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Mr Conable

# OFFICE MEMORANDUM

DATE October 9, 1986

TO Memorandum for the Record

FROM Baelhadj Merghoub, Chief, AEACH

EXTENSION 72565

SUBJECT CHINA: Summary of Discussions between President Conable and His Excellency Wang Bingqian at the 1986 Annual Meetings Washington, September 27, 1986

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1. A meeting took place at the Bank on Saturday, September 27, at 12:30, between His Excellency Wang Bingqian, State Councilor and Minister of Finance, People's Republic of China, and Mr. Barber B. Conable, President of the World Bank. Mr. Wang was accompanied by:

- Messrs. Li Peng, Senior Vice Minister of Finance
- Xu Naijiong, Executive Director
- Yang Guanghui, Alternate Executive Director
- Zhang Yuanzhong, Secretary to the Minister
- Zhou Yuequn, Deputy Chief, World Bank Division, External Finance Department, Ministry of Finance
- Ms. Li Shurong, Chief, World Bank Division, External Finance Department, Ministry of Finance

The Bank staff attending included Messrs. Stern, Karaosmanoglu, Kaji, Lim, Sam, and Merghoub.

2. Mr. Conable welcomed the Chinese delegation to the Annual Meetings of the Bank and expressed his satisfaction with the close cooperation existing between China and the World Bank. Minister Wang thanked the President for receiving him at this very busy time of the year. He expressed the appreciation of his government for the excellent and increased assistance of the Bank to China. He indicated that his government is particularly pleased with the volume of lending reached after six years and the quality of the projects financed during that period. The Minister extended an invitation to the President to visit China at a convenient time to him. Mr. Conable thanked the Minister and accepted the invitation for sometime next spring (probably April 1987).

3. Turning back to the volume of lending to China the Minister remarked that about 41 projects are being financed in China for a total commitment of IBRD/IDA funds of US\$4.1 billion. He hoped that this volume of lending will further increase to levels more in line with China's size. He also indicated that his government is particularly appreciative of the advice and support that it receives in the economic field and system reform. He made special mention of the two economic reports prepared by the Bank and the special attention given to them by the highest level of the Chinese leadership including the Premier. Mr. Conable said that he was delighted by this outcome and pledged further support of the Bank in economic and financial fields.

October 9, 1986

4. The Minister indicated that his government supports wholeheartedly and in every respect the proposed general capital increase. He, however, requested that the current voting powers of less developed countries should not be decreased from their present level of 42.6% of the total. He particularly hoped that China's current position will not be affected by such general capital increase. The President replied that the total voting rights of the developing countries are likely not to change because of a general capital increase. It is a matter of negotiations among shareholders and the Bank is anxious to facilitate consensus among its member governments.

5. The Minister raised the subject of IDA's eighth replenishment and indicated that his government is supportive of a US\$12 billion or more for IDA VIII. The President said that the Bank was encouraged by the progress and he hoped for further progress to be achieved soon. Major negotiations involving the U.S. and Japan are taking place and an agreement is expected to be reached by November 1986. The Minister said that he will present the recommendation of his government on IDA VIII to Secretary Baker and will discuss them further with his colleagues at the Annual Meetings. Mr. Conable thanked the Minister for his support and said that the Bank would need all the help that it could get. The Minister indicated that his government supports the Bank's formula for IDA funds allocations among recipient countries. Like the Bank he feels that African countries have a first claim on these funds, but hoped that China's needs would be carefully considered and that a fair share of the increase provided by Japan for Asian countries will be allotted to China. Mr. Conable replied that the Bank is well aware of the needs in different parts of the world and it will keep this in mind. The Minister expressed concern about the proposals from major IDA donors to shorten the maturity of IDA funds for "blend" countries and requested the Bank to reconsider them. Mr. Conable informed him that the decision will be made by the Board and the Ministers of Finance may wish to discuss this matter among themselves and provide the proper instruction to their respective representatives at the Board.

6. Mr. Conable concluded the meeting by reiterating Bank appreciation for the excellent relations and close cooperation that exist with China. He also indicated that the Bank will be happy to consider a larger lending program in appropriate areas to be agreed with the Government. Mr. Conable thanked the Minister for his visit and said that he was looking forward to continuing this discussion during the Annual Meetings and in Beijing next spring.

BMerghoub:caa

Cleared with and cc: Mr. Kaji

cc: Messrs. Conable, Stern, Karaosmanoglu, Yenil, van der Meer, Turnham, Lim, Levy, Ahmed, Sam

ANNUAL MEETINGS BRIEF

Name of Country: CHINA

Date: September 27, 1986

Meeting with:

Minister of Finance and IBRD Governor  
(Mr. Wang Bingqian)  
Vice-Minister of Finance and Alternate IBRD Governor  
(Mr. Li Peng)

**Population:** 1,035 M (1985) **Growth Rate:** 1.1% p.a. (1985)

**GNP per capita:** \$310 (1984)

(\$ M)

(\$ M)

<b>Total Commitments</b>	\$4,086.1	<b>FY86: Commitments</b>	\$1,137.0
of which:		Disbursements	\$ 609.8
Bank: (25 loans)	\$2,459.9	Amortization	-
IDA: (26 credits)	\$1,626.2		

**Total Undisbursed:** \$1,991.7

**Lending Program:** FY87-88 \$3.8 billion (tentative)

<u>Summary Data</u>	<u>Avg 83-85 (SAEM Figures)</u>	<u>86 (Region's estimates)</u>	
	%	%	
GDP growth (constant prices)	12.0	8.0	Aid Group Meeting: Not Applicable
Export growth (constant prices)	9.7	14.4	IMF Status as of August 1986:
Import growth (constant prices)	35.7	-5.8	Article IV Consultation
Current Account			discussions July 10-August 2, 1986 -
Surplus (Deficit) % GDP	(-0.7)	(-4.5)	Standby requested (see para. 3)
Gross Debt Service Ratio	5.8	7.0	
Annual Inflation Rate	5.0	5.0	

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Background (text provided in para. 1)

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Issues likely to be raised by delegation:

1. Policy-based (program) lending
2. China's capital share in the context of GCI
3. IDA allocation
4. Visit to China

Issues to be raised by Bank Management:

1. Lending Program
2. ADB membership and lending program
3. External Debt Reporting

Attachments:

FIVE-YEAR LENDING PROGRAM: FY86-90 (86 actual) - Annex I  
Biographical Information - Annex II

## Background

1. The leadership under Deng Xiaoping introduced its first phase of major economic reforms in 1979. Reforms were first undertaken in the rural areas, where they have been most successful. Individual or small groups of households were given autonomy over production decisions; as the government raised agricultural prices, farmers responded by raising production and increasing efficiency. Mandatory planning and compulsory sales to the Government have now been abolished, and collectivization largely reversed. Other rural activities have also developed, generating higher rural incomes and employment, as well as healthy competition with the urban sector.
2. Urban and industrial reforms have been considerably slower and more complicated, as they involve fundamental changes in the distribution of responsibility between the central government and state or locally-controlled enterprises, in labor and wage policies and in the overall price structure in the economy. Gradually, state enterprises are being given greater autonomy and are allowed to respond to financial incentives. They now may trade in the market, rather than being limited to planned transactions, and may pay bonuses to workers based on performance. They retain part of their profits and, in some cases, foreign exchange earnings and are encouraged to finance their activities from retained earnings or through borrowings. But the partial reforms instituted so far, particularly the decentralization of decision-making, have themselves led to short-run problems -- difficulties in controlling investment and foreign borrowing, a fragmented foreign exchange system and, in some instances, increased subsidies to urban areas. Also, the greater freedom of enterprise managers to respond to market incentives gives greater weight to remaining price distortions, which cause sharp differences in the profitability of enterprises in different regions and industries unrelated to true economic advantage. Hence, enterprise reforms must now be accompanied by more extensive pricing, trade and regulatory changes to encourage appropriate investment decisions. Reforms will have to extend into very sensitive areas, such as the wage and employment system, urban subsidies, social security needs and macroeconomic management.
3. A cornerstone of China's strategy of modernization has been the expanded role for foreign trade, capital and technology. This open door policy, introduced in 1979, replaced three decades of "self-reliance" regarding China's external stance. Steps are being taken to improve the climate for foreign investment in response to well-publicized difficulties encountered by foreign investors. Such difficulties arise, in part, from cultural differences and, in part, from differences in expectations regarding direct investment -- with China wanting technology transfer and exports and investors looking to China's large domestic market.
4. In any case, the Government plans to proceed cautiously in further opening of the economy, especially on the import side, as the tools of demand management are yet to be perfected and, in the near term, there remains the danger of excess demand pressures adversely affecting the balance of payments. The latter is of continuing concern to the authorities. Spurred by the reforms to date and improved production incentives, the economy grew at double-digit real rates in 1984-85, far exceeding the growth of the previous decade. But the rapid growth led to increasing demand pressures and relatively high inflation (9% in 1985). China's external balance deteriorated; exports rose by 5%, while imports jumped by 60%. Foreign exchange reserves declined sharply, although they have since stabilized at a comfortable level (\$13.2 billion at end-1985), and there was a substantial increase in commercial borrowing (especially short-term borrowing). Exports are indeed likely to continue to be squeezed in the near

future, due to lower prices for oil exports (about 25% of total exports) and expected continued stagnation in textile exports due to the restrictions of major importers. In response to these concerns, in mid-1985 the Government adopted a tight budgetary policy and stricter investment and credit controls to slow the pace of growth. It also devalued the renminbi by 13.5% this July and is making improvements in its debt authorization procedures to ensure a more controlled growth in borrowing.

5. Still, China's leaders remain committed to the dual objectives of growth and reform. China's Seventh Five-Year Plan (1986-90), adopted earlier this year, calls for steady growth (7.5% p.a. in industry and 4% p.a. in agriculture), with a focus on infrastructure investments, greater use of foreign capital and know-how and further economic reform. After this year of consolidation, further reform measures are expected in 1987.

6. China's Relations with IMF. China's annual Article IV Consultation with the IMF has just taken place. The IMF mission also discussed an adjustment program for the Chinese economy which might be supported by a first credit tranche standby arrangement of SDR 597.7 million. Negotiations are expected to be concluded by mid-October and consideration by the IMF Board of both the Standby request and the Consultation has tentatively been scheduled for early-November.

7. Bank-China Relationship. Our relationship with China continues to evolve smoothly. Annual lending has topped \$1 billion in each of the last three years, and the Government hopes to substantially step up the lending program (to approximately \$1.8 billion in FY87 and over \$2 billion in FY88). A programming mission in June made considerable progress in agreeing with the Government on firm projects for FY87-88, and possible projects for FY89-90. Also in late 1985, the Government agreed to an expanded economic and sector work program, with the Bank undertaking 13 studies on key economic and sectoral issues, most of which have already begun. The Government has indicated that it hopes these studies will form the analytical basis for Bank involvement in helping the Chinese prepare the Eighth Five Year Plan (1991-95).

8. Some problems persist, however, which you should be aware of. One is the lack of consensus in China on a foreign borrowing strategy. The highest levels of Government (including Minister Wang) are aware of China's need to expand its foreign exchange borrowing and are relatively liberal about mixing the sources of funds, but the Bank's key counterparts at the operational level in the Ministry of Finance and State Planning Commission remain generally hesitant about cofinancing of Bank projects, particularly with commercial money. Another issue is the highly fragmented system of foreign exchange management and utilization of foreign capital, which leads to the requirement that Bank loans and IDA credits onlent to project entities (central ministries and agencies or provinces) be repaid in foreign currency, regardless of whether the project entity generates foreign exchange, thus biasing project selection. The Government is considering transitional solutions for onlending and repayment of Bank loans, but the issue basically has to be addressed in the context of the foreign exchange retention and allocation system. The Bank's upcoming study on foreign trade and capital flows will examine some of these problems. Finally, project development is slow in China because of the compartmentalized bureaucracy and the still evolving roles of institutions such as the Ministry of Finance and State Planning Commission.

Issues likely to be raised by Delegation

9. Policy-Based (Program) Lending. During Mr. Kaji's trip in June, the Chinese made their first formal enquiry about the possibility of program lending, specifically in the form of a series of loans in support of additional system reforms (prices, taxes, financial structure) expected to be initiated during the current Seventh Five-Year Plan. The Government expressed interest in annual Bank loans of up to \$1 billion for this purpose. You should state that the Bank is prepared to consider assistance of this nature; however, the frequency and size of such operations, would be dictated by the nature of assistance required to support any adjustment effort and would also have to be viewed in the context of the overall size of the lending program. You should emphasize, though, that annual loans for amounts as much as \$1 billion are unlikely to be achievable.

10. It was agreed in June with the Government that the next step would be for the Bank to have follow-up exploratory discussions in mid-September on specific program ideas with the State Commission for Restructuring the Economic System. If there are any developments, we will provide a supplemental brief on the results at that time. You should emphasize, however, that the Government's interest in possible policy-based loans should at this stage be pursued independently of the agreed immediate priority of expanding the lending program on the basis of a strong medium-term project pipeline.

11. China's capital share. The delegation is expected to raise the issue of China's capital share in the context of the next General Capital Increase. A supplemental brief on this issue will be provided by the Finance Complex.

12. IDA allocation. The Government no longer insists on a certain IBRD/IDA blend (60/40 for FY85 and FY86); hence the issue is not as crucial as in the earlier years and may not be raised this year. China is programmed to receive \$510 million in IDA funds in FY87 compared to \$442 million in FY86. The Government, however, continues to be concerned that China receive its fair share of IDA resources, particularly in relation to other large borrowers such as India, and is thus closely following the IDA-8 negotiations. If the delegation raises the IDA allocation issue with respect to IDA-8, you should explain that the Bank must consider numerous factors in determining IDA allocations, but the Bank is certainly interested in ensuring that China receives its fair share; at the same time there are other low income member countries with claims on IDA funds. You should welcome the Government's decision to delink its borrowing program from any particular IBRD/IDA blend figure and to step up its IBRD borrowing to meet its foreign borrowing requirements during the Seventh Five Year Plan period.

13. China Visit. The Chinese may invite you for a visit. We recommend that you accept the invitation, at a date to be mutually agreed later.

Issues to be raised by Bank Management

14. Lending Program. You should express our satisfaction with the FY86 lending program of approximately \$1.14 billion and the cumulative lending of over \$4 billion in six years. You should indicate that the Bank, too, hopes the lending program will expand further in light of China's foreign borrowing requirements under the Seventh Five-Year Plan. Lending operations had, until recently, been hampered by a very short planning horizon which limited the Bank's early and comprehensive involvement in project identification, design and preparation. You should welcome the Government's recent initiative toward establishing a longer planning horizon and a stronger project pipeline as the basis on which to build an expanding lending program. In order to ensure that this expanded pipeline of



projects is realized, you should emphasize the importance of Government measures to allow Bank involvement at earlier stages of project preparation and to overcome problems caused by the foreign exchange repayment system. You may also wish to express the importance of the recent agreement to hold semi-annual lending program reviews, to help ensure that timely follow up action is undertaken to prepare projects and address issues early. You should express your confidence that with the excellent cooperation the Bank and China has enjoyed since 1980, the very challenging task of attaining an annual commitment \$2 billion within two years could be accomplished.

15. ADB membership and lending program. You may wish to congratulate China on its entry into the Asian Development Bank (ADB) this year, and inquire what their borrowing plans are likely to be, particularly in regard to any prospective cofinancing operations with us.

10. External debt reporting. You should express our satisfaction that China has recently provided the Bank's Debtor Reporting Service with data on its external borrowing outstanding through end-1984, and has thereby met its reporting requirement to the Bank. You should commend the recent State Council decision to give People's Bank responsibility for overall debt coordination, which reflects the serious attention the authorities are devoting to this important issue.

*In October industrial sector*

**China**  
**FY86-90 Lending Program**

Lending FY	Project	Lending Amount (\$ Million)		
		IBRD	IDA	
FY86	Rural Credit II	-	90.0	
	CIB III	75.0	25.0	
	Technical Cooperation Credit II	-	20.0	
	Provincial University	-	120.0	
	Third Railway	160.0	70.0	
	Tianjin Port	130.0	-	
	Freshwater Fisheries	-	60.0	
	Beilungang Thermal Power	225.0	-	
	Yantan Hydroelectric	52.0	-	
	Liaodong Bay Petroleum Appraisal	30.0	-	
	Rural Health & Preventive Medicine	15.0	65.0	
Total	687.0	450.0	1,137.0	
FY87	Red Soils	-	40.0	
	Shanghai Machine Tools	100.0	-	
	Power V (Shuikou)	176.0	-	
	Beijing-Tanggu Expressway	163.0	70.0	
	Huangpu Port	108.0	-	
	Coal II (Jincheng)	110.0	25.0	
	Shanghai Environment	-	145.0	
	Gansu - Agriculture	20.0	110.0	
	- Education	-	20.0	
	- Industry	20.0	-	
	CIB IV	250.0	-	
	Xinjiang Area Development	-	70.0	
	Power VI (Yanshi Thermal)	100.0	-	
	Rail IV	200.0	-	
	Fertilizer II	140.0	-	
	Special Credit	-	30.0	
Total	1,387.0	510.0	1,897.0	

<u>Lending FY</u>	<u>Project</u>	<u>Lending Amount (\$ Million)</u>		
		<u>IBRD</u>	<u>IDA</u>	
FY88	Coal III (Kailuan)	350.0	-	
	South China Offshore Gas	200.0	-	
	Rural Credit III	-	100.0	
	He Tao Irrigation	-	85.0	
	Education - Textbooks	-	100.0	
	Education - Teacher Education	-	100.0	
	Highways III	150.0	-	
	Dalian Port	150.0	-	
	Power VII (Wujin Thermal)	200.0	-	
	Cement	100.0	-	
	DFC V	100.0	100.0	
	Power VIII (Hainan Hydro)	200.0	-	
	<b>Total</b>	<b>1,450.0</b>	<b>485.0</b>	<b>1,935.0</b>
FY89	Health III	-	75.0	
	Shanghai Port	150.0	-	
	Livestock I	-	100.0	
	Agro-Processing I	-	75.0	
	Industry VI	100.0	-	
	Fertilizer III	150.0	-	
	Coal IV	250.0	-	
	Technical Education	-	75.0	
	Highways IV	150.0	-	
	Coal V	250.0	-	
	DFC VI	200.0	75.0	
	Rural Water Supply II	-	100.0	
	Phosphate Mining	100.0	-	
Dongpu Gas	90.0	-		
<b>Total</b>	<b>1,440.0</b>	<b>500.0</b>	<b>1,940.0</b>	

<u>Lending FY</u>	<u>Project</u>	<u>Lending Amount (\$ Million)</u>		
		<u>IBRD</u>	<u>IDA</u>	
FY90				
	Industry VII	150.0	-	
	Industry (Chemical)	100.0	-	
	Inland Waterways	200.0	-	
	Education (unidentified)	-	100.0	
	Power IX (Thermal)	200.0	-	
	Coal VI	300.0	-	
	Urban (Liaoning)	-	100.0	
	Agriculture - Area Devt SW	-	100.0	
	Agriculture (unidentified)	100.0	-	
	Education (unidentified)	-	100.0	
	Roads V (unidentified)	150.0	-	
	Railways V (unidentified)	200.0	-	
	Power X	200.0	-	
	Petroleum/Gas (unidentified)	150.0	-	
	DFC VII	250.0	-	
	Health IV	-	<u>100.0</u>	
	Total	2,000.0	500.0	2,500.0

Footnote: FY88-90 lending program likely to be increased; discussion with Government ongoing.

DELEGATION/BIOGRAPHICAL SKETCHES - CHINA

Delegation

WANG Bingqian	-	Minister of Finance and Governor, IBRD
LI Peng	-	Vice Minister of Finance Alternate Governor, IBRD

Biographical Sketches

WANG Bingqian: Mr. Wang Bingqian was born in 1925 in Hebei Province. He has made his career in the Ministry of Finance, rising eventually to become Minister in 1980, when he was China's youngest minister. In 1983, he became a State Councillor, giving him a status equivalent to a Deputy Prime Minister.

LI Peng: Vice Minister Li was born in 1921 in Jiangsu province. He is a graduate of South-West China University. He understands some English but speaks only a few words. He has made his career in the Ministry of Finance, rising to become the senior vice-minister in mid-1982.

## OFFICE MEMORANDUM

Mr. Sam

DATE October 9, 1986

TO Memorandum for the Record

FROM Baelhadj Merghoub, Chief, AEACH

EXTENSION 72565

SUBJECT CHINA: Summary of Discussions between President Conable and His Excellency Wang Bingqian at the 1986 Annual Meetings Washington, September 27, 1986

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External Finance Department, Ministry of Finance  
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The Bank staff attending included Messrs. Stern, Karaosmanoglu, Kaji, Lim, Sam, and Merghoub.

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3. Turning back to the volume of lending to China the Minister remarked that about 41 projects are being financed in China for a total commitment of IBRD/IDA funds of US\$4.1 billion. He hoped that this volume of lending will further increase to levels more in line with China's size. He also indicated that his government is particularly appreciative of the advice and support that it receives in the economic field and system reform. He made special mention of the two economic reports prepared by the Bank and the special attention given to them by the highest level of the Chinese leadership including the Premier. Mr. Conable said that he was delighted by this outcome and pledged further support of the Bank in economic and financial fields.

October 9, 1986

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Cleared with and cc: Mr. Kaji

cc: Messrs. Conable, Stern, Karaosmanoglu, Yenil, van der Meer,  
Turnham, Lim, Levy, Ahmed, Sam

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION  
**OFFICE MEMORANDUM**

Date: May 16, 1986

To: Memorandum for the Record

From: Gautam S. Kaji, Director, AEA 

Ext: 72103

Subject: China: Mr. Clausen's Meeting with Vice Minister Yao Yilin

1. Mr. Clausen, at the request of the Chinese authorities, met with Vice Premier Yao Yilin today at 11 a.m. at the Madison Hotel. I accompanied Mr. Clausen to the meeting. Other Chinese officials present at the meeting included Mr. Gan Ziyu, Vice Chairman of the State Planning Commission; His Excellency Han Xu, Chinese Ambassador to the United States; and Mr. Xu Naijiong, the Chinese Executive Director.

2. After an exchange of pleasantries, Mr. Clausen opened the meeting by thanking the Vice Premier and his colleagues for the excellent cooperation between the Bank and the Chinese Government, which has resulted in the development of a significant level of Bank activities, including the build-up of commitments, in the short time since China had resumed its seat in the Bank. Mr. Clausen went on to comment that he had been particularly happy to hear, following Mr. Stern's visit to China in October last year and his meeting with the Premier, that the Government wished to see a stepped-up borrowing program from the Bank. With respect to this, Mr. Clausen expressed two concerns which were interrelated. The pipeline of projects presented to the Bank was still rather thin and did not provide enough of a time horizon to permit the orderly development and financing of activities. This led to continued uncertainty as to the level of Bank commitments possible in any given year and equally had implications for the disbursement levels that could be achieved. Referring to the subsequent discussions with the Chinese authorities in March this year, Mr. Clausen stated that while we believe we are doing everything we can to try and meet the objective of the Government, which was to generate disbursements of Bank funds totalling US\$6.2 billion during the next plan period, unless a strong pipeline of projects which was well integrated in their overall plan priorities was presented to the Bank in June, our ability to assist the Chinese in generating the level of fund flow that they were anticipating would be seriously compromised. In response to the stated desires of the Chinese Government, we had taken all the necessary preparatory steps to position ourselves to respond. In addition to the opening of the office in Beijing, we had allocated additional staff resources at headquarters to handle an enlarged program, and our staff had been geared to provide the necessary

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May 16, 1986

inputs, but unless we had concrete proposals from the Chinese authorities, we could not proceed further. At this juncture there was considerable exchange between the Chinese officials, presumably clarifying the relationship between commitment and disbursement levels.

3. The Vice Premier responded that he agrees that we do not yet have an adequate pipeline of projects which would generate the necessary commitments that would yield the desired level of disbursements. He also agreed that the Chinese authorities need to step up their activity to identify projects which could make good use of Bank resources. At that point, we suggested that to the extent SPC was trying to identify a further pipeline of projects, this was an endeavor that the Bank and SPC could carry out concurrently and not sequentially as SPC often suggested. Mr. Gan Ziyu indicated that that is an approach we must discuss more fully during my visit to China in June. It was clear that the message on the paucity of the pipeline was duly received, and at the same time, there was no hesitation confirming that they were indeed looking to the Bank for a significantly larger lending program.

4. Mr. Clausen also thanked the Chinese Government for their support of the Bank on institutional issues. He appreciated their support for the IDA Replenishment, not only through their discussion with the major bilateral donors, but equally through their effective use of IDA resources. As regards the General Capital Increase, he again appreciated the Chinese support and hoped that the discussions in the Board could be brought to closure by next Spring so that the Board of Governors could be presented with the formal decision. With regard to MIGA, Mr. Clausen particularly appreciated the support from the Chinese chair in the difficult discussions at the Board which had culminated in the approval of MIGA in Seoul. He informed the Vice Premier that, in addition to the other signatories, the United States and Japan were also expected to sign shortly, and he very much hoped that China could become a signatory before the convening of the preparatory committee meeting.

5. The Vice Premier recalling his relationship with Mr. Clausen prior to, and during his presidency of the Bank, expressed the great appreciation of the Chinese Government for the important role the Bank had played, not only as a provider of capital, but equally for the economic analyses, and the training of Chinese officials. He expressed the hope that the same open

May 16, 1986

relationship would continue with the Bank after Mr. Clausen's retirement. Mr. Clausen responded that while he thanked the Vice Premier for those very kind personal comments, he wanted to emphasize that the relationship with China is institutionalized, that there was great admiration within the Bank for what China has achieved and is attempting to achieve, and he wished to assure the Government that the nature of the relationship of the Bank was an enduring one.

6. At the close of the meeting, the Vice Premier conveyed to Mr. Clausen on behalf of the Minister of Finance and himself, an invitation to visit China in his personal capacity whereupon he may have an opportunity to visit parts of China he had not seen, and that the Government would be delighted to make such arrangements. The meeting ended with Mr. Clausen thanking the Vice Premier, and through him, the Minister of Finance, for their kind personal invitation.

cc: Mr. Clausen's Office  
Messrs. Stern (SVPOP)  
Karaosmanoglu (o/r) (AENVP)  
Kirmani (AEPDR)  
Turnham (AEPDR)  
Koch-Weser (AEACH)  
Lim (RMC, Beijing)

GSKaji/jh

RECEIVED

1986 MAY 23 AM 11: 02

OFFICE OF THE PRESIDENT

MEMORANDUM

TO: THE PRESIDENT  
FROM: [Name]  
SUBJECT: [Subject]

DATE: [Date]  
BY: [Name]

The following information was received from [Name] on [Date]. [Name] advised that [Name] had been [Action] on [Date]. [Name] stated that [Name] had been [Action] on [Date]. [Name] also stated that [Name] had been [Action] on [Date]. [Name] further stated that [Name] had been [Action] on [Date]. [Name] concluded that [Name] had been [Action] on [Date].

