Changing Natures of Rural Poverty and New Policy Orientations

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I. Introduction

Since the reform initiated in the late 1970s, China has achieved the fastest economic growth and the largest poverty reduction in the world. While the real per capita income of rural households increased from 134 yuan in 1978 to 2622 yuan in 2003, the total number of rural residents living below official poverty line decreased from 250 million to 29 million, with a decline of poverty incidence from 30.7 percent to 3.2 percent, in the same period (Table 1). China has been extensively approved by international community for its achievements in poverty reduction (for example, the World Bank, 2001)[1]. Since the late 1990s, however, China has slowed down the speed of poverty reduction with decreasing marginal effects of the poverty alleviation efforts. While some scholars assert the wide spread of poverty in developed rural areas (Khan, 1998; Riskin, 1994), a common agreement is that the rural poor in China have been marginalized both in geographic and in demographic sense (ADB, 2004). This argument is important, because how to understand the nature and attributes of the existing poverty in rural areas will significantly impact the policy measures the government implements.

Table 1 Numbers of the Rural Poor and Poverty Incidence

Year	No. of the Poor(million)	Poverty Incidence (%)
1978	250	30.7
1985	125	14.8
1990	85	9.4
1991	94	10.4
1992	80	8.8
1994	70	7.7
1995	65	7.1
1997	50	5.4
1998	42	4.6
1999	34	3.7
2000	32	3.4
2001	29	3.2

[1] Combining rural poverty together with urban poverty, the overall poverty incidence in China decreased from 53 percent in 1981 to 8 percent in 2001 (Ravallion and Chen , 2004).

2002	28	3.0
2003	29	3.1

Sources: Rural Survey Organization of National Bureau of Statistics, 2004. *Poverty Monitoring Report of Rural China,* China Statistics Press: Beijing.

The poverty alleviation process in rural China can be divided into three phases. The first phase dates back to the period 1978 to 1985 when the rural reform indicated by the adoption of household responsibility system. During this short period of time, the numbers of rural residents living under the absolute poverty line were halved, the most significant achievement in human history. The poverty reduction at this phase can be viewed as the effect of successful economic reform in rural China, because the reform released hundreds of thousand farmers from the shackle of People's Commune System and increased the productivity of agriculture by improving incentives.

The second phase of poverty reduction in rural China started in the mid 1980s and is characterized as regional development oriented government program, especially the *8-7 Poverty Alleviation Program* during the period between 1993 and 2000, with which the Chinese government announced its goal to reduce the numbers of the rural poor by 80 million within the last 7 years of the century. Encouraged by the experience in the early years of the rural reform when the economic growth substantially reduced overall rural poverty and the regional concentration of poverty after the first phase of poverty alleviation, the Chinese government initiated the unprecedented largest scale program of poverty reduction since the middle of 1980s. In implementing the program, the government budgeted special poverty alleviation funds (PAF) consisted of fiscal alleviation funds, food for work funds, and interest-subsidized loan to support the economic growth in designated poor areas.

Since poverty was observed as being mainly concentrated in removed mountainous, ethnic minority-populous, and borderline regions, the Funds were only invested to selected areas which are known as National Designated Counties, totaling 592 counties and accounting for about one fifth of county level jurisdiction all over the country. From 1986 to 1993, in National Designated Poor Counties farmers' net income increased from 206 yuan to 484 yuan and Chinese rural poor population decreased from 125 million to 80 million with the annul rate of poverty reduction of 6.7 percent (Office of Leading Group of Poverty Alleviation in State Council, 2004). In the same period of time, the poverty incidence in the entire rural areas decreased from 14.8 percent to 8.7 percent (Office of Leading Group of Poverty Alleviation in State Council, 2004). The regional concentration of the rural poor had become more and more obvious after the period. Poverty turned out to concentrate to Central and Western China, like southwest rocky areas, northwest loess plateau, Qinba mountainous areas, and Qinghai-Tibet Plateau. In addition to weak infrastructure, less developed social service, natural conditions are major factors causing poverty. Believing that regional development would help eradicate poverty, the Chinese government put forth the important document announcing the implementation of *8-7 Poverty Reduction Program* in 1993.

