

## STRUCTURAL CHANGES OF PUBLIC EXPENDITURES IN CHINA

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**ABSTRACT.** This article describes structural developments of public expenditures in China in the past 30 years and demonstrates an increasing public's need for services in areas of education, health care, social security, and housing. Starting with a theory explaining the need to adjust the spending structure, the article specifies a proper proportion of public service expenditures in total governmental spending and discusses a possible path to this spending structure.

### INTRODUCTION

Governmental spending is a significant financial source for the Chinese economy. In 2006, the government spent RMB 4.042 trillion (RMB is Chinese monetary unit, US \$1 is about RMB 6.7), about 19.1 percent of the Gross Domestic Product (GDP). Governmental spending is particularly important in areas of national defense, education, economic development, transportation, healthcare, housing, social security, and state-owned enterprises, constituting the sole or a critical source of finance in these areas.

Since the 1980s, the government's spending has experienced significant structural changes that have led to a shift from direct investment in the economy to education, social security, and healthcare. This shift has been labeled by many economists as a sign that the Chinese public finance system is becoming more public

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service-oriented. However, the current expenditure structure is still inadequate for the government to address significant challenges in meeting the increasing public demands for public services. What are the specific areas of these demands? How should the government do to adjust spending structures to meet these demands? What should be a proper expenditure level on public services, and how should the government do to achieve this level? This article discusses these issues.

#### **THE EXPENDITURE STRUCTURAL CHANGE IN CHINA: A THEORETICAL EXPLANATION**

In this article, the term “public expenditure (or spending)” is used to describe the actual spending of Chinese central, provincial, and local governments. The government’s spending of direct economic investment is termed “economic construction expenditure (or spending)”, a term commonly used in budgetary classification and glossary of Chinese government budgets. This spending category often consists of the spending in public infrastructure such as highways and bridges, investment in state-owned enterprises, and investment in public financial institutions, though some operating expenses in state-owned enterprises and governmental agencies are not included. The term “public service expenditure (or spending)” is used to refer to Chinese government’s spending in areas of education, social security, health care, and other human services. In addition to the above two spending areas, the Chinese government also spends significant amounts in areas of national defense, international aids, emergency financial assistances, and debt payments.

The governmental spending structure reflects the preferences of those making resource allocation decisions in government (Lee, Johnson, & Joyce, 2008). Many political economists in China attribute the growth in economic construction expenditure to the government’s urge to maintain a healthy economic growth. One of best known theories argues that the Chinese economy has to maintain a minimum 8 percent annual growth to keep the unemployment at an acceptable level and any growth lower than that would cause sociopolitical unrest which is considered as the failure of governance for the Chinese government. Although the role of the government in the economy has been in a constant decline for the past thirty years

due to a booming private sector, the government is still a major economic engine and its spending in economic construction is the fuel to keep the engine running. This theory of sociopolitical stability has been powerful to explain the existence of a significant portion of Chinese government spending in direct investment in economic activities. It also provides a plausible explanation for the current governmental stimulus plan of \$500 billion in a slowing economy in which a major portion of the money is the economic construction spending used to propel economic activities.

With the increasing income of the population measured by the per capita GDP reaching \$3,000 and in some areas more than \$10,000, the demand for public services in education, social security, and health care has increased significantly. Just like a high unemployment rate will cause trouble for the government, the lack of education, housing, and health care opportunities can also lead to social unrest. For example, the recent failure in reforming the health care system has caused social uproar about the health care cost which is quickly becoming unaffordable for many families. The public's complaints and protests as results of the poorly-managed health care system, housing system, and educational system are not uncommon. The government's urge to avoid any social unrest is again the cause to increase the expenditures on public services. Therefore, based on this theory of sociopolitical stability, public service spending is associated positively with income of the population. Increase in personal income results in or requires more governmental spending on public services and consequently a proportional decline in governmental spending on economic construction.

Several social and demographic developments also contribute to the urgency of the government's spending growth on public services. A continual aging population and longer life expectancy increases the government's share on health care, retirement, and pension financing. Growth in college and university admission leads to larger governmental spending on education. Migrant workers and the unemployed increase the size of so-called the "urban poor" in metropolitan areas, resulting in an increasing need for governmental spending on housing, healthcare, and social welfare.

