

Yining Li  
Zhiqiang Cheng *Editors*

# The Chinese Path Toward a Leaner Government



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ISBN 978-981-19-6717-7      ISBN 978-981-19-6718-4 (eBook)  
<https://doi.org/10.1007/978-981-19-6718-4>

Jointly published with The Commercial Press, Ltd.

The print edition is not for sale in China (Mainland). Customers from China (Mainland) please order the print book from: The Commercial Press, Ltd.

ISBN of the Co-Publisher's edition: 978-7-100-12639-7

This book is published with financial support from the Chinese Fund for Humanities and Social Sciences.

Translation from the Chinese language edition: “中国道路与简政放权” by Yining Li and Zhiqiang Cheng, © The Commercial Press, Ltd. 2016. Published by The Commercial Press. All Rights Reserved. © The Commercial Press, Ltd. 2023, corrected publication 2023

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The registered company address is: 152 Beach Road, #21-01/04 Gateway East, Singapore 189721,  
Singapore

# Preface

**Building a leaner government (*Jian Zheng Fang Quan*, or “streamlining administration and delegating powers” in the official translated documents) is essential in China’s transition from a planned economy to a market economy and in an effort to improve the country’s socialist market economy.**

People of our generation have all had some experiences with the planned economy. It was a time when the government managed everything from production to consumption. In other words, the government assumed the role of both the producer and distributor of goods. Little was outside the government administration. It set quotas that matched its plans and organized supplies according to the quotas. No one in China at that time had ever heard about the term *Jian Zheng Fang Quan* or streamlining administration and delegating powers. In fact, it was impossible to streamline the government then because everything was controlled by the government, every decision had to come from the higher authorities, and all kinds of stuff were placed under the quota system. When a government assigned each of its staff with a particular task to either manage or supervise economic activities, how could it be streamlined? Power devolution was even more beyond imagination. The planned economy was based on the concentration of power. If power was delegated, how could the economy and people’s daily life go as the government had planned for them?

Indeed, there were times when the Chinese government was concerned about the low efficiency and poor performance of the planned economy that too much concentration of power had entailed. However, there were no better ways. China had quite a few lessons learnt in a hard way. Trials to cut government power or remove some quota all ended up in market disorder. Shifting back to old practice only stifled the economy. Such policy flip-flops occurred time after time during the period of the planned economy. It was a doomed cycle that no one was able to break.

When did the government and the people of China draw their attention to the idea of a leaner government and gradually move in this direction? In the transition from the planned economy to the socialist market economy, cutting government power became a must. This was because under the planned economy, industrial and agricultural production and distribution were carried out on a quota-based term initiated and dictated by the government. Nothing could be done without government

approval, and there was no way to circumvent it. When businesses and investors were restricted by too many regulations and authorities at lower levels lacked initiatives to press ahead, market economy would be a goal too elusive to reach. For the market economy to take root, China needed a leaner government with less centralized power. This would free up the market and help businesses become real market players who operate independently in a competitive environment. Only in this way could businesses gain more vitality and the role of the market be taken into full play in regulating the economy and allocating resources. It would also enable the urban jobless to start a business of their own and join the rank of market players.

The most telling case is the adoption of the rural household contract responsibility system established in 1979. In the years of the planned economy, farmers were fixed to the land and were under heavy restrictions. Such decisions as what crops to grow, how big the growth area was, or even when to sow the seeds were made by the higher agricultural authorities and passed onto farmers through local rural officials. This was the same as how much grain should be handed over to the government as a farm tax and how much of the remaining grain can be sold and at what price. Rural residents are under a household registration system different from urban dwellers. When farmers wanted to work in cities, they had to obtain the government's prior consent. Otherwise, they would be called *Mang Liu* (meaning people who blindly flow into cities) or vagrants. The planned economy builds its success on established and compulsory plans, where hungry and poorly clad farmers had no incentive to make improvements. After the Cultural Revolution ended in 1976, farmers in some places tried the "Big Contract," or what we now refer to as the rural household contract responsibility system, which was simply unimaginable before 1976. After careful study, the CPC Central Committee praised the pilot programs and began to popularize them across the country. Only a few years later, food coupons that had been circulated across China for decades were no longer valid, farmers were allowed to work in cities, and township enterprises emerged one after another and seemed to be everywhere. As their products were not on the government's purchase list, they had to look for their own clients. An interesting phenomenon occurred in China in the 1980s. One often saw farmer-looking people on coaches and trains, dressed in suits, sometimes with ties and carrying baggage big and small. They were found to be farmers, or more specifically, managers and salesmen of township enterprises who carried product samples in the baggage and traveled across the country to look for customers. They were the ones who broke the shackles imposed on them over the years. The market created by emerging township businesses tore down the monopoly of the distribution channel by the government under the planned economy. It could be hailed as the initial achievements for administrative streamlining and power devolution. In the eyes of economists, the emergence of township enterprises and the creation of markets for their products have quietly broken the domination of the planned economy.

In the process of breaking the domination of the planned economy, the establishment of special economic zones (SEZs) was as important as the rural household contract responsibility system and township businesses. SEZs were set up in Shenzhen and Zhuhai, two towns in Guangdong Province bordering Hong Kong and Macao. Market rules were enforced there instead of the old practice. This brought

fast economic growth to the SEZs with a more liberalized market, greater autonomy for businesses and massive inflows of migrants from northern provinces. This marked the beginning of a nationwide transition from the planned economy to the socialist market economy.

The release of Deng Xiaoping's statements during his trip to South China in early 1992 triggered another wave of reform and opening-up. The Chinese Communist Party set for itself a clear target at its 14th National Congress of building a socialist market economy with Chinese characteristics to replace the long-standing dominating policy of the planned economy. The reform covered many areas. One of them is administrative streamlining and power devolution.

The policy of reform and opening-up over the past two decades spanning from the 14th to the 18th National Party Congress has gradually led China onto the path of the market economy. The efforts to make the government leaner also continued during this period of time and covered the following three areas.

