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Publisher Routledge

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## The Pacific Review

Publication details, including instructions for authors and subscription information:

<http://www.informaworld.com/smpp/title-content=t713707111>

### State and market in public service provision: opportunities and traps for institutional change in rural China

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Online Publication Date: 01 July 2008

**To cite this Article** Li, Linda Chelan(2008)'State and market in public service provision: opportunities and traps for institutional change in rural China',The Pacific Review,21:3,257 — 278

**To link to this Article:** DOI: 10.1080/09512740802134117

**URL:** <http://dx.doi.org/10.1080/09512740802134117>

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# State and market in public service provision: opportunities and traps for institutional change in rural China

*Linda Chelan Li*

**Abstract** International experience tells that public services often fail to work for those in need. To make things work requires complex institutional changes that are difficult to come by, let alone sustain. This paper examines the situation of rural public service provision in China and a local attempt to revamp the service provision institution through adjusting the mix of state and the market. It reveals the dialectical process of policy evolution whereby innovation, and resistance to it, has emerged.

**Keywords** Public service unit reform; township government reform; public services for the poor; institutional change; China.

## Introduction

International experience tells that public services often fail to work for those in need. A recent edition of the World Development Report series, *Making Services Work for Poor People*, identifies three interrelated ‘legs’ of accountability relationships upon which effective service delivery for poor people hinges (World Bank 2003: 6–10) – relationships between, respectively, citizen and policymaker, policymaker and service provider, and citizen/client and

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*The Pacific Review*

ISSN 0951-2748 print/ISSN 1470-1332 online © 2008 Taylor & Francis

<http://www.tandf.co.uk/journals>

DOI: 10.1080/09512740802134117

service provider. Firstly, when setting policy objectives policymakers need to know what are in demand by citizens: what, and how much, is preferred under what circumstances. Secondly, policymakers need to convey effectively their policy decisions to service delivery agents, and monitor their performance. Thirdly, users of services need to be sufficiently motivated and feel able to provide feedback on service delivery performance. Adequate incentive structures need to be in place in all three 'legs' to make things work for the poor: service delivery agents will care about their clients; the poor will bother to apply effort to demand improvements instead of withdrawing from the system; and policymakers will seriously examine users' feedback in the interest of improving the services.

The Chinese situation scores badly against these expectations. The authoritarian political system has so far thwarted the development of 'voice' mechanisms vital to the demand-side information. Policies are often decided behind closed doors despite the 'mass line' rhetoric which claims that official policy is a result of refining the demands of the people. The consequence is that the need for public services by the rural population – the peasants – has scarcely been researched and documented.<sup>1</sup> An indication of the dearth of demand-side knowledge is the recent, and belated, effort by the central government to gather information on peasants' needs, when 'touch-base' surveys on peasants' needs for services were hastily commissioned *after* the promulgation of a new policy in March 2006 to 'Construct a New Socialist Countryside' to increase rural services and spending (Author's interviews 2006).<sup>2</sup>

Even when policymakers get their objectives roughly right, implementation has been a major problem. Agency control is at best uneven, relying on costly methods to achieve compliance (Tsai 2007). On the client-agent front, the local rural public service units (PSUs) assigned the role of delivering public goods to rural residents often fail to do their job. As part of the authoritarian state bureaucracy, PSU officials tend to act more like 'masters' than service providers, and are more interested in imposing fees than in providing service. Two books have received international attention and become 'underground' best sellers in China – one by former township party secretary Li Changping in 2002 (*Telling the Truth to the Premier*) and the other by rural researchers Chen Guini and Chun Tao in 2004 (*A Survey of the Chinese Peasants*) – which contain vivid and compelling accounts of the abuses of local officials and PSU workers.

Serious as these problems of accountability deficit are, they are nevertheless not unique to the Chinese situation. Poor people in many developing countries have complained of the deplorable treatment they are offered (World Bank 2003: 4). Complicating things more is that whilst increased wealth and more public spending on service provision help, neither alone is sufficient to bring about desirable changes to benefit services to the poor (World Bank 2003: 35–42). More deep-seated changes in institutional arrangements (budget, political, administrative) are required. International

experience shows that while such changes are difficult to come by in the first place, they are even more difficult to sustain over time.

Against this context this paper looks in detail at a local reform program in central China which, through institutional changes adjusting the role of government and the market, sought to align the incentives of rural service providers and to improve agency control by policymakers. The paper will examine the processes and context of reform – why the attempt was made; who were behind it; and how resistance to change was dealt with. Two thoughts underline the emphasis on *process*. Firstly, there can be no success in bringing changes if people dare not try. Understanding how actors *initiate* change is, therefore, in itself important – part and parcel of understanding how successful changes may come about. Secondly, we may get to know more about *what* reforms can work to bring about improved services for the poor through a close examination of how reforms, in actual cases, made progress, and how resistance to change was overcome.

The rest of the paper will proceed as follows. The next section outlines, briefly, the policy background of the PSU institutional reform, and in particular the burden-reducing rural tax reforms preceding it. I shall then discuss the objectives and reform designs of the PSU reform in Hubei Province of central China. The processes leading to the initiative will be dissected and major actors identified. I conclude with some preliminary observations on the reform's future prospects and implications for institutional reforms in general.

