POLITICAL, ECONOMIC AND SOCIAL RATIONALE OF WELFARE AND SOCIAL SECURITY
A COMPARATIVE ANALYSIS OF MALAYSIA AND CHINA(1)

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Abstract

Despite common beliefs regarding the damaging side effects of income redistribution, equity and efficiency can coexist. Institutional stability depends on the consensus established between the government and the population. A relatively egalitarian distribution of resources is conducive to political stability and economic development. By contrast, long-term economic development can be undermined by skewed wealth distribution. Equity and efficiency may be compatible under a growth-oriented government, but not so under a government that focuses on its short-term survival strategies. A welfare system becomes efficient if the short-term political goals do not undermine the long-run goals of economic development. The cases of China and Malaysia are further compared and analyzed in this theoretical framework.

Introduction

It has become apparent in recent years that fast-track economic reform in China has generated an immediate urgency to create a safety-valve mechanism to cope with public stress or frustration resulting from massive unemployment, rapidly aging population, and widening gap

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between the rich and poor in social stratification. The attempts made to establish a social security system aim at ensuring social order and stability in China.

China is now in such a critical transition that the social organizational structure upon which the traditional social protection system has been based is falling apart, whereas a new social organizational structure has yet to take place to meet the needs for a new social security system. As Dreze and Sen (1991) point out, the Chinese government's success during the pre-reform period in enhancing the quality of life was associated with inefficiencies and constraints in the economy and "a sever neglect of the market." In the reform period, "there is evidence that there has been some set-back in the sharp decline of mortality rates and related features of the quality of life… and that this may be connected with some withdrawal from public provisioning" (Dreze and Sen, 1991: p. 30). As the market plays an increasingly important role at the cost of central control and as traditional social protection breaks down, a new integrative mechanism is required for continued success of its economic reform.

Socio-economic theories consider the welfare state a response to both industrialization and democratization (Wilensky, 1975; Flora, 1981; Pierson, 1991). Both processes alter fundamental social structures and create the necessity for a mechanism to integrate the society. The primary role of the welfare state is to build the necessary social cohesion for sustained economic development. To secure the participation of all socio-economic classes in the productive process, the government needs to integrate the population. To that extent, the two functions of the welfare state – resource redistribution and social cohesion – are complimentary rather than antithetical.

Before we explore China's efforts to establish a modern welfare state, we should understand why and how welfare programs intervene in the redistribution of resources and whether they can result in desired policy outcomes. In that regard, this paper deals with a broader issue than other papers in this collection. What we are concerned about are not only social security policies but also various kinds of welfare transfer. The second section of this essay discusses the political and social rationale for social security and welfare systems. The third section examines the consequences of wealth redistribution on economic growth. The fourth section analyses the difference between welfare programs that have short-run political consequences and those that have long-run effects on economic growth. The fifth section summarizes the Malaysian experience with social welfare reforms and their implications for China. The sixth section focuses on the emergence of a new social security and welfare system in China.

The Raison d'Être of the Welfare State: An Overview

Social security and welfare transfers are only some of the many mechanisms for redistributing resources. The welfare state as an institutional framework is at the core of the interaction between economic growth and economic equity, which reflects social justice as well (Baldassari and Piga, 1996: pp. 257-258).(2) Normatively, the system per se of social security can be considered a public good. The market would not provide the appropriate level of social security for public consumption because of the problems involving overlapping generation incentives. In this connection, it is also assumed that the market will fail to achieve socially optional income distribution (Dilnot, 1989: p. 5). Governments can adopt a variety of actions to reduce poverty and disparity. In this perspective, a government is seen as the provider of a public good to correct market failures. In this essay, we focus on the incentive of the government to provide this public good as a means of promoting a cause upon which its tenure of office is pivoted.

The welfare state as an institutional framework was initially established to build up consensus within the population by way of redistributing resources. It remains a formidable task to define the term "welfare state," although welfare programs have been in existence since the nineteenth century. A variety of elaborate programs by government and non-profit organizations fall under this category. In its narrowest definition, the phrase "welfare state" denotes specific policies and services provided by the state, which usually exclude educational and military expenditures as well as public investments.(3) In a broader sense, "welfare state" refers to either a specific type of polity, a form of the state or a certain type of society (Pierson, 1991: p. 7). Despite the popular view that welfare payments mainly assist the poor, these payments are only a small portion of government transfers. Thus, in many cases the term "social security spending" is preferred to "welfare state" so that the role of social security in maintaining a minimum income level can be delineated (Pampel and Williamson, 1988: p. 16).(4)

The core of the western welfare state has been political and social security, as well as equality. In the modern welfare state, social security has been associated with the expansion of social rights and comprehensive social citizenship. Both elements are associated with social inclusion and policies. The social welfare state distributes either direct funds or services in-kind to secure the working class from such contingencies as involuntary unemployment, sickness and injuries, maternal leaves, and old age retirement.