First, Deng's statements in 1992 encouraged many people to make investments and start businesses in Shenzhen and the wider Pearl River Delta or Shanghai and other eastern seaboard cities in Jiangsu, Zhejiang, Shandong and Fujian. They found that business traveling and home settlement there did not require as much administrative approval as before and that they could own a business as they wished in a short period of time. This was hard to imagine in the planned economy.

Second, as SEZs and coastal cities saw a surging tide of entrepreneurship and innovation after the release of Deng's remarks, labor was needed for creating new businesses, expanding existing ones and infrastructure construction. Rural laborers flocked to the south and the east for opportunities. These migrant workers did not need administrative approval to move from the countryside to the cities, as was required in the early days of reform and opening-up. Nobody could have imagined how big impact this may have on the life of the rural migrant workers.

Third, a big event that shaped the course of China's market economy in the 1990s was its bid to join the WTO. To meet the WTO criteria, China had to transform itself from a planned economy to a market economy. This included removing or reducing administrative constraints placed on the market and businesses, including domestic private companies and potential foreign investors. At that time, people in Chinese political and economic communities were all crying "the wolf is coming." They believed that once government protection of the agriculture, manufacturing, commercial and service sectors was scrapped, China would be dealt with a heavy blow. Their arguments aroused a big controversy. Ultimately, the central leadership and the State Council made the decision to accept the commitments the WTO set for China and fulfill China's obligation on inbound foreign investment and liberalization of foreign trade in a phased manner. The result is that "the wolf" did come, but instead of inflicting huge losses on China, it has helped improve the competitiveness of Chinese companies and make the path smoother for China to move from the planned to the socialist market economy. More importantly, the system of the planned economy, with fewer sectors to cover, had less say on the future of China's economic development.

The above three areas clearly show that in the period of building and improving the socialist market economy between the 1990s and the lead-up to the 18th National Party Congress, good progress was made in building a leaner government, which is necessitated by narrowing the scope of the planned economy and making the underlying structure of the socialist market economy function better.

**The 18th National Party Congress brought China's reform and opening-up program into a new phase. It was reaffirmed at the congress that the market should play a decisive role in resource allocation and China must pursue law-based governance. A clear direction was set for the efforts on power decentralization.**

As the process of shifting to the market economy is yet to be completed, much remains to be improved in making the system work better. The 18th Central Committee of the CPC made the decision of letting the market play a decisive role in resource allocation at its third plenum and adopted the resolution on law-based governance at its fourth plenum. More efforts are needed for enforcement. In this context, there is much to be done in cutting government power as a means to improve the socialist market economy.

First, the administrative review and approval system must match the principles in the market economy. This system is indispensable because in a market economy, lawful, well-regulated and institutional-based operations are essential for the market to remain in good order.

The microeconomic players can be divided into three groups: companies, individuals and administrative departments overseeing the market. They all have to obey laws and follow market rules, which in turn incentivizes businesses and individuals and makes them vibrant and helps administrative agencies ensure that the market is well regulated and in good order. The focus of streamlining is now law-based governance and administration, which underpins the sound development of the market economy.

Second, due to the impact of the planned economy over the years, it is likely that a few administrative review and approval policies will remain inconsistent with market rules after the reforms. It is therefore necessary to review the current policies one by one and decide which provisions are to be removed, revised or created. The government must adopt policies that motivate and energize market players (companies and individuals), remove those obsolete policies that stand in the way of the growth of the market economy and delegate power of review and approval to lower authorities. New review and approval rules should help increase the incentives and vitality of market players, companies and individuals included. Outdated policies that restrain the growth of the market economy must be abolished. A number of items subject to approval should be delegated to lower government authorities. This will increase the sense of responsibility of the agencies at the lower level and drastically improve administrative efficiency.

Third, items of administrative charge should also be checked against reality. In the past, many charges (levies and fines included) collected by administrative agencies and their affiliated bodies were connected with their economic interests. In some cases, excessive and exorbitant charges and fines that have weighed down businesses

and individuals have been put into the pockets of the collectors. Making charges better regulated and rule-based will help make administrative approval more compatible with the efforts of promoting the rule of law and building a clean government.

Going forward, it is advisable to set up a system of negative lists and power and responsibility lists in line with international practice. The negative list targets market access. The power list spells out the power of the government. The responsibility list defines the responsibilities of the government and its agencies. The three lists are important elements of law-based governance.

The following are elaborations on the three lists and suggestions on ways of their enforcement that help make the government leaner.

### **I. The negative list on market access**

The negative list on market access was first introduced to the Shanghai Pilot Free Trade Zone on a trial basis for later adoption in other cities. This means that the government lists a number of industries, sectors and businesses where investment and business operations are strictly prohibited or under restriction. All types of market players are allowed to enter on an equal basis those industries, sectors and businesses that are not on the list. It has been made clear to all market players that things on the list are redline and off-limit zones. Industries, sectors and businesses that are not on the list should give equal access to all market players without favoring one over the other.

The release of the negative list on market access is a credible means to boost the confidence of all types of market players. If it was changed to a positive list by writing down which industries, sectors and businesses are allowed in for investment and business operation, the list would go on and on and may not be exhaustive. Specifying the redline and the no-touch zone will be reassuring to the market players, as they will know the boundaries and act with more enthusiasm.

### **II. The government power list**

A government acts according to law in a market economy. The government power list defines the power boundaries and way of enforcement of the government and its departments. This means that when the government acts, it must act within laws and regulations. Without their mandate, no action should ever be taken.

If the government goes beyond the boundaries set by laws and regulations specified in the government power list, the action it takes will be illegal and the law would require that the government make apologies to the injured party and compensation for the loss incurred and discipline the staff involved.

There is an essential difference between the market economy and the planned economy. In the market economy, the government must carry out law-based governance, and the boundary of its administrative power is clearly defined by the power list. This means that the government cannot take action unless mandated by the law. While in a planned economy, the government and its departments are not subject to the limits of laws and regulations when performing their duties. Since government acts are not confined by laws, the government will never be caught “breaking laws or regulations” for its acts.

### **III. The responsibility list of the government and its departments**

There are both similarities and differences between the responsibility list and the power list of the government.