### **Chinese rural tax reforms and 'hollowing out' of local governments**

During the past two decades there have been various attempts to reform the Chinese public service sector. The efforts were, however, mostly piecemeal initiatives of individual ministries and local governments in 'lack of a well-developed overall strategy and coordination' (World Bank 2005: 4). Results were at best mixed as new issues of equity and access problems emerged. Against this, the need to improve public service provision in the countryside has lately gained added urgency in the Chinese policy agenda. Looming large in this renewed salience are the rural tax reforms implemented nationwide since 2002, and subsequently the specter of a 'hollowing-out' of rural local governments in the aftermath of the tax reforms.

The Chinese government started to contemplate the need to revamp the rural tax regime around the time of 1998, after nearly a decade of increasing tension between peasants and the grassroots-level governments and years of local reform experiments (Linda Chelan Li 2006a). The reform package addressed the underlying institutional problems superficially, however, if at all, and local officials, and those at the township level especially, were made the scapegoats for what went wrong (Linda Chelan Li 2006b; Yep 2004). Cash-strapped local governments had historically relied on various kinds of local fees and surcharges to finance the bulk of local spending, including paying for the salaries of officials. Under the reform such fees were no longer

allowed, and local governments were also under severe pressure to downsize to reduce the demand for revenues to pay for staff. A stringent system of top-down monitoring was put in place to ensure local compliance, with the dispatch of provincial inspection teams to each and every county (Li 2007: 101). The consequence was that the official target of burden reduction was achieved quickly, exceeding original expectations both in terms of speed and magnitude. At the same time, however, fears emerged as to how long such results could last (Li 2006c), and rural public services were further depleted – causing outcries about the ‘hollowing out’ of local governments (Fu 2001; Heimer 2004; Kennedy 2007; Li and Dong 2004). In some cases, maintaining the basic operation of government – such as paying for basic staff salaries, transport expenses, telephone fees for government offices – had become a challenge (Li 2007: 103).

Ironically, as the reform to reduce state tax extraction on peasants succeeded in its original objectives, it also deepened the crisis in local governance as the supply and the quality of rural public services, which had been at a low level, received another blow. It was in this context that the central government eventually had to pick up the bill – through taking up more responsibility for some services which were hardest hit, e.g. education and basic health care, culminating in the adoption of the ‘Construct the New Socialist Countryside’ new policy initiative in 2006.

The emphasis of rural policy from then on shifted from one of burden reduction to one of increasing rural public spending. In the 2006 national budget alone, 340 billion yuan was allocated to rural public services, an increase of 42 billion yuan from 2005. In 2007, rural public spending further increased to over 430 billion yuan and to 562 billion yuan (budgeted) in 2008.<sup>3</sup> The challenge is tremendous, however, given the breadth and depth of the ‘service deficit’ after long years of neglect. Increasing central spending on rural services requires a suitable administrative capacity at the local level to match. The pressures from the earlier rural tax reform had, however, ill prepared local governments for the new task (Li 2007). An obvious question is: can township governments pull themselves together to meet the additional demands upon them for more and better services, having been severely demoralized and stripped of personnel and local revenues? Conversely, can the new central resources made available in the ‘new countryside’ program be put to their intended purposes to improve public services, rather than squandered by self-serving local officials? Given the deep-seated deficiencies in the system – weak agency control, lack of accountability to citizens and clients, passivity and helplessness of the clients – worries abound that the latest drive to improve rural public services, largely through an increase in public spending, may degenerate into yet another wasteful campaign of the ‘Great Leap Forward’ genre (Guo 2006; Li Changping 2006a, b). The stakes for institutional failures were high.

### **Public service unit reform: separation and agency control**

Hubei Province in central China had seen high burden levels and was hard hit by the rural tax reforms.<sup>4</sup> It was thus perhaps not surprising to see reform experiments aiming at the deep-seated incentive and control problems, as pressures and difficulties *sometimes* motivate action (and innovation) (Linda Chelan Li 2006a, c). The PSU reform started in early 2003 as a district-initiated experiment in Henggouqiao Town in Xian-an District, some 70 kilometers from Wuhan, the provincial capital.<sup>5</sup> The reform involved converting state-run public service agencies (in Chinese, *zhan-suo*, literally meaning (service) 'stations') at the township level into non-state-owned market entities, to which the township government would 'contract out' the delivery of rural public goods. Seen as a way to improve rural service provision at little additional cost, the reform was subsequently endorsed by provincial leaders and implemented throughout Hubei Province, in phases, from 2004 (Li and Yuan 2007).

Two key features of the Hubei reform are: (1) conversion of the state PSUs into non-state market players; (2) funding of rural public services being output based instead of input based. Through a structural separation of the township government as policymaker and non-state units as service provider, it has been argued, the government is more likely to focus on outcomes and goals and be less distracted by problems in delivery and implementation, resulting in more effective monitoring over the service delivery units (World Bank 2003: 98).

### ***New market players***

Arguably the key measure in the reform was the conversion of 'ownership status' of the state public service units. All township service units were to be firstly abolished, and then re-established as non-state 'service centers.' When this transfer from state to non-state units was completed – and workers in the new units were no longer government employees, township governments would, after a review of the scope of services, re-delegate the service delivery functions formerly performed by the state agencies to the newly constituted units. A contract would be drawn specifying the scope and details of services, and how the units would be compensated.