The basic assumption of this study is that governments use welfare state programs to integrate segments of the population into social citizenship. Thus, under the present theoretical framework, the most critical function of the welfare state would be to protect the political system against disruptive changes. Political instability is often the outcome of an unequal distribution of economic and political power within the society. As welfare institutions intervene and alter the original allocation of resources in the society, governments are able to mitigate social grievances and to promote political stability, interfering with the efficient but often socially unacceptable distribution of income in the market (Scully, 1991: p. 200).

We can distinguish three primary goals of welfare programs: redistribution, efficiency and social cohesion in the society. Redistribution targets the promotion of equality or social justice. It is presumed that the state intervenes in the process of redistributing resources. Ironically, the quest for social security originates in the liberal arguments for individual freedom and limited action by the state. However, it is only the state that can provide social security and welfare programs, as the state is equipped with institutional mechanisms in modern society to deal with the demands for entitlements. States have the ultimate authority and power to ensure redistribution.(5)

The problems for the welfare expenditures arise from the supply-side. For instance, who is going to bear the costs? At what point do these costs produce net benefit to the society? Does the welfare state lead to moral hazard and free riding? In answering all these questions, what remains critical, however, is that the welfare state must be based upon a socially defined conception of what amount of welfare is optimal based upon social consensus (Offe, 1994:pp. 87-90).

Finally, the goal of efficiency becomes pertinent, because of market imperfections (e.g., adverse selection and externalities), while social unity (i.e., consensus building) is one of the primary objectives of the welfare state for social integration. This aspect of the welfare state remains secondary in the literature, although it deserves further exploration as a source of positive externalities of government intervention.

Even though inefficiencies may arise from the price discrimination process (redistribution includes different prices to different segments of the population and may create disincentives), there is no substantive trade-off between redistribution and the other goals of the welfare state (Goodin and Le Grand, 1987). The debate of equity (redistribution of resources to reduce inequalities of wealth) vs. efficiency (maximum production given available resources) remains an important issue for economic theory, since Kuznets (1955) and Kaldor (1956) reintroduced the topic in the mid-1950s.(6) For any modern industrialized state, the relationship of economic efficiency and social equity touches upon the nature of political and economic institutions.

Institutional political stability depends on the consensus established between the government and the population (North and Weingast, 1989; North, 1990). A relatively egalitarian distribution of resources is conducive to political stability and economic development. By contrast, income inequality can be erosive to the stability of the political regime. Sustained economic development can be undermined by a severely unequal distribution of income. For instance, Malaysia's New Economic Policy (NEP) is an informative illustration of using welfare transfers to reduce income inequality among the three ethnic groups and to maintain regime stability in the long run.

The relationship between equity and efficiency enhances the argument that resource redistribution and political consensus building are compatible as well. The objective of redistributing resources is to avoid political violence caused by economic inequality. In this context social cohesion implies a core of values, perceptions and beliefs shared by a critical mass of the population. These values permeate various ethnic, social, religious or demographic groups that may divide the society. By enhancing political stability, welfare spending indirectly affects the level of economic growth.(7)

The Economic Significance of Income Inequality

Economists choose to base their models on the political mechanisms of income distribution and economic growth, assuming democratic processes in which the median voter determines the tax rate. Intuitively, when the decisive voter is poor relative to the average voter, he faces a relatively low opportunity cost of redistribution through tax prices. Consequently, if the mean income is above the median income, a majority of voters can win a redistribution of income from the rich to the poor. As shown by various economists, inequality tends to be positively associated with the level of taxation and redistribution (Romer, 1975; Roberts, 1977; Meltzer, 1981).

Using this rationality as their conceptual foundation, Alesina and Rodrik (1994), Persson and Tabellini (1994) and Perotti (1993) all analyze the effects of income distribution on growth through the channel of a public tax-collecting sector, which is perceived to have some consequences for growth in terms of either public investment in production services or simply through redistribution.(8) The key assumption for all of these models is the median voter theorem, in which the median-voter determines a tax rate and a balanced budget, and thus affects economic growth through the public sector's inputs in the marketplace. In this process, the political mechanism and the economic structure are integrated.