The similarities lie in the fact that the power list tells what the government can and cannot do. The government must pursue law-based governance and administration, and its behavior must be backed by laws and regulations. The responsibility list also requires that the government and its departments perform their functions mandated by laws and regulations instead of acting willfully.

They are different in a way that the responsibility list is more specific about legally defined responsibilities of the government. This means that the government must perform its administrative responsibilities as specified in the laws, or it will be charged with negligence of duty. The responsibility list also standardizes and clarifies the procedures of performing government functions.

At a workshop on cutting red tape, participants discussed the phenomenon that some government officials act arbitrarily while others fail to perform their duties. The former can be checked by the government power list. According to the principle that the government can only take actions mandated by the law, arbitrary acts constitute violation of laws and regulations, which will never be allowed in a law-based society. However, the government power list does not directly deal with the failure of officials to perform their duties. These officials should be taken accountable against the government responsibility list, which spells out what the government should do and how to do it. The list provides enforceable criteria for the business community and the public in their supervision of the government and its employees.

The work around the negative list of market access, the government power list and its responsibility list will be a key priority in both building a leaner government and improving the socialist market economy.

**Macroeconomic control is indispensable in the socialist market economy. However, the measures should be appropriately based on China's economic reality. In this sense, it is related to streamlining administration and delegating government power.**

In the years of the planned economy, although fiscal, monetary, human resource and regional development policies were employed to regulate the economy when needed, the term “macroeconomic control” that originates from the Western economic theories was hardly mentioned because it was thought that macroeconomic control was only used by Western countries as a means to stabilize the national economy.

It was not until the 1990s that the State Council of China resorted to macroeconomic control to curb the overheated economy featured by excessive investment, swelling credit and rising inflation. The problem was triggered by the reform following Deng's statements in South China, especially after the 14th National Party Congress, which set the goal of building a socialist market economy. However, the

measures taken in the 1990s were more like administrative directives, which is understandable since China had just begun to transition from the planned economy to the socialist market economy.

Things are different now. The coverage of the planned economy has shrunk considerably. Private businesses account for over half of China's GDP. Private investments have entered quite a few areas previously closed to them. Therefore, macroeconomic control in today's China is characterized by the following:

- I. The macroeconomic control in this context is the one under the ever-improving system of the socialist market economy. It should be law-based and shall not violate the rule of law.
- II. Macroeconomic control should be used as appropriate in all market economies and suit national realities. There is no one-size-fits-all model. The government should know when to make the policy tight and when to make it moderate, when to launch and when to stop. Structural readjustment or targeted regulation also follows this methodology and should be used when necessary.
- III. Macroeconomic control aims at maintaining steady economic growth. It is a means and not an end in itself. No one should take it as a "magic pill," as every macroeconomic control measure has side effects. Disproportionate measures and miscalculated intensity will only create more problems for the future.
- IV. The government must refrain from taking macroeconomic control as the only way to keep the economy going. Such thinking is harmful to the market economy. If macrocontrol becomes indispensable, how can the market play a decisive role in the allocation of resources?
- V Streamlining administration and delegating government power are closely related to sound macroeconomic control. They do not undercut each other's role and deal with different aspects of the issue. The former is a key measure in raising administrative efficiency and requires continuous attention from the government even if China has completed its transition to the market economy. The latter is a critical tool for the government to meet the policy goals of steady economic growth, full employment, price stability and equilibrium of international balance of payment. Mutual coordination and reinforcement between them is important in managing the "new equilibrium" the country faces.

**Greater vitality of businesses and stronger initiatives of the public are the source of continuous economic growth and the lasting competitiveness of companies. In this sense, there is a huge potential in improving the market economy.**

State-owned Enterprises (SOEs) in China were not real market players in the planned economy. Their ownership and investors were unclear, and they had to obey the orders from the administrative authorities without any freedom to run the business independently. In essence, SOEs were nothing but affiliates of government agencies. Therefore, the top priority for China in its "plan-to-market" transition is to reshape the basis of the microeconomy and make SOEs true market players that can operate freely and compete in the market and to ensure that their investors are responsible for any losses incurred. This was the subject dominating the debate among Chinese

economists concerning corporate ownership reform since the beginning of the reform and opening-up. For a market economy to take full shape, China's SOEs must all complete the ownership reform and become true players to compete in the market as vibrant microeconomic entities.

The corporate ownership reform, which started in the 1980s and was completed in the first decade of the twenty-first century, has come a long way. Ownerships were clearly defined. A number of SOEs completed share-holding reforms to become joint-stock companies, and some were even listed in the stock market. In addition, a large number of private companies emerged. These companies generally have clear ownership structures, including some family businesses with stocks shared by family members in the form of joint-stock companies. Thus, the number of market players in China increased sharply. In the past couple of years, I have been to the city of Jiaxing, Zhejiang Province, for field studies. I have seen with my own eyes great enthusiasm among farmers after the reform of separating rural land ownership rights, contract rights and use rights. With rights and interests protected by the law, they become highly motivated to run family farms or rural cooperatives. They are pushing for the creation of the new countryside, new townships and new communities. I have also visited entrepreneurship and innovation incubators in Zhongguancun, northwest of Beijing, where many young university students, graduates, investors and researchers join each other in making business and innovation plans. In Chongqing, a large city in central China, I saw happy new owners of small and micro businesses who found it much easier to start a business than before and were entitled to more preferential treatment. Some of them were talking about the possibility of growing their ventures into medium-sized ventures in the coming years. Their potentials will be fully unleashed once they see opportunities and promising prospects.

The growth of a company hinges on its ability to seize business opportunities, tap its own potential and display dynamism. However, ultimately it is decided by the economic system of the country. There are three key questions in it. First, does a company have a solid microeconomic basis, such as clear ownership, a full-fledged corporate governance structure and a good sense of cohesion? True market players are companies that have gained growth potential and full vitality through reform. Their potential and vitality sustain the growth of China's economy and the companies' own business. Second, does macroeconomic control include appropriate steps and sound decisions, suit economic realities and mobilize all types of market entities? Third, has the entire economic system transformed from the traditional planned economy to the socialist market economy, with the market playing a decisive role in resource allocation? The questions point to the ultimate goals for China's market-oriented reform. They are not short-term targets. To meet these goals, other institutional reforms are also needed. They include the reform of the administrative review and approval system aimed at building a leaner government.