Moreover, the power and institutional structure of the Chinese government makes the change of the spending structure possible. It

is important to note that public budgeting literature in the U.S. tends to treat budgetary outcomes as the result of a political process in which diversified interests collide and compromise (Wildavsky & Caiden, 2004; Rubin, 1997). Unlike the U.S. system which has an independent legislative entity and a tradition of stakeholder participation in the budgetary process (Simonsen & Robbins, 2000), the spending adjustments in China are mainly a result of the government (the executive branch)'s intentions and its preferences with little or no inputs or oversight from the legislature and other stakeholders. The strong position of the executive branch in budgetary decision making suggests that spending structure adjustments in China are likely to occur with relatively limited resistance or interferences.

#### **THE STRUCTURAL CHANGES OF PUBLIC EXPENDITURES IN THE PAST**

Before the 1980s when China started its policy of economic reform, the government's budget was loaded with economic construction projects which exceeded more than 50 percent of the total budget, while the spending on public services was often less than 15 percent. This focus on economic development is the result of the fact that the government was the major investor in a planned economy and economic development was believed to be a priority over public service provisions.

Since the 1980s, as the result of significant socioeconomic changes from the economic reform, the proportion of economic construction expenditure in the total expenditure was reduced to 26.6 percent in 2006 and the portion of public service expenditure increased to 26.8 percent. The spending structural change is clearly reflected in education, social security, and health care. Table 1 shows the change of several major spending categories from 1978 to 2006. It is important to note that, because China implemented a budgetary reform that reclassified budgetary revenue and expenditure items in 2006, this article mainly uses the budgetary data up to 2006 in order to keep the data consistent for analysis. Also important to note is the possibility of that some off-budget spending items are not included in the data.

One of the salient changes in the expenditure structure is in education which saw an increase from 9.3 percent in 1980 to 17.8

**TABLE 1**  
**Major Public Expenditure Categories and Proportions of Public Service Spending 1978 to 2006 (in billion RBM)**

Year	Economic Construction	Education, Health Care, and Science	Social Security	Total of Major Spending Categories	Education, Health Care, Science (% in total)	Social Security (% in total)	Economic Construction(% in total)
1978	451.92	112.66	18.91	989.69	11.38%	1.91%	45.66%
1979	443.68	132.07	22.11	1213.32	10.89%	1.82%	36.57%
1980	346.36	156.26	20.31	1109.26	14.09%	1.83%	31.22%
1981	257.55	171.36	21.72	1056.24	16.22%	2.06%	24.38%
1982	269.12	196.96	21.43	1137.09	17.32%	1.88%	23.67%
1983	344.98	223.54	24.04	1299.00	17.21%	1.85%	26.56%
1984	454.12	263.17	25.16	1541.32	17.07%	1.63%	29.46%
1985	554.56	316.70	31.15	1769.81	17.89%	1.76%	31.33%
1986	596.08	379.93	35.58	1969.10	19.29%	1.81%	30.27%
1987	521.64	402.75	37.40	1979.91	20.34%	1.89%	26.35%
1988	494.76	486.10	41.77	2169.14	22.41%	1.93%	22.81%
1989	481.70	553.33	49.60	2405.19	23.01%	2.06%	20.03%
1990	547.39	617.29	55.04	2663.62	23.17%	2.07%	20.55%
1991	559.62	708.00	67.32	2910.81	24.32%	2.31%	19.23%
1992	555.90	792.96	66.45	3151.33	25.16%	2.11%	17.64%
1993	591.93	957.77	75.27	3774.40	25.38%	1.99%	15.68%
1994	639.72	1278.18	95.14	4604.71	27.76%	2.07%	13.89%
1995	789.22	1467.06	115.46	5374.58	27.30%	2.15%	14.68%
1996	907.44	1704.25	182.68	6274.13	27.16%	2.91%	14.46%
1997	1019.50	1903.59	328.42	7219.15	26.37%	4.55%	14.12%
1998	1387.74	2154.38	595.63	8625.59	24.98%	6.91%	16.09%
1999	2116.57	2408.06	1197.44	10733.47	22.44%	11.16%	19.72%
2000	2094.89	2736.88	1517.57	12328.12	22.20%	12.31%	16.99%
2001	2510.64	3361.02	1987.40	14471.49	23.23%	13.73%	17.35%
2002	3142.98	3979.08	2636.22	17515.87	22.72%	15.05%	17.94%
2003	3429.30	4505.51	2655.91	19185.52	23.48%	13.84%	17.87%
2004	3437.50	5143.65	3116.08	22186.78	23.18%	14.04%	15.49%
2005	4041.34	6104.18	3698.86	26035.25	23.45%	14.21%	15.52%
2006	4390.38	7425.98	4361.78	30829.65	24.09%	14.15%	14.24%

Source: The National Institute of Statistics, China.