Alesina and Rodrik (1994) predict that the greater the inequality of wealth and income, the higher the rate of taxation and lower the rate of growth. The key feature of their model is that individuals differ in their factor endowments of capital and labor. Growth is driven by the expansion of the capital stock, with the aggregate production function as linearly homogeneous in capital, and by productive government services financed by a tax on capital. As government services are productive, a small tax on capital leads to the provision of the public good for the benefit of all. However, different individual endowments of capital and labor imply that individuals have different ideal rates of taxation. An individual whose income completely derives from capital returns prefers a tax rate on capital that maximizes the economy's growth rate. Other agents prefer a higher tax, with a subsequent lower growth rate for the economy. The lower an agent's relative capital income, the higher his ideal tax rate and the lower his ideal growth rate. When the median voter theorem is applied, the theoretical implication is that the worse the median voter is endowed with capital, the higher the tax rate and the lower the growth rate. As the model specifies that the redistribution of income is monotonically and negatively related to growth, income inequality is predicted to have an adverse impact on the subsequent growth rate.

Persson and Tabellini (1994) also predict that higher inequality is associated with lower growth. The inverse relationship between income inequality and growth in their model is more immediate than in that of Alesina and Rodrik (1994). The individual born poorer or richer than average has, respectively, less or more capital than the average person. Thus, individual preferences for redistribution can be ranked by their idiosyncratic endowment. The equilibrium political variable here is redistribution represented in the value preferred by the median voter born with the median endowment. A better endowed median voter is in favor of relatively less redistribution. As redistribution monotonically depresses growth, income inequality, as represented by a poorly endowed median voter, will lead to relatively high income redistribution, in turn causing a decrease in growth rates.

Perotti (1993) distinguishes between the role played by the median voter in a poor country from that in a rich country. In a poor country, growth is engendered by the upper income class' investment in human capital. The two requisite conditions for growth in a poor country are that the upper income class is initially rich enough, and that the middle income class is close enough to the upper income class not to have an incentive to tax the rich heavily, understanding that such taxation would prevent the rich from investing in human capital. A rich country faces just the opposite problem, as continued growth in such a nation depends on the low income class investing in human capital. Accordingly, the two conditions for growth in developed countries are that the low income class is not initially too poor and that the middle income class is close enough to the low income class so that sufficient income redistribution would help the low income class invest in its human capital. Indeed, the median voter in a rich country trades off more redistribution than presently desired for a higher per capita income in the future, possible only if the low income class can invest today.

In addition to the above connection between growth and income distribution through fiscal policies such as taxation, the linkage between the two has also been established through various *sociopolitical instability* (*SPI*) models. Some scholars argue that income inequality causes political instability when the poor expropriate the wealth of the rich through informal and illegal means. This will result in further deterioration of property rights protection and a rise in non-productive activities to obtain income (for instance, through illegal means such as burglary and armed robbery) (Zak, 1997; Alesina, 1996; Gupta, 1990; Venieris, 1986).

When development does not benefit the low-income classes, their frustration grows and their opportunity cost of engaging in non-productive means to make a living becomes smaller. Therefore, as the distribution of wealth widens, sociopolitical instability increases. Sociopolitical instability caused by income inequality adversely affects growth for three reasons, as summed up by Zak (1997). First, SPI may reduce growth in terms of income redistribution policies implemented to alleviate sociopolitical instability; second, the government may try to coerce the opposition, resulting in the diversion of resources from productive sectors; third, SPI may lead to the downfall of the current government, adding to political uncertainty. The empirical results of Alesina and Perotti (1994) demonstrate that income inequality causes sociopolitical instability, leading to a reduction in investment.

A third approach to income distribution and growth, as summarized by Perotti (1996), focuses on income distribution and investment, assuming that agents borrow to improve their future position. Galor and Zeira (1993) assume that investment in education will enhance future growth. If the constraints on borrowing are small, people can borrow in the present to invest in future gains through education. But if it is difficult to borrow for education, those without financial resources must forego education, trapped in poverty for generations. Therefore, given sufficiently large budget constraints on education investment, income distribution will matter a great deal in promoting or inhibiting growth, as leaving a large portion of society uneducated results in a shortage of the human capital necessary for continued growth. Furthermore, Galor and Zhang (1993) extend the study of education and income distribution to that of fertility. Given the distribution of income, a higher fertility rate decreases the average resources for each child's education; with budget constraints, investment in human capital will be further reduced. Relatively unequal income distribution, combined with high fertility rates, thus leads to low investment in education.

