistance and diversified its distribution, the system retains most of the flaws associated with the earlier arrangements. In lack of effective regulation, supervision and enforcement mechanisms, problems pertaining to under-coverage, leakage and unequal access abound (ibid).

Pension

Pension reform has been a focal point for the government because pensions comprise a major part of central and local government welfare expenditure. The pre-reform pension system was inextricably interlocked with the central planning economy. Headway has been made in reorganizing the pension system in accordance with economic transition, but the liabilities of the old system carry on into the present. Moreover, due to demographic changes, these liabilities will greatly increase in the future (West 1999).

Under pre-reform arrangements, pension administration was the duty of the state enterprise. SOE revenues formed the basis for pension funding. Arrangements were generous by all standards. The allowances dispensed upon retirement averaged well over sixty percent (Selden and You 1997) and actually increased in subsequent years to seventy-five because of adjustments made in

accordance with macro-economic indicators (James 2001). The retirement age was set at sixty for men and fifty-five for women (ibid). The low average age of China's population at the inception of communist rule deferred the costs of such lenient policies (Selden and You 2001), and allowed for a pay as you go funding arrangement. Moreover, enterprises had little incentive to be parsimonious while the state ultimately had to bear the costs of pension arrangements (James 2001). Indeed significant problems did not arise until the reforms of 1978. The push for greater efficiency instigated prevalent downsizing of the SOE workforce. To curb unemployment, the government used various incentives to motivate workers to retire early. Because of the growing number of retirees, providing funding for pensions became an excessive burden for many collective enterprises (ibid). In consequence, the employee to retiree ratio swiftly fell, to below five to one in 1995 (Selden and You 1997).

The pressure for reform was intensified by continuous protests by SOE retirees who had not received their pensions or experienced arrears (Hurst and O'Brien 2002). The right to pensions is seen as an inextricable and enduring component of the social contract between these former SOE workers and the communist state (ibid). It is important to note that, while the old pension system engendered significant financial problems, it still excluded the private sector and the rural population.

Pension reform thus had to address several issues. First, it had to deal with the rising disparity between pension costs and contributions, as well as the discrepancy between needs and resources. Second, in order to improve the mobility between the public and private sector, it had to abolish the link between SOEs and pension provision. Third, it needed to extend coverage beyond the borders of the publicly owned industry. The Chinese government has responded to this challenge in an incremental fashion.

In 1986, the lifetime employment policy was replaced by a contract based one, relieving SOEs of some of their welfare obligations (Selden and You 1997). Experimentation with consolidated funds started in the same year, when the state council encouraged the pooling of pension funds at the municipal level. This increased the size of the funding pool and improved labor mobility within

the municipality. However, pooling arrangements did not address insolvency issues, and many municipalities ran structural deficits. Moreover, local authorities often lacked the skills and capacity to administer the social security system, so that enterprises remained responsible for the bulk of pension administration. With financing obligations lying with the municipality and administration being carried out by the enterprises, the original agency problems persisted. Non-compliance and under provision to municipal funds were common practice (ibid). Another problem was that municipal level arrangements still had limited redistributive capacity (James 2001).

In 1991, the state promulgated the three-pillar system. The new system was bolstered by the introduction of the basic old age insurance in 1997. The central features of this scheme were a diversification of pension funding and a higher degree of consolidation. In the new system, funding responsibilities are shared between the individual, enterprise and the central state. Proceeds are divided between a pay-as-you go, non-contributory state pension and fully funded privately managed pillar and augmented by voluntary individual savings (Yu 2007). This system expanded welfare policy to the private industry and consolidated proceeds at the provincial level. Rural enterprises were still excluded. Moreover, because the new system was not accompanied by structural improvements in supervision, non-compliance remained a salient issue (James 2001). Reluctance to contribute to the new system partly originated out of prevalent concerns about poor management of public funds (Selden and You 1997). More generally, many workers may feel that having to shoulder both current and future pension obligations is excessive and undue. The new system gave significant discretion to local governments in deciding contribution rates and the level of subsistence provided by the pensions. Many local authorities were struggling with structural deficits and thus decided to devolve the brunt of financial responsibilities to individuals (Selden and You 1997). In 2000, the national social security fund (NSSF) was established. The fund is intended to help meet future pension obligations and supplement the basic old age insurance system. The NSSF is characterized by comparatively high standards of management and governance, and has performed

accordingly (Impavido et al 2009). The NSSF started investments in SOE shares, private equities and overseas markets by 2001, with an average return of 8.98% for the period 2001-2008 (NSSF website). However, assessments of the NSSF's performance are complicated by the fact that its objectives are not linked to future pension expenditure estimates.

