Poverty and Inequality and Social Policy in China

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Editorial Note

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Abstract

Despite prolonged economic growth, poverty has become a more notable and noted feature of Chinese society. The paper examines three phases of development since the foundation of the People's Republic: the central planning era (1949 –1978); the pro-urban growth model (1978 – 1999); and more recent changes (1999 – 2004). For each phase the nature of the economic and social policies are described and the effects on poverty and inequality are examined. The limitations of a social policy that is subservient to the economic strategy are considered. The alternative of a model of social development based on the livelihood approach is analysed and its potential to reduce poverty and inequality are considered.

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Key words: poverty, inequality, social policy, China, livelihoods, social development.

Introduction

Poverty has long been a feature of Chinese society (Li, 2003; Khan, et al., 2002). The long period of economic growth in China has helped many people become richer. A series of research studies in the late 1990s, however, unveiled a disturbing fact that alongside the 'new rich', there are people suffering from absolute poverty including urban marginalized groups, such as the long term unemployed (or laid-off workers) and low income households, rural-urban migrant workers, and farmers living in remote rural areas. The economic and social conditions of the poor contrast sharply with the conditions of the booming middle class.

There are very different opinions over the importance of poverty and inequality. Since the beginning of the economic reform, a cleavage between economists and sociologists has developed. Economists took on the responsibility of unleashing China from the control of the central planning system and integrating the Chinese economy with the prevailing market economy in the world. Various social problems have been left to sociologists whose voices have long been overwhelmed by the 'fast train loaded with gold rushers' (Guan, 2003).

As the reform moved on, there was growing awareness of slow social development turning to a 'bottleneck' of further marketisation and economic growth. Thus in the 1990s various social policies, including housing, healthcare, pensions and the social safety-net, were forced onto both the political as well as the academic agendas. In the new agendas, the Chinese equivalent of the term 'social' is no longer treated as a disturbance only aimed to distract from market freedom. The study of social problems was no longer considered to be an attempt to disturb social solidarity and stability as in the central planning era and the early days of the reform, but rather to be an 'engineering' project to facilitate further economic growth. Consequently, reforms in social policy areas such as housing, pensions, education, healthcare and social security were all added to the 'system' changes and accelerated in order to facilitate the functioning of a stable urban society—the backbone of economic development. Following the logic of market reform, the general principle was to reduce the welfare burdens of the state sector and promote decentralisation and privatisation.

Nevertheless, towards the end of the 1990s, the mounting political and social instability represented by protesters, increased urban crime rate and various rights issues related to rural-urban labour migration, revealed many social problems hidden behind the growing economic prosperity in China. The income

of some social groups decreased in absolute value and the gap between the rich and the poor widened quickly (Li$_a$, 2003). Confronted with the new social challenges, the market appears to be unable to offer a satisfactory solution. Contemplation of the social policy reform in China reveals some conflicts:

1) The giant engineering projects led by top-down state policy to facilitate the growth of business sectors face constraints both in terms of resources and the administrative capacity of the system.
2) The urban-centric social policy reform and the newly established urban social security system are not compatible with the growing pressure of growing numbers of redundant rural labours.

At this point, we unavoidably come to a central policy dilemma. Without sufficient financial resources, the state will not be able to handle social problems yet without dealing with the social problems, economic growth cannot be sustained. In this paper, we examine poverty and inequality in China and suggest that there need to be efforts to get out of the dilemma. The problems are rooted in the focus on the two ends, the accumulation of resources and stability of society, both of which seem to rely on the other. In this paper, we argue that the arbitrary division between the economic growth and social stability has only focussed on financial constraints and choices. It has failed to grasp the potential of integrating social development into the overall national development strategy. This paper discusses the problems faced by the traditional combination of economic development strategies and supportive social policy and looks into the alternative—the livelihood approach.

In the following sections, we first study three stages of China's development. In each stage, we look at the economic growth strategies and the overall outcomes; then trace the social policy of the same period and identify the impact of economic and social changes on poverty and inequality. We then comment on the problems of social policy models that are led by economic strategy and suggest that the problems posed by economic strategies have literally forced the state to take on more tasks on social development. This suggests it is time to move towards a more comprehensive approach toward development. In the final section, we discuss the livelihood approach and its relevance to resolve China's poverty and inequality.

Development in the People's Republic of China

Since the formation of the Communist government in 1949, China has experienced many changes of policy and outcomes. There has been much pain

and much progress. It is convenient if somewhat arbitrary to distinguish three eras of economic development. They are:

1) Central Planning era (1949-1978);
2) pro-growth urban biased economic reform era which focussed on industrial achievement with state provision of various social services and social security (1979-1999) and
3) pro-poor growth era which begins to deal with poverty, particularly in rural areas (2000-2004)[1].

The economic policies of each era reflected the political and development strategy at the time. Social policy in each era also corresponded to the economic strategies to remove the barriers to achieve economic goals. The combination of economic and social policies had very different effects on poverty and inequality. In this section, we follow the history of development in China to examine the economic strategy and outcomes and the social policies and we examine the outcomes in terms of poverty and inequality in the three eras.

1. Central planning era (1949-1978)

In common with most communist countries, China adopted central planning from 1949. The central planning system was an attempt to boost fast growth of heavy industries in urban areas. Social policy played a supportive role to strengthen the state's ability to lower labour costs and maintain social control.

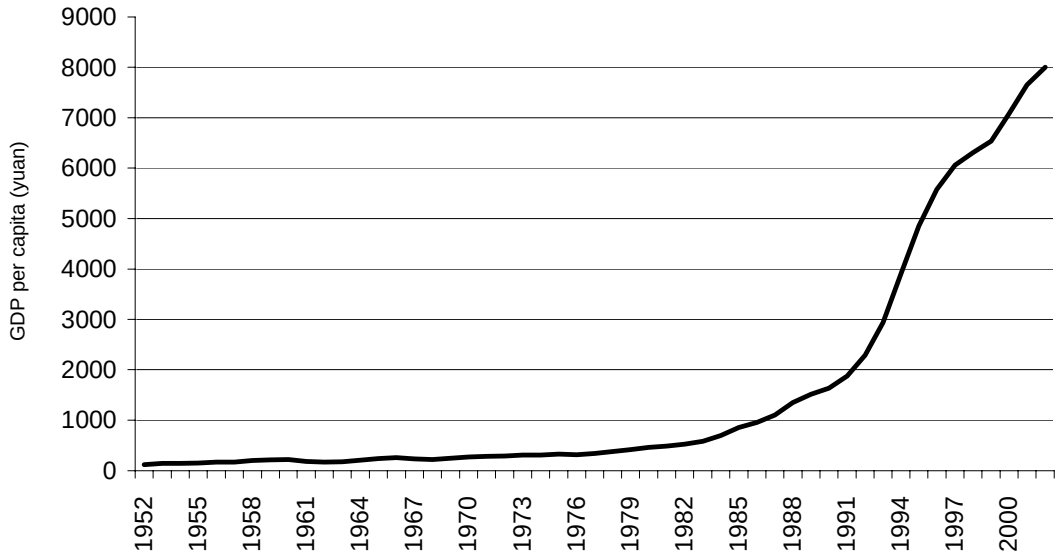
1A. DEVELOPMENT OF HEAVY INDUSTRIES

When the Communist Party first came into power, the People's Republic of China faced hostility from several sources. First, the new Chinese government was not recognised diplomatically by many western powers. Second, the dissident government in Taiwan was eager to come back to mainland China. Third, in 1949 the Liberation Army were still busy consolidating control in western China. Fourth, in 1950, China entered the Korean War. All these factors contributed to the feeling of urgency that China needed to build up the ability to maintain strong national defence. Domestically, after years of internal war, the economy was severely damaged. The economy largely relied on traditional farming. Modern industry almost did not exist. The new state had won enthusiastic support from the people. The communists' goal was to 'fighting for

1 Many people call 2003 the beginning of a new era on the basis of the new policy to change the treatment of rural-urban migration and rural development. However, China's 'Developing the West' program started in 2000, the focus being to narrow the gap between coastal and inland areas and boost growth in western China, the poorest region. This program aimed at diverting resources from the fast growing coastal areas to less developed western provinces.

unification, stabilising the country and starting constructions', all at the same time. Immediately after 1949, the priority for development was heavy industry and national defence (*The First Five Year Plan*, 1952). By 1957 when the first five year plan was completed, the Chinese government was confidently promoting the idea of catching up with the US and Britain by boosting iron and steel production--a symbol of industrialisation. By 1957, through systematic nationalisation, the economy had been brought completely under state control. The state stipulated the intended output levels in heavy industries, in particular the output of iron and steel. Light industries' output and farming production were calculated according to the needs of urban heavy industries (Lin et al., 1994).

Figure 1: GDP per capita (1952-2002)



Data source: China Statistics Press, *China Statistics Yearbook*, Various issues.

The economy recovered and grew very fast during the First Five Year Plan and despite catastrophic set backs during the 'Great Leap Forward' and the Cultural Revolution, growth was generally maintained. As shown in Figure 1, from 1952 to 1978, the annual growth rate of GDP averaged 6.5 percent. Industrial production grew at 11.4 percent per annum. Heavy industries grew at 13.8 percent per annum. However, farming output only grew at 2.7 percent per annum during the same period. The focus on heavy industries secured high capital accumulation in the related sectors and low investment in other industries, and in farming. The economic structure changed rapidly from an economy dominated by farming to one dominated by heavy industries. In 1949,

farming output was 58.5 per cent of the total output, whilst industrial output was 30 per cent. Heavy industry was only 26.4 per cent of industrial output. By the end of the central planning period, in 1978, farming output was only 28.1 percent of total output, with heavy industry dominating the national economy (China Statistics Bureau, 1999).

1B. URBAN BIASED SOCIAL POLICY

During the central planning era, various areas of social policy were considered to be supportive to industrial production. The basic idea was 'production first and living secondary'. The concept of social development had never been written into the national development plans until the 'Sixth Five Year Plan', well into the reform era (1980-1985). However, the state had intervened heavy-handedly in various 'social' aspects. Starting from 1952, a rationing system was established. Social provisions were made to guarantee for urban residents basic food, housing, education and healthcare at very low prices.