As is shown in Table 1, the poverty reduction in rural China seemed to stop since the late 1990s, which indicates the marginalization of the rural poverty as the total number of .the rural poor decline. A marginalized poverty refers to the situation in which the poor mainly consist of those who have low education attainment and bad health and live in regions with bad living

and production conditions. Therefore, the third phase of poverty alleviation began in the late 1990s and is characterized by the marginalization of the poor in terms of personal endowments and geography. If this characteristic of the existing poverty means anything, the on-going poverty alleviation policies through regional development need to be revised. For example, one better option is to help the remaining poor through social security system (ADB, 2004; Cai and Du, 2004). This paper describes the changing natures of rural poverty and makes policy suggestions in accordance with this analysis.

The rest of the paper is organized as follows. Section 2 briefly retrospect the special poverty alleviation program implemented by the Chinese government through regional targeting, suggesting the completion of the concept of regional development-oriented poverty alleviation. Section 3 reveals that the marginalized poor are venerable in taking advantage of labor markets and cannot be got rid of poverty through conventional strategy of poverty alleviation. Section 4 proposes the way of relieving marginalized poverty through social protection mechanism that is believed to work more effectively at targeting the marginalized rural poor. Section 5 concludes by drawing some policy suggestions based on the changing natures of poverty.

II. Changed Natures of Rural Poverty

With the completion of *8-7 Poverty Reduction Program*, the total number of poor population reduced to 32.09 million in 2000. It is good to believe that the government's efforts to poverty alleviation began its third phase since this most important program has been finished. The transition of phases of poverty alleviation can be depicted by Figure 1. The horizontal axis represents time or efforts made for poverty alleviation and the vertical axis the numbers of the poor or effectiveness of poverty reduction. As is shown in figure 1, the marginal effect of poverty alleviation efforts has been diminishing, and the numbers of the rural poor have remained almost unchanged since the late 1990s. Considering that the economic resources spent on poverty reduction activities are increasing over time, we may infer that poverty alleviation through regional development is not as efficient as before. This implies a change in natures and attributes of the poverty in rural China. What follow are some observations on the effectiveness of poverty alleviation in recent years.

