

TOWN-BASED URBANIZATION FOR BALANCED DEVELOPMENT OF URBAN SYSTEM

1. Background

For years the debate among urban policy makers in the People's Republic of China (PRC) has focused on the relative merits of developing towns versus cities. While cities offer economies of scale and greater productivity, towns hold promise for a more evenly developed urban system. In the central government's 11th Five Year Plan (FYP), one objective of promoting sound development is to encourage rural population to settle down in cities and towns, through which the government aims to increase economic productivity as a whole and narrow the urban-rural income gap. This paper presents case studies of town development in the PRC under an Asian Development Bank (ADB) technical assistance (2005), which reveals that cities and towns both have important roles to play in the country's rapid urbanization.

Currently, cities are the main engines of economic growth in the PRC. Most manufacturing takes place in large urban areas where enterprises can be grouped together and the marginal cost of infrastructure is low. In support of industrial production and administrative activity, the service sector in cities has expanded massively in recent years, creating large numbers of jobs per unit of investment. At the same time, many towns located within metropolitan areas

or development corridors play increasingly important roles as manufacturing centers, tourist destinations, and agro-processing sites. In some metropolitan areas, towns serve as bedroom communities for center-city workers or transportation hubs for passengers or freight. Compared to cities, towns have the advantages of physical proximity to rural migrants' homes and families, bearing cultural similarities and social linkages with rural traditional systems, and having a relatively low cost of living. Promoting town-based urbanization would provide an economically efficient and socially harmonizing way for the PRC's urban-system development.

2. Significance of Study

Regional and urban-rural disparities have been two major issues in the PRC's dramatic economic development. As a linkage between rural and urban development, town-based

Contents

- Town-based Urbanization for Balanced Development of Urban System 1
- Town Incorporation as a Foundation for Town-based Urbanization 10
- Employment Generation as a Primary Goal of Town-based Urbanization 21
- Unified Social Service Provision as a Basis for Town-based Urbanization 35

urbanization is expected to help bridge such gaps in the country's existing economic and geographic contexts:

- It provides an alternative way of urbanization for rural population in addition to the migration to existing metropolitan areas.
- It mitigates the problems associated with current metropolitan-area based urbanization, including over-burdened urban environment and infrastructure, inadequate public services and housing, reckless urban sprawl, and already serious urban unemployment.
- It helps establish an evenly developed urban system in the country and reduces the urban-rural disparities and the disparities within urban areas.

Given these potential benefits, this paper hypothesizes that, complementary to metropolitan area-based urbanization, town-based urbanization provides an alternative and efficient way for balanced development of urban system in the PRC.

3. Literature Review

3.1. Urban Development Theories

Urbanization takes place in two ways: (i) rural migration to existing metropolitan areas and (ii) development of rural economic centers into urban areas with required public services and socioeconomic activities. Economists often attribute the growth of a city or a metropolitan area to the increasing returns to scale and the economies of agglomeration. Urban physical infrastructure, such as transport and water-supply and sanitation systems, usually observes a declining marginal cost (the scale economies), which encourages cities to keep growing. At the same time, the growth of a city densifies its labor market, lowering search costs of firms

and workers and thereby improving the city's competitiveness. Moreover, the knowledge-spillover effects among firms and workers in an urban area further increase productivity and boost the city's competitiveness. Both of the latter two contribute to the agglomeration economies.

As cities or metropolitan areas keep growing, however, many urban problems emerge. Roads become congested; people have to commute longer to the workplace; air quality deteriorates; urban land supply becomes scarcer and housing prices as well as many other types of costs of living rise rapidly. To deal with these problems, urban economists (Fujita and Ogawa 1995; McMillan and Smith 2003) proposed a theory of multi-center urban system. By focusing on the trade-off between the agglomeration economies and high wages to compensate for expensive commutes (including time costs), researchers argue that the equilibrium number of sub-centers of a region is likely to increase with population and the per-unit cost of commuting. A study in the United States and Canada implies that an urban area with a low congestion level develops its first sub-center when its population reaches 2.7 million and its second sub-center at a population of 6.7 million. The development of second-tier and third-tier cities and towns in such Asian countries as Japan and South Korea after World War II also shows an improved balance between urban and rural development. In all these countries, town-based urbanization has played a significant role in developing a balanced and efficient urban system.

3.2. Town-Based Urban Development in the PRC

Since the 1950s, Chinese policy makers have debated the virtues of pursuing an urban development strategy based on settlement

size. From the 1950s to the 1970s, the national urbanization strategy favored smaller settlements over larger settlements. The government pursued a policy of regional economic self-efficiency in order to reduce inequality and to address national security concerns. Industrial facilities were scattered, sometimes located in towns in remote mountainous areas with little or no infrastructure. The restriction of labor mobility through the household registration system (*hukou*) allowed the government to control the size and growth of towns and cities.

By the late 1970s, 80 percent of the country's population was living in villages and towns.

The government's determination to pursue a town development policy was articulated at the National Conference on Urban Work in 1978 and the National Conference on Urban Planning in 1980. The objectives were to (i) strictly control the development of large cities, (ii) rationally develop medium-sized cities, and (iii) vigorously promote the development of small cities and towns.

Policy reforms in the first reform phase (1979–1984), which emphasized reform in the agriculture sector, had a great impact on town growth. Policies with the most significant impact included the introduction of the "household responsibility system" in 1979 (the reorganization of agriculture), whereby contract farming replaced the communes. Also, the government introduced two important measures in 1984, permitting rural migration to towns and allowing for the private operation of non-agriculture enterprises (referred to as "town and village enterprises" or TVEs). A greater emphasis on the role of small cities was given priority in the PRC's first comprehensive set of urban planning laws that were introduced in 1989. After 1992, the government reached an agreement to promote town development despite

the diverse range of opinions in official circles on this subject.

In 1995, 11 ministries and commissions embarked on a national pilot program of institutional reforms in selected towns, which was a prelude to accelerating nationwide town development. Both national and provincial pilot town programs were introduced to experiment with policies that would help facilitate urbanization in key towns. The success of these programs is debatable; many of the town development plans never achieved their goals. Several towns have been held up as success stories, but their success has derived more from unexpected growth than the implementation of the development plans.

In 2000, the central government made it official policy to actively develop towns when the Communist Party of China (CPC) Central Committee promulgated *Some Opinions on Promoting the Healthy Development of Towns*. The State Council also put forth guidelines and principles for the town reform and development, which covered such topics as town planning, household registration system reform, administrative reform, land use, governance, public finance, and law. In 2001, *Urbanization Planning under the Compendium for the National 10th Five-Year Plan* reiterated the guidelines and principles for the reform and development of towns. In 2002, the 16th Central Committee of CPC further emphasized that the urbanization process with Chinese characteristics should be one of compatible development of towns and cities.

By early 2005, the population of the PRC reached 1.3 billion, of which the urban share was estimated to be more than 40 percent. About three quarters of the annual population

increase of 4.5% is attributed to rural-urban migration. Even these high figures underestimate the rate of urbanization since an additional 100 million people are residents in urban areas, but not recognized by the official statistics. By 2005, the PRC has about 22,000 towns, and a roughly equal number of townships, compared to about 660 cities. Towns are making a substantial contribution to national economic growth. Across the country, towns had an average of 32,309 permanent residents and 16,719 workers in 2002. They produced revenues of CNY 11.4 million annually, up from 7.2 million in 1999, indicating that they were growing at an annual rate of 16 percent.

However, towns face a growing number of challengers. First of all, towns must generate employment for increasing numbers of residents and migrants. In many cases, key components of basic infrastructure, such as wastewater treatment and solid waste disposal facilities, are lacking. Also, property markets are constraining urban development. Financial resources are inadequate, making it difficult to provide social services, such as health care and education. These challenges, if not addressed properly, could constraint the growth of towns and limit their contribution to economic development of the country.

4. Challenges and Potentials of Town-Based Urbanization in the PRC: Case Studies

4.1. Rationale for Selection of Towns

The case studies under this technical assistance were conducted in two provinces, Liaoning and Shanxi. Six towns were selected: Goubangzi, Tengao, and Xiliu in Liaoning, and Gutao, Wutong, Yangqu in Shanxi. The following criteria were used in identifying the towns: (i) the selected towns were generally representative

of the economic functions of towns in each province, (ii) both towns that have enjoyed recent success and those that are poorer or more marginalized were included, (iii) selected towns had a population in the range of 20,000 to 150,000, which represented the average of the country, and (iv) towns were selected from different prefectures, located in existing clusters or corridors of development.

4.2. Towns' Strengths in Economic Development

The selected towns in Liaoning and Shanxi Provinces have made substantial progress in facilitating economic growth. On the supply side in particular, and with the help of provincial and national incentives, town governments are effective in providing key inputs to investors, such as serviced land, regulatory support, and adequate supplies of labor. They are less sophisticated on the demand side, rarely use market information to guide policy development, and do not systematically promote their assets to private investors. Furthermore, the government-wide priority on gross domestic product (GDP) growth in recent years has privileged industrial development over service-sector growth, which has limited the impact of investment on job creation.

The case studies find that towns' strengths in economic development promotion lie in the following five areas. First, towns have clearly defined goals. Most studied towns have set key investment goals for the near term, and town leaders have a clear understanding about the role of the town in the larger regional and national economy. Investment policies and programs are clearly linked to the achievement of the overall economic goals. Town leaders deliver succinct and cogent presentations on the economic function of their towns, their

development objectives, and the mechanisms for achieving them.

Second, development of some towns is based on local assets and resources. Many towns thrive off abundant natural resources, including minerals (coal in Wutong and Kanping), agricultural products (Fuzhoucheng and Goubangzi), and shellfish (Pikou). Other towns, including Gutao in Shanxi Province, contain important historical architectural assets, which form the basis of an emerging or developed tourism industry. In all of these locations, town governments have demonstrated their ability to attract investment in the processing of resources. Levels of investment and production are sometimes determined more by quotas set by higher-level governments rather than transactions with investors in the marketplace.

Third, regional linkages are important for towns' development. The success of such towns as Xiliu and Yangqu is due more to their access to larger markets than to local resources. The best locations for these towns are along development corridors or in metropolitan areas. Xiliu, for example, has taken advantage of its position in the Dalian-Shenyang corridor and its proximity to a large international port. Its immediate expressway access, rail links, and a dense highway have allowed it to develop its apparel market into a regional textile hub. Yangqu's stainless steel industry is rapidly expanding to take advantage of its location near the steel plants in Taiyuan city. Teng'ao has developed downstream linkages with steel, producing machine tools, metals, and spare parts for vehicles; Teng'ao's GDP has increased twelve-fold since 1991 to CNY 8.7 billion in 2003.

Fourth, industrial parks often played a crucial role in towns' development. Many towns in

the two provinces have developed industrial parks to ensure the timely provision of serviced industrial land. The parks are well managed and have played a key role in attracting domestic and foreign capital to towns.

Fifth, fiscal incentives are important for towns' initial development. Demonstration towns participating in provincial and national "key town" programs have made effective use of fiscal incentives, such as business income tax and value-added tax rebates for new investors. Enterprises have also benefited from waivers of land use rights fees in many towns.

4.3. Towns' Shortcomings in Economic Development

At the down side, towns' shortcomings in economic development are found as follows. First, town governments set growth over employment as the primary development goal. Consistent with national policy, town leaders have placed top priority on economic growth, as measured by investment, GDP growth, and increased tax revenues. Such policy has favored capital-intensive and high-value sectors that often do not employ many workers per CNY invested. In this way, the impact of economic growth on employment generation has been limited.

Second, towns' development focused on industry over services. A corollary of the emphasis on GDP growth has been a tendency in many towns to favor industrial development over growth in the service sector. Although service sector development in many towns requires a strong industrial base, this policy has tended to put downward pressure on employment generation.