1. In healthcare, a new system was established, in which government employees could enjoy free healthcare and state enterprise employees could receive healthcare as a form of labour protection. Healthcare funds for government employees were paid directly out of public funds. Healthcare funds for enterprise employees were paid by their work units. Farmers were not included in the public healthcare system. In the late 1950s, the state organised farmers and collectives to pay jointly for and operate 'cooperative healthcare'[2] in rural areas (Zhang, 2003). In the late 1960s, cooperative healthcare developed quickly. By 1980, nearly 90 per cent of rural areas were covered by cooperative healthcare.
2. The education system in 1949 was developed from the Communist's education campaigns before the Liberation that had emphasised mass education. The focus was on equity through providing primary school education to everyone. In the early 1950s, China began to copy the Soviet

2 In 1955, in the rural areas of Shangxi and Henan provinces, a number of healthcare clinics were established with the help of 'Rural Production Cooperatives'—the authorities at the village level. Members of the cooperatives contributed in the form of 'healthcare fees'. The production cooperatives used local public funds to contribute for the operation of the clinics. In some cases, farmers contributed to mutual funds to pay for cooperative healthcare. Later, a series of documents issued by the central government to promote cooperative healthcare to all rural areas in China helped to formalise the rural healthcare system. In the rural cooperative healthcare system, all financial resources for running the clinics came from farmers contribution or from local collectives which accumulated money though local production. Funds were pooled locally without state support.

Union's education system. The idea was to link education directly to economic development. The new system focused on the direct contribution of science and technology and the preparation of skills for industrialisation and national defence. As a result, the education system was transformed from a universal education system to an elite education system with the latter paying more attention to higher education and less to basic education, more to science and engineering and less to social sciences and the humanities, and more to vocational training and less to general education. University education was made free. The state was in charge of recruiting students and of job allocation after the students finished higher education. This policy ended free labour mobility (China Encyclopaedia Press, 1984).

3. In the 1950s, China began to set up a public housing system in urban areas. The purpose of the new system was to make housing a form of welfare. Funding for housing construction came from the state and was allocated to work units as part of basic construction funds. Employers and local authorities were responsible for housing construction and allocation. Only urban employees with urban residency were entitled to public housing which was owned by the state. Residents of public housing only needed to pay a small amount of money as rent. In rural areas, farmers were responsible for their own housing. This system was not changed in the central planning era.

4. China started to establish an urban social security system fairly early. In 1951, the State Council published the first 'Regulations of Labour Security for the People's Republic of China'. According to this regulation, employees working for enterprises of more than 50 staff members would be able to enjoy benefits of pension, healthcare, child birth and work injuries. The 1953 revision was considered to be the beginning of a formal social security system in China. In 1954, the right to social security was written into the constitution. It was stipulated that when workers became old, sick or disabled, they had the right to receive material help. The state promised to organise social security schemes to protect this right of workers. In the next twenty years, China gradually established retirement and pension schemes for urban employees of state and collective work units. At the same time, the urban poor who did not have wage income would receive social relief benefits. However, the rural population were not included in the social security system (China Statistics Bureau, 2002).

1C. POVERTY AND INEQUALITY

Social policy in this era reflected the fact that the priority of developing heavy industries was under great resource constraint. The high investment and accumulation rates often associated with heavy industries made it impossible for other economic sectors to develop at the same rate. Social policy, being a tool to facilitate industrialisation, was strictly limited to help urban development. This system had several implications for poverty and inequality.

First, during the central planning era, as a result of the development strategy of industrialisation through heavy industries and strict control of workers' salaries, the income of the urban population increased only very slowly. In 1978, the average disposable income per capita in urban areas was 343 yuan per year, 35.4 percent higher than that in 1957; if price changes were taken into account, the real income growth was 18.5 percent or less than one percent per annum. However, as most of the living necessities were rationed by voucher, the actual living standard was not directly linked with individual income. Some earlier surveys on consumption disclosed the changes in living standard of the urban population. In 1957, the average consumption was 222 yuan, of which 130 yuan was on food, 27 yuan was on clothes. In 1964, the average consumption was 221 yuan, 10.4 per cent lower than in 1957 if price changes are considered, of which 131 yuan was on food and 24 yuan was on clothes. By the end of the central planning era, in 1978, the average consumption was 311 yuan: 131 yuan was on food and 24 yuan was on clothes. Allowing for inflation, the level of consumption in 1978 was 22.6 percent higher than in 1957. During the period, the structure of consumption remained almost unchanged; most household spending was on food and clothes (National Statistics Bureau, 1999). In rural areas, the annual net income per person in 1978 was 134 yuan, only 40 per cent of average urban consumption. In terms of living costs, an average farmer spent 116 yuan per year on consumption, in which 79 yuan was on food and 15 yuan was on clothes (*China Statistics Yearbook*, various issues). These data on income and expenditures suggest that for nearly 30 years, Chinese people's living condition did not improve very much.

In 1978, 28 per cent of the population, about 270 million people, lived in absolute poverty[3] (Chen, 1998). The Chinese government's definition of

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3 It should be noted that the poverty line used in China is much lower than the internationally recognised poverty line. The poverty line for 1985 was 206 yuan per year. It is adjusted annually for inflation. In 1990, the poverty line was 300 yuan. In 1999, it reached 625 yuan, much lower than the poverty line of US$1 per day (2800-2900 yuan per year). Also, in the official statistics, the data used to calculate rural income include the income that farmers have to put aside for reinvestment, which is

absolute poverty is based on the minimum standard of living, that is not suffering from problems of 'wenbao' – directly translated as 'difficulties in keeping warm and having a full stomach'. It means that a person should not suffer from hunger, have clothes to wear and do not suffer from cold weather. For many years, the calculation of numbers in poverty was based on the average income of a county. When a county's average income fell before the minimum income level, it would be rated as a 'county of poverty', and all people in the county would be counted as in poverty. Conversely, no-one in a county on average above the poverty level was counted as poor. This system did not change until 1996.

Second, the majority of the population in rural areas did not enjoy any of the benefits which were available to urban residents. The money income of urban residents was 2.6 times of the income of rural residents. If we also include benefits, the ratio of rural expenditure to urban expenditure is more unequal. In 1978 a rural resident's consumption averaged 138 yuan, while urban residents' consumption averaged 405 yuan, a ratio of 1:2.9 (*China Statistics Yearbook*, 1996).

Third, one of the key functions of the social welfare system was control of labour mobility. Through job allocation after education, work units' welfare provision and the urban residency registration system, farmers could not live and work in urban areas. As a result, industrialisation was not accompanied by urbanisation. In 1949, there were 132 cities in China. The non-agricultural population in urban areas was 27.4 millions, 5.1 percent of the total population. Despite the rapid urbanisation during the 1950s (208 cities and 10.5 percent urban non-farming population in 1961), the tightened control in 1962 led to serious de-urbanisation. After 1962, the ratio of urban to rural population started to decline. By 1978, there were 193 cities and 8.5 per cent of the total population were registered as non-farming urban residents, as shown in Figure 2.

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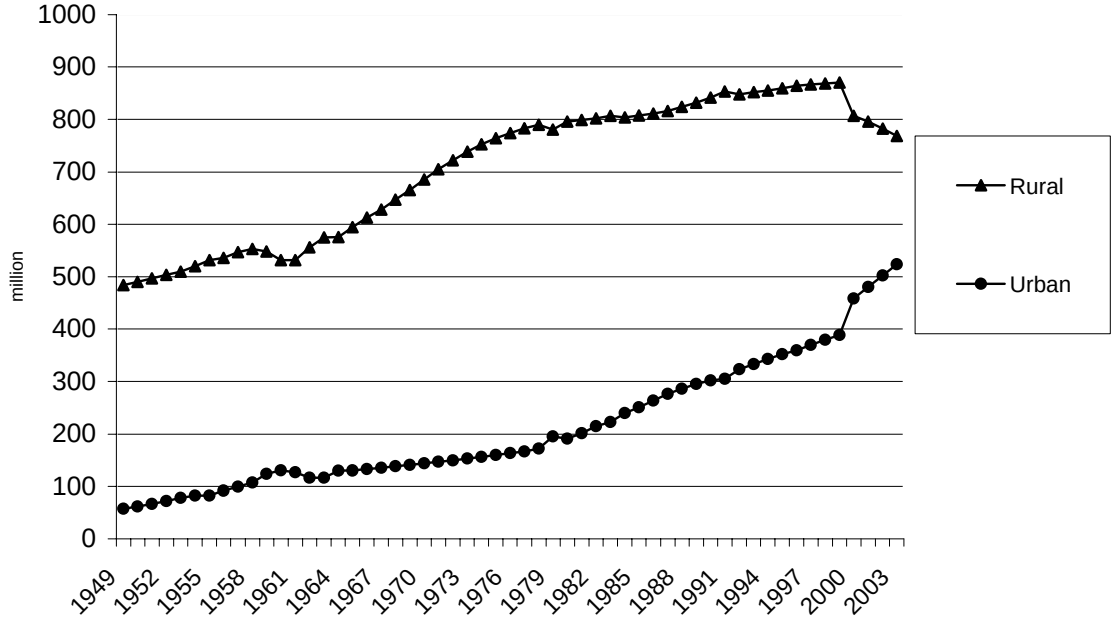
on average around one third of the total income. Therefore, if calculated according to international standard, rural poverty in China would be more serious than the official data have suggested.

Figure 2: Rural and Urban Population (1949-2003)



Note: Growth of rural population began to slow down after 1978 and increased after 1984. It started to slow down again in the late 1990s. Growth of urban population began to accelerate after 1978. The several kinky sections in the urban population line such as the rise in urban population in the late 1950s, in late 1970s and after 2000 were related to policy that affected urbanisation.
Source: China Statistics Press, *China Labour Statistical Yearbook*, Various issues. Data for 2003 were officially announced.

Finally, within urban areas, inequality was partly disguised by the fact that the majority were poor. The system suffered from all the illnesses of central planning: incomplete information for the policy makers, low efficiency and low productivity under state ownership and, for the purpose of administration, great limitation of freedom through highly centralised social control.[4] In theory, all urban employees in state or collective sectors received equal pay,[5] the state promised full employment and a range of state sponsored social welfare to make sure that basic needs were satisfied from cradle to grave. However, one should not neglect that resource constraints meant not everyone could receive the stipulated state benefits all at the same time. A queuing system which unavoidably cultivated favouritism was particularly visible in the allocation of

4 The extent of political control of all activities means that statistics in incomes and poverty during this period must be treated with great caution. For example, many lived and died in labour camps, omitted from official statistics on poverty.

5 There were adjustment for skills and working age.

housing. What is more, while the education system offered individuals the opportunity to have higher education without paying any fee, nevertheless the state also had total control of where and what kind of job the graduates would work at. Therefore, people with the same qualification could end up very differently in terms of career development. Meanwhile, the social security system together with the equal pay system had a strong disincentive effect on workers. A very good example was the prevalence of people taking advantage of labour protection by taking long term sick leave.

The result of central planning was clear. Nearly thirty years of central planning led to low productivity even in the fastest growing sector, pervasive poverty both in urban and rural areas as well as extremely low morale of the people.