[Name] advised that [Name] had been [Action] on [Date]. [Name] stated that [Name] had been [Action] on [Date]. [Name] also stated that [Name] had been [Action] on [Date]. [Name] further stated that [Name] had been [Action] on [Date]. [Name] concluded that [Name] had been [Action] on [Date].

Very truly yours,  
[Name]

[Name]

# OFFICE MEMORANDUM

DATE May 13, 1986

TO Mr. A.W. Clausen

Through: Mr. Ernest Stern, Senior Vice President, SVPOP

FROM Gautam S. Kaji, Acting Vice President, AENVVP

EXTENSION 72103

SUBJECT **CHINA - Your Meeting With Vice Premier Yao Yilin**  
**Briefing Note**

*Red Pop  
BenJin  
SPROFATION AU  
35% increase*

*ES*  
*[Signature]*

*86  
670  
+450  
1120*  
*87  
1055  
450  
1505*

*Disbursements  
are in  
Jeonmoy.*

1. You are scheduled to meet with Vice Premier Yao Yilin on Friday, May 16, at 11:00-11:45 a.m., at the Madison Hotel, Room 1531. I will accompany you.
2. Vice Premier Yao, who is on an official visit to the U.S., is in charge of various economic matters in China, including work of the State Planning Commission which he himself headed until recently. He is the Vice Premier most directly involved in matters relating to the World Bank, and has met with you and other Bank officials over the past few years, including Mr. Attila Karaosmanoglu, Vice President of East Asia and Pacific Region. While in Washington, Vice Premier Yao is expected to preside over the opening and closing ceremonies of the annual meeting of the U.S.-China Joint Commercial Committee held here this year.
3. Also present at the meeting will be Mr. Gan Ziyu, who has been Vice Minister of the State Planning Commission since 1978 and whom you have met during your visit to China in June 1983. He has been one of our main counterparts since the early days of the Bank-China relationship and has played a major role in the development of our dialogue over the past few years. His Excellency Han Xu, Ambassador of China to the U.S., is also expected to be at the meeting.
4. At the meeting you should express satisfaction at the overall development of the Bank-China relationship over the last few years, and especially convey the following:
  - (a) the Bank confirms the agreement reached between Mr. Stern and Premier Zhao Ziyang last October to substantially increase Bank lending to China over the period of the 7th Five Year Plan (1986-90), and to better integrate Bank lending with the objectives and strategy of the 7th Five Year Plan;
  - (b) however, we are concerned that insufficient progress has been made so far towards both objectives, especially in the identification of a sufficient number of potential projects to be included in an expanded lending program consistent with the priorities of the 7th Five Year Plan;

KAZI'a

- (c) therefore, much work remains to be done by both sides; and we hope that at the time of my visit to Beijing in late June to discuss the longer term lending program, the authorities will be in a position to fully discuss and present their proposals; and
- (d) we look to the Vice Premier for his personal support and would be grateful if he could convey our concern to Premier Zhao Ziyang.

5. Vice Premier Yao Yilin's biographical data is attached for reference.

Attachments

## YAO Yilin


Yao Yilin was born in Anhui Province in 1917. As a student in Beijing, he became actively involved in politics and joined the Chinese Communist Party (CCP) when he was barely eighteen. He soon became Secretary of the Tianjin Municipal Party Committee, and later Secretary-General of the Shanxi-Qahar-Hebei Bureau of the CCP Central Committee. During the War of Liberation (1946-49) he served as Director of the industrial bureau of the Shanxi-Qahar-Hebei border area people's government and Deputy Director of its financial and economic office, and later became Head of the industry and commerce department of the North China people's government.

Since the founding of the People's Republic of China in 1949, Yao Yilin has held many important posts related to economics, commerce and trade in both the government and the Party. He was First Vice Minister of Foreign Trade, Minister of Commerce, Secretary-General of the Committee of Financial and Economic Affairs under the State Council, and Minister in charge of the State Planning Commission. He was appointed Vice Premier in 1982, following a major restructuring of the State Council and the central government organs. In September 1985, he was elected member of the Politburo of the CCP Central Committee.

## OFFICE MEMORANDUM

DATE April 3, 1986

TO Mr. A. W. Clausen

FROM Gautam S. Kaji, Acting Vice President, AEN 

EXTENSION 72103

SUBJECT CHINA: Note for Your Dinner with Vice Minister Li Peng on  
Friday, April 4, 1986

1. Vice Minister Li Peng will head the Chinese delegation to the Development Committee meetings and will host a dinner tomorrow evening in your honor. You last met with the Vice Minister at the 1985 Annual Meetings where he raised the issues of the IDA allocation for China and the resulting blend of IBRD/IDA funds in the lending program. He also expressed his view that price reform has become the most difficult issue for policy-makers in China.

Recent Economic Developments

2. China's economy continued to grow rapidly in 1985 (about 12% in real terms). Excessive credit expansion beginning in the second half of 1984, however, resulted in an acceleration of inflation and a sharp deterioration of the external accounts. Consumer prices rose at an overall rate of 8.8% in 1985, but over 12% in the cities (7% in rural areas). The rapid expansion of imports, and a slowdown of export growth led to a current account deficit of about US\$11 billion in 1985, compared to a \$2 billion surplus in 1984. The deficit was financed principally by short-term borrowing and the drawdown of international reserves. Direct controls have been tightened on credit and imports, and there does not appear to be any immediate danger of a balance-of-payments crisis. Falling oil prices and increased protectionism have further weakened export prospects, however, and longer-term adjustment measures may be needed. A comprehensive debt monitoring system and external borrowing strategy are also needed.

3. China's Seventh Five Year Plan (covering 1986-90) has been drafted and is now under discussion in the National People's Congress. The proposals call for steady growth at 7% p.a., and focus on building the foundation for future growth through relieving major bottlenecks in the energy, transport and raw materials sectors, technological modernization, greater reliance on foreign capital, and continuation of economic reform (particularly in price corrections and the financial system, following a period of consolidation in 1986). Total investment during the Seventh Plan period is expected to be about 1 1/2 times the level undertaken during the Sixth Plan.

Status of the Bank's Program in China

4. As follow-up to the well-received second economic report, economic and sector work is ongoing in several areas. Of particular importance is a mission to study reform of the investment finance system, which has just returned and is preparing its report for discussion with the Government later this year. A mission to study the foreign trade and investment regimes is

scheduled for the fall. Major sector studies are also underway or soon to be undertaken in, among other areas, transport, electric power pricing, coal utilization; the fertilizer sector, and urban health delivery and financing.

5. To date the Bank has approved lending for 34 projects in China for a total of US\$3.3 billion. Of that total, slightly more than 40% was IDA funding. The priority sectors have been energy and transport. Total lending for FY86 is expected to be \$1.15 billion for 11 operations. We anticipate major expansion in our lending program. However, we have not yet been able to agree with the Government on a specific strategy for a longer-term lending program that would link Bank borrowing with the overall plan for foreign borrowing and the investment program under the Seventh Plan.

Issue likely to be raised by the Vice Minister

6. The concern most likely to be raised by the Vice Minister is the status of IDA-8 negotiations and the question of China's access to IDA funds over the coming years. We have conveyed to the Government that there is a strong feeling among donors that the nominal amounts allocated to the large blend countries (India and China) under the current replenishment should not increase under IDA-8. China received \$400 million in IDA funds in FY85 and \$450 million in FY86. We anticipate an allocation of roughly \$400 million in FY87.

Issues that you should raise

7. You should convey your satisfaction with the development of the Bank-China relationship, mentioning the development of the lending program so far and China's impressive recent performance in project implementation. You should also say how pleased you are with the growing cooperation in economic and sector work, particularly the very successful recent economic mission on investment and finance, which you hope will contribute to the Government's effort in financial system reform. You should also express appreciation for the Government's support and assistance in establishing the Resident Mission in Beijing, which is now fully staffed and operational.

8. You should recall Mr. Stern's discussions with Premier Zhao Ziyang and Minister Wang Bingqian last October, which indicated an expanded role for the Bank in China. You should stress that we expect in the near future to more closely link our longer-term lending program with the Government's foreign borrowing strategy and investment program under the Seventh Plan. You should emphasize that if the Government indeed intends to expand borrowing, then we would need to move quickly to reach agreement on the sectoral priorities and firm up the longer-term project pipeline. Mr. Kaji will lead a mission in June for further discussions aimed at reaching such an agreement.



9. You should say that in order to deliver an expanded program, both the Bank and the Government will need to streamline and better synchronize their project processing procedures as well as strengthen staffing. The Bank has taken a major step in this direction with the establishment of the Resident Mission in Beijing. You should express the Bank's willingness to support the Government's efforts to strengthen its own staffing, particularly in the core agencies.

10. You should mention the Bank's involvement in the proposed Three Gorges Project. Further to Mr. Stern's discussions in October with Finance Minister Wang, the Bank has recently been asked to assist in undertaking a comprehensive investment study of the project, focusing on its economic justification in the context of China's plans for energy sector development. We will also help to bring together a panel of international experts to advise the Government and oversee the study to be carried out by a consultant.

11. Three Gorges remains highly controversial among Chinese officials, because of the enormous potential costs (\$10 billion plus) and impact on the environment and population residing in the proposed project site. The project has attracted the involvement of many bilaterals, including Canada, the U.S., Sweden and Italy. In fact, one problem we face is that the Chinese Government has asked the Canadians to undertake a study virtually identical to the one we are planning. Carrying out two such similar studies would not only cause unnecessary duplication of effort and resources but would also be impractical, for the Chinese in terms of counterpart staffing. The State Council needs to be presented with recommendations on the proposed project by the end of 1987 in order to make a final decision on whether to go ahead with the project.

12. In discussing Three Gorges, you should say that we are looking forward to assisting the Government in bringing in foreign expertise to undertake the careful analysis of the economic justification for the project. The Government would have to ensure that there is no duplication of assistance provided by the Bank and bilateral donors. You should also mention that we hope to finance the pre-investment work under the existing Technical Cooperation Credit so that work can proceed quickly.

# OFFICE MEMORANDUM

For MC information  
Mr. Clausen

E-1227

OPS/MC85-68

DATE: December 12, 1985

TO: The Managing Committee

FROM: Ernest Stern *ES*

EXT.: 72004

SUBJECT: CHINA Country Program Paper

Attached for your information is the China CPP which was reviewed by the Operations Policy Sub-Committee on November 25, 1985. The Agenda for that meeting and the Postscript are also attached.

Attachments

cc: Mr. Southworth

CHINA

Country Program Paper

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WBG ARCHIVES

Postscript

97. The OPSC discussed the CPP on November 25, 1985. The discussion focussed on questions of macroeconomic management, system reform, and the country's development strategy. As to the significance of the recent upsurge of the current account deficit, the Region commented that it has been caused by ineffectiveness of macroeconomic controls, and that it reflected the problems of transition from direct to indirect management. This process has inevitably been neither smooth nor quick, and the Government is trying to develop new instruments. In the effort to regain control, however, the Government had little choice but to resort to some direct controls of imports. This does not constitute a retrogression, but is a pragmatic response to the lack of price-responsiveness of the economic system. For example, in the case of automobiles - the most conspicuous example of a rapid rise of imports - demand emanates from economic enterprises whose price elasticity is still so low that import duties could not be expected to generate a quick contraction.

98. In the view of the Region neither the need for ad hoc responses to temporary difficulties of economic management, nor a shift of the balance of power within the political leadership posed a threat to the momentum of reform, as its proponents within the leadership appear to be very much in control.

99. Regarding China's borrowing strategy, ~~strict linking of IDA and IBRD borrowing was no longer pursued by the Government~~, although it remained sensitive to cross-country equity regarding the blend of Bank resources. The Region emphasized that ~~China was experiencing some problems of debt management~~, and that EPD was prepared to continue providing assistance in improving the debt reporting system.

100. The question was raised whether rapid transfer of technology, which seemed to be a major concern of the Chinese, would be associated with rising capital-intensity and thus negatively affect ~~employment generation~~. The Region replied that the link with capital-intensity had to be judged on a case-by-case basis, and that the case for technology transfer rested on the effect on total factor productivity. The Chinese gave also increased emphasis to technological adaptation. Another question referred to follow-up work on the promotion of the service sectors, as recommended in the last economic report. The Region responded that in conventional Marxist terms, services were not highly regarded since they are included in "non-productive" activities; for that reason the report had stressed the supplementary role of services in the development of the economy. The new Five-Year Plan, however, foresees a greater emphasis in this direction. On a different plane, the ~~Region plans to address the development of the service sector~~, including collective and private activities, through provincial studies.

101. The Region, reflecting Government concern, proposed the application of the same cost-sharing formula as applied to India, (50%; in very exceptional cases, 75%) and this was approved.

102. The proposed Lending Program was approved.

103. The Sub-committee directed that the CPP, the agenda and the postscript should be forwarded to the Management Committee for information.

December 12, 1985

# OFFICE MEMORANDUM

DATE: November 21, 1985

TO: Operations Policy Sub-Committee

FROM: Luis de Azcarate, Director, CPD

EXT.: 60063

SUBJECT: CHINA CPP: OPSC Review

1. Attached is an agenda and comments on major policy issues identified by CPD and PBD for consideration by the Sub-Committee. The suggested agenda items are:

- a) Macroeconomic Management;
- b) Borrowing, Debt Management, and Creditworthiness;
- c) Bank/Country Relationship;
- d) Volume of Lending, IDA reserves; and
- e) IFC/Bank Cooperation.

2. The Review Meeting will be held on Monday, November 25 at 2:30 p.m. in Room E-1208.

Attachments

cc: Regional Office: Messrs. Kaji  
Kirmani  
Yenal  
Linn  
Koch-Weser  
Levy  
Calderisi

Messrs. Ryrie  
Huang  
Jansen

## CHINA COUNTRY PROGRAM PAPER

### Topics for Discussion

1. Since the last CPP was reviewed in 1981, there have been fundamental changes in China's system of economic management. These contributed greatly to the rapid overall development of the economy and substantial improvements in the standard of living, particularly in rural areas. After implementing a comprehensive restructuring of rural institutions, which made the family farm the unit of management to be guided in its production decisions by market prices, the focus of the system reform is now turning to the urban-industrial sector. The most important step in this direction was the decision of the Central Committee of the Party in October, 1984, on a comprehensive outline of a strategy for reform. It envisages a transition from an administratively managed to a decentralized system, with considerable scope for enterprise autonomy in determining output, procurement of inputs, price formation, and investment. Macroeconomic control by central intervention is gradually to be replaced by micro-responses to price signals and centrally set policy levers. The details of the system changes are gradually to be defined and introduced over the next five years. The Bank, thus, can look forward to a most challenging phase of collaboration.

#### Macroeconomic Management

2. During 1980 to 1984, China combined a vigorous GDP growth (averaging 9% per year) with a strong external position. Between 1981 and 1984 the current account balance was positive, and by end of 1984 reserves were equivalent to nine months of imports. This year, however, while GDP is expected to grow again by more than 10%, the external balance is expected to deteriorate sharply. The growth of exports is expected to decelerate from 13% to a mere 3%, but imports to continue last year's momentum and to grow by more than 20%. The CPP estimates the resulting current account deficit to be around \$4 billion; more recent Fund estimates reportedly put the expected deficit as high as \$10 billion (equivalent to about 3% of GDP). From 1986 onwards, the CPP projects a more modest growth of nearly 7% for GDP and an average of 5% for investment, and a stabilization of the real current account deficit at around 1.5 - 2% of GDP.

3. The acceleration of growth till 1984 and the sudden emergence of a sizeable external imbalance in 1985 raise two major questions about the capacity of China for managing growth under decentralization. First, does the recent deterioration indicate a lack of control and ineffective macroeconomic management; and is the "strict stabilization program" working (para 14)? And second, if stabilization implies return to direct, central intervention, how does this affect the chances for sustaining the process of system reform towards greater decentralization?

#### Borrowing, Debt Management and Creditworthiness

4. The CPP suggests that the Government has adopted a borrowing strategy in line with the Base Case projections. If maintenance of the corresponding current account deficit were jeopardized, for example, by a shortfall in

export growth, the Government is more likely to curtail imports rather than increase borrowing. With a debt service ratio of only 6.4% projected for 1990, this borrowing strategy is perhaps more conservative than necessary for balancing the risks inherent in the reform process. In the Region's view, would a borrowing volume somewhere between those of the Base Case and the High Borrowing Case be more desirable and worth discussing with the Government?

5. The Bank's exposure in China is presently only about 1% of total DOD and debt service, but according to the Base Case projection it would increase to 18% by 1995, although of a still moderate total debt service ratio of 8.1%. China's share in the Bank's loan portfolio would reach 10% in the 1990s. While this would normally not raise creditworthiness as an issue, some of the causes of the recent deterioration of the balance of payments - reportedly decentralization of the right to import and to borrow to provinces and enterprises without effective control - raise questions about the institutional framework for debt management. What changes in this area does the Region expect, and how does it see its future role in helping the Government to develop more effective procedures and practices?

6. The CPP notes that China has not made use either of export credits available to it or of cofinancing opportunities with commercial banks, including B-loans, but that the Chinese are likely to make greater use of these sources of finance in the future as their borrowing requirements increase. It seems from these observations that a well-thought-out and diversified borrowing strategy could create substantial long-term advantages. How does the Region intend to support the Government's efforts in this direction?

#### Bank/Country Relationship

7. The CPP (paras 15 and 20) points to the precarious economic and political basis of the reform momentum, while the thrust of the Assistance Strategy is in support of the progress of reform of the economic system. How does the Region assess the risk of retrogression if economic imbalances start to multiply or exceed a tolerable margin, or if there is a shift in the power balance of rival factions in the Party?

8. The CPP points to the development of an active policy dialogue at the national level, based on the Bank's economic work, as the major and growing achievement over the past four years. On the other hand, receptivity to sector dialogue appears limited, and "it has proved difficult to generate a free-standing sector work program (para 41). Furthermore, "involvement with broad institutional issues is still quite limited in most projects" (para 43). In the Region's view, what are the prospects for a major change of attitude by many of the organizations with whom the Bank has to deal, and what can the Bank do to overcome the reservations which seem to linger on at the working level?

#### Volume of Lending; IDA Resources

9. Contrary to what the CPP asserts (para 58-59), IDA resources cannot - given the size of proposed IDA lending in China's total lending - have more than a marginal impact on overall debt servicing and creditworthiness. The main point is obviously that the Chinese government expects a certain blend

ratio for reasons of cross-country equity, and might be inclined to maintain this ratio by curtailing its borrowing from the Bank at hard terms. Since the IDA allocation and the level of Bank activity seem to depend on this linkage, it would be interesting to hear the Region's views on the likelihood of attaining a harder blend than in the past.

#### IFC/Bank Cooperation

10. The Chinese were initially seeing IFC as a catalyst for direct foreign investment, and are now increasingly appreciating the potential of a closer cooperation in the areas of foreign investment policies, transfer of technology, etc. IFC has, in addition to a first investment, embarked on a major promotion effort in China. What are the prospects for expanded IFC operations?

#### Other Matters

11. Local Cost Financing. The CPP recommends financing the foreign exchange costs of the project or 35% of the total project cost, whichever is higher (para 70).

12. Timing of Next Review. The Region recommends that in the absence of political or economic developments that are likely to significantly affect the objectives or size of the program, the next CPP be prepared in 1989.

Annex I compares the lending for China in this CPP with programs previously approved.

Annex II presents a comparison of various country performance indicators.



## CHINA

Annex 1

	Actual				Current		Program				Five-Year Totals				
	FY81	FY82	FY83	FY84	FY85	FY86	FY87	FY88	FY89	FY90	FY81-85	FY82-86	FY85-89	FY86-90	
<b>Operations Program (No.)</b>															
Approved, February 1982	1	3	6	8	9	9	7	..	..	..	27	35	..	..	
Proposed, Oct. 1985	1	1	6	10	12	14	12	14	15	11	30	43	67	66	
<b>Lending Program (No.)</b>															
Approved, February 1982	1	2	5	7	8	9	11	..	..	..	23	31	..	..	
Std. Table IVa, Nov. 1984	1	1	6	10	12	11	12	13	13	..	30	40	61	..	
Proposed, Oct. 1985	1	1	6	10	12	10	11	14	15	16	30	39	62	66	
<b>Lending Program (Cur. \$m)</b>															
Approved, February 1982	IBRD	100.0	135.0	430.0	930.0	850.0	850.0	1600.0	..	..	..	2445.0	3195.0	..	..
	IDA	100.0	50.0	75.0	75.0	650.0	650.0	650.0	..	..	..	950.0	1500.0	..	..
	Total	200.0	185.0	505.0	1005.0	1500.0	1500.0	2250.0	..	..	..	3395.0	4695.0	..	..
Std. Table IVa, Nov. '84	IBRD	100.0	-	463.1	616.0	661.0	950.0	1200.0	1400.0	1600.0	..	1840.1	2690.1	5811.0	..
	IDA	100.0	60.0	150.4	423.5	440.0	420.0	395.0	485.0	500.0	..	1173.9	1493.9	2240.0	..
	Total	200.0	60.0	613.5	1039.5	1101.0	1370.0	1595.0	1885.0	2100.0	..	3014.0	4184.0	8051.0	..
Proposed, Oct. 1985	IBRD	100.0	-	463.1	616.0	659.6	810.0	1240.0	1400.0	1700.0	2000.0	1838.7	2548.7	5809.6	7150.0
	IDA	100.0	60.0	150.4	423.5	442.3	450.0	400.0	485.0	500.0	500.0	1176.2	1526.2	2277.3	2335.0
	Total	200.0	60.0	613.5	1039.5	1101.9	1260.0	1640.0	1885.0	2200.0	2500.0	3014.9	4074.9	8086.9	9485.0
<b>Lending Program (Const. FY86 \$m)</b>															
Approved, February 1982	IBRD	127.6	168.3	515.0	1055.6	906.2	850.0	..	..	..	..	2772.7	3495.1	..	..
	IDA	127.6	62.3	89.8	85.1	693.0	650.0	..	..	..	..	1057.8	1580.3	..	..
	Total	255.1	230.7	604.8	1140.7	1599.1	1500.0	..	..	..	..	3830.5	5075.4	..	..
Std. Table IVa, Nov. '84	IBRD	127.6	-	554.6	699.2	704.7	950.0	1128.9	1246.7	1355.9	..	2086.1	2908.5	5386.2	..
	IDA	127.6	74.8	180.1	480.7	469.1	420.0	371.6	431.9	423.7	..	1332.3	1624.7	2116.3	..
	Total	255.1	74.8	734.7	1179.9	1173.8	1370.0	1500.5	1678.5	1779.7	..	3418.3	4533.2	7502.4	..
Proposed, Oct. 1985	IBRD	127.6	-	554.6	699.2	703.2	810.0	1166.5	1246.7	1440.7	1619.4	2084.6	2767.0	5367.0	6283.3
	IDA	127.6	74.8	180.1	480.7	471.5	450.0	376.3	431.9	423.7	404.9	1334.7	1657.2	2153.4	2086.8
	Total	255.1	74.8	734.7	1179.9	1174.7	1260.0	1542.8	1678.5	1864.4	2024.3	3419.3	4424.2	7520.5	8370.0
Commitment Deflator (FY86=100)		78.4	80.2	83.5	88.1	93.8	100.0	106.3	112.3	118.0	123.5				

Note: November 1984 Review Group Decisions: FY85-89 - IBRD \$5800 million.  
IDA SDR 2240 million.

## COMPARATIVE COUNTRY ANALYSIS

	<u>CHINA</u>	<u>INDIA</u>	<u>PAKISTAN</u>	<u>BURMA</u>				
<u>Economic Structure</u>								
Population 1983 (millions)	1,019.0	733.2	89.7	35.5				
GNP per Capita 1983	300.0	260.0	390.0	180.0				
% Agriculture in GDP 1983	35.7 <u>a/</u>	36.0	27.0	48.0				
% Industry in GDP 1983	44.4 <u>a/</u>	26.0	27.0	13.0				
% Services in GDP 1983	19.8 <u>a/</u>	38.0	46.0	39.0				
Debt Service Ratio 1983	4.9	10.3	28.1	33.8				
<u>Economic Performance</u>								
Real GDP Growth Rate 1973-83	6.0	4.0	5.6	6.0				
Gross Domestic Investment/GDP 1983	29.5 <u>a/</u>	25.0	17.0	22.0				
Exports GNFS/GDP 1983	9.5 <u>a/</u>	6.0	13.0	8.0				
Resource Balance/GDP 1983	0.0 <u>a/</u>	-3.0	-11.0	-5.0				
Gross Domestic Savings/GDP 1983	30.0 <u>a/</u>	22.0	7.0	17.0				
<u>Recent Social Indicators</u>								
Population Growth Rate 1980-2000	1.1	1.8	2.4	2.3				
% Change in Crude Birth Rate 1965-83	-51.2	-25.0	-12.7	-9.6				
% Change in Crude Death Rate 1965-83	-50.8	-39.6	-29.4	-33.5				
Infant Mortality Rate (per 1,000) 1983	38.0	93.0	119.0	93.0				
Life Expectancy (years) 1983	67.1	55.0	50.0	55.0				
Adjusted Education Enrollment Ratio								
- Primary	110.0	79.0	44.0	84.0				
- Secondary	35.0	30.0	14.0	20.0				
	<u>FY80-84</u>	<u>FY85-89</u> <u>b/</u>	<u>FY80-84</u>	<u>FY85-89</u> <u>c/</u>	<u>FY80-84</u>	<u>FY85-89</u> <u>c/</u>	<u>FY80-84</u>	<u>FY85-89</u> <u>c/</u>
<u>Lending Program</u>								
Nominal IDA US\$M	733.9	2277.3	5780.0	3385.9	941.3	918.3	461.7	415.0
Nominal IBRD US\$M	1179.1	5809.6	4629.1	8001.0	345.2	1735.0	0.0	0.0
p.c.p.a. Lending US\$	0.4	1.6	2.8	3.1	2.9	5.9	2.6	2.3
p.c.p.a. IDA Equivalent US\$	0.2	0.7	1.9	1.5	2.3	3.0	2.6	2.3
p.c.p.a. Constant 1985 US\$	0.4	1.4	3.3	2.7	3.4	5.2	3.1	2.0

Sources: China CPP  
1985 World Development Indicators

a/ 1984  
b/ CPP Proposal  
c/ Table IVa

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# Country Program Paper

C H I N A

October 8, 1985

East Asia and Pacific Regional Office

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COUNTRY PROGRAM PAPER

CHINA

		FY80-84	FY85-89 /b	FY86-90
1983 Population	1,019 mln /a	IBRD 1,179.1	5,809.6	7,150.0
1983 per capita GNP	\$300 /a	IDA 733.9	2,277.3	2,335.0
Total		<u>1,913.0</u>	<u>8,086.9</u>	<u>9,485.0</u>

Current population growth rate: 1.1% p.a.