Third, demand-side management is underdeveloped. Towns rarely carry out market

analysis prior to establishing target sectors and investment priorities. Moreover, town governments have a passive approach to investment promotion; they do little branding, marketing, and direct courting of potential investors in targeted sectors.

Fourth, little was done to improve the quality of labor, the main resource of the town. As the study shows, what investors value most about towns is the availability of inexpensive labor with appropriate skill levels. Towns do surprisingly little to cultivate this resource. Towns and upper-level governments rarely work together to offer training courses to assist rural migrants to enter the urban labor market. Also, few towns have taken steps to make social services and benefits available to migrants on terms equal to those of local residents.

Finally, one-sector economy has been a potential issue. The economic base of many towns depends almost entirely on one sector, often the processing of local natural resources. This dependency makes the town economies vulnerable to the business cycle of that commodity, increasing the risk of economic downturn and associated hardship of the local population.

Many of the most significant findings of the case studies with respect to economic development were captured by the Enterprise Survey, a sample survey of managers of the five largest enterprises in each of the study towns. The survey showed that the most important factor for business expansion or development from the managers' perspective is availability of labor. Availability of land, while valued, was not considered a major constraint in the studied towns. Urban infrastructure services and industrial park management was generally rated

"good" or "very good." Financing is considered critical by enterprises, although this input is largely beyond the scope of local governments. Towns are seen as generally responsive to private enterprises, suggesting that local governments are succeeding in the creation of an enabling environment for economic development.

Guided by national policy, town economic managers are looking for ways to vertically integrate their economies, creating linkages among different sectors and extending the value added chain. This has been particularly successful in manufacturing towns, where local producers in Yangqu, for example, have gone from steel to stainless steel sheeting and tubing, and then from sheeting and tubing to cookware. The policy applies to agro-processing, too, although progress has been relatively slow; the ratio of agro-processing output value to agricultural output value ratio is 0.85:1 in the PRC, in contrast to 3:1 in many developed countries.

Tourism is a growth sector for Shanxi Province, where 70 percent of 1,000-year-old buildings in the PRC are located. The Shanxi Tourism Bureau has prepared a master plan for the sector in order to attract more tourists to the province's Buddhist temples, merchants' courtyard houses, and other historical and architectural assets. While the plan identifies tourist routes designed to encourage overnight stays in different towns and cities, it does not detail capital investments or other specific measures needed for implementation. Moreover, tourist planners have not carried out detailed market research, and do not actively promote Shanxi through tourism agencies in other parts of the PRC.

4.4. Developing Towns in Context of Large Urban Agglomerations

The contribution that cities and towns are making to the parallel processes of urbanization and economic development makes it clear that the "city or town" choice is a false one; rather, the PRC should grow cities AND towns by facilitating the development of larger urban agglomerations—metropolitan areas, industrial corridors, tourist zones, and other sub-regions—made up of different types of urban settlements.

Central and provincial governments should focus resources on the towns with the highest employment and economic growth potential resulting from location, access to markets, labor pool, natural resource base, and other factors. Towns should be encouraged to compete among themselves for private and public sector investment. This approach will tend to concentrate resources in a limited number of towns where returns on investment are highest. At the same time, government should introduce a town-based component into the poverty alleviation program that would allocate funding, technical assistance, and training to towns below a certain poverty threshold to enable development of disadvantaged towns.

To increase the capacity of towns to support economic growth, job creation, and urban development, towns and cities should be incorporated by provincial governments as regulated and independent entities with the authority to levy taxes, incur debt, and provide selected services. By liberalizing the property market and introducing a property tax, the central government can provide towns with own-source financing for infrastructure investment and offer incentives for the production of housing and other real estate products that

meet the needs of migrants and other residents.

Government should create a unified social services and benefits system for all citizens. Benefits should be de-linked from employment status to ensure coverage of temporary and informal sector workers. Town governments should provide social services to all residents of the town—independent of *hukou* status—under the same terms and conditions. This will remove a significant disincentive to living in towns and encourage migration from the farm to new employment areas.

Strategically, town development should be conceived and implemented as part of the development of metropolitan areas, development corridors, and other sub-regions. The government should foster the development of physical and economic linkages among different types of urban settlements within the sub-region to improve access and to take advantage of economies of scale and multiplier effects. This coordinated approach will be the most effective in enabling growth and generating employment. Public sector entities should lead a metropolitan or sub-regional planning process in which the roles and functions of urban settlements of different sizes are defined and the public investments in roads and environmental infrastructure are identified.

- In metropolitan areas, identify optimal functions for different towns within the group of settlements and develop them to that end. Some towns can best serve as bedroom communities for the core city, others as manufacturing centers, and still others as transportation hubs, such as multi-modal centers.
- In industrial corridors, town economies should be developed to extend the production

chain of sub-regional industry or services, for example, linking steel production downstream to stainless steel production, or linking electrical power generation upstream to coal mining.

- Tourist zones can be created from clusters of towns with significant tourist assets. Sub-regional planning is critical for the creation of marketable products, such as specific tourist routes and itineraries. Investments in transportation and regional environmental infrastructure should be carried out in a coordinated fashion among the town governments and higher-level entities.

Central and local governments should rationalize and upgrade their approach of channeling resources to key towns. Rather than selecting them on the basis of population or functional and regional distribution, towns should be targeted based on their potential to grow economically and to provide jobs to immigrants from rural areas. The overarching factor should not be growth of production, but rather growth of employment. The latter will contribute more toward the government's goal of closing the rural-urban income gap. This will require a paradigm shift in the thinking of provincial- and local-level managers of the development process.

For the purposes of allocating state and provincial resources, cities and towns should be subject to the same type of growth potential analysis. What matters is not whether a town or a city is the object of government's efforts to generate employment, but rather how much employment is generated for what amount of public sector investment, and what are the impacts on rural-urban wealth distribution. In the future, key towns should be selected based on their "employment rate of return," i.e., the

number of jobs created per CNY invested by provincial or central government. The analysis of employment generation and economic growth potential should be based on the overall development dynamics of the town and the sub-region in which it is located. Major factors for consideration include:

- Location near or within cities, metropolitan areas, and sub-regions;
- Location along major transportation routes;
- Natural resource base of town and hinterland;
- Quality of regional food products to which value can be added;
- Current and potential labor pool of town.

The analysis will yield a ranking of towns by employment and growth potential. The government should focus development assistance to those towns. The exact number of towns is not important, nor is the geographical distribution of towns within the province. It should be assumed that the workers will come to the jobs where it is most efficient to create them. The number of towns will be determined by the amount of development assistance funding available and the amount invested in each town. Investment budgets for different towns should be determined not by formula or rote allocation, but again by a careful analysis of the development dynamics and identification of the public investments that will leverage the greatest amount of private investment and job creation. This will vary by type of town and by individual town.

Some high-growth towns will not require assistance from higher-level governments to develop. The governments of these towns are capable of using their own resources and those of their private sector partners to facilitate

investment and create jobs. These towns should be highlighted in regional urbanization plans prepared by the provincial government, but will not necessarily be beneficiaries of development subsidies. This approach will tend to concentrate resources in a limited number of towns where returns on investment are highest. At the same time, assistance should be demand-driven. Towns should be encouraged to compete for provincial and central governments' funding for infrastructure.

4.5. Supporting Poor Towns

Parallel with the introduction of a demand-driven system in which towns compete to create the best conditions for investment and employment generation, the government should introduce a town-based component of poverty alleviation programs. Towns below a certain income threshold—for example, the 20th percentile of income per capita measured at the town level in a given province—should be eligible to apply for provincial funding, technical assistance, and training. The objective of the assistance is economic growth and job creation. Grant financing could be made available for infrastructure improvements that will facilitate economic investment, such as roads and water supply in an agro-processing industrial park.

Through a systematic technical assistance and training program, the government can disseminate best practices, guidelines, and analytical tools to enable less well endowed town governments to mobilize local resources and lead the local development process. In this respect the approach to town development is both top-down and bottom-up. The recommendation is to adopt a more effective, integrated, and analytical approach to state promotion of key towns, on the one hand; while empowering other towns

with tools and limited financing to chart their own development courses.

This town-based initiative should complement other poverty alleviation components that directly benefit households or individuals, since by nature town-based assistance cannot address issues of distribution of wealth within the population of a town. Rather than being open-ended, the programming of assistance to poor towns should be correspond to the current demographic "window of opportunity" in which the PRC's ratio of workforce to total population is high. As the ratio decreases, the poor town program should be phased out.

5. Conclusion

Complementary to metropolitan-area based urbanization, town-based urbanization provides an efficient way of urbanization for rural population. The contributions that cities and towns are making to the parallel processes of urbanization and economic development make it clear that the PRC should grow cities and towns at the same time by facilitating the development of larger urban agglomerations made up of different types of urban settlements. Within that context, national and provincial governments should focus their efforts on towns with high potential for employment generation and economic growth. Provincial governments should also enable selected towns to formulate and implement their development strategies by granting them greater authority for planning, budgeting, revenue generation, and infrastructure investment. Built on these strategies, town-based urbanization will bridge rural and urban development and help establish a balanced urban system in a rapidly urbanizing PRC.

TOWN INCORPORATION AS A FOUNDATION FOR TOWN-BASED URBANIZATION

1. Introduction

The People's Republic of China's (PRC) rapid urbanization is expected to observe a rural population of 200-300 million migrated to the urban area in the next twenty years. To assume the massive responsibility for facilitating the generation of 10–12 million jobs yearly for migrants, cities and towns need a solid legal and regulatory basis for the financing and delivery of services. The central government should empower provincial governments to incorporate cities and towns as independent legal entities with specific responsibilities for service delivery and authority to levy and collect taxes and fees. Specified in the city or town charter, the responsibilities and authorities should correspond to the managerial and technical capacities of the local government. In practice, this means that they should be set to low to moderate levels for town government in the short run, and increased with time as institutional capacity increases. In all cases, revenue-generating authority should be set in such a way that it corresponds to service delivery responsibility. This paper hypothesize that improving towns' financial and administrative autonomy, i.e., incorporating towns, forms a foundation for successful town-based urbanization in the PRC. Analysis in this paper is based on case studies in Shanxi and Liaoning provinces under an ADB technical assistance (2005).

2. Literature Review

2.1. Roles and Capacity of Towns

The role of town government is changing in the PRC. From being the direct provider of employment, housing, and other services, towns are increasingly serving as regulators and providers of basic infrastructure and services. Towns do not always strike the most appropriate balance, and are often still engaged in activities that are better carried out by the private sector, e.g., industrial production. Completing the transition, and better defining the appropriate roles of the government, the private sector, and community organizations, will be a key challenge in the future.

Towns are growing rapidly and their needs are changing. As they urbanize, they will face the challenges of urban areas: managing crime, creating jobs, delivering infrastructure, etc.

To meet these needs, they will need greater financial resources (including access to private capital); appropriate levels of qualified staff; improved access to technology, such as computers; and better approaches, systems, and procedures. Assisting them in fulfilling these needs should be a central task of provincial and national policy makers.

2.2. Municipal Finance of Towns in the PRC

Like many local governments worldwide, towns

and cities in the PRC do not have the resources needed to shoulder the burden imposed by rapid urbanization, limited authority, and expanding responsibility. Several of their most important revenue sources have been reduced or eliminated. Tax sharing is determined by the central government and at the province level using an opaque distribution scheme. Many potential revenue sources that offer the greatest promise are unfamiliar to local government officials. Other sources, like the various forms of debt, are not a true income source but are "pay as you use" financing instruments, in which infrastructure improvements are financed through debt. Another major problem is the failure to keep financial management authority in line with service delivery responsibilities. Furthermore, tax rates and service tariffs are generally set by the central government, with little regard for local requirements and unique circumstances, despite that each town or city has an environment that is unique, with different demands on construction of infrastructure due to terrain and geographic setting.