Overall, significant advancements have been made in pension reform. Pension coverage, in the shape of either basic old age insurance, rural pensions or minimum life security has increased to 40% of the labor force (Impavido et al 2009). The new system is characterized by a higher degree of consolidation, improving both labor mobility and the capacity for inter-regional transfers. The multi-pillar system mitigates the imbalance between expenditure and revenue. Nonetheless, it remains to be seen whether these improvements will prove sufficient to meet extant and future challenges. If replacement rates are not lowered and retirement age increased, liabilities may well surpass the government's financial capabilities (James 2001). Nonetheless, the pension scheme will have to eventually incorporate the rural population. Pension administration still suffers from high levels of fragmentation and discretion which leads to low levels of transparency and accountability. The effectiveness of the system is further confounded by a lack of supervision and adequate enforcement mechanisms. Solutions will have to be implemented swiftly in order to provide an adequate response to the looming pension crisis brought about by an ageing population.

Healthcare

In the communist era, health services were provided by means of a dual system. A multi-tier system existed in rural areas. At the village level, bare-foot doctors provided basic health care. Subsequent tiers provided referral and specialist services and were responsible for the supervision and coordination of the subordinate levels. These services were supplemented by nationwide preventive and health awareness campaigns (Bloom and Gu 1997). In cities, healthcare was provided through government run health care facilities. Employees in the government or academic sector and military personnel,

including veterans were covered by a public insurance scheme. Labor insurance was available to SOE workers, and to a smaller extent, laborers in collective enterprises. Combined, the two programs covered about three quarters of the urban labor force in the late seventies (Guo 2003). During the three decades of communist rule, average life expectancy increased from 39 to 69 (Bloom and Gu 1997). In the same period infant mortality dropped from 17 to 5.2% (UNdata 2009). Many of the endemic infectious and parasitic diseases were successfully combated.

Notwithstanding the advances made in public health, the system also had its drawbacks. Problems compounded in the wake of the market reforms. Free provision of urban health care led to rampant over-utilization. With no effective cost controlling mechanisms in place, expenditures increased twenty-eight fold in the period 1978-97 (Guo 2003). Cost containment strategies centered on the privatization and marketisation of health care. Fee charging for medical services commenced in the nineteen-eighties and has become ubiquitous since then. The devolution of financing responsibilities from the state to the individual has curbed over-utilization. On the other hand, access to health-care is now increasingly contingent on individual financial resources, and medical fees have deterred poor individuals from seeking health care (Wang 2002; Guo 2003). The results of marketisation have also been ambivalent. Institutions and doctors now have to vie for contracts and clients. The proliferation of the private health care industry has given consumers greater discretion in selecting services. Public bidding mechanisms and a division between hospitals and pharmacies have been installed in 2000 to decrease drug costs. However, proceeds from medicine constituted a major portion of health care providers' revenues. These institutions thus have to increasingly rely on revenue from medical fees. As such, efficiency gains from privatization have not resulted in lower consumer costs.

Another issue was that the pre-reform arrangements, where access to healthcare was linked to industrial categorization didn't correspond with the new market situation. This led to a reversal of the pre-reform advances made in health insurance coverage. The impetus to address this structural imbalance

was provided in a resolution by the central committee in 1993. Health care insurance was decoupled from the enterprise and came under the auspices of local authorities. Funding was to be derived from individual and enterprise contributions. In 1998, requirements pertaining to basic health care insurance (BHCI) were adjusted to include all urban residents, save for the self-employed (Guo 2003). However, implementation has been cumbersome. Xu et al (2007) note that, although participation in BCHI grew ahead of official targets, urban health insurance coverage actually declined between 1998 and 2003. This is primarily due to the diminishing importance of enterprise based arrangements. However, the endurance of the government and labor insurance system obstruct the transition to a unified health insurance scheme. Moreover, coverage is still linked to employment, which gives rise to unequal coverage of genders age cohorts and income groups (ibid).