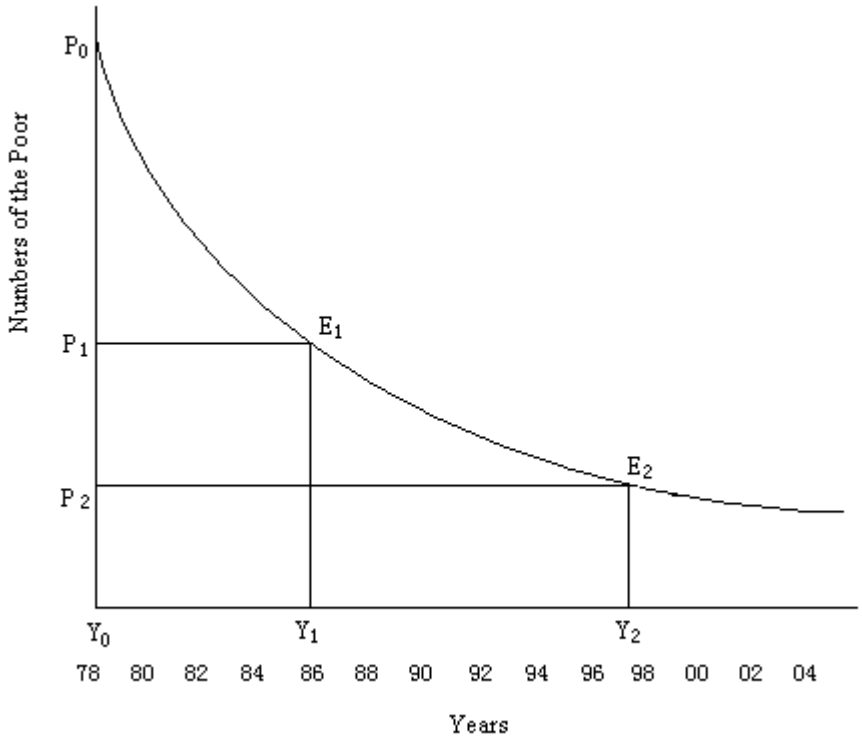

Figure 1 The Diminishing Marginal Effect of Poverty Alleviation Efforts

The first observation is the insignificant effect of projects and general economic growth on poverty reduction. As is described above, the government's efforts to poverty reduction were mainly implemented through projects. The effectiveness of those programs is based on two assumptions: (1) the projects implementing in rural areas can facilitate regional economic growth, and (2) regional economic growth can lift the rural poor out of poverty. However, those two assumptions are no longer the truth after the second phase of the poverty reduction ended. According to existing studies, due to implausible directions of investments of poverty alleviation funds, the effects of projects on economic growth are very limited (Cai, et. al, 2000). Another study by the World Bank shows that during the 1990s, the overall economic growth increased the income gaps and only people with two highest income deciles have faster income growth rate than average. In 2001 and 2002 annual PAF input were 3.7 times and 2 times of that during the periods of *Eighth Five Plan* and *Ninth Five Plan* respectively, while the effects on reduction of poverty incidence were only half and one third of corresponding periods.

A second observation is that the regional poverty alleviation programs have limited coverage of the rural poor. Under the regional development-oriented programs of poverty alleviation, county is the basic unit of targeted area. The central government arranges all poverty alleviation funds (PAF) to support the development of poor counties (Table 2). The selection of poor counties directly affects the accuracy of the PAF's target and thus the effectiveness of the programs. Park et al. (2002) shows that some non-economic determinants made the selections unreasonable. In 2000, only 60 percent of rural poor population lived within the 592 State Designated Poor Counties (SDPC). To solve the problem of inaccuracy in poverty targeting caused by the nature of countywide investment of the funds, in 2001 the Chinese government began to emphasize targeting poor villages or even poor households and

148 thousand poor villages were selected so as to target 83 percent of total poor population in rural areas (Rural Survey Organization of National Bureau of Statistics, 2004). Now that the county governments allocate the distribution of PAF, it is believable that the poverty alleviation funds are more likely to be invested countywide rather than targeting the lower levels and therefore the programs cover the poor poorly.

Table 2 Central Government's PAF by Category (100 million yuan)

Year	Loan with Subsidized Interests		Food for Work Funds		Fiscal Development Funds		total	
	Current price	Price at 1986	Current price	Price at 1986	Current price	Price at 1986	Current price	Price at 1986
1986	23.0	23.0	9.0	9.0	10.0	10.0	42.0	42.0
1987	23.0	21.4	9.0	8.4	10.0	9.3	42.0	39.1
1988	29.0	22.8	0.0	0.0	10.0	7.9	39.0	30.7
1989	30.0	20.0	1.0	0.7	10.0	6.7	41.0	27.4
1990	30.0	19.6	6.0	3.9	10.0	6.5	46.0	30.1
1991	35.0	22.2	18.0	11.4	10.0	6.4	63.0	40.0
1992	41.0	24.7	16.0	9.6	10.0	6.0	67.0	40.4
1993	35.0	18.6	30.0	16.0	11.0	5.9	76.0	40.5
1994	45.0	19.7	40.0	17.5	12.0	5.3	97.0	42.5
1995	45.0	17.2	40.0	15.3	13.0	5.0	98.0	37.4
1996	55.0	19.8	40.0	14.4	13.0	4.7	108.0	38.8
1997	85.0	30.3	40.0	14.3	28.0	10.0	153.0	54.6
1998	100.0	36.6	50.0	18.3	33.0	12.1	183.0	67.0
1999	150.0	56.6	50.0	18.9	43.0	16.2	243.0	91.7
2000	150.0	57.5	50.0	19.2	48.0	18.4	248.0	95.0
2001	185.0	71.5	60.0	23.2	40.0	15.4	285.0	110.1
2002	185.0	72.4	66.0	25.8	40.0	15.7	291.0	113.9
total	**1246.0**	**554.0**	**525.0**	**225.8**	**351.0**	**161.3**	**2122.0**	**941.1**

Sources: Office of Leading Group of Poverty Alleviation in State Council, 2004, Poverty Reduction: Efforts of Chinese Government, mimo.