Notes: The contents of spending categories may vary from year to year depending on the change of standards of statistical data. Some items may be classified in different categories in different years. Some spending categories may be merged to create new categories. It is important to note that these categories combine multiple spending items. For example, the spending on education was included in "education, health care, and science."

percent in 1996 for an annual growth of 4.2 percent. Since 1997, however, there has been a significant decline for education spending to 11.7 percent in 2005. Although there was a slight increase in 2006 and 2007 (14.3 percent), the spending on education has never reached the level of 2005 (Ministry of Finance, 2007).

Since the 1980s, public expenditure on social security has increased, particularly since 1998 when an accelerated rate of growth was observed. For example, from 1980 to 1997, public expenditure on social relief and welfare programs showed an annual growth of 12.13 percent, and the annual growth rate doubled to 23.2 percent during 1998 to 2006. Compared with the annual growth of total public expenditure of 17.0 percent from 1998 to 2006, the spending on social security had an annual increase of 28.3 percent. Among social security spending items, social security supplemental spending (mainly the spending on public pension programs and the social security fund and unemployment financial support) had an annual growth of 39.3 percent, becoming the fastest growing spending category, while other fast growth categories include the spending on social relief and welfare (23.2 percent) and nonprofit organization retirement support programs (21.8 percent). During six of the eight years from 1998 to 2006, the annual growth of the public expenditure on social security exceeded that of the total public expenditure growth, making the spending on social security one of the largest expenditure categories at 11.0 percent in 2007, as compared with 5.2 percent in 1998 (Social Security Division of the Ministry of Finance, 2002).

Compared with the spending growth for social security, the growth in health care has not been salient since the 1980s. It was until 2003 when the spending growth on health care started to elevate. For example, health care spending had a 15.1 annual growth from 1985 to 1997, but the growth rate declined to 11.4 percent from 1998 to 2002 (Social Security Division of the Ministry of Finance, 2002). The annual growth surged to 19.3 percent from 2003 to 2006 after the outbreak of Severe Acute Respiratory Syndrome (or SARS) in China in 2003. As the result, the health care spending in the total public expenditure has increased from 2.9 percent in 2002 to 3.3 percent in 2006.

### **The Need to Focus on Public Services**

The improvement of public wellbeing has been seen as a top priority of the Chinese government. In a 2007 Chinese communist party (CCP) document, it was made clear that the goal of economic development activities is to improve people's standards of living (Hu, 2007). This goal provides a direction for governmental functions and spending that need to be refocused on the following areas.

#### ***Increasing Investment in Education***

The expenditure on education has reached the highest level in the proportion of the total expenditure in 1996 since the 1980s. The decline since 1996 contradicts with an administrative law that requires "a continual increase in public spending on education as a proportion of total public expenditure and GDP in order to meet the public demand for high quality education" (People's Republic of China, 1995). The law further specifies a clear positive relationship between economic growth and public demand for education, predicting a long-term growth trend of educational spending. A 1993 policy of the State Council clearly established a goal of 4 percent as educational spending in GDP. However, educational spending was only 3.3 percent of GDP in 2007 ("Report on Educational Development," 2009). Clearly, there is a need to increase the spending on education based on the established policy goal.

The need for increasing educational expenditure is also reflected in the poor condition of educational facilities in the country. According to Department of Education ("Public Spending on Education," 2007), only 67.8 percent of high schools and 53.3 percent of elementary and middle schools in the nation met established capacity standards for sport fields and stadiums in 2006. High schools and elementary/middle schools meeting the standards for sporting equipment capability were only 64.7 percent and 47.4 percent respectively. Only 72.2 percent of high schools and 52.8 percent of elementary/middle schools had enough laboratory and teaching equipments. The lack of governmental educational investment is particularly salient in rural areas of the nation. In 2006, the classrooms in danger of collapse were 4.3 percent and 6.5 percent for high schools and elementary/middle schools in rural areas respectively, compared with 3.0 percent in the national as a whole. It is very common to find a rural school with students without learning

equipment and even books, tables, and benches. The lack of basic learning facilities and the poor learning environment in rural areas have become more salient for the past 10 years. Because the government's investment is the only source of revenue for an overwhelming majority of schools in the country, the continual decline in governmental spending indicates a severe deterioration of the country's educational system in quality and the loss of a significant portion in a generation of bright students.