In the countryside, developments have been less ambiguous. Following the marketisation of health care services and the dismantling of the Cooperative Medical System, the increased financial burden on personal income prohibits many of the rural poor to seek medical treatment (Dummer and Cook 2007). In 2002 the government reinstated the community based health insurance. However, the related costs undermine rural residents' willingness to participate in such schemes (Zhang et al 2005). Although the ruralities still have a relatively proficient health care infrastructure, there is tendency towards urban concentration of health care facilities and expertise. A lack of central control and administration and a lack of economic incentive have also brought about a decline in the provision of preventive health services and awareness campaigns. As such, China has seen the reemergence of epidemic diseases which were virtually absent during communist rule (Dummer and Cook 2007). From the above, it may be clear that decentralization and marketisation alone cannot solve China's health problems.

Education

Since the economic reforms, clear advancements have been made in the area of education. The illiteracy rate steadily decreased from 31.9 to 8.4 percent in the period 1981-2007 (China Statistical Yearbook 1981, 2008). Gross

enrolment rates for primary and secondary education also increased between 1980 and 2005 from respectively 88 and 73 percent to 99 and 101 percent (UNESCO 2008). However, government expenditure as a proportion of GDP is low at 2.5 percent (2002 est., OECD 2006b), which includes both operating and infrastructure expenses. Even more so than other welfare services, education is characterized by a high degree of privatization and decentralization. The reduced role of the state has negatively affected the availability and quality of education (Bai 2006). The devolution of financial responsibility from the central government to local authorities and educational institutes has resulted in the proliferation of tuition and other fees. From 1990 to 1998, average tuition more than tripled (Hannum and Wang 2006). The increased importance of personal finance has created an imbalance of access to education in poorer and more affluent regions (OECD 2006a; Hannum and Wang 2006; Guo 2007). This is worrisome, because the difference in human capital between the coastal and inland provinces has been cited as an important determinant of the economic disparity. The government has tried to address the inequity of access to education through a variety of initiatives. The 2001 tax for fee reform replaced local taxes and levies on rural households with a centralized agricultural tax. This has alleviated demands on farmers' wages, but has also significantly impaired the ability of local governments to raise revenue (Guo 2007). Because the increase in central revenue was not balanced by a proportionate increase in central spending responsibilities, the problem of financial inadequacy was not solved but merely transferred from the individual to the township level. Therefore, the government announced in 2006 that it would waive tuition fees for the nine years of compulsory schooling for some 150 million rural children (Xinhua 2006).

Indiscriminately increasing the state spending on education might however not be an adequate or sustainable solution to the problems of the educational sector. First, government initiatives are diluted by administrative inefficiencies. A disproportionate amount within the budget for education is allotted to non-teaching staff (OECD 2006b). A second factor hampering the development of an egalitarian education system through government spending

is a structural prioritization of higher education. In 1999, the Chinese government initialized a series of reforms aimed at transforming the educational system to accommodate “mass higher education”. This move was in part motivated by a concern over long-term competitiveness of the Chinese economy. Nevertheless, the immediate motivation was to boost domestic consumption, and deflect the issue of high school graduate unemployment. The speed with which this transformation was realized allowed the government to reach its target of a 15 percent enrolment rate in higher education well ahead of schedule, but also caused significant quality, funding and organizational problems (Bai 2006). A related problem is that the development of human capital doesn't coincide with geographic and market demand. In the state-led push for higher education, emphasis lay on rapidly increasing the scale of universities. Therefore, these institutes did not have time to adjust their curricula to market demands. The discrepancy between education and required skills is a main cause of graduate unemployment (ibid). Moreover, human capital accumulates in the coastal cities, where most high quality educational institutions are situated. The imbalance of human capital is intensified by the outflow of educated workers from the countryside to the coastal cities, where wages are higher.

Given the limited capacity of townships to address these issues, further improvement of the educational system will thus to a large extent be contingent on the efforts of central government. The state should not only take on a more active role in the provision and allocation of funding, but also promote the quality and efficiency of education through supervision and by ensuring that the supply of education corresponds to local needs. Centrally promulgated, nationwide targets will have to be replaced with more heterogenic objectives based on the diversity of needs and situations in the various regions. This will require that the decentralization and privatization that have characterized the educational system after the reforms will have to be reversed to an extent.

Poverty alleviation and Western development

According to official statistics, (based on a daily income of only USD\$0.66, OECD 2004), rural poverty has rapidly dwindled from 250 million in 1978 to 32 million in 2000 (OECD 2006b), or about 4 percent of the rural population (China Statistical Yearbook 2000). More conservative figures by the World Bank (based on a USD\$ 1.00 poverty line by PPP) put the number considerably higher at 11.5 percent (2000 est., ADB 2004), but nonetheless depict an impressive decline in the number of rural poor in the last decades.

