

China's Fiscal Decentralisation and the Financing of Local Services in Poor Townships

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The major theme of the economic reforms initiated in 1978 has been to decentralise economic management, giving greater autonomy to local governments and state enterprises, and allowing the development of non-state sectors. Within this context, fiscal reforms during the 1980s have been characterised by decentralisation. Despite the remarkable economic performance over the past 18 years, comparable improvements have not been achieved in the provision of basic social services to rural households. In some poor areas these services have even deteriorated. Inadequate funding is a dominant problem in the provision of basic social services in poor areas.

1 Overview of Fiscal Decentralisation

Before 1980, China's fiscal system was highly centralised. All taxes and state enterprise profits were remitted to the central government and transferred back to the provinces according to planned expenditure needs approved by central government. In the early 1980s, revenue sharing arrangements between the central and local governments were devised, with the aim of promoting local governments' tax mobilisation efforts.

There are five levels of government in China: national, province, prefecture, county and township. In this article, 'local' refers to governments at the provincial level and below, unless otherwise stated. This section emphasises revenue sharing between central and provincial governments. The system of revenue sharing has been extended to the arrangements between provinces and their prefectures, between prefectures and their counties, and so on. While there are some local variations in the methods employed, the principles are largely the same at all levels.

1.1 Contract-based revenue sharing

In 1980, a system of revenue sharing between central and provincial governments was introduced.²

¹ This article has benefited from many detailed and valuable comments made by Adrian Wood, Gerald Bloom and Christine Wong.

² Some large cities were later accorded a special fiscal status which allows them to share revenue directly with the centre rather than the provinces in which they are located.

The sharing scheme was modified twice, prior to the more far-reaching tax reform of 1994. The basic principles of these sharing schemes remained unchanged until 1994.

The revenue sharing scheme of 1988-1993 provides an illustration of how the system operated. The central government determined the bases and rates of all taxes. Almost all tax revenues were assessed and collected by local governments' tax bureaux. All revenues collected by provinces were classified into three categories: fixed central government revenues, fixed local government revenues, and shared revenues. Provinces which in 1987 were in surplus (i.e. whose fixed local plus shared revenues exceeded their approved expenditures) were required to turn over an agreed amount or percentage of their revenues to central government. The remaining portion of shared revenues was retained by the province. The precise sharing arrangements were determined in case-by-case negotiations between central and provincial governments.

A number of different sharing arrangements applied to different provinces (Bahl and Wallich 1992). For the majority of provinces in a surplus position, high nominal growth rates of revenue in the contract period implied that they were able to retain an increased share of revenues. Those provinces in a deficit position, mainly poorer provinces, received subsidies from central government. However, these subsidies were fixed in nominal terms, implying declining subsidies in real terms.

2 Trends in Revenues and Expenditures

2.1 Budgetary revenues

An important outcome of these revenue sharing schemes was a decline in the 'two shares'. Between 1979 and 1993, the share of government revenue in GNP declined by almost one half, from around 30 per cent to just over 15 per cent of GNP (Ma 1996). The central revenue share in total government revenue also declined during the second half of the 1980s. To some extent, the decline in the two shares was an intended result of the economic reforms. Increased competition has decreased the average profitability of state enterprises and eroded the revenue base, while with more autonomy for state

enterprises, the share of gross profits retained by enterprises increased. The growing proportion of enterprises in the non-state sector (notably, rural enterprises, foreign funded and joint-venture enterprises), which are generally subject to lower tax rates, has worked in the same direction.

These trends have also had some unintended consequences. Of significance for this article is the impact of fiscal decentralisation on the centre's redistributive role. Since the mid-1980s, inter-regional and rural-urban inequalities have increased. In the recently approved Ninth Five Year Plan (1996-2000), more attention has been paid to the reduction of regional disparities.