The framework for municipal finance determines the type and amount of financing available to towns for critical infrastructure. In the PRC, the finance system is divided into two levels: national (central) and sub-national (local). Revenue sharing between the central and sub-national (province) levels is fixed (although the provincial share is decreasing), but the percentage that towns receive is not. Towns are at the bottom of the local system, which extends down from the provinces. Within these systems, however, there is great variation.

The amount/proportion of taxes received by town governments is determined at a local level and differs from one location to another. This

has led to a situation in which town revenues are insufficient and unstable. In Liaoning Province, taxes are proportioned among four different levels. The provincial government determines the share it will keep and the share to be distributed to prefecture-level cities. The prefecture city then decides what percentage to share with its counties, towns, and townships. As shown in Table 1, Xiliu and Goubangzi belong to different cities, so they have a different tax share rate. In addition, some towns get a tax rebate or revenue from their county- or county-level city, based on the total revenue submitted by the town.

Also, as shown in the table, there is no fixed tax-sharing proportion for towns in Shanxi province. Towns receive funds for salaries and an office operation fee from their county or county-level city only, which is allocated from budgets at the beginning every year. Usually, the office operation fee is very limited and not enough to cover the costs. A town may receive additional tax rebates or revenue, based on the total revenue the town submits. They may also seek to raise funds from extra-budgetary revenue sources in towns.

In practice, the great majority of tax revenues are retained at the central level, despite the fact that responsibilities for the provision of most basic infrastructure and services rest with local government. This mismatch of responsibilities and funding impedes ability of town governments to fulfill their designated role as facilitators of urbanization. In spite of the relatively rapid increase in fiscal revenues, there is an expanding gap between revenues and expenditures at the local level. This is due to a lack of stable tax resources and low transfer levels in relation to responsibilities. The proportion of total taxes remitted directly to the sub-national

level decreased from 78 percent in 1993 to 48 percent in 2001 though these figures do not include remittances from the central to provincial governments. Despite this, the proportion of local expenditures as a percentage of total expenditures has remained at around 70 percent. This situation is a primary cause of the fiscal difficulties experienced by local governments.

To bridge the gap between income and needs, towns often resort to extra-budgetary revenues, such as fees for services and land transfers. These activities tend to undermine fiscal discipline, erode the link between expenditures and priorities, and distort incentives. However, they are often the only way that governments can provide essential infrastructure and services to their growing populations.

The mismatch between responsibilities and resources is of particular concern from the point of view of town development. Funding shortages in towns have led to:

- Shortfalls in meeting needs for rural compulsory education
- Shortages of rural infrastructure
- Difficulties in establishing a rural social security system
- Poor conditions of rural medical and health care services
- Inability to pay government staff (in particular those in central and western provinces)

Attracting private sector investment and facilitating the provision of housing and services to migrants will require massive investment in infrastructure. Currently, town governments do not have the authority to raise and retain sufficient taxes and fees to cover their investment requirements. Their only recourse

is participation in bargaining with higher-level governments on redistribution of tax revenues, but towns do not have enough political clout to secure from that process the resources they need. If town governments are to lead a process of local development that will make a significant contribution to restructuring the national economy, then they will require greater authority to raise and retain more tax revenue. In addition, towns will most likely need increased amounts of targeted, predictable transfers from the central and/or provincial governments for investment in roads and environmental infrastructure.

2.3. Issues in Towns' Property Markets

Well-functioning property markets are critical to the full development of towns. Land in the PRC is regulated by a complex set of planning and legal regulations that serve in some ways to facilitate the development of towns, and in other ways to impede it. Because all land in the country is either collective or state-owned, it is important to understand both systems and the restrictions and opportunities both provide.

State-owned land is owned by the government. Nearly all property in cities is state-owned, but a large proportion of land in towns is not. The maximum term of use rights to residential property is 70 years. Such rights can be traded freely among private citizens, with prices determined by market value. The system of state ownership of land imposes no particular constraints on the development of towns.

Held jointly by members of the collective, collective land consists of plots with housing improvements on them and agricultural land. In both cases, members of the collective are given use rights to specific plots of land. All village land is collective, and a large proportion of land

Table 1: Revenue Allocations in Selected Towns in Liaoning and Shanxi Provinces, 2004 (%)

No. Main Taxes	Government Level	Liaoning		Shanxi		
		Goufangzi	Xiliu	Wutong	Gutao	Yangqu
1. Value-added Tax	Central	75	75	75	75	75
	Provincial	10	10	8.75	8.75	8.75
	Prefecture-& County-Level Cities (combined)	0	5			
	Prefecture-Level Cities Only			5	3.75	0
	County-Level Cities Only			11.25	12.5	16.25
	Town	15	10	0	0	0
2. Business tax	Central	0	0	0	0	0
	Provincial	30	30	35	35	35
	Prefecture-& County-Level Cities (combined)	0	30			
	Prefecture-Level Cities Only			20	15	
	County-Level Cities Only			45	50	
	Town	70	40	0	0	0
3. Income tax on enterprises	Central	60	60	60	60	60
	Provincial	20	20	14	14	14
	Prefecture-& County-Level Cities (combined)	0	5			
	Prefecture-Level Cities Only			8	6	
	County-Level Cities Only			18	20	
	Town	20	15	0	0	0
4. Income tax on individual	Central	60	60	60	60	60
	Provincial	15	15	14	14	14
	Prefecture-& County-Level Cities (combined)	0	10			
	Prefecture-Level Cities Only			8	16	
	County-Level Cities Only			18	20	
	Town	25	15	0	0	0
5. Housing property tax	Central	0	0	0	0	0
	Provincial	50	50	0	0	0
	Prefecture-& County-Level Cities (combined)	0	0			
	Prefecture-Level Cities Only			0	0	0
	County-Level Cities Only			100	100	100
	Town	50	50	0	0	0
6. Agriculture tax	Town	100	100	100	100	100

Source: PADCO/CCTRD, field investigations, 2005

in towns, including land within the built-up area of the town, is collective as well (this proportion is as high as 60-70 percent in many towns, and includes all land not developed for industry or new housing). Collective land cannot be traded freely, as only a member of the collective can be given use rights to collective land. Although use rights to collective land is sometimes exchanged in private transactions, the exchange is not formally recorded or legally sanctioned. When collective land is developed, it must be converted to state land first; holders of use rights are given compensation.

Collective land poses a series of challenges for towns. First, methodologies to set compensation for expropriation are problematic because use rights are not freely tradable. Market prices are only possible to ascertain through comparison with similar properties on state land, which in practice is difficult because of the very different type of structures found on state land in towns. Compensation generally includes only the improvements on the land (buildings), and does not encompass the use rights to the underlying land (which is often more valuable). Disputes over compensation for expropriated land leads to tensions between farmers and the government. In addition, without use rights to the land, farmers lack incentives to invest in improving their homes. These improvements include incrementally adding floors or buildings to respond to demand for rental housing or adding living space as farming incomes increase. Farmers would find it difficult to get loans for home improvements or other purposes in any case, because they have no real collateral.

The process for development of collective land is complicated, and differs from town to town.

The development of land is sometimes initiated by the government and is sometimes initiated by the private sector or by collectives themselves; it is not standard and is not clearly governed by national regulations. There are several problems with the land development process. First, the government is involved in nearly every step, which provides opportunities for corruption. Developers may induce government to initiate and approve the land development process, or attempt to evade regulations through informal transactions. Second, the process would appear to require a long period of time to complete, despite the indications by officials that it requires only months. Third, negotiations with households on compensation occurs late in the process, and direct negotiations of the developer with displaced households may put them at a disadvantage, especially if the development has by then been sanctioned by several government agencies. In addition, this price is generally estimated by an appraisal company that is hired by the developer, which could bias the price.

In their rush to modernize, towns are copying the housing models of Chinese cities almost wholesale. Many require all new housing developments to be at least six floors and to meet other minimum design standards. The desire among officials for high-quality buildings is understandable. However, it does not allow towns to capitalize on their comparative advantage: cheap land. In addition, developers in several demonstration towns have had a difficult time selling new units because the unit price exceeds the ability of residents to pay. Units that are built are occupied primarily by middle- and upper-income families, reducing the diversity of neighborhoods and forcing lower-income families to live on the outskirts of towns.

3. Challenges and Potentials of Town Incorporation in the PRC

To fully realize their urban and economic growth potential, towns will need access to and control over substantial amounts of financial resources. The main sources of funding today are intergovernmental transfers from higher levels of government. Towns, as the lowest administrative entity in the national hierarchy, have very little control over the amount of resources that they receive. This makes it almost impossible to effectively plan for development and finance large-scale infrastructure projects, since future revenue streams are unpredictable. It is therefore advisable for towns to develop new "own-source" revenues that they can implement locally to generate and retain the funding necessary to support development. But it is not enough to pass laws on individual revenue instruments; rather, the very legal and regulatory footing of local governments needs to be strengthened before they can be given new authority to generate revenue.

3.1. Incorporate Cities and Towns

Provincial governments should be empowered to incorporate cities and towns as legally independent entities with the power to raise taxes and incur debt. National policy should promote this change by establishing the regulations by which provincial governments will incorporate cities. Provincial governments would then pass enabling legislation that specifies the process by which local governments are endowed with specific responsibilities and authorities. In turn, local governments should then adopt a "home rule charter" that outlines the powers, organization, and duties of its major components and responsibilities to the state, the province, and the citizens.

This proposal responds to the central government's stated aim of increasing the capacity of local governments to enable growth of towns. However, it represents a departure from the current position of local governments in the public-sector hierarchy. This can be viewed either as a step away from the unitary system government, or as a deepening and greater articulation of that existing system. Newly empowered local governments would not only be able to exercise their new authorities, but they would also (i) be clearly prohibited from exercising any authorities not articulated in the enabling legislation, and (ii) be clearly required to execute their assigned responsibilities with respect to service provision and growth management.

It is important to note that the incorporation process allows the provincial government, operating within national guidelines, to specify the exact responsibilities and authorities that will be delegated to a particular local government. The responsibilities and authorities should be compatible with the technical and managerial capacity of the local government. It is understood that many town governments are not financially strong enough today to issue a municipal bond. Such government should not in the short term receive from provincial government bond-issuing authority, but could rather be given authority to implement other new revenue-generating instruments that are consistent with their managerial capacity. Over time, local government demonstrating responsible use of new authorities can be granted additional authorities through modification of their charters.

3.2. Introduce a Range of Revenue-Generating Instruments

Once a town government has been placed on

solid legal footing, it should consider introducing a range of new revenue-generating instruments. In principle, no local government should rely on a single revenue source or even a small number of sources. In general, the broader the range of independent sources, the more financially robust the local government. Town governments should plan in the future to generate revenues through taxes and fees, shared revenue, and service charges.

Property taxes

Local governments should be granted authority by provincial government to levy and collect annually a tax on privately owned improvements located on real property. The improvements can be either collectively or individually owned. The tax should be levied on the improvements, not the land. The basis for the tax should be the market value of the improvements. It is not necessary to change land tenure forms to introduce the property tax. Property taxes can be levied on improvements on state land or collective land. The valuation process will be simpler for improvements on state land, since the value of the land use rights is implicit in the value of the improvements when the latter are sold on the open market.

Moreover, the introduction of a property tax will not necessarily result in a higher overall tax burden on local businesses, and therefore will not cause the local economies to stagnate. Other taxes—such as enterprise income taxes—can be reduced accordingly so that the net tax burden on the private sector does not rise. The proof of the possibility of levying property taxes without stifling economic growth can be seen in the vibrant local economies of towns and cities in North America and Western Europe, the large majority of which levy property taxes.

Special assessment districts

The provincial government should grant the right to incorporated cities to levy a special tax on improvements that provide a benefit to an identifiable group of residents or businesses. When a specific group or zone within the city receives specific benefits from an improvement, such as a road or neighborhood park, that group or the properties within that zone should participate in the financing of the improvement. The zone in question is called a special assessment district. Special assessments are sometimes used as part of the funding package for a major infrastructure improvement in the area. The special assessment is usually levied on property holders within the district as an additional charge on the property tax. For example, if the property tax rate in the town as a whole is 2.5 percent, then property owners in the special assessment district might have to pay an additional 0.5 percent (or 3.0 percent in total) to pay for a road or a public transit facility, for example. Usually the assessment (or tax) is spread over several years to avoid overly burdening the residents and businesses of the area. A typical feature of a special assessment is that generally no property can be assessed a fee or tax in excess of the benefit (improved value of the taxed property).