No. of loans/credits	18	65	69
No. of loans/credits per million population	0.02	0.06	0.07

Current Exchange Rate: Y 2.85 = US\$1.00

Average lending per capita p.a.: Current \$ (Const. FY85 Commitment \$)

IBRD/IDA	0.4 (0.4)	1.6 (1.4)	1.9 (1.5)
IDA	0.1 (0.2)	0.4 (0.4)	0.5 (0.4)

/a Based on Per Capita Income Guidelines for Operational Purposes dated November 8, 1984 and March 1985 revisions for WDI.

/b The FY85-89 lending program proposed in this CPP compares with the program for the same period approved at the last Bankwide lending program review in November 1984, as follows:

	FY85-89 lending program		Percentage change Proposed/Approved
	Approved	Proposed	
No. of loans and credits	61	65	+7%
Current \$ million	8,051.0	8,086.9	-
Constant FY85 commitment \$	6,964.0	6,979.7	-
Per capita per annum (constant FY85 commitment \$)	1.4	1.4	-

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## A. Introduction

1. The first CPP in December 1981 proposed three major objectives for the Bank's program in China: (a) to facilitate China's reentry into the global community; (b) to contribute to China's development effort by financing an increased supply of inputs and by helping to improve efficiency; and (c) to assist in the reduction of remaining poverty. A strategy and work program to achieve these objectives was also set out but the CPP stressed that there was a great deal of ignorance on both sides and that there was a need for patience and flexibility. It was important to gain experience and develop sound working relationships.

2. Over the past four years dramatic changes have taken place within China and in the China-Bank relationship. Within China a fundamental and ongoing program of reforms in the system of economic management have contributed greatly to the rapid overall development of the economy and the increase in living standards, particularly in rural areas. Progress in developing working relationships between China and the Bank and meeting the overall objectives for the Bank's program have also been significant and often beyond our expectations. The lending program has expanded from one project and \$200 million in FY81 to 12 projects and \$1.1 billion in FY85 and the Bank is also engaged in a large program of ESW work, EDI training and other activities.

3. This CPP reviews the recent impressive performance of the Chinese economy and the Government's ambitious plans for further economic reform and structural adjustment. It also summarizes the considerable progress that has been made in establishing a sound relationship between China and the Bank and developing a broad program of Bank assistance. The CPP concludes that the Bank may have a unique opportunity in the next five to ten years to assist China in the formulation and implementation of fundamental institutional and policy changes and proposes a large program of economic and sector work, lending and other assistance activities. But it recognizes that major uncertainties remain concerning both the pace and pattern of political and economic reform and the response of the economy to such reforms and that unexpected developments in any of these areas might require a major rethinking of the proposed assistance strategy and work program.

## B. Recent Developments

### Economic and Political Reform

4. Reforms of economic management in China have so far been greatest in rural areas. Following some experiments with the abolition of collective farming in impoverished areas, the Government has moved swiftly to implement a comprehensive restructuring of rural institutions based on various forms of the "production responsibility system". By 1983 the farm household had become the fundamental unit of management and production in agriculture, within a framework of collective or state ownership of land and major fixed assets. In early 1985 the system of compulsory state procurement of agricultural products was also abolished in favor of voluntary contracts and free market sales.

Households are still obligated to pay taxes, contribute money to collective welfare funds and supply labor to maintain or construct public works. But all remaining output belongs to the household. Rural households also have much greater freedom to develop nonagricultural activities, establish joint ventures with households in other parts of the country, and so forth.

5. Under the new rural system, teams of 20-40 households function largely as administrative bodies, make periodic adjustments in the distribution of land and other assets, collect taxes, and implement family planning activities. Efforts to separate economic from administrative activities are also underway at both the village (formerly the brigade) level and the township (formerly the commune) level. Supply and marketing and rural credit cooperatives are also being restored to their initial role as dividend-paying, shareholder-managed institutions owned largely by farm households.

6. Economic reform has not yet proceeded as far in urban areas, but significant changes have taken place and momentum has picked up markedly over the past year. The scope for collective and individual economic activities in urban areas has been greatly enlarged, and management of state enterprises has been affected by a number of changes and experiments aimed at improving incentives. Nearly all state enterprises now pay a profit tax plus an "adjustment tax" (computed separately for each enterprise), instead of direct profit remittances to the government, and have much greater freedom in production, pricing and marketing above their mandatory plan targets. Decentralized management systems have also been introduced within many enterprises.

7. Accompanying this increase in enterprise autonomy have been further changes in banking and finance and efforts to develop indirect economic levers. The central banking functions of the People's Bank of China have been separated from commercial functions. New methods of credit planning and control have been introduced, and interest rates on loans and deposits have been increased. The trend toward loan rather than grant finance of investment projects has also been accelerated by the decision in early 1985 that capital construction appropriations through the government budget should be made on a loan rather than grant basis. An increasing share of total supply is no longer subject to plan allocation at set prices but instead is allocated through market mechanisms and at flexible prices. Certain urban areas have also been designated as pilot reform cities and are being encouraged to institute new institutional and policy arrangements in finance, marketing and pricing, foreign trade, etc.

8. The Government has continued to promote the overall policy of opening up to the rest of the world by further decentralization of external trade, investment and foreign borrowing responsibilities. In 1984, this included the opening of onshore areas for oil exploration by joint ventures and the opening of 14 coastal cities to foreign investment. An unexpected drain on foreign exchange resources in late 1984 and early 1985 has slowed but is unlikely to reverse the direction of these changes, which have been a major stimulus to China's growing presence in the world economy. Between 1978 and 1984 the share of exports in GDP nearly doubled to about 10%, a ratio considerably above that of India and similar to other large countries such as the

U.S. and Brazil. Today, China's share in world trade (1.3%) is 2.5 times that of India. Direct investment flows have also increased rapidly.

9. The political basis for reform in China over the past seven years has been the declining influence of the "leftist" (Maoist) group in the Chinese Communist Party (CCP). The 12th Party Congress in September 1982 marked the decisive defeat of the Maoists with only four politicians who are closely associated with the Maoist group remaining in the 28-member Politburo. This change was brought about by a coalition that included the reform group (Deng Xiaoping), the advocates of a return to Soviet central planning, and the military who want to retain central planning and state control over heavy industry. In the transition, however, the supporters of reform had to make concessions on the pace of reform. These concessions were a particular setback for those, including Premier Zhao Ziyang, who advocate a more strongly market-oriented system than the rest of the reform advocates.

10. The deferred dispute between the proponents and opponents of reform on the course of future institutional and policy change resurfaced at the Third Plenary Session of the 12th Central Committee in October 1984. The decision on economic reforms taken at that session appears to have been a tactical victory for the reform group, and this victory has been further consolidated by the September 1985 special party conference which selected six new members of the Politburo, five of whom are firm advocates of economic reforms. As a result the way seems open to further institutional and policy change during the 7th Plan period (1986-1990). Economic reforms, however, are still expected to be divorced from political reforms; the brief flirtation with political reform during the years of the "democracy wall" is unlikely to be repeated in the near future, and greater freedom of expression will probably be allowed only in a very gradual and nonpolitical way. But progress with economic reforms will almost certainly lead to increased pressures for political reforms.

11. Accompanying institutional and policy change has been a major rejuvenation of leadership in the CCP, the Government and the military. This rejuvenation is being pushed most actively by Deng, who wants to hand over power to an entirely new generation of younger and better educated leaders. The process was begun with the reorganization and streamlining of the Government in 1982 which involved a large reduction in the number of ministries and commissions of the State Council and in the number of ministers and vice ministers. Over one-half of the new top officials had college education - compared with about one-third before - and their average age was 58 compared with 64 before. Similarly, the number of departments and bureaus in ministries and commissions was cut by one-third and the number of department and bureau heads by nearly one-half, with the average age declining from 59 to 54 years and the share of college educated officials rising from about one-third to one-half. Similar changes took place subsequently in provincial and local governments, party organs and the army. A second rejuvenation is currently underway. During 1985, more than 200 government officials above deputy minister level and more than 1,000 officials at bureau and department head level are to be replaced by younger technocrats with strict application of the mandatory retirement age. In June, for example, eight ministers were replaced. The new incumbents range between 48 and 58 years of age. Six of



the former ministers had reached retirement age. Again similar changes are being carried out in local governments and party organs. The army has been drastically streamlined under new military and political leadership, with a total reduction in force of one-quarter, or about one-million soldiers.

### Growth and Stabilization

12. Reforms have helped stimulate rapid development of the whole economy. Real GDP growth averaged 6% p.a. between 1978 and 1981 and 10% p.a. between 1981 and 1984. During these six years, per capita incomes in real terms more than doubled in rural areas and increased by more than 50% in urban areas. Agriculture has continued its remarkably strong performance, with gross agricultural output value (excluding rural industry and commerce) rising at nearly 11% p.a. between 1981 and 1984 and grain output at 8% p.a. (reaching over 400 million tons in 1984). Cash crops and animal husbandry, stimulated by rising demand and attractive prices, have also grown rapidly. Gross industrial output value grew at over 10% p.a. over the same period, with heavy industry growing somewhat faster than light industry (12% p.a. vs. 9% p.a.). If rural industrial output is included, total industrial output value grew at close to 12% p.a. in real terms between 1981 and 1984. The energy constraint on industrial growth was eased by rising coal output (8% p.a. between 1981 and 1984), renewed increases in crude oil production (4% p.a. between 1981 and 1984) and improvements in the efficiency of energy utilization (primary commercial energy consumption grew only 60% as fast as GDP between 1981 and 1984). Manufactured exports growth at 8% p.a. between 1981 and 1984 was slower than the 1978-81 period but it started from a much higher base and in the face of worsening world market conditions.

13. The Government continues to face difficulties in combining system reform and rapid overall growth with maintenance of economic stability. During 1979 and 1980 China experienced large budget and current account deficits combined with excessive investment and inflationary pressures. In response a strict stabilization program was introduced in 1981 relying mainly on administrative controls on investment spending. The program slowed growth but also helped lower the budget deficit from about 5% of GDP in 1979 to less than 1% in 1981, reduce inflation to around 2% p.a., and change China's external position to one of current account surpluses averaging nearly \$4 billion during 1982-84. As a result, foreign debt and debt service ratios remained at low levels (\$6.4 billion and 4.9% respectively in 1983) and China's foreign currency reserves (excluding gold) rose to \$17 billion (over 7 months' imports) by mid-1984.

14. This comfortable balance of payments position, achieved at the cost of drastic reductions in investment spending and some recentralization of investment decision making, disappeared rapidly during the course of 1984 and early 1985. Partly as a result of decentralization of decision-making and the lack of effective indirect levers, there was a rapid acceleration of investment during 1984 and the first half of 1985. Imports of capital goods increased from \$4 billion in 1983 to over \$7 billion in 1984, with most of the increase occurring in the second half of the year. There was also a rapid expansion in consumer goods imports. These trends continued during early 1985. As a result, foreign exchange reserves (excluding gold) had fallen to

about \$11 billion by June 1985, and the current account deficit for the year is likely to be in the range of \$4-6 billion. The Government has responded quickly by launching a strict stabilization program that includes further increases in interest rates as well as a series of administrative directives. But the developments over the past six months are likely to slow down the overall pace of institutional and policy change. At the same time they also highlight the urgent need to put in place the institutions and macro-economic management tools for a decentralized and more market-oriented economy.

### C. Prospects for Reform and Growth

#### Economic Reform

15. Achievement of the Government's ambitious targets of quadrupling the gross value of industrial and agricultural output (GVIAO) between 1980 and 2000 and increasing per capita national income from about \$300 to \$800 (about 5% per year) will almost certainly depend on further progress with reforms, particularly in urban areas. However, while it appears very unlikely that past reforms will be reversed in the foreseeable future, there remain substantial uncertainties about the extent and pace of further reforms in China. In fact, given the delicate balance between different political groups within the CCP, the pace of future reforms is likely to depend largely on the success of ongoing reforms. Recently, the success of institutional and policy changes in rural areas has strengthened the position of the reform advocates. By the same token, adverse results of ongoing or future reforms, such as inflationary pressures, large balance of payments deficits, increased regional imbalances, falling living standards for certain groups, or other social strains, could easily shift political power toward the opponents of reform.

16. At present the October 1984 decision on "reform of the economic structure" is the only official indication of the emerging consensus on economic reforms within the party. Recent reform developments have been fully in accordance with the directions indicated in the October decision: (a) state enterprises should be made fully independent units which pursue profits and are responsible for losses; (b) the scope of mandatory planning should be reduced and replaced by indicative planning while the focus of planning should shift from annual to medium- and long-term guidance planning; (c) a more rational price system should be introduced by reducing the role of state-controlled prices and increasing the role of "floating" and free market prices; and (d) the tax system should be improved, finance and banking should be reformed and a larger role should be given to indirect macroeconomic regulation. Nonetheless many major issues still need to be analyzed and resolved concerning both the specific nature of future reforms and the interlinkage and appropriate sequencing of reforms. Some of these issues are outlined briefly in the following paragraphs. They were discussed in more detail in the Bank's recent report China: Long-term Issues and Options, 5206-CHA, and are expected to be a major focus of our dialogue and future work program in China.

17. Enterprise Motivation. Despite the measures introduced over the past few years, the Government recognizes that establishing motivated and

competitive state enterprises remains one of the hardest and yet one of the most fundamental tasks of system reform. Clearer separation of economic from administrative activities and of enterprises from line agencies is still required. Internal management arrangements are needed that help ensure that enterprises operate for the benefit of the national economy rather than solely for those who work in them. State enterprises also require greater freedom to buy and sell commodities and to recruit and fire workers. In addition the efficient functioning of the system as a whole will depend on improvements in accounting and auditing and the development of a system of commercial and contract law.

18. Investment Decisions and Finance. In recent years major efforts have been made to decentralize investment decision making, to change from grant to loan finance of investment projects and to increase the role and autonomy of the banking system. However, no clear distinction has emerged concerning which activities should be financed on a grant basis and through the budget and which activities should be loan financed. In addition more mobility of investment funds, through more varied channels, is still required. This will be achieved in part by allowing enterprises to diversify and invest in other enterprises, but the development of financial institutions which truly act as intermediaries between suppliers and users of resources will also be very important.

19. Trade and Prices. Recent reforms have increased internal as well as external trade and have led to a two-tier pricing system in which the share of sales at market-related prices has been rising quickly with rapid growth of production. However, major administrative barriers to trade and protection of local activities still remain. The Government is also concerned about the danger of rapid price inflation in a situation where most enterprises are still not pressured by competition to hold down costs, and effective indirect fiscal and monetary instruments to regulate the general price level have yet to be developed. Some further price changes could be made quite quickly (for example, increases in energy prices), but overall decontrol will have to be gradual and coordinated with other aspects of reform.

20. Planning and Macroeconomic Management. The absence of appropriate institutions and policy tools for macroeconomic management is part of the explanation for China's recent problems of economic instability, and it remains a serious obstacle to further reform. Institutional and policy tools need to be developed to effectively control the overall level and growth of credit. The Government needs to develop the expertise to use direct and indirect taxation not only to raise revenues but also to influence household savings and consumption behavior, enterprise investment behavior, and the amount and pattern of foreign trade. Mechanisms for dampening price fluctuations of certain products and the development of an appropriate foreign exchange rate system are also required. In addition the scope of planning will need to be changed to emphasize policy rather than production planning.

21. Social Issues and Policies. The Government recognizes that economic reforms will require major institutional and policy changes in the social sectors if China's past achievements in reducing poverty and meeting basic needs are to be maintained. New institutional arrangements and increased

central and provincial government support of rural social services will be necessary, especially in poor and backward localities, if education and health conditions are to improve. Strategies to address the problems of poor and remote localities, which may involve limited migration, need to be developed. In addition a social security system and institutional arrangements for housing that are consistent with a reformed urban economy will be required. All these areas are now receiving the attention of the Government, but it is likely to be quite some time before new policies and institutional arrangements are well established.

#### Economic Growth and Structure

22. Human Resources. China's ability to attain the per capita income target of \$800 by the year 2000 depends crucially on the expected slow rate of population growth (1% p.a. compared with an expected 2.2% p.a. in middle income countries). This will require a substantial drop in rural fertility but the target seems feasible as well as desirable. China will need to continue to improve basic health through preventive measures such as investment in water and sanitation as well as develop cost effective preventive strategies for chronic diseases. Improvements in the quality of basic education and rapid progress in advanced education and training (to make up for the damage inflicted by the Cultural Revolution) will also be very important.

23. Food and Agriculture. Rapid overall growth and rising per capita incomes will require from agriculture both greatly increased production and productivity and structural transformation. This will need to include major changes in cropping patterns, including switching the use of land from foodgrains to coarse grains or other crops, and the development of an efficient livestock industry. To enhance agricultural growth prospects, the Government will need to take a number of steps beyond the introduction of the responsibility system and other rural reforms. These include improvements in agricultural research, education and extension services, particularly in livestock; improved irrigation and drainage systems; better nutrient balance in fertilizer supplies; increased availability of agricultural credit; and improvements in rural transport, storage, and marketing facilities.

24. Energy Production and Use. Because China's high consumption of energy per unit of output offers great scope for conservation, it would be possible to attain the Government's target of quadrupling GVIAO with a much smaller proportionate increase in energy production - though probably not as small as the doubling that the Government originally envisaged. Electricity production probably has to quadruple by 2000 to meet demand, which will require a huge amount of investment. Crude oil production is hard to predict, because it depends heavily on success in replacing the output of existing fields with that of new discoveries, but the 200 million ton target (twice the present level) could be more than enough to meet the likely level of domestic demand. It is coal, however, that will bear most of the burden of bringing future energy production into line with demand. Depending on the progress with enterprise management and its impact on energy conservation, coal requirements in 2000 could range from 1,200 to 1,600 million tons compared with 770 million tons in 1984. In either case major investments in new coal mines as well as modernization of existing ones will be necessary.

25. Industry and Trade. Rapid and efficient industrial development will depend, to a very large extent, on the capacity to innovate and hence on the overall progress with economic reform. In addition, however, protectionist measures in industrialized countries directed against light industry and other low technology goods imports could become a major obstacle in expanding Chinese exports and - concomitantly - the capacity to import sophisticated machinery and other capital goods that China needs so urgently. Thus, direct technology transfer through imports may be more constrained in the future, and China will need to rely more on industrial technology diffusion among domestic firms and on technology transfer through increased borrowing and foreign direct investment.

26. Transport. China's coal production targets depend on railway expansion. Similarly, China will need to very substantially expand its ports and inland waterways facilities for domestic and foreign trade. But probably the most serious transport need is for dramatically expanded road transport, especially in rural areas where increased specialization has created an urgent demand for better farm to market transport services. China now has a rural road network only half the size of India's and fewer trucks per rural person than the Sahelian countries of West Africa. Major intercity highways, the vehicle fleet, and vehicle fuel production and distribution are also inadequate. These problems are well recognized by the Government, but the institutions, plans, financing mechanisms and so forth are not yet in place to address the problems.

27. Services and Specialization. The share of the service sectors in output and employment in China is at present strikingly small compared with other developing countries, despite unusually large education and health sectors. Accelerated development of the service sectors, which is closely connected to reform of the system of economic management, will be important in enabling China to shift to a different pattern of growth. Expansion of commerce should go hand-in-hand with greater reliance on market mechanisms and increased specialization of production units and localities. Expansion of enterprise support services, including finance, accounting and law, will be essential to increasing enterprise autonomy and specialization.

#### Alternative Development Paths

28. The pace and pattern of reform will have a major impact on the growth and structure of the Chinese economy and hence on its overall development path. One scenario, called QUADRUPLE in the recent economic report, assumes that the pace and pattern of reforms are sufficient to maintain China's future investment efficiency at the same level as the average of the past three decades. Under such a scenario the Government's target of quadrupling GVIAO between 1980 and 2000 (equivalent to increasing national income by between 6% and 7% p.a.) is likely to require an investment rate of about 30% of national income. This is comparable to the rates in other fast growing East Asian economies, as well as East European countries, and in line with China's past investment rate. With reasonable improvements in energy and materials use and provided that the population in 2000 is fairly close to the official target of 1.2 billion, quadrupling GVIAO would allow the per capita income target to be attained.

29. More rapid progress with economic reforms could enable China to achieve an alternative development path, involving both greater emphasis on services and more efficient resource use. With a level of investment efficiency similar to the average in Japan in 1950-80 and in all middle-income countries in 1960-82, such a path could result in China attaining the Government's target national income growth rate with an investment rate of only 26%, and hence faster growth of consumption. On this path, China would also have the option of maintaining the investment rate at 30% which would make it possible for national income to grow at 7-8% p.a., about one percentage point faster than the target rate. The key to reaching these and indeed the Government's official target growth rates is, however, resource efficiency and there is of course no guarantee that China will be able to achieve the levels of resource efficiency assumed. Indeed if the extent and pace of reforms is slower than expected and the overall efficiency of investment is similar to that of the Soviet Union in 1950-75 and India in 1960-82 national income growth might be in the 5-6% range.

#### External Assistance Needs and the Balance of Payments

30. In the coming years China is likely to pursue its outward-oriented strategy through a variety of mechanisms. Trade of goods and services will clearly play a major role, not only in terms of importing advanced machinery, equipment and services, but also in terms of teaching enterprises to produce export goods that meet the exacting quality standards of overseas customers. Imports of disembodied technology through licensing arrangements and foreign direct investment are also likely to be important, as will overseas education and training of scientists, engineers and managers. Technology transfer and capital formation will be further increased through greater reliance on external borrowing. But such borrowing will be primarily at market rates because, apart from IDA and some additional bilateral flows, mainly from Japan, China's access to concessional finance is limited and cannot be expected to increase substantially in the present political climate.

31. Table 1 gives two alternative scenarios of China's balance of payments and debt position over the next 5-10 years and shows the range of feasible borrowing strategies. Both projections are closely related to the QUADRUPLE scenario of the recent economic report, and in line with the Government's long term growth target (para. 28). The QUADRUPLE-BASE scenario is based on the assumption that exports grow at 8% p.a. between 1984 and 1990 (primary 6% p.a. and manufactures 9% p.a.) and imports grow at 9% p.a. This implies a relatively modest current account deficit in the balance of payments of around \$4-5 billion p.a. during the remainder of this decade, equivalent to about 1% of GNP. Under this scenario, gross borrowing would reach \$6.5 billion by 1990 of which up to \$1 billion might be financed by Japan (both the Overseas Economic Cooperation Fund and the Export-Import Bank), \$1.5 billion by the Bank (IBRD and IDA) and the remainder by the private market. The debt service/export ratio would increase to about 6% in 1990 and stabilize around 8-9% by the mid 1990s.

Table 1: ALTERNATIVE BALANCE OF PAYMENTS AND DEBT SCENARIOS

		BASE CASE	HIGH BORROWING CASE
Current account balance	1985 (\$ billion)	-4.0	-6.0
	1990	-5.1	-14.0
	1995	-8.2	-17.6
Debt service ratio (%)	1985	5.2	5.2
	1990	6.4	10.6
	1995	8.1	19.7
Debt outstanding \$ billion, (% of exports)	1985	6(22%)	8(27%)
	1990	29(49%)	53(100%)
	1995	59(52%)	132(122%)

32. The QUADRUPLE-HIGH BORROWING scenario helps highlight the major uncertainties that prevail concerning China's future balance of payments and debt situation and represents the likely upper range of external borrowing. The BASE scenario, for example, assumes export growth rates that are considerably below the rates achieved during the past five years but substantially higher than Bank projections of exports for all developing countries as a whole (4.7-6.4% for merchandise exports and 7.5-9.7% for exports of manufactures during 1985-95 according to the 1985 WDR). If progress with economic reform is slower than expected or protectionism increases China may not be able to expand exports that rapidly. The HIGH BORROWING scenario therefore assumes substantially lower manufactured exports growth (6%), with increased borrowing sustaining a higher investment rate and higher economic growth than otherwise feasible. Under this scenario the debt service ratio would increase rapidly to about 11% of exports by 1990 and 20% by 1995. Net borrowing would have to grow more slowly in the early 1990s if the debt service ratio is to stabilize around 1995 with the current account deficit declining to about 2% of GNP by 1995.

33. We expect China's Seventh Five-Year Plan (1986-90) to include a cautious external borrowing strategy in line with the BASE scenario. The Government is determined to continue opening up the Chinese economy to the rest of the world. But it is also determined to maintain very moderate current account deficits and if export growth is slower than expected the Government is likely to opt for a strategy of slower import growth rather than higher borrowing (this would be similar to the MODERATE scenario of the recent economic report). Moreover, a higher borrowing target, as implied in the HIGH BORROWING scenario, although feasible in terms of debt service indicators, does not appear advisable for several reasons. First, China is undergoing profound economic reforms that could result in temporary imbalances but does not yet have the macroeconomic tools to fine-tune its emerging market economy. Second, real interest rates are expected to stay considerably higher

than during the 1970s and, more importantly, are likely to be variable, entailing substantial interest-related liquidity risks. In the HIGH BORROWING scenario, variable interest debt to private lenders would reach 80% of total debt outstanding by the early 1990s. Third, China's borrowing under the HIGH BORROWING scenario would be large in absolute terms (gross borrowing of \$13 billion from the private market by 1990), and China would quickly become one of the largest developing country borrowers. Given the portfolio constraints of international banks and their lack of familiarity with China, efforts to borrow on such a scale could face supply constraints.<sup>1/</sup>

#### D. Progress Towards Prior CPP Goals

##### Status of Country Relationship

34. During the past four years senior Chinese leaders have demonstrated their strong commitment to China becoming a full and active member of the Bank Group. China has fully subscribed to its share of the general capital increase (see attachment 5), encouraged the development of a large and varied program of Bank assistance and supported the establishment of a Bank resident mission in Beijing. Senior leaders appear to value highly the Bank's advice on system reform and have provided strong support for the recent economic report. They also seem keen to expand the scope as well as the extent of the policy dialogue. Other aspects of the Bank's assistance program have also received their support but not to the same extent as economic work; it may not yet be apparent to the Chinese leadership that Bank-supported sector and project work could also play an important role in facilitating and supporting policy and institutional change.

35. Relations between the Bank and several of the research institutes under the State Council that are directly concerned with system reform issues also appear to be very good. We have been working directly with the Chinese Academy of Social Sciences (CASS) on some research projects and have involved CASS and other research institutes more informally in other economic work. Such contacts have been important in helping us understand the thinking and concerns of some of the younger economists and future policymakers in China.

36. The External Finance Department of the Ministry of Finance is responsible for coordinating Bank activities in China and it now includes three divisions concerned exclusively with Bank-related work. At present, however, the department is still overwhelmed with the administrative complexities of the China-Bank relationship. It is not well staffed and has yet to be able to develop satisfactory arrangements for coordinating Bank activities, onlending Bank funds etc. The Bank's contacts with other departments of the Ministry of Finance, which are more involved with economic issues, remain limited.

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<sup>1/</sup> China's entry into certain capital markets, such as the U.S. or the U.K., could also be affected by the issue of the nonsettlement of China's pre-1949 debts.