The basic aim of the revenue sharing system is to stimulate the provinces' tax mobilisation efforts through higher and often progressive provincial retention rates. This benefits the better-off provinces, since the revenue sharing formulae imply that the expenditure capacity (total revenue after sharing) of high-income provinces grows faster than that of deficit provinces which receive direct transfers (Bahl and Wallich 1992). Thus, a growing proportion of revenues are retained and spent in the province where the revenues are collected, indicating a tendency towards the regionalisation of fiscal resources.³

While inter-provincial inequality can be lessened through fiscal transfers to poor provinces, the diminished importance of central revenues has constrained the capacity of central government to redistribute income. The proportion of local fiscal collections remitted to the centre fell by almost one half between 1985 and 1990 (Wong *et al.* 1995). Of ¥59.6 billion fiscal transfers from the centre to provinces in 1990, only ¥8.6 billion were subsidies under fiscal contracts made to poor provinces on the basis of their needs. The majority of the remainder consisted of earmarked grants (e.g. price subsidies

³ In 1994, the contract-based fiscal system was changed to a rule-based system, which strengthens the centre's position by assigning it a large proportion of key revenues. Chung (1995) notes that some poor provinces objected to the lack of preferential arrangements in the standardised rules. For example, Yunnan and Guizhou provinces may be disadvantaged by the recentralisation of taxes on tobacco and liquor production in which they specialise. However, it is too early at the time of writing to evaluate the impact of the new system on the regional distribution of fiscal resources.

to urban residents), which are distributed on the basis of 'entitlements' rather than need (Wong *et al.* 1995). The increasing inequality in fiscal resources is supported by provincial expenditure data, which show that expenditures grew faster in wealthier than in poorer provinces, and that per capita expenditures were significantly higher in the former.

2.2 Extrabudgetary revenues

Another consequence of fiscal decentralisation has been the growing size and importance of extrabudgetary funds. Extrabudgetary funds are not included in the government budget but are raised and used by local government and ministerial agencies, and state enterprises. Extrabudgetary funds controlled by local government finance bureaux primarily derive from surtaxes, such as the industrial and commercial surtax, agricultural surtax and urban public utility surtax. These surtaxes are off-budget to the central budget, but can be considered as budgetary funds for local governments. Extrabudgetary funds are supposed to be spent on specific items, but there is much room for manipulation by local governments in their use. Extrabudgetary funds should therefore be taken into account when considering the regional distribution of fiscal resources and the financing of infrastructure and social services.

The importance of extrabudgetary funds is indicated by the ratio of extrabudgetary funds to budgetary revenues. This increased from 31 per cent in 1978 to nearly 98 per cent in 1992. The rapid growth of extrabudgetary funds is partly a result of the shift of economic resources from the general governmental sector to the enterprise sector. It is also a result of the avoidance behaviour of local governments, since extrabudgetary revenue is generally not subject to provincial-central remittances. It is reasonable to expect that the provincial distribution of extrabudgetary funds would be more unequal than of budgetary funds. The increased importance of extrabudgetary funds has further strengthened the trend towards the regionalisation of fiscal resources.

2.3 Self-raised funds

Some revenues controlled by governments or governmental agencies are neither reported as bud-

getary nor extrabudgetary funds. These off-budget funds include bank loans, local government bonds and additional fees levied on enterprises. Data on self-raised funds tend to be the least transparent, but it is clear that governments in prosperous coastal provinces are more capable of extracting these funds than those in poor hinterland provinces. Thus, self-raised funds also tend to accentuate regional inequality in fiscal resources.

3 Expenditure on Social Sectors

Constrained by falling revenues, government budgetary expenditures as a share of GNP experienced a parallel decline, from about 35 per cent in 1978 to 18 per cent in 1993. The central share in total government expenditures also declined over this period (SSB 1995). Government budgetary expenditures on culture, education, science and health (CESH)⁴ grew by an average of 8.5 per cent per annum between 1978 and 1992 (SSB 1994). Much of this increase went to escalating labour costs so the real increase was somewhat lower.

Of these expenditures, most occurred in wealthier provinces and urban areas, resulting in an increased rural-urban inequality of per capita CESH expenditure (Wong *et al.* 1995). For example, recurrent expenditures on health increased by 62 per cent between 1978 and 1989. However, the share of funds allocated to hospitals at the county level and above increased over this period, while the share of expenditures on township health centres and preventive activities declined (MoPH 1991). Government expenditures on education, health and rural relief in poor areas have remained roughly constant (World Bank 1992).

In 1992, almost 90 per cent of expenditures on CESH were made by local governments, accounting for more than a quarter of total local expenditures (Wong *et al.* 1995). Since townships and village communities are responsible for the provision of most basic social services in rural areas, the financial situation of township governments and villages are the critical determinants of the extent and quality of social services provided.