Provincial governments should authorize town and city governments to receive "special assessment loans" to finance specified improvements in a special assessment district. The special assessment is used to repay the loan. Periods for such loans are generally medium-term—three to seven years.

General revenue sharing

The central government now currently uses

a standard formula to share revenue with provincial governments. This commendable practice should be extended to cities and towns. Shared revenue should be based on a transparent and easily calculated formula using only three factors:

- Ten percent of the total revenue of the province allocated to cities and towns on a population basis; that is, each city should receive a share commensurate with the ratio of its population to the total urban population in the province or country
- An adjustment (progressive indexing) based on the average per capita income of the town's population compared to the average per capita income in all urban areas
- An additional factor to compensate those towns with a high proportion of households under the provincial or national poverty line

To maximize transparency and predictability in intergovernmental finance, the exact formula for allocation of national and provincial funds to cities and towns as well as actual projections of the amount of future transfers to local governments should be distributed to local governments and made available to the general public.

Block grants

The central government should establish a block grant program designed to mobilize capital expenditure financing for infrastructure improvements that are consistent with the objectives of the state. These grants should be set at 50 percent of the total audited project capital cost with the remaining 50 percent financed through revenues or debt instruments of the city.

Service charges

The provincial government should give cities the right to charge users for the services it provides. There are generally two types of service charge. The first is for a service that is closely connected to the health, safety, and well-being of the community at large, such as water supply, wastewater collection and treatment, and solid waste collection and disposal. These fees should be mandatory and sufficient to pay the full cost of operations and maintenance, and, where possible, capital debt service.

Town governments should use ability-to-pay analysis as part of the infrastructure investment planning process and should set tariffs at levels that users can afford. Capital subsidies should be introduced where full cost-recovery tariffs are not affordable to all user groups (especially domestic users) and where the investment is considered critical for public welfare and/or the technical performance of the infrastructure service system (e.g., water pipe replacement).

Commercial bank loans

Local governments demonstrating sound financial management should be granted the authority to take loans from commercial banks. The most appropriate use of commercial loans is investment in infrastructure or other capital investment projects for services that generate a revenue stream. Where the financial internal rate of return of the project is higher than the interest rate on the loan, then it is in the town government's advantage to borrow money to finance the project. Use of commercial bank financing to pay recurrent expenditures is not advisable, but should be permitted when necessary to settle accounts with creditors.

The use of credit financing is only appropriate for local governments that are "creditworthy," or capable of repaying the loan. Qualified, professional commercial banks are capable of determining the creditworthiness of a local government and deciding whether the risks of making the loan outweigh the benefits. However, provincial government should limit risk of default on loans by establishing stringent performance criteria with respect to financial position and financial management that towns will have to meet before they are granted authority to borrow from banks. The authority can be granted on a town-by-town basis according to specified criteria. Achieving the level of creditworthiness necessary to borrow from a commercial bank will generally first require progress on successful introduction of other revenue-generating instruments identified above. This is true for both credit financing and debt financing.

Debt financing

Provincial governments should grant selected cities and towns the authority to incur debt through issuance of municipal bonds. This is one of the best mechanisms for financing expensive, large-scale infrastructure, since it allows local governments to "flatten out the payment stream," investing in the next 2–3 years but paying for the investment over 10–25 years. Most towns are not yet ready to issue bonds. Cities should be granted this authority first and, if initial bond offerings are successful, then authority should be extended to towns. As for bank loans, authority should be granted on a town-by-town basis to those local governments that demonstrate the necessary financial performance by meeting specified criteria.

There are several types of debt that should

be authorized. The first and most common are called "general obligation bonds." General obligation bonds are a commitment of the full faith and credit of the issuing authority. For this reason, they usually command the best available interest rate in the market. The second type that is essential to the expansion of important infrastructure is the "revenue bond." These bonds represent a call on the resources of the fee-based services financed by the bonds. For example, revenue bonds are used to finance water treatment plants, and user fees are then collected to repay the investors.

3.3. Strengthen Institutions for Enhanced Fiscal Responsibility

Mobilizing additional revenues to finance development will require more than the introduction of new instruments. Improving the organization, systems procedures, and staff of local government finance departments is also critical. All incorporated cities should be required to:

- develop, approve, and implementing performance budgets that designate the funds allocated for each segment of the work program, including the operations and maintenance of facilities and services under control of the local government;
- operate a fully staffed, professional finance department, including divisions of Tax Assessment/Collection, General Accounting, Budget and Research, Purchasing, and Comptroller; and
- ensure that heads of the construction department/office and the entities providing infrastructure services (water supply, wastewater, and solid waste) are trained, professional, and experienced engineers. In addition, all chief executive officers of

incorporated cities should be required to attend training in local government management, including financial management. This training should require attendance annually for at least three weeks and be repeated annually with increasingly complex course material for at least three years.

Government should initiate the creation of professional associations of local government officers for the purposes of education, development of entry qualifications, and definition of performance standards. Membership should be required at a minimum for all chief executive officers, construction and public works engineers, water and wastewater engineers, finance directors, and economic development directors.

3.4. Convert Collective Land in Towns to State Land

The availability of land is a prerequisite for new housing, industrial, and commercial development. The current structure of state and collective land ownership constraints the development of new housing. To remove that constraint, most collectively held land in towns—and in particular that collective land with housing on it—should be converted to state ownership. Farmers currently living on collective property should be given use rights to the land, which they could transfer freely to others. This would be especially appropriate in the construction land areas where farmers have built their homes.

This conversion would accomplish a number of goals. First, it would free more land for development. Second, it would encourage incremental development of collective property by those who use it. Farmers will have incentives

to incrementally develop their homes, adding amenities, floors, extra rooms, and other improvements, because they will be able to sell the use rights to the land along with the buildings and receive compensation for them. Third, it would allow for more accurate valuation of land use rights; when farmers have use rights to the land on which their home is built and are able to freely transfer these rights, the market property prices will be easier to ascertain, which will make land use rights transactions—for example, in the case of expropriation by a local government—more transparent. Finally, this system would alleviate tensions between farmers and government officials by removing the necessity for the town government to always be involved in land development activities.

The conversion of collective land to state land is often effected in towns today on a project-by-project basis and requires no regulatory changes per se. However, generalizing the approach to convert most collective land in targeted growth areas in and adjacent to the existing built-up area of the town does require a policy change. This proposal is consistent with the overall goal of opening up the property market to a larger number of actors who can produce real estate (housing, commercial space, etc.) for sale and/or for rent, without requiring direct participation of local government in the development process. The role of the town government in such a development process would be in plan review, issuing land use and building approvals, and ensuring adequate provision of infrastructure and urban services.

3.5. Allow Management Companies to Develop and Lease Collective Land

An alternate or complementary approach

to converting collective land to state land is to allow the collectives to use management companies to bring their land onto the urban property market. The collective would employ the management companies to develop portions of the collectively owned land, and to rent or lease this land on a short- or long-term basis. This solution allows collectives to benefit from expanded or more intensive use of their land and does not require the direct involvement of local government. Since the collective would retain use rights to its land, this would help diminish the reluctance of some collectives to develop and transfer land based on speculation about future land prices.

Since the two approaches above are new to the PRC, it is recommended that they be the object of pilot projects in selected towns in Shanxi and Liaoning to test their feasibility. The approaches could be piloted among selected collectives in given towns, and not throughout the entire town. If successful, the pilot projects could be rolled out at the provincial or national level at a future date.

3.6. Improve Institutional Capacity and Town Governance

Effective governance is essential to the functioning and development of small towns. With the devolution of many vital public functions to the local level, town governments are now ultimately responsible for the provision of many basic services. These include ensuring adequate sanitation services and solid waste collection, maintaining law and order, and promoting the conditions necessary for economic growth. To improve the accountability, responsiveness, transparency, and efficiency of town governments, it is recommended that:

- the roles of government, the private sector, and the community be clarified;

- the functions of town governments be streamlined and redundancies reduced;
- opportunities for citizen input be increased;
- new opportunities for local leadership be created;
- representation of migrants in local government be increased;
- the capacity of town governments be strengthened; and
- a strategic and socioeconomic planning approach be adopted.

4. Conclusion

In the PRC's rapid urbanization, towns are expected to assume an increasingly large responsibility of the public-service delivery. To enhance the sense of ownership of town governments and provide economic incentives, the central and provincial governments should establish an enabling environment to facilitate incorporation of local governments, particularly town governments, giving them a solid legal foundation and financial and administrative autonomy for fulfilling their public functions. By incorporation, towns are expected to be financially stronger, institutionally more transparent, and operationally more responsive. They are expected to more effectively deliver the public services needed to support town-based urbanization and economic development in the PRC's vast rural areas.



EMPLOYMENT GENERATION AS A PRIMARY GOAL OF TOWN-BASED URBANIZATION

1. Introduction

The People's Republic of China (PRC) has taken full advantage of its immense labor pool to sustain high economic growth during the past 25 years. Economic growth in the Pearl River Delta and the Yangtze River Delta, the PRC's two fastest growing sub-economies, has greatly benefited from the development of labor-intensive sectors in which 56 percent of the country's total 66.5 million trans-province migrant laborers are employed (Li and He, 2005). An enterprise survey under an Asian Development Bank (ADB) technical assistance also revealed that most of the enterprises, e.g., 58 percent in Liaoning and 52 percent in Shanxi, identified labor availability, rather than land availability and access to financing, as the top priority for future expansion. These facts indicated that an abundant, inexpensive supply of labor will continue to be a key to future growth of the PRC as a whole and for inland provinces in particular. Off-farm job provision not only serves as a growth engine, but also contributes to social stability. The rural-urban income gap will be narrowed by continued out-migration of underemployed farmers from the agricultural sector, which employs about 50 percent of the total labor force but produces only 13 percent in GDP. Moreover, the growth of labor-intensive industry in towns allows city economies to climb the economic value ladder, producing goods and services that require

more advanced skills and, increasingly, higher levels of innovation.

As a result of long-term urbanization lag, however, it will not be easy for the PRC to meet its off-farm employment goals over the medium term. An estimated additional eight million surplus agricultural laborers will need to be employed every year in the industrial and service sectors from now until 2010. However, the jobs generated in urban areas, including towns, in recent years (6.41 million on average and 9 million maximum per year over the period 1996-2000) can hardly meet the employment needs of the existing surplus agricultural laborers, let alone those of additional laborers. To deal with the increasing employment need, central government should continue to reinforce its urbanization strategy by placing employment generation at the top of the development agenda. This paper hypothesizes that employment generation should be set as a primary development goal in town-based urbanization.

2. Literature Review of Employment Generation of Towns

2.1. Change Performance Evaluation Criteria of Town Governments

The PRC has set the objective of building a harmonious society characterized as development-for-all. However, the growth-driven, urban-oriented, identity-biased development model from the command-

economy era is still largely in place and is impeding the achievement of that objective. This is especially true when priority is given:

- through a performance evaluation system, to growth at the expense of employment, environment, or social equality when tradeoffs must be made;
- through a segmented labor market, to an urban *hukou* population when there are insufficient job opportunities;
- through the settlement hierarchy system, to higher-level urban centers when financial resources are limited.

To build a truly inclusive society, government should make a transition from direct intervention in economic production focusing on GDP growth to the provision of public services that enable the creation of jobs. Within this policy framework, governments should set a new set of targets:

- creation of new jobs, broken down by different levels of government;
- access to social services for the entire population, including migrants, within an integrated labor market and a single-standard social safety network; reform should be phased step-by-step over the medium term;
- clear and predictable resource allocation

between different levels of government so that the breakdown targets of employment generation and social service provision can be financially met.