A fourth approach endogenizes the fertility decision, which is subject to effects from both income and substitution. The income effect refers to the fact that when income increases, the demand for children increases as well, thus resulting in an increase in fertility; the substitution effect implies that when income increases, the opportunity cost for having more children increases, thus leading to a dampening effect on fertility. For the extremely low-income classes, the income effect dominates the substitution effect, as the opportunity cost foregone as the consequence of having children is low. Thus a small increase in human capital leads to a general increase in children. For high-income classes, the substitution effect dominates the income effect, as the opportunity cost of having additional children is relatively large. In this context, children are "inferior" goods for high-income classes, implying that a human capital increase will lead to fewer children. Redistribution from the rich to the poor will likely increase the opportunity cost of having children for the low-income group, when appropriately large redistributed wealth translates into investment in human capital. Therefore, income redistribution may induce those who cannot afford education to invest in human capital; the increase in human capital in the society will then lead to economic growth.(9) It should be noted that even though the argument based upon the income-fertility nexus appears to have the same implication as those based upon the income-tax or income-SPI nexus (that is, equal income distribution leads to growth), the latter two cases treat income distribution as the initial condition, while the former treats it as the equilibrium state. In other words, income redistribution as a means of reducing income inequality is negatively associated with growth in the income-tax and income-SPI models, but it is positively associated with growth in the income-fertility model.

Political and Economic Goals of Social Security and Welfare

With some exceptions, equity and efficiency are compatible under a government that is growth-oriented, but not so under a government that identifies its short-term survival as the highest priority.(10) The former government is driven by a long-run development goal that requires shared economic growth among a wide range of social groups. The latter government utilizes social security and welfare to satisfy social and political groups vital for its survival. While the former government ensures relatively equal distribution of wealth, the latter government may increase or decrease wealth inequality, dependent upon who the most important social groups are. When political and economic goals are consistent, equity and efficiency can reinforce each other in the long-run.

Welfare states that are sustainable and consistent in their political and economic goals can both reduce income inequality and enhance the long-term stability of the political system. In the short-term, welfare programs reduce political instability, thus helping the government maintain office. Dependent upon whether the government is growth-oriented or survival-oriented (in a short-term sense), redistribution will not necessarily reduce income inequality, even though it does reduce political violence. Governments may choose to subsidize social and political groups essential for their survival, driven by their short-term interest in remaining in power. In this case, inequality may actually increase among various social groups.

It is well established that political stability and economic growth are interconnected (Barro, 1991; Alesina, 1992; Chen, 1996; Feng, 1997). However, few researchers connect income distribution with political stability. Muller's (1985) article deals with regime type, income inequality and political violence. He concludes that there is a positive relationship between political instability and income inequality. His results confirm that a country cannot emphasize economic growth, while ignoring the macro-economic effects of income inequality. Moreover, intermediary regimes are prone to political violence compared to those that have either low or high levels of political violence (Muller, 1985: p. 60).

The critical question is whether income inequality causes political violence. If income inequality does not have any significant effect on the level of political violence, then no country should consider income inequality a political issue.(11) The relationships between political violence, income distribution and welfare expenditures are critical since they determine the extent to which income inequality causes political violence. There is no indication that extreme inequality is the necessary and sufficient condition for political violence. What is critical is how people perceive and measure their living standards with their conceptions of how life should be.

Economic transformation changes people's conception about living, thus increasing the likelihood of political violence. Similarly, economic growth itself is not sufficient to inhibit civil violence if a large number of people believe that their living standards are on the decline (Davies, 1962; Briton, 1938; Chong, 1991: pp. 236-237). A rapidly developing country like China or Malaysia faces a great challenge in balancing its political goal of stability and economic goal of sustainable growth. Social security and welfare programs can play an important role to achieve this balance.

A variety of activities – from protests and strikes to rioting and revolutions – determine the degree of political violence and the survivability of a political system. For any government, controlling political instability remains a practical goal. Aside from the eradication of the causes of political instability, it is commonplace among all types of political systems to mobilize the population around institutions that are acceptable to either a significant majority or essential segments of the population. Welfare institutions have been created as a response to the likelihood of political violence (Germany) or as an effort to unite the whole population in the common effort of warfare (England). Thus, welfare programs constitute an effort by states to build social cohesion and reduce the possibility of political violence.

If we accept the argument that welfare programs reflect an attempt to create social cohesion, along with redistributing resources, then we can explore how the state uses its programs to promote sustained economic growth. Political goals of income distribution and political stability are strongly related to the level of economic development for a growth-oriented government. As the literature indicates, each variable is a critical part of a larger puzzle regarding the choices that a government can make.

Thus, when redistribution targets certain groups that can improve the quality of investment, it should affect economic growth positively. Obviously, institutions in the welfare state should adjust themselves to the existing economic and social structures so as to improve efficiency. The evolution of institutions in developed countries indicates that the process of initially empowering the middle class started early in the process of economic development (Ames, 1977; North, 1989; Miller, 1989; Downing, 1988). Redistribution that supports the middle class or segments of the middle class is also beneficial to support the political regime. Political stability may imply that the government needs to strike bargains with groups that are essential to maintaining the political coalition. In the short term, welfare transfers can be used as a means to obstruct political opposition and avert political instability, even though it may accentuate an unequal distribution of income.