2. A pro-urban growth model (1978-1999)

Although both were urban biased, the pro-urban growth model during 1978-1999 was different from the Central Planning model. After 1978, markets were increasingly liberalised. The new model took advantage of all possible sources to support growth in urban areas. Before the focus had only been on heavy industries. There was much freer labour mobility in contrast to the complete state control which caused tremendous difficulties for any changes. From 1978 to 2000, the solution to achieve economic growth in China was industrialisation and urbanisation. The most important indicator of the success of the economy that was used was the growth in GDP. Like the experiences of many other countries, the model focused on industrial achievement with state provision of advanced education for the urban population, housing and transport systems for urban expansion, and social security for workers engaged in the process of industrialisation and urbanisation. Many developing countries had gone through a similar path during their transition from rural society to industrialised society. Hall and Midgley (2004) have a very clear description of the logic behind this model:

> Many political leaders and social scientists today believe that poverty has little to do with wider issues of privilege or structural inequality and they argue instead that poverty problem can be solved when countries promote economic growth by creating free markets, reducing government regulations and social services, attracting foreign investment and permitting entrepreneurs to pursue profits. By adopting a vibrant form of free market capitalism, governments create employment opportunities and in this way raise the incomes of the poor (Hall and Midgley, 2004, p.45).

In this section, we first examine China's growth strategies with regard to industrialisation and urbanisation, then look at the role of social policy during this period and finally identify the problems behind this type of development.

2A. INDUSTRIALISATION

China's industrialisation after 1978 changed direction. Heavy industries were no longer considered the only source of growth. At the beginning of the reform, the state set two very simple targets for economic growth: to increase the GDP by 3 times by the end of 1990 and by another 3 times by the end of 2000.

To achieve the targets, there needed to be reforms in the industrial sector. It was acknowledged that the tight state control and closed economy were the key constraints on economic development. To change the situation, there were a series of reform policies in the industrial sector. First, the state gave up direct control over state enterprises allowing enterprises to keep some of their profits. Related policies included:

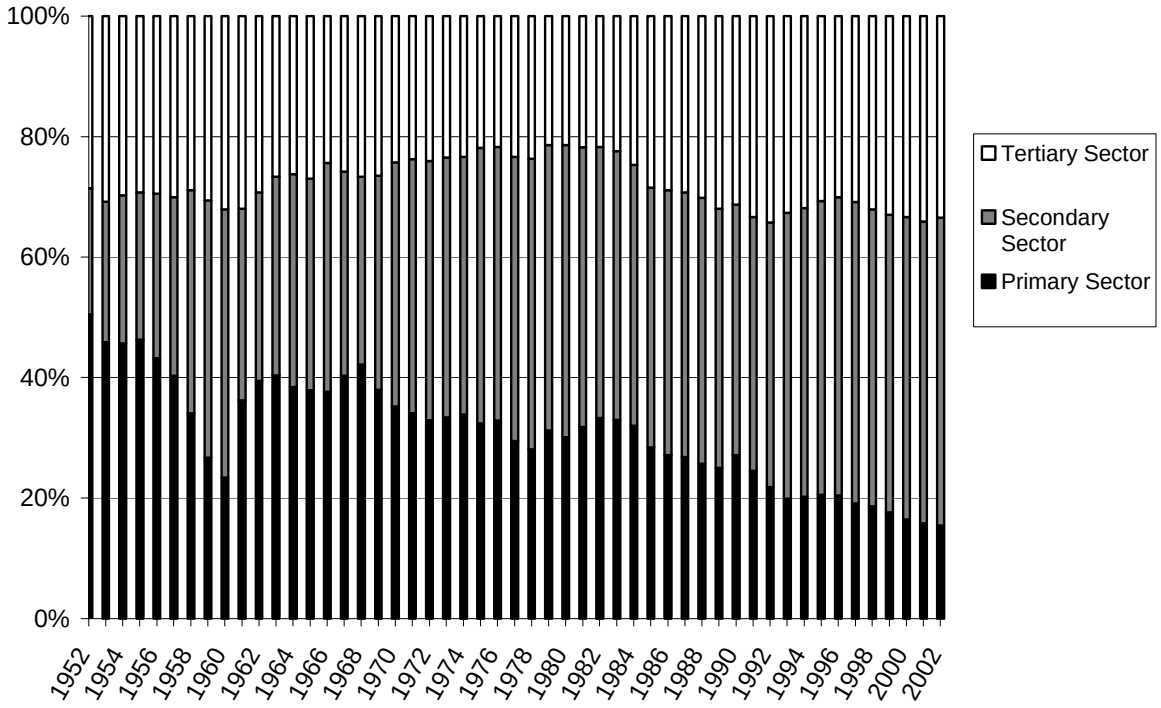
1) enterprises were allowed to decide what to produce and how much to produce;
2) a management responsibility system to give managers greater incentives was introduced, and
3) enterprises could use variable wages and bonuses to reward employees according to their performance.

In the 1990s, reform of large and medium state-owned enterprises became a very serious challenge to the economic reform. To avoid the possible effects of serious unemployment and accumulation of huge amount of debts, the state called for further reforms in state enterprises and allowed new management styles and public shareholding. Second, the gradual and incremental reform style generated great opportunities for private businesses. The state was eager to promote growth in small and private businesses as well as rural industries which existed on the margin of the economic system. Third, China began to introduce overseas investment and open up trade to the outside world. To attract foreign investment, the state implemented favourable tax policies for joint ventures as well as foreign companies. Furthermore, some cities and ports were designated by the state as special economic zones or development areas in which registered enterprises could be exempted from various controls that restricted business activities in other parts of the country as well as provided with good business services which were heavily subsidised by local governments.

These policies had several outcomes. The economic structure changed dramatically. The domination of home-based heavy industries was replaced by fast-growing light industries and processing industries which were funded by

overseas investors and targeted overseas markets. The dominance of state ownership was replaced by a mixed economy in which the state sector took a smaller share of the economy. Industrialisation led to higher ratio of industrial output to GDP as well as higher employment in industrial sectors, as shown in Figure 3. In 2000, total industrial production was 20 times of that of 1978. In terms of employment, by the end of 2002, the manufacturing sector employed around one in five of urban employees and absorbed nearly one quarter of the surplus labour from rural areas (*China Statistics Yearbook*, various issues).

Figure 3: Composition of Gross National Product (1952-2002)



Notes:

1: The economic structure has changed with the help of national development plans. During 1952-1978, the importance of primary sector dropped and the secondary sector gradually became the most important sector. This was because of the national economic strategy to develop heavy industry. After 1978, the state dropped heavy industry strategy and encouraged light industry as well as service industry.

2: Data in value terms in this table are calculated at current prices.)

Data Source: China Statistics Press, *China Statistics Yearbook*, Various Issues.

2B. URBANISATION

Urbanisation policy after the 1970s was mainly designed to cope with the pressure of rural surplus labour, the result of rural economic reform and increased labour productivity. The basic principle was to maintain the rural and urban division and avoid large scale rural-urban migration flooding into large

cities. Worried that farmers would flood into cities and cause tremendous pressure on the then frail urban infrastructures, the state did not want to remove the strict urban resident registration. Rather, it counted on incremental changes, allowing rural towns to develop into small cities. The National Urban Planning Conference set the principle of urbanisation in 1980: 'to control the scale of large cities, develop medium cities at reasonable pace and develop small cities actively' (*China Urban Construction Yearbook*, 1989). Under this guideline, urbanisation policy experienced several stages.

1. In the early stage of the reform, county level cities were upgraded to regional level cities. In three years (1983-1985), 50 regional cities were established. Another 50 regional cities were built in the same way up to 1998. During the same period, the communes in rural areas were replaced by a township system which allowed towns to be set up with a lower population density requirement. During 1984-1986, 7750 towns were created.
2. In 1986, the state relaxed the definition for new cities. 286 county level cities were set up by 1996. In 1992, the state council revised the standard for setting up small towns and began to tidy up and expand the township system. In 1992-1994, another 4247 towns were set up.
3. In 1993, the Ministry of Construction decided to focus on developing small cities. To facilitate surplus rural population to move into small cities, the Ministry of Public Security decided to reform the residential registration system of rural areas and small cities. According to the new regulations, registered rural residents who had worked and lived in small cities for a certain period would be allowed to change their registration to permanent residents in small cities when specific requirements were met. Later, many small cities removed all residential registration control. However, similar policies were not adopted in medium-sized and large cities. Rural migrants were not allowed to work freely in these urban areas. They needed to satisfy strict requirements before they could start working in these cities.

With these changes, urbanisation accelerated. According to the 5th National Census, on 1st November 2001, there were 456 million urban residents, 36% of the total population; and 807 million rural residents, 64% of the total population. Over the years, the urban population grew but not as fast as China's booming economy had suggested, as shown in Figure 2.

We can compare the experience in some other countries to see the progress of China's urbanisation. Quite unlike China, in many other countries, industrialisation was accompanied by rapid urbanisation. One can generally observe that urban population increases as the industrial sector grows. This was

the case in Britain, for example. At the beginning of the 19th century, around 30 per cent of British people lived in towns and 21 per cent in towns of over 10,000 persons. By the end of the century, 80 per cent of the population was urbanised. Rural male workers decreased by 40 per cent from 1861 to 1901 alone (Matthew, 1991).

The extent of urbanisation is shown in Table 1. If we look at some other developing countries which are experiencing or experienced rapid industrialisation not long ago, such as Mexico and Brazil in Latin America and Indonesia and the Philippines in South-East Asia, the ratios of urban population to total population are in most cases much higher than what we can see from China even after 20 years of fast industrial growth. At the moment, the world average level of urbanisation is 47.7 per cent. China is way below the average.