37. We are gradually increasing and broadening our contact with other core agencies. For much of the past four years the State Planning Commission, which plays the key role in selecting and approving projects in the Bank's program, has tended to remain somewhat aloof from the Bank. During the past year, however, the Foreign Capital Department and some of the sectoral departments of the Commission have taken a much more active role in assessing Bank sector and project capabilities; the Commission's staff, as a whole, is also being encouraged by senior leaders to work more closely with Bank missions in economic as well as project work. We are also increasing contact with officials in the State Economic Commission, which plays an important role in the technical transformation of industry and energy conservation. They have expressed their strong support for cooperation with the Bank on several major policy and institutional issues. Our direct contacts with the People's Bank of China are still quite limited but the IMF has been working closely with them in technical assistance activities as well as in the annual consultation missions.

38. The expansion in the lending program has helped us to build relations with many different line agencies. But perceptions of the Bank and its role in China vary within as well as between these agencies. Some officials, particularly those at the working level, perceive the Bank as having a useful contribution to make in a broad range of areas including project design, financial and economic analysis, technical assistance and training, institution building, and cost saving through international competitive bidding. But others continue to see the Bank primarily as a funding agency that has overelaborate procedures, requests too much information and attempts to impose too many conditions. These varying attitudes result partly from the relatively low level of inter-agency cooperation and coordination in China as well as from the level and depth of our contacts with specific agencies (for example, the extent to which we have been able to work closely with planning bureaus as opposed to foreign affairs bureaus or special loan offices set up to handle relations with the Bank). But it also reflects the wide variation in attitudes about the policy of opening up to the rest of the world that still prevails in China.

39. Through our various assistance activities we have been involved with virtually all of China's 29 provinces and municipalities. Relations are particularly strong with the municipality of Shanghai where we have been supporting various urban development and infrastructure studies. Good relations have also developed with the very poor province of Gansu where we are now undertaking a detailed assessment of development issues and prospects and the possibilities for Bank project assistance.

#### Bank Assistance Program

40. The Bank's assistance program to China now includes many different elements. The economic work program has developed well. Formal comprehensive reviews such as the first economic report and the recently completed report on long-term issues and options have absorbed the bulk of our resources. They have required agreement and support at very senior levels of the government and have been difficult to organize and manage. But these reviews have enabled the Bank to provide a broad intersectoral approach, which has

contrasted with the narrow sectoral perspective of China's own planning, and have been well received and closely studied by senior leaders and policymaking institutions in China. The program of economic studies undertaken in collaboration with CASS seems to have been another useful way to offer advice and transfer advanced analytical techniques. An effective means of policy dialogue has also been advisory reports on selected issues of system reform prepared by informal missions comprising not only Bank staff but also experts from western as well as socialist countries.

41. Comprehensive economic reviews have proved useful in enhancing our knowledge of specific sectors and in linking sector with general economic work. Otherwise, however, it has proved difficult to generate a freestanding sector work program. There have been exceptions, particularly the urban sector work in Shanghai and the review of issues and options in the health sector which took place prior to project identification. But, in general, agencies have been reluctant to provide broad sector information (except in the context of formal economic reports), and many have yet to be convinced that they would benefit from a dialogue with the Bank on the overall structure of their investment programs or on sector-specific policy and institutional issues.

42. The development of a large and expanding lending program has provided us with many opportunities to assist China in gaining access to modern technology and equipment. Our early investments in higher education had this as a major objective. In agriculture we have facilitated the transfer of improved techniques for irrigation design and mapping, as well as introducing China to international experiences in a variety of specialized subsectors such as mechanized grain farming, plantation rubber and forestry and in specialized services (crop and livestock research, seed supply etc.). In energy and transport we have helped to provide high-priority items of foreign equipment and technology and to ensure that the benefits extend beyond the projects being financed. Our lending in industry has also focused heavily on technology transfer, especially for energy conservation.

43. The lending program has also provided us with many opportunities to help improve investment efficiency in China by strengthening the project preparation and appraisal capacities of institutions and by demonstrating how the Bank's appraisal methodology can be applied in different sectors to improve project selection and increase the efficiency of project design. In the case of the industrial and rural credit projects, for example, the Bank has assisted in the development and strengthening of two important financial institutions, the China Investment Bank and the Agricultural Bank of China. This assistance included help in the preparation of project appraisal manuals which are now being used by both banks and studied by many other agencies. The Bank has also assisted in the preparation of planning and appraisal manuals for rural water supply systems. All Bank-assisted projects have been used, to a greater or lesser extent, as examples of how the economic costs and benefits of proposed projects can be assessed. Consequently, although our involvement with broader institutional issues is still quite limited in most projects, we have been able to help stimulate the trend in China towards improved project appraisal methods.

44. To date, the Bank's involvement with projects directed at poverty alleviation has been limited to components of the North China Plain, Rural Credit, Rural Health and Medical Education and Rural Water Supply projects. This is due in part to the fact that core agencies initially saw the Bank's role in terms of access to foreign technology and equipment. More recently, however, they have shown increasing interest in the Bank's potential contribution to the development of strategies for poverty alleviation and are strongly supporting the sector and project identification work being carried out in Gansu.

45. Over the past four years there has been a slow but growing recognition in China of the value of technical assistance, particularly for project preparation and implementation. The Bank has been able to support and stimulate such activities by being the executing agency for a UNDP technical assistance project, by providing an IDA technical assistance credit and by including technical assistance components in most projects. Initially, most of the technical assistance took the form of overseas study tours for Chinese officials. More recently there has been a trend toward greater use of short-term consultants for very specific activities. In the education sector, for example, the work of international advisory panels in coordinating specialist services is now well regarded. However, many agencies in China are still not convinced about the usefulness of longer-term assignments of foreign experts or of more policy or institutionally based technical assistance.

46. The actual size and scope of the lending program has conformed quite closely to the projections made in the first CPP. The total volume of lending in the period FY81-85 was only 11% less than projected (See Table 2). The proportion of IDA lending was somewhat higher than expected (39% compared with the projected 28%), due primarily to the Government adhering closely to a 60/40 IBRD/IDA blend; without such a limitation IBRD and total lending would have been greater. We were also able to expand the number of projects more rapidly than projected, thereby broadening the range of our assistance activities, but at some cost in average project size (\$100 million instead of \$150 million) and therefore in the quantity of Bank staff and consultant resources per dollar of lending. In all of the major sectors we either met or exceeded the projected number of projects; the agricultural program (including agricultural education), in particular, was much larger than projected in terms of dollars lent and number of projects.

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Table 2: PLANNED AND ACTUAL LENDING FY81-85

	Planned		Actual	
	\$ million	No. of projects	\$ million	No. of projects
Agriculture /a	455.0	5	638.8	10
Energy	1,155.0	7	776.9	7
Industry	450.0	3	342.6	3
Transport	585.0	4	651.6	4
Urban/Water Supply	- .0	0	80.0	1
Education	650.0	3	430.0	3
Health	100.0	1	85.0	1
Other	-	-	10.0	1
<b>Total</b>	<b>3,395.0</b>	<b>23</b>	<b>3,014.9</b>	<b>30</b>
(of which IDA)	950.0	5	1,176.2	12

/a This includes Agricultural Education and Research I and Agricultural Education II.

47. Apart from delays in procurement for some projects, due both to China's inexperience with Bank procedures and to inadequate interagency coordination, project implementation has been good and is improving. Disbursements have accelerated greatly (see Table 3). Studies and the training and technical assistance components of projects have generally been carried out on schedule, and over three-quarters of the projects under implementation are rated as problem-free or having only minor problems. It is also apparent that, through ICB, China has been able to realize large savings in projects for education, agriculture, power and ports, and this has helped facilitate the overall trend in China toward greater use of competitive bidding procedures for civil works and equipment procurement. However, the State Planning Commission and the Ministry of Finance remain concerned about commitment charges and would like to reduce these through more rapid procurement. This will be among the issues to be addressed by the first country implementation review which has received the strong support of the core agencies and is due to take place in Beijing in December 1985.

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Table 3: IBRD/IDA DISBURSEMENTS  
(\$ million)

Fiscal years	1981	1982	1983	1984	1985
Undisbursed balance as of July 1 /a	-	-	259.9	828.6	1629.7
Commitments during FY	200.0	60.0	613.5	1039.5	1101.9
Total disbursed during FY	-	0.1	33.8	120.5	381.9
Disbursement rate	-	-	13.0	14.5	23.4
Comparators %					
(a) Disbursement rate for total of other loans in the region /b	21.5	26.3	23.9	26.1	21.8
(b) Bank-wide IBRD/IDA average disbursement rate /b /c	22.2	24.1	23.4	25.0	23.7
(c) Selected comparators					
Brazil	16.5	16.0	23.5	35.7	27.6
India	23.2	28.8	22.9	20.6	14.4
Indonesia	15.1	17.8	18.1	19.2	17.2

- /a Undisbursed balance includes signed but not effective loans and credits for all computations.
- /b Includes structural adjustment loans.
- /c Excludes IFC loans.

48. As proposed in the first CPP, EDI-supported training activities have been a large and integral part of the Bank's assistance program to China. Over the past four years EDI has worked closely with two major training institutes in China (the Shanghai Institute for Foreign Economics and the Central Institute for Finance and Banking in Beijing) and has developed a training program which is now the largest of EDI's national programs with 8-10 courses per year, each attended by about 40 officials. Initially the emphasis was on direct training of senior and middle level officials, and in the period 1980-84 over 1,100 Chinese officials attended EDI courses. But increasingly the emphasis has been shifting to training of trainers, development of training materials and institution building.

## E. World Bank Assistance Strategy

### Role and Objectives

49. The coming five to ten years will be a difficult period of transition for China as the Government endeavors to complete the program of economic reform and establish a system that maintains the strengths of the old system while overcoming its weaknesses. Many of the required changes will be without historical precedent, but China could still learn much from the experiences of other countries. It also seems clear that many in China now see the Bank as more than a source of concessional finance and are looking to us for support in almost all aspects of the transition. In the next few years, therefore, the Bank will have a unique opportunity:

- (a) to increase China's access to foreign technology and practices; and
- (b) to assist in the development and implementation of reforms that will help to increase the efficiency of resource use and reduce poverty.

50. To achieve these objectives we will continue to make use of many different types of assistance including economic work, sector studies, project lending and EDI training, and further efforts will be made to make these more mutually reinforcing and less independent activities. The objective of technology transfer will be pursued both by bringing the Bank's multi-country experience to bear on project design and by widening the search for appropriate technological solutions through such mechanisms as ICB procedures, overseas study tours for Chinese officials, foreign technical assistance, and EDI courses and seminars. A well developed program of economic and sector work will be critical to attaining the objective of assistance in economic reform, but priority will also be placed on designing project loans which help address broader institutional and policy issues (thereby becoming more like sector loans even if they are not officially designated as such). In addition, EDI courses will be geared more toward institutional and policy issues. In view of the major uncertainties that still prevail concerning the pace as well as the pattern of reform, it will also be important that we develop a good understanding of the political and other dynamics behind the overall process of reform.

### Reform Agenda

51. Although there is no detailed blueprint for future reform in China, the directions of expected change have been clearly indicated. They will involve consolidating and building on the institutional and policy achievements already made in the rural sector while initiating and perfecting similar types of change in the much more technologically and institutionally complex urban sector. In this regard there are five major elements common to both rural and urban reform that will be the focus of the Bank's assistance strategy and work program.

52. Institutional change, involving both the separation of economic and administrative functions and substantial decentralization of decision-making to more independent and motivated enterprises and units, will be a fundamental

aspect of the overall process of economic reform. It will affect every sector of the economy as well as the whole process of planning and management. In industry, the Bank has already been studying state enterprise management through the collaborative research program, and a similar project on the management of collective enterprises is under discussion. But a major objective of our future dialogue and sector and project work in all sectors will now be to assist in the development and implementation of institutional arrangements that are appropriate to the reformed economic system. In agriculture, for example, we will focus attention on the changes in the organization and management of agricultural support services that need to accompany the change to household production systems. And in infrastructure and services we will look closely at institutional arrangements that would stimulate the overall development of these sectors as well as separate economic from administrative activities.

53. Investment finance and the development of financial institutions that can function as intermediaries between the suppliers and users of resources is a second aspect of economic reform where much experimentation is already underway and where Bank assistance could be valuable. Through ESW the Bank will be reviewing the development of the financial system and issues of industrial and rural finance as well as the utilization and allocation of resources through the state budget. We also intend to maintain and broaden our operational involvement with CIB and ABC, while initiating operations with other financial institutions including the Industrial and Commercial Bank of China and the Peoples Construction Bank.

54. Improvements in planning and project analysis will be a critical aspect of reform in sectors such as agriculture and industry where, increasingly, decisions are being made by households and independent enterprises, as well as in the physical and social infrastructure sectors where a continued and often enlarged direct government involvement will be required. The Bank will therefore continue to emphasize the importance of thorough project appraisal and will assist in the preparation of appraisal manuals for specific sectors and subsectors. We also intend to expand the scope of our work to include sector and subsector investment and financial planning as well as intersectoral planning issues such as under the proposed intermodal transport study.

55. In the coming years the Government will be involved in a major program of price reform as well as in the development of instruments of indirect control via money, credit and fiscal policies. Agencies and officials in China are, however, very inexperienced in the development and use of such instruments. Price reform and the development and use of economic levers will, therefore, be a major focus of our dialogue and our research and economic and sector work programs in China. These issues will also be addressed in the development of specific projects as well as in EDI seminars and courses.

56. The final aspect of economic reform that will be a focus of Bank assistance involves institutional and policy change relating to social programs including reforms in the systems for providing health, education and other services in urban and rural areas and measures to address the problems

of poor people, most of whom live in rural areas of the interior. The Bank's ESW program will have such reforms as a major focus. It is likely to include studies of alternative social security systems and the organization of health, education and housing services, as well as assessments of the problems of poor localities and policies required to address such problems. The implementation of such institutional and policy changes will then be a major focus of the Bank's lending program, particularly in the agriculture, health, education and urban sectors.

#### Volume and Terms of Lending

57. The progress in the China-Bank relationship over the past four years, China's need for additional external assistance of all types and senior leaders' requests to the Bank for assistance with economic reform all argue for continued expansion in the volume of lending. But the appropriate pace of expansion of lending will depend both on creditworthiness and Bank exposure considerations and on the capacity of China and the Bank to develop projects to which the Bank can make a substantive contribution to technology transfer and policy and institutional reform. In both these respects the availability of IDA funds for China will be of great importance.

58. Although China has yet to incur large external debts there are substantial financial risks associated with its reform and adjustment program. One year ago, for example, China's short-term liquidity position was very strong, but the recent sharp fall in foreign exchange reserves has served to highlight the fragility of the balance of payments and debt situation and the need for close monitoring and response capabilities. Over the next decade or so, China will need to expand its import program rapidly and incur substantial external debt at the same time as it is adapting to a new economic system and trying to develop an appropriate combination of indirect market-related and direct administrative policies that will help to maintain macro stability and improve efficiency. If all of the external debts were to be incurred on commercial terms the debt servicing burden and the risks associated with China's overall development program would be significantly increased.

59. Continued IDA lending to China will, therefore, help moderate the early build up of debt servicing and facilitate the transition to a reformed economic system. In addition there seems little doubt that the scope and coverage of the Bank's assistance program will be significantly affected by the availability of IDA. The State Planning Commission and other core agencies would like to take advantage of the Bank's technical and economic expertise in a wide variety of sectors but many officials are still reluctant to borrow on near commercial terms for social sector projects. Therefore, in sectors such as education and health, - and as in some other countries - Bank involvement may be possible only on IDA terms for some time to come.

60. Apart from the above considerations, China has a strong claim on IDA resources as one of the poorer countries of the world with a per capita income of only \$300 in 1983, significantly below that of some other IDA recipients. Despite the Government's long-standing commitment to basic needs and the rapid growth in rural areas in recent years, the living standards of some 100 million people are still miserably low, and provision of IDA funds would



facilitate Bank involvement in the development of strategies and policies to help address the problems of such people.

61. The provision of IDA finance is therefore an important element in the Bank's strategy for assisting China. IDA lending to China has increased from \$100 million in FY81 to \$442 million in FY85 and a projected \$450 million in FY86 and \$400 million in FY87. It will be important that China's need for IDA resources is fully and equitably taken into account in IDA 8; the proposed assistance program is based on the assumption that the IDA allocation will be of the order of \$500 million p.a.

62. Assuming that China's IDA allocation could be increased to \$500 million and then remain at that level, Attachment 1a projects that IBRD lending could increase to \$2.0 billion by 1990 if a gradual hardening of the IBRD/IDA blend from 60/40 in FY85 to 80/20 in FY90 is accepted by the Government. We feel that a more rapid hardening in the blend than this will probably be unacceptable and, if IDA allocations to China fall or there is a feeling that China's needs have not been equitably taken into account, the Government may well insist on a more gradual expansion of the total program. Assuming IBRD commitments do reach \$2.0 billion by FY90, China's share of Bank-wide DOD would be about 5% in FY90 and, even with a gradual expansion in commitments in subsequent years, would be unlikely to reach 10% before the second half of the 1990s.

#### Number of Projects and Sectoral Coverage

63. The potential contribution of the Bank to technology transfer and institutional and policy reform in China could be affected as much by the number of projects as by the level of lending. In the coming five years Bank lending will continue to consist primarily, if not entirely, of traditional project loans. In some sectors it may be possible to broaden the coverage of projects and the size of Bank loans, thereby increasing the average loan size of the program as a whole. Still, it would not be realistic to expect the average loan size to be more than \$150 million in FY90. This compares with the current average loan size for China of about \$100 million and would be roughly double the expected Bank wide average. It would involve approval of 16 projects in FY90, assuming the total lending program is about \$2.5 billion, which would be a significant increase from the 12 approved in FY85 and the expected 10 in FY86. However, this number of projects appears both desirable and feasible assuming the additional staff and consultant resources can be provided (see para. 94). Moreover, if the total amount of lending does not expand as rapidly as projected, the technology transfer and reform assistance objectives of the Bank's program in China would probably be better served by aiming for a slower expansion in average loan size rather than a reduction in the number of projects.

64. In the first CPP the broad sectoral coverage of the Bank lending program was justified primarily as a means of learning about China's economic situation and problems and about Bank project capabilities. But government preferences and the experience gained to date suggest that such a broad sectoral coverage should and can be maintained, provided some IDA funds continue to be available to China. As mentioned earlier, even in sectors such as

health, where China's experience could be very helpful to other low income countries, there are useful technologies and ideas to be transferred to China as well as difficult institutional and policy issues to be resolved. Moreover the Bank is uniquely placed to act as a channel for provision of assistance from a wide variety of countries and sources. Thus the broad sectoral coverage of the Bank's lending program will be maintained. However, the number and type of projects to be undertaken in particular sectors will be based on the potential contribution that the Bank can make in technology transfer and institutional and policy assistance. To be effective in these areas, it will also be important that Bank-supported projects cover some of the poorest as well as some of the richest regions. But some concentration of lending within these regions may be desirable (e.g. concentrating on Shanghai as an example of some of the issues confronting richer provinces and Gansu as an example of some of the issues confronting poorer regions).

#### Link between Performance and Lending

65. Senior leaders in China are determined to push ahead as quickly as possible with major reforms of the economic system and appear to welcome the Bank's advice on national economic issues for its own sake rather than as a precondition for lending. Moreover there seems little doubt that the effectiveness of the Bank as an agent for institutional and policy change at the national economic level will depend much more on the quality of our economic work and dialogue than on the volume of lending. The effectiveness of our dialogue at this level is also likely to be much greater if we continue to operate in an informal and advisory fashion and do not attempt to arrive at explicit understandings that are set down in loan or other legal agreements. Therefore we do not propose that there should be any formal link between progress on system reform and the level of Bank lending. We will, however, continue to monitor policy developments in China and the overall growth and balance of payments performance with a view to assessing the country's credit-worthiness and the appropriate levels of IBRD and IDA lending.

66. The development of an effective dialogue at the sector level will, in most cases, be a longer and more difficult process, depending not only on the quality of our work but also on the receptivity of officials at many different levels. At present it is not possible to predict where future progress is likely to be greatest, in part because almost all agencies are experiencing major personnel changes including the promotion of younger, more technocratic and possibly more reform oriented staff. But we will closely monitor how useful we are being in specific sectors and subsectors in terms of both the quality and the impact of our institutional and policy advice and adjust the level of our involvement accordingly.

67. At the project level it will remain essential that we gather all the information necessary for sound project analysis and that we make use of explicit conditions where these bear directly on the effectiveness of a proposed project. While it will always be difficult to decide where to draw the line both in terms of information and project conditionality, the Bank's credibility in China depends on maintaining the highest standards in our project work, as well as undertaking high quality economic and sector work. We will, therefore, continue to require thorough analysis and discussion of

the technical, financial, economic and institutional aspects of proposed projects. If essential information is not forthcoming or important issues have not been resolved, we will postpone projects or drop them altogether from the lending program. And where institutional or policy, including price, changes are regarded as critical to effective project implementation they will be included as explicit conditions.

#### Onlending and Cost Sharing Arrangements

68. Project onlending arrangements are not yet satisfactory primarily because the issue is tied to major aspects of system reform - specifically the fiscal and financial relationships between central and local governments and between line agencies and enterprises, the sources of finance for different types of investments, price and interest rate reform, and the foreign exchange management system. Bank funds are being onlent at interest rates which are generally higher than those attached to domestic funds (which themselves vary greatly) and, in some instances, to other foreign funds. In addition beneficiaries are frequently required to assume the foreign exchange risk (through repayments in foreign exchange or foreign exchange retention rights rather than local currency), in contrast to foreign borrowings from some other sources and even in cases where the projects are not directly using or earning foreign exchange. Such variations in terms and conditions are likely to distort the selection and design of projects, including creating a bias toward projects that directly earn foreign exchange and encouraging the development of special institutional relationships to link activities that do not earn foreign exchange directly with those that do.

69. Our strategy for dealing with the onlending issue recognizes that it will ultimately be resolved only when the economic system as a whole has been reformed. In our economic work and dialogue we will endeavor to assist China in reform measures that bear on the onlending issue, including investment finance and central/local fiscal relationships. However, reform will be a gradual process. The Bank, therefore, will need to ensure that the onlending arrangements for specific projects facilitate and do not set back the development of a more efficient system for financing investment and managing foreign exchange and borrowing. This will involve a gradual move to a more appropriate level and structure of interest rates, more open access to foreign exchange, and improved procedures for monitoring and managing foreign borrowing. It will not be an easy task and may be made more complicated by the current staffing difficulties in the Ministry of Finance.

70. The Bank's willingness to finance some local costs when the foreign exchange costs of projects are low helps reduce some of the incentives in the present system for developing projects that are overly import intensive. Our present policy is to finance the foreign exchange costs or 35% of total project costs, whichever is higher. Experience with this guideline suggests that the 35% limit has not prevented the Bank from making a significant contribution to project formulation and that sufficient other resources have been available to cover the remaining financing requirements. It is also apparent that the 35% limit is likely to apply primarily to IDA financed agriculture and human development projects; in such cases any raising of the cost sharing percentage would result not in an increase in the level of lending but rather

in a reduction in the scope or number of projects. Therefore we do not feel that any change in the guideline on cost sharing is desirable at this time. The guideline would, however, need to be reviewed again if the domestic resource or IDA situations were to change significantly.

#### Opportunities for Cofinancing

71. Several projects have been cofinanced with multilateral or bilateral agencies and this will remain a feature of our assistance program. Official cofinancing will be used primarily for technical assistance, training and other software components, and although the dollar value of such assistance is likely to remain low it will be important in the overall process of technology transfer to China. We also intend to press for more cofinancing with export credit agencies. Large lines of export credits have been made available to China but until now the Government has preferred to rely on its own reserves to complete foreign exchange financing; this may change, however, with the recent decline in China's foreign reserves. Commercial bank cofinancing may also become attractive to China as it increases the overall size of its borrowing program and the possibility of using B-loans, particularly in the power, coal and industry sectors, will be explored.

#### Coordination with the IMF

72. Although not expected to make use of Fund resources in the immediate future, China could certainly benefit greatly from Fund expertise on a number of elements of the reform agenda including investment finance and the development of instruments of indirect control. In a number of these areas the Fund has already organized training courses in China as well as inviting Chinese officials to participate in courses in Washington. The fund's current program includes advisory work on financial programming and monetary policy instruments and a seminar on government finance statistics, both of which are scheduled to take place in early 1986. In addition, the People's Bank of China has recently expressed interest in receiving technical assistance from the Fund on external debt management and balance of payments analysis. The Fund and the Bank have maintained close working relations on China in part through frequent informal discussions as well as through joint missions (Bank staff participated in a Fund Article IV consultation mission and a Fund staff member participated in the most recent Bank economic mission). Such cooperation and coordination will be even more important in the future as both institutions become increasingly involved in advising the Chinese government about the formulation and implementation of economic reforms.

#### F. World Bank Program

73. In order to translate the Bank's assistance strategy into a work program and ensure that the elements of Bank assistance are well integrated, it will be essential that the Bank work with the core agencies in China to develop a longer term planning horizon that includes an agreed package of sector and project identification work. At present, however, the planning horizon for Bank activities in China is still very short term, and the program outlined in the following paragraphs is, therefore, likely to be subject to substantial modification, particularly in the outer years. Substantial

modifications to the program might also be required if there were to be unexpected developments in the pace or pattern of economic reform.

#### Economic and Sector Work Program

74. The ESW program will play an important role in helping achieve the reform assistance objectives of our China program and will cover all the following elements of the reform agenda outlined in paras. 51-56. Attachment 4 summarizes the FY85 program and the proposed program for FY86 and FY87. The program has been revised since the indicative statement to take account of the economic report discussions and has now been formally approved by the Chinese State Council. It will still, however, be necessary to discuss with counterpart agencies the specific scope and issues to be addressed by each study before work is begun.

75. One major component of future ESW will be indepth studies of issues in economic reform combined, from time to time, with reviews of recent economic developments. In FY86 a major study of investment finance will develop and evaluate alternative scenarios of how investment financing and allocation might be organized and managed in China in the medium term future, based on international experience and China's objectives and current system. We expect this to be followed by a study of foreign trade and investment issues (which would be combined with a review of recent economic developments) in FY86/87 and a study of issues in public finance in FY87/88. The possibility of a detailed review of international experience with the development, management and financing of social security systems is also under discussion.

76. An important new area of the ESW program will be provincially based multi sector, sector and subsector studies that will complement our economy-wide studies and will help in the review and development of measures and programs to increase interregional resource flows, improve the spatial efficiency of development and reduce poverty. The ongoing multi-sectoral study of Gansu province is designed to further understanding of regional development issues and problems of poverty areas. In FY86 a study of urban development in Zhejiang and Liaoning provinces will include an assessment of the future pattern of urbanization, urban service levels and investment requirements, financing mechanisms and institutional and policy changes. A study of intermodal transport planning, policy and financial issues in a single province will also be initiated in FY86. In addition, some of the industrial subsector work may focus on specific provinces.