When the reform started in Henggouqiao Town in 2003, twelve PSUs with a total of 141 staff members were affected. These comprised all service units directly under the town government with the exception of the medical center, namely construction, housing management, husbandry and veterinary, transportation, justice, agricultural technology, agricultural mechanics, water works, rural economic management, family planning, cultural services, and broadcasting. Education has been managed from the county level as from 2002 and thus was not included. Within a year or so the reform was extended to cover 1,056 staff members in over 150 township PSUs across

*Table 1* Scope of Hubei public service unit (PSU) reform

	Henggouqiao Town	Xian-an District	Hubei Province
PSU staff nos	141	1,065	70,000+
Nos of PSU	12	About 150	About 10,000

*Source:* Author's interviews, Hubei (2004, 2006); Yuan (2009 forthcoming).

Xian-an District and subsequently across Hubei Province, affecting over 70,000 PSU staff (see Table 1).

A full metamorphosis, as envisaged in the reform design, comprised the following phases.<sup>6</sup> First was 'setting the ground.' A leading official from the township government was sent to the service agency to oversee the process. Account books were checked and assets and liabilities recorded. Pre-existing management problems in the agency were taken note of, and dealt with wherever possible. Extensive communications were held with existing staff to convey to them the reform plan, and what next to expect. 'Excessive' personnel who had joined the agency workforce without proper approval, that is, those 'temporary employees' without formal state cadre status, were 'counseled out.' The objective, in this initial phase, was to 'prepare the ground' for reform through rationalization. In the second phase, the scope of public service functions of the agency was clarified, given the often murky boundary of public vis-à-vis profit-making services in the actual operation of the units. The legal responsibility to provide the public service to the community was then 'transferred' to an office within the township government. Third was abolition of the township service agency. With its public service duties transferred away, the agency as a state unit was formally abolished. Fourth was the change of status of the agency personnel. Compensation akin to 'severance payments,' based on the length of service and level of pre-existing pay, was calculated and dispensed to the permanent workers, whose status as government personnel ended at that point. Fifth was the formation of new non-state legal entities, either as enterprises or social organizations. To facilitate their development and to 'sweeten' reform, assets of the former agencies, such as buildings and equipment, might be 'lent,' or simply assigned, to the new units. Sixth was the contracting out of public service delivery from the township government to this newly constituted organization. A contract was drawn up specifying expected outputs, funding level and methods of disbursements, assessment criteria and timing, etc. Apart from fulfilling the public service duties, the new agency was encouraged to undertake other market-oriented activities to buttress its income.

The most difficult part in the above process was the fourth step – individual workers severing their government cadre status permanently. For many, the status of government cadres brought them not only a stable job and source of income but also substantial formal powers, informal influence and perks. Resistance to change came from both sides of the employment relationship:

service workers did not want to leave the government ranks; and already hard-pressed county and township leaders did not want to spend their stringent budgetary resources on the 'severance payments.' Indeed, the provincial government waited until 2005 to offer county governments a subsidy of 4,000 yuan for each township public service employee leaving the government ranks, as a move to mitigate resistance to reform across the province, which was about one-fourth of the average severance payments paid eventually. In the face of the lack of fiscal support from above and yet the political pressure to implement reform, local officials resorted to all kinds of tactics, from delayed and phased implementation to half-baked implementation.

In Xian-an District, of the total 1,000 plus PSU workers affected by the reform, just under half (48 percent) left the ranks of government in accordance with the original reform design. Almost as many workers (44 percent) adopted the 'traditional' methods of downsizing used in previous rounds of administrative reforms – so-called 'streamlining' (or, in Chinese, *fen-liu*). Streamlined workers continued to receive about 60–70 percent of their basic pay for three years during which they are expected to find alternative employment or start their own businesses. About 7 percent of workers went into various retirement arrangements.

In other counties the difficulty in implementing reform was even more marked. In an extreme case, almost none of the PSU workers underwent the formal severance process in Jianli County,<sup>7</sup> where peasant burdens used to be very high. The staff were treated as 'streamlined' (*fenliu*) staff, as in previous downsizing exercises, and continued to work in the reconstituted PSUs. A hybrid situation existed: non-state-owned PSUs and staff retaining their status as government employees and still drawing salaries from the government coffers.

### ***Funding sources and mechanism***

A problem with rural PSUs in China and elsewhere in the developing world is the low quality of service despite a massive body of staff. This has produced a vicious cycle: with salaries consuming most of the resources available and little left to pay for necessary operational costs (such as equipment, running costs), workers find their hands tied in doing their job. Morale is low; 'ghost workers' abound, as many collect pay without effective work. Finding a way to motivate performance hence underlies the second key measure in the Hubei PSU reform: public monies would henceforth finance the delivery of service directly rather than pay for maintenance costs of an agency. In the reform discourse, the phrase 'fund the service, not the personnel' (*yang shi* or *yang ren*) was coined in relation to output-based contracts. Tables 2 and 3 show the expected outputs in two service units, namely family planning (and birth control) and water works services.

The contracts sent a message that the newly constituted non-state service centers, while entrusted by local government with public service delivery,



Table 2 Family planning services: performance criteria, Town X, County Y, 2005

Item	Content	Weight (%)
1	Report monthly to Town Government of work progress through written reports	12
2	Publicize family planning policy and knowledge on eugenics, birth control, and health care, reaching 80% of households	20
3	Regularly survey the 'prospective target' of family planning services; deliver post-operation after-care services	28
4	Distribute free medicine and birth control devices, reaching 80% of households	20
5	Train staff on policy and technical know-how	20
	Total (%)	100
	Contracted, and paid, funding	Rmb 46,700

would have their performance watched closely. Any awarding of public funds was henceforth to be based strictly on performance. This was not easy to achieve, however. In many areas of public service it is difficult to specify *what* exactly needs to be done, not to mention to decide whether