However, the experience of Chinese SOEs in transition to joint-stock or listed companies shows that no one should underestimate the rigidity of the planned economy in the "plan-to-market" reform. The planned economy is similar to a huge and tightly knit net. It will not fade away simply because the government claims that the market should play a decisive role in resource allocation. Nor will it relinquish

its influence and control over businesses simply because they are now joint-stock or listed companies. It has been proven that no joint-stock companies in China, whether they are previously owned by the state or by private families, are yet joint-stock companies in the real sense. Let alone listed companies. The reason will be given in the following description of the two types of companies.

First, some words about SOE ownership reform. Some joint-stock companies that were previously SOEs complain that years after the reform, they are still dominated by the government on all things except for attracting investment. The shareholder meetings become meaningless as the state holds the dominating shares. The policy of giving companies independence in decision-making, business management and handling profits and losses thus become empty talks when you find that the government continues to treat the companies as their affiliates and decides the appointment and removal of their management teams. In this context, how can businesses be called true market players?

For some family business-turned stocking holding companies, the governance structure remains the same, and the head of the family is the boss of the company. Others see the shares spread out among the family members, with the family head serving as the board chairman. However, the business model remains the same without any reforms to support the new governance structure. It will be hard for private companies, family businesses in particular, to grow in a highly competitive market without any remodeling of the underlying governance structures.

The result of the joint-stock reform of SOEs and family businesses still falls short of the expectations for a perfect market economy. There is still a long distance to cover in this endeavor. It is fair to say that further reforms on SOEs and the transformation of private companies, family businesses included, are both necessary in improving China's market economy. Further progress in decentralizing government power is obviously important in this process.

Now, the most important thing in the government's efforts to upgrade the Chinese economy and strengthen its market competitiveness is the reform of the state capital system and the introduction of mixed ownership in SOEs, including companies wholly funded by the government and companies where the government holds dominating or majority shares. Administrative streamlining needs to match the reform in this area.

In my book *Chinese Economy in Dual Transition* published (by China Renmin University Press) in 2013, I said there are two layers in the reform of the state capital system. The first layer is the reform on the way state capital is allocated, and the second layer is the reform on the SOE management system. The two layers should not be mixed into one.

The reform of the state capital allocation system comes first. State capital undertakes more social responsibility in the market economy. Inadequate or inefficient allocation that sets more state capital idle will be the largest loss for the government. Importance should therefore be placed on higher efficiency in its allocation. This means that sound investment decisions are needed to both prevent the erosion of state capital and generate higher returns. Based on this thinking, the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council

has become the owner of the state capital but is only responsible for its allocation. A working structure of SASAC-state investment fund corporations-SOEs has taken shape.

At the second layer, reform of the SOEs aims to turn all companies, both those wholly funded by the government and those where the government holds dominating or majority shares, into market players that take care of their own profits and losses with sound corporate governance structure and management autonomy. They act upon the decisions of the shareholders' meeting and the board of directors in business dealings and are subject to oversight by the board of supervisors. Like other types of businesses, their social responsibility includes providing quality products and services to the market, nurturing talented people and sharing good experience and practices. Developing and expanding market share represent their biggest contribution to society.

The current reform of introducing mixed ownership to SOEs aims to make them independent market players, a goal shared by the reform of the SOE management system.

To a large extent, moving toward mixed ownership and reforming the management system of SOEs serve the same purpose. As part of the reform of the administrative system, a leaner government helps promote the reforms of both the state capital allocation system and the SOE management system.

In the reform toward mixed ownership, the corporate CPC committee must play a leading role in both the ownership transformation and business operation and participate in major decision-making of the company. It must use its special status in corporate governance to ensure preservation and increase state asset value and take part in corporate governance in more fields and at more levels as mixed ownership further develops. The following areas are especially important. First, the CPC committee must unite the thinking of the whole company on the reform. Rallying the entire company around its goals, strategies and management is its greatest responsibility. It should provide political and organizational guide to the SOE or its later form with mixed ownership to ensure full implementation of state policies in the company. This requires that corporate CPC organizations gain greater knowledge of the company, a broader vision of future development and better skills to adapt government policy to business reality. Second, the CPC committee must be a good corporate supervisor. Inadequate supervision over SOEs both from within and outside is a prevailing problem in China. Therefore, companies themselves have the obligation of supervision through internal personnel management and external oversight to make up for the institutional weakness of the corporate management system. It is indeed important for corporate CPC organizations to focus their efforts on the daily operation of the company, protect the interests of all parties and garner more drive for the company to grow faster and better. Third, the CPC committee should put the management staff under its supervision, a key role for CPC organizations in SOEs. It covers all aspects of the company's business operations. The CPC committee's decision-making power on economic incentives also helps bring corporate behaviors in line with policies from the central government. Companies are required to place corporate personnel management under CPC leadership to forestall disagreement on

policies. CPC organizations at all levels of the company are entitled by law to appoint or remove members of the management team under their supervision.

The higher efficiency of state capital allocation and greater vitality and competitiveness of reformed SOEs will help the Chinese economy enjoy sustained growth. It will bring more initiatives to the individuals and the business community and more sophistication and dynamism to the market economy with Chinese characteristics. It will also foster cooperation between state capital and private funds for win-win outcomes.

There is a story in the ancient Chinese classics of *the Water Margin* about Lin Chong, a military officer who was escorted to a distant prison to serve his terms under false charges. On his way, he met a rich landlord who heard about him and wanted to give him a treat. An acquaintance of the landlord named Hong got jealous and suggested having a boxing game with him to see who had better fighting skills. Lin did not agree until he was told that Hong was not a friend of the landlord. Soon after the fight started, Lin claimed defeat on reasons that he had shackles on and there was no way to win. After the landlord had them removed, Lin defeated Hong only with a couple of punches and drove him away. Like Lin in the story, SOEs and private businesses in China are going through reforms to break the shackles on them to display their “fighting skills.” This makes building a learner government a bigger imperative. It can be expected that both SOEs and private businesses will enjoy faster growth when the government cuts items for review and approval and only focuses on what truly falls within its jurisdiction.