77. Another important component of future ESW will be a program of collaborative economic studies with the Chinese Academy of Social Sciences and other Chinese research institutions. The ongoing study of management and guidance of state-owned industrial enterprises will be followed by a study of collective industrial enterprises, which are expected to become increasingly important industrial organizations in the reformed system. Consideration is also being given to a study of the organization and management of state and collective enterprises in the commercial sector, which are critical to system reform and will be growing rapidly and undergoing major structural change in the next few years. In addition in the education sector a study of the costs of different types of secondary education in Shanghai municipality is being

carried out jointly with the economics department of Fudan university. An extension of the study to two other major cities and to an analysis of the changing patterns of transition of graduates from school to work is under consideration.

78. Other sector and subsector studies, focusing both on institutional and other reform issues and on the investment requirements for structural change and growth, will be another major component of the ESW program. These studies will be critical in linking the Bank's economic and lending work and ensuring that individual projects help facilitate overall reform in China. In some sectors and subsectors such studies will be undertaken prior to any major lending involvement by the Bank. In agriculture for example a review of the prospects for and issues in livestock development will be undertaken prior to the preparation of any Bank supported livestock project; in transport an assessment of the potential for development of inland waterways and coastal shipping will precede discussions of possible water transport projects; and in industry a review of the telecommunications subsector will be used as the basis for determining whether there is a rationale for Bank lending. In other sectors and subsectors the Bank may already be involved in project lending but further sector work could help to broaden the scope and issues to be addressed by future projects. In energy, for example, there will be an analysis of the major strategic choices and interdependencies in coal utilization as well as an analysis of the issues and options in moving from administrative allocation of electric power to use of prices; in education, issues in the management and finance of higher education will be reviewed; and in health, there will be an analysis of future investment and policy choices in urban health with special emphasis on financial issues.

79. A final but very important component of our ESW in China will be more informal reports and seminars. There will be many situations in which direct contacts between Chinese and foreign experts, both inside and outside the Bank, and specific explanations of the experiences of different countries will be much more useful to China than formal World Bank reports. In such situations the Bank might be able to play an important role in identifying and organizing individuals or teams of foreign experts to work with Chinese experts in setting out concrete options for the Government to consider. This type of assistance has already been provided at both the macro and sector levels. But more such requests can be expected. For example the System Reform Commission recently asked the Bank to help organize a seminar on economic planning and management that was attended by a number of the world's most respected economists. Such seminars and informal reports can be financed in a variety of ways, including from future UNDP umbrella projects and IDA technical cooperation credits as well as from domestic resources. But considerable staff time of Bank economists will also be required to help organize and manage such work.

#### Lending Program

80. An expanding lending program (see Table 4 and Attachment 1a) will provide the Bank with many new opportunities to help China gain better access to improved technologies and develop and implement new policies and institutional arrangements. The broad sectoral focus of Bank lending will be main-

tained, but we have agreed with the core agencies that some changes in the relative emphasis given to different sectors may be desirable. Energy and transport will continue to account for about half of the lending and a third of the number of projects. Both sectors require improved technologies and major institutional and policy reform as well as substantial investment resources if they are not to constrain growth and development. Bank lending will also continue to focus on the further structural and institutional changes required in agriculture. However, reforms have proceeded much further and have been more effective in agriculture and rural areas than in industry and the urban sector; the need for technological change also appears to be much greater in industry than in agriculture. Therefore, assuming that we are able to undertake the necessary sector work, we expect that there will be a gradual shift in the emphasis of Bank lending (particularly the volume of lending) away from agriculture and toward industry and urban development. Education and health will continue accounting for a significant share of the lending program, subject to the availability of IDA funds.

Table 4: SECTORAL DISTRIBUTION OF LENDING PROGRAM

	Actual lending FY81-85			Proposed lending program FY86-90		
	Amount (\$ mil)	Share (%)	No. of projects	Amount (\$ mil)	Share (%)	No. of projects
Agriculture /a	638.8	21.2	10	1,070.0	11.3	12
Energy	776.9	25.8	7	2,640.0	27.8	15
Industry	342.6	11.4	3	1,785.0	18.8	11
Transport	651.6	21.6	4	2,440.0	25.7	13
Urban/Water supply	80.0	2.6	1	520.0	5.5	5
Education	430.0	14.3	3	745.0	7.9	8
Health	85.0	2.8	1	240.0	2.5	3
Others	10.0	0.3	1	45.0	0.5	2
Total	3,014.9	100.0	30	9,485.0	100.0	69

/a Includes lending for agricultural education.

81. In all sectors we have reached some understanding with the Government about the types of projects that the Bank is likely to support and how the Bank could contribute most to technological, policy and institutional change. But much further analysis, discussion and development of sectoral lending strategies are required. This will be accomplished using a variety of mechanisms including further sector work and reviews of sector investment programs for the period of the Seventh Five Year Plan (when these have been prepared) as well as through discussions of sectoral issues in the context of project preparation and supervision.

82. Agriculture. Bank lending will focus on helping develop agricultural institutions that are capable of providing the services that individual farmers require and of monitoring and stimulating appropriate changes in the pace and pattern of agricultural development. The shift from grant to loan finance and the increased autonomy of the rural banking system will be major aspects of change that the Bank will be supporting through a series of rural credit projects. These now involve lending to specific provinces and for specific activities but should gradually change to general lines of credit, provided in a context of ongoing improvement in the operations and financing of the Agricultural Bank of China and the rural credit cooperatives. Another dimension of Bank lending will be support for education, research, extension, planning and other service activities of bureaus in the ministries of agriculture, forestry and water resources. We also expect to be supporting integrated programs of assistance for specialized agricultural activities, including livestock, fisheries and certain crops, that need to grow at rates much above the growth rate of the sector as a whole and where the Bank could potentially play a useful role in technology transfer as well as institutional and policy change. Finally, the program will include support for irrigation and area development projects, particularly in poor areas and where there is a special need for an integrated approach to overcoming natural resource problems and stimulating agricultural development.

83. Energy. Bank lending will be aimed at reducing energy consumption as well as expanding energy production and is expected to involve approximately one project per year in each of the major subsectors - coal, power and petroleum/gas. In the coal subsector we will continue to push for price increases as a means of energy conservation and will endeavor to analyze some of the major choices and interdependencies in coal utilization (following on from the proposed sector work in this area) as well as the environmental implications of increased coal use. We will also assist in transfer of improved technology for coal exploration, medium and large underground mining, open pit mining and coal washing. In the power subsector we will endeavor to assist China in moving from the present system of administrative allocation to one based primarily on prices as well as supporting transfer of modern technology, staff training and institution building, with emphasis on system planning and modern financial management. In the petroleum/gas subsector the rationale for Bank project involvement will lie in the identification, packaging and transfer of specialized technologies as well as in the strengthening of investment planning and management capabilities. In all three subsectors Bank involvement will be used as a catalyst for encouraging and facilitating involvement by foreign companies, and special emphasis will be placed on cofinancing to help meet the huge investment, including foreign exchange, requirements of the energy sector.

84. Industry. A major focus of Bank lending in industry, as in agriculture, will be on the strengthening of banks and other financial institutions concerned with provision of credit to state and collective enterprises. We hope to be able to broaden our institutional involvement to include the Industrial and Commercial Bank of China and the People's Construction Bank of China as well as the China Investment Bank. In addition we expect that there will be a series of subsector projects concerned both with upgrading technology, including for energy conservation, and with changes in the overall organiza-



tion and management of the subsectors. The range of subsectors to be covered by such projects is unlikely to exceed four or five and will depend partly on the Bank's comparative advantage with respect to other sources of foreign technology and advice (including IFC), as well as on the progress made in undertaking sector work and helping develop policy and institutional reform packages that address the specific problems faced by different subsectors. Among the most likely subsectors to be included in the Bank's future program are fertilizers, cement, machine tools and other capital goods and telecommunications.

85. Transport, which could be as much of a constraint to future development in China as energy, will be another major focus of Bank lending. We expect to have about one project per year in each of the major subsectors of roads, railways and ports/inland waterways. All projects will aim both at upgrading technology and at policy and institutional reform. In roads, major changes in organization and financing will be required as a result of administrative decentralization and the introduction of the production responsibility system in rural areas. Drawing on Bank experience in other countries, we will endeavor to assist China in introducing institutional and financing arrangements at both national and local levels. In railways we will continue to assist in technology transfer by shifting the emphasis of future projects from line construction and electrification toward expansion and improvement of domestic production of locomotives and other railway equipment and materials. We will also aim to assist the Ministry of Railways in improving investment planning and operational and financial management. Ports is the subsector where we have had the most difficulty in establishing a productive relationship, but some progress has been made. We expect that it will soon be possible to develop projects that help further the considerable institutional and financial reform that is now underway. We also intend to broaden our involvement in this subsector to include coastal shipping and inland water transport.

86. Urban/Water Supply. Project preparation work in the urban sector is currently concentrated on improvements in services (especially sewerage and housing) in Shanghai. In addition to introducing the city to ideas and technologies from other countries our assistance will be designed to help develop and strengthen relevant municipal institutions. Future lending is expected to involve other major cities as well as support for the development of medium and small urban areas in specific provinces, possibly through the mechanism of municipal development funds. In addition we expect to remain involved in lending for rural water supply where our assistance will focus on planning and project analysis, development of institutional arrangements for construction, operation and maintenance, and financing mechanisms.

87. Education. Bank lending in education will gradually be broadened beyond the present concentration on higher education to include all levels of education. Lending for higher education will continue and will focus both on increasing China's access to the outside world through overseas fellowships and study tours, and on improving both the external productivity and the internal efficiency of the higher education system. A second major component of the program will be lending for vocational and technical education, a potentially very costly aspect of education which is now being given great

emphasis in China; Bank experience in planning, executing, monitoring and evaluating of similar programs in other countries could be very beneficial. Third, support for teacher education takes on urgent priority in view of the Government's recent decision to universalize access to primary and lower secondary education. A fourth major element of Bank assistance will involve the development of institutional and financial mechanisms for basic education in poor rural areas, which are now faced with many of the same problems of declining enrollment ratios (especially for girls), inadequate finance mechanisms and other problems that low income countries experience. Bank support for education is also expected to include assistance in improving domestic production capabilities for educational equipment and materials as well as support for the education and training systems of specific line ministries.

88. Health. Bank lending in health will continue to focus on the policy and institutional changes required to address both the lingering problems of communicable diseases, particularly in poor rural areas, and the emerging problems of chronic diseases. This will involve further support for medical training and planning and management at different levels as well as assistance in reforming the systems for supplying and financing health services in both rural and urban areas. The second health project, for example, will include some assistance in the development of rural health insurance schemes.

89. Technical Assistance. In addition to technical assistance components in specific projects, we will continue to make use of technical assistance credits as well as acting as executing agency for a second UNDP umbrella project. In addition, we intend to broaden the coverage of such projects to include policy advice and institution building as well as project preparation and implementation. We will also endeavor to use technical assistance projects and components of other projects to help strengthen the local consulting industry in China.

#### IFC

90. In the very early stages of the relationship between China and the Bank, the Government expressed general interest in IFC operations as a catalyst for direct foreign investment. To assist Chinese enterprises to obtain a good understanding of joint-venture arrangements, IFC co-sponsored a seminar in 1983 with the China International Trust and Investment Corporation (CITIC) on this subject. IFC's staff has also participated in a number of seminars sponsored by the EDI. Many in China now recognize that IFC's role could go beyond foreign private capital mobilization to include assistance in such areas as selection of technology, evaluation of the manner and terms on which technology should be transferred to China, project structuring, and assessment of project viability. The Government has also approached IFC for technical assistance on the subject of foreign investment policies and its administration. Close cooperation and coordination between IFC and the Bank will be important in this area and in the overall review of the investment allocation system as well as in the development of IFC's own investment program in China.

91. In June 1985, IFC made its first investment in China of US\$17.02 million (consisting of a loan of US\$15.0 million and an equity

investment of US\$2.02 million equivalent) in the Guangzhou Peugeot Automobile Company, Ltd. IFC is discussing with foreign sponsors a number of potential joint-venture projects in the areas of agri-business, electronics, miscellaneous mechanical and chemical products etc. Apart from funding reasons, a number of foreign sponsors desire IFC's presence for its umbrella role. IFC is also mounting an active promotional effort in China focussing on the four coastal cities of Dalian, Tianjin, Shanghai, and Guangzhou and identifying particular sectors where IFC could play a meaningful role in project promotion. While the potential for substantial IFC investment in China is excellent, near-term proposals will be dependent upon timely progress of joint-venture agreement negotiations and their approvals.

#### EDI

92. Training provided by EDI will remain an important element of our assistance to China and will continue to be aimed both at training government officials in project and economic management and at building up counterpart training institutions. The program will involve three main types of training. First, we will continue holding policy seminars in Washington for senior Chinese officials every two or three years. These seminars will focus increasingly on specific aspects of system reform and how other countries have addressed such issues. Second, there will be a series of macroeconomic training courses in China for middle level officials which will include courses on national economic management, international economic management, public finance and financial sector development. Third, there will continue to be sector related courses for other officials but those concerned with project analysis in specific sectors will increasingly be handed over to local training institutes and EDI will concentrate more on courses concerned with sector planning. In project analysis courses, however, EDI will continue to provide some technical assistance to local training institutes especially in the development of training materials.

93. A major effort will be made to increase the number of counterpart training institutions. To date, almost all EDI's contacts have been with SIIEM and CIFAB, both affiliated with the Ministry of Finance. However, institutes under other ministries have begun to sponsor some EDI courses and this development will be encouraged. Efforts will also be made to involve Chinese trainers much more in Bank economic, sector and project missions as a means of providing them with some on-the-job training as well as helping in the development of case studies and other training materials. UNDP has provided substantial financial support to the EDI training program in China and this support is expected to continue.

#### Internal Resource Requirements

94. The projected internal resource requirements for the proposed Bank assistance program are provided in Table 5. They show a continued buildup in requirements for lending and supervision as well as in the resident office. Requirements for economic and sector work will be less in FY86 than FY85, as the findings and implications of the economic report are assessed, but will rise again thereafter. On a per project basis the projected requirements are well within the range for other major borrowers.

Table 5. INTERNAL RESOURCE REQUIREMENTS  
(Staff-weeks)

	Actual					Projected	
	FY81	FY82	FY83	FY84	FY85	FY86	FY87
<u>China</u>							
ESW	799	516	530	948	745	685	860
Lending	353	1,114	959	1,648	1,735	1,940	1,942
Supervision	-	15	172	277	619	640	716
Resident mission	-	-	-	-	-	130	260
Other	97	180	153	172	190	200	200
Total SW	1,249	1,825	1,814	3,045	3,289	3,595	3,978
Sw per Project	1,249	1,825	302	305	274	360	362
<u>Selected Comparators</u>							
Brazil - total Sw	3,023	3,233	2,920	3,109	3,217		
Sw per project	378	404	417	311	357		
India - total Sw	5,211	4,754	4,949	5,316	5,447		
Sw per project	372	432	330	313	419		
Indonesia - total Sw	4,290	3,944	3,543	3,509	4,086		
Sw per project	613	329	295	390	371		

#### Role of the Resident Mission

95. The new resident mission in Beijing should greatly facilitate implementation of the Bank's large and growing work program in China. The functions of the mission will be: to represent the Bank in the field to all agencies of the Chinese Government and all external agencies stationed in China; to help strengthen and broaden the relationship between the Bank and China, especially in programming and policy dialogue; and to contribute to and facilitate all headquarters work on China. Of particular importance will be the mission's regular and informal contacts with core and line agencies which should greatly facilitate the linking of economic, sector and project work and the development of a better integrated program of Bank assistance. The mission will initially be staffed with six staff from headquarters and some local staff. The specific functions and the appropriate staffing of the mission will, however, be reviewed regularly, both within the Bank and with the Government, so that a clear division of responsibilities between field and headquarters staff can evolve over time.

G. Conclusions and Recommendations

96. China is in the midst of a fundamental transformation of its economic system. Over the past four years major institutional and policy changes have been made which have contributed greatly to the rapid development of the whole economy. The future pace and pattern of reform is still uncertain. But there is no doubt that China's present political leaders intend to make further major institutional and policy changes and recognize that such changes are critical to efficiency and growth. The Bank's assistance program in China is still relatively new but good progress has been made in developing a broad range of assistance activities and in establishing that the Bank can be much more than a source of concessional finance. As a result we expect that the Bank will have a unique opportunity in the next five to ten years to assist China not only in technology transfer but also in the development and implementation of reforms that will help to increase the efficiency of resource use and reduce poverty. In order to fully respond to this opportunity we have proposed an ambitious program of economic and sector work, lending and other activities. We seek management recognition of both the uncertainties and the opportunities of our work in China and management approval of the proposed strategy and program. In the absence of political or economic developments that are likely to significantly affect the objectives or size of our program in China, the next CPP will be prepared in 1989.

Indonesia - total SW 4,290 3,944 3,543 3,209 4,086  
 SW per project 613 329 392 390 371

Role of the Resident Mission

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Population : 1,019 million (mid-1983)  
GNP per capita: US\$300 (1983)CHINA: ACTUAL AND PROPOSED LENDING OPERATIONS THROUGH FY90  
(US\$ million)

		Actual					Current FY86	Proposed				Total FY80-84	Total FY85-89	Total FY86-90
		FY81	FY82	FY83	FY84	FY85		FY87	FY88	FY89	FY90			
<b>Agriculture</b>														
North China Plain	IDA	-	60.0	-	-	-	-	-	-	-	-	-	-	-
Hailongjiang Land Reclamation	IBRD/IDA	-	-	80.3	-	-	-	-	-	-	-	-	-	-
Rubber Development	IDA	-	-	-	100.0	-	-	-	-	-	-	-	-	-
Pishihang-Chaohu Area Development	IBRD/IDA	-	-	-	-	92.0	-	-	-	-	-	-	-	-
Red Soils	IDA	-	-	-	-	-	-	45.0*	-	-	-	-	-	-
Gansu Area Development	IDA	-	-	-	-	-	-	100.0	-	-	-	-	-	-
Xinjiang Area Development	IDA	-	-	-	-	-	-	70.0	-	-	-	-	-	-
Irrigation/Area Development	IDA	-	-	-	-	-	-	-	-	100.0*	-	-	-	-
Irrigation/Area Development	IDA	-	-	-	-	-	-	-	-	-	100.0	-	-	-
Forestry I	IDA	-	-	-	-	47.3	-	-	-	-	-	-	-	-
Forestry II	IDA	-	-	-	-	-	-	-	85.0*	-	-	-	-	-
Aquaculture I	IDA	-	-	-	-	-	60.0	-	-	-	-	-	-	-
Livestock I	IDA	-	-	-	-	-	-	-	-	-	100.0*	-	-	-
Rural Credit I	IDA	-	-	-	50.0	-	-	-	-	-	-	-	-	-
Rural Credit II	IDA	-	-	-	-	-	110.0	-	-	-	-	-	-	-
Rural Credit III	IDA	-	-	-	-	-	-	-	100.0	-	-	-	-	-
Rural Credit IV	IBRD	-	-	-	-	-	-	-	-	-	-	100.0	-	-
Agricultural Education and Research	IDA	-	-	75.4	-	-	-	-	-	-	-	-	-	-
Agricultural Education II	IBRD/IDA	-	-	-	68.8	-	-	-	-	-	-	-	-	-
Agricultural Research II	IDA	-	-	-	-	25.0	-	-	-	-	-	-	-	-
Agricultural Education and Research III	IDA	-	-	-	-	-	-	-	-	100.0*	-	-	-	-
Seeds I	IDA	-	-	-	-	40.0	-	-	-	-	-	-	-	-
<b>Energy</b>														
Changcun (Luan) Coal Mining	IBRD	-	-	-	-	126.0	-	-	-	-	-	-	-	-
Coal II	IBRD	-	-	-	-	-	135.0	-	-	-	-	-	-	-
Coal III	IBRD	-	-	-	-	-	-	120.0	-	-	-	-	-	-
Coal IV	IBRD	-	-	-	-	-	-	-	150.0	-	-	-	-	-
Coal V	IBRD	-	-	-	-	-	-	-	-	250.0	-	-	-	-
Coal VI	IBRD	-	-	-	-	-	-	-	-	-	300.0	-	-	-
Daqing Petroleum	IBRD	-	-	162.4	-	-	-	-	-	-	-	-	-	-
Zhongyuan-Wenliu Petroleum	IBRD	-	-	100.8	-	-	-	-	-	-	-	-	-	-
Karamay Petroleum	IBRD	-	-	-	100.3	-	-	-	-	-	-	-	-	-
Gas Engineering	IBRD	-	-	-	-	25.0	-	-	-	-	-	-	-	-
Gas II	IBRD	-	-	-	-	-	-	100.0*	-	-	-	-	-	-
Petroleum/Gas IV	IBRD	-	-	-	-	-	-	-	150.0*	-	-	-	-	-
Petroleum/Gas V	IBRD	-	-	-	-	-	-	-	-	150.0*	-	-	-	-
Petroleum/Gas VI	IBRD	-	-	-	-	-	-	-	-	-	150.0	-	-	-
Lubuge Hydroelectric	IBRD	-	-	-	145.4	-	-	-	-	-	-	-	-	-
Power II	IBRD	-	-	-	-	117.0	-	-	-	-	-	-	-	-
Power III	IBRD	-	-	-	-	-	275.0	-	-	-	-	-	-	-
Power IV	IBRD	-	-	-	-	-	-	60.0*	-	-	-	-	-	-
Power V	IBRD	-	-	-	-	-	-	200.0	-	-	-	-	-	-
Power VI	IBRD	-	-	-	-	-	-	-	200.0	-	-	-	-	-
Power VII	IBRD	-	-	-	-	-	-	-	-	200.0	-	-	-	-
Power VIII	IBRD	-	-	-	-	-	-	-	-	-	200.0*	-	-	-

		Actual				Current	Proposed				Total	Total	Total	
		FY81	FY82	FY83	FY84	FY85	FY86	FY87	FY88	FY89	FY90	FY81-85	FY86-90	FY87-90
<b>Industry</b>														
Fertilizer Industry Rationalization	IBRD	-	-	-	-	97.0	-	-	-	-	-	-	-	-
Phosphate Mining	IBRD	-	-	-	-	-	100.0	-	-	-	-	-	-	-
Fertilizer II	IBRD	-	-	-	-	-	-	150.0*	-	-	-	-	-	-
Fertilizer III	IBRD	-	-	-	-	-	-	-	-	150.0	-	-	-	-
Cement I	IBRD	-	-	-	-	-	-	100.0	-	-	-	-	-	-
Cement/Building Materials II	IBRD	-	-	-	-	-	-	-	-	150.0	-	-	-	-
Shanghai Machine Tools	IBRD	-	-	-	-	-	135.0	-	-	-	-	-	-	-
Machine Tools II	IBRD	-	-	-	-	-	-	-	-	-	100.0*	-	-	-
Telecommunications I	IBRD	-	-	-	-	-	-	-	-	200.0*	-	-	-	-
Industrial Credit I	IBRD/IDA	-	-	70.6	-	-	-	-	-	-	-	-	-	-
Industrial Credit II	IBRD/IDA	-	-	-	175.0	-	-	-	-	-	-	-	-	-
Industrial Credit III	IBRD/IDA	-	-	-	-	-	-	200.0*	-	-	-	-	-	-
Industrial Credit IV	IBRD	-	-	-	-	-	-	-	250.0	-	-	-	-	-
Industrial Credit V	IBRD	-	-	-	-	-	-	-	-	-	250.0	-	-	-
<b>Transport</b>														
Three Ports	IBRD	-	-	124.0	-	-	-	-	-	-	-	-	-	-
Tianjin Port	IBRD	-	-	-	-	-	170.0	-	-	-	-	-	-	-
Huangpu Port	IBRD	-	-	-	-	-	-	150.0	-	-	-	-	-	-
Ports IV	IBRD	-	-	-	-	-	-	-	150.0	-	-	-	-	-
Ports V	IBRD	-	-	-	-	-	-	-	-	200.0	-	-	-	-
Ports VI	IBRD	-	-	-	-	-	-	-	-	-	200.0*	-	-	-
Railways I	IBRD	-	-	-	220.0	-	-	-	-	-	-	-	-	-
Railways II	IBRD	-	-	-	-	235.0	-	-	-	-	-	-	-	-
Railways III	IBRD	-	-	-	-	-	170.0	-	-	-	-	-	-	-
Railways IV	IBRD	-	-	-	-	-	-	-	200.0*	-	-	-	-	-
Railways V	IBRD	-	-	-	-	-	-	-	-	300.0	-	-	-	-
Railways VI	IBRD	-	-	-	-	-	-	-	-	-	300.0	-	-	-
Roads I	IBRD/IDA	-	-	-	-	72.6	-	-	-	-	-	-	-	-
Roads II	IBRD	-	-	-	-	-	-	150.0	-	-	-	-	-	-
Roads III	IBRD	-	-	-	-	-	-	-	150.0	-	-	-	-	-
Roads IV	IBRD	-	-	-	-	-	-	-	-	150.0*	-	-	-	-
Roads V	IBRD	-	-	-	-	-	-	-	-	-	150.0	-	-	-
<b>Urban and Water Supply</b>														
Shanghai Environment	IBRD/IDA	-	-	-	-	-	-	145.0	-	-	-	-	-	-
Shanghai Urban	IDA	-	-	-	-	-	-	-	75.0	-	-	-	-	-
Urban II	IBRD	-	-	-	-	-	-	-	-	100.0	-	-	-	-
Urban III	IBRD	-	-	-	-	-	-	-	-	-	100.0	-	-	-
Rural Water Supply I	IDA	-	-	-	-	80.0	-	-	-	-	-	-	-	-
Rural Water Supply II	IDA	-	-	-	-	-	-	-	-	100.0	-	-	-	-

Category	Type	Actual					Current	Proposed			Total FY80-84	Total FY85-89	Total FY86-90	
		FY81	FY82	FY83	FY84	FY85		FY86	FY87	FY88				FY89
<b>Education</b>														
University Development I	IBRD/IDA	200.0	-	-	-	-	-	-	-	-	-	-		
University Development II	IDA	-	-	-	-	145.0	-	-	-	-	-	-		
Provincial Universities	IBRD/IDA	-	-	-	-	-	120.0	-	-	-	-	-		
University Development III	IDA	-	-	-	-	-	-	75.0	-	-	-	-		
Polytechnic/TV University	IDA	-	-	-	85.0	-	-	-	-	-	-	-		
Polytechnic II	IDA	-	-	-	-	-	-	-	-	100.0	-	-		
Technical Education I	IDA	-	-	-	-	-	-	100.0	-	-	-	-		
Technical Education II	IDA	-	-	-	-	-	-	-	-	-	100.0*	-		
Teacher Education	IDA	-	-	-	-	-	-	-	75.0*	-	-	-		
Basic Education I	IDA	-	-	-	-	-	-	-	-	75.0	-	-		
Basic Education II	IDA	-	-	-	-	-	-	-	-	-	100.0	-		
<b>Health</b>														
Rural Health & Medical Education	IDA	-	-	-	85.0	-	-	-	-	-	-	-		
Health II	IDA	-	-	-	-	-	65.0	-	-	-	-	-		
Health III	IDA	-	-	-	-	-	-	75.0	-	-	-	-		
Health IV	IDA	-	-	-	-	-	-	-	-	-	100.0	-		
<b>Others</b>														
Technical Cooperation I	IDA	-	-	-	10.0	-	-	-	-	-	-	-		
Technical Cooperation II	IDA	-	-	-	-	-	20.0	-	-	-	-	-		
Technical Cooperation III	IDA	-	-	-	-	-	-	-	25.0	-	-	-		
<b>LENDING PROGRAM</b>														
	IBRD	100.0	-	463.1	616.0	659.6	810.0	1,240.0	1,400.0	1,700.0	2,000.0	1,179.1	5,809.6	7,150.0
	IDA	100.0	60.0	150.4	423.5	442.3	450.0	400.0	485.0	500.0	500.0	733.9	2,277.3	2,335.0
	<b>Total</b>	<b>200.0</b>	<b>60.0</b>	<b>613.5</b>	<b>1,039.5</b>	<b>1,101.9</b>	<b>1,260.0</b>	<b>1,640.0</b>	<b>1,885.0</b>	<b>2,200.0</b>	<b>2,500.0</b>	<b>1,913.0</b>	<b>8,086.9</b>	<b>9,485.0</b>
	Number	1	1	6	10	12	10	11	14	15	16	18	65	69
	(Of which IDA)		(1)	(1)	(5)	(5)	(4)	(3)	(6)	(6)	(5)	(7)	(24)	(24)
<b>Lending program in constant FY85 commitment \$</b>														
	IBRD	123.9	-	529.9	660.9	659.6	755.6	1,083.9	1,153.2	1,326.1	1,482.6	1,314.7	4,978.4	5,801.4
	IDA	123.9	721	172.0	454.4	442.3	419.8	349.7	399.5	390.0	370.6	822.4	2,001.3	1,929.6
	<b>Total</b>	<b>247.8</b>	<b>721</b>	<b>701.9</b>	<b>1,115.3</b>	<b>1,101.9</b>	<b>1,175.4</b>	<b>1,433.6</b>	<b>1,552.7</b>	<b>1,716.1</b>	<b>1,853.2</b>	<b>2,137.1</b>	<b>6,979.7</b>	<b>7,731.0</b>
<b>Commitment deflator (FY85 = 100)</b>														
		80.7	83.2	87.4	93.2	100.0	107.2	114.4	121.4	128.2	134.9			
<b>Standby projects</b>														
	<b>Total</b>						<b>405.0</b>	<b>660.0</b>	<b>700.0</b>	<b>700.0</b>				
	Number						4	5	5	5				

\* = Standby project.