Notwithstanding the impressive advances made in rural poverty alleviation, results ought to be interpreted with a degree of caution. For the most part, households' financial situation was merely raised to a level where exogenous economic shocks, such as natural disaster or illness would instantly hurl them back into poverty. Moreover, the increases in income allow households to ensure their subsistence, but provide no slack for investments in capital or education, which could structurally improve their economic status (OECD 2006a). The extent of urban poverty is decisively harder to estimate. This is because there is no official urban poverty line. Poverty lines are determined independently by each city, and in consequence vary considerably according to local economic conditions (ADB 2004). The National Bureau of Statistics estimated that in 2001, some 10.1 million or 3.1% of registered urban citizens lived in poverty (ibid). The actual figure is significantly higher, because the NBS estimate does not include the floating population.

The relationship between demographic factors and the likelihood of poverty is intuitive. Poor households are often larger and have more dependents (i.e. a greater ratio of non-working to employed household members)(OECD2006b; Meng et al 2007). A low level of education also increases chances of being poor. A third categorization is geographic rather than demographic. The vast majority of China's poor is located in the countryside and in the West (OECD 2006a). China's urban poor population consists primarily of the floating population and unemployed and laid-off SOE workers (Liu and Wu 2006; Solinger 2007). In the cities, the minimum living security system (MLS) has been the primary vehicle for combating poverty. The

MLS was introduced in Shanghai in 1993 and consequently expanded to other cities. Local authorities are responsible for the administration of the system and deciding on the allocation and the height of stipends (Shang and Wu 2004). In consequence, the criteria for eligibility varied widely from city to city, and many of the urban poor did not receive assistance (ibid). Therefore, the government focused on improving the criteria for allocation and removing many of the additional requirements and restrictions imposed by local governments. Now, income is the most important determinant for eligibility. However, MLS assistance still excludes the floating population, a major part of the urban poor.

As for the countryside, initiatives were primarily aimed at improving productivity and incentives of agriculture (such as the household responsibility system). These initiatives produced significant results, but became less useful when the prices of produce decreased as a consequence of market pressures (OECD 2006a). As such poverty alleviation has increasingly taken on the shape of central financial assistance. The government based allocation decisions for rural poverty alleviation programs on geographic criteria. Due to the dispersion of poor households, this gave rise to problems of under-coverage and leakage (Gustafsson and Zhong 2000; OECD 2004). Xu (2004) notes that significant disparity can exist between proximate townships with similar physical endowments. He cites entrepreneurship and political gaming by wealthier townships as reasons for such differences.

Despite their shortcomings, geographic criteria continue to function as the main considerations on which central initiatives are based (ADB 2004). The Western development program (initiated in 1996) is a notable example. The structural and growing economic disparity between the West and the coastal provinces motivated a series of comprehensive initiatives in the shape of anti-poverty programs, increased investment in infrastructure and education, as well as policies aimed at attracting investment from abroad and China's East coast (Tian 2004). Results have been equivocal. While acknowledging the multifaceted nature of poverty, programs have overly relied on financial instruments, such as tax exemptions, financial assistance and industrial investment. Further advances in poverty alleviation will first require further

development of the rural economy (OECD 2004; ADB 2004). However, rural economic development is hampered by administrative obstacles. The most salient of these is the *hukou* system. Lifting the stringent restrictions of the *hukou* system is expected to aid in rural development in three ways. The flow of rural laborers to urban areas would increase productivity of labor in the agricultural sector. Remittances from migrant workers to their homes would provide rural households with additional income, which might be used to improve productivity in agriculture or rural industry. With the insecurities pertaining to legal status of migrant workers gone, the arable land market could function more efficiently, which would lead to a more optimal allocation of resources. This in turn provides farmers with the incentives to invest in goods that improve the productivity of newly acquired plots and allow them to profit from scale economies (OECD 2006b). Finally, given the heterogeneity of factors that give rise to poverty, greater coordination between local and central efforts is crucial.

Marginalized groups

It is self-evident that within the welfare system, special provisions ought to be made for the most vulnerable groups in society, that is, those who lack the ability to provide for themselves and cannot rely on the assistance of next of kin or the local community. Unfortunately, post-reform developments have brought about a decisive decline in welfare arrangements for these groups. After the dismantling of the commune system, rural welfare was characterized by a retrenchment of the state and an emphasis on self-reliance (Zhang 2002). In instances where the township government lacks the resources for setting up a welfare system, the responsibility for the provision of welfare services rests upon the community and the family in particular. The childless elderly are one group that has been especially adversely affected by this transition (ibid). As yet they constitute a marginal portion of the Chinese population, but because of stringent birth control and the resultant imbalance in the male-female population ratio, this problem will likely become increasingly salient in the future. Questions

have also been raised as to the ability of current adolescents born under the one-child policy to provide for an ever growing group of elderly.