In this scenario, governments redistribute resources to these coalitions that are essential for their political survival. By doing so, however, the governments may accentuate the existing levels of income inequality. As is analyzed earlier, the population is more prone to revolt or express dissatisfaction during an economic transition. Thus, the impact of income inequality on political instability can be stronger for the middle range economies that are industrializing. On the one hand, they need to build welfare programs to prevent significant threats to political instability. On the other, they have to assure relatively equal wealth distribution from the point of view of a long-run development strategy.

The Case of Malaysia

What happened in Malaysia could be a lesson for China in its transitional economy. Until 1969, when the worst ethnically related civil violence occurred, Malaysia had been relatively stable and peaceful. The ethnic violence that erupted in Malaysia was related to the dissatisfaction of the local Malays with their lower economic status as compared to that of the ethnic Chinese and even the Indians. The critical socioeconomic element in Malaysia is the disparity between political and economic status, which stems from not only the ethnic division, but also the division between rural and urban populations. This unique characteristic of Malaysian politics led to welfare programs that extensively targeted income redistribution as a way to mitigate political violence and to increase long-run economic growth.

Malaysia remains an interesting case for the dual goals of political stability and economic growth. Its population primarily consists of Malays (55 percent), Chinese (35 percent), and Indian (10 percent).(12) Among the three ethnic groups, Malays tend to live in the rural area. Chinese are mostly urban residents with incomes twice as large as the Malays. Indians follow in between the Chinese and the Malays, many of them working as rubber tappers. Although the Chinese are by far the wealthiest group, politically the Malays have control. The political stability of Malaysia depends on the balance among the three ethnic groups and particularly between the Chinese and the Malays (Root, 1996: pp. 70-71).

It should be noted that historically, peasant revolutions were far more intense and broader in scope than strikes or riots in cities. In developing countries, the working class is very small. Hence it is the rural population whose revolt threatens the government. For developing countries that are in a transitional phase of their socio-economic development, unequal distribution of resources between the rural and the urban populations can increase the extent to which the political system is threatened. Such a perspective has broad and important implications for countries like Malaysia and China.

The extremely slow process of income distribution led to racial conflicts on May 13, 1969 and the preexisting formula for peaceful co-habitation of the three ethnic groups collapsed. Riots started in Kuala Lumpur when Malays demanded the expulsion of non-Malays.(13) The Malay political leaders (including the current Prime Minister Mahatir) argued that economic and political equity among the three ethnic groups was necessary for harmony to be re-established. In other words, Malays demanded to become active economic actors as well (Root, 1996: pp. 71-72).

Following that period, the Malaysian government reorganized the economic and political foundations of the country, which aimed at eradicating ethnic tensions. The Malay government implemented the New Economic Policy (NEP), a plan that operated from 1971 through 1990 with a dual goal: the eradication of poverty among all Malays and a reduction in the economic disparities among the ethnic groups.

Based on the solid foundations of solidarity between the private and public sectors, NEP was a rather successful program. An overview of the NEP program shows that it benefited the rural and poor segments of the population (Malay in its majority). There are three primary channels of redistribution that the Malaysian government followed: education, health and welfare transfers. The combined federal expenditures per capita on education, health and pensions were highest in rural regions where the Malays live, and lowest in the area of Selangor where most of the Chinese reside (Meerman, 1979: p. 7). Overall, NEP's policies were effective in redistributing resources and improving the quality of human capital, which had significant ramifications for economic growth and development (Hammer, 1995: pp. 540-541).

In a dynamic sense, the unequal distribution of income between the rural and urban sectors leads to a continuous movement of the population towards the urban areas. This trend has both political and economic implications. Primarily, it puts pressure on the government that tends to be more responsive to the needs of the urban population. The fear of urban uprising, such as riots and strikes, leads to extensive government programs to support the urban population. However, most of these programs work at the expense of the rural population. In the agricultural sector, the need for protecting people from unexpected contingencies, such as disease or retirement, or work related accidents, is low as the very socio-economic structures of that sector allow for other mechanisms to protect the population. Once people move to the cities, the traditional methods of protection against contingencies – often related to extended families structures – break down.

How does this discussion relate to the distinction between the political and economic goals of welfare transfers? In the long-term, a growth-oriented efficient welfare state may reduce income inequality. Malaysia is a good example of how a stable political system utilized resources to redistribute income for the purpose of long-run growth and met high standards in both efficiency and equity, despite a rather divided population (Hammer, 1995).

The China Experience

There is clearly an association, as indicated in the above discussion, between resource distribution and political stability that is crucial to the balance of the short-term goal of political survival and the long-term goal of economic development. The China case is quite similar to the Malaysian experience in many aspects, despite the differences in territory and population. One of the major similarities can be seen in the government effort to employ the social security system as a means to achieve social cohesion as an end by distributing surplus resources to balance out the interests of rural and urban populations in order to reduce social tension.