CHINA: SUMMARY OF BANK GROUP AND OTHER OFFICIAL LENDING

	Through FY81	Actual				Current FY86	Proposed				Total FY80-84	Total FY85-89	Total FY86-90
		FY82	FY83	FY84	FY85		FY87	FY88	FY89	FY90			
<b>Sectoral Distribution of Bank Group Commitments (%)</b>													
Agriculture /a	-	100.0	25.4	21.0	18.5	13.5	13.1	9.8	9.1	12.0	22.7	12.1	11.3
Energy	-	-	42.9	23.6	24.3	32.5	29.3	26.5	27.3	26.0	26.6	27.9	27.8
Industry	-	-	11.5	16.8	8.8	10.7	24.4	21.2	15.9	20.0	12.9	17.1	18.8
Transport	-	-	20.2	21.2	27.9	27.0	18.3	26.5	29.6	26.0	18.0	25.9	25.7
Urban/Water Supply	-	-	-	-	7.3	-	8.8	4.0	9.1	4.0	-	6.2	5.5
Education	100.0	-	-	8.2	13.2	9.5	6.1	8.0	7.9	8.0	14.9	8.5	7.9
Health	-	-	-	8.2	-	5.2	-	4.0	-	4.0	4.4	1.7	2.5
Other	-	-	-	1.0	-	1.6	-	-	1.1	-	0.5	0.6	0.5
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Bank Group Disbursements (US\$ mln)</b>													
IBRD o/s incl. undisbursed	100.0	100.0	563.1	1,123.6	1,787.6	2,597.8	3,833.7	5,215.4	6,887.1	8,794.4	-	-	-
excl. undisbursed	-	0.1	0.7	20.3	260.3	533.8	998.3	1,666.4	2,528.3	3,566.6	-	-	-
IBRD gross disbursements	-	0.1	0.6	19.6	240.0	273.5	467.8	683.7	894.4	1,111.0	20.3	2,559.4	3,430.4
Less: Amortization	-	-	-	-	-	-	3.3	15.7	32.4	72.7	-	51.4	124.1
Equals: Net disbursements	-	0.1	0.6	19.6	240.0	273.5	464.5	668.1	861.9	1,038.3	20.3	2,508.0	3,306.3
Less: Interest and charges	-	0.1	1.7	8.1	13.0	53.2	94.5	154.1	231.4	325.5	9.9	546.2	858.7
Equals: Net transfer	-	-	-1.1	11.5	227.0	220.3	370.0	514.0	630.5	712.8	10.4	1,961.8	2,447.6
IBRD/IDA gross disbursements	-	0.1	33.8	120.5	381.9	393.4	635.6	923.2	1,171.7	1,426.7	154.4	3,505.8	4,550.6
Less: Amortization	-	-	-	-	-	-	3.3	15.7	32.4	72.7	-	51.4	124.1
Equals: Net disbursements	-	0.1	33.8	120.5	381.9	393.4	632.3	907.5	1,139.3	1,354.0	154.4	3,545.4	4,426.5
Less: Interest and charges	-	0.1	1.9	9.4	16.0	55.5	97.9	159.0	238.2	334.6	11.4	566.6	885.2
Equals: Net transfer	-	-	31.9	111.1	365.9	337.9	534.4	748.5	901.1	1,019.4	143.0	2,887.8	3,541.3
<b>IBRD Exposure (%)</b>													
IBRD disbursements/total gross disbursements	-	-	0.2	14.8	-	-	28.1	8.1	10.7	14.2	16.6	18.3	17.4
IBRD DOD/total DOD	-	-	0.1	1.7	-	-	5.9	7.5	9.1	10.4	11.8	13.3	18.0
IBRD debt service/total debt service	-	-	0.2	0.7	-	-	1.4	3.1	4.9	10.5	11.8	11.8	18.1
<b>Commitments from Official Sources (US\$ mln)</b>													
Grants	156	129	174	279	-	-	170	170	170	170	170	170	190
<b>Concessional Loans</b>													
IDA	96	165	139	329	-	-	442	420	395	485	500	500	500
Japan	100	214	300	285	-	-	285	285	285	285	285	285	285
Others	399	25	-	-	-	-	-	-	-	-	-	-	-
<b>Nonconcessional Loans</b>													
IBRD	100	165	299	616	-	-	648	950	1,200	1,400	1,700	2,000	2,700
Japan	550	700	950	-	-	-	480	480	480	480	480	480	480
Other	580	960	478	-	-	-	-	-	-	-	-	-	-
<b>Total Commitments</b>	<b>1,981</b>	<b>2,358</b>	<b>2,340</b>	<b>1,509</b>	-	-	<b>2,025</b>	<b>2,305</b>	<b>2,530</b>	<b>2,820</b>	<b>3,135</b>	<b>3,435</b>	<b>4,155</b>

/a Includes agricultural education.

TABLE 3A

PAGE 1 of 4

	CHINA, PEOPLE'S REP. OF - SOCIAL INDICATORS DATA SHEET			REFERENCE GROUPS (WEIGHTED AVERAGES) /a	
	1960/b	1970/b	MOST RECENT ESTIMATE/b	LOW INCOME ASIA & PACIFIC	MIDDLE INCOME ASIA & PACIFIC
<b>AREA (THOUSAND SQ. KM)</b>					
TOTAL	9561.0	9561.0	9561.0	.	.
AGRICULTURAL	3257.6	3882.0	3865.9	.	.
<b>GDP PER CAPITA (US\$)</b>					
	..	..	300.0	278.3	1011.1
<b>ENERGY CONSUMPTION PER CAPITA (KILOGRAMS OF OIL EQUIVALENT)</b>					
	202.0	259.0	441.9	285.7	566.8
<b>POPULATION AND VITAL STATISTICS</b>					
POPULATION, MID-YEAR (THOUSANDS)	651000.0	815160.0	1019102.0	.	.
URBAN POPULATION (% OF TOTAL)	18.4 /c	..	21.0	22.3	35.9
<b>POPULATION PROJECTIONS</b>					
POPULATION IN YEAR 2000 (MILL)			1242.3	.	.
STATIONARY POPULATION (MILL)			1571.0	.	.
POPULATION MOMENTUM			1.6	.	.
<b>POPULATION DENSITY</b>					
PER SQ. KM.	68.1	85.3	106.2	173.8	386.9
PER SQ. KM. AGRI. LAND	199.8	210.0	260.8	353.3	1591.2
<b>POPULATION AGE STRUCTURE (%)</b>					
0-14 YRS	38.9	37.6	32.0	36.3	38.2
15-64 YRS	56.2	57.2	63.1	59.4	57.7
65 AND ABOVE	4.7	5.0	5.0	4.3	3.5
<b>POPULATION GROWTH RATE (%)</b>					
TOTAL	1.1	2.2	1.7	2.0	2.3
URBAN	..	..	..	4.1	4.1
<b>CRUDE BIRTH RATE (PER THOUS)</b>					
	39.2 /d	35.7	18.6	27.5	30.1
<b>CRUDE DEATH RATE (PER THOUS)</b>					
	23.5 /d	8.8	7.1	10.2	9.4
<b>GROSS REPRODUCTION RATE</b>					
	2.8 /d	2.3	1.0	1.7	1.9
<b>FAMILY PLANNING</b>					
ACCEPTORS, ANNUAL (THOUS)	..	..	..	.	.
USERS (% OF MARRIED WOMEN)	..	..	71.0	49.4	56.5
<b>FOOD AND NUTRITION</b>					
<b>INDEX OF FOOD PROD. PER CAPITA (1969-71=100)</b>					
	..	100.0	123.0	116.6	124.4
<b>PER CAPITA SUPPLY OF</b>					
<b>CALORIES (% OF REQUIREMENTS)</b>					
	94.6 /d	101.6	119.8	106.3	115.7
<b>PROTEINS (GRAMS PER DAY)</b>					
	53.0 /d	56.2	69.7	60.1	60.3
<b>OF WHICH ANIMAL AND PULSE</b>					
	12.5 /d	13.3	15.9	14.4	14.1
<b>CHILD (AGES 1-4) DEATH RATE</b>					
	13.5	8.5	2.0	7.3	7.2
<b>HEALTH</b>					
<b>LIFE EXPECT. AT BIRTH (YEARS)</b>					
	41.0 /e	60.9	67.1	60.5	60.6
<b>INFANT MORT. RATE (PER THOUS)</b>					
	165.0 /d	69.0	38.0	69.2	64.9
<b>ACCESS TO SAFE WATER (%POP)</b>					
TOTAL	..	..	50.0	44.2	46.0
URBAN	..	..	85.0	77.2	57.6
RURAL	..	..	40.0	34.6	37.1
<b>ACCESS TO EXCRETA DISPOSAL (% OF POPULATION)</b>					
TOTAL	..	..	..	7.8	50.1
URBAN	..	..	..	28.8	52.9
RURAL	..	..	..	5.5	44.7
<b>POPULATION PER PHYSICIAN</b>					
	7940.0 /f	3690.0 /f	1740.0 /f	3318.0	7751.7
<b>POP. PER NURSING PERSON</b>					
	3830.0	2760.0	1710.0	4690.7	2464.8
<b>POP. PER HOSPITAL BED</b>					
TOTAL	1040.0	760.0	440.0	1039.2	1112.1
URBAN	210.0	..	160.0	299.1	651.4
RURAL	10140.0	..	1020.0	6028.2	2596.9
<b>ADMISSIONS PER HOSPITAL BED</b>					
	..	..	..	52.3	41.1
<b>HOUSING</b>					
<b>AVERAGE SIZE OF HOUSEHOLD</b>					
TOTAL	..	..	5.1	..	..
URBAN	..	..	4.1	..	..
RURAL	..	..	5.4	..	..
<b>AVERAGE NO. OF PERSONS/ROOM</b>					
TOTAL	..	..	..	..	..
URBAN	..	..	..	..	..
RURAL	..	..	..	..	..
<b>PERCENTAGE OF DWELLINGS WITH ELECT.</b>					
TOTAL	..	..	..	..	..
URBAN	..	..	..	..	..
RURAL	..	..	..	..	..

TABLE 3A

CHINA, PEOPLE'S REP. OF - SOCIAL INDICATORS DATA SHEET

CHINA, PEOPLE'S REP. OF REFERENCE GROUPS (WEIGHTED AVERAGES) /a

	1960/b	1970/b	MOST RECENT ESTIMATE/b	LOW INCOME ASIA & PACIFIC	MIDDLE INCOME ASIA & PACIFIC
<b>EDUCATION</b>					
<b>ADJUSTED ENROLLMENT RATIOS</b>					
PRIMARY: TOTAL	109.0	110.0	110.0	92.6	100.7
MALE	..	..	123.0	105.5	104.4
FEMALE	..	..	97.0	79.3	97.2
SECONDARY: TOTAL	21.0	23.0	35.0	31.3	47.8
MALE	..	..	46.0	40.8	50.6
FEMALE	..	..	25.0	21.9	44.8
VOCATIONAL (% OF SECONDARY)	..	..	2.2	3.2	18.4
<b>PUPIL-TEACHER RATIO</b>					
PRIMARY	..	33.0	25.0	38.0	30.4
SECONDARY	..	22.0	16.0	17.4	22.2
<b>CONSUMPTION</b>					
PASSENGER CARS/THOUSAND POP	..	..	0.2 /h	0.9	10.1
RADIO RECEIVERS/THOUSAND POP	..	14.7	210.1	129.8	172.9
TV RECEIVERS/THOUSAND POP	..	0.6	35.3	19.8	58.5
NEWSPAPER ("DAILY GENERAL INTEREST") CIRCULATION PER THOUSAND POPULATION	..	..	33.4	25.7	65.3
CINEMA ANNUAL ATTENDANCE/CAPITA	..	..	..	6.0	3.4
<b>LABOR FORCE</b>					
TOTAL LABOR FORCE (THOUS)	321646.0	380555.0	470692.0	..	..
FEMALE (PERCENT)	38.3	38.0	37.3	33.2	33.6
AGRICULTURE (PERCENT)	..	..	68.9	69.6	52.2
INDUSTRY (PERCENT)	..	..	18.7	15.8	17.9
<b>PARTICIPATION RATE (PERCENT)</b>					
TOTAL	46.8	45.0	46.1	41.9	38.9
MALE	55.9	54.5	55.4	53.6	50.8
FEMALE	37.0	35.0	35.1	29.1	26.8
ECONOMIC DEPENDENCY RATIO	0.9	1.0	0.8	1.0	1.1
<b>INCOME DISTRIBUTION</b>					
PERCENT OF PRIVATE INCOME RECEIVED BY					
HIGHEST 5% OF HOUSEHOLDS	..	..	12.5 /g	..	..
HIGHEST 20% OF HOUSEHOLDS	..	..	39.3 /g	..	48.0
LOWEST 20% OF HOUSEHOLDS	..	..	6.8 /g	..	6.4
LOWEST 40% OF HOUSEHOLDS	..	..	18.4 /g	..	15.5
<b>POVERTY TARGET GROUPS</b>					
ESTIMATED ABSOLUTE POVERTY INCOME LEVEL (US\$ PER CAPITA)					
URBAN	..	..	..	133.9	..
RURAL	..	..	..	111.6	151.9
ESTIMATED RELATIVE POVERTY INCOME LEVEL (US\$ PER CAPITA)					
URBAN	..	..	..	..	177.9
RURAL	..	..	..	61.7	164.7
ESTIMATED POP. BELOW ABSOLUTE POVERTY INCOME LEVEL (%)					
URBAN	..	..	..	43.8	23.5
RURAL	..	..	..	51.7	37.8

.. NOT AVAILABLE  
 . NOT APPLICABLE

NOTES

- /a The group averages for each indicator are population-weighted arithmetic means. Coverage of countries among the indicators depends on availability of data and is not uniform.
- /b Unless otherwise noted, "Data for 1960" refer to any year between 1959 and 1961; "Data for 1970" between 1969 and 1971; and data for "Most Recent Estimate" between 1981 and 1983.
- /c 1964; /d 1955-65 average; /e 1955-64 average; /f Senior doctor of western medicine; /g Distribution of people ranked by households per capita income, 1979 data; /h 1980.

JUNE, 1985

## DEFINITIONS OF SOCIAL INDICATORS

Notes: Although the data are drawn from sources generally judged the most authoritative and reliable, it should also be noted that they may not be internationally comparable because of the lack of standardized definitions and concepts used by different countries in collecting the data. The data are, nonetheless, useful to describe orders of magnitude, indicate trends, and characterize certain major differences between countries.

The reference groups are (1) the same country group of the subject country and (2) a country group with somewhat higher average income than the country group of the subject country (except for "High Income Oil Exporters" group where "Middle Income North Africa and Middle East" is chosen because of stronger socio-cultural affinities). In the reference group data the averages are population weighted arithmetic means for each indicator and shown only when majority of the countries in a group has data for that indicator. Since the coverage of countries among the indicators depends on the availability of data and is not uniform, caution must be exercised in relating averages of one indicator to another. These averages are only useful in comparing the value of one indicator at a time among the country and reference groups.

**AREA** (thousand sq.km.)

**Total**—Total surface area comprising land area and inland waters; 1960, 1970 and 1983 data.

**Agricultural**—Estimate of agricultural area used temporarily or permanently for crops, pastures, market and kitchen gardens or to lie fallow, 1960, 1970 and 1982 data.

**GNP PER CAPITA (US\$)**—GNP per capita estimates at current market prices, calculated by same conversion method as *World Bank Atlas* (1981-83 basis); 1983 data.

**ENERGY CONSUMPTION PER CAPITA**—Annual apparent consumption of commercial primary energy (coal and lignite, petroleum, natural gas and hydro-, nuclear and geothermal electricity) in kilograms of oil equivalent per capita; 1960, 1970, and 1982 data.

**POPULATION AND VITAL STATISTICS**

**Total Population, Mid-Year (thousands)**—As of July 1; 1960, 1970, and 1983 data.

**Urban Population (percent of total)**—Ratio of urban to total population; different definitions of urban areas may affect comparability of data among countries; 1960, 1970, and 1983 data.

**Population Projections**

**Population in year 2000**—The projection of population for 2000, made for each economy separately. Starting with information on total population by age and sex, fertility rates, mortality rates, and international migration in the base year 1980, these parameters were projected at five-year intervals on the basis of generalized assumptions until the population became stationary.

**Stationary population**—Is one in which age- and sex-specific mortality rates have not changed over a long period, while age-specific fertility rates have simultaneously remained at replacement level (net reproduction rate = 1). In such a population, the birth rate is constant and equal to the death rate, the age structure is also constant, and the growth rate is zero. The stationary population size was estimated on the basis of the projected characteristics of the population in the year 2000, and the rate of decline of fertility rate to replacement level.

**Population Momentum**—Is the tendency for population growth to continue beyond the time that replacement-level fertility has been achieved; that is, even after the net reproduction rate has reached unity. The momentum of a population in the year  $t$  is measured as a ratio of the ultimate stationary population to the population in the year  $t$ , given the assumption that fertility remains at replacement level from year  $t$  onward, 1985 data.

**Population Density**

**Per sq.km.**—Mid-year population per square kilometer (100 hectares) of total area; 1960, 1970, and 1983 data.

**Per sq.km. agricultural land**—Computed as above for agricultural land only, 1960, 1970, and 1982 data.

**Population Age Structure (percent)**—Children (0-14 years), working age (15-64 years), and retired (65 years and over) as percentage of mid-year population; 1960, 1970, and 1983 data.

**Population Growth Rate (percent)—total**—Annual growth rates of total mid-year population for 1950-60, 1960-70, and 1970-83.

**Population Growth Rate (percent)—urban**—Annual growth rates of urban population for 1950-60, 1960-70, and 1970-83 data.

**Crude Birth Rate (per thousand)**—Number of live births in the year per thousand of mid-year population; 1960, 1970, and 1983 data.

**Crude Death Rate (per thousand)**—Number of deaths in the year per thousand of mid-year population; 1960, 1970, and 1983 data.

**Gross Reproduction Rate**—Average number of daughters a woman will bear in her normal reproductive period if she experiences present age-specific fertility rates; usually five-year averages ending in 1960, 1970, and 1983.

**Family Planning—Acceptors, Annual (thousands)**—Annual number of acceptors of birth-control devices under auspices of national family planning program.

**Family Planning—Users (percent of married women)**—The percentage of married women of child-bearing age who are practicing or whose husbands are practicing any form of contraception. Women of child-bearing age are generally women aged 15-49, although for some countries contraceptive usage is measured for other age groups.

**FOOD AND NUTRITION**

**Index of Food Production Per Capita (1969-71 = 100)**—Index of per capita annual production of all food commodities. Production excludes animal feed and seed for agriculture. Food commodities include primary commodities (e.g. sugarcane instead of sugar) which are edible and contain nutrients (e.g. coffee and tea are excluded); they comprise cereals, root crops, pulses, oil seeds, vegetables, fruits, nuts, sugarcane and sugar beets, livestock, and livestock products. Aggregate production of each country is based on national average producer price weights; 1961-65, 1970, and 1982 data.

**Per Capita Supply of Calories (percent of requirements)**—Computed from calorie equivalent of net food supplies available in country per capita per day. Available supplies comprise domestic production, imports less exports, and changes in stock. Net supplies exclude animal feed, seeds for use in agriculture, quantities used in food processing, and losses in distribution. Requirements were estimated by FAO based on physiological needs for normal activity and health considering environmental temperature, body weights, age and sex distribution of population, and allowing 10 percent for waste at household level; 1961, 1970 and 1982 data.

**Per Capita Supply of Protein (grams per day)**—Protein content of per capita net supply of food per day. Net supply of food is defined as above. Requirements for all countries established by USDA provide for minimum allowances of 60 grams of total protein per day and 20 grams of animal and pulse protein, of which 10 grams should be animal protein. These standards are lower than those of 75 grams of total protein and 23 grams of animal protein as an average for the world, proposed by FAO in the Third World Food Supply; 1961, 1970 and 1982 data.

**Per Capita Protein Supply From Animal and Pulse**—Protein supply of food derived from animals and pulses in grams per day; 1961-65, 1970 and 1977 data.

**Child (ages 1-4) Death Rate (per thousand)**—Number of deaths of children aged 1-4 years per thousand children in the same age group in a given year. For most developing countries data derived from life tables; 1960, 1970 and 1983 data.

**HEALTH**

**Life Expectancy at Birth (years)**—Number of years a newborn infant would live if prevailing patterns of mortality for all people

at the time of its birth were to stay the same throughout its life; 1960, 1970 and 1983 data.

**Infant Mortality Rate (per thousand)**—Number of infants who die before reaching one year of age per thousand live births in a given year; 1960, 1970 and 1983 data.

**Access to Safe Water (percent of population)**—total, urban, and rural—Number of people (total, urban, and rural) with reasonable access to safe water supply (includes treated surface waters or untreated but uncontaminated water such as that from protected boreholes, springs and sanitary wells) as percentages of their respective populations. In an urban area a public fountain or standpost located not more than 200 meters from a house may be considered as being within reasonable access of that house. In rural areas reasonable access would imply that the housewife or members of the household do not have to spend a disproportionate part of the day in fetching the family's water needs.

**Access to Excreta Disposal (percent of population)**—total, urban, and rural—Number of people (total, urban, and rural) served by excreta disposal as percentages of their respective populations. Excreta disposal may include the collection and disposal, with or without treatment, of human excreta and waste-water by water-borne systems or the use of pit privies and similar installations.

**Population per Physician**—Population divided by number of practicing physicians qualified from a medical school at university level.

**Population per Nursing Person**—Population divided by number of practicing male and female graduate nurses, assistant nurses, practical nurses and nursing auxiliaries.

**Population per Hospital Bed**—total, urban, and rural—Population (total, urban, and rural) divided by their respective number of hospital beds available in public and private, general and specialized hospitals and rehabilitation centers. Hospitals are establishments permanently staffed by at least one physician. Establishments providing principally custodial care are not included. Rural hospitals, however, include health and medical centers not permanently staffed by a physician (but by a medical assistant, nurse, midwife, etc.) which offer in-patient accommodation and provide a limited range of medical facilities.

**Admissions per Hospital Bed**—Total number of admissions to or discharges from hospitals divided by the number of beds.

## HOUSING

**Average Size of Household (persons per household)**—total, urban, and rural—A household consists of a group of individuals who share living quarters and their main meals. A boarder or lodger may or may not be included in the household for statistical purposes.

**Average Number of Persons per Room**—total, urban, and rural—Average number of persons per room in all urban, and rural occupied conventional dwellings, respectively. Dwellings exclude non-permanent structures and unoccupied parts.

**Percentage of Dwellings with Electricity**—total, urban, and rural—Conventional dwellings with electricity in living quarters as percentage of total, urban, and rural dwellings respectively.

## EDUCATION

### Adjusted Enrollment Ratios

**Primary school - total, male and female**—Gross total, male and female enrollment of all ages at the primary level as percentages of respective primary school-age populations. While many countries consider primary school age to be 6-11 years, others do not. The differences in country practices in the ages and duration of school are reflected in the ratios given. For some countries with universal education, gross enrollment may exceed 100 percent since some pupils are below or above the country's standard primary-school age.

**Secondary school - total, male and female**—Computed as above; secondary education requires at least four years of approved primary instruction; provides general, vocational, or teacher training instructions for pupils usually of 12 to 17 years of age; correspondence courses are generally excluded.

**Vocational Enrollment (percent of secondary)**—Vocational institutions include technical, industrial, or other programs which operate independently or as departments of secondary institutions.

**Pupil-teacher Ratio - primary, and secondary**—Total students enrolled in primary and secondary levels divided by numbers of teachers in the corresponding levels.

## CONSUMPTION

**Passenger Cars (per thousand population)**—Passenger cars comprise motor cars seating less than eight persons; excludes ambulances, hearses and military vehicles.

**Radio Receivers (per thousand population)**—All types of receivers for radio broadcasts to general public per thousand of population; excludes un-licensed receivers in countries and in years when registration of radio sets was in effect; data for recent years may not be comparable since most countries abolished licensing.

**TV Receivers (per thousand population)**—TV receivers for broadcast to general public per thousand population; excludes unlicensed TV receivers in countries and in years when registration of TV sets was in effect.

**Newspaper Circulation (per thousand population)**—Shows the average circulation of "daily general interest newspaper," defined as a periodical publication devoted primarily to recording general news. It is considered to be "daily" if it appears at least four times a week.