⁴ Education and health care are the two major items in this category.

4 Township Government Finance

Both the rural economic reforms and fiscal decentralisation measures have increased township governments' fiscal functions. The majority of townships have adopted a system of revenue sharing with their jurisdictional county governments, which in principle is a mimic of revenue sharing arrangements between central and provincial governments. Similar patterns in the distribution of fiscal resources between localities and between revenue components are found at the township level.

In 1990, township budgetary revenues equalled 12 per cent of total local budgetary revenues. Over the period 1986-1990, township budgetary, extrabudgetary and self-raised funds grew by 86 per cent, 181 per cent and 241 per cent respectively. In 1990, revenue collected by township governments amounted to ¥48.5 billion, of which 75 per cent was budgetary revenue, six per cent were extrabudgetary funds and 19 per cent were township self-raised funds (Xiang 1992).

Each of the three components of township revenue has its own tax sources. Budgetary revenues include industrial and commercial taxes, such as VAT, income tax of township and village enterprises (TVEs) and private rural enterprises, animal slaughter tax, animal trading tax, free market transaction tax and the agricultural tax. Extrabudgetary funds derive from agricultural surtaxes, industrial-commercial surtaxes, education surtax and public utilities surtax. Township self-raised funds come from various fees levied on TVEs and rural households. As off-budget funds have increased in importance, significant disparities in the volume of revenues between townships have become apparent (Xiang 1992).

Non-agricultural production has made significant contributions to rural economic growth since the early 1980s. There are a number of different forms of rural enterprise in China. TVEs are collective enterprises which are owned by township governments and village committees. Initial capital for TVEs comes mainly from township governments and village committees, but enterprise management may be contracted to individuals. In return, these enterprises pay taxes and surtaxes, and may remit a share of profits to the entity which owns them. In 1994, the gross value of industrial output of TVEs surpassed that of state industry for the first time.

The number of private rural enterprises has also grown rapidly. In some areas, private enterprises dominate rural non-agricultural production. They are also subject to a number of taxes and levies, often constituting the main source of extrabudgetary funds of local governments.

The development of rural enterprises has been highly concentrated in coastal provinces. In general, the development of rural industry in poor areas has been constrained by low levels of physical and human capital, and disadvantaged access to domestic and international markets. In poor areas, the economy continues to be dominated by agriculture. Taxes and fees levied on rural households often represent a higher proportion of household incomes in poor areas than in better-off areas, but total revenues remain insubstantial. The relative importance of the different sources of township government revenue therefore varies considerably between townships, and poor townships are able to derive less revenue from all three (budgetary, extrabudgetary and off-budget) revenue sources. These poor townships can hardly pay the salaries of township government workers. This situation, known as *chi-fan caizheng*, or 'finance for meals only', has a strong impact on the provision of social services to rural households.

4.1 A comparison of two townships

To illustrate the revenue sources and expenditures of township finance, this section presents information from two townships: Taiping Township of Donglan County in Guangxi Province, and Huacao Township of Minhang District in Shanghai Municipality. Although a sample of two townships is too small to generalise about other townships in such a large and varied country, such a comparison provides some insight into the problems faced in township finance.

Taiping Township is located in a nationally designated poor county in a mountainous area of southwest China. Taiping's per capita household net income in 1993 was ¥533, much lower than the national average of ¥922. Taiping's economy is dominated by agriculture, which accounts for over 93 per cent of total employment. Four per cent of residents found jobs in local non-agricultural sec-

Table 1 Fiscal revenues of Taiping Township, Guangxi Province, 1993

	Amount (¥1,000)
Budgetary revenues	
Total collected	304.9
Industrial and Commercial Taxes	198.3
Agricultural Taxes	106.6
Net transfer from the county	751.0
Total available	1,055.9
Extrabudgetary revenues	
Total collected	11.3
Agricultural Surtax	9.6
Agriculture/Forestry Specialty Surtax	1.7
Total available	11.3
Self-raised funds	
Total collected	57.8
Family Planning Fee	12.8
Five-guarantee Welfare Fund	9.0
Water Improvement Fee	9.0
Militia Training Fee	9.0
Levy for subsidies to families of military personnel	18.0
Total available	57.8

Source: Taiping Township Government, Donglan County, Guangxi Province

tors, and two per cent found employment outside the township. In 1993, the gross value of total output (GVTO) in Taiping was around ¥15 million, nearly two-thirds of which came from agriculture.