In recent years, about 30 billion yuan were assigned to the 592 SDPCs every year, but the numbers of the poor in those counties have not been reduced significantly, which shows a poor mechanism of targeting. From Figure 2 we can see the gap in numbers of the rural poor between national total and those living in SDPCs. Since 2000 the difference between the two numbers has been almost unchanged, which indicates the difficulty to eradicate the remaining poor through SDPC-based programs of poverty alleviation.

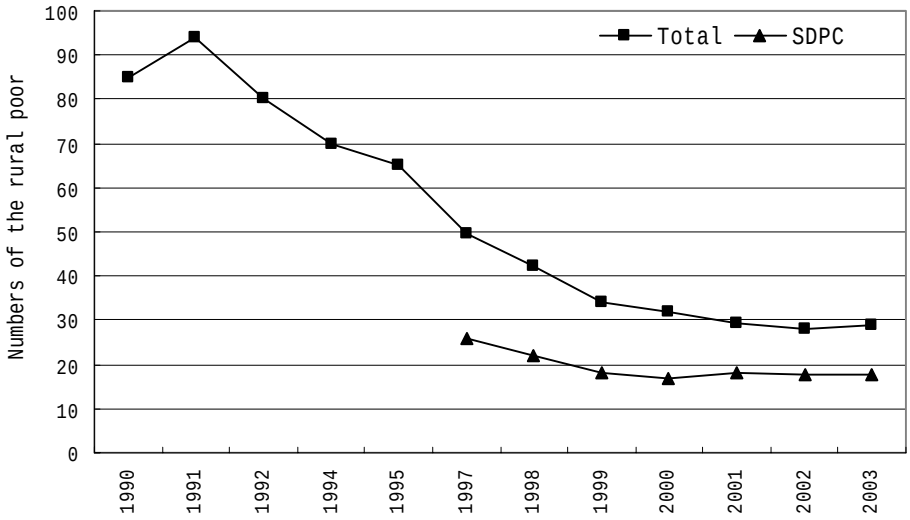

Figure 2 the Numbers of the Poor Living and Not Living in SDPCs

Sources: Rural Survey Organization of National Bureau of Statistics, 2004. *Poverty Monitoring Report of Rural China,* China Statistics Press: Beijing.

In addition to the observed features of county-based strategy of poverty alleviation, the components of the rural poor have been changed as well. Among the remaining poor, there are about one fifth are *Five Guarantees Families*[2], more than one third are the disabled, and over one fourth are those who live in the areas with extremely adverse natural resources. In short, those people in fact lack ability to take advantage of the projects aiming at regional poverty reduction and thus are unlikely to benefit from an overall economic growth. According to official statistics (Rural Survey Organization of National Bureau of Statistics, 2000), the human capital endowments of rural poor families are significantly lower than non-poor families. For instance, 31.3 percent of poor families had no single family member gained the education attainment above primary schooling. Adult illiteracy rate among the poor was 22.1 percent, while that of non-poor families was only 8.9 percent. In addition, some other characteristics of poor families made difficult for them to jump out of poverty. Poor families turn out to have bigger household size with high dependency ratio and to own family asset with low quality, which produces vulnerability when they face risks. In order to cope with this kind of poverty, the general strategy of poverty alleviation should shift to one with more precise targeting through social protection programs in rural areas.