The other major similarity is the way in which the government mobilizes both the state and private resources to finance the extensive social security scheme through sustained economic growth. As in the case of Malaysia, China is faced with a policy-making dilemma – namely it must strike a balance between the need to maintain political stability and the necessity to redistribute resources such that sustained economic growth will not be hampered. The following will discuss the emerging social security system in China as an initial effort in the development of a modern welfare state and the potential problems that may arise given such an endeavor.

As many scholars point out, the reason why China did not experience uncontrollable social turmoil in the Mao years is that China's traditional social protection system, developed in the 1950s and 1960s, played a crucial role in ensuring political stability. This traditional social welfare system became effective because it was built into the highly centralized administrative arrangements of social control mechanism, a unique experience in the pre-reform period (Li, 1996). The principal feature of the traditional system is that it operated under the command economy at three levels of coverage. The state protection program covered the employees of government, military or state-related organizations. The enterprise protection program covered those working in state-owned enterprises, mostly in urban areas. The collective protection program covered peasants organized into production teams in rural areas. The state protection program was entirely financed by the state treasury, and considered the best of all three programs. While the enterprise protection program provided for employees was financed by each state-owned enterprise through its productive earnings, the collective protection program was primarily supported by funds allocated from economic gains in farming. Thus the traditional social protection system functioned as a closed system with the three programs basically isolated from and independent of each other.

The system eventually turned into a source of societal instability as the system became not only a heavy financial burden to the state, but also the source of social tension due to the unbalanced distribution of limited resources. The economic reforms initiated by Deng Xiaoping have greatly changed the economic landscape of China in the past twenty years. In particular, economic restructuring has greatly weakened the old social control mechanisms. The traditional social welfare program has become so incompatible with economic restructuring that it is falling apart as a result of decentralization process characterized by the rapid growth of private industries and radical reform in state-owned enterprises. Demographic change caused by fast urbanization has triggered massive labor and population migration, creating difficulties for social control. A current challenge is to balance the interests of those working in public and private sectors in terms of social welfare coverage, as a large portion of agricultural population has moved into non-agricultural sectors, and as semi-private and private industries are playing an increasingly important role in the national economy.

As China is in a critical transition of economic development, political stability is now the top priority on the government's agenda. The new social security system will inevitably become a test ground for the state's ability to mobilize resources to achieve the goals of social cohesion as well as long-term economic growth.

The macro framework for a new social security system is proposed as consisting of six independent subsystems, and yet they are in close coordination with one another to have a wide range of coverage (Zheng, 1997). These six subsystems are social assistance, social insurance, social welfare, medical care, military personnel protection, and supplementary protection programs. Specific programs under each subsystem cover old-age insurance, work-related injury insurance, unemployment insurance, medical insurance, and pregnancy insurance. They constitute the core of the whole system.

The major difference between the traditional system and the new system is that there is a transformation from a closed system to an open system in which all six subsystems are coordinated with each other to create a comprehensive coverage. For example, old-age insurance could be financed through multiple sources cutting across two to six subsystems. Unemployment insurance is designed to cope with social tension arising from a fluctuating market economy. The new system also extends its coverage to the vast rural population that has historically been considered "second citizens" as compared with the urban population in terms of social welfare benefits.

As previously discussed in the case of Malaysia, whether or not a comprehensive social security scheme can be successfully implemented depends critically on how well the relative balance can be achieved among the redistribution of resources, the decrease in wealth inequality, the increase in political stability, and long-run economic growth. To a large extent, this balancing process determines how effective the social welfare programs can be to help minimize the degree of threat to the political regime. In other words, badly implemented social welfare programs will only invite social unrest as resources are distributed disproportionately in society. In reality, most welfare transfers are targeting urban populations. Moreover, pensions are especially designed to support the retired working force that lose their income as they exit the working force. Pensions, as such, have small relevance to peasants. The experiences from other developing countries demonstrate that the social security system, if not carefully planned and carried out, will increase social inequality rather than narrow the gap between the rich and the poor. Clearly it is not an easy task.

Structural barriers and progressive extension of the welfare programs determine the restricted coverage of the population. In developed countries the majority of the labor force consists of urban salaried employees, whereas in developing countries the labor force is still primarily concentrated in the agricultural sector or self-employment. In developing nations, self-employed workers or farmers have low incomes and they are unable to contribute to the social insurance system. Furthermore, the existence of an extensive informal sector prohibits an additional segment of the population from seeking coverage from the welfare programs. These demographic restrictions imply that the universal welfare state that exists in European countries is not possible for developing countries. Moreover, accumulated economic crises impose fiscal constraints on the economies of most developing countries and their ability to expand welfare programs to cover a large segment of the population (Mesa-Lago, 1991: pp. 186-187).