Huacao Township is in suburban Shanghai, one of the most prosperous coastal cities in China. In 1993, Huacao's per capita after-tax net income was ¥2,227, more than four times that of Taiping.⁵ Six out of every seven residents of Huacao were engaged in off-farm activities, and nearly one sixth of total employment occurred outside the township. Huacao's GVTO in 1993 was more than ¥520 million, and was dominated by non-agricultural output.

Most of the disparities between the two townships are associated with differences in the development of TVEs. Taiping's TVEs accounted for only two per

cent of GVTO and one per cent of total employment. By comparison, Huacao's TVEs generated 93 per cent of GVTO and nearly half of total employment. From its TVEs, Huacao derived a total of over ¥66 million in taxes and remitted profits, almost 2,000 times more than in Taiping. Despite the strong non-agricultural sector in Huacao, it is still considered to be a rural area, since all administrative townships in China are categorised as rural. The comparison between Huacao and Taiping therefore represents two extreme cases of rural finance.

4.1.1 Township revenues

The two townships' government revenues and their sources are reported in Tables 1 and 2. The three components of revenues collected in Taiping totalled ¥374,000, or about ¥20 per capita. By comparison, the total revenues collected in Huacao were ¥35 million, well over ¥2,000 per capita. Taiping received a transfer of ¥751,000 from the county,

⁵ This calculation omits the substantial profits retained by township and sub-township enterprises and authorities in Huacao, and thus underestimates the actual disparity between the two townships.

Table 2 Fiscal revenues of Huacao Township, Shanghai Municipality, 1993

	Amount (¥1,000)
Budgetary revenues	
Total collected	18,283.7
VAT	3,830.3
Business Tax	9,349.2
Corporate Income Tax	3,944.1
Agricultural Tax	485.3
City Construction Tax	172.9
Foreign Funded Enterprise Tax	501.9
Submitted to county government	- 11,180.7
Transfers from county government	0.0
Total available	7,103.0
Extrabudgetary revenues	
Total collected	15,645.9
Rural Education Surtax ^a	432.6
Embankment Maintenance Surtax ^b	213.3
Revenues from real estate development	15,000.0
Submitted to district government	-154.0
Transfers from district government ^c	1,520.0
Total available	17,011.9
Self Raised funds	
Total collected	993.2
Agricultural Activities Fund ^d	556.6
Sideline Production Fund ^d	143.1
Social Spending Fund ^d	293.5
Total available	993.2

Notes: ^a The Education Surtax was delivered to the township education committee after ¥54,000 was submitted to the district government.

^b ¥100,000 of the Embankment Maintenance Surtax was submitted to the district government.

^c This transfer was for spending on education.

^d Agriculture and sideline production subsidy funds are levied based on the gross value of output of enterprises; the social spending fund is based on their profits. Individual business owners pay ¥200 per household for subsidies to agriculture and ¥60 per household for subsidies to sideline production.

Sources: Economic Office of Huacao Township, and Compiled Statistical Data of Huacao Township (1993)

more than double the revenues collected in the township. This transfer increased its available budgetary revenue to over ¥1 million. On the other hand, Huacao remitted over 60 per cent of its ¥18 million budgetary revenue to the county. Despite these transfers, considerable disparities between the two townships remain. After-transfer available revenues in Taiping were ¥1.1 million, or ¥63 per capita, and in Huacao were ¥25.1 million, or ¥1479 per capita.

An examination of the structure of the three revenue components finds that Taiping's off-budget (extrabudgetary and self-raised) revenues were insignificant compared with budgetary revenues. The former accounted for just 18 per cent of total revenue collected and only six per cent of total after-transfer revenues. In Huacao, off-budget revenues accounted for almost half of total revenue collected and 72 per cent of total after-transfer revenues. The larger share of off-budget revenues in