Beijing, China

Yining Li

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# Theory

# Shifting Government Functions and Streamlining Administration—Policy Initiation, Reflection and Prospects



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## Policy Initiation: An Imperative to Stimulate the Market

The chapter focuses on the past and present context of the policy adopted by the State Council to streamline administration and delegate government power. It starts with a general background briefing on the period from 1978, when the reform and opening-up program started in China, to the leading-up of the 18th National Party Congress. Then, analysis is made on the factors behind the decision of the State Council to issue the policy after the 18th National Party Congress. The importance of building a leaner government has drawn more attention than ever before. Actions have been taken, and progress has been made. However, the initiative was not created by this administration. Such issues as “obstruction in the middle of policy implementation” also occurred in the trials during the 1980s. Administrative streamlining and power delegation were mentioned 134 times in documents issued by the State Council and its General Office, including 24 times in the leading-up to the 18th National Party Congress,<sup>1</sup> and 213 times by *the People’s Daily* (official newspaper of the Chinese Government), including 56 times on the eve of the 18th National Party Congress.<sup>2</sup> (see Table 1).

### I. Pilot reform of administrative streamlining and power delegation

The idea of a streamlining administration was raised in 1985 and 1993, well within the first two decades of the reform and opening-up (1978–1998). It was suggested in 1985 for sorting out relations between the government as an investor and SOEs to invigorate businesses, markets, research activities and the light industry and ultimately break the fetters of the planned economy for faster growth.

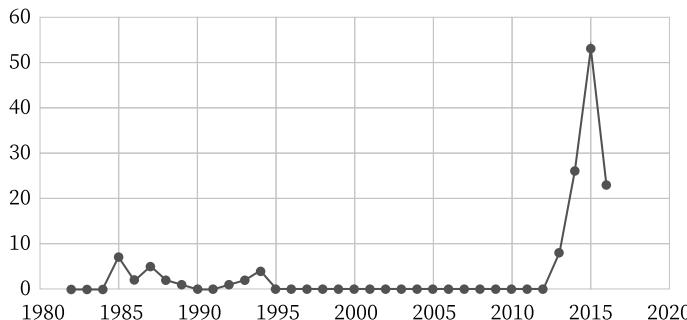
<sup>1</sup> Data source: <http://www.gov.cn/>.

<sup>2</sup> Data source: China Daily database.

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**Table 1** Number of documents on administrative streamlining and power delegation mentioned by the State Council



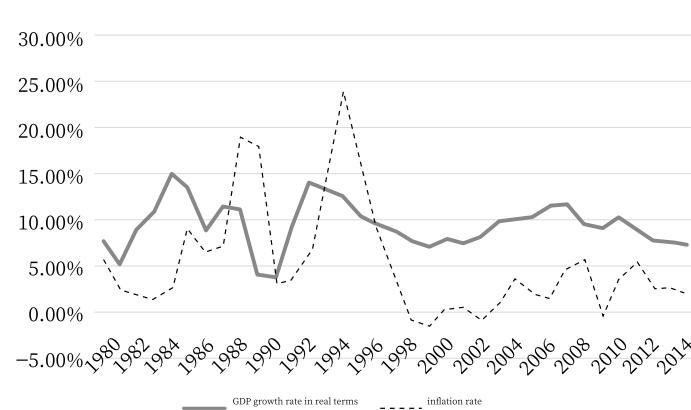
Data source China Economic Net (<http://en.ce.cn/>)

The State Economic Restructuring Commission issued the *Summary of the Symposium on the Urban Economic Restructuring Trial Reform* in May 1985. It said that by giving SOEs decision-making power over production plans, purchasing and product sales, the reform on streamlining administration and delegating government power would unleash the huge potential of SOEs. The People's Daily published an article stressing the importance of nurturing joint bodies of research institutes and enterprises and separating government administration from business operations. Following this guideline, local institutions with overseas business ties in Guangzhou opened a joint office in 1985, and the government of Laiwu, Shandong Province diverted a large number of officials to rural townships or service entities affiliated with the government in 1986 (which ended up in a doomed cycle for reasons to be discussed later).

Economists offered all kinds of solutions, such as improving the price regime with administrative streamlining (Guo, 1984), revitalization of traditional collectively owned enterprises (Shen, 1984), better relations between company headquarters and manufacturing plants (Yong, 1984), and removing obstacles in the middle of the reform (Huang, 1986). However, instead of stimulating growth, this round of cutting government power was followed by a GDP slowdown between 1985 and 1990 (see Table 2). The data do not mean that the efforts were made in vain since economic growth is impacted by a number of domestic and international factors. The reform in a sense has challenged or even changed the mindset of the Chinese people who had been influenced by the thinking of the planned economy and paves the way for more drastic SOE reforms.

GDP growth rate in real terms; inflation rate.

This round of reform drew full attention from the central and local governments, the academic community and the public. Efforts and reflections were made, and lessons must be gained. In a broader sense, the reform toward less government power has continued since 1978. In the transition from the economic system under which

**Table 2** GDP and CPI growth rate from 1980 to 2014

Data source China Economic Net (<http://en.ce.cn/>)

everything was tightly controlled to the one driven by the market, the government has been implementing various policies to loosen control and delegate power. They were accompanied by obstructions from the vested interests, as well as debates and concerns over the problems that the reform may entail. Despite the failed trial of Laiwu, which caused temporary flip-flops, SOE reforms and the WTO accession later brought the economy onto a new stable path.

## II. Renewal of the policy after the 18th National Party Congress

According to the *Plan on Institutional Reform and Functional Transformation* of the State Council approved by the 12<sup>th</sup> National People's Congress, items for administrative review and approval on investment, production and business activities must be cut or passed over to government agencies at lower levels. Items for qualification and credential review and certification must be reduced. A total of 117 items of administrative approval were removed or delegated as required by the No.19 Document of the State Council in 2013. Since then, the State Council has issued 110 documents on this subject.