Table 3 Water works and irrigation services: performance criteria, Town X, County Y, 2005

Item	Content	Weight (%)
1	Advise government on flood prevention work	12
2	Revise and improve the flood prevention plans; on duty round the clock during the flood period; ensure smooth and effective communication with all relevant parties, especially during flood period	18
3	Implement anti-drought services for agriculture	10
4	Manage irrigation and water works facilities	10
5	Formulate plans, design, organize construction works, and manage the water works infrastructure and roads leading to villages	15
6	Protect and manage water resources, prevent pollution to water resources; ensure safety in drinking water	10
7	Provide technical advice and services on water works matters; arrange technical training activities at least once per year	8
8	Mediate disputes over water works within the town; ensure safety in water works	10
9	Other matters related to water works services delegated by the government	7
	Total (%)	100
	Contracted, and paid, funding	Rmb 99,400

a service has been delivered or performed effectively. Such insusceptibility to measurement and clear-cut specification is a characteristic intrinsic to the nature of the work involved (some classic examples are policing, teaching, counseling, learning to drive) which Scott (1998) describes as practical knowledge or 'mêtis.' The World Bank (2003: 52–3) has noted the absurdity of being 100 percent specific in the design of public service contracts, as previous 'work-to-rule' strikes by public service workers in various countries have amply demonstrated. In the Hubei cases described above, it might be more appropriate to quantify output requirements in family planning and birth control services than in the case of water works. But even in family planning, the assessment criteria apparently followed an implicitly 'negative' approach – whether rules were contravened, or some quantitative yardsticks had been met – rather than focusing directly on the quality of services. For example, the service contract required the family planning service center to submit twelve written reports, one each month, to the Town Government on work progress (Table 2, performance item 1). This carried a weight of 12 percent in the total performance required, with each monthly report accounting for 1 percent. On the other hand, how well or badly the reports were written would not, apparently, affect the assessment. In water services, there was a sliding scale of incentives, according to which unsatisfactory work performance would lead to a cut in funding. But it is not clear how judgments regarding performance were made, what criteria were adopted, etc. Township governments were required to conduct periodic users' surveys to assess the views of residents as part of the assessment of the service centers, but how vigorous these surveys were conducted and how reliable the results were is an open question.<sup>8</sup> In any event, as noted in Tables 2 and 3, the contracted service amount was paid in full in both cases. The question arises as to what this implied for service delivery. To what extent did the contract have a genuine impact on service performance? How did the impact work out exactly? Was it achieved through more vigorous monitoring despite the generic difficulty in assessing service provision? No easy answer is readily available to these questions.

In this connection one should bear in mind that government funding accounted for only a portion of what had kept up the provision of essential rural services before the PSU reform, as well as part of the total budget of the reconstituted service centers post-reform. Township PSUs had been starved of public funds and left to live on arbitrary extractions using their leverage of being part of the state apparatus. Indeed, malpractice and corruption had become so prevalent that rural PSUs were infamous for collecting fees without delivering any meaningful service. Solving this problem of excessive extraction had led to the rural tax reforms across China since 2002, as noted above.

With many fees abolished and remaining fee incomes more tightly supervised, rural PSUs faced a fiscal crisis. The change in funding mechanism outlined above, as part of Hubei PSU reform, was intended to improve the

*Table 4* Budgetary funds for township public services: Xian-an District (million yuan)

	(Pre-PSU reform) 2003	2004	2005
Personnel/service contract funds	1.68	2.11	2.53
Other personnel costs <sup>a</sup>	1.43	n/a	n/a

<sup>a</sup>These refer to staff costs for those not in active deployment, including pension payments for retirees and staff not assigned positions.

Source: Author's interviews, Wuhan (2006); Yuan (2009 forthcoming); Xian-an District Fiscal Finance and Government Establishment website (accessed at <http://www.hbcz.gov.cn/421202/>, 20 December 2005).

efficacy of government funding in rural service delivery. At the same time, the converted service centers were encouraged to develop new, and related, services using a market approach to buttress their incomes. The idea was that since the new units were no longer part of the government, they would need to provide services that met a genuine demand in order to earn more income. From the perspective of the end users, this meant that a wider spectrum of services might be made available, with some services financed largely by public funds under service performance contracts, albeit often still requiring a fee, and others purchased at full cost.

Field research has indicated the fluidity in the relative balance of various funding channels and immense difficulty in obtaining a 'full' picture across the board. In some parts of Hubei Province, the county government has, apparently, stepped up funding to rural service provision by a quite considerable degree (see Table 4). Budgetary funds to rural services increased after the PSU reform in Xian-an District by 50 percent between 2003 and 2005, excluding the personnel costs for retirees and other non-active staff. Regarding the sharing of expenditures on rural services between the district and the township, information available on 2005 suggests that about 60 percent of the 2.53 million yuan funding came from the district-level budget, with the remainder coming from the township.

No direct information is available for other years, but the township was likely to shoulder a higher portion of a smaller sum-total before the PSU reform, a time when higher level governments had yet to pay attention to rural service provision. A Xian-an District government document prescribes a total of five avenues of rural service funding as of 2006: (1) district budget provision; (2) provincial subsidy under the PSU reform; (3) funds from the rural tax reform transfer payments; (4) special earmarked grants from above; (5) township 'own funds.'<sup>9</sup> Of these, avenues (2) and (3) are new features arising from the PSU and rural tax reforms. Article 5 of the document also pronounces the District government's commitment to increase funding to rural public services in the future 'if its general financial situation permits.' During an interview with a senior provincial official, it was mentioned that the Hubei provincial government had recently required the counties to maintain county budgetary provision to rural services at or above the 2004 level as a precondition for qualifying for special subsidy from the province.