Table 3 Fiscal expenditures of Taiping Township, Guangxi Province, 1993

	Total (¥1,000)	% spent on wages, subsidies and pensions
Total budgetary expenditures	1,153.1	82.8
Aid to agricultural production	40.0	
Agriculture and forestry	60.7	75.5
Culture, education and health total:	859.6	90.5
Culture	2.4	89.3
Education	766.7	92.8
of which:		
High schools	174.3	79.9
Primary schools	592.4	97.0
Health		
of which:	72.3	65.4
Township health centre	72.3	65.4
Village health stations	0.0	0.0
Family planning	12.8	92.0
Radio, movie and TV	5.4	89.9
Administration cost	148.9	61.9
Township fiscal office	52.1	28.4
General administration	96.8	80.0
Other	43.9	88.5
Total extrabudgetary expenditures	11.3	
Education recurrent costs	1.0	
Broadcasting	0.2	
Administration fee	5.1	
Other	5.0	
Total self-raised fund expenditures	57.8	

Source: Taiping Township Government, Donglan County, Guangxi Province

the total revenues available is due to the fact that they are not subject to remittance to the upper level of government.

In rural China, taxes and fees are levied on either enterprises or households. In general, industrial and commercial taxes (ICT) are borne by enterprises, whereas most agricultural taxes (e.g. the agricultural tax, agricultural and forestry specialty tax, and farmland user tax) are borne by agricultural households. Therefore, it is worthwhile to compare the proportion of taxes and fees directly imposed on rural households in the two townships.

Just like other poor townships in rural China, Taiping is characterised by the underdevelopment of rural enterprises. Due to the absence of TVEs as sources of revenue, the township government has to rely heavily on direct collections from rural households. Over one third of Taiping's budgetary revenues came from agricultural taxes, which were levied on rural households (Table 1). This is also true for off-budgetary revenues. Although just under two-thirds of budgetary revenues came from the category of ICT, part of this was borne by households, since this category includes such taxes as free market transaction tax, animal trading tax, and slaugh-

Table 4 Fiscal expenditures of Huacao Township, Shanghai Municipality, 1993

	Total (¥1,000)	Recurrent costs (¥1,000)	Capital investment (¥1,000)	% wage in recurrent costs
Total Budgetary and Extrabudgetary expenditures	17,744.0	6,881.9	10,862.1	51.4
Budgetary expenditures	8,147.7	4,408.3	3,739.4	61.0
Administration	950.0	950.0		25.7
Agriculture	321.0		321.0	
Education	2,690.0	2,690.0		82.3
Health care	1,244.5	150.0	1,094.5	
Welfare	162.3	162.3		15.8
Other	2,777.9	456.0	2,323.9	45.0
Extrabudgetary expenditures	9,596.3	2,473.6	7,122.7	34.4
Administration	1,400.3	1,400.3		42.8
Agriculture	5,220.0	450.0	4,770.0	55.6
Education	498.3	498.3		
Others	2,477.7	125.0	2,352.7	
Self-raised funds	909.8			

Source: Fiscal Office of Huacao Township, Minhang District, Shanghai Municipality

ter tax. In Huacao, on the other hand, taxes levied on enterprises accounted for over 96 per cent of budgetary revenue collected (Table 2). Most extra-budgetary revenues and self-raised funds were also derived from enterprises. Thus, in spite of the much smaller volume of per capita township government revenues in Taiping, rural households have a heavier tax burden relative to their net income, since in Huacao virtually all taxes are paid by TVEs.

The way taxes are collected from households has an adverse effect on the distribution of income. Most taxes and fees, such as fees for education, cultural activities, family planning, militia training etc., are imposed on a per capita or per household basis at a flat rate regardless of income (Li *et al.* 1990). Some are levied on household land area, but since land and household size do not vary greatly within a township in China, they approximate per capita fees. This implies a regressive tax rate, in which poor households pay proportionately more than better-off ones. To protect rural households from over-extraction by local governments and village authorities, the central government has stipulated

that levies should not exceed five per cent of household net income. Some reports suggest that this limit has sometimes not been observed.

4.1.2 Township expenditures

Township expenditures in Taiping and Huacao are reported in Tables 3 and 4. Reflecting the disparity in the revenues available to the two townships, total budgetary and off-budgetary expenditures were ¥1.2 million in Taiping and ¥18.7 million in Huacao,⁶ which translates into per capita expenditures of ¥66 and ¥1,040 respectively.