There are four factors behind the decision to raise the importance of cutting government power to an unprecedented level.

### 1. It is an important tool in advancing reforms in an all-round manner.

The 18th CPC Central Committee decided to focus the economic reform on letting the market play a decisive role in resource allocation and remove long-standing obstacles. Cutting government power includes devolving the power from the central to the local governments and from the government to the market and streamlining complicated approval procedures for higher efficiency in business operations. It is an important measure to advance the reform to greater depths, broader areas and higher

levels. For example, a large number of SOEs and collectively owned companies were privatized in the 1990s, and many of the remaining ones were shifting to the joint-stock system. Going forward, the state capital monopoly in the hydropower industry will be further replaced by market competition. The power to control and manage SOEs has been steadily delegated from SASAC's local branches to the companies' management teams or the market. The problematic relations between the state as the investor and SOEs that run business on its behalf have been addressed step by step. In this way, more vitality will come back to SOEs.

## 2. It is mutually reinforcing with efforts to combat corruption.

The new administration is pushing hard to fight corruption by going after both "tigers" and "flies" (referring to both high- and low-ranking corrupt officials). The anti-corruption campaign can facilitate streamlining efforts, as the hard nuts to crack in cutting government power are those departments with vested interests who are reluctant to relinquish power. In return, a leaner government with less power will narrow the space for rent-seeking and sustain progress in building a cleaner government.

## 3. It is a perfect trigger for more market dynamism

The essence of cutting government power is to unleash the vitality of the Chinese economy. Since 2007, China has experienced a stock market crash, the global financial crisis, aging of the population and waning demographic and reform dividends. Since the 18th National Party Congress held in 2012, the anti-corruption campaign has made significant progress, and corruption dubbed the "economic lubricant" has been effectively crushed. The momentum of fighting corruption should be sustained despite weaker drive in the economy and less dynamism in the market. Cutting government power thus becomes a perfect tool to revitalize the economy and the market, while government efforts continue to combat corruption. It helps quicken the approval and launch of business projects, create development space for new business models and build synergy among the business, academic and research communities. Relations between the government and the market can thus become clearer, and the market will be under less undue government intervention. A new propeller for economic growth will be ignited.

### (1) Less government power serves the growth of small and micro businesses.

Micro, small and medium-sized businesses are the main victims of a myriad of administrative approvals and controls. Innovative in business ideas but weak in economic strengths and with no means to curry favor with higher authorities, these cash-strapped businesses have to bear huge costs in the project approval and financing phase. At the same time, traditional sectors in China are in transition with less-than-expected efficiency of resource allocation. Micro, small and medium-sized businesses can attract huge amounts of idle funds, quicken the commercialization of research results and create new business models and new markets. A leaner government will help promote their growth and ultimately the growth of the economy.

## (2) Less control will improve economic performance in many aspects

Streaming administration narrows government control over the market. According to Western economic classics, the government can only intervene where the market fails to play its role, and the market will reach its optimum efficiency when a few simple conditions are met (at the cost of fairness in some cases). Government control holds back economic growth and lowers all-factor productivity in a number of ways. Analyzing low economic performance caused by excessive control will help readers understand why administrative streamlining will bring high performance. The manifestation of government control and its effects are as follows.

First, state monopoly and industrial control discourage companies with lower cost, innovative technologies and high productivity from entering the market. According to economic theory, government control removes the threat from potential competitors in favor of companies in monopoly. This practice leads to lower industrial efficiency, higher profits for the monopoly and more net losses on social welfare. Less control will help the market play a better role in the economy and curb the net losses on social welfare. Mobile ride hailing apps are a good example. The traditional taxi industry is not fully market-driven, as market entry and pricing are controlled by the government, whereas the “premier cars” model on the apps makes travel more convenient and raises the utilization rate of private vehicles due to better allocation of resources. More importantly, it lets the market play a decisive role. The fares are determined by the market. It increases during peak hours and at midnight when the demand is high or the supply is low or under bad weather, such as rainstorms, when the demand-supply balance is seriously twisted. A higher price encourages supply and suppresses demand. That said, the government should also pay attention to addressing issues such as taxation for this new business model and its market regulation.

Second, government control hampers investment utilization and business operations. Market regulatory offices are immediate contacting bodies for businesses. However, their efficiency is extremely low, as applicants have to secure prior consent of at least three offices and sometimes over 10 offices within an agency for approval of any single item. Low efficiency in government approval translates into low efficiency in project commencement and business operation. As businesses and individuals obtain their impression of the government mostly from the primary-level offices they deal with, less government control will help build an image of the CPC and the government as efficient organizations.

## 4. This helps increase government credibility

Power is exclusive and expansive by nature. If unchecked, administrative discretion will further expand, and approval and control will be tightened in more areas for rent-seeking purposes. More power brings more responsibilities. When the government overreaches itself in exercising power, it will have to take more responsibilities than it currently fulfills and build an impression among the public that the government should take care of everything since everything is under its control. A government

with too much power becomes less credible. Once anything goes wrong, the public will blame the government without rational thinking or self-reflection.

In contrast, streamlining government procedures and transferring power to the market will improve public satisfaction. Credibility is a key bedrock of the legitimacy of a ruling party. It is built up by public opinion and at the core is the level of public satisfaction.

## **Policy Reflection: Issues and Solutions Concerning Power Delegation, Improved Regulation and Better Services**

The chapter analyzes the journey covered by the reform of cutting government power in three phases, reflects on the challenges facing the reform and provides possible solutions. The first phase was from 2013 up to the State Council reform teleconference in May 2015, when the government took the first few steps in the principle of “crossing the river by feeling the stones”. The second phase was between the two reform teleconferences in 2015 and 2016 when the streamlining administration was combined with improved regulation. The third phase started in May 2016, when “better service” was added to the reform.

- I. The government only cut power with low value in the initial phase and did not build enough momentum for the reform.