2.2. Achieve Economies of Scale by Growing Towns

Chinese cities and towns are on average small in relation to the total urban population (Table 1), which means that they have difficulty achieving substantial economies of scale for economic production (Henderson, 2002). In 2002, 45 cities—7 percent of the total 660 cities—had a population with urban *hukou* of more than one million. 279 cities at the prefecture level and above produced 61 percent of the total economic output, but only accommodated 26 percent of the total population. The average city population was 1.18 million, of which 680,000 with urban *hukou* were covered by the social welfare system and were fully integrated into the urban labor market. The rest, about 500,000 migrants and others, were actually excluded from the formal economy. Towns accommodated the remaining one-third of the urban population, with an average population of 8,392, of which 1,669 (20 percent) were migrants. This size of settlement, particularly in towns, is not capable of achieving an

Table 1. Urban Population Size by City and Town, 2002

	Urban population	As % of total population	Average settlement population	Population with urban <i>hukou</i>	As % of total population	Average settlement population with urban <i>hukou</i>
Total	502,120,000	39		328,847,000	26	
Cities	329,238,000	26	1,180,000	190,347,000	15	682,200
Towns	172,882,000	13	8,392	138,500,000	11	6,723

Source: calculated on data from the PRC Statistical Yearbook 2003 and the PRC City Statistical Yearbook 2003.

Note: cities refer to 279 cities at prefecture level and above; towns include 20,601 county seats and administrative towns.

agglomeration effect from investment or enabling the development of the tertiary sector.

It is estimated that the PRC can resettle at least an additional 200 million people and employ an additional 75 million laborers in the urban areas should its urbanization pattern synchronize with the current industrialization pattern (He and Du, 2004). This suggests there will be substantial leeway for Chinese cities and towns to grow in population size; hence, the PRC should continue and accelerate its moves on liberalization of *hukou* and other mechanisms that limit the size of the urban population.

2.3. Focus on Tertiary Sector Development

As a partial result of undersized cities and towns, employment in the tertiary sector in 2003 only accounted for 29 percent of total employment in the PRC, in contrast to 50 percent of many other developing countries and 70 percent in many developed countries. Many observers have pointed out that while the secondary sector, mainly manufacturing, generates most economic growth, the tertiary sector creates more jobs. In the past five years, employment in the secondary sector shrank by more than 5 million, while the number of tertiary jobs rose by nearly 30 million. This national employment trend is true for towns in the case studies of Liaoning and Shanxi; in Liaoning the transportation/post and hotel/restaurant sub-sectors contributed significantly to employment growth in towns, while in Shanxi the key sectors for employment were trade and hotel/restaurant. As cities and towns become larger through the development and articulation of the urban system, employment in the tertiary sector will continue to rise.

2.4. Promote Small and Medium-Sized Enterprise Development

The private sector in the PRC in 2003 consisted mainly of SMEs that provided about 70 percent of the total jobs in urban areas and about 82 percent of the total off-farm employment in the country. Yet the short-term loans from national banking institutions for urban private sector and TVEs accounted for only 4.6 percent and 3.4 percent, respectively, of total lending. This fact helps explain why many enterprises in the surveyed towns (50 percent in Liaoning and 41 percent in Shanxi, respectively) put financing as the second most important factor (next to labor availability) for business expansion. This mismatch between employment and financial support is a clear indication that, despite the central government's stated priority on employment generation, the policy and implementation mechanisms necessary to achieve that goal are to a large extent still not in place. Moreover, urbanization strategy alone is far from sufficient to release the potential of the service sector and SMEs for employment generation.

To encourage private sector development in labor-intensive sectors, the following measures may work as incentives.

- Introduce a short-term waiver in business taxes for targeted sectors: retail, hotel, restaurant, tourism, apparel, and transport/communication. This could be done in combination with a phasing out of such fiscal incentives for sectors with low labor intensiveness, such as textiles and highly polluting manufacturing.
- Provide business incubation services to start-up businesses in the same targeted labor-intensive sectors. Work with local banks to make start-up financing available. Waive business registration fees.
- Promote the retail, restaurant, and

entertainment sectors by creating new or rehabilitating existing shopping and entertainment areas. Develop urban design guidelines for selected streets. Beautify the streets with tree planting and sidewalk improvements. Work with private developers to build a few key stores/restaurants. Promote investment by other developers over time.

- Invest in roads to and from existing and new market areas to enable growth of trade (e.g., county roads to neighboring towns).
- Train town officials in investment promotion so that they can attract investors in key economic sectors with high growth potential and employment generation potential.
- Carry out a pilot project in deeper reform of the *hukou* and social security system, including abolition of *hukou* and provision of single-standard social security benefits and social services to all residents of a town.
- Develop housing that is attractive to migrants, e.g., medium-density 2-3 story terrace housing in which most units have private yards. Consider appropriate mix of rental and for-sale units as rental units provide flexibility for short-term workers.

3. Practical Strategies for Employment Generation in Town-Based Urbanization

The number of jobs that a town can generate is a function of the level of investment in industry and services, on the one hand, and the labor requirements of those investments, on the other. This section focuses on how the public sector—the town government working in collaboration with city and provincial governments—can enable investment in labor-intensive sectors and attract migrants from

rural areas to fill the new jobs.

3.1. Target Labor-Intensive Economic Sectors

The ratio of jobs created per monetary unit of investment varies widely in the PRC, as in every country. Since job creation is the ultimate goal of town development, it is critical to focus economic development activities on sectors that have high labor requirements. Generally, services employ more people per unit of output than industry does. But industry is the backbone of the economies of many towns, and so is also important; the key here is to focus not on heavy industry, which is capital-intensive and employs relatively few workers, but on light industry. The following list shows major labor-intensive sectors.

Light Industry:

- Apparel (rather than textiles)
- Food processing
- Handicrafts
- Furniture manufacturing
- Electronics and computers
- Instruments, meters, and office machinery
- Cultural, education, and sports goods

Services:

- Retail and wholesale trade
- Hotel and restaurant
- Transportation
- Tourism

Construction is a labor-intensive activity that lies somewhere between industry and services. Developing construction as a sector may not be a part of a town's economic development plan, since the level of production will depend primarily on the local demand for real estate.

Nevertheless, growth towns should facilitate construction activity because where the demand for real estate is high; the sector can employ many workers.

3.2. Market Analysis to Identify Growth Opportunities

Town governments in the PRC need to be more sophisticated about identifying opportunities for growth in particular sectors, and then finding ways to enable investment in those sectors that are capable of producing more jobs. This section presents a summary description of the methodology for assessing markets and identifying sectors with growth potential. While this methodology is fairly standard and practiced in many countries around the world, the required skills will not be found in many town governments. Moreover, the opportunities that are presented by a particular economic sector will in general not be limited to one town, but shared by the economies of many towns in the same sub-region. Rather than conducting market analyses themselves, therefore, town governments should consider alternative arrangements for the implementation of such studies such as: (i) joining forces with cities and with provincial government to carry out market analysis at the sub-regional level, and (ii) contracting market studies out to private firms or research institutes that have specialized staff in this area.

Step 1. Estimate current and future demand

First, estimate current consumption. This involves collecting and aggregating statistical data on consumption in recent periods of the good or service in question. If we take the example of buckwheat in Shanxi Province, then the analysts should collect data on

consumption of buckwheat in the province (if possible by prefecture or smaller geographic area), in other provinces in the PRC, and overseas. The geographic scope of the analysis should be determined based upon the analysts' understanding of the potential market; where there is a possibility of expanding the sale of Shanxi buckwheat in another country, that country should be included in the market analysis. The data should be collected tabulated for recent years (e.g., last 5 years or in some cases last 10 years) and estimated for the current year.

Then identify any recent or pending legal/regulatory changes that will affect future consumption. For example, if there are pending changes in the taxation of the consumption buckwheat, the potential impact of these changes on demand should be estimated. Any changes in buying power of consumers in key markets, such as rising disposable income, should also be taken into account.

Finally, project future demand. Looking at current trends and any expected changes in consumption due to the regulatory framework, buying power of consumers or other factors, estimate future demand in different geographical areas and calculate the total effective demand for the project in the defined market area. Present the results in tabular and graphic form.

Step 2. Study existing supply

First, study the inventory of existing facilities by geographical region. Collect data on production for recent years and illustrate any trends. Supplement the quantitative analysis with a discussion of the factors that are contributing to observed trends. Break down the production

by market segment, that is, by particular category or type of product currently being offered on the market and being purchased by different types of users. Segments are generally defined by some combination of product quality and cost. The enterprise survey can be used to collect information on the type, quality, cost and amount of different products that are produced in a given geographic region.

After analyzing recent and current trends, collect information on the "pipeline," that is, goods or services that are currently in the planning or production stage and are expected to come onto the market in the near future. Then identify any current or future anticipated supply constraints: (i) are there new regulations that will impede production by making it more costly; (ii) are there barriers to entry into the market, such as licenses that are difficult to acquire; (iii) do other countries or regions impose import quotas that effectively close off markets from international competition. Present the results of the supply analysis in tabular and graphic form.

Step 3. Compare demand to supply

Finally, overlay supply map on demand map. Identify existing markets that are not saturated or highly competitive, i.e., in which demand is greater than supply in the near to medium term. Then identify any potential new markets, in which the good or service is not currently being consumed, but that could become a consumer in the near future. Project "excess demand" (demand minus supply) on a region-by-region or country-by-country basis for the next 5, 10, or 20 years. It is this projection of excess demand that determines the extent to which a potential sector holds future potential.

Typical conclusions of the market analysis might include: (i) there exists excess demand in a given geographic area and market segment in the near future; (ii) there are future markets (geographical areas or market segments) that could be opened up over a given time period; (iii) the degree to which these current and future markets can be tapped by producers in our sub-region will depend on certain factors.

Armed with this information, town governments, in cooperation with provincial, prefecture and/or city governments, can begin to put in place the factors that will enable the local production of goods and services that target the markets identified in the study. These factors might include, for example, reliable infrastructure services in an industrial park or access roads from production areas to sales markets. Such interventions are discussed in the following section.

3.3. Facilitating Supply-Side Investment through Infrastructure Provision

What types of infrastructure do investors need in order to build a new factory, hotel or shopping center? Which of these infrastructure investments are merely desirable, and which are absolutely indispensable for development of a new facility or expansion of an existing one? The answers to these questions should guide the infrastructure improvements process undertaken by the town government and its sub-regional partners. Sources for this information include the market analysis discussed above; enterprise surveys; and informal contacts with business leaders in the town and the sub-region. In general, the more systematic the data collection method, the more precise and useful the findings. The objective of the investment is to remove any

bottlenecks in infrastructure requirements of private sector investors in industry or services.

The specific infrastructure needs of industries, such as tourism, agro-processing and manufacturing, include roads, electrical power supply, water supply, wastewater treatment plants, and sanitary landfills. Town governments should link the infrastructure improvements project cycle to employment generation and investment promotion efforts. This means that the outputs of the market analysis and enterprise surveys should be taken into account when identifying priority infrastructure improvements to be undertaken in the town or sub-region. Other factors include technical needs as evidenced by an engineering diagnostic and financial feasibility. The potential benefits of infrastructure improvements with respect to leveraging private sector investment and creating jobs should be quantified and analyzed as part of the justification of such projects, e.g., as part of the calculation of financial internal rate of return (FIRR) or economic internal rate of return (EIRR). In addition to infrastructure provision, two other activities that are critical for creating jobs are (i) investment promotion, and (ii) ensuring adequate labor supply, which in towns usually requires attracting migrants through advertising employment opportunities and improving access to social services.

3.4. Attracting Migrants by Improving Access to Social Services

Along with job potential, access to social services is an important factor that determines where migrants move to, with or without the family. Small towns already have a comparative advantage over cities in attracting migrants by virtue of (i) physical proximity to migrants'

homes and families in the surrounding villages, (ii) bearing cultural similarities and social linkages with traditional systems in villages, and (iii) having a lower cost of living than cities.