III. Who Can Use Labor Market, Who Cannot?

Ultimately, lifting the rural poor out poverty not only relies on the government financial support but also replies on the work of labor market. China is experiencing a process of urbanization and industrialization with tremendous flood of rural-to-urban migration. The conventional wisdom of migration theories (Todaro, 1969; Stark et al., 1991) suggests that absolute income differentials among regions and relative deprivation are driving forces of

[2] The childless and infirm elderly who are guaranteed for food, clothing, medical care, housing and burial expenses by communities.

migration. An extended implication of those theories then asserts laborers in poor areas can increase their income by taking advantage of labor markets. According to the statistics in *Poverty Monitoring Report of Rural China in 2004*, it is also very common that labor forces in poor areas tend to be out of hometown for non-agricultural jobs. In 2003, 14.4 percent of total labor forces in state designated poor counties left for outside work. Among those migrants, 64.3 percent of them migrated across provinces and 47.3 percent of migrants had worked outside their hometown for more than two years.

Migration as a response of poverty could also be reflected by a household survey data called the China Rural Poverty Survey (CRPS). Before going to the details of data analysis, we first briefly introduce the data collection and sampling. CRPS was conducted in 1997 and 2000. In 1997, the survey re-sampled 442 rural survey households framed by National Bureau of Statistics in 6 state-designated poor counties located in 6 different provinces. The 2000 survey sampled 582 households (2567 adults of working age) in 4 of the same poor counties surveyed in 1997, all in western China. In each county, 15 households were sampled in each of ten villages.[3] Sampling probabilities for new households included in the 2000 survey were designed to create a representative sample. In order to facilitate comparisons over time, we restrict attention to the 1997 data from the 290 households in the four counties also surveyed in 2000. According to CRPS, as Table 3 presents, in poor areas migration frequency increased significantly over time. We break down the labor forces by education and age. It is evident that most groups had an increase in migration frequency, which is consistent with the general trend seen from China's rural areas and all state-designated poor counties.

Table 3 Migration Frequency by Education and Age, CRPS (%)

	1997		2000	
	Male	Female	Male	Female
Education				
0-6 years	21.4	7.5	25.3	10.0
(sample size)	(182)	(264)	(356)	(520)
7-9 years	37.3	30.7	47.9	26.2
(sample size)	(158)	(75)	(307)	(141)
10+ years	18.2	25	38.5	28
(sample size)	(44)	(8)	(104)	(25)
Age				
16-25	45.9	30.3	44.2	27.6
	(122)	(109)	(215)	(196)
26-35	37.6	8.7	47.8	15.5
	(93)	(103)	(201)	(207)
36-45	14.0	4.0	39.3	8.1
	(86)	(76)	(168)	(160)
46+	3.2	0	10.7	2.5
	(93)	(71)	(225)	(163)

Sources: CRPS.

[3] In 1997, 10 households were sampled in each village, with the number of villages ranging from 6 to 10 across the four counties.

In order to examine the effects of migration on household income and poverty reduction in poor rural areas, we need to discuss about the definition of household. Average income calculation of household always encounters difficulty relating to definition of family since migrants are absent of home. In the CRPS, we define a migrant as a family member who spends any time during the year living outside the township engaging in economic activity. Only wage jobs lasting more than 10 days are reported in the survey. In many household surveys, individuals are considered household members only if they live at home for a certain duration. The CRPS follows this approach by defining "households" to include only those individuals who lived for at least 6 months in the past year at home. By this definition, long-term migrants are not considered household members even when their economic life is closely tied to the household. Therefore, the economic contribution of such individuals to their families can only be measured through remittances. In this paper, in addition to the household definition described, we define "family" to include the migrated household member as well as the household head, his or her spouse, and all unmarried children of the household head regardless of where they live. For studying migration behavior, the family is often a more relevant unit of observation than the household.[4]

We now look at the summaries of CRPS that show the importance of remittance decisions to income and poverty measurement. We compare the incomes of migrants and other family members before and after remittances to illustrate how remittances affect the incomes and poverty of both groups (Table 4). Before remittances, per capita income of migrants was 2907 yuan, while that of other family members was 602 yuan. On average, migrants remitted a third of their income per person (980 yuan), with other family members receiving 465 yuan per person or 77 percent of their own per capita earnings. Using the rural poverty line of 635 yuan in 2000, we calculate the poverty incidence of migrants as 17.5 percent before remittances and 27.8 percent after remittances, whereas the poverty incidence of other family members was 67.1 percent before receiving remittances and 49.2 percent afterward. These results prove that migration does help the poor families deal with poverty.