Thus apparently rural service funding in the province was on the rise after 2005 as a result of policy encouragement and direct fiscal injection at the provincial level. A report from the Provincial Fiscal Bureau notes that total rural service funding at the county level increased by 27 percent in 2006 over 2005, to 455 million yuan (Fu 2007). In addition, the provincial government also dispensed an additional 200 million yuan as special subsidies to the counties (avenue (2) as above) to encourage the implementation of the PSU reform, at a rate of 5 yuan per peasant, on average. This was doubled to 10 yuan per peasant in the 2007 budget, costing the provincial coffers a total of 350 million yuan.

Despite the increase in budgetary provision, fees collected directly from users remained an important source of public funding. As the case of 'husbandry, veterinary' service center (see Table 5) indicates, budgetary provisions from the district and township levels together accounted for 12.3 percent of total funding in 2004, the first year after PSU reform, whilst incomes from 'public service fees' accounted for 34.3 percent. Thus, despite the drive to abolish 'illegal' fees, public service provision still depended quite considerably on fee collection, albeit that these remaining fees were, theoretically, legal and closely monitored.

Moreover, altogether, public funding (including public service fees) comprises only under half (46.6 percent) of total funding of the husbandry and veterinary service center, the rest being 'market-based' incomes from new services, such as the introduction of new breeds of pigs, transportation logistics and market networking across localities (Li and Yuan 2007). Traditional services performed by the center and funded by public funds are related mostly to public health (e.g. vaccinations), whilst new, market-based services are all economic/business oriented.

*Table 5* Husbandry, veterinary service center, Town Y, Xian-an: income sources (2004)

Income sources	Yuan	% share
1. Public, of which	61,200	46.6
1.1 District government	4,200	3.2
1.2 Town government	12,000	9.1
1.3 Public service fee incomes	45,000	34.3
2. Private (market)	70,000	53.4
Total	131,200	100.0

### **'Killing two birds with one stone': reform under and despite pressure**

How did this process of change, as outlined above, come into being? I argue that the turn to the market – the main feature of Hubei's PSU reform – was largely a result of agency interaction with local pressures. In 2003 Xian-an was still recovering from a breakdown of rural credit associations in the late

1990s when it found itself in the trough of the rural tax reform. Xian-an was a 'high-burden' locality and was thus hit hard by the burden-reduction reforms imposed from above in 2002. Centrally authorized extractions, covering various agricultural taxes and the 'five and three township-village level levies,' was on average 160 yuan per capita in 1999, against the provincial average of 129 yuan (Li 2006c). Despite the increase in central transfer monies, almost half of the 'lost' revenues from peasants went uncompensated, since central transfer payments covered largely the centrally and provincially mandated fees and taxes only. A net shortfall of some 30 million yuan was reported in 2003 against the pre-reform total revenues, and accumulated debt at the township level amounted to 226 million yuan (Yuan 2008).

The township PSU reform came to the fore in 2003 amidst a series of interrelated government reforms engineered, since 2000, by then District Party Secretary Song Yaping.<sup>10</sup> From the beginning the reform had two parallel goals – to 'kill two birds with one stone.' On the one hand there was the imminent pressure – real or political – to downsize. On the other, the condition of public services in the countryside had been extremely poor. As local governments faced additional hardships during the rural tax reforms, rural services were under even greater threat. As a senior district official described it, the township PSU reform had emerged as a result of a confluence of ideas and opportunities posed by parallel reform processes:

Secretary Song believed that to solve the many problems in our villages, and to develop our economy, of fundamental importance is to reform the practice of the government . . . The functions of the government had to change. Just when we were contemplating how and what to do, there came the national rural tax reform. Then those familiar consequences: our township cadres could no longer collect fees as they did before; the township could hardly maintain its normal functioning. These new circumstances presented us an opening to launch the [township service unit] reform.

Song himself made clear in interviews that his eyes were set on *developing* the market, and that stripping the township service units of their government status was a step in that direction:

Downsizing [the public sector] is not my major objective. What I think matters is changing the functions of the government. The development of [a] market economy requires it.

Our township public service units are products of . . . the planned economy. As they stand now they will not live up to the current needs . . . Now we are abolishing them altogether, and converting them to autonomous agencies in society. They can then do whatever they like to follow the market needs . . . This PSU reform is the first step to foster commercialization and the market in the countryside.

We can draw two observations from the above. Firstly, the township PSU reform was part of an integrated program of reform engineered by a local leader in whose mind the market occupied a central place in the order of development. Where the market was weak or had yet to exist, as in service provision in the Chinese countryside, one way to develop the market was through converting non-performing state service units into private, market players. On the other hand, the *immediate* context of reform, namely the immense fiscal pressure on township governments and the political pressure from the central government to downsize, was critical to putting reform ideas into *practice*. Despite Song's dismissal as 'not being the major objective,' the renewed pressure to downsize, or the rhetoric of it, in the aftermath of the burden-reduction reforms served to attract allies at *higher* levels to the township PSU reform, for precisely the reason that the reform caused the most controversy amongst local officials: it promised to cut staff! At a time when people were increasingly weary of the prospects of successful downsizing through conventional methods, Xian-an's PSU reform rekindled hope once again of the possibility of reducing personnel expenditure.