The major problem that encounters China in its effort to build up a comprehensive social security system is a structural one. It remains an uncertainty whether China will reform its economic and political infrastructure to such extent that it could fit in an open, market-oriented social security system to be supported by societal wealth. Recently, this uncertainty has been reinforced by structural constraints that have slowed down the transition of state-owned enterprises toward semi-privatization, which will adversely affect the efficiency of the emerging social security system.

Another problem related to the structural constraints is a fragmented administrative system in terms of resource allocation for welfare needs. Currently, there are as many as twenty government agencies that are involved in managing diverse social welfare programs, resulting in inefficiency and opaqueness in responsibility and accountability.

As a consequence, these “tunnel-visioned” government agencies are not capable of dealing with cases that cut across many government administrative departments. It is, thus, necessary to have a social security administration to coordinate social assurance and welfare. The Ministry of Labor and Social Security, which was established in 1998, is one major effort to facilitate welfare transfers through redistribution of resources.

However, it will be no easy task to disentangle the complicated relationships in the current system, due to the resistance from state bureaucrats who care more about their own gains than the nation's benefit. The task is even more challenging, since the coordination of various social welfare programs in China has historically involved complex and even intricate relationships that exist between government agencies.

As in the case of Malaysia, China's formidable task is how to narrow the gap between resource-rich and resource-poor regions through the means of social security programs that avert the social violence threatening the political regime. Unequal economic development between coastal and interior regions in recent years has already generated regional animosity, and similarly, the unequal distribution of resources between the urban and rural regions has widened the income gap that aggravates tensions between social groups. While the populations in advanced (urban) regions will continue to benefit from social welfare (as they simply can afford it), the populations in backward, rural regions will remain less protected. As social control mechanisms are no longer effective due to economic restructuring, popular grievance is likely to spread out to cause political instability. Without compatible social control mechanisms, it is hard to expect the new social security system to become functional and effective in rural areas, unless there is a great redistribution of resources in welfare transfers to narrow the gap of income between the regions. Lessons learned from the experience of Malaysia discussed in previous sections indicate that social stability can be guaranteed only if there is congruence between the economic and political goals of the social security system. In other words, welfare transfers should be carried out to the extent that they will not impede long-term economic development.

In order to expedite welfare transfers, China needs to set up a strong legal system to protect the process of transfer as demonstrated in the case of Malaysia. In the legal arena, China currently lacks a powerful legal-rational environment to effectively protect and enforce the implementation of the new social security system. From the 1950s until the end of the 1980s, China had no systematic legal codes relating to social insurance, and even in the past decade, China's legislature has been very slow in making social security and welfare laws.(14) The existing political system remains resistant to any substantial change of legal codes to replace its conventional control mechanism characterized by top-down "administrative orders," which is viewed as the corner stone of China's social-legal system. As we have learned from the experiences of many developing countries, lack of legal-rational protection will render any kind of social security system ineffective. Furthermore, the government's arbitrary policy may be inconsistent with the long-run economic development of the nation. As a result, the social security system may become a source of reinforcing the existing inequalities rather than alleviating social poverty and tension as originally intended (Benda-Beckmann, 1988).

China traditionally lacks the social base of civil society. In the relevant literature, a civil society is commonly believed to be the source of societal wealth to be mobilized to fund social welfare systems. As Mann (1986) points out, a strong civil society is key to a strong state power to enforce its policy, not vice versa. In the case of China, the near absence of non-governmental and non-profit welfare organizations and charities are a clear sign of a weak civil society. As compared with China, Malaysia, as a developing country, made a great effort to build a civil society in a diversified and formerly colonized territory. Although the size of the country implies significant differences in the design and implementation of its social security policies, there are two general rules that might be useful references to China. First, there is the need to bring harmony between the political and the economic goals of welfare transfers and social security. This implies that a growth-oriented government must adopt a shared growth strategy so as to have broad-based support for its development programs. Balancing out the political and economic goals of a social security system has proved to be a good strategy for reducing the income gap between social groups while maintaining economic development, as exemplified in the case of Malaysia. Second, sustained and shared economic growth is the caveat for financing such programs when there is no extensive tax-base for the governments to collect resources. Thus, tapping the funding sources from within society to support social security is obviously an option for China.

China's economy is currently at a downturn. Consumption has significantly slowed down in China in recent years. The main reasons for the lack of purchase are that the prospects of lay-off are looming large when the restructuring the state-owned enterprises deepens and that a sound social security system is lacking. What contributes to the decrease in economic growth is that the people are concerned about the sufficiency of unemployment compensation, pension funds and medical benefits, causing them to hoard resources while they still can. The lack of purchasing momentum dampens economic activities, which worsens the whole economy. Social security and welfare reforms build a safety net for not only those who are adversely affected by the privatization of the economy, but also the ultimate success of economic reforms that have been in force since 1978.