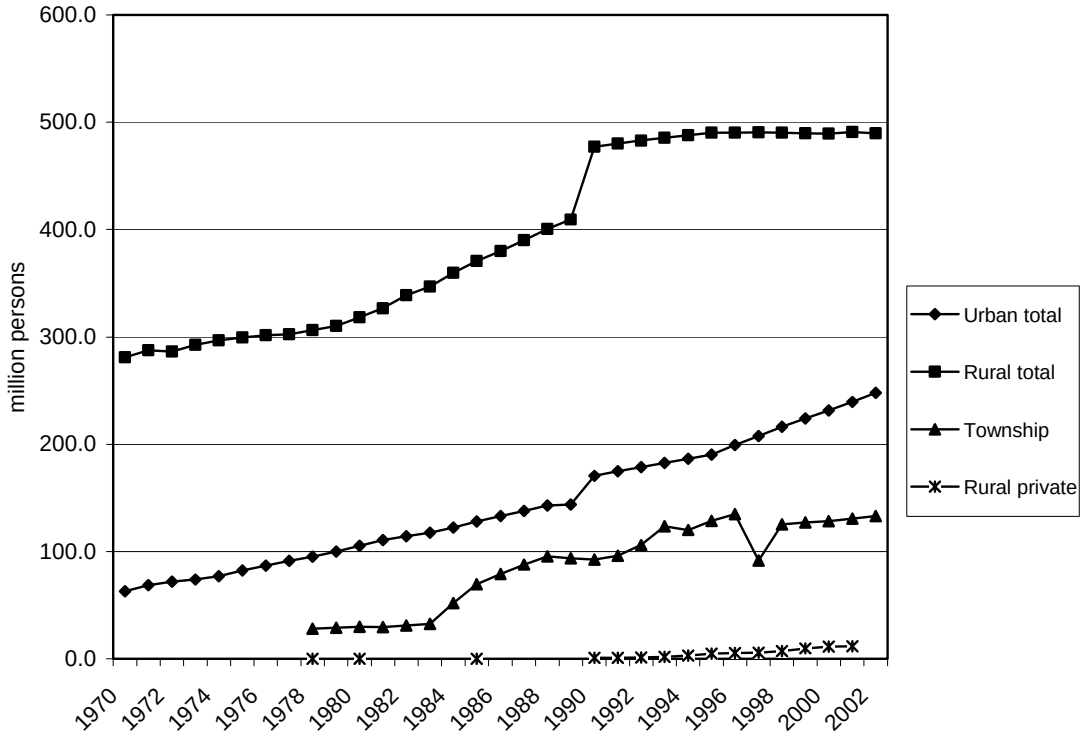
The situation of urban unemployment and township enterprises invited questions about the effects of slow urbanisation: is China's economic growth good enough to dissolve the employment pressure and let the poor escape the trap of poverty? Many people began to examine more carefully the relationship between industrialisation and urbanisation. Figure 4 shows that despite the growing urban industrial sector absorbing a large number of rural workers, the number of people in rural employment remained largely unchanged. Apart from township-village enterprises and a slow growing rural private sector, the majority of the rural labourers stayed in rural areas, as shown in Figure 2. This raises the question of why, unlike many other countries, the long-lasting economic growth in China has not generated commensurate urbanisation.

Table 1: Urbanisation in the World (Urban Population as % of Urban Population)

a. Country	1975	2001
Brazil	61.8	81.7
Mexico	62.8	74.6
Philippines	35.6	59.3
Indonesia	19.4	42.0
China	17.4	36.7
India	21.3	27.9
b. Areas		
Developing countries	26.3	40.8
Least developed countries	14.7	25.7
Arab States	41.5	53.9
East Asia and the Pacific	20.2	38.8
Latin America and the Caribbean	61.4	75.8
South Asia	21.3	29.5
Sub-Saharan Africa	21.0	34.8
Central & Eastern Europe & CIS	57.0	63.0
OECD	70.4	77.1
High-income OECD	73.7	79.1
High human development	71.7	78.3
Medium human development	28.1	41.6
Low human development	19.1	31.6
High income	73.8	79.4
Middle income	35.0	51.6
Low income	22.1	31.5
World	37.9	47.7

Data Source: UNDP (2003).

Figure 4: Rural and Urban Employment (1970-2002)



Note: Township and village enterprises became one of an important source of employment for rural labour. However, the ability of township enterprises to continue to absorb labourers were limited and the total employment in township enterprises remained largely unchanged since mid the 1990s. However, starting from the 1950s, cities become the fastest growing sector for employment.
Data Source: China Statistics Press, *China Labour Statistical Yearbook*, Various issues.

The answer to this question lies in the long lasting policy-driven rural-urban division and a whole series of supporting policies in which social policy played a very important role. In the following section, we will look at how social policy helped to reinforce the state economic strategy to promote urban growth rather than a broader based growth.

2C. SOCIAL POLICY, INDUSTRIALISATION AND URBANISATION

Social policy in China's post reform era was designed to accompany the pro-urban growth model. Achievement in industrialisation and growth in total output were the prime goal for the government and the state was to 'guarantee' the provision of public services for the fast growing parts of the economy. The effect of this was to leave little or nothing for the rural majority. This accelerated migration to cities, and it guaranteed growing inequality.

In terms of new ideology, as the market reform went on, despite the political controls, market principles dominated all business sectors. In social policy, however, reform started quite late and was still largely directed by the central government through top-down policy making. Quite often, due to the reluctance of the reformers to change the status quo, local reform programs developed within the framework of the old 'centrally planned' system. The continuation of urban-centric provision alongside localised reform plans led to wide geographic variations and gaps in coverage.

Developments in key social policy areas may be considered in turn.

1. Establishment of urban health protection system and collapse of rural cooperative healthcare.

   The old healthcare system became a heavy burden for the non-state sectors. From the 1980s, many enterprises started to develop independently from state control. However, the state did not really try to deal with healthcare reform until 1999. Therefore, in urban areas, various forms of healthcare system came into existence to cope with the funding shortage in healthcare. The purposes of these schemes were mainly to control costs and provide basic healthcare. Chen (1994) puts the new urban healthcare schemes into four categories.

   a. Cost sharing between work units and employees. Employees received a fixed amount for healthcare. If they spent less than this fixed amount, they could keep the residuals. If they needed to spend more, they could claim from the state allocated healthcare funds which were maintained by the work units.
   b. Hospital responsibility system. Work units gave up the control of funding and allowed hospitals to take over. Hospitals had to bear all the costs including salaries for medical professionals.
   c. Health insurance. Individuals received part of the healthcare funds and they could spend within the limit without restriction. However, if more was needed, they had to bear part of the excess costs.
   d. Fixed coverage. Employers allocated all the state healthcare funds to employees and did not bear any extra costs.

   In contrast, the rural cooperative healthcare system which could in theory offer primary healthcare to nearly 90 percent of the population collapsed as the ability of rural collectives to pool funds for healthcare fell to nothing under the influence of household responsibility system.[6]

6 The household responsibility system in China started in 1978. It was a system which allowed farmers to leave the old style collectives which, under the central planning system, required farmers to work for the collectives and laid down what to produce

Hospitals in towns and counties depended less on public funding and more on collections. As a result, in the 1990s, more than 50 per cent of the cooperative healthcare clinics were operated by profit earning individuals (*China Healthcare Yearbook*, 1999). In many rural areas, in particular the poor areas, farmers had to pay for healthcare out of their own pocket.

2. Enforcement of the elite education system and deteriorating rural education.

   Starting from the 1980s, the elite education system was further strengthened by the establishment of 'beacon schools' at various levels. According to this system, primary and secondary schools as well as high schools were to train and select talented students for university education. Students were selected strictly according to their exam results. Therefore, the focus of the education system lay in higher education which was considered to be the most important level to satisfy the demand for industrialisation and economic development. Under the same principle, rural areas failed to attract state investment in education. Most of the 'beacon schools' were set up in urban areas. Investment in compulsory education in rural areas was much lower than in urban areas. The gap grew even faster in the 1990s (Xiao, 2003). In the 1990s, education at various levels was more and more geared toward paid education. Even students in compulsory education had to pay high tuition fees. The tendency to collect high tuition fees became more explicit in higher education in the late 1990s when the state decided to transform education into a market sector with households sharing the costs of higher education by paying tuition fees. The fees for ordinary universities were as high as the average annual income of an urban employee (Xiao, 2003). This system increasingly helped to force prospective students from poorer backgrounds to give up education.

3. Privatisation in urban housing.

   Since state housing provision only existed in urban areas, housing reform occurred only in cities. Housing reform started from the 1980s. The purpose of the reform was to relieve state employers from the burden of housing provision and help households to build up savings to pay for housing in the long run. For nearly two decades, the state was trying to withdraw from direct housing provision, re-establish housing as a commodity, and push individuals to take up housing costs. Gradually, the

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and how to distribute the products. In the household responsibility system, farming decisions are made at household level. Farmers are responsible for production on their own land and sell their own products in the market.

state stopped being the main provider of houses; employers took on a greater role in organising savings (through individual accounts) and individuals relied more on the market than on the state and employers to acquire housing.

4. Individual accounts for social security and empty account pension system.

Until 1997, China had established a two-part social security system: social insurance for urban employees and social relief for the poorest. The former only covered the state sector and part of the private sector. The latter was used for rural areas and the urban private sector. Social relief was based on means-testing and other conditions such as inability to work and being without relatives (Shang, 2001). Under the pressure of urban disturbances caused by private employers' inability to pay for pension and healthcare, in the late 1980s, a pension system was established based on a mutual fund. The system depended on employer contributions based on forecast expenditures. As the overall economic situation improved, employers had to pay higher rates of contribution. Thus, many enterprises could not afford to pay and were on the verge of bankruptcy. In 1997, the state took action to reduce the burdens for the contributors: this stopped the government's collection of administration costs, integrated the administration of pension funds and forced more employers to participate in paying contributions (Shang, 2001). Apart from the administration, the new system was not different from the old system in that both depended on high contributions and the new contributions were paid to the retired straightaway on a pay-as-you-go-basis. The new system stopped counting on the employers to collect and distribute pension. It was operated through a social pooling mechanism operated by the local government.

In rural areas, the state began to experiment with a new social security system which aimed at shifting the existing 'collective security' to 'social security'. Individuals were the main contributors to their social security funds. Rural collectives could also contribute on a voluntary basis. By the end of 1998, more than 65 per cent of the rural areas adopted the social safety-net scheme which covered more than 800 million rural residents. At the same time, a rural poverty relief scheme was established by the state to use public and private finance to support remote and poor rural areas.

5. Greater labour mobility.
   In 1982, the State Council published 'Administrative Measures on the Arrest and Eviction of Urban Vagrants and Beggars' (State Council Issue, 12-05-1982). The regulation was largely used to catch and punish rural migrants who lacked official approval. This regulation allowed the police to arrest and evict people from rural areas if they could not show their identity card on the spot. In the late 1980s, the state abandoned the regulations preventing farmers from going into urban areas to work. However, this did not mean that farmers could become urban citizens and enjoy the same treatments as their urban peer workers. The system continued to generate prohibitive barriers preventing the rural population from moving to the urban areas.

Despite the greater efforts on rural poverty relief, social policy in the 1980s and 1990s remained largely urban-centric and counted very much on employer contributions. It served the rapid growth in urban areas and to a certain degree facilitated the process of enhanced urban industrialisation.

2D. POVERTY AND INEQUALITY

Reform in China enhanced economic efficiency and the growth of the economy lifted a large number of people above the absolute poverty line. However, as the economy continued to grow, it became clear that the pro-growth strategy was not improving the well-being of the lowest income groups. Economic growth tended to reinforce and improve the financial well being of the people that had already become rich rather than remove poverty at the same pace as during the early years of reform (Chen and Wang, 2001).

The combination of the economic strategy and the social policy in this era had several implications for poverty and inequality.

The result of the fast long-term growth was impressive but not without many problems, as shown by Chen and Ravallion (2004). In the 1980s, the economic growth reduced the number of people living in poverty. Table 2 shows the changing poverty line, used by the Chinese government.[7] The 1978 poverty line was set on an undefined basis whereas from 1984 it has been based on nutritional needs and updated as prices changed. Table 2 also shows the percentage of the rural population who were poor. The data suggest that rural poverty had decreased rapidly during the earlier reform period, almost halving from 1978 to 1984, although this change is not based on a consistent poverty

7 We cannot find comparable data using international standard before 1985.

line. Rural poverty further decreased, but not as fast as the earlier period, during the late 1980s. However, the trend of poverty reduction was not steady.