Between 2013 and 2014, government agencies under the State Council began removing and delegating items for administrative approval, sorting out items requiring nongovernmental review and approval, and revoking items of performance evaluation and awards and professional qualification review and accreditation. The State Council also set up a leading group on transforming government functions. For example, the State Administration of Taxation revoked or streamlined tax-related statements. The State Energy Administration moved wind and photovoltaic projects from the category of “review and approval” to that of “registration for record keeping”. The Ministry of Science and Technology delegated the power of approval to set up science and technology awards.

A number of challenges surfaced during the reform. They include the following:

First, the government only cut powers of less value and kept those with big room for rent-seeking in its own hands. Many revoked items were peripheral or rarely heard of. During a meeting with non-communist party personages in July 2014, General Secretary Xi Jinping called for advancing the reform on the investment system and cutting more substantive power of the government. The general public will not be satisfied unless reform measures touch the underlying interests of the government and cut more powers of higher value.

Second, the enthusiasm gradually waned from the central to the local governments in administrative streamlining. After the reform in 2013 and 2014, the State Council abolished and devolved quite a number of items for administrative approval, but

progress was slow for some provinces. Some municipal governments even failed to function after streamlining. The reform there encountered huge reluctance and was stalled. In some places, one item was divided into several subitems only to be cut later to meet the target set by the State Council. In this way, the number of items seemed to be reduced, but approval procedures remained complicated.

Third, many items require approval from more than one government agency, but these agencies failed to move in tandem in cutting power. Applicants had to go to government at a higher level to complete all required procedures because power cuts in one agency did not bring corresponding policy adjustments to other related agencies. The complexity diluted the effects of the reform.

Fourth, some government agencies at lower levels were unable to take over approval power devolved from the higher authorities. For example, when the review and approval power was passed from the municipal down to the district-level government, there were no professionally qualified staff in the district-level offices who could handle the delegated items. Ultimately, the power had to return to the municipal government.

In addressing these challenges, the State Council gradually developed a guideline of “delegating power, strengthening regulation and improving service”.

## II. Power delegation and tightened regulation should go hand in hand

At the Teleconference on Streamlining Administration Procedures and Cutting Red Tape held by the State Council on 12 May 2015, the idea of combining power delegation with strengthened regulation was added to the reform. Progress was reviewed on the reform. Over the previous two years, State Council agencies canceled or delegated administrative approval power for 537 items. The number of investment projects subject to central government approval was down by 76%. All overseas investment projects except for a few exceptional cases could proceed without administrative approval. For companies seeking registration, they could have their business licenses issued before obtaining administrative permits; 85% of the matters that once needed prior approval only required ex post approval; with regard to capital registration, the paid-in capital scheme was replaced with a pledged capital scheme; and annual business inspections were canceled in favor of annual information disclosure. The number of qualification accreditation and performance appraisals was cut dramatically. At the central government level, 420 administrative fees and government-managed funds were abolished or reduced, relieving businesses and individuals of their financial burden by nearly RMB100 billion every year. Some provinces moved even faster in this regard, canceling or delegating over half of the administrative approval power. Some provincial non-administrative approvals were cancelled.

The author is of the view that the aim of the State Council’s decision of combining power delegation with strengthened regulation was to further streamline the government while preventing market disorder. Administrative streamlining and tightened regulation are mutually reinforcing. A leaner government will focus more on proper regulation. Only when fake products, unlawful merchants and unapproved projects are penalized can the government protect the interests of the public in a more liberalized market. The essence lies in what kind of power should be canceled, what should

be further regulated, how to cut red tape and how to strengthen oversight. The author believes that there should be less direct government support to the photovoltaic industry and others to avoid overcapacity. At the same time, policy-based market access control should be relaxed. New business models should be encouraged with tailor-made implementing rules on civil and commercial law and tax codes. Taking the example of the premier car hailing market, cutting administrative approval means revoking the franchise right of the taxi companies. It is welcomed by the market. However, this sector involves the interests of vendors, drivers and passengers, and a lack of regulation will lead to a higher probability of criminal acts. At issue is what kind of mechanism (including legal provisions and industrial rules) is needed to ensure that the market operators protect the interests of both passengers and drivers and improve supervision over their behaviors. The design of the mechanism should also take in more public views instead of those of the government alone. Views of the vendors, consumers and taxi drivers should all be taken into consideration.

To make the reform successful, the academic community suggested that the government draw a power list and a responsibility list. The suggested was taken by the government. Trials have been conducted by the National Development and Reform Commission, the Ministry of Civil Affairs, the Ministry of Justice, the Ministry of Culture, the General Administration of Customs, the General Administration of Taxation and the China Securities Regulatory Commission since 28 December 2015. A negative list should also be drawn that includes production or investment items with strong negative externalities. Although the government has been exercising tight regulation over these items, a negative list is highly necessary. The three lists testify to the resolve of the government to put its power and responsibilities under an institutional and regulatory framework, since a well-established system is needed to produce a lasting effect of the reform. A spelled-out list cuts the discretion of government agencies by preventing the government, to some extent, from making arbitrary intervention in the market or seeking rent from businesses.

### III. Improving government service aims to promote mass innovation and entrepreneurship and unleash market potential

The State Council held a teleconference on advancing the reform and improving public services on 9 May 2016. Compared with 2015, this conference stressed the importance of “improved service”. Major achievements of the reform were summarized, including further reduction of items for administrative review and approval, integration of the business license, the organization code certificate, and the certificate of taxation registration into one document for business registration as well as one social credit code for each license. Items under central government pricing were cut by 80% to ensure better market roles. To lower the burden on companies, the government made more reductions on tax and general charges, adopted a series of taxation incentives, cancelled most of the items for intermediary services of administrative review and approval, and cancelled, suspended or reduced a large number of administrative charges and government-run funds.

Improving service is the key to a vibrant market. The initiative of mass entrepreneurship and innovation launched by the State Council aims to find new

growth drivers of the Chinese economy. As cutting red tape aims to create a favorable environment for the initiative, the government needs to emphasize better service. It includes the following:

First, efforts should be made to provide an enabling environment for new entrepreneurs and, more importantly, cultivating the innovative abilities of big companies. Entrepreneurship and innovation are two key words of equal importance in this initiative. Therefore, the government must refrain from putting entrepreneurship before innovation in allocating human resources and funding. There are now a large number of industrial parks for start-ups and young entrepreneurs and incubators and joint platforms for commercializing research results. They have given a strong boost to start-ups, young entrepreneurs and the new economy. These platforms are important sources for innovation, but in reality, their innovation is low-cost based on low competitiveness and growth potential, and few research findings meet the criteria for commercialization.