There also is a need to increase public spending on higher education, which saw a decline in the proportion of public educational expenditure from 60.8 percent in 1992 to 40.6 percent in 2005 and an increase in tuitions and fees from 5.7 percent to 31.5 percent during the same period. In comparison, in the U.S., more than 50 percent of revenues in public universities come from governments' appropriations, and tuitions and fees were only 18.8 percent in total revenues in the mid-1990s. The government's large financial input in education appears to be the case in other developed countries too.

It is commonly recognized in developed countries that government's educational input propels economic development and improves social equity, and their public finance practices reflect this recognition even during the early times of their industrializations. In Japan and Germany, for example, governments' spending on education exceeded 20 percent of their total expenditures in the early 1900s. In Canada, the U.S., Great Britain, Norway, Japan, Holland, and many other developed countries, governments' educational expenditures exceeded 4 percent in GDP in the 1960s. Even in some developing countries, governmental spending on education also accelerates, reflecting an understanding on the importance of education and a governmental strategy to increase economic development by developing a highly-skilled labor force. For example, in 2002, the government's spending on education was above 4 percent of GDP in India, Malaysia, Thailand, Brazil, Mongolia, and South Africa.

### ***Meeting Public Need for Health Care***

It has been increasingly difficult and expensive for patients to see doctors and stay in hospitals for their medical needs in recent years, which reflects the lack and decline of government's financial input in health care. In 1985, for example, the government's expenditure on



health care was 38.5 percent of total health care expenses and the proportion declined to 18.1 percent in 2006. In comparison, about 80 percent of health care expenses are from governments in Great Britain, France, Germany, and Japan. Even in developing countries such as Indonesia, Brazil, Malaysia, and South African, about 35 to 60 percent of heal care expenses are provided by governments.

In China, more than 80 percent of health care expenses are covered from private sources such as companies or individuals. Health care expenses have become a significant burden for individuals, particularly for middle and low income families. High costs for medicines and medical treatments, combined with a growing poor population as a result of failure of the government's policy in income distribution, have caused significant hardship for a large portion of the population. One specific area of health care hardship is the difficulty to see doctors. The number of hospitals and medical clinics has decreased from 67,556 in 1996 to 60,037 in 2006, for an 11.1 percent decline within a short span of ten years. From 1994 to 2004, though there was an annual increase in number of patients (as the Chinese population ages quickly) by 2.95 percent, the annual increase of hospital beds was only 0.84 percent (National Institute of Statistics, 2007). In 2004, there were only 0.9 Magnetic Resonance Imaging (MRI) equipment and 3.7 computed tomography (CT) machines per million people, significantly less than an average of 7.6 MRI and 17.9 CT machines in countries of Organization for Economic Co-operation Development (OECD) and even less than the level of some developing countries (e.g., there were 4.5 CT machines per million people in Thailand in 1999). A significant portion of the population, mostly in rural areas, has very limited or no health insurance coverage (Wang et al., 2005). The above data indicate a need for a significant increase in the government's spending on health care.

Aging population in China is another factor that requires an increase in governmental spending on health care. Health cost for an elder population is significantly higher (Cichon et al., 1999; Fuchs, 1984). In addition, aging population is associated with the decline in the number of payees to health insurance plans, which in turn leads to a decline in premium paid to these plans. Though most of provinces (equivalents to states in the U.S.) in China have a budget surplus in their health insurance balanced sheets, with an increasing

rate of aging populations, it is expected that more and more provinces will have revenue shortages soon and the demand for the financial assistance of the central government (equivalent to the federal government in the U.S.) will increase.