**Cinema Annual Attendance per Capita per Year**—Based on the number of tickets sold during the year, including admissions to drive-in cinemas and mobile units.

## LABOR FORCE

**Total Labor Force (thousands)**—Economically active persons, including armed forces and unemployed but excluding housewives, students, etc., covering population of all ages. Definitions in various countries are not comparable; 1960, 1970 and 1983 data.

**Female (percent)**—Female labor force as percentage of total labor force.

**Agriculture (percent)**—Labor force in farming, forestry, hunting and fishing as percentage of total labor force; 1960, 1970 and 1980 data.

**Industry (percent)**—Labor force in mining, construction, manufacturing and electricity, water and gas as percentage of total labor force; 1960, 1970 and 1980 data.

**Participation Rate (percent)**—total, male, and female—Participation or activity rates are computed as total, male, and female labor force as percentages of total, male and female population of all ages respectively; 1960, 1970, and 1983 data. These are based on ILO's participation rates reflecting age-sex structure of the population, and long time trend. A few estimates are from national sources.

**Economic Dependency Ratio**—Ratio of population under 15, and 65 and over, to the working age population (those aged 15-64).

## INCOME DISTRIBUTION

**Percentage of Total Disposable Income (both in cash and kind)**—Accruing to percentile groups of households ranked by total household income.

## POVERTY TARGET GROUPS

The following estimates are very approximate measures of poverty levels, and should be interpreted with considerable caution.

**Estimated Absolute Poverty Income Level (US\$ per capita)**—urban and rural—Absolute poverty income level is that income level below which a minimal nutritionally adequate diet plus essential non-food requirements is not affordable.

**Estimated Relative Poverty Income Level (US\$ per capita)**—urban and rural—Rural relative poverty income level is one-third of average per capita personal income of the country. Urban level is derived from the rural level with adjustment for higher cost of living in urban areas.

**Estimated Population Below Absolute Poverty Income Level (percent)**—urban and rural—Percent of population (urban and rural) who are "absolute poor."

Population : 1,019 million (mid-1983)  
 GNP per capita: \$300 (1983)

## CHINA - ECONOMIC INDICATORS

Indicator	Amount - 1984 (million US\$ at current prices) <sup>b</sup>	Annual growth rates (%)											
		Actual					Projected						
		1980	1981	1982	1983	1984/ <sup>a</sup>	1985	1986	1987	1988	1989	1990	1995
<b>NATIONAL ACCOUNTS /a</b>													
Gross domestic product	281,260	6.6	4.9	7.8	9.6	14.0	10.4	6.8	6.8	6.8	6.8	6.8	6.6
Agriculture	100,430	-1.7	6.4	11.2	9.0	13.9	6.0	4.9	4.9	4.9	4.9	4.9	4.8
Industry	125,010	12.3	2.3	7.3	11.4	16.6	14.0	7.7	7.7	7.7	7.7	7.7	7.3
Services	55,820	8.2	8.9	3.3	6.5	7.7	10.0	7.9	7.9	7.9	7.9	7.9	7.4
Consumption	198,190	9.1	5.2	5.9	9.0	12.5	12.5	8.9	7.4	7.4	7.4	7.1	6.7
Gross investment	83,100	1.3	-1.8	10.9	15.2	20.7	11.0	2.3	4.8	4.8	5.1	5.7	6.7
Exports of GNFS /a	26,720	17.8	16.7	0.6	9.5	13.0	3.0	8.9	8.8	8.8	8.8	8.8	7.4
Imports of GNFS /a	26,750	16.1	-6.7	-5.7	28.1	25.9	22.5	7.1	5.8	5.9	6.0	6.2	7.8
Gross national savings	85,870	-0.2	3.6	17.0	12.0	17.0	5.7	1.8	5.1	5.1	5.6	6.2	6.6
<b>PRICES</b>													
GDP deflator (1980 = 100)		100.0	101.8	101.7	102.9	107.6	113.1	118.7	124.7	131.0	137.5	144.4	184.2
Exchange rate (Yuan/US\$)		1.50	1.70	1.89	1.98	2.32	2.84	2.84	2.84	2.84	2.84	2.84	2.84
<b>Share of GDP at market prices (%)</b>													
(at current prices)													
		1960	1970	1975	1980	1985	1990	Average annual increase (%)					
								(at constant 1981 prices)					
								1960-70	1970-75	1975-80	1980-84	1984-89	1989-94
Gross domestic product /a	100.0	100.0	100.0	100.0	100.0	100.0		6.1	5.2	6.6	9.0	7.3	6.6
Agriculture	23.0	35.0	32.8	32.0	34.2	31.3		6.7	3.4	3.3	10.1	5.0	4.8
Industry	48.0	41.0	45.8	48.0	47.9	49.9		7.8	7.5	9.9	9.4	8.6	7.4
Services	29.0	24.0	21.4	20.0	17.9	18.8		3.4	4.5	5.4	6.6	8.2	7.5
Consumption	62.4	70.8	69.1	71.3	66.7	69.3		6.1	4.7	6.4	8.1	8.4	6.8
Gross investment	37.8	29.2	31.1	30.0	34.4	30.9		9.5	6.9	9.7	11.3	5.1	6.1
Exports of GNFS	4.8	2.8	5.3	7.1	7.7	8.5		-1.5	10.8	5.7	12.3	8.0	7.7
Imports of GNFS	5.0	2.7	5.5	8.4	8.8	8.6		1.2	13.9	13.0	12.2	8.4	7.4
Gross national savings	37.7	29.2	30.9	28.9	33.6	30.7		9.1	6.7	7.2	14.0	4.8	6.2
<b>As % of GDP</b>													
					1957	1970	1980	1983	1984				
<b>PUBLIC FINANCE</b>													
Current revenues				28.7		29.6	30.6	27.8	26.7				
Current expenditures				15.1		29.0	34.0	29.4	28.3				
Surplus (+) or deficit (-)				+13.6		+0.6	-3.4	-1.6	-1.6				
Capital expenditure				13.7		13.3	11.0	7.8	7.3				
Foreign financing				0.7		n.a.	0.5	0.2	0.3				
<b>OTHER INDICATORS</b>													
GNP growth rate (%)		1960-70	1970-75	1975-80	1980-84	1984-89	1989-94						
GNP per capita growth rate (%)		6.1	5.1	6.4	9.2	7.2	6.6						
Energy consumption growth rate (%)		3.5	2.9	5.2	7.9	6.1	5.5						
ICOR		-0.3	9.2	5.8	4.1	5.3	4.8						
Marginal savings rate		3.3	4.7	5.1	3.8	4.0	4.6						
Import elasticity		0.4	0.4	0.3	0.3	0.2	0.3						
		0.2	2.7	2.0	1.4	1.1	1.2						

/a Data for 1981 and 1982 are from different sources; data for 1982 exclude re-exports.

Population : 1,019 million (mid-1983)  
GNP per capita: \$300 (1983)

## CHINA - EXTERNAL TRADE

	Amount - 1984 (million US\$ at current prices)	Annual growth rates (%) (at constant prices)							
		Actual					Projected		
		1980	1981	1982	1983	1984	1985	1990	1995
<b>EXTERNAL TRADE /a</b>									
Merchandise exports	25,020	14.8	17.3	5.5	10.1	10.4	2.8	8.7	7.2
Primary	11,410	1.5	-1.4	3.9	14.6	9.6	3.3	6.8	5.6
Manufactures	13,610	32.2	36.2	6.6	7.0	11.1	2.4	10.4	8.4
Merchandise imports	26,740	6.8	7.2	0.2	29.7	22.3	23.9	6.2	7.9
Food	2,330	9.1	68.3	42.9	-30.9	-24.9	14.4	7.1	9.3
Petroleum	130	52.6	-65.5	130.0	-43.5	30.8	0.0	35.5	6.6
Machinery and equipment	8,420	16.4	19.0	-41.7	34.7	82.3	44.8	5.1	7.6
Others	15,860	0.9	-13.5	7.1	71.7	16.8	16.7	6.3	7.9
<b>PRICES</b>									
Export price index (1980=100)		100.0	102.7	98.7	88.8	90.5	88.0	126.0	165.5
Import price index (1980=100)		100.0	104.5	89.2	76.7	78.4	77.3	112.0	140.7
Terms of trade index (1980=100)		100.0	98.3	110.7	115.8	115.4	113.8	112.5	117.6

	Composition of merchandise trade (%) (at current prices)				Average annual increase (%) (at constant prices)		
	1978	1981	1984	1990	1980-84	1984-89	1989-94
	<b>Exports</b>	100.0	100.0	100.0	100.0	10.8	7.9
Primary	53.4	46.6	45.6	42.1	6.7	6.4	6.1
Manufactures	46.6	53.4	54.4	57.9	15.2	9.4	8.2
<b>Imports</b>	100.0	100.0	100.0	100.0	14.9	8.5	7.5
Food	12.8	17.4	8.7	9.7	13.9	8.9	8.5
Petroleum	0.5	0.4	0.5	0.9	13.0	17.2	16.1
Machinery and equipment	18.9	29.2	31.5	33.3	23.6	12.0	6.8
Others	67.9	53.0	59.3	56.1	20.5	6.7	7.5

	Share of trade with industrial countries (%)			Share of trade with developing countries (%)			Share of trade with the USSR and Eastern Europe (%)		
	1977	1980	1983	1977	1980	1983	1977	1980	1983
	<b>DIRECTION OF TRADE</b>								
Exports	36.4	44.7	42.1	46.8	48.7	53.2	16.8	6.6	4.7
Imports	63.1	73.6	69.0	20.7	19.7	24.5	16.2	6.7	6.5

/a Based on customs statistics. Exports, f.o.b., imports, c.i.f.

East Asia and Pacific Regional Office  
September 30, 1985

Population : 1,019 million (mid-1983)  
 GNP per capita: \$300 (1983)

**CHINA - BALANCE OF PAYMENTS, EXTERNAL CAPITAL AND DEBT**  
 (Millions of US\$ at current prices)

Indicator	Actual							Projected		
	1978	1979	1980	1981	1982	1983	1984	1985	1990	1995
<b>BALANCE OF PAYMENTS</b>										
Exports of goods and nonfactor services	10,370	14,983	20,324	24,423	23,637	23,186	26,716	26,840	58,590	109,700
Of which: Merchandise f.o.b. /a	9,607	13,658	18,492	22,027	21,125	20,707	23,905	23,900	52,130	97,600
Imports of goods and nonfactor services	11,668	17,759	24,058	23,446	18,900	20,711	26,748	32,320	63,180	114,600
Of which: Merchandise f.o.b. /a	10,745	16,212	22,049	21,047	16,876	18,717	23,890	29,180	56,950	104,000
Net factor income from abroad	-8	-77	-117	-200	452	1,253	1,620	1,140	-850	-3,600
Net transfers	597	656	640	464	530	436	304	300	300	300
Current account balance	-709	-2,197	-3,211	1,241	5,719	4,164	1,892	-4,040	-5,140	-8,200
Private direct investment (net)	-	-	57	265	430	636	1,100	1,210	1,950	2,500
Official grant aid (net)	-	-	21	156	-44	75	137	140	140	140
MLT loans (net)	549	3,815	1,069	310	301	927	-145	0	4,450	7,880
Disbursements	549	3,895	1,670	1,659	2,481	1,600	718	950	6,390	13,080
Amortization	-	80	601	1,348	2,180	673	863	950	1,940	5,200
Other capital /b	-628	-1,021	2,455	-47	-115	-1,672	-2,889	-10	-	-20
Change in reserves ("-" indicating increase)	788	-597	-391	-1,925	-6,291	-4,130	-95	2,700	-1,400	-2,300
International reserves	6,677	7,274	7,665	9,590	15,881	20,011	20,106	17,400	23,500	33,610
Of which: Gold /c	5,120	5,120	5,120	5,120	5,120	5,120	5,120	5,120	5,120	5,100
Reserves as months of imports	6.2	4.5	3.5	4.8	10.1	11.7	9.1	6.5	4.2	3.2
<b>EXTERNAL CAPITAL AND DEBT /d</b>										
Gross disbursement	549	3,895	1,691	1,815	2,437	1,675	855	1,090	6,530	13,220
Official grants (net)	-	-	21	156	-44	75	137	140	140	140
Concessional loans	-	-	-	407	255	326	192	350	700	780
DAC	-	-	-	-	223	242	118	200	280	280
IDA	-	-	-	-	1	67	57	140	420	500
Other	-	-	-	407	31	17	17	10	0	0
Nonconcessional loans	549	3,895	1,670	1,252	2,226	1,274	526	600	5,690	12,300
Official export credits	149	300	139	681	667	573	350	280	440	480
IBRD	-	-	-	-	-	4	110	275	1,180	2,280
Other multilateral	-	-	-	-	-	-	-	-	-	-
Private	400	3,595	1,531	571	1,559	697	66	45	4,070	9,540
External debt										
Debt outstanding and disbursed	549	4,364	5,433	5,261	5,562	6,397	6,340	6,340	29,440	58,970
Official	149	449	588	1,676	2,556	3,287	3,890	4,620	10,620	21,180
Private	400	3,915	4,845	3,585	3,006	3,110	2,450	1,720	18,820	37,790
Undisbursed debt	167	422	1,432	1,688	1,446	2,008	2,510	3,420	7,660	10,760
Debt service										
Total service payments	46	399	1,213	2,170/e	2,821/e	1,210/e	1,440	1,490	3,910	9,130
Interest	46	319	612	821	641	537	580	540	1,980	3,950
Payments as % of exports	0.4	2.7	6.3	9.0	11.4	4.9	5.0	5.2	6.4	8.1
Average interest rate of new loans (%)	-	-	-	-	-	-	5.0	5.8	8.0	8.4
Average maturity of new loans (years)	-	-	-	-	-	-	29.0	26.2	15.1	12.7

/a Data for 1978-81 are not comparable with those of 1982-85 because of a difference in their sources. The latter exclude re-exports.

/b Includes net use of IMF credit and net flow of short-term capital.

/c Valued at US\$402/troy ounce.

/d Excludes short-term loans (one year or less).

/e Includes prepayments.



CHINA

ECONOMIC AND SECTOR WORK PROGRAM

The main text of the CPP proposes a general strategy for ESW in

China. This attachment summarizes the FY85 program and the proposed program

for FY86 and FY87.

Indicator	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Balance of Payments	10,370	14,883	20,724	24,413	23,837	23,186	22,714	22,846	28,746	104,700
Exports of goods and nonfactor services	9,607	13,438	18,493	21,027	20,711	20,707	20,714	20,720	27,320	97,840
Imports of goods and nonfactor services	11,048	17,739	24,028	23,448	18,900	18,900	18,917	18,916	24,180	104,000
Net factor income from abroad	-8	-77	-117	-100	422	1,203	1,430	1,146	820	-3,200
Net transfers	381	636	444	444	370	438	304	300	300	300
Current account balance	-709	-2,187	-2,211	-1,241	2,719	4,184	1,881	-2,080	-2,140	-4,100
Private direct investment (net)	-	-	27	262	430	638	1,100	1,100	1,100	1,300
Official grants aid (net)	-	-	21	138	137	137	137	137	137	137
MTI loans (net)	249	3,812	1,088	310	301	937	-143	-433	-433	7,880
Disbursements	249	3,812	1,088	310	301	937	-143	-433	-433	7,880
Repayments	-	-	-	-	-	-	-	-	-	-
Other capital	-	-	-	-	-	-	-	-	-	-
Change in reserves ("-" indicating increases)	788	-387	-281	-1,432	-4,381	-4,130	-82	-1,700	-1,400	-1,300
International reserves	4,077	3,274	1,463	9,280	12,881	20,011	20,108	11,400	23,200	33,810
Of which gold	2,120	2,120	2,120	2,120	2,120	2,120	2,120	2,120	2,120	2,120
Reserves as months of imports	4.2	4.7	3.7	4.8	10.1	11.7	4.1	4.7	4.3	4.1
External Capital and Debt	249	3,812	1,088	1,812	1,437	1,832	822	1,080	2,320	11,130
Gross disbursement	-	-	21	138	137	137	137	137	137	137
Official grants aid (net)	-	-	21	138	137	137	137	137	137	137
International loans	-	-	407	407	328	342	118	200	180	180
DAI	-	-	-	-	1	67	37	140	430	300
IDA	-	-	-	-	17	17	17	17	17	17
Other	-	-	407	407	31	31	31	31	31	31
Nonconcessional loans	249	3,812	1,810	1,321	1,238	1,238	528	600	1,800	11,100
Official export credits	149	300	108	481	607	373	110	320	180	480
IBRD	-	-	-	-	-	-	-	-	-	-
Other multilateral	400	2,382	1,231	271	1,239	631	88	24	4,370	4,740
External debt	249	4,388	2,433	2,187	2,205	2,205	838	1,080	2,320	11,130
Debt outstanding and disbursed	249	4,388	2,433	2,187	2,205	2,205	838	1,080	2,320	11,130
Official	400	3,812	2,282	2,282	2,008	2,008	1,210	1,430	1,700	10,750
Private	422	1,432	1,088	1,432	1,432	1,432	1,210	1,430	1,700	10,750
Undisbursed debt	-	-	-	-	-	-	-	-	-	-
Debt service	48	389	1,110	2,104	2,421	1,440	1,440	1,440	1,440	1,440
Local service payments	48	389	1,110	2,104	2,421	1,440	1,440	1,440	1,440	1,440
Foreign	-	-	-	-	-	-	-	-	-	-
Payments as % of exports	0.4	2.7	6.3	8.7	10.1	6.1	6.1	6.1	6.1	6.1
Average interest rate on new loans (%)	-	-	-	-	-	-	-	-	-	-
Average maturity of new loans (years)	-	-	-	-	-	-	-	-	-	-

1. Data for 1978-81 are not comparable with those of 1982-85 because of a difference in their reporting. The larger value is shown in parentheses.

2. Includes net use of IFC credits and net flow of short-term capital.

3. Excludes US\$-denominated credits.

4. Includes short-term loans (one year or less).

5. Includes repayments.

Source: Staff and Public Relations Department, December 1985.

CHINA

Economic and Sector Work Program by Task, FY85-87

Task/aim and coverage	Man. div.	Total staffweeks required		
		FY85 (Actual)	FY86 (Pro- jected)	FY87 (Pro- jected)
<b><u>REGIONALLY MANAGED</u></b>				
<b><u>ECONOMIC REPORTS</u></b>				
<u>Investment Allocation and Finance</u>	17360	2	75	25
Analysis of existing investment finance system, recommendations for improving incentives and efficiency of existing system, and analysis of options for system reform.				
<u>Issues and Options</u>	17360	229	0	0
Review of options and issues 1985-2000: employment of human resources; savings and investment; location of activities; structural and technological change; external economic relations.				
<u>CEM</u>	17360	0	10	110
Review of recent trends, 7th FY Plan (1986-90) and foreign trade and investment issues.				
<u>Gansu Provincial Study</u>	17360	56	100	0
In-depth study of Gansu province. Aimed at improving our understanding of poverty and problems of regional development and identifying possible projects for Bank lending.				
<u>Enterprise Guidance</u>	17360	75	35	0
Research study involving: review of management system of state enterprises; relations between state and enterprises. Focus on incentive system and distribution and marketing.				
<u>Special Economic Study</u>	17360	5	15	0
Study of economic reform, in particular, problems of transition and implementation, and lessons of international experience, will be undertaken in collaboration with EMENA and CPD.				
<u>Structural Change</u>	17360	18	0	0
Comparative and historical analysis of Chinese economic structure and macroeconomic modeling. This study is part of collaborative research with China.				
<u>Collective Enterprises</u>	17360	0	20	70
Study of rural and small urban collectives, focusing on relationships with state enterprises, incentive systems, marketing and distribution.				
<u>Issues in Public Finance</u>	17360	0	0	50
Relations between central and provincial governments; implications for public finance of reform of enterprise management and foreign trade; and other issues.				
Subtotal Staffweeks - Economic Reports (ERA)		<u>385</u>	<u>255</u>	<u>255</u>

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Task/aim and coverage	Man. div.	Total staffweeks required		
		FY85 (Actual)	FY86 (Pro- jected)	FY87 (Pro- jected)
<b>SECTOR REPORTS (SRA)</b>				
<b>Livestock or Forestry</b>	17614	0	30	30
Subsector study of livestock or forestry.				
<b>Agricultural Support</b>	17614	11	0	0
Assessment of development prospects in agriculture to the year 2000; the agricultural annex to country economic report.				
<b>Agriculture Sector Review</b>	17614	0	0	50
Special study in agriculture, possibly natural resource development including irrigation facilities and management.				
<b>Higher, Technical and Vocational Education</b>	17629	39	50	20
Subsector studies in (A) management and finance of higher education; and (B) development of technical and vocational education and training (TVET).				
<b>Educational Materials Development</b>	17620	0	10	30
Study of educational materials development, hardware and software for both formal and nonformal education including educational television.				
<b>Coal Utilization</b>	17360	0	40	60
Analysis of major strategic choices and interdependencies in coal utilization, including transport and environmental issues.				
<b>Electric Power Tariffs</b>	17640	0	10	40
Analysis of issues and options in moving from administrative allocation of electric power to use of prices, with emphasis on lessons of international experience.				
<b>Industrial Subsectors</b>	17650	0	10	40
Review of priority needs in selected industrial subsectors.				
<b>Transport Support</b>	17630	19	0	0
Assessment of future transport requirements in support of preparation of economic report.				
<b>Water Transport Subsector</b>	17630	0	45	0
Assessment of potential for development of inland waterways, coastal shipping and related infrastructure.				
<b>Intermodal Transport</b>	17630	0	10	50
Study of intermodal transport planning, policy and financial issues in a single province.				
<b>Shanghai Urban Plan</b>	17660	48	0	0
Technical assistance to city of Shanghai in urban planning, urban transport, water supply and sewerage in conjunction with other mission work. (No formal report to be issued.)				
<b>Urban Sector Study</b>	17660	0	35	15
Assessment of needs and resources for urban services in one province; appropriate service levels and investment requirements; sources of finance; institutional requirements; financial and tariff policies.				
Subtotal Staffweeks - Sector Reports (SRA)		117	240	335
<b>CPP</b>	17360	10	20	0
<b>OTHER ESW</b>				
EWO		61	70	70
SWO		65	70	70
Subtotal Staffweeks - Other ESW		126	140	140
Subtotal Regionally Managed Staffweeks		638	655	730

Task/aim and coverage	Man. div.	Total staffweeks required		
		FY85 (Actual)	FY86 (Pro- jected)	FY87 (Pro- jected)
<b>EIS/OPS-MANAGED</b>				
<b>SECTOR REPORTS (SRA)</b>				
<u>Energy Sector</u>	EGY	62	0	0
Review of long-term issues and options emphasizing supply and demand trends and policy options; conducted within framework of 1984 Economic Mission; annex to economic mission report.				
<u>Regional Cement</u>		25	0	0
Study of Shanghai/Jiangsu/Anhui region; to assess current capabilities and efficiencies of cement plants in operational, financial and economic terms; to identify major subsector issues; etc.				
<u>Phosphate Development</u>		0	15	40
Study of major alternatives for phosphate mining, processing and transport.				
<u>Industrial Study</u>		0	0	50
Study of selected industries, possibly chemicals, refineries, nonferrous or capital goods; will include analysis of the impact of pricing, tax and trade policy on subsectors.				
<u>Rural Health Issues</u>		20	15	0
Collaborative activity with the National Center for Preventive Medicine in China aimed at developing methodology for surveying and analyzing health and nutrition conditions in poor rural areas.				
<u>Urban Health Services</u>		0	0	40
Analysis of future investment and policy choices in urban health with special emphasis on financial issues.				
<u>Subtotal EIS-Managed Staffweeks</u>		<u>107</u>	<u>30</u>	<u>130</u>
<u>TOTAL STAFFWEEKS - CHINA</u>		<u>745</u>	<u>685</u>	<u>860</u>

STATUS OF IBRD CAPITAL SUBSCRIPTIONS  
(As of May 31, 1985)

Resolution No.	Adopted	Shares allocated		Amounts to be paid in for the sub- scription of share not yet subscribed		Local currency	Local currency unreleased for shares subscribed (\$ mln)
		Subscribed No.	\$ mln	Unsubscribed No.	\$ mln		
346	01/04/80	11,232	1,354.97	0	0.0	0.0	0.0
347	01/04/80	250	30.16	0	0.0	0.0	0.0
356	03/09/80	4,500	542.86	0	0.0	0.0	0.0
395	12/09/84	0	0.0	1,660	200.25	1,752.22	15,770.00
<b>Total</b>		<b>15,982</b>	<b>1,927.99</b>	<b>1,660</b>	<b>200.25</b>	<b>1,752.22</b>	<b>15,770.00</b>

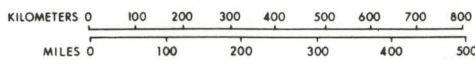
TOTAL SUBSCRIPTIONS - CHINA



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**CHINA**  
RELIEF AND ADMINISTRATIVE DIVISIONS

- Roads
- Railways
- Rivers
- ⊗ National capitals
- Province capitals
- Province boundaries
- International boundaries
- Elevations in meters:
- Above 3,000
- 500 - 3,000
- Below 500



## OFFICE MEMORANDUM

*Mr Clausen's office*

DATE October 8, 1985

TO Memorandum for the Record

FROM Gautam S. Kaji 

EXTENSION

SUBJECT CHINA - Mr. Clausen's Meeting with the Chinese Delegation  
at the 1985 Annual Meetings

1. Mr. Clausen met with the Chinese Delegation headed by Vice Minister Li Peng on Sunday, October 6, 1985 at 4:30 pm in the Hilton Hotel complex, Seoul, Korea. Those attending the meeting were:

Chinese Delegation

Mr. Li Peng, Vice Minister, Ministry of Finance  
Mr. Wang Liansheng, Director, External Finance Department,  
Ministry of Finance  
Mr. Jin Liqun, Deputy Division Chief, World Bank Division,  
External Finance Department, Ministry of Finance  
Ms. Li Shurong, Deputy Division Chief, World Bank Division,  
External Finance Department, Ministry of Finance  
Mr. Zhao Xiaoyu, Deputy Section Chief, External Finance  
Department, Ministry of Finance (also Interpreter)

EDS

Mr. Xu Naijiong, Executive Director

IBRD

Messrs. Clausen, Stern, Karaosmanoglu, Kaji

2. Mr. Clausen opened the meeting by congratulating the Chinese Government on its continued impressive economic performance. He went on to say that he was equally pleased with our growing program in China and in particular he was very glad that the Bank was getting to learn more and more about China while the Chinese have obviously mastered their way around the Bank's "bureaucracy". Mr. Clausen then commented on the Bank's second Economic Report which, while significantly different from the backward-looking focus of the first Report, was, he felt, particularly well done and he sincerely hoped that it was of use to the Chinese authorities in having an objective observer help focus attention on issues which the economic managers will need to address over the balance of this century. He also noted the opening of the Bank's Resident Mission and expressed his appreciation for the acceptance of such a mission by the Chinese authorities and the assistance they had provided towards its establishment which would be mutually beneficial for the Bank and China in terms of enlarging and deepening our interaction for the totality of the Bank Group including the IFC which has just made its first investment in China.