Two observations can be made about the structure of Taiping's spending. First, Taiping's expenditures were almost exhausted by recurrent costs. Nearly 90 per cent of total expenditures were spent on recurrent costs of the culture, education and health (CEH) sectors and the township administration. By comparison, although recurrent expenditures on these sectors in

⁶ It is not clear whether the ¥6.4 million difference between total available revenues and expenditures is due to an actual surplus or to unreported expenditures.

Table 5 Social welfare expenditures, Huacao Township, Shanghai Municipality, 1993

	Total (¥1,000)	Township (¥1,000)	Village (¥1,000)	Sub-Village units (¥1,000)
Total	3,324.5	1,397.9	1,405.8	520.8
Five-guarantee programme	14.8	10.0	3.9	0.9
Income maintenance	21.8	8.2	11.7	1.9
Subsidies to families of military personnel	140.7	105.0	15.6	20.1
Kindergartens	300.9		289.4	11.5
Culture and Education	598.3	490.0	91.4	16.9
Pensions	1,473.7	617.5	536.6	319.6
Nursing homes	70.0	70.0		
Cooperative health care schemes	621.4	91.1	401.9	128.4
Family planning programme	82.9	6.1	55.3	21.5

Sources: Economic Office of Huacao Township, Minhang District, Shanghai Municipality

Huacao were four times the level of Taiping's, they only accounted for 20 per cent of total expenditures.

Second, Taiping's recurrent costs were dominated by the labour costs (wages, subsidies and pensions) of employees of township government and public institutions, such as schools and the township health centre. This item accounted for nearly 83 per cent of total budgetary expenditures, and over 90 per cent of CEH expenditures (Table 3). By comparison, Huacao allocated more than 60 per cent of its total expenditures to capital investments, indicating the active involvement of the township in developing economic activities. While recurrent costs accounted for less than 40 per cent of total expenditures, labour costs accounted for just over half of recurrent costs (Table 4).

Since the number of government employees has proved difficult to reduce, and their salaries are based on a national salary scheme, the labour costs of township governments are downwardly rigid. Thus, only revenues after payment of labour costs are really at the disposal of township governments. The gap in after-payroll revenue between the two

townships is much wider than that for total revenues. The ratio of Huacao's after-payroll revenues to Taiping's is 45:1, compared with the ratio of total available revenues (24:1) and total expenditures (16:1).

4.1.3 Village funds

Villages are not a level of government, but are a community or collective entity, and their revenues are not included in local government budgetary data. However, villages also have self-raised funds. The actual disparities between the two townships are even more striking if we take into account the different financial capacities of their villages.

In Taiping, villages have little resources to finance any services for their residents. Even the ¥40 monthly subsidies for village leaders are paid by the township government. In contrast, villages and sub-village units in Huacao have their own financial resources, funded by revenues from their enterprises. This enables them to operate their own health care, pension and primary education programmes. Villages and sub-village units in Huacao provided 58 per cent of the total off-budgetary

funding for local social services (Table 5). They accounted for 62 per cent of the off-budgetary funding for income maintenance programmes, 58 per cent of the off-budgetary funding for pension programmes, and 85 per cent of the off-budgetary funding for cooperative health care schemes.

4.1.4 Provision of social services

Huacao spent over ¥4.4 million on the education and health sectors, or ¥261 per capita. This is almost six times Taiping's figure of ¥47 per capita. Abundant funding has allowed Huacao to extend its social services. The township runs its own pension programmes which provided 2,696 elderly with an average of ¥445 per person in 1993. Cooperative health care schemes were established in all villages, reimbursing their residents for 50-80 per cent of health care expenses.

In contrast, 'finance for meals only' means that after public employees' wages are paid (to better-off non-agricultural households), little is left for spending on basic social services for poorer agricultural households. For example, in Donglan county as a whole, most villages have no health stations at all, and none of its villages have cooperative health care schemes or other health insurance programmes. Similar problems are faced in education and other basic social services. In 1993, 89 households in Donglan were entitled to welfare support through the five-guarantee programme.⁷ The government provided each with only ¥12 cash per month and 14 kg of food-grains per year. This support is far too little to bring them above the poverty line, or to ensure they have access to health services when they are sick. Only half of rural residents who had foodgrain shortages received aid from relief programmes (Donglan 1994).

Insufficient funding of health services has led to an emphasis on income-generating activities. Fees are now charged for many services, leading to a shift of resources from primary health care to more expensive, curative practice (Tang *et al.* 1994) and a sub-optimal level of preventive service provision (see Shu *et al.* 1997). Other basic services, such as telephones and postal services, have also been underfunded or cut altogether.

⁷ This provides food, clothing, fuel, housing and funeral expenses for the elderly and disabled who are unable to work and who lack family support.

5 Options for Increased Funding to Poor Townships

The trend towards the regionalisation of fiscal revenues is partly induced by fiscal decentralisation. At the macro-level, the centre's redistributive role should be strengthened on the basis of a more transparent, rule-based fiscal system. More demand elements, such as population and income level, should be incorporated into the formulae for determining central-provincial transfers, and transfers between lower level governments. Off-budgetary revenues should be redefined and closely monitored. In poor areas, the government finance required to maintain the minimum acceptable level of basic social services, especially primary education and primary health care, should be rigidly defined and given the highest priority. The provision of basic social services should be an important indicator in the evaluation of local government performance. In addition, strong urban-biased development policies, such as suppressing the procurement prices of grains to subsidise urban residents, should be gradually eliminated.

Fiscal decentralisation has placed pressures on poor townships by strengthening the link between township expenditures and revenues. Although this strategy may stimulate more active involvement of township governments in local economic development, it leaves the quality and extent of basic social services in rural communities conditional upon local revenues. At the township and village levels, it is important to ensure that fiscal resources are efficiently utilised and that social services reach the poor villages and households. Most fiscal revenues available to poor townships are spent on the labour costs of government and public institutions. These tend to be concentrated in the county and township seats, favouring non-agricultural households and exacerbating the shortage of social services provided to rural households. Yet taxes and fees place a heavier burden on rural households in poor areas. It is important to ensure the full participation of villagers or village committees in decision making regarding the use of these levies. This would help ensure that the funds are spent more equitably on the welfare of the whole community.

Insufficient funding is a major cause of the under-provision of social services to rural households in poor townships. Even if all collected funds are appropriately

used for the community, poor villages will still not be able to finance basic social services without external financial assistance. To increase fiscal transfers from the centre involves complicated issues, and not just economic ones. Therefore, two additional sources of funding for social services are suggested here.

Poverty alleviation funds. One potential source of financing social services in poor rural areas are the national and provincial poverty alleviation funds. Since 1986, China has shifted the focus of poverty alleviation programmes from relief to poverty reduction through economic development. In recent years, the central government has allocated more than ¥4 billion in grants and subsidised credits annually to assist the nationally designated poor provinces. In addition, most provinces have their own programmes to support provincially designated poor counties. Total provincial support to these counties is roughly equal to central government support to nationally designated poor counties. These programmes have played a significant role in promoting income growth of the poor through improvement of infrastructure and development projects in poor areas (World Bank 1992).

The new strategy of focusing on economic development in poor areas is of great significance. However, there has been a tendency to overemphasise projects that generate short-run revenues. The provision of basic social services which cannot generate quick profits has been neglected. Since investment in human capital, such as primary education and health care, is an important determinant of eco-

nomie growth, this can be harmful to the long-run development of poor areas. The illiterate and those who suffer from illness will be least able to participate in growth and more likely to remain in poverty. In poor townships with little resources to finance social services, provincial government or poverty alleviation offices could request that a certain proportion of the funds be used for financing social services.

Family planning programme funds. Another alternative source for financing health care, particularly for women and children, is government family planning funds. In 1980, the government decided to implement the 'one child' policy,⁸ and family planning commissions were instituted at central and local levels. Budgetary expenditure on family planning increased rapidly as the campaign intensified, amounting to ¥1,345 million in 1990 (Wong *et al.* 1995). This was over five times more than the expenditures on maternal and child health.

China's family planning programmes have focused on fertility control to limit population growth, with considerable success in many areas. Recent demographic trends now allow family planning programmes to place more emphasis on quality-enhancing aspects, such as education and health. Family planning programmes and maternal and child health programmes could be integrated and scarce resources used more efficiently. If only 10 per cent of family planning funds were allocated to maternal and child health care in poor areas, these services would be improved substantially.

⁸ The policy has been modified since the mid-1980s. Most provincial regulations now allow rural couples to have a second child if the first one is a girl after a specified minimum years of spacing.

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