This perhaps explains how Song's reform experiments could find an ally at the apex of the provincial leadership. Provincial Party Secretary and Politburo member Yu Zhengsheng soon became an ardent supporter shortly after he arrived in Hubei as its top official. Yu was instrumental in Song's promotion to the provincial government in late 2003 and the subsequent provincial approval of the reform.<sup>11</sup> The statement below, made during a visit to Xian-an in March 2004, is suggestive of Yu's attitude:

Township comprehensive reforms hold the key to sustaining the achievements of the rural tax reform – keep the peasant burden low. *And the critical part in township reforms lies with the public service units. We need to find a way of developing rural public services, and yet without risking the rebound of the peasant burden.*<sup>12</sup> (Emphasis added)

It is apparent that given the national policy of burden reduction, provincial leaders were under pressure to reduce extractions from peasants and *keep* them low. At the same time, the heat was on the townships. 'Township comprehensive reform' was hailed as holding critical importance to sustaining a low level of burden. However, as Linda Chelan Li (2006b) notes, national policy had given little guidance *how exactly* to reform townships – apart from a reiteration of the need to downsize, the limits of which even central officials had by then realized. As the impact of fee reduction on local budgets was felt, local governments were pressured into finding new means to maintain a minimal presence and functioning with reduced resources. In 2002 there was, therefore, a market for innovative reform ideas.

Xian-an's township agency reform thus met a need at the time. Song's articulation and the elegance of his ideas linking government downsizing with market development enhanced the reform's appeal to the provincial leaders. Its greatest attraction, to provincial leaders, was a promise of a new path to downsize and reduce personnel costs. Paradoxically, however, this has also been the source of most resistance. There were two dimensions to this resistance. First was affordability: were there the resources to pay for the one-off severance payment? Second was doubt about its effectiveness: could the payment serve its intended purpose – could downsizing be *made* effective?

Full compensation per member of staff, including social insurance payments, was, on average, 25,500 yuan. Depending on different estimates of numbers of eligible staff, the cost of reform ('one-off' severance payments plus social insurance payments) varied from 1.7 billion to 7.2 billion yuan across the province. As noted above, the provincial government had been slow to shoulder this burden, expecting the counties and the townships to pay for most of the cost. However, cash-strapped local governments were equally unwilling to accommodate even the smallest estimate. Even Henggouqiao Town of Xian-an, where the reform was first piloted, did not complete the step of permanent severance until the district government promised to pay the costs involved. A town official described their considerations in 2003 as follows:

The district government did not issue any policy document on the PSU reform. There were only oral instructions from Secretary Song that the reform must sever the government-cadre status of the personnel. But we could not do it since no monies were made available to us to pay the required compensation. We needed a few million *yuan* to pay the outgoing staff, covering the one-off severance payment, pension and medical insurance payments, etc. We simply could not implement the reform in one go without new resources.

As a chosen location for pilot reform there was no turning back. What Henggouqiao Town did eventually was to implement the reform in two phases. In early 2003, the state-owned service units were abolished and non-state service centers came into existence, except that the former PSU staff still remained in the government ranks. The same local official as above explained how they did it:

We are now implementing the reform with a contingency plan. We'll regroup the service agencies and combine some of them. The government status of the agencies will be abolished, but the original status of the staff as government personnel will not be affected. We'll have the new 'service centres' set up and start running business first. Then wait for opportunities [to gain] fiscal support from above.

Eventually, in 2004, the district government provided the funds for severance payments, and the reform was 'completed' in Henggouqiao. Across the Xian-an District a total of 7 million yuan was paid to 518 staff as 'severance payments,' representing an average of 14,000 yuan per person (Yuan 2008). Xian-an's leaders had a large stake in seeing through the reform that they had initiated. In any event, the provincial government in 2003 awarded Xian-an with 6 million yuan of additional transfer monies for its government reforms (Li 2006c: 68). Other counties were much less enthusiastic and most waited for provincial monies before initiating any action. In 2004, seven counties were given a total subsidy of 120 million yuan to spearhead the reform. In 2005, as mentioned above, all counties received a provincial subsidy of 4,000 yuan for each PSU worker leaving the government ranks, with a total provincial outlay of 1.26 billion yuan.

For the reformer Song Yaping, worries over reform costs were entirely unnecessary. In his words to the author, in 2005:

How much does it cost to keep a staff? Take an average annual payroll of 12000 *yuan* per person. Then there is the indirect cost, such as office expenses, which is about 5000 *yuan* per person per year. On the other hand the severance cost is at most 25000 *yuan*, which is less than 2 years of staff costs! Cost is not a problem. That is why Xian-an did it and other bolder leaders, like those in Jingshan County, have also done it, even without fiscal support from the province. It makes good business from the perspective of the public purse.

If cost is not the real issue, then what is? 'People's mind-set,' Song concluded, in 2006:

People lacked confidence and were often besieged by a pervasive sense of insecurity, so that they were worried about resistance from staff. They thought our staff could not make it to the market. They thought our people could not survive [other than] as government cadres, and thus this reform – severing the employment relations – would not work. The [severance] monies would only be wasted, as the staff would eventually press for a return. Many localities have hence adopted a wait-and-see approach, and have not implemented the severance arrangement.