In the 1990s, China began to use the internationally recognised poverty line of US $2 per day. According to this standard, the number of people who were poor increased dramatically from 730.8 million in 1987 to 824.6 million in 1990. The poverty rate did not start to fall again until 1993. If we look at the very poorest people living below $1 per day, earlier growth did help to lift more than 300 million people out of absolute poverty. However, the number later increased, from 308.4 million in 1987 to 374.8 million in 1990, more than one fifth higher. Although the number fell in the 1990s, unlike the steady reduction of the number of people living under $2 per day, the number of people living under $1 per day did not go down steadily, which suggests a relatively stable number of people who were trapped in poverty. The growth model did not work equally effectively for all groups. As the economy continued to grow, the gap between the rich and the poor also grew. The growth rates of income rose as one moved up the distribution. The annual rate of growth in the 1990s was about three percent for the poorest percentile and nine percent for the richest (Ravallion, 2004).

The social insurance and social security system were increasingly incompatible with the growing private sector. Welfare provision was largely dependent on local government and business both to pay for it and administer it. Although the state tried to establish a work-based contribution system to finance a social safety-net, it could no longer force all enterprises to commit themselves to welfare tasks. As a result, the gaps in coverage widened. Many people from the non-state sectors were excluded from the 'new' social protection schemes. Although, in the late 1990s, the state took actions to secure contributions from more employers, many enterprises simply could not afford the high rate of contributions (Shang, 2001).

In terms of employment, the 'Iron Rice Bowl'[8] and state owned and collective 'work units' ceased to protect the majority of urban employees. The number of people employed in urban state and collective sectors dropped as market competition forced many enterprises to close down or reduce labour costs to raise efficiency, as shown in Figure 5. At the same time, private companies, joint ventures and overseas companies started to provide more and more employment opportunities.

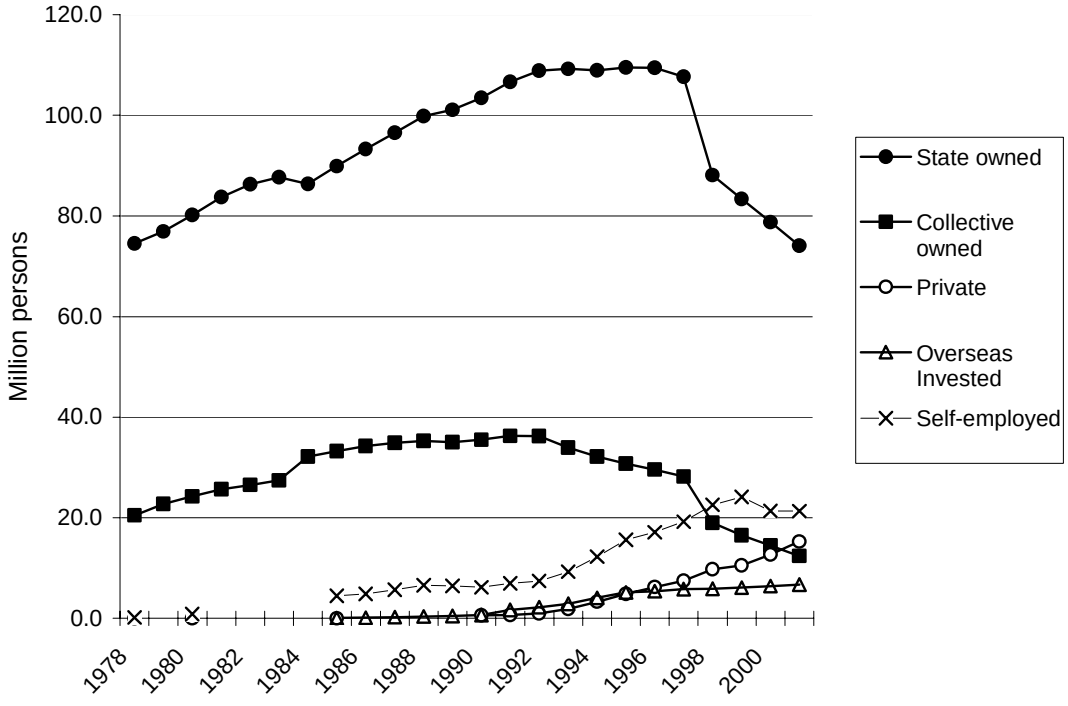
8 The 'unbreakable' source of food, which meant that employers offered permanent jobs and full welfare protection to all employees.

Table 2: Rural Poverty 1978-2002

	Poverty line yuan/year	Rural Population (million)	Rural population in poverty (million)	Rural poor/rural population (%)
1978	100	790.1	250	31.6
1984	200	803.4	128	15.9
1985	206	807.6	125	15.5
1986	213	811.4	131	16.1
1987	227	816.3	122	15.0
1988	236	823.7	97	11.8
1989	259	831.6	102	12.3
1990	300	841.4	85.1	10.1
1991	304	852.8	94	11.0
1992	317	848.0	80.6	9.5
1993	350	851.7	70.2	8.2
1994	440	855.5	70	8.2
1995	530	850.5	65.4	7.7
1996	580	864.4	60	6.9
1997	640	866.4	49.6	5.7
1998	635	868.7	42.1	4.9
1999	625	870.2	34.1	3.9
2000	625	807.4	32.1	4.0
2001	625	795.6	29.3	3.7
2002	627	782.4	28.2	3.6

Note: Data for rural population are from China Statistics Bureau:
a) Data of rural population for 1978 was were taken from the annual reports of the Ministry of Public Security. Data for 1982-1989 were adjusted on the basis of the 1990 national population censuses. Data for 1990-2000 were adjusted on the basis of the estimated on the basis of the 2000 national population censuses. Data in 2001 and 2002 have been estimated on the basis of the annual national sample surveys on population changes.
b) The data on poverty lines and rural poverty are officially published data. However, they are open to many qualifications, especially the numbers before and for 1978. They use methodologies that are not fully comparable to those calculated according to internationally recognized poverty lines. However the overall trend suggested by the series suggest a long term decline in absolute poverty in China. The poverty line for 2002 was equivalent to $0.66/day.
Data sources: China Statistics Bureau, *China Statistics Summary Report*, various issues. China Statistics Bureau, *China Rural Poverty Monitor Report*, various issues.

Figure 5: Urban Employment (1978-2001)



Note: The labour demand in the state and collective sectors, the only sources of employment during the central planning era, began to drop in the mid 1990s and early 1990s respectively, Private sector, overseas sector and self employment appeared in the 1990s and became important job providers.
Data source: China Statistics Press, *China Labour Statistical Yearbook*, various issues.

The differences between rural and urban areas became greater than ever. The favourable policies to support urban industrialisation, the unquenched demand for urban spending, and the priority given to maintaining urban stability were in part underpinned by the rural tax revenues which deprived rural areas of development opportunities (Gordon and Li, 2002; Pieke, 2002; Li, et al., 1998). At the same time, the reforms maintained, to a large extent, the rural-urban division forcing rural industrialisation onto a very different path from urban development. In rural areas, township and village enterprises (TVEs) had offered opportunities for farmers to leave farmland and work in industrial sectors. China's experiences of transforming farmers into industrial workers without forcing them to leave their home town had become a new model for industrialisation and had drawn a lot of attention from international society (such as overseas research interests and international organisations like the World Bank). It was a new model of modernisation in which farmers left their land but not their home and entered factories but not the cities. Qian (2003) and Jefferson and Rawski (2002) attributed this innovation to the lack of clear

property rights. However, the phenomena of TVEs raises many questions. Why would farmers prefer to work in TVEs than in private enterprises in urban areas? Why did the urban society welcome the fact that farmers did not need to go to cities to work in factories? When the rural-urban population control mechanism is taken into account, answers to these questions become fairly straightforward. More farmers would like to leave the farmland and work in industries. However, under the old state regulations, they were not allowed to move freely and work in the urban areas. TVEs met the demand for providing jobs in the industrial sectors without having to acquire urban residency. TVEs were a result of the absence of alternatives.

From what we have discussed above, several elements were missing in the pro-growth model which prevented it working to the benefit of all:

1. A flexible labour market which allowed people to move from one place to another to take advantage of employment opportunities;
2. Compatible industrialisation and urbanisation which relieved the pressure of excess labour in rural areas; and
3. Sufficient resources to provide infrastructures and public services necessary for rural areas.

In the 1990s, the Chinese society was not an integrated society. The majority of the population still lived far away from the cities. There were still great barriers for people to move from rural to urban areas. Even when farmers had opportunities to work and live in cities, they did not enjoy the rights and benefits that were available to urban residents. Even when the control over migration became less tight, the gap in education was a barrier for rural migrants facing the challenges of urban job requirements. Therefore, even when they came to urban areas, they remained at the bottom of the society (Sha and Jiang, 2003) and were treated like an underclass (Li$_a$, 2004; Lu, 2002).

3. Recent changes (2000-2004)

From 2000, the problems with the pro-urban growth model became ever more obvious, in particular the tension between the slow progress in rural areas and fast growing urban areas. People started to question whether the long-lasting growth and prosperity would be sustained and expressed concerns over the threat of overheating in urban growth and worries over the possibility of a 'hard landing' for the economy, i.e. a fast cooling down through economic crises and social disturbance. Partly in search of a 'soft-landing' and finding an outlet for the overinvestment in urban areas, and partly to ease the social pressures, the state began to reconsider the development strategy.

Since China adopted the open door policy and began to offer favourable treatment to investment and businesses in coastal areas in the 1980s, a difference between 'coastal' and 'inland' areas developed in terms of economic growth and income levels, with the 'west' suffering much slower growth. Over two decades, investment from inside and outside the country had poured into coastal areas. The economy in the east boomed. By contrast, inland areas were not so attractive to investment and, for quite a long time, did not enjoy favourable tax treatment, did not receive as much money for infrastructure construction, and did not reform so rapidly as coastal areas--and failed to become as prosperous. If we compare the rural areas only, it was much easier for farmers living in coastal areas to find non-farming jobs in cities than for farmers living in inland areas. Therefore, inter-regional income inequality in rural areas between the coastal regions and inland regions also increased (Li, 2002; Kanbur and Zhang, 2002; Khan and Riskin, 2000; Kanbur and Zhang, 1999).