To facilitate growth and economic development, towns must be able to attract migrants to meet the demand for labor. This includes not just short term unskilled labor, but more importantly, migrants who will choose to stay long-term, bring their families, treat the town as their "home," and share responsibility for and contribute to the its economic development. In order to encourage migrants to bring their families, the town must be able to provide more than simply a job; it must also provide adequate and affordable access to education, healthcare, and social assistance programs for the family.

For the local government, this implies improving the quality of social services, making the quality comparable to that offered in counties and cities, and doing away with practices and policies that discriminate between migrants and locals. Granted, this might be difficult so long as the *hukou* system exists. But rather than waiting for the *hukou* reform to get fully implemented, a phased transition is recommended:

Step 1. Establish legal residency status for migrants

Given the slow pace of the *hukou* reform, it is recommended in the interim period to institute a category of permanent or temporary "residency," which gives migrants the same benefits as the local residents without changing the *hukou* status.

Step 2. Equalize access to social services

In terms of education, this residency status will entitle migrant children to attend school

without the burden of additional fees. In terms of healthcare, subsidized/cheaper health plans (insurance, other medical services) should be offered to include "legal residents" without full-time employment, especially since most migrants initially start out with temporary jobs. Free or subsidized services provided by the government at the place of *hukou* should be extended to the "current" place of residence, regardless of "temporary" or "permanent" stature. Since funding for these services is coming from the central government anyway, there is no reason why it cannot be channeled to the local government of the place of residence instead of the original *hukou* town/village. The same applies to social assistance programs such as the rural health insurance program. These should target the poor, and be based on income levels, rather than the type of *hukou* (agricultural or non-agricultural) or place of *hukou*. The proposed legal residency status should entitle the migrants to these benefits as well.

4. Case Studies in Liaoning and Shanxi

This section uses the case studies in Liaoning and Shanxi Provinces as examples of how the local government can take a leading role in promoting employment generation by developing manufacturing clusters and labor-intensive industries.

4.1. Creation of Manufacturing Clusters

Since the pre-reform period, the Liaoyang-Yingkou corridor has long been one of the main industrial sites in the PRC, accounting for a large share of domestic steel, machine tools, and vehicle parts production. Given the country's nearly insatiable demand for steel and metal products during the current economic boom, the corridor continues to experience

robust economic growth. Existing assets of the Liaoyang-Yingkou corridor include: (i) well-developed industrial production facilities; (ii) skilled labor pool in two major cities (Anshan and Haicheng) and some towns; (iii) Shenda Expressway running through the corridor and connecting it to the capital Shenyang in the north and the port city of Dalian in the south; (iv) railway running parallel to the expressway; and (v) sea access within the corridor at the port city of Yingkou.

The construction of the Shenda Expressway through the corridor shows how important this sub-region is to the provincial government. But the corridor has not realized its full growth potential. The development is essentially linear, following the expressway and the railway; there are relatively few east-west connections among cities and towns. There are also too few highways and prefecture-level roads in relation to the land area and the number of settlements. By densifying the road network and increasing the number of east-west connections, it would be possible to increase access to markets and facilitate exchanges among producers at different points along the production chain. Much of the success of the corridor has been derived from backward and forward linkages among the industrial sectors of neighboring towns and cities; these linkages can be strengthened and extended by developing the road network further.

Liaoning Province could prepare a plan for development of the Liaoyang-Yingkou Industrial Corridor. The plan should be based on careful market analysis and identification of infrastructure improvements that will facilitate future investment and that will preserve and enhance the quality of the environment.

Particular attention should be paid to demand-side interventions, such as investment promotion. The main proposals may include the following.

Create a public-private partnership for investment promotion

The province should initiate the creation of an economic development corporation for the corridor. The board of directors would include chief executive officers of major corporations in the area and representatives of provincial development and infrastructure agencies. This forum would serve to build consensus on the needs of the sub-region and the ways in which the different parties will contribute to meeting them.

Study national and international markets for a range of products

The proposals for developing the sub-region should be based first and foremost on real opportunities for reaching new markets or expanding the corridor's share of existing ones. The market study should include all of the major products produced in the corridor, and some other products closely related to existing production (to test the possibility of selected linkages). Input-output analysis should be used to quantify the existing linkages among industrial sectors. Underexploited linkages will be identified and targeted in development proposals.

Densify the road network and provide additional east-west connectors

The province should develop a package of specific roads improvements projects that will increase access and economies of scale within the corridor. The main focus should be on east-west connectors between the main north-south roads. Where towns are demonstrated to have

high growth potential because of their economic relationship to larger cities, the new connections should be built or existing ones upgraded.

Develop multi-modal centers in selected towns

The market study should identify the potential for creating viable multi-modal transportation centers that combine road, rail, and warehousing. The feasibility of constructing such centers in towns with good access to highways and rail lines should be explored.

Work with towns to provide sub-regional environmental infrastructure

Many towns do not generate the volume of wastewater or solid waste required to make investment in treatment facilities cost-effective. The province and/or prefecture should explore the possibility of providing regional (sub-regional) facilities that will serve more than one town. Sanitary landfills, for example, can be located along a good road between three or four towns, all of which can dump their solid waste in the facility. Similarly, wastewater treatment plants can serve more than one settlement, provided that they are located reasonably close to one another (e.g., within a 10-15 mile radius). The economies of scale achieved through regional solutions may increase the size of the market enough to attract the private sector. Few private sector firms will be interested in investing in environmental infrastructure in towns because of the small population size and limited ability to pay. But small companies may be interested in larger contracts involving multiple towns, or towns and cities bundled together.

Develop and implement area-wide environmental standards

Provincial government should set air quality

standards for the entire sub-region and hold all polluters jointly responsible for meeting them. When standards are not met, all of the polluters are held accountable, and all must take actions, such as reducing production or installing cleaner technology, to rectify the situation. Industries with a large financial investment in their facilities will not want to be forced to relocate or reduce operations because others in the same area are emitting excessive pollution. So this policy can encourage industries to establish their peer monitoring scheme to ensure universal compliance with regulations.

Market the corridor with national and international investors

The Liaoyang-Yingou Industrial Development Corporation should develop and implement a marketing plan to attract and secure investment by private companies in targeted sectors. Marketing expenses should be financed by the corporation through grants from corporations and provincial government. The corporation should hire a public relations/advertising agency to develop a brand and prepare a marketing strategy and marketing materials. Marketing activities should be undertaken by the corporation staff as well as members of the board of directors and their representatives.

4.2. Agro-Processing Development

While the PRC's primary agriculture output has expanded at an astounding pace in recent years, growth in agro-processing has been modest. The ratio of agro-processing output value to agricultural output value ratio is 0.85:1, in contrast to 3:1 in many developed countries. Given domestic consumer income growth trends and the PRC's integration into the world commodity market following

World Trade Organization (WTO) accession, the pressure on the agro-processing sector to improve its performance is growing. Agro-processors need to adjust to increasingly diversified consumer demands, improve the quality and nutritional content of foods, introduce new food products, shift to more sophisticated processing methods, adopt innovative packaging methods, and comply with new labeling requirements. The central government has made it clear that vertical integration of agriculture and downstream links through agro-processing constitute a key to enabling town development. This section uses case studies of towns in Liaoning and Shanxi as examples. Neither province is competitive in bulk commodities, but both are rich in other distinct food products and thus have respective comparative advantages.

Liaoning:

- Seafood (for example, Pikou). Liaoning can take advantage of its long coastline to develop fishing and farming for the domestic and international markets.
- High-quality japonica rice (Goubangzi, for instance). Liaoning can maintain a share of the japonica rice market the PRC and perhaps in Japan and Korea, too.
- Other products, e.g., Goubangzi Roast Chicken, may function as a brand of Liaoning agro-processing products in domestic market.

Shanxi:

- Small grains, such as oats, naked oats, millet, buckwheat, and sorghum, may have a high potential in domestic and international market, depending on the creation of demand and development of new processed products.
- Red meat (beef and lamb) and dairy products

can figure more prominently in the regional North the PRC market.

- Vegetable production is mainly for provincial consumption.
- Liquor and vinegar production processing has traditionally been competitive, but requires diversification in products and marketing skills in promotion.
- Other traditional products, e.g., Pingyao beef and Shanxi dates, will continue to be distinctive Shanxi products on the domestic market.

While these products enjoy some comparative advantages, they are not sufficient to guarantee business success. The development of agro-processing sector depends on a number of factors besides resource endowment, including diversification of products, creation of novel foods, processing and packaging methods, marketing and branding skills, and meeting changing nutrition and safety standards. Entrepreneurs and provincial planners will need to join forces if the agro-processing sector is to meet this broad set of challenges. It is recommended that the provincial government takes the lead role in implementing the series of measures described below.

Carry out market analysis and identify niche markets

Economic planning in the PRC has historically been supply-oriented. But success in agro-processing depends primarily on responsiveness to demand. Drawing inspiration from successful development of niche markets, such as asparagus production in Puzhou, provincial planners should team with industry associations to study the national and international markets for key products, such as those listed above. Through demand analysis,

Shanxi Province can identify existing demand overseas for small grains, for example, and create additional demand by marketing the nutritional value of its specialty products to potential consumers. These activities should be carried out before taking steps to guide farm production.

Improve the market environment for private sector investment

Agro-processing in general needs a relatively large initial capital input and a long period to receive an adequate return on investment. It is also exposed to the risk of natural disaster. But agro-processing should be a priority sector for economic development planners because it creates many jobs per unit of investment. Because of its great potential helping achieve government's goal of closing the urban-rural income gap, agro-processing investment should be stimulated by provincial government by implementing the following measures.

- Streamline the regulatory environment. Make it easier and faster for agro-processing investors to get licenses and permits.
- Initiate tax holidays, e.g., 3-year business tax exemption for firms locating in priority agro-processing zones (industrial parks).
- Facilitate access to financing. Consider incentives as required to make commercial bank financing available to SMEs. If necessary, introduce national/provincial government guarantees on a percentage of the capital portion of loan to agro-processing companies for development of expansion of facilities.
- Give priority to agro-processing enterprises in accessing industrial land.
- Provide business support services, e.g., technical assistance in management, sales, and promotion, etc.

- Facilitate contacts between private agro-processors and farmers to help them do business together.

Develop feeder roads and trunk highways

A town that processes agricultural goods has different needs from those of manufacturing clusters or tourism towns. Provincial, city, county, and town planners should develop good feeder roads to bring agricultural inputs from nearby farms into town and trunk highways linking to those feeder roads to the agro-processing factories and the production centers to markets.

Perishable goods are normally shipped by truck. This allows individual farms, or groups of farms, to ship goods to an agricultural marketing center with minimal delay. It is not cost-effective to build quality, high-class highways between several villages and the agro-processing town, but the agro-processors will most likely choose suppliers from towns with good access to existing trunk infrastructure. Therefore, the town planners should focus on developing rural roads that lead to trunk road, and processing centers along trunk roads.

4.3. Tourism Promotion

Tourism is among the most labor-intensive sectors and will play a key role in employment generation in the coming years. The PRC is expected to become the number one international tourist destination in the world by 2020, according to a WTO projection. Moreover, the Chinese people are becoming more affluent and will spend more on tourism as their disposable income rises. While Liaoning is among the top 10 provinces in terms of

tourism earnings and tourist numbers, Shanxi lags behind at 26th among Chinese provinces. This is a very low ranking in light of the fact that 70 percent of the buildings more than 1,000 years old in the PRC are located in Shanxi. This mismatch indicates there is great potential for the province to diversify its economic base and to create more jobs through the expansion of tourism and related sectors. As most of the tourism sites are located in rural areas, it provides a unique window of opportunity for many towns along the tourism routes to take advantage of the tourism development to take off.