Notes

1. The authors are grateful to a reviewer's constructive comments. Yi Feng would like to thank the Fletcher-Jones Foundation for a faculty research grant, which has facilitated this research.

2. Inefficiencies undoubtedly plague the welfare state. Nevertheless, eradicating welfare state inefficiencies should not jeopardize the existence of the welfare state.

3. Educational expenditures contribute more to equality of opportunity than to social security and equality. For more information on this argument see Wilensky, 1975. For the variety of welfare programs and the different types of welfare state, see Baldwin, 1989, Kloosterman, 1994, and Sainsbury, 1991. Last, but not least, see the seminal work by Epsing-Andersen, 1990.

4. Most of the historians of the "welfare state" accredit imperial Germany as the forerunner of modern welfare programs. In 1881 Bismarck instituted the basis of the first social security legislation in an effort to shift the loyalties of the working class. Bismarck's system was a 'carrot and stick' policy, targeting the social democratic movement. It was specifically planned to cope with prevailing social problems. Insurance reform was not an actual expansion of the state's functions but a qualitative transformation (Ullmann, 1981: pp. 134-135). The term 'welfare state' was coined in Britain in 1941, while Great Britain alone was standing against Germany. The predecessor of the British welfare state was established in 1911 as the Liberal government's National Insurance Act, promoted by experts such as William Beveridge and prepared by Winston Churchill and Lloyd George. This Act was targeting the 'left out millions who were miserable' in the heyday of the British empire. In both cases of policy-making, British administrators replicated the social policies established in imperial Germany (Flora, 1981: pp. 18-19). The welfare state has been an integral component of the developmental process and the solidification of the

state within the developed countries in the late nineteenth- early twentieth centuries.

5. There are concerns regarding the authority of the state to provide welfare programs. First of all, from a critical point of view, the state distribution follows the predetermined distribution of resources. The right critique to welfare state is that welfare programs create a condition of moral hazard since they provide incentives to people to get into undesirable behavior. On the other hand, the counter argument remains that the state is the only institution that has the power to ensure that the system is not abused. Most of the arguments that favor state interference are based on moral and ethical considerations. The most well known argument is by John Rawls. Thus, the tradeoff is between the society's need to expand its production and the redistribution of production goods in a socially appropriate way (Taylor-Gooby, 1994: pp. 82-85).

6. One of the first studies on this area was Lenski's (1966) theoretical argument that combines the "functionalist" and the "conflict" school of thought. Lenski argued that countries that do have a surplus product tend to follow the power distribution in the society, when they distribute the surplus (the conflict argument). The surplus is affected by technology, which determines the political and economic structure, as well (Cutright, 1967: p. 562).

7. Endogenous theories of growth have indicated that investment has positive externalities on economic development. For efficient investment to occur, however, a stable political system is required.

8. Alesina and Rodrik assume that the consequences fall on public investment, while Perotti, and Persson and Tabellini assume they occur through redistribution.

9. See Becker et al. (1990: pp. S12-S37) and Perotti (1996: pp. 149-187.)

10. As a reviewer points out, the growth-oriented government will not necessarily employ welfare program or social security system to reducing income inequality. Likewise, income inequality may not rise in a survival-oriented government. For example, suppose there are two groups of agents in a society: rich and poor. The rich are endowed with human capital that drives long term growth. The poor provide labor. If the median vote happens to be among the rich, a

survival-oriented government will choose not to redistribute from the rich to the poor. Furthermore, this survival-oriented government is also a growth-oriented government.

11. Studies have concluded that the relation between income inequality and political violence is spurious, while controlling for levels of economic development (Hardy, 1979; Nagel, 1974; Weede, 1981). The literature is divided as to whether political violence is the outcome of discontent or of "resource mobilization" and the organizational structure of general dissatisfaction (Muller, 1985:p. 48).

12. The remainder of the population (less than 1 per cent) consists of various ethnic groups. The British policy of immigration encouraged the explosive mixture of Chinese, Indians, and Malays. Till the beginning of the twentieth century the Malays were the majority of the population, even further back in history they were the only ethnic group inhabiting Malaysia. By the end of 1930's Malays were a minority within their own land.

13. At that time Malays controlled only 1.5 percent of businesses, contrary to 22.5 per cent held by the Chinese, while the rest of the corporate equity was held by foreigners (Root, 1996: p. 71).

14. The answer could be found in China's own legal development. As in many other areas, China's legal system is also in transition. Whether the reform would bring the system toward formal legalism remains uncertain and questionable (Li, 1996).

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