### ***Dealing with Pressing Need for Retirement and Pensions Financing***

The cost of pension plans is shared by companies, individuals, and the government. Individuals pay about 8 percent from their wages while companies' contribution rate is around 20 percent on average; the government is responsible for the deficits of the pension programs (The National Institution of Statistics, 2007). With a large number of people eligible for retirement every year, it is becoming increasingly difficult for the current finance system to cover the cost of pensions. In most of provinces (except a few places such as Guang Dong and Zhe Jiang), individual and company payments are not enough to cover pension costs and significant financial assistance from the government, particularly the central government, is needed. Governmental spending on pension plans reached to about \$18 billion in 2007, and among it, \$ 12.7 billion was the spending of the central government.

The continual aging of population poses challenges for retirement financing to the government. According to a U.N. estimate, 16.8 percent of Chinese population will be 60 or above in the year of 2020, up from about 11 percent now, and in 2030, 23.6 percent of the population will be 60 or more (United Nations, 2002). Annual increase of populations aged 60 or above was 3.3 percent from 1997 to 2000, and the growth will be 3.5 percent from 2000 to 2025 and 4.8 percent from 2025 to 2050 (National Institute of Statistics, 2002). Life expectancy has gradually increased for the past 50 years, reaching 73 in 2007 according to the World Bank (2009).

Urbanization also increases living expenses for retirees and creates greater demands for pensions. About 45 percent of areas in China are urbanized in 2008, and it is estimated that, by the year of 2020, 52 percent of areas in China will be urbanized. Clearly, an aging population largely living in the expensive urban areas creates great demands for pensions and retirement finance. There are two options to deal with this challenge. One is the increase in premiums paid by individuals and companies. However, the higher cost as the result of this option will surely reduce the competitiveness of the

companies, which in turn causes higher unemployment. The pension rates of individuals and companies in China (8 percent and 20 percent respectively) are already higher than the averages of other countries (5.6 percent and 10.5 percent respectively) and even higher than the averages of European countries (6.8 percent and 14.2 percent) excluding Russia and eastern European countries (United Nations, 2002). Clearly, the effectiveness of the option to increase individuals' and companies' share is very limited to close the ever-growing gap in pension cost. The only other option is to increase the government's share of the coverage. Increasing the government's role in pension and retirement financing should alleviate the burden on individuals and companies and increase the companies' competitiveness. The government should accelerate its financial support to retirement and pension financing.

### ***Meeting the Need for Public Housing***

There was not a housing market in urban areas of China before 1998. Houses were distributed to residents by the government mostly free of charges and sometimes with minimum rental fees. Housing shortage was prevalent. Since 1998, a housing market has been developed and housing has been commercialized. With a large population needing housing and a very limited supply of land, the price of houses has jumped significantly for the past decade to a level that fewer and fewer working class people can afford. In many places in China, the average price of a house is 15 times as much as the annual family income (wages and salaries included), compared with only 5 times in many developed countries. The price is so high that the majority of middle or low-income populations cannot afford to buy houses. For the small number of families who buy, they become the "slave of the house", a popular term coined to describe low- and middle-income homeowners whose income is exhausted by the housing payment. The lack of affordable housing has attracted complaints of many people. It is conceivable that the lack of a living space for many people will lead to social unrest. Public housing, a notion that the government provides basic housing to low- and middle-income families, is a policy option to deal with the housing shortage. International experiences should provide guidance to the development and implementation of this policy. The Housing Act of U.S., passed in 1949 and revised in 1969, clearly states that the government is obligated to provide housing to every person. Before

the 1980s, the U.S. government provided 45,000 housing units to low income families annually. Because of government-run rental programs, only about 50 percent of families have their own houses in developed countries such as the U.S. (65 percent), Switzerland (42 percent), and Great Britain (46 percent) in 2006. In comparison, private housing exceeds 80 percent of total housing supply in China. Clearly, the government should play a more important role in meeting the basic housing need of the public.

### **A Proper Structure of Public Expenditures**

Based on the data and analysis above, we can outline a perspective on the structure of public expenditures from now to the year of 2020 that focuses on public service expenditures. This perspective is meant to initiate, not settle, a discussion about what should be a proper spending structure for the Chinese government.