Success in tourism development requires partnership building among provincial government, town government, and the private sector in four key areas.

- Availability of tourism assets. The availability of tourism assets in Shanxi in general is not a constraint. The Shanxi Tourism Development Master Plan 2000-2010 identifies inventories 1,000 sites, of which about 150 have been developed. The question is how to capitalize on these resources.
- Accessibility to the tourism sites. With the construction of trunk infrastructure like the Dayun Expressway and associated feeder roads, access to most sites has been greatly improved, but the question remains as of how to link the dispersed sites through tourist-friendly routes by using the trunk and feeder roads to create lively and diverse tourist experiences.
- Marketability of tourism products. The provincial government's marketing activities do not seem to have achieved the desired results. Alternatives must be found to package and market assets and experiences in an innovative way in order to fuel the take-

off of regional tourism.

- Capacity of tourism services. Domestic and especially international tourists must be offered higher-quality accommodation, dining, and other services for Shanxi to attract large numbers of new tourists. Environmental conditions around sites and in towns must also improve.

The major function of town government in tourism development is to provide job opportunities for local residents, including surplus agricultural laborers and migrants. This can be accomplished through rehabilitation of tourism assets, creation of an attractive urban environment around the assets and in the town as a whole, and working with the private sector to facilitate the provision of tourist infrastructure, such as hotels and restaurants. Town government should:

- Develop the arterial road network. A tourism center should have high capacity to accommodate traffic on peak visitor days (moon festival, spring festival, May Day festivals, and, of course, weekends, when most tourists visit the town). Arterials should link tourist sites to expressways and rail lines conveying visitors from distant location. Redundant road networks will provide release valves permitting traffic to move from one highly congested point to links that are operating below capacity.
- Develop adequate parking. Several parking areas located at different sites throughout the road network are often necessary. The town should provide public transport links between the parking lots and the main attraction to tourists at no charge. An alternative is to have a few large "drop-off" points near the main attraction from which visitors will disembark

and embark, and buses will go to distant parking lots while tourists enjoy the city.

- Improve street cleaning and garbage collection and disposal. An attractive, pleasant environment is critical to the success of any tourism site. Cleanliness is a particularly strong factor in tourist site selection for many international tourists. Towns that seek to attract international tourism should improve the quality of these services, ensure adequate sanitation services to limit odors, and undertake street and open space beautification projects.

The main functions of the private sector are to provide sophisticated market analysis and promotion services for the formulation and implementation of tourism plans on the one hand, and the construction and operation of tourism services and amenities (hotel, restaurant, travel services) on the other. Private sector firms should:

- conduct market surveys, mainly by those large travel agencies, with the public sector in tourism promotion; these agencies should fully take advantage of their marketing expertise from a demand-side management point of view in supporting the government to capitalize the tourism assets and become "first comers" in the market;
- participate in "tourism site" development in various ways, e.g., independent investment, shareholding, and subcontracting, etc., to introduce a business management in tourism development;
- build hotels, restaurants, amenities, and other related services that are affordable to target customers; and
- develop local crafts that are attractive to tourists.

5. Conclusion

The PRC is facing a daunting task of providing enough jobs to increased unemployed and underemployed population in its urban and rural areas. In town-based urbanization, town governments should set employment generation as a primary development goal to absorb rural migrant laborers. In line with this goal, the central and provincial governments should change the performance evaluation criteria of town governments. Employment generated per CNY of investment should be placed at the top of development agenda

and evaluated accordingly. To maximize employment generation, town governments should target labor-intensive economic sectors, such as light manufacturing and services, and promote private SME development. At the same time, towns should try to facilitate investment and attract migrants through infrastructure development and improving migrants' access to public social services.

UNIFIED SOCIAL SERVICE PROVISION AS A BASIS FOR TOWN-BASED URBANIZATION

1. Introduction

Economic growth is critical for town development; equally important is the need for health care, education, and social security in order to address the existing inequities and the poverty of vulnerable groups—poor, elderly, rural people, and migrants. If towns are to grow and release some urbanization pressure from cities, they must first become attractive to locals and migrants alike. An often understated factor in a migrant's decision to move to a town is the quality of social services, particularly educational facilities that it offers. This paper hypothesizes that successful town-based urbanization should be based on a unified provision of social services. The research is based on the case studies in Shanxi and Liaoning provinces under an Asian Development Bank (ADB) technical assistance (2005) on town-based urbanization strategy study in the People's Republic of China (PRC).

2. Review of Towns' Social Service Provision in the PRC

2.1. Education

Public education services in towns are getting worse, as many schools are being relocated upward to the county level for efficiency reasons. Town governments have few resources to make local improvements, since budget allocations from upper-level governments to towns are set as a function of the *hukou* population only

(migrants excluded). School fees still vary greatly from town to town and by *hukou* status, perpetuating the disincentive to migrate to towns. The provincial government allocates funds for education to the city- and county-level governments to cover teachers' salaries and the cost of basic infrastructure. The county- or city-level government then matches additional funds from the local budget to cover the costs of local schools and those in the towns and villages. However, allocations for education from higher levels of governments to towns are discretionary: they depend in large part on the town's size, importance, and revenue contributions.

A major problem identified in Liaoning was that education finance is based on the population which holds a local *hukou*. For towns with a large migrant population, this implies that the local town and village governments must cover all costs not provided for by transfers from their own revenues. This has resulted in inadequate classroom space and equipment, a student-teacher ratio of up to 70 students per classroom (in Xiliu town), and poor-quality education. The situation is graver at the village level, where the revenue base is extremely small. In Xiliu's villages, for example, the primary source of local revenue is an annual tax collected from each household. Hence, farmers are often forced to finance the construction of new classrooms and schools themselves. In Shanxi, however, budget allocations for education to counties and cities are based on

the total number of students enrolled in school, including migrants.

Despite national legislation requiring that towns create a level playing field for access to social services by *hukou* residents and migrants, school fees vary greatly from town to town in the case study provinces. In the Liaoning towns, the general attitude was that migrants should pay extra to compensate for the "additional" resource requirements imposed by them on the town or city. In Shanxi, however, the emphasis was on charging a "school change fee" to all students opting to study in schools other than the one assigned to them in their place of residency. Senior high school is not subsidized, and since these schools are at the county level, the cost of education is extremely high. Participants from focus group discussions in the towns reported figures ranging from CNY 2,000 to 8,000 per year to cover the cost of senior high school education and boarding.

The school system is now in the process of being made more consolidated, i.e., all senior high schools (formal and vocational) are being moved upward to the county level. The objective is to increase the efficiency of schools and quality of education, since it is felt that teachers prefer to work in a central town or city. However, by adding boarding costs to school fees, the policy creates a disincentive for poor families to send children for higher education.

2.2. Health Care

Health care services in towns are much poorer than those available in cities. Despite recent government initiatives, only a small portion of town residents are covered by health insurance. Since town governments lack the resources

to improve services, quality and coverage will likely be dependent on provincial and national government programs for the foreseeable future.

Services related to family planning are provided free of charge in local hospitals (funded by the central government), but migrants must pay for these services upfront and get a refund later in their place of origin. Most small towns report inadequate health care services, in terms of equipment and medicine. In addition, doctors (particularly "barefoot doctors" in villages) are reportedly unreliable, with limited skills and qualifications. For serious ailments, residents of small towns and townships go to the city hospital, which makes costs (including transportation and other expenses) prohibitive.

In Shanxi, the concept of health insurance is still widely unknown, except to full-time government employees. Private companies, for the most part, provide only accident insurance. Liaoning, however, was recently selected for a government pilot program for social insurance (2000-2003) which includes four components: (i) social security/retirement pension, (ii) health care insurance, (iii) social assistance to low-income families, and (iv) unemployment insurance. Under this program, health care insurance can be purchased by anyone, regardless of employment or *hukou* status. Participation to date is low. This is attributed to the fact that health insurance is a relatively new concept in the country and the province and not yet widely known, especially among town and village residents. Some focus group participants assessed the costs of the insurance to be almost equal to the full cost of medical treatment. Moreover, additional charges for each dependent are as high as those for the employee.

The Cooperative Medical System (CMS) provides medical coverage in government hospitals to people with agricultural *hukou*. Government subsidies cover two-thirds of health care charges. Shanxi Province has some 25 CMS pilot projects currently ongoing. Liaoning Province conducted a feasibility study in 2001, but little progress has been made to date in implementing the program. Yangqu is the only demonstration town among the six in this study to have started the CMS (in March 2005), as part of an initiative by the county government.

2.3. Social Security

Based on information from town officials, of the 42 million people in Liaoning province, 7.67 million are currently enrolled in the government-funded retirement plan, and 7.82 million are in the health care insurance program. However, this includes mostly formal sector, full-time government employees. Shanxi Province has made little progress so far in institutionalizing social security.

According to the national Labor Law, it is mandatory for private companies to extend social insurance to their employees, but enforcement of this rule has been difficult. Teng'ao is the only study town in Liaoning to have made social security compulsory in full-time formal sector employment (government and private). Still, the majority of the population—part-time or informal sector workers and the unemployed—do not have social security coverage. Half of the current jobs in Liaoning, roughly 10 million, are in the non-agricultural sector. The social security program primarily targets this non-agricultural population. Officials estimate that the current coverage is approximately 60-70 percent of

the employed urban population. It is likely that much of this is centered in big cities, where competition, particularly from multinationals and foreign investors, forces employers to provide better benefits.

The Minimum Living Standard Program (MLSP) is a national social assistance program that targets the population below the poverty line. The central government subsidizes this program through funds that must be matched one-to-one by the local government. The amount depends on the local poverty line, on whether one has agricultural or non-agricultural *hukou*, and on the financial capacity of the local government. Due to funding shortages, some town governments restrict this assistance to specific sub-groups of the population, such as holders of non-agricultural *hukou*.

Conversion of agricultural collective land to state land for industrial or other types of development affects two population subgroups: farmers whose land is being acquired and families that are being resettled to the other parts of town. In Gutao town, for example, the town government is planning to re-site some 20,000 residents from the central historic area to the periphery of the town as part of its tourism promotion and conservation program. In Wutong town, there will undoubtedly be a need to relocate town residents to "planned" residential zones, away from the polluting coke and coal industries currently located in the town center. Other towns will likely face similar challenges as this trend for growth and development continues.

The national compensation policy provides guidelines to LGs to address the needs of farmers displaced by such developmental

activities, but the implementation is uneven and there is little negotiation with the farmers or the affected population. In the case of expropriation of land in the center of towns, the compensation value is usually low in relation to the property's market value, limitations on transferability of land use rights notwithstanding. In such cases, the benefits of development are not equitably distributed among the various stakeholders in towns.

2.4. Household Registration System and Migration

Migrants coming to small towns may be classified into three subgroups: (i) those with agricultural *hukou* from a village under the jurisdiction of the town; (ii) those with agricultural *hukou* from a village outside the town jurisdiction; and (iii) those with non-agricultural *hukou* of another town, county, or city. Based on observations in the six study towns, *hukou* is not a critical issue in small towns. This is largely because social benefits associated with urban *hukou* status in small towns are very minimal to begin with. Besides, allocation of farm land associated with the agricultural *hukou* status presents an inherent incentive to retain the rural *hukou* status.

Although the reform of the *hukou* system is under way, the *hukou* continues to be the primary form of identity for the local population. Some towns, such as Teng'ao, have formed a third category of *hukou*, which in effect is a local agricultural *hukou* without agricultural land. Although this does not entitle them to the benefits per se, it gives them legal rights of residency. Preconditions to change one's *hukou* from agricultural to non-agricultural typically include one or more of the following: ownership of a house, proof of job, relatives living in the town, and other requirements that

vary by the town. Some towns require payment of a fee.