Table 4 Changes in Incomes of Migrants and Other Family Members, 2000

	Migrants	Other family members
Income (yuan)		
Income per capita before remittance	2907	602
Remittances per capita	-980	465
Income per capita after remittance	1928	1067
Poverty incidence: rural poverty line		
Poverty incidence before remittance	17.5%	67.1%
Poverty incidence after remittance	27.8%	49.2%

[4] NSB also uses a 6-month standard to define a household member, but in practice often includes other family members whose economic life is tied closely to the household using unclear criteria. In the 1997 CRPS, the mean number of household members based on a strict 6-month standard was 4.2, compared to 4.6 according to NSB standards.

Poverty incidence: lowest city poverty line		
Poverty incidence before remittance	25.1%	--
Poverty incidence after remittance	37.3%	--

Sources: CRPS.

Note: In 2000 the lowest city poverty line is 143 yuan per month.

What follows we estimate the relationship between poverty status and migration probability so as to reflect how sensitive of families with different status of poverty to labor markets. First step is to estimate a non-parametrical relationship between the likelihood of migration and household endowments, which gets to the heart of the question of whether the poor are able to migrate. Though income per capita is the most often used indicator to reflect the status of poverty, it probably is also affected by migration and is an endogenous variable[5], so we use household fitted income to be a proxy of poverty status as follows.

$$\ln y_i = \alpha_0 + \alpha_1 Edu_i + \alpha_2 Land_i + \alpha_3 Irri + \alpha_4 Labor_i + \alpha_5 Geor_i + \varepsilon_i \quad (1)$$

On the left-hand side of the equation, the logarithm of family income per capita is considered as a dependent variable. A set of its determinants that would be regarded as more exogenous variables than family income is put on the right-hand side. We first regress the log of household net income per capita on the set of exogenous endowments, including highest years of education in family, cultivated land per capita, share of irrigation land, household members that are laborers, and village dummy variables that capture geographic and other community endowments affecting migration. With the regression parameters, we predict the fitted income for each family according to the regression results and actual family endowments. The predicted family income is a more desirable index of poverty status than income since it comes from a set of exogenous variables of family endowments. So we may assume that migration probability affects income, but not fitted income, since the latter is more exogenous. We then estimate the non-parametrical relationship between probability that household has one family member having migrated and its fitted income per capita in log term. Here, fitted income acts as an index of exogenous household endowments and proxy for poverty, where each endowment is weighted by its relative importance to income generation.

The results estimated with 1997 and 2000 data are presented in Figure 3, where the horizontal axis denotes fitted income per capita of family in log term and the vertical axis the probability of migration of family member. In general, the likelihood of migration is small at low endowment levels and enhances as the income increases. As mentioned above, the fitted income represents the poverty status of family, by which we divide the families into three groups with different levels of endowments, and therefore each requires policy focus. With the belief that policy adjustment by shifting to target more specific groups will improve the efficiency of poverty alleviation efforts of the government, the findings are interesting and noticeable.

[5] We lack a plausible instrument for migration that would enable us to estimate the household's expected income absent migration. Since migration is positively correlated to some endowments that increase income but negatively correlated to other variables, the direction of simultaneity bias due to the effect of migration on income is ambiguous.

Figure 3 Migration Probabilities and Grouping of Families

Source: the authors' estimates based on CRPS data.

The first part of the curve shows that when family income per capita in log term is below 6 (below 443 yuan), the families have difficulty to respond to labor market opportunities, because of the lack of ability to overcome various obstacles in labor markets. Neither regional economic growth, nor job opportunities in labor market can bring any significant effects on the welfare of this group of families. Therefore, this group of families is actually a marginalized one. In view of this situation, the poverty alleviation strategy should focus on programs providing social protection.