In mid 1999, the Central Government approved the 'Developing the Western Region' strategy. In 2000, the Office of the Leading Group for Western Region Development of the State Council was established to lead the new economic strategy (State Council, 2000, No. 33). For 15 years, economic development in the western region had lagged behind the other parts of China. The average income gap between the east and the western provinces further widened. In 1985, the average income of the eastern region was 1.15 times of that of the west; this increased to 1.42 in 1995 and was 1.40 in 1999 (China Statistics Yearbook, various issues). The purpose of the strategy was to narrow the gap in incomes and regional development, maintain social and political stability in the west through boosting economic development, and create new engines for economic growth. There were five aspects of the government plan: infrastructure construction (especially water power, communications, transportation, tourism and broadcasting), ecological development and environmental protection; improvement of the structure of industries (creating new sources of growth); development of technology and education and acceleration of skills trainings; and promotion of reforms and openness. Under the government guidance, large quantities of funds and investment were shifted into western China to engage in large scale projects as well as financing development policies (Zhang, 2003).

In the 10th Five Year Plan, for the first time in the history of P.R. China, the three 'F' issues[9] (sannong wenti)—farmers, farming and farming areas—were put high on the agenda. The purpose was to remove the barriers that prevent farmers from getting out of poverty. The first step toward increasing income was to remove many unreasonable taxes and charges on farmers' incomes (Li_b, 2003). The second step was the restructuring of production encouraging more economic crops and fewer staples and developing food processing industries. These methods were to help farmers to overcome the problems of the higher price elasticity of staples in the market, and to help develop the market for farm produce by providing better information and infrastructures. As to the farmers living in areas which were not suitable for farming or too isolated, the state planned to relocate the farmers in nearby urban areas.

At the same time, to ease the pressure generated by excess rural labour, the state decided to further encourage the development of small cities and towns. In 2001, the government reformed the urban residency registration for small cities and towns. According to the new regulations, all people from rural areas with long term residence, a stable job or source of living, together with their family members in small cities and towns could apply for permanent urban residency. Some local areas also took active measures to encourage farmers from remote areas to resettle in urban areas. The purpose was to help them escape the trap of poverty. In large cities, the detention of rural workers by the police was banned. The detention and eviction regulation of 1982 was withdrawn and replaced with 'Administrative Measures on Helping and Managing Poor Urban Vagrants and Beggars (Draft)' (State Council, 2003). There were also state led campaigns to collect delayed salary payments to rural workers. Although these efforts facilitated migration from rural to urban areas, the residency registration system continues to exist. There were still unequal rights for urban and rural residents as citizens.

POVERTY AND INEQUALITY

These recent changes reflect the increasing flexibility in the labour market and greater determination to tackle rural poverty. Again, social policy served an accompanying role. Developing the western regions and relieving burdens for farmers were designed to increase farmers' income. However, despite these efforts, China still faced challenges in poverty and inequality. Since the later 1990s, poverty and inequality began to develop some distinctive features.

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9 'Three 'F' issue' is a direct translation of the Chinese term '三农问题' (Sannong Wenti, or more directly three 'Nong' issues), which is the short form for three important aspects of rural issues: 农业（nongye），农村(nongcun)，农民(nongmin).

First, there were 'new poor' in urban areas – people who have never managed to improve their living standard at all since the reforms (Wu, 2002). Marginalised groups such as the disabled, the long-term sick and the elderly who have no support from the community and relatives are the traditional type of poor people in the society. In the late 1990s, the 'new poor' became visible in the urban poverty profile. They are people who lost their jobs, failed in their businesses, or simply could not gather sufficient means to support their own families. At the same time, a lot of farmers left their home and land and came to urban areas to look for jobs in the factories. Many of these rural-urban migrants lived very close to the poverty line (Chen, 2002). The officially registered urban unemployment rate changed from 0.1 per cent in 1980 to 4.3 per cent in 2003. However, it is estimated that if unregistered unemployment is included, the actual urban unemployment rate can be as high as 10 per cent (Li_b, 2004). Nowadays, urban unemployment is the fastest growing source of urban poverty. Some of the new poor managed to get out of poverty fairly quickly through finding new jobs or starting their own businesses or even moving to a different place to find jobs, whilst others found it difficult to cope.

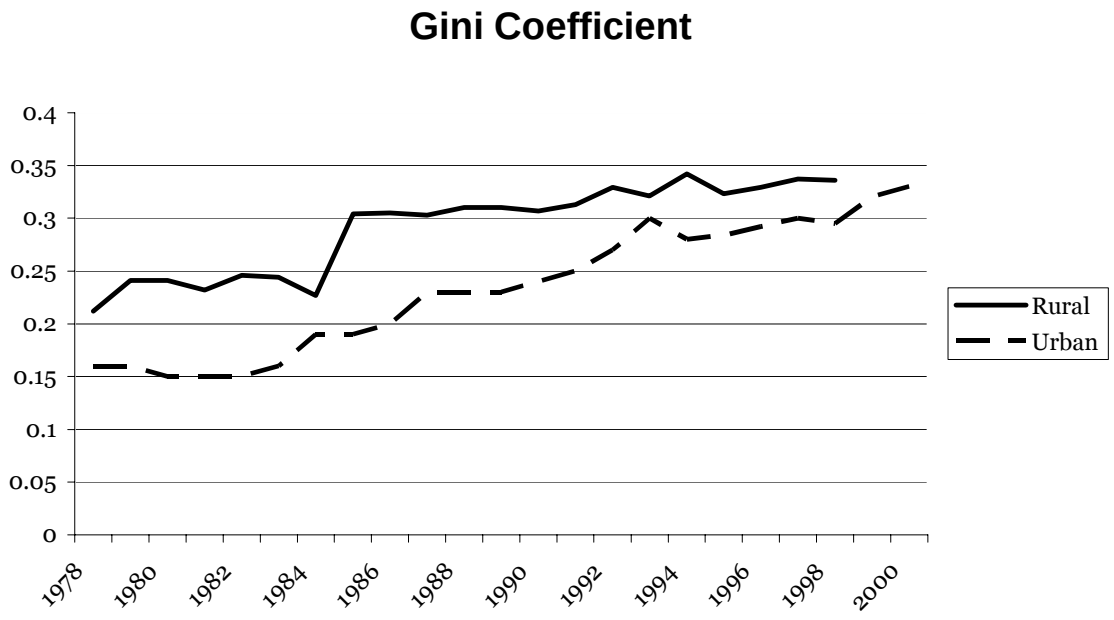
Second, in rural areas, three 'F' issues--farming, farmer and farming areas (in essence, rural poverty issues) have grown to be ever more challenging to policy makers. By the end of 2003, there were still three per cent of rural residents living in absolute poverty (People's Daily, 27 May, 2004). Also, 6.2 per cent of the rural population lived close to the poverty line and suffered from transient poverty or fell into poverty because of unexpected risks such as natural disasters, bad harvest, or shortage of working capital (Jalan and Ravallion, 2001, 1999, 1998). Table 1 shows the trend of poverty reduction since 1990. Up to now, there are still a large number – nearly 30 million – of people living in absolute poverty. What is more, throughout the 1990s, the living standard of the poorest continued to deteriorate in absolute terms (Li_a, 2003).

Third, income inequality between the urban rich and the urban poor increased considerably (Meng, 2002; Guan, 1999; Khan, et. al, 1999; Milanovic, 1997; Knight, and Song, 1991). The officially published Urban Gini Coefficient for disposable income is above 0.30. The trend of growing inequality in urban areas is very clear, as shown in Figure 6. This is a result of the relatively slower income growth of the lowest income groups compared to the highest income groups (Meng, 2004). What is more, the increase of Gini Coefficient rose more sharply at the end of the 1990s.

Fourth, the gap between different regions remains very wide. According to the survey by the General Survey Team of Rural Areas of China National Statistics Bureau, by the end of 2002, 29 million people in western rural China were in poverty (annual consumption below 869 yuan), equivalent to 50.6 per cent of

the total poor population in China. In the middle inland area, the number of rural residents in poverty was 18 million, 31.4 per cent of the total. In the east (coastal areas), there were 11 million poor, 18.0 per cent of the national total. This suggests that poverty is distributed unevenly across the country. The poverty problems are much more serious in the inland areas, in particular, in the west, than in the coastal areas. Places like the more urbanised coastal areas which can offer more job opportunities attract the largest number of rural labourers.

Figure 6: China's Income Inequality (1978-2000)



Data Sources: China Statistics Bureau, Household Survey, related years.

Fifth, and most seriously, income inequality between urban and rural areas has become one of the highest in the world (Yang, 2002; Benjamin et al., 2000; Benjamin and Brandt, 1999; Yang and Tang, 1999). The official statistics have underestimated the seriousness of the inequality. In 2001, the average income of urban residents was 6860 yuan and that of rural residents was 2366 yuan (*China Statistics Yearbook*, 2001). Urban average income was nearly three times rural average income. However, 40 per cent of farmers' income is in the form of farm produce. If this 40 per cent is deducted, the monthly income of farmers fell to only 1800 yuan. In addition, farmers usually used around 20 per cent of their income to reinvest in the production of the next year. Thus, farmers' net disposable income is much lower than the official statistics suggest. In contrast, if urban welfare benefits, such as healthcare and education, housing subsidies and pensions, and other grey incomes, such as 'moonlight' income are all

included, the average income of urban residents can be as high as 7200 yuan. The adjusted ratio of urban average income to rural average income can be at least 6:1 (Qiu, 2002).

Beyond these traditional divisions, some new phenomena have been largely neglected by official statistics. So far, rural migrants to urban areas are not included in any urban poverty studies as rural-urban migrants are not registered as urban residents. Further, because of the incentives of the local government to over- or under-state poverty for political or financial reasons, the statistics on urban poverty are not accurate. Researchers have very different estimates of the total number of urban poor (Hussain, 2003; Li, 2001; Khan, 1998; Li and Gustafson, 1998). The most frequently quoted number, '14-15 million', is the estimate of the Ministry of Civil Affairs, the National Statistics Bureau and All China Trade Union after their separate surveys during 1999-2000. However, many researchers argue that this number underestimates the actual poverty situation in urban China (Tang, 2002). Because of the shortage of systematic information, the extent of urban poverty has not been fully assessed.

The limits of economic strategy-led social policy

From what we have seen from the history of development in China so far, social policy has played an accompanying role which serves the purposes designated by the top-down, targeted economic strategies. Since these economic strategies were focused on specific goals—heavy industries, urban areas, or infrastructures in the west—social policy has also been designed to cater for these special needs. However, a full picture of poverty and inequality suggests that these development models often neglected the demand for development in the rest of the country. The strategies were based on resource constraints—a large country could not afford to scatter the limited resources all over the place. Yet this view failed to recognize the connections between different policies, different regions and different groups of people within the country, and their ability to have an impact on each other.

The path of development in China displays several distinct characteristics.

1. Despite the rapid changes in the economy, the essential relation between economic policy and social policy has not changed much over the years. Both in the central planning era and the reform era, social policy served as a tool to realise economic strategies. During the central planning era, there was urban-biased social policy to support heavy industries in urban areas. In the pro-urban growth era, there was urbanisation and urban social reform to support a wider growth in urban industrial sectors. In

these areas, social policy was considered to be supportive to economic growth and, therefore, people outside the centre of growth were not cared for as much as the others. The work-based social policies in housing, pension and healthcare are obvious examples of protecting people in urban employment.