Although migrants enjoy equal "access" to education and health services as the *hukou* residents, they often have to either pay more or pay upfront and get a refund later for services subsidized by the government. They are also not entitled to social assistance programs, such as the MLSP or the CMS, or any "free" services or government subsidies. Unlike the larger cities, many small towns encourage in-migration to meet the demand for labor in the local business enterprises and industries. For example, in Teng'ao town "temporary" migrants constitute 80 percent of the labor (mostly unskilled) in the industrial sector. Focus group participants in both Yangqu and Gutao reported that local businesses mostly prefer to hire locals simply because they are "more stable, unlike migrants, who are likely to undergo the necessary training for the job, and leave." As a result, much of the migrant labor in these towns is involved in temporary jobs in the construction sector.

3. Challenges of Towns' Social Service Provision in the PRC

3.1. Background

The urbanization case studies in Liaoning and Shanxi Provinces demonstrated that social services in PRC towns are underdeveloped for several reasons. The first is a chronic shortage of funding. Since the intergovernmental finance system sets funding for social services in a given location at a level proportional to local tax collection, poor towns always have the least resources to address local development issues. Second, with responsibilities for financing and delivering social services devolved to lower

levels of government, towns are focused on activities that generate most revenue and less on those that do not generate a cash flow. The "marketization" of public services has compromised coverage and service levels for some social services. Finally, the social development agenda has taken a back seat to economic development and industrial growth in recent years.

3.2. Education

Since funding for schools is the responsibility of the local government, education quality and cost are both determined by the local economic conditions. According to a UN-Habitat report, more than 90 percent of the country's education budget comes from sub-national governments, of which 70 percent are at the county and town level. For town governments, education makes up 60 percent of total expenditure. The bulk of this money goes to paying teachers' salaries, and very little is used for education subsidies for poor children.

3.3. Health Care

Since most public medical facilities are self-funded, local governments emphasize provision of services that generate the most revenue. Apart from essential medical facilities, including immunization, communicable disease control, and family planning programs that are run by central government, much of the health care in small towns is private. Government hospitals are located at the city and county level, and sometimes in large towns. Towns and villages have private clinics operating with licenses from the local government. Fee waivers and subsidies are granted to poor families for services in government hospitals. Other than

that, everyone must pay out-of-pocket for medical treatment. A health insurance program was launched recently by the government, but its success has been limited so far.

3.4. Social Security

According to a UN-Habitat report, the ratio of working-age persons to elderly person will decrease from 5:1 in 2000 to 3:1 in 2040. The breakdown of the safety net provided hitherto by extended families (as a result of the one-child policy) will make people more reliant on formal systems of social security. The retirement age for women is 55, for men 60. As reported in Liaoning Province, where the social security program is underway, contributions must be made for a minimum of 15 years to qualify for social security benefits. For women and men older than 40 and 45 years, respectively, this means that they cannot reap the benefits of social security at retirement age. To do so, they will either have to wait longer to start receiving benefits or pay more over a shorter period, which is difficult, if not impossible, for poor families. This is notable in light of the fact that the one-child policy came into effect in 1980. People who were then in their twenties and thirties are now in their forties and fifties, and will be effectively excluded from the social security program.

3.5. *Hukou* System and Migration

Given the inherent structural problems with the existing social insurance program, many urban residents of small towns are without coverage. Hence, there is not a stark difference in social benefits accrued based on *hukou* status. However, as the systems for social insurance evolve and get reinforced over time, so too will the difference between the haves and the have-

nots. Also, as these towns grow, it is inevitable that they will face the same problems of discrimination and inequity if the *hukou* reform is not institutionalized.

4. Policy Recommendations

4.1. Education

To address the issues in the current education system of towns, it is recommended that the government to (i) improve access to post-primary education, particularly at the village and township level, (ii) reform the existing system of financing education, and (iii) expand vocational training to enable farmers to enter the urban labor market.

Improve access to post-primary education

- Reverse the policy of concentrating schools at the county and city levels. Instead, build higher-level schools at the town level, where they can be accessed by village residents. This will increase access and make higher education (post-compulsory school) more affordable and feasible for poorer families and help retain the population in the towns, which is especially important in light of the current policy of merging small townships to form larger towns. Unless these newly formed larger towns have local schools, families will send their children to the nearest city, which will encourage out-migration from the town (as these young graduates find jobs in the city where they study) and increase pressure on the cities.
- Create incentives for parents to send their children for higher education. This means removing all extra fees levied on migrant families; establishing linkages between schooling and vocational training or other part-time job opportunities, so that children

can get practical experience and possibly even some income as they attend school; and increasing financial assistance programs for students from poor families, as well as merit-based scholarships.

- Establish public-private partnerships and encourage (or create incentives for) private schools to enroll poor and/or talented children by providing scholarships. As most existing private schools cater only to the higher-income groups, establishment of more private schools targeted to middle-income families should also be encouraged. For a start, this will ease part of the fiscal burden from local government, improve the quality of education in public schools (by decreasing the student-teacher ratio), and extend access to private school education to more students.
- Allow children to take their higher middle school entrance exam in the place of residence rather than at their *hukou* residence. This may be done by extending the senior high school entrance examination to include all students graduating from the local general middle school, regardless of *hukou*.

Reform existing system of financing education

- Education budgets, regardless of the "importance" of the town in the economic context, should be based on the "total" number of students rather than the number of "*hukou*" students. This rule should apply to allocations from all levels of government, i.e., from the province to the counties/cities, from the cities/counties to the towns, and from the towns to the villages.
- Progressively index allocations of education funds to lower levels of government. Introduce a factor that increases allocations

for areas with a small revenue base, i.e., highest factor for the villages, next highest for the townships and towns, and so on.

- Explore the possibility of attracting more qualified teachers in primary and junior middle schools in villages and townships by offering better salaries, comparable to schools in cities and counties (taking into account the cost of living).
- Develop incentives in the form of matching funds or grants to encourage local governments to increase financing for education. This may include establishment of targets and indicators, and "bonus" allocations in subsequent years, if targets are met.
- Include an education component in the subsidy program to poor towns, whereby local governments meeting certain poverty criteria are eligible to apply for education grants from the special fund. The provincial governments are also promoting vocational middle schools at the county level, with a full-time program like the formal school system, but one that is less intense and requiring lower scores in the entrance examination than the senior middle schools. This is to encourage students who do not get high grades, and those from poor families, to continue higher school education.

Expand vocational training to enable farmers to enter urban labor market

- Tie training programs in the public vocational schools to local sectors through better links with enterprises in the towns, in terms of both program design and job placement arrangements.
- Provincial- and prefecture-level vocational schools should establish branches at the sub-

regional level, especially in towns with high employment generation potential. Funding for these schools at the town level can be leveraged from corporate income taxes.

4.2. Health Care

To address the issues in towns' health care systems, it is recommended that government to (i) extend the coverage of the existing health insurance program, (ii) reform the design of the health insurance program, and (iii) expedite the introduction of the CMS.

Extend coverage of existing health insurance program

- Extend coverage to include vulnerable groups—elderly persons, part-time and informal sector workers, unemployed and displaced people—through cross-subsidies to make it more affordable.
- Extend "discounted" insurance to family members of the customer. The current system provides insurance to only the individual subscriber, which means that a full-time private sector employee will have to bear the full cost of insurance for his or her family members.
- Extend coverage to elderly persons, as "dependents" of blood relatives who are employed but not necessarily part of the household.
- Create incentives for private companies to provide health insurance to employees through tax deductions, etc.

Reform design of health insurance program

- Include a wider range of hospitals, both public and private, in the plan(s).
- Make the program more flexible to meet the

varying needs of the different population groups, e.g., establish different plans based on income (low, middle, high), employment (full-time, part-time, unemployed), and so on.

Expedite introduction of CMS

Liaoning has already taken steps to reintroduce the CMS to its villages, but implementation has been slow. Instead of being based on agricultural *hukou*, the CMS should extend coverage to all "low-income" groups. This will facilitate better targeting of all the "poor" without access to health services or formal sector insurance programs in both urban and rural areas.

4.3. Social Security

Recommendations on social security reform of towns include (i) increase access to social security programs, (ii) reform the MLSP, and (iii) establish an enforce standardized guidelines for determining compensation for farmers displaced by new development.

Increase access to social security programs

- Create incentives, or make it mandatory, for private-sector companies to provide social security to their employees.
- Make the program more flexible to meet the varying needs of the different population groups, e.g., by income (low, middle, high), employment (fulltime, part-time, unemployed), location (urban, rural), and so on. In particular, identify means to include vulnerable groups—elderly persons, migrants, informal sector workers, unemployed and displaced people—in the social security program.
- Invest in more retirement homes, and explore

short-term assistance schemes for the fast growing elderly population.

Reform MLSP

- Reassess disbursements through the MLSP; increase them to a realistic amount. The current amount ranges from CNY 180 per capita per month in urban areas to CNY 20 per month in villages. This amount is extremely low, and inconsistent with the current cost of living.
- Standardize and extend coverage of the MLSP to both the agricultural and nonagricultural population. The program should target the poor, regardless of type of *hukou* (agricultural or non-agricultural) or place of *hukou* (local or migrant status). As a national program, it should include a computerized system for monitoring and disbursing funds, whereby beneficiaries can receive assistance wherever they are, i.e., independent of the LG of place of origin.

Establish and enforce standardized guidelines

- Establish a participatory process for town governments to determine compensation for displacement that is transparent and that involves consensus building with the stakeholders.
- Consider requiring private companies setting up shop in town to take social responsibility by employing the farmers they displace, or financing their training for alternative livelihood in the local vocational schools.
- Consider extending compensation beyond cash transfers to include purchase of social insurance coverage for displaced families, especially for the older population who, unlike the younger population, may be at a

disadvantage to find other jobs.

- Design compensation packages with variable options, ranging from a one-time payment (the existing system) deemed more suitable for the younger population to periodic (annual, biannual) payments in cash or kind to shares in industrial development.
- In cases where compensation is given to the Village Commission, devise process guidelines for local stakeholders to participate in deciding how best to use the funds in the interests of the community.

4.4. *Hukou* System and Migration

The household registration system, i.e., the *hukou* system, has been impeding the development of an efficient labor market and the equitable provision of public social services. To address these issues, it is recommended that the government should (i) institutionalize *hukou* reform in small towns, and (ii) reform social assistance programs to better target the poor, regardless of *hukou* status.

Institutionalize hukou reform in small towns

- Pilot test the removal of the *hukou* system in one of the two case study provinces. This may be linked with Liaoning's ongoing program for *hukou* reform.
- While towns await implementation of the reform, institute a category of permanent or temporary "residency," which gives migrants the same benefits as the local residents without changing the *hukou* status. This will serve as a transition toward the reform and will fast-track standardization of the new identification system, starting with the migrants. (Rather than changing their *hukou* now per the current system, and getting

another identification card later per the "reformed" system, this will allow migrants to skip the first step.) This gradual transition into the new system will ease the administrative burden on local governments, both now and in the long term, and will encourage mobility and migration.

Reform social assistance programs to better target the poor

- Reform the design of poverty alleviation and social assistance programs, such as the MLSP and the CMS, to make them target the poor based on economic conditions, not *hukou* status. For example, the reintroduction of the CMS is commendable, but falls short of effective targeting because it is based on the traditional *hukou* system, which, in effect, excludes the urban poor and includes the rural rich.
- If the objective of the towns is to attract migrants and spur economic development, they must be able to provide the same services to the migrants as they do to the local *hukou* residents. This level playing field implies no additional school fees for migrant children, same access to government-subsidized health care and social assistance programs, etc.

5. Conclusion

Social services, including education, health care and social security are seriously underprovided in the PRC's rural area. To promote town-based urbanization, it is important for developing towns to attract skilled migrants and retain them and current town residents for a long term, but both goals cannot be realized without an adequate provision of decent and affordable

social services. Reform of the current education, health care, and social security systems in towns is therefore necessary and in some cases imperative for successful town-based urbanization. Pilot towns should be encouraged to reform the current *hukou* system and de-link the access to public social services with *hukou* to achieve an efficient labor market and an equitable provision of social services.

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