#### ***Education***

Education directly contributes to economic development. A highly-educated labor force is critical to keep a nation's economic competitive advantage. Growth in government's spending in education also reflects the fact that a very large number of students in China need mandatory education (14.5 percent in the total population) (National Institute of Statistics, 2007). International experiences indicate that the government should take a major role financially to support education at all levels including elementary schools, middle and high schools, and higher education, and educational spending growth should largely explain the budget increase of the government. Government's spending on education is also associated with the admission rate of schools, particularly the admission rate of colleges. With the proliferation of the high school education and the increase in government-sponsored college admissions, education should take a large share of governmental resources (Tanzi & Schuknecht, 2000). Based on the data and discussions above, it is reasonable to believe that the public expenditure on education is too low now and its proportion in the budget should reach to 15 percent in the near future. By the year of 2020, the educational spending in total government spending will be ideal in the range of 18 to 20 percent and the educational spending

in GDP should be above 5 percent if public expenditure in GDP is above 30 percent.

### **Social Security**

Social security expenditures, including retirement and health care expenditures, are about 11 percent of total public expenditure now. Several factors can determine the proper size of this spending. As discussed above, the quick aging of the population requires a significant increase in government's social security spending. Also important is the consideration that China is not a wealthy country by the standard of GDP per capita and limited resources constrain government's spending on elder populations. In line with a goal stated by the Finance Minister XuRen Xie (2004), a proper proportion of governmental spending on social security should be 20 to 25 percent of total governmental spending. Because there are social security items listed under other categories in the budget (such as pensions to retired professors under "education"), the actual level of spending on social security should be a little higher.

### **Health Care**

Public expenditure on health care should directly affect people's access to health care and medicines. In spite of recent increase in government's input in health care, there is still a large unmet need for health care. The health care spending has not reached to 4.3 percent of the total budget, the level of 1996, although it has grown from 2.9 percent in 2002 to 3.3 percent in 2006. Including the economic construction portion of health care, the total spending on health care was still only about 4.0 percent of the total public spending in 2007, lower than 5.5 percent reached in 1988. As a comparison, most developed countries spend more than 10.0 percent of their total governmental expenditure on health care and most developing countries spend more than 6.0 percent. Here are a few examples in the year of 2006: the U.S. 21.0 percent, Australia 18.2 percent, Czech Republic 14.5 percent, Germany 13.6 percent, Russia 12.7 percent, Swaziland 11.4 percent, Romania 10.7 percent, Poland 10.3 percent, Bolivia 9.6 percent, Mauritius 8.8 percent, Iran 6.0 percent, and Singapore 5.8 percent. As a developing country, China's limited resources determine that its spending on health care is hard to reach to the level of developed countries. Nevertheless, a

spending level of 4 percent is clearly too low to meet public demand for health care. Based on the data and analysis on public demand, this is realistic to believe that the health care spending should be about 6.0 percent of the total government spending in the near future and should reach to 8 percent to 10 percent in the year of 2020.

### ***Housing***

Since 1999, local governments in China have been required by the central government to develop a system that provides affordable housing to the families in the lowest income bracket. However, the development of this system has been slow. By the end of 2006, the public expenditure on affordable housing was only about \$ 588 million, and only about 3 percent of families in this income bracket (about 0.5 percent of total families at this income level) improved their housing condition, compared with about 10.0 percent in developed countries on average (Tanzi & Schuknecht, 2000). This slow start propelled the State Council to develop a policy that allows the central government providing financial assistance to local governments through direct budget appropriations or established affordable housing funds. This assistance was specifically targeted on the remote areas in central and western regions of China. The 2008 budget saw a spending of \$1 billion on affordable housing, which is about 0.5 percent of central government's total annual budget. The experience of many countries indicates an ideal spending level of affordable housing at 1.0 to 3.0 percent of total government spending. Because of the current large demand for affordable housing in China, the government should spend about 2.0 percent of total budget on affordable housing and, with the improved living conditions of families over time, the spending can be reduced to about 1.0 percent in long run (after 2020). Table 2 summarizes the proper spending levels on public services suggested by this article by 2020.