A second marginalized group is comprised of abandoned (and often disabled) children, orphans and street children. Several hundred thousand children are estimated to fall in one or more of these categories. In urban areas, only orphans and abandoned children who have been registered under the urban household system are eligible for government support. The 'five guarantees' system (*wubao*) nominally also covers the orphaned and abandoned children. However, many of these children are ineligible for these services, which are only provided to recognized members of the community. In many cases, it is not possible to establish who the parents of these orphans and abandoned children were (Shang et al 2005).

In the face of inadequate government provisions, voluntary organizations have emerged to try and fill the gaps in the social security net. However, these NGO's cannot rely on the state for funding, lack legal status and organizational support and supervision by the state, and therefore care provided by these organizations is often inadequate (*ibid*). Given the demographic transitions and disparate effects of economic development, the state will need to assume a greater and more active role in the provision in welfare services for marginalized groups.

Conclusions and recommendations for future research

Since the reforms, economic efficiency has taken precedence over concerns about equity. Pre-reform China was poor but rather egalitarian. The remarkable economic development of China has engendered higher per capita incomes, but also a tremendous and growing divergence in wellbeing. Deng Xiaoping famously proclaimed that it would not hurt to 'let some people get rich first'. The consensus was that the initial economic disparity would be mitigated eventually by a 'trickle down' effect (Wong 2002). However, in China there is little evidence to support the endogenously stabilizing effect of the market economy. Concerns about the sustainability of China's economic growth and its concomitant social effects have led the government to revise its

responsibilities in promoting equity and effectiveness. Since the late nineties government spending has rapidly increased (OECD2006a). However, the effect of increased government spending is impaired by administrative obstacles and the absence of a comprehensive and consistent welfare strategy. As to the former, it will be crucial to reduce the duplication and overlap that exists in the current bureaucratic apparatus. This will decrease administrative expenses and mitigate the ambiguity concerning responsibilities. A step in the right direction has been taken with the centralization of funding and fiscal administration for many welfare services, but the role of the central state must not end there. Greater cooperation between local and central government is called for, and standardized mechanisms for monitoring and control will need to be established. A more unambiguous legal framework and more rigorous enforcement mechanisms need to be put into place to curb the problem of non-compliance. Spending responsibilities need to be matched with corresponding allocation of revenue. The state will have to play a greater distributive role to ensure that poorer regions can meet welfare objectives. Eligibility criteria for welfare services have to be adjusted to reflect needs rather than professional or economic status. To further improve living standards, a comprehensive strategy needs to be formulated, which pays due attention to the interrelatedness and complexities of various welfare elements. Care needs to be given to avoid the promulgation of contradicting objectives. For example, it would be unrealistic to expect concurrent high investments in measures increasing short term economic growth and human capital.

As such, it is clear that there is a large need for additional research on China's welfare system. Up until now, research has by and large focused on describing the advances and deficiencies of the various elements of welfare, with due attention given to China's large social, demographic and geographic variety. The effects of pre-reform arrangements and economic transition have featured prominently in this research. Now that the various elements of welfare such as healthcare, education and unemployment and pension assistance have been scrutinized, a logical step would be to holistically research the functioning of the whole welfare system. This would provide valuable opportunities for

improving the administration and organization of welfare systems. Due to the inherent constraints of research and the heterogeneity of resources and demands, such research ought to be conducted on the sub-national level. This also corresponds to the incremental approach in welfare development taken by the government.

Another interesting area for research pertains to the relationship between welfare and political and economic objectives. Political considerations have featured prominently in welfare reforms. In the contest for economic development the state has redefined its relationship with society. Yet, the communist social contract, in which equality is prominent, still dominates many Chinese's perception of the responsibilities of the state (Hurst and O'Brien 2002). Economic development has brought about greater disparity and as such has served to exacerbate the sentiment that the government has reneged on its obligations.

Notwithstanding that economic development initially engenders greater inequality, it is important to remember that the prioritization of either efficiency or equality is a choice. The renewed concern for the provision of a ubiquitous standard of living thus may well herald the beginning of a more egalitarian society. After all, the one thing that cannot be denied sixty years after the establishment of the People's Republic is the capacity of the Chinese state to engender change.

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