



# Technical Assistance Consultant's Report

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## People's Republic of China: Fiscal Policy Reform and Management

### TA 8452: Output 1 Narrowing the Urban-Rural Gap in Living Standards

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Asian Development Bank

# Narrowing the Urban-Rural Gap in Living Standards

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## BACKGROUND

The Government of the People's Republic of China (PRC) recognized the importance of reducing income and cultural disparities between urban and rural areas. The Twelfth Five-Year Plan, 2011–2015 established a framework for fiscal policy and management reform in the PRC,<sup>1</sup> Fiscal policy was to be better coordinated with monetary, investment, industrial, and land policies. An improved public fiscal system was to help gradually narrow the gap in living standards between urban and rural areas and between regions by increasing the proportion of government expenditure allocated to public services and social security. The Plan also provided for the alignment of the financial resources of governments with their respective authorities and improvements to financial administration.

In 2012, the 18<sup>th</sup> National Congress of the Communist Party reinforced the importance of fiscal policy and management. The congress called for accelerating the reform of fiscal and taxation systems and ensuring that both the Central and local governments have sufficient financial resources to exercise their authority and fulfil their responsibilities.

It was projected that Improvements to fiscal policy and management and a deepening of government administrative system reforms would result in a well-structured, accountable, and efficient service-oriented government, streamlined administration, and an increase in the delegation of authority to lower levels of government. The PRC Government recognized that a wide range of fiscal policy and management initiatives would be needed to implement these reforms and they would need to extend to township and village-level governments if rural incomes and agricultural productivity were to be raised and the provision of basic services in rural areas was to be improved.

However, local budgets were incremental, segmented and prepared using out-dated procedures. They did not provide an adequate means of exercising effective control and oversight (particularly of wages and salaries and out-sourced activities). The Central Government recognized that to ensure equal access to public services would require additional resources for social services, safety nets and infrastructure at the township and village level, and increased efficiency and effectiveness in service delivery.

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<sup>1</sup> Government of the People's Republic of China. 2010. *Twelfth Five-Year Plan for National Economic and Social Development of the People's Republic of China, 2011–2015*. Beijing.

## OBJECTIVES

In September 2013 at the request of the Central Government, the Asian Development Bank (ADB), approved a policy and advisory technical assistance (TA) for *Fiscal and Policy Reform Management*. One of the components of the TA was to develop fiscal policy and management initiatives for township and village-level governments that could narrow the gap in living standards between urban and rural areas. The emphasis was to be on budget preparation and reporting and expenditure management with a view to lessening deficiencies in public services in rural areas.

The component was to present policy and management initiatives for township and village-level governments. A final report was to draw on four subreports covering: (i) links between fiscal policy and management initiatives at the township and village-level and rural development policies (e.g., land and environmental management, and population policies); (ii) fiscal governance mechanisms at the township and village level (e.g., the allocation of decision making authorities, information disclosure); (iii) the performance of systems and procedures used by township and village-level governments to plan, fund, and deliver public services; and (iv) the adequacy of fiscal support by township and village-level governments for infrastructure, social services and agricultural services (e.g., agricultural extension, food safety standards, and development and distribution of improved seeds).

More specifically the study was to examine the implications of the disparity of social services in rural areas and the relation between the deficiencies in such services and the desirability of living in the rural towns and villages. The study was to provide recommendations for the modification of policy to rectify the areas where existing fiscal policies were deficient.

## FINDINGS

The study included:

- (i) a survey of rural service disparities by students from various colleges and universities. This covered 102 counties (cities, districts) and 121 villages in 15 provinces — Jiangsu, Shandong, Guangdong, Fujian, Hubei, Anhui, Henan, Hunan, Jiangxi, Sichuan, Guangxi, Guizhou, Inner Mongolia, Shanxi, Ningxia.
- (ii) three towns — Xihe town in Suizhou city, Baoan town in Huangshi city, and Xianing all in Hubei province — were chosen for an experiment to achieve the same level of social services in rural areas as could be found in urban settings.
- (iii) a regional survey was undertaken in Henan, Hubei, and Guizhou provinces as well as in Beijing with the lead provincial reform groups to ensure that the proposed policy reforms would prove effective.
- (iv) In depth reviews were undertaken of laws and regulations that have influenced public services available in rural and urban areas, including

the Urban and Rural Community Services System and the rural land reform system.