The second part of the curve represents a group of people around the critical point of migration. Viewing the curve as a whole, the relationship between migration probability and fitted income is nonlinear. The key inflection point is when fitted log income per capita equals about 6.5, which is very close to the official poverty line[6]. This suggests that the migration decision is most sensible to income increase when household income is around the poverty line, though this group of families still has low likelihood of migration due to the restrictions of family endowments. The minimum critical efforts are required for the government to support them to take advantage of migration opportunities. Providing trainings and eliminating institutional barriers in urban labor markets are mostly helpful for this particular group.

The third part of the curve shows the behaviors of the families, who hold good endowments and have already surpassed the critical points. As for this group of families, there are three interesting features to be considered: (1) it has much bigger probability of migration than any groups with lower endowments, (2) its probability increases over time, and (3) it is sensible toward labor market opportunities. This suggests that migration is an effective way

[6] The poverty line in rural areas in 1997 was 640 yuan, somewhere close to 6.46 of log income per capita in Fig. 3.

for those families to increases income, and the government's role to help them is to build up a better institutional environment for labor mobility.

IV. Social Protection for Marginalized Rural Poor

From the foregoing analysis, we can conclude that the poorest poor in rural China have been marginalized in terms of their family and community endowments and cannot take advantage of economic opportunities that supposedly provided by current poverty alleviation programs. Characterized by marginalization, the remaining 20 to 30 million rural poor urgently need alternative programs of social protection with more accurate targeting.

Although there still exist some problems when implementing the social security program in urban areas, a good institutional basis of social protection have been formed in cities. This social security system is mainly consists of basic pension system, health insurance, unemployment insurance, and minimum living standard scheme. Theoretically, any person with urban household registration (or *hukou*) is entitled to at least one of those programs. However, because of the existence of socio-economic segregation between rural and urban areas, both rural residents and rural-to-urban migrants in cities are excluded from benefiting from those social security programs. And there has not yet a social security system and social protection is particularly not desirable in rural areas. The present mechanism in rural areas is officially called social relieves, which is budgeted by the central government. In 2002, this program provided totally 13.09 billion yuan of social relief covering 22.89 million poor population in rural areas.

In spite of the existence of rural and urban gap in social protection, the amount of money spent on rural social protection has increased and the mechanisms, through which the government aims at relieving the real poor in rural areas, has improved in recent years. Figure 4 indicates that, while the total numbers of the rural poor declined from 125 million in 1985 to 28.3 million in 2002, the numbers of rural people covered by social relief program increased from 1.17 million to 22.89 million in the same period of time. This suggests that with an additional effort made by the government, the remaining marginalized poor in rural areas can be well covered solely by social protection program.

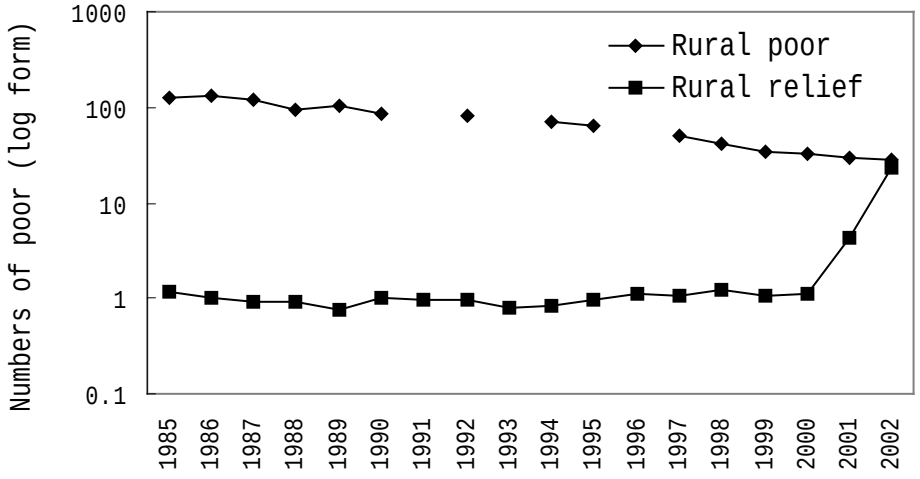

Figure 4 Number of Rural Poor and Social Relief Coverage

Source: Ministry of Civil Affairs of China, *China Civil Affairs Statistical Yearbook 2003*, China Statistics

Press, 2003.