Apparently, the 'confidence' deficit was also found amongst central officials. A senior central official said the following in an interview:

Now it is too early to talk about a possible national extension of Hubei's model. The effect of the reform is as yet unclear. First it is uncertain if the reform will foster genuine competition in service provision, and thus improve service quality. If no real competition exists, if the services are simply delegated to the same batch of people who have been



around before reform, the current reform is unlikely to lead to significant improvement in public service provision. The severance arrangement, which is peculiar to Hubei's model, also raises new questions. The measure requires injection of new resources but now peasants' fees and taxes have been cut the central government is already spending more on the villages [vide the special central transfers on rural tax reform and funds for the 'New Countryside' projects]. We need to be very careful if still more new monies are needed. The current thinking is that, with the New Socialist Countryside plans, new monies will be spent on direct services to the peasants, like roads, energy, water, the impact of these are more direct and easier to see. We're thus putting less emphasis on making changes in the institutional front at this stage. But sure Hubei may still proceed with its institutional reform using provincial resources. The central government will wait and see ... (Author's interviews, Beijing, 2006)

In October 2006 the State Council issued a directive on 'rural comprehensive reforms' focusing on rural education, county-township fiscal management and township government reform (State Council 2006). Whilst the directive confirmed the earlier experiments on education and rural finance (largely the centralization of township management functions to the county, first started in Anhui), Hubei's PSU reform – as an important pilot measure in the third area – was conspicuously not mentioned. A general reading by local officials in Hubei and other provinces was that the central government had 'cold-shouldered' Hubei's experiments (author's interviews, Hubei and Hong Kong, 2007).

### **Conclusion**

By 2006 central policy seemed to have come full circle since national burden-reduction reform commenced a few years ago. Drastic measures to reduce state extractions on peasants had led to calls for radical institutional reforms – to the extent that the entire layer of township government might possibly be done away with (Li 2007: 94, fn. 20). The pendulum started to swing back, however, when it had made the farthest swing. As burdens reduced, concerns emerged over the 'hollowing out' of local government and amidst these came the new plan to construct the 'New Socialist Countryside.' With the current emphasis on direct services, interestingly, as the above remarks by a central official suggest, the latest policy turn seems to have had an effect of *redefining* the problem in the countryside, as well as what constitute possible solutions.

International experience reminds us, however, that too often increased public spending alone is insufficient to meet the challenge of improving public services for those in need. In many cases deep-seated changes in institutions – how public monies are allocated and spending monitored, whether the needs of the clients are adequately surveyed and fed to the

decision-making process, and how service providers with the necessary capability and aptitude are trained and put to work – are required, or at least some of them. Where does the township PSU reform stand in this process, and Hubei's experiments in particular? Problems in rural services in China are embedded in a whole range of institutional and historical arrangements, and the PSU reform described in this paper is only a small step in tackling the 'thick' institutional 'base' and offers, therefore, a partial solution at best. Taking this first step is important, however, if through it people's *awareness* of the need to tackle *other* institutional reforms is also raised. This last effect has worked better amongst officials at the lowest level of the state hierarchy. Township officials in Henggouqiao were quick to point out the need for reform at higher levels of government and the limitations of a bottom-up approach to government reform, when the PSU reforms were piloted in 2003:

What do we need to do next? Reform the upper levels! If government reform is confined at the township level, it won't last long. As long as our upper levels don't change as well, they will make demands on us in the old way, and we will still have to comply, even though these do not fit in our reformed system. We still have to creatively make ways for these demands. These adaptations may work for a while, but will eventually weaken our reform ... Then reform will succumb to pressures from the top ... Right now reform has only taken place at the bottom. The upper levels [county and above] have not changed at all. They are just watching us ... *But government reforms are not like enterprise reforms. For the latter a decentralized approach has worked. This won't work for government reforms.* There is a need for more and better coordination and leadership. (Emphasis added)

Township officials looked for leadership in two directions. The first was a vision of reform that would extend government reform beyond townships to all levels. Secondly, they demanded strategic decisions on which specific reform models should be adopted. Local experiments had been helpful but national and provincial leaders needed to take responsibility at some point – not so much to promulgate a unified model nationally but to analyze and assess the local reform experiences for wider implementation. To an extent this step has been taken up at the provincial level in Hubei. As noted above, the central government has so far remained non-committal. Perhaps the difficulties in township reform, as seen from the experiments in Hubei so far, have had the ironic effect of alerting the central government to the fact that there is *no* easy solution when it comes to government reform.

In the mid-summer of 2006, given the lukewarm central response to Hubei's institutional reform efforts, Song Yaping – the main architect of Hubei's reforms – made an assessment regarding the PSU reform's prospects:

Institutional reform takes time and needs the right context to proceed. At this juncture, the 'right' context [of extending the reform] is not there. The 'New Countryside' plans focus largely on the material side, not on the institutional ... But there is a limit [to which] our traditional government structure can work, especially given the new demands. That is why I believe the time will come when Hubei's township institutional reform will be seen as useful again.