2. The relationship between social policy and economic strategies had implications for poverty and inequality. During the planning era, the most important effect was the strict social control of both the urban residents and the rural residents in all policy areas and the different treatment of rural and urban residents in various aspects of social policy. The pro-urban growth era continued to use many of the discriminatory policies that were used earlier. Although the reform sparked rapid urban growth, it treated economic growth as the priority, for which rural areas had to be sacrificed to support urban growth. Social policy helped to reinforce the poverty in rural areas and rural: urban inequality.

The economic strategy-led social policy has had a number of weaknesses.

First, the pro-urban growth model which did not pay attention to the bottom of the society led to a widening of the gap between the rich and the poor as a relatively small part of the economy continues to grow at much faster pace than the rest. The trickle-down effect which was anticipated by the reformers was not be realised within the pro-urban growth social policy framework.

Second, although more recent reforms try to deal with rural poverty issues, it is driven by the reformers ideas of developing the west. There is no guarantee that this will not become one of the many ‘new economic growth points’, such as rural household responsibility system and township enterprises, that did not last as the state moved on to a new strategy.

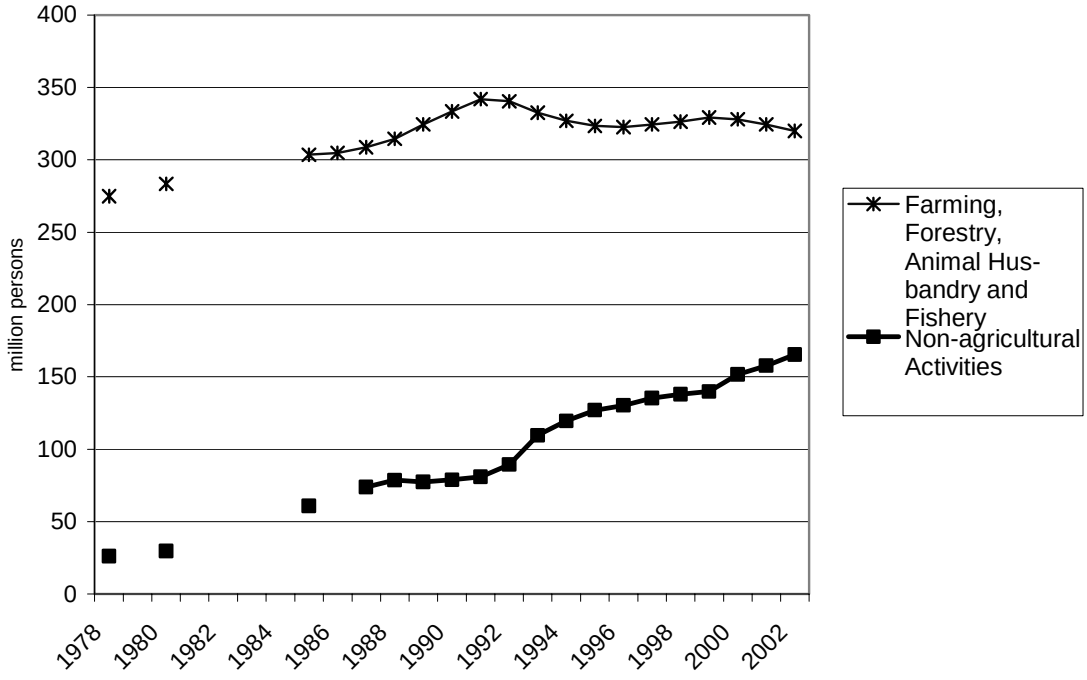
Third, the gap between urban and rural areas generated by the pro-urban growth model continued to attract rural labourers to move to urban areas which might provide better employment opportunities, as shown in Figure 7. However, new large scale migration challenges urban infrastructures and the ability of the urban social system to cater for the needs of a fast-growing population. The current social control system and the biased social welfare provision in large cities cannot really solve the problems in the long run as the labour market becomes more flexible.

All these weaknesses have their consequences in poverty and inequality. However, before any prescription can be suggested, it is crucial to raise a fundamental question: do poverty and inequality matter?

The debate over whether poverty and inequality matter has several aspects:

1) Whether the increasing inequality will at some point affect economic growth and whether a certain degree of inequality can contribute to economic growth?
2) How to justify the growing inequality when the well-being of the poorest is not improved?
   3) How far can the society contain inequality? There are several views on these questions.

Figure 7: Rural Labourers working in Agricultural and Non-Agricultural Sectors



Note: The number of labourers by sector in this table is classified by main activity. For example, those engaged primarily in agriculture and secondarily in commerce are classified under farming, forestry, animal husbandry and fishery.
Data Source: China Statistical Press, *China Labour Statistical Yearbook*, various issues.

People supporting priority for economic over social development argue that the growing inequality in China is rooted in the historical legacy of central planning and poverty. To overcome the problems of poverty, the first order solution lies in economic growth and through this the poor can escape poverty gradually. Therefore, at this stage, China should pursue economic growth and cannot afford to slow down the momentum of growth with too much redistribution. What is more, it is argued, there is no clear proof that inequality threatens

economic growth. The pro-growth idea is also the official line followed by the Chinese government in the last two and half decades: pro-growth policies that promote industrialisation and urbanisation will create more wealth and employment opportunities and finally lift all the population out of poverty (Fan, 2003; Liu, 2003).

Nevertheless, the threat of greater social instability has intensified (Li$_a$, 2003; Yang, 2002; Yep, 2002). On the one hand, corruption and various rent-seeking activities that aim at benefiting some privileged groups have become more serious than ever (Chen, 2002). On the other, the higher risks of unemployment and the loss of basic social protection, and, in rural areas, farmers having to cope with heavy burdens of taxes and charges, generate strong feelings of deprivation among the disadvantaged groups (Li$_a$, 2003).

Internationally, there has been a renewed interest in inequality (World Bank, 2004; Persson and Tabellini, 1994). The renewed interest is stimulated by empirical evidence suggesting that there is a negative relationship between inequality and growth, which means that economies with greater inequality tend to have lower economic growth. Inequality affects economic growth through political economy (Findlay and Wellisz, 1993; Alesina and Rodrik, 1994; Banerji, et al., 1995; Alesina and Perotti, 1996; Perotti, 1996; Bénabou, 1996a; Saint-Paul and Verdier, 1997; Chang, 1998), through social channels (Rodrik, 1997) and through imperfect capital markets (Banerjee and Newman, 1993; Saint-Paul, 1994; Bénabou, 1996a, 1996b). As suggested by the arguments and evidence provided in the literature, in the long run economic growth may be slowed down by inequality and may fall into a vicious cycle of more unequal distribution and slower growth.

Whatever the different opinions over the evidence on the relation between economic growth and inequality, the Chinese Government is attempting to combine growth with reduced poverty and inequality. This provokes a complicated and difficult question for China: how to strike a balance between restricting market power to prevent further widening of the inequality of income and at the same time not bringing economic development to a stop?

Having reviewed the history of China's development, an answer to this question may be found through the previous experiences of China. The mounting attention to reform in various social policy areas in the 1990s, and even more after 2000, suggests that many changes in social welfare system and social services, in particular concerning the poor and vulnerable groups, have gradually gained importance in China's overall development. This trend shows that social development, though not the prime target of the reform, has become more significant. In other words, during the reform, to clear away 'barriers' to

further economic development, the Chinese government has already been 'forced' to go on a path toward social development. It seems that in the last two and a half decades, while China has focused on economic growth it addressed some problems in social development when they began to affect economic progress. Various aspects of social development including urbanisation, poverty relief, employment and social protection had to be dealt with as the reform moved along. The efforts in this aspect can be briefly summarised as:

1) In the urban areas: a) carrying out urban social welfare reform to transform state welfare to contribution-based mixed welfare; b) building up social protection for the unemployed and the disadvantaged group; and, c) loosening social controls.
2) In rural areas: a) using urbanisation in rural areas to solve the pressure of rural-urban migration on the existing urban infrastructure; b) carrying out poverty relief through income redistribution and various social supports; c) investing in rural infrastructure to help farmers to earn a living; and, d) relocating farmers from remote and isolated areas to urban areas to help them to escape poverty.
3) Gradually loosening control over rural-urban migration.

These changes involved several transitions: from state dominated welfare provision and social control to a mixed social system in which the state, employers and individuals all play a part; from financial redistribution to providing various resources or capital (such as infrastructure, information, training and education) to help people to avoid or cope with poverty.

However, as demonstrated earlier in this paper, though the unintended piecemeal changes in social development had some positive impacts, they are not necessarily well connected and they lack a comprehensive approach to some fundamental issues such as poverty and inequality and the coordination between social and economic policies. Some policies can be protective to urban economic interests but fail to consider the effect of the rural-urban interactions; for example, policies that failed to cater for the need for rural-urban migration and policies that ignore rural economic support to urban economic stability. Some policies can be redistributive in the short term but do not boost the potential of individuals or communities to improve their own life. Some policies can be designed to resolve economic problems but fail to realise that there can be social problems behind the proposed solutions and are therefore defeated by lack of preparation; for example, some farmers moved from remote rural areas to new towns and found themselves trapped in even greater poverty because of unemployment and poor infrastructure. All these aspects suggest that without the determination to make social development a central goal, poverty and inequality may be reduced, but they may also get worse.

The experience of China highlights the need to adopt a broader based social development approach. Poverty and inequality may generate unprecedented social tensions. Urban unemployment plus surplus rural labour put great pressure on the economy. The already strained engine of growth has found it hard to absorb an unlimited supply of labour. The state has found it almost impossible to stretch the limited resources to redistribute to the poor. The predicament calls for a new model of development to help the economy to grow without fear of economic and social crises.

As we summarised above, the piecemeal social reforms show that China through its gradual and pragmatic reform is converging slowing on the social development model which emphasises making use of resources at many levels to build up the necessary capital for human development. In the following section, we introduce the livelihood approach and examine its relevance to China's experience.

A social development model—the livelihood approach

The livelihood approach emerged through the search for an integrated approach to tackling poverty and deprivation. The 'sustainable livelihoods framework' has been developed into an analytical and operational tool. It moves away from single-sector strategies and allows 'livelihood strategies to be analysed within their wider environment, and context-specific solutions to be devised based on local capacities and needs' (Hall and Midgley, 2003, p.7). It responds to the problems of a biased growth model and emphasises tackling the causes of poverty and striving for balanced growth. In the livelihood approach, social policy is no longer an attachment to the growth strategies. It takes a holistic view of social policy, in which welfare provision and safety nets only play a minor part. As Hall and Midgley put it:

> In this conceptualisation, social policy is concerned essentially with more fundamental questions of sources and stability of employment, support institutions, processes and structures that determine people's well-being as well as broader natural and political factors which encourage and constrain human development (Hall and Midgley, 2003, p.6).