Since the end of the last century, investment in PRC in public, rural infrastructure has risen rapidly, from CNY108.6 billion in 1999 to CNY1,335.0 billion in 2013. Although subsidies from the Central and Provincial governments to rural areas have represented an important source of revenue the study found that the most significant problem has been the variability of the subsidies between different locations.

The towns and villages remain the grass-roots unit of public financial investment and management and their financial situation and governance mechanisms were found to have a direct impact on agricultural production, peasants' lives and rural development. The governments of these lower level units have responsibility for major expenditure items including, among other things, rural education, roads and rural health. However, commonly these local governments face a serious mismatch between their expenditure responsibilities and their financial capability.

The surveys found that for a majority of these lower level governments, land remains the major source of revenue. However, this reliance has constrained the ability of the town and village governments to expand their revenues to match their increased obligations for provision of infrastructure and services. The current rural land system is based on the principle of collective ownership, which separates ownership, contract rights and management rights. Accordingly, the real ownership of land is blurred. This limits the capacity of local government officials to impose and collect rates and land taxes and pressures them to sell or mortgage publicly owned land in order to meet their commitments.

The survey emphasized that given the role of agriculture in the rural economy improvements in land registration could be expected to contribute significantly to increased productivity and concomitant reductions in rural and urban differentials. Farmers will receive a greater degree of certainty with respect to rewards from their investments (financial and physical) and there will be increased opportunities for farmers to specialize.

In addition, agricultural extension services (socialized services system for agriculture), which cover such areas as agricultural technology, promotion, production information services, animal and plant disease prevention and control, supervision of agricultural product quality and safety, were identified as critical for improving productivity. Several problems were identified; with respect to existing extension services. Firstly, there is wide divergence in the importance that towns attach to extension services with the result that coverage varies considerably. In many areas there is little in the way of these services and farmers must rely on their own resources. Secondly, there is uncertainty regarding the role of the private sector in providing extension services.

## **RECOMMENDATIONS**

**Clarify Responsibilities of Various Levels of Government** — The study recommended that the provinces be given increased powers and responsibilities related to rural expenditures. Further, the report emphasized the importance of clearly defining the powers and expenditure responsibilities of different levels of government. Spending responsibilities and administrative powers and shared powers

for the three levels of government — Central, Provincial and Local — need to be spelled out in detail. The report suggests that the Central Government should have responsibility and powers related to large-scale, long period and cross-regional projects. It is recommended that local governments withdraw from involvement in commercially oriented activities and construction projects. As an example, the following allocation of responsibilities is suggested:

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| (i) <i>Rural Roads</i>          | — | Central and Provincial governments   |
| (ii) <i>Rural Water</i>         | — | Central, Provincial and County governments   |
| (iii) <i>Teachers Wages</i>     | — | County government  |
| (iv) <i>Rural Public Health</i> | — | Central and Provincial government but with management responsibility at the local level. |

**Reform of Transfer Payments** — Special transfer payments to selected counties should be retained for the construction of public infrastructure such as safe drinking water in rural areas, small-scale irrigation and water conservation. An important objective of transfer payments from the Central government to the provinces and counties should be to achieve “national equalization of rural basic public services”.

**Reform of the Rural Land System** — The study advocates reform of the land property rights system and improvements in the system of property registration and argues that this will solve the main problems resulting from the current rural land system. It suggests that defining peasants' property rights and other measures will allow towns and villages to gradually establish or improve their property tax systems and thereby develop a strong local government tax base. There needs to be introduction of appropriate legislation relating to real estate taxes and local governments must shift from the sale and mortgaging of land as their revenue base to a system based on local real estate taxes. The town and village governments should have the management rights for the property tax including property assessment. In addition, an inheritance tax and gift tax should be synchronized with the property tax. These measures should assist in resolving revenue difficulties currently faced by local governments.

**Public Private Partnerships** — The study recommended greater involvement of the private sector in the construction of rural infrastructure and in the provision of public services. For example, it suggested that the private sector could play an important role in the construction of rural roads and bridges and could be involved in provision of medical and social services.

**Developing Agricultural Extension Services** — The study recommended improvements to existing extension services both in terms of the services and areas covered. As in other countries government funding should play an important part but it is important that the relationship between the roles of the government and the market be clarified.

The findings and recommendations of the study have been widely published by the TA team in high level papers in Chinese language journals.