For example, there are a number of university students' start-up projects in a young entrepreneurship park, such as postcards that reflect images in sunlight, university bicycle share programs, mobile phone apps, and WeChat businesses, which are popular among WeChat users. However, lack of funding and professional developers has kept the innovation at a low technology level and consequently held back the growth potential of the start-ups, let alone the prospect of becoming business giants. Even worse, in a technology incubator in Guangdong Province, a government-university joint platform on nanometers did nothing to commercialize the patented technologies transferred from the university after getting RMB70 million of grant from the provincial government for "commercializing the research results" it claimed. Too many such incubators and joint platforms originally intended for nurturing new growth drivers may eventually create bubbles and suck up funding originally reserved for traditional industries. What we need is high-tech products that are internationally competitive and world-class innovations that drive the global economy. Baidu and a few other companies that are large in size but weak in innovative capabilities are under criticism for relying solely on trade barriers and market restrictions for survival instead of creating new business models or products. In implementing the policy of "improving service", the government should give more support to R&D in incumbent companies instead of investing too much in incubators and technology commercialization joint platforms.

Second, efforts are required to tailor services to the needs of different industries.<sup>3</sup> The satisfaction rate varies among industrial sectors on cutting red tape. The satisfaction rate on the reform to cancel or delegate administrative approval items was 9.2% in the hospitality and catering industry, much higher than the 5.9% average. The highest dissatisfaction rate was on the reform to cut down fees and charges, which was 15.6% in the wholesale and retail sector. The lowest dissatisfaction rate was 5.0% among other industries.

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<sup>3</sup> Data source: <http://www.gov.cn>.

## Policy Prospects: Moving from the Old to the New Equilibrium

The following are three possible future scenarios for the reform based on historical experience.

- The government sees its functions fully transformed and its roles clearly defined. A new equilibrium is created featuring a more credible government, more vibrant businesses, greater sense of gains for the public and a booming economy.
- The cancellation of low-value administrative power brings some vitality to the economy but fails to lift it from the old equilibrium. The economy continues to run on the old track.
- The economy is plunged into a doomed cycle whereby power delegation leads to market disorder, which, in turn, leads to tighter control.

Efforts must be made to avoid the third scenario, steer away from the second one and strive for the first.

### I. How to avoid the doomed cycle.

Here is the case of Laiwu, Shandong Province. In 1986, Laiwu became the first county-level municipality in China to carry out the reform on streamlining administrative power to solve the issue of fragmentation or lack of coordination between central government agencies and local authorities. Within two years, it devolved all the staff, funding and property of the municipal industrial and commercial administration, hospital, food authorities, credit cooperatives, traffic bureau and police station to townships. Despite power delegation, the municipal government continued to exercise responsibilities over township offices. Township offices had to share revenue surplus with the municipal government and could retain the balance for future use, but they would receive no subsidy from the municipal government when spending more than it collected. The reform drastically stimulated the economy at the township level with the creation of a large number of township enterprises and all sorts of streamlining efforts. It was later commended by the minister of civil affairs and the governor of Shandong Province. Its experience was replicated in other parts of the country and even appeared in *People Daily*, the official newspaper of the central government.

Around the 1990s, the new central leadership suspended the reform across China out of concern for social stability. In Laiwu, big agencies at the township level with strong revenue-generating capabilities were suddenly taken over by the provincial and municipal governments, with only government leaders' statements instead of official documents in some cases. The cash-strapped township governments were unable to hire professional staff, which seriously affected the competency of their administrative functions.

The author offers the following policy suggestions based on the experience of Laiwu and the current reality in China.

## 1. Higher professional competency of civil servants at the community level is much needed

In the case of Laiwu, township authorities such as the industrial and commercial administration and the traffic bureau failed to exercise the power delegated from above due to a lack of professional staff. The current reform also exposes the low level of professionalism of local government employees. The success of the reform hinges upon the professional competency of civil servants at the community level. This can be improved in three aspects.

First, efforts must be made to prevent mismatch of human resources in the context of rising size of professionals.

In the past, it was hard for government offices at the community level to have professional staff partly because they were in short supply. As the applicants with higher educational backgrounds were limited in number, community-level offices had to remove professional criteria when hiring employees. Things have changed in recent years with a growing number of universities and an abundant supply of professional graduates. Efforts should therefore be made to avoid mismatch of human resources by encouraging more students to enroll in less hot disciplines. It will help build a talent pool for the subjects concerned and prevent fluctuations in the number of professionals in specific areas that may take place years after the demand shift in the labor market. For example, life science and genetic engineering were very hot ten years ago and attracted more students than the market could manage. In recent years, the much sought-after programs of economics and finance have raised the concern that years later, there will be too many graduates flocking into sectors with limited human resource needs and too few graduates for sectors with a much bigger market demand. The publicity and educational authorities must develop a greater sense of urgency to get things under control, such as correcting the ill-informed expectation of the public on labor market demand and forestall problems that information asymmetry may entail.

Second, government offices at the community level should try their best to meet the expectations of professionals.

Generally, people with professional skills regard civil service as a good career choice, and many of them would take such jobs. However, few of them want to work at township offices. Better benefits for government employees there and more chance for them to move to urban government agencies will help meet the career expectations of the professionals.

Third, there should be fewer barriers from the heads of the community-level agencies.

The heads of these agencies have big discretion over the selection of staff, which gives them much room for rent seeking. As a result, who to hire becomes a way of maximizing their personal gains. More applicants and fiercer competition will only increase the room for rent-seeking. This explains why there are more incompetent but well-connected people than professional staff in these agencies. It is common to find a financial desk officer without any financial training background and agricultural officials who know little about farming. The practice is so widespread