### **Policy Options to Achieve a Proper Structure**

There are two ways to increase government spending on education, social security, health care and other public services. One option concerns the adjustment of the existing spending structure through reducing spending on economic construction and other

**TABLE 2**  
**A Proper Spending Structure by 2020 (As % of Total Budget)**

Types of Spending	2007 spending	2020 target
Education	14.3	18.0 to 20.0
Social security	10.9	20.0 to 25.0
Health care	3.6	8.0 to 10.0
Housing	0.5	1.0 to 2.0

Source of Data: The Ministry of Finance, People's Republic of China.

spending categories. Nevertheless, it has proven very difficult to do so because of the pressure to cut back the existing spending. Experiences show that any cutback on the current spending faced large resistance from organizations where the cutback occurred. The political resistance and negative economic consequences (as the result of loss in productivity) could be prohibitive for the cutback. As a result, hardly has the Chinese government reduced the existing spending amount on a specific spending category. Most of times, the governments, including Chinese government and governments in many other countries, adjust the spending structure by increasing budget increments. The recent spending increase in public services (education, health care, social security etc.) reflects this strategy of spending structure adjustment. For example, the central government revenues were about \$418 billion in 2007, about \$106 billion more than that in 2006. Most of the increment was budgeted for education, health care, and social security expenses in 2007. Among the spending increments, about \$ 15.7 billion was for education for an annual increase of 76.3 percent, \$ 9.3 billion for health care for an annual increase of 276.0 percent, and \$35.5 billion for social security for an annual growth of 20.2 percent. This strategy of "adjustment of increments" appears to gain momentum. The first 11 month of 2007 saw a large increase in education and health care in the spending at all levels of the government. The total governmental spending on education, health care, and social security during this period reached to unprecedented \$163.6 billion, including spending on education (\$82 billion, 32.7 percent increase over the same period of last year), spending on health care (\$20.9 billion, 40.6 percent increase over the same period of last year), and spending on social security (\$60.7 billion, a 28.6 percent increase). The growth

rate of all these three spending categories exceeded the average growth rate of the total public spending (25.2 percent). These data indicate the use of “adjustment of increments” in Chinese government’s attempt to achieve a spending structure more favorable on public services.

### CONCLUSION

With a theoretical framework that explains the growth of government spending on public services, this article describes the existing spending structure of the Chinese government and presents a prospective spending structure on public services. This section concludes this discussion with implications of this shift on Chinese and global economies.

For the past 30 years, the Chinese economy has become more market-oriented from a planned economy where the central government controlled almost all economic activities through mostly direct involvement in the economy. The involvement has been reflected in a large portion of economic construction expenditure in government budgets. With an increasingly important role of the private sector in economy since the market-oriented reform 30 years ago, government’s direct economic involvement has declined. More importantly, with the increase in income, there has been a growing public demand for public services. It is clear that the government is spending more on education, health care, social security, and other public services.

This article proposes a spending structure that advocates even more spending on public services. The possible impact of this proposed spending structure, if achieved, includes a more public service-oriented government, a lesser role of the government in providing direct economic activities, and the increase in the private sector competitiveness through the reduced spending burden on health care, retirement, and other public services. A lesser role of the government in the direct economic activities implies that the government should have less economic incentives to intervene the economy on a regular basis.

It is important to note that this trend of the increase in public service expenditure does not preclude a temporary governmental spending surge on economic construction designed for specific



purposes. The current financial crisis starting in 2008 has called for more direct economic aids to companies in China, which could result in a temporary increase in economic construction spending. This increase is in the interest of stabilizing the global economy, with a belief that a stable Chinese economy would strengthen the chance of a global economic recovery from a battered global economy. It is anticipated that the increase will be temporary and the spending on public services will resume with the passing of the current economic and financial crisis.

Also interested is that the shift from a structure of direct economic investment to more public service-oriented structure in China is coincided with the attempt in the U.S. and other developed countries to spend more to stimulate economic activities. For example, the Obama stimulus package (American Recovery and Reinvestment Act) includes a significant portion of the \$775 billion spending on public infrastructure. With a U.S. administration focusing more on the economy, it should not be surprising to see an increasingly important, though maybe temporarily, role of the governments through direct economic involvement activities (such as investments in education, energy, natural resources and environment, transportation and economic development). Clearly, both China and the U.S. are searching a good public spending mix that maintains the governments' key functions as public service providers but also allows it the mechanism of directive economic investment to guide the economy.

Finally, it is important to discuss the nature and limitation of this article. This article provides a normative discussion on the Chinese spending structure, supported by a theoretical explanation. It suggests a policy direction for the Chinese government. The article is not designed as an empirical test of spending data, although the arguments of this normative discussion can be used to formulate hypotheses for testing. Empirical observations are needed to prove or disapprove if the proper spending structure suggested in this study is indeed achieved.

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