Perhaps the difference between central and local thinking should not be overstated. A senior central official's remarks made at roughly the same time came very close to Song's, if with a slight twist:

We anticipate the townships will soon face more challenges. They have already had a hard time from the rural tax reform. With the additional demands from the New Socialist Countryside policy, the challenge is even greater. The fact is that provision of public goods in the countryside was, historically, not impressive. Maintaining the provision at the preexisting level with reduced means will be hard, but relatively manageable since the standard has been low. If expectations are raised, however – as is now the case with 'the New Countryside' plans – the conventional system will find it really difficult to cope ... We in the central government are aware of the ongoing local experiments [in Hubei] ... We shall wait and observe how they go ... (Author's interviews, Beijing, 2006)

The Chinese experiment on adjusting the mix of state and market elements in rural public service provision outlined in this paper suggests a dialectical process of policy evolution. Institutional reforms to align actors' incentives are complex, and resistance to change commonplace. Governments are often tempted to look for quick 'fixes,' placing hopes on, say, a bigger budget or a good year in the economy, as in the current case. Since 2006 township institutional reform has entered an impasse in China, as national attention has shifted to direct rural services, and hopes for service improvement placed on increased funding. I argue, however, that the impasse may likely be temporary, as maintaining the status quo will not work. The pre-existing system has not performed previously and cannot possibly perform better now with additional demands from more spending projects. Further change will likely come when local failures to deliver, under the pre-existing institutional framework, become a conspicuous fact rather than a theoretical possibility, or when local implementation of institutional reform has brought more fruit, despite the absence of national approval, as has happened in previous waves of policy evolution.

## Acknowledgements

The author would like to thank the Hong Kong Research Grant Council for funding the research on township fiscal institutional change (RGC reference: CityU 1064/02H) from which this paper draws, and the Fulbright Scholarship Program which financed my stay at UC, Berkeley where I drafted the paper. Fieldwork was conducted during 2002–07 in Hubei, Anhui and Guangdong provinces, and in Beijing. Many individuals have helped in this process, in particular Jingyao Wang and Licai Wu. Earlier versions of the paper were presented at the Provincial China Workshop organized by the University of Technology, Sydney and Uppsala University, Sweden, at Taiyuan, China in September 2006, and at the ‘State Capacity’ conference at the City University of Hong Kong in April 2007. Comments and suggestions by participants, in particular Vivienne Shue, David Goodman, Christine Wong, Maria Heimer and Minglu Chen are much appreciated. Research assistance was provided by Kin-on Li in Hong Kong, and Yamin Xu at Berkeley.

## Notes

- 1 Two recently published studies on peasants’ needs are Liu (2006) and Yuan *et al.* (2006). The situation is not much better in more democratic political systems, however, as noted by Chhibber and Sisson (2004) writing on India.
- 2 Unless otherwise stated, information in this paper comes from author’s interviews in Hubei during 2003–07.
- 3 See full text of budget at [http://news.xinhuanet.com/misc/2006-03/17/content\\_4313792.htm](http://news.xinhuanet.com/misc/2006-03/17/content_4313792.htm), accessed 10 July 2006; and ‘2008 government report,’ accessed at <http://www.xinhuanet.com/20081h/gzbg/20080305.htm>, 8 March 2008.
- 4 Hubei Province, whilst also home to traditional heavy industries including iron and steel and automobiles, is one of the agricultural ‘heartlands’ of China (like Hunan to its south and Sichuan in the south-west) and has shared similar problems including heavy peasant burdens.
- 5 Xian-an District was Xianning City (county level) until 1999, when it was renamed Xian-an and made a district of the new and enlarged Xianning City (prefecture level). It has a population of 570,000, of which 77 percent are rural (accessed at: <http://www.xajw.com/Article/ShowArticle.asp?ArticleID=318>, 15 July 2006). The ‘district’ in the Chinese hierarchy of governments occupies a near-equivalent ranking as the county. The only difference is that a district government is considered part of an urban municipality so that the municipal government often exercises more coordinating functions.
- 6 This account is based on the pilot reform experience in Henggouqiao Town, Xian-an District (author’s interviews; Song 2006; and ‘Xian-an government report on the reform experience,’ accessed at <http://www.xaxx.gov.cn/villagechange/exprienceone.htm>, 10 July 2006).
- 7 Jianli County is infamous for its high peasant burden and violent clashes between village and township cadres and peasants during tax-fee collection. Li Changping’s famous book on the plight of peasants (Li 2002) is based on his observations as township party secretary in Jianli County.
- 8 A county official and formerly township party secretary admitted to the author in 2007 that most opinion gathering exercises conducted in townships were at best loosely executed.

- 9 'Temporary regulation on fund management of rural public services in Xian-an District,' March 2006, accessed at <http://www.hbcz.gov.cn/421202/lm3/lm340/2006-12-01-14443.shtml>, 12 June 2007.
- 10 Song was reportedly the first senior cadre from Hubei to resign from the government to work as a 'private individual' in south China, when he left the government for Shenzhen/Guangzhou in 1988, after two years in the Provincial Policy Research Office. After a few years in the south he returned to Wuhan to study and earned a doctorate in history in 1993. From 1993 to 1998 Song went to Hainan and participated in the 'Yangpu' project there. He rejoined the government ranks during a recruitment drive by the Hubei government in 1998, and was Party Secretary of Xian-an District from August 1999 to late 2003 (accessed at <http://www.nanfangdaily.com.cn/rwzk/20040630/sz/200408030039.asp>, 11 July 2006, and <http://www.phoenixtv.com.cn/home/phoenixweekly/145/20page.html>, 25 July 2006).
- 11 Hubei Provincial Government Document No. 17 (2003), 4 November 2003, 'Advice on implementing comprehensive township government reforms,' promulgated provincial-wide reforms of township government and service agencies along the line of reforms in Xian-an. From January 2004, Song became vice-director of the Research Office at the Provincial Party Committee and vice-director of the Leading Group of the Hubei Township comprehensive reform.
- 12 *Hubei Daily*, 26 March 2004, accessed at <http://www.chinarural.org/old/readnews.asp?newsid=%7B70BA71C6-3718-45E3-AF33-8D5B780D40A1%7D>, 10 July 2006.

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