V. Conclusions and Policy Implications

With the changed natures of rural poverty, the marginal effects of using PAF as poverty reduction tool have been diminishing, and therefore the regional development-oriented poverty reduction program is no longer an effective strategy for lifting the remaining poor out of poverty. Grouping the poor and implementing specific policy to each group will be a new orientation that poverty alleviation strategy should incline to. Based on the stylization of facts about marginalized poverty in rural China, we propose the following policy adjustments to be made in the near future.

A strategic transformation is urgent for poverty relief in rural China – that is, the regional development-oriented poverty reduction strategy should be shifted to an individual identify-based program of poverty relief. Observing the changed natures of rural poverty, the government has tried to focus its efforts of poverty reduction on narrower levels since the later part of 1990s. However, with the framework of regional poverty alleviation strategy, it cannot screen the difference among individual families. While the regional development-oriented strategy of poverty alleviation works inherently subject to large-ranged spatial projects, the individual identity-based policy by nature is suitable for more targeted objects.

There is a need to design specific tools for different groups of rural residents to increase their incomes in accordance with their characteristics of endowments and behaviors. As is described previously, even in poor areas, the various groups of people with different levels of endowment tend to respond to labor market opportunities differently. For those who can actively participate in labor markets with positive response to any economic opportunities, given their family endowments, eliminating the existing institutional barriers in labor markets can be a more effective and sustained way to take them away from poverty. For those whose household income level is around the threshold to be out of poverty, any public supports to enhance their ability to overcome obstacles of migration caused by disability of physical, social and human capitals. Then again, for those who still stay incapable of taking advantage of labor market opportunities, setting up a social safety net is far more important than any other kinds of program.

In order to complete the transformation from a regional development-oriented strategy of poverty alleviation to a more focused safety net in rural areas, the following tasks are required to accomplish.

The first is to prioritize the social security policies in rural areas. The most obvious distinction between farmers and urban residents is that that the former own land. Thus unemployment insurance is not a priority of social security in rural areas. Since there exist a number of people who are extremely poor, establishment of minimum living standard guarantee (or *dibao*) program is a pressing matter. Illness is an important determinant bringing about poverty, so fiscal support to New Cooperative Medical System from central government is another prioritized task of social security in rural areas. Pension system is almost a blank in rural China, and there are overlaps in functions between providing for the Five Guarantees Families, regular relief, and *dibao*. For this reason, based on the scheme of minimum living standard guarantee in rural areas, setting up a pension system gradually in rural areas is important for reducing the poverty incidence of the rural elderly.

The second is to dovetail the rural and urban social security programs, because a portable social security mechanism is an important precondition for labor mobility. Given the large income gap between rural and urban residents, it is not realistic to have a level-playfield social security benefits between rural and urban areas. However, the two systems of social security should keep a consistency in organizations, operation, management, and targeting process.

The third is to change the PAF allocation by following the way to finance the rural social security. Financial requirement for the rural social security has all along been a constraint of establishment of social security system in rural areas. In fact, central government spent substantial amount of money on poverty alleviation every year. As table 4 shows, total amount of PAF has been increasing since 1986. In 2002 total PAF reaches 29.1 billion yuan, which is 68 percent more than that allocated for urban *dibao*, whereas the urban *dibao* program covers about the same amount of poor people as the amount of considered as the poor in rural areas. Limited by the way of using PAF, the marginal effects of PAF on poverty reduction are deceasing. So it is possible to increase the benefits the poor get by reallocating a significant part of PAF without increasing the total amount of PAF.

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