October 8, 1985

3. Mr. Clausen summed up by saying much has happened during the short span since China resumed its seat and we can look back on our achievements during that period with pride.

4. Mr. Li Peng, after conveying greetings from Minister Wang, expressed on behalf of his Government their gratitude for the excellent work done by the Bank and particularly welcomed the opening of the Bank's Office. The Bank's recent Economic Report had been very well received in China and the interest the Chinese had in the Bank's analysis and recommendations was amply demonstrated by the fact that it had been read from the Prime Minister to Department Directors in each of the major ministries. Commenting on Chinese economic programs, Mr. Li Peng felt that while they hoped to maintain a growth rate of about 7% in the future, the pace of reforms was indeed very fast and the Government had to move swiftly but surely because the cost of mistakes could be very high. He felt that in particular the issue of price reform was the most difficult one of concern to the policy makers. In terms of Government priorities their major emphasis had to be on removing the major infrastructural bottlenecks particularly in transport and energy. In response to this Mr. Clausen agreed that indeed the process of reforms had to be undertaken with great care and that we fully share the Government's priorities which were reflected in the scope and composition of our Lending Program.

5. Mr. Li Peng then commented that they saw the Bank's Lending Program size dictated by the often-stated Chinese desire to maintain an approximate 60/40 blend. In response to this both Messrs. Clausen and Stern suggested to the Chinese that, given the fact that the IDA resources were scarce, the amount available under the Seventh Replenishment relatively firm, and the portion equitably allocated to China has been made known to the Chinese authorities, talking of the Lending Program solely in terms of a set ratio was not particularly meaningful. As long as they were satisfied that there was a reasonably equitable distribution of the very limited IDA resources available, their decision on how much Bank money they should borrow should not be dictated by a concept of Bank/IDA proportionality but should be based most importantly on their assessment of the productive use they can make of Bank resources. The important point is therefore the return that they can get from Bank-financed projects. In response, Vice Minister Li Peng commented that in sectors such as education and regional development schemes they found it difficult to onlend Bank funds but did not comment on the central issue posed. Undoubtedly this issue will be brought up in Beijing during the visit of Messrs. Stern and Karaosmanoglu.

6. In closing, Mr. Li Peng noted that Chinese total borrowings from the Bank Group had reached the \$3 billion mark and that 90% of this had been during Mr. Clausen's presidency. He expressed the hope that during the course of the next couple of years it will be possible for Mr. Clausen to visit China again and see at first hand the changes that had taken place. In the meantime, the Chinese authorities were looking forward to the visit of Mr. Stern and his colleagues on the occasion of the opening of the Bank's Office.

cc: Mr. Clausen's Office; Messrs. Stern, Karaosmanoglu, Kirmani,  
Koch-Weser, Lim

GKaji:sap



ANNUAL MEETINGS BRIEF**CHINA**

October 6, 1985 4:30 p.m.

Meeting with:

Senior Vice Minister of Finance (Mr. Li Peng)

Population:

1,019.1 (mid-1983)

**Growth Rate:** 1.1% p.a.GNP per capita:

\$ 300.00 (1983)

	(million)		(million)
<b>Total Commitments:</b>	\$2,949.9	<b>FY85: Commitments</b>	\$1,101.9
(net of cancellations)		Disbursements	\$ 235.7
of which: Bank	\$1,773.7	Amortization	-
IDA	\$1,176.2	Total Undisbursed:	\$1,553.74
		(only effective loans and credits included)	

**Lending Program:** FY86-87 \$2,880.0Background

<u>Summary Data</u>	<u>Avg 82-84 (SAVEM figures)</u>	<u>85 (Region's estimates)</u>	
GDP growth (constant prices)	9.7	10	<u>Aid Group Meeting:</u> Not applicable
Export growth (constant prices)	15.1	4	<u>IMF Status as of May 31, 1985:</u>
Import growth (constant prices)	15.5	21	Article IV: no current standby
Current Account			(Note: Consultation discussion -
Surplus (Deficit) % GDP	1.4	(1.5)	July 19, to August 2, 1985)
Gross Debt Service Ratio	8.2	5.4	
Annual Inflation Rate	1.1	5.0	

Issue likely to be raised by delegation:

1. IDA Allocation

Issues to be raised by Bank Management:

1. Economic and Sector Work
2. Lending Program
3. Resident Mission

Attachments:

FIVE-YEAR LENDING PROGRAM: FY85-89 (85 actual)  
Biographical Information

*IFC  
1st joint  
venture*

*CGIAR  
# 500 to  
# 1 mil*

## Background

1. China's economic performance in 1984 was remarkable, with national income rising by 14% in real terms--16% in industry and 14% in agriculture. Personal income per capita grew in real terms by about 12%. Economic growth continued in the first half of 1985 with a 23% increase in industry. On the whole, the Chinese economy has exhibited a remarkable supply response to economic liberalization, strong profit incentives, and increased demand.
2. Not surprisingly given such rapid economic growth, demand pressures have intensified and there are signs of macroeconomic instability. There has been an explosive growth of domestic credit (36% in 1984), an increase in inflation (the first half of 1985 showed a 7% increase over the first half of 1984), and sharp deterioration in the balance of payments. China's current account surplus of over \$4 billion in 1983 dwindled to a current account deficit of around \$5 billion by mid-1985. So far, however, this trade deficit has been absorbed comfortably by China's foreign currency reserve cushion, which totalled \$12 billion in March-April 1985, equivalent to 5 months imports.
3. The momentum of China's economic reforms picked up, particularly after the October 1984 decision on structural reforms by the Party's Central Committee. In early 1985 the system of compulsory state procurement of agricultural products was abolished in favor of voluntary contracts and free market sales. Another important reform is the now complete shift from grant to loan financing for large investment projects funded by the government budget. In price reform, adjustments have been made to reduce distortions, including, for example, those among energy prices, which have long been very low. More important, many price controls have been relaxed, particularly for goods produced outside of mandatory state production quotas. However, China still has a long way to go in both design and implementation of system reforms. There is some indication that present difficulties in the short-term management of the economy could slow reform progress considerably.
4. Our relationship with China continues to show achievement and promise. Annual Bank lending has averaged over \$1 billion in the last two years and is expected to grow substantially. The second economic report which focussed on China's long-term issues and options has been much appreciated by Chinese leaders and has contributed to a fuller understanding of the quality and usefulness of our economic work. In October the Resident Mission in Beijing will be formally opened.
5. Certain problems persist, however. We need to expand our sector work where cooperation has been less successful and its significance less well understood. The planning horizon for the Bank's lending program is still not sufficiently long-term and needs to be extended as the Seventh Five-Year Plan becomes final. Lastly, planning and coordination of our operations and staffing of core agencies need to be strengthened to enable our counterparts to manage a rapidly growing workload.
6. Country Subscription Action. As of end June 1985, China holds 23,482 shares. China voted in favor of the Special Capital Increase under which it would be eligible to subscribe for 1,660 additional shares. While no formal


action has yet been taken to subscribe for these shares, the Chinese Government is planning to complete subscription before next year's Annual Meeting, certainly before the expiration of the subscription period in December 1986.

Issue likely to be raised by Delegation:

1. Mr. Stern will be visiting China immediately after the Annual Meetings at which time he will hold in-depth discussions with the Chinese leadership. Thus, we do not expect the Chinese delegation to raise any major issue at the Annual Meetings. However, it is possible that the issue of China's IDA allocation may be raised again.

2. IDA Allocation. This issue is not as serious as in past years. The Government is aware that between \$400 and \$450 million per year has been programmed for China for the IDA-7 period. However, China's IDA allocation still influences the scope of total lending to the extent that the Government wishes to adhere to a certain IBRD/IDA blend (60/40 for FY85). If the delegation raises this issue with respect to IDA-7 and IDA-8, you should reiterate the factors the Bank considers in determining China's allocation and point to the needs of other low income countries with claims on IDA funds. You should express the Bank's view that China can and should borrow more from all sources; it should take advantage of more IBRD funds, and indeed should not allow a desired blend to constrain expansion of the lending program at a time of strong economic growth and increasing foreign borrowing needs.

Issues to be raised by Bank Management

1. Economic and Sector Work. You should express our satisfaction with the recently completed economic report and the excellent discussions Mr. Karaosmanoglu and his staff had with senior Chinese leaders. You should also convey our hope that we will be able to build upon this successful cooperation with further joint work on important economic issues that need to be addressed in connection with economic reform (such as investment finance and foreign trade and investment) and key sectoral issues. Mr. Karaosmanoglu sent a letter to Finance Minister Wang Bingqian in June in which we presented proposals for economic and sector work in the next two years, and we await the Government's response. 

2. Lending Program. You should congratulate the Government on the FY85 lending program of approximately \$1.1 billion and the cumulative lending of nearly \$3 billion which represents a rapid build-up for the first five years of our relationship. You should convey our willingness to expand the lending program further in coming years, in light of China's requirements under the Seventh Five-Year Plan (1986-90) and ongoing economic and financial reforms. Moreover, you should mention that a longer-term planning framework and a solid project pipeline supported by a strong sector work program are essential for an expanding lending program.

3. Resident Mission. The Bank's Resident Mission in Beijing will be opened formally by Mr. Stern during his visit to China following the Annual Meetings. You should convey the Bank's confidence that the establishment of the Mission will mark a new phase in the Bank-China relationship and express gratitude for the Government's cooperation which made this possible.

CHINA: FY85-89 LENDING PROGRAM  
(US\$ million)

Page 1 of 2

	FY85	FY86	FY87	FY88	FY89	
<u>Agriculture</u>						
Agricultural Research II	25.0	-	-	-	-	
Seeds	40.0	-	-	-	-	
Forestry I	47.3	-	-	-	-	
Pishihang-Chaohu Area Development	92.0	-	-	-	-	
Rural Credit II	-	110.0	-	-	-	
Aquaculture	-	60.0	-	-	-	
Red Soils	-	-	45.0	-	-	
Gansu	-	-	100.0	-	-	
Xinjiang Development	-	-	70.0	-	-	
Rural Credit III	-	-	-	100.0	-	
Forestry II	-	-	-	85.0	-	
Irrigation II	-	-	-	-	75.0	
Agriculture (Unidentified)	-	-	-	-	50.0	
Rural Credit IV	-	-	-	-	100.0	
Subtotal	<u>204.3</u>	<u>170.0</u>	<u>215.0</u>	<u>185.0</u>	<u>225.0</u>	<u>999.3</u> (14)
<u>Education</u>						
University Development II	145.0	-	-	-	-	
Provincial Universities	-	120.0	-	-	-	
Technical Education	-	-	100.0	-	-	
Teacher's Training	-	-	-	75.0	-	
Education (Unidentified)	-	-	-	75.0	-	
Education (Unidentified)	-	-	-	-	75.0	
Education (Unidentified)	-	-	-	-	100.0	
Subtotal	<u>145.0</u>	<u>120.0</u>	<u>100.0</u>	<u>150.0</u>	<u>175.0</u>	<u>690.0</u> (7)
<u>Transport</u>						
Highway	72.6	-	-	-	-	
Railway II	235.0	-	-	-	-	
Tianjin Port	-	170.0	-	-	-	
Railway III	-	170.0	-	-	-	
Beijing-Tanggu Expressway	-	-	150.0	-	-	
Huangpu Port	-	-	150.0	-	-	
Roads III	-	-	-	150.0	-	
Railway IV	-	-	-	200.0	-	
Ports and Waterways IV	-	-	-	150.0	-	
Roads IV	-	-	-	-	150.0	
Railways V	-	-	-	-	300.0	
Ports V	-	-	-	-	200.0	
Subtotal	<u>307.6</u>	<u>340.0</u>	<u>300.0</u>	<u>500.0</u>	<u>650.0</u>	<u>2,097.6</u> (12)
<u>Housing/Urban/Water Supply/Regional Development</u>						
Rural Water Supply	80.0	-	-	-	-	
Shanghai Environment	-	-	145.0	-	-	
Shanghai Urban	-	-	-	75.0	-	
Water Supply II	-	-	-	-	100.0	
Urban II	-	-	-	-	100.0	
Subtotal	<u>80.0</u>	<u>-</u>	<u>145.0</u>	<u>75.0</u>	<u>200.0</u>	<u>500.0</u> (5)

	FY85	FY86	FY87	FY88	FY89	
<u>Industry</u>						
Fertilizer Rehabilitation & Energy Saving	97.0	-	-	-	-	
Shanghai Machine Tools	-	135.0	-	-	-	
DFC III	-	-	200.0	-	-	
Phosphate Mining	-	-	100.0	-	-	
Cement	-	-	100.0	-	-	
DFC IV	-	-	-	250.0	-	
Fertilizer II	-	-	-	150.0	-	
Industry (Unidentified)	-	-	-	-	150.0	
Industry (Unidentified)	-	-	-	-	200.0	
Subtotal	<u>97.0</u>	<u>135.0</u>	<u>400.0</u>	<u>400.0</u>	<u>350.0</u>	<u>1,382.0</u> (9)
<u>Energy</u>						
Power II	117.0	-	-	-	-	
Changcun (Luan) Coal Mining	126.0	-	-	-	-	
Weiyuan Gas Field Technical Assist.	25.0	-	-	-	-	
Coal II	-	113.7	-	-	-	
Power III	-	250.0	-	-	-	
Power IV	-	-	60.0	-	-	
Power V	-	-	200.0	-	-	
Gas II	-	-	100.0	-	-	
Coal III	-	-	120.0	-	-	
Power VI	-	-	-	200.0	-	
Petroleum IV	-	-	-	150.0	-	
Coal IV	-	-	-	150.0	-	
Power VII	-	-	-	-	200.0	
Petroleum/Gas V	-	-	-	-	150.0	
Coal V	-	-	-	-	250.0	
Subtotal	<u>268.0</u>	<u>363.7</u>	<u>480.0</u>	<u>500.0</u>	<u>600.0</u>	<u>2,211.7</u> (15)
<u>Health</u>						
Health II	-	65.0	-	-	-	
Health III	-	-	-	75.0	-	
Subtotal	<u>-</u>	<u>65.0</u>	<u>-</u>	<u>75.0</u>	<u>-</u>	<u>140.0</u> (2)
<u>Other</u>						
Technical Assistance II	-	20.0	-	-	-	
Subtotal	<u>-</u>	<u>20.0</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>20.0</u> (1)
<u>Total</u>	<u>1,101.9</u> (12)	<u>1,213.7</u> (10)	<u>1,640.0*</u> (14)	<u>1,885.0*</u> (14)	<u>2,200.0*</u> (15)	
<u>GRAND TOTAL</u>						<u>8,040.6</u> (65)

\* The lending program for FY87-89 is not yet fully agreed with the Government.

DELEGATION/BIOGRAPHICAL SKETCHES - CHINA

Delegation

- LI Peng - Senior Vice Minister of Finance  
(Alternate Governor, Bank/IFC)
- WANG Liansheng - Director, External Finance Department,  
Ministry of Finance

Biographical Sketches

LI Peng: Vice Minister Li was born in 1921 in Jiangsu province. He is a graduate of South-West China University. He understands some English but speaks only a few words. He has made his career in the Ministry of Finance, rising to become the senior vice-minister in mid-1982.

WANG Liansheng: Born in 1931 in Hebei Province. He was China's first Executive Director to the World Bank (1980-83), and upon return became Deputy Director of the External Finance Department which is the Bank's main contact in the Ministry. In 1985 he became Director, External Finance Department, Ministry of Finance.

Oct. 6  
4:30

IFC

1985 ANNUAL MEETING BRIEF

CHINA

The Government has strongly welcomed IFC's operations in China particularly to (i) act as a catalyst for direct private foreign investment in the joint-venture sector; and (ii) provide assistance in technology selection, project structuring, and assessment of project viability. Foreign sponsors generally seek IFC's umbrella role.

The Chinese Government has recently requested IFC for policy advice on its foreign investment program and administration. To comply with this request, IFC has proposed an 18 month program of research work and seminars, to be concluded with a report on policy recommendations. IFC is now awaiting China's response to the proposal and its nomination of a host organization.

In June 1985, IFC's Board of Directors approved a first investment in China (consisting of a loan of US\$15.0 million and an equity investment of US\$2.02 million) in Guangzhou Peugeot Automobile Company Ltd. (GPAC) - a \$79.5 million Sino-French joint-venture to manufacture pick-up trucks. IFC has been approached on projects in textile, agribusiness, electronics and miscellaneous mechanical/chemical products. IFC's promotional effort has focused on the four key coastal cities of Dalian, Tianjin, Shanghai and Guangzhou. Preliminary dialogue with Government has also indicated that the development of joint-ventures in non-ferrous metals, a priority sector, could be an area where IFC can play a role. While the potential for IFC in China appears promising, near-term results may be modest due to time consuming process of joint-venture negotiations and their approvals.

Mr. Ryrie will visit Beijing October 14 to 17 to sign documents relating to IFC's first investment in China.

Oct. 6  
4:30

CHINA AND THE CGIAR

China joined the CGIAR two years ago and contributes half a million dollars a year. We believe that this figure could be increased, particularly since China could turn out to be the biggest single beneficiary of the system.

The Centers have had ongoing programs with their Chinese counterparts for at least ten years and their impact has already been very substantial indeed. This was one of the reasons China joined the system. We do not expect a major contribution but an increase to at least \$1 million a year would be appropriate.

Should the occasion arise, you might care to endorse the CGIAR to the Minister and express your admiration at recent increases in agricultural productivity (to which the Centers have contributed).



Sa. Oct. 6  
4:30

CHINA

China has been increasingly forthcoming in its support for MIGA and Mr. Xu has participated actively and constructively in the discussions of the Committee of the Whole. Most of his points are reflected in the Convention. We were advised by the Executive Director's office that China will probably support MIGA in Seoul, but that it might abstain in a vote if pressured by other developing countries.

You might wish to express your satisfaction about the agreement achieved by the Executive Directors on the Convention establishing MIGA and your appreciation for the active and constructive role played by Mr. Xu in the negotiations. You might note that the Convention represents a balanced package serving the interests of developing countries well and establishing a joint facility where developed and developing countries will eventually share political oversight on an equal footing. You might furthermore indicate that MIGA is a very timely initiative in order to strengthen developing countries' ability to attract more foreign investment and negotiate better terms and conditions.

You might finally request the active Chinese support for the approval of the Convention and your confidence that China will continue to exercise its leadership among developing countries in the forthcoming work of the preparatory committee on MIGA's operational policies.

## OFFICE MEMORANDUM

132  
DATE: April 17, 1985  
TO: Mr. A. Clausen  
Through: Mr. E. Sterns *ES*  
FROM: Attila Karaosmanoglu *AK*  
EXTENSION: 74503  
SUBJECT: China: Economic Report

5-8-85  
★

I attach, for your information, a copy of a letter which I have just sent to Premier Zhao Ziyang and minutes of my meeting with him in March.

We are now revising the draft economic report to take account of comments received in China, and will distribute the final report to the Board in May. It now appears that revisions will be mainly in the text of the main report and the annexes, and there will be little change to the Summary and Conclusions which you had asked to see. I am therefore attaching herewith the present version of the Summary, instead of waiting - as we had agreed earlier - for the final "Gray-cover" version.

cc: Mr. Kaji

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1985 APR 18 PM 5:58

OFFICE OF THE PRESIDENT

**The World Bank**

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT  
INTERNATIONAL DEVELOPMENT ASSOCIATION

1818 H Street, N W  
Washington, D C. 20433  
U S A

(202) 477-1234  
Cable Address INTBAFRAD  
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April 12, 1985

His Excellency  
Zhao Ziyang  
Premier, People's Republic of China  
Beijing, China

Excellency:

I very much appreciate your taking time to meet with my colleagues and myself to exchange views about the Bank's draft economic report and to tell us about the Government's plans for further price and wage reforms. Your support for and interest in the Bank's economic study has been a source of encouragement to all of us and we were especially gratified to learn that you found our report useful.

Our discussions of the draft report with a wide range of government organizations and economic research institutions in China were very productive. My colleagues and I learned a great deal about many of the important issues that China may face in the coming decade. I am confident that the report will be much improved following revisions to take account of our new understanding.

Our discussions in China also indicate that further studies of a number of issues raised in our report would be useful. These include analysis of the possibilities for developing a socialist financial market aimed at improving mobility of investment funds and increasing efficiency of investment; policies and measures to promote development of the tertiary sector; ways of combining the use of direct and indirect controls in the management of the national economy; policies and measures to maintain and improve social achievements and alleviate poverty, especially through improved basic education and health, and strengthening of social security; and analysis of investment priorities and improved planning and management in order to overcome possible constraints in key sectors such as transport and energy. I very much hope that the World Bank will be able to contribute in some way to the ongoing work in China on these issues.

In the coming few months, we will be having further discussions with the Ministry of Finance and the State Planning Commission on studies and research that the World Bank might undertake that would go deeper into some of these issues. I sincerely hope we will continue to have your support and encouragement.

His Excellency  
Zhao Ziyang

- 2 -

April 12, 1985

I am sure you are aware, Your Excellency, that the rest of the world is following with great interest the effort of your Government to reform the economic system in China and to set the direction for sustained development over the next few decades. Your success in this endeavor will be of critical importance not only to the Chinese people, but to the world generally. I would like to assure you that the World Bank stands ready to contribute to your development effort in any way we can.


Sincerely,



Attila Karaosmanoglu  
Vice President  
East Asia and Pacific Region

## OFFICE MEMORANDUM

DATE March 29, 1985

TO Files 

FROM Ian Porter, AEACH

EXTENSION 75018

SUBJECT CHINA - Minutes of Mr. Karaosmanoglu's Meeting with Premier Zhao Ziyang, Beijing, March 7, 1985

Mr. Karaosmanoglu met with Premier Zhao Ziyang, Vice Chairman of the State Planning Commission Gan Ziyu, Vice Minister of Finance Chen Rulong and other Chinese government officials on Thursday, March 7, 1985 at 5:00 p.m. Accompanying Mr. Karaosmanoglu were Messrs. Yenai, Koch-Weser, Lim, Wood and Porter. Mr. Xu Naijiong also attended the meeting.

Premier Zhao began the meeting by asking Mr. Karaosmanoglu about his visit to Gansu and to Dingxi county. The Premier said that he had been there in 1983 and that conditions were still very difficult. Mr. Karaosmanoglu said that he had been impressed by the very difficult natural conditions but also by the efforts being made to develop such areas. The Bank intended to undertake a more detailed analysis of development issues and prospects for Gansu in the next few months.

Premier Zhao said that he had read the Summary and Conclusions of the economic report and that it was a very good document, better than the Bank's first economic report because it was both broader in coverage and deeper in its analysis. He much appreciated the high quality of the report and the efficient way in which it had been prepared. It would be valuable to the Government in the formulation of the Seventh Plan and of a longer term development program. A study on developments to the year 2000 was also being undertaken in China under the auspices of the Chinese Academy of Social Sciences and the main report plus annexes from this study would shortly be finalized. There were lots of similarities between this study and the World Bank report and a general consensus of views. The Premier said his preliminary impression was that the World Bank report contained more detailed analysis on some issues while the Chinese report contained more detailed analysis on others.

Mr. Karaosmanoglu said that the World Bank had prepared the economic report at the suggestion of the Premier and it was therefore particularly gratifying that the Premier had found it useful. The report was only a draft and after review by the Government would be revised and finalized. Mr. Karaosmanoglu said that his discussions of the report had been excellent. They had covered three main areas: the projections and the assumptions underlying the projections; the development of the tertiary sector and its contribution to national efficiency; and the management of state enterprises and the mobilization and allocation of financial resources. Other issues including the pattern of foreign trade, price reform, etc, had also been discussed. With regard to the projections Mr. Karaosmanoglu said that the report, which presented three of the literally hundreds of alternative possible scenarios for achieving the Government's targets for the year 2000,

had concluded that with some changes in policies the targets were feasible, although energy and transport were potential constraints. With regard to savings mobilization and allocation China would need to develop a financial system that was appropriate to the country's unique situation. The Bank hoped that its next major piece of economic work could involve working with institutions in China on a review of issues and options in the development of the financial system.

Premier Zhao said that the Government shared the same view as the Bank on the feasibility of the target of quadrupling GVIAO as well as on the key constraints, although China might be a little more optimistic than the Bank. With regard to the energy constraint, onshore oil production from existing fields, had been better than expected. Prospects for coal production (including coal from small local mines) were also encouraging and the target of 1.2 billion tons would probably be achieved before the year 2000 if the transport constraint could be overcome.

The Premier said that he was interested in the alternative scenarios in the Bank report and especially in the discussions of alternative savings rates and the importance of the tertiary sector. Although he understood the role of the tertiary sector in theory, he hoped that the Bank could explain further how the development of the tertiary sector might be promoted and how its development would improve national efficiency.

The Premier also said that he was very interested in the idea of a socialist financial market discussed in the economic report and wished to hear more about this idea.

Turning to the report's discussion on development management, the Premier said that once China had been able to invigorate the micro economy it would need to improve the use of indirect levers, in particular to direct the behavior of enterprises in a socially desirable manner. But the country was inexperienced in how to combine direct and indirect controls. In this area the Premier hoped that the Bank would continue to provide China with suggestions, not just in the economic report but also in the future.

The Premier said that he would like to say a few words about price and wage reforms. Prices and wages policies were obviously of great importance and China would be making changes in these areas. The prices of agricultural products would from this year be basically determined by market forces. The agricultural sector was developing well and prices would probably go down; indeed some minimum agricultural prices would need to be set to protect farmers. Lower grain prices would also stimulate animal husbandry. In the case of raw material and fuel prices, China was now introducing a dual price system (plan price and above-plan price). This would lead to gradual price increases, especially as the share of production under the plan price would be falling relative to the share under the above-plan price. The Premier said that he understood the potential for speculation, but a dual price system may be more easily acceptable in China as China has for some time successfully used such a system for agricultural and some other raw materials. It would inflict less of a shock than general across-the-board price increases. The prices of minor consumer goods would all be decontrolled during 1985. The prices of other consumer goods would be decontrolled where supply matched demand. The range of prices would also be widened to reflect

quality differentials (e.g. for Shanghai and Tianjin bicycles). But the prices of major consumer goods in short supply would remain under control to avoid general price increases. The Government would also be undertaking wage system reform in administrative (including the education and health) agencies (which included 20 million people) as well as in industry, transport and commerce. In the directly productive sectors wage increases would be geared to efficiency improvements. Wage-related problems caused by price and profit distortions would be resolved through taxation.

Mr. Karaosmanoglu said that the Bank report had focussed not so much on China's ability to expand energy production but on whether doubling energy production would be sufficient to quadruple GVIAO. The Bank felt that this would be very difficult to accomplish but hoped to study the issue further together with colleagues in China. Mr. Karaosmanoglu agreed with the Premier that transport could be more of a constraint than energy and more of a constraint than was indicated in the draft Summary and Conclusions to the economic report. He said that the issues requiring attention in the transport sector