The livelihood approach identifies several sources of human development. The sources are represented in the form of capital or assets. The model does not look at financial resources as the only way to get people out of poverty. Rather, it attends to the availability and interaction of different types of capital in order to enhance the ability of an individual, community or a society to maintain long

term development. In the following sections, we first introduce the basic elements in the model and then discuss its relevance to China.

The model

There are differences in the typology of capital. The UK Department for International Development distinguishes five types of capital: financial capital, physical capital, human capital, natural capital and social capital (DFID, 2001, p44). Piachaud (2002) separates public infrastructure, or collective physical capita, from other physical capital. In this paper, we include both natural capital and public infrastructures and distinguish six types of capital, as follows:

1. Financial capital—derived from work income, savings, capital gain, inheritance and gifts, and profits.
2. Natural capital—environmental resources for livelihood and sustainable development, such as clean water and air which can be improved through investment in environmental protection (DFID, 2001).
3. Human capital—individual skills and capacities which can be accumulated through investment in education, training and work experience.
4. Physical capital—the stock of physical assets that can be used to produce goods and services.
5. Social capital—networks, norms, rules and social values. These are the collective component of human capital and collective human values and relations.
6. Public infrastructure—collective physical capital, such as drains, schools, hospitals, roads and other public facilities (Piachaud, 2002), which can be improved through investment in the relevant infrastructures.

These sources of livelihood are not isolated from each other. For example, financial and physical capital can be traded but not the others. All the types of capital need investment (either in money, goods, labour or time) to build up. They jointly contribute to the future level of living (Piachaud, 2002). Absence or insufficiency in one or more types of capital may result in poverty whether of individuals, families, villages or regions.

There are several differences between the pro-urban growth model and the livelihood approach. First, economic growth on the livelihood approach is intrinsically pro-poor emphasising the importance of capital in human development and the prevention of poverty. Lack or loss in one or more of the six types of capital may lead to poverty. The livelihood approach emphasises the empowerment of poor people through providing capital in various forms. It therefore emphasises redistribution, but not limited to income redistribution. It tries to empower the poor and relieve them from the state of financial

dependence and help them to help themselves. It is concerned with the society as a whole with its interacting layers of individuals, families, employers, communities, and the state all being important elements. Therefore, rather than over-emphasising the individuals' efforts in a free market where individuals are treated as discrete entities, the livelihood approach emphasises the empowerment of all parts of the society through capital redistribution and accumulation.

In the context of China, the livelihood approach implies deliberate countering of tendencies towards urban bias.

First, the livelihood approach emphasises the identification of livelihood-related opportunities and constraints regardless of where these occur (Farrington et al., 1999). As we discussed before, urban China suffers from serious unemployment. The capacity of urban areas to recruit more rural labourers is limited. At the same time, the rural-urban migrants who do not enjoy the status of urban residents suffer from many disadvantages when they work as contract employees (Li, 2004a). This problem demands changes in the urban resident registration system and granting rural migrants complete citizens' rights.

Second, the livelihood approach provides a holistic perspective on social policy which helps to bring up a broad range of issues that would not be addressed otherwise. For example, the state in China has been operating a 'third way' to poverty relief—resettlement of farmers from remote rural areas to urban areas or newly constructed small towns (Merkle, 2003). However, the result of resettlement is very much debateable, especially when the resettlement is involuntary (Croll, 1999). The challenges to resettlement are not limited to providing homes for the resettled. The greatest challenge lies in the establishment of a social and economic system that can help the resettled to fit into urban life. The components of such a system include various types of capital that are crucial for an individual, a community or a newly established city to survive: education and training, healthcare, employment opportunities, infrastructures, compatible social services and social protection.

The livelihood approach sees social policy in much broader terms than being about provision of social services. However, social provision continues to play an important role. Crucially, it leaves room for the market, communities and various non-government organisations to play their parts. It is a development model which recognises the importance of local resources and experiences and encourages bottom-up initiatives (Hall and Midgley, 2003, p.104).

State dominance in social reforms has been particularly strong in urban China. The state, as has been discussed, initiated reforms in all areas of traditional state

welfare: housing, pension, healthcare, education as well as social safety nets. It urged and compelled individuals and employers to contribute to individual accounts which aim at long term saving and social pooling to guard against bulky needs and emergency. These top-down changes reflected the state's intention to withdraw from welfare provision and to negotiate and redraw the boundary between the state and the other potential undertakers of welfare payment and delivery. The state established social safety nets for the people experiencing various risks, such as job loss, ill health and loss in earning ability either in the short term or in the long term. Although the state began to serve as an enabler, assisting individuals or groups of peoples to get out of poverty by offering capital support, nevertheless the shrinkage in state responsibilities did not mean corresponding shrinkage in state control. In the whole pack of social policy, reforms were mainly top-down. Although in some areas such as healthcare and migrant housing, bottom-up changes are literally unpreventable (Shang, 2001), there have rarely been involvements of other actors during the process of policy planning. As a result, it is quite often the situation that the state became the 'enemy' of local initiatives and often engaged in destroying new initiatives at an early stage.

Conclusion

This paper has discussed the relationship between economic development and social policy, and the outcomes in terms of poverty and inequality in China. This paper has distinguished between three main stages of reform. The first was based on the central planned model which tried to maintain equality through deep income redistribution and state social provision. Although China had set up a basis for heavy industry in the 1950s in this way, it suffered severely from the ills of central planning in the years to come. Social policy in this period was designed to serve urban industrialisation and keep social control. The second stage was the pro-urban growth era which focused on industrialisation and urbanisation. The role of social policy was mainly to facilitate privatisation and build up social protection for urban residents to guard them against the greater risks in the market economy. However in the 1990s, the shortcomings of the pro-urban growth model became clear. Rural areas failed to grow in step with the urban areas. Long term economic growth could not guarantee sufficient job opportunities for the growing urban population and the ever-increasing number of rural-urban migrants. The third stage started at the beginning of this century. It showed the state's intention to cool down the overheating economy and target the poorest regions to narrow the gap between rural and urban areas.

The centrally planned model and pro-urban growth model highlighted some major constraints facing China:

1. It is a vast country size with a large population.
2. The majority of the population remained in agriculture.
3. Rural-urban divisions were great.
4. Regional development has been unbalanced.
5. Shrinking labour demand in the state enterprises has led to growing unemployment in urban areas.

Some of these constraints are natural and some were caused or made worse during the central planning and pro-growth periods by state economic and social policies.

Relevant data suggest that the early 1980s saw remarkable progress in reducing absolute poverty. However, in the 1990s, when the prolonged and fast economic growth dominated China's image, some people, particularly those in rural areas and the loss-making state enterprises, had escaped poverty but fell into poverty again later. However, this was not a universal phenomenon. As some people fell more deeply into poverty, there rose up a new middle class who accumulated wealth faster than ever. The result was increased inequality and growing social tension.

Such challenges have several consequences for social policy. First, the changing pattern of development in China reveals that in an economy limited in resources and constrained by various social and economic conditions, the state cannot single-handedly take up all the social responsibilities and effectively end poverty. Even if it claimed to do so, as in most centrally planned regimes, the coverage of social provisions would not be sufficient to keep people out of poverty. Secondly, economic growth needs to be accompanied by compatible social development. Biased social policy to guard the interests of urban population ultimately sets a limit on further growth and threatens social stability. Thirdly, social policy in the traditional sense plays an important role in developing countries but with the constraints of population, resources and level of development, it is almost impossible for the whole population to wait for the state to develop complete social services and provide them in the similar way as in many developed countries.

We can generate an analogy of the problems faced by China. Imagine a tall building with modern flats built on top of ancient foundations and a basement accommodating a large population. The flats have the most up to date design and are equipped with new furniture; whereas the basement is dilapidated and poorly equipped. People living on the top update their flats so that the conditions can be as good as any newly built houses. They are also interested in further improving their living conditions by expanding the building upwards. They add more floors of modern flats on the top and hope they can improve

their living conditions endlessly in this way. However, they have little interest in taking care of the basement. Over the years, the bottom is further damaged by the heavier and heavier weight on top. People living in the basement are eager get out of the crushed basement and obtain better conditions at higher level. However, the capacity of the top flats is limited. It is constrained by two factors: the space limit and the limited potential for expansion. What is more, the potential for expansion is actually constrained by the condition of the poor quality of the base. In the past, people from the upper floors tried to limit the number of people trying to move upward so that the capacity of the upper floors would not be too stretched. However, this approach neglected the fact that the bottom is very crucial for the stable expansion of the top. It was the poor condition of the basement that actually bounded the capability for further expansion on the top. To improve the capacity of the building, it is crucial to strengthen the base and improve the living conditions of the people in the basement as well. The improvement can be done with the help of the people from the upper floors. It can also be achieved in part by the people living in the lower part. However, it is important to provide them with the skills, resources and equipment to improve the basement. Fundamentally, it is crucial to understand the fact that improving the basement is not only necessary to improve the living conditions of the people living at the bottom, but also a necessary condition to be satisfied for the expansion of the whole building—including the expansion at the top.

The message in this analogy is clear, China's experience in development and the accumulated problems of poverty and inequality provide a very good case for broad-based development, in which social policy deliberately targets the 'weakest links', and generates opportunities, and reallocates capital of all types to facilitate long term development.

The livelihood approach provides a useful framework for analysing the relationship between economic development and social policy. It does not treat social policy as serving a specific development strategy, but rather playing a holistic role addressing various sources of opportunities for and constraints on human development. Also, social policy is not limited to state intervention and top-down policy initiatives. It aims to integrate actors at various stages and seeks development at all levels. China's history of economic development suggests that there is a growing need for re-examining wider social policy as distinct from the specific economic development strategies. The overall constraints in economic resources also suggest that mobilisation of all resources (including various assets held by individuals, households, communities and localities) is very important to achieve social development.

The People's Republic of China has had a most remarkable and, in parts, turbulent history. While there have been heavy and tragic human costs in terms of famines, persecution and waste of human potential, there has also been rapid economic development. This development has not been equally distributed and poverty and inequality are major, probably growing, problems. State policy has in general, emphasised economic progress, while social policy has been treated as secondary. Yet social policies have, as described here, been crucial to how China developed and in particular to the extent of poverty and inequality. Indeed, there are many other aspects of broader social policy not considered here—population policy, policy towards minorities, the system of political control, for example—which have had profound influences.

The analysis presented here does point to the importance of approaching social policy not just in relation to 'social services'—a concept essentially imported from richer industrialised countries. For the future, in which Chinese social policy will undoubtedly face many challenges, the livelihood approach within a broad social development model offers an approach to social policy that may best address the problems of poverty and inequality and promote harmonious development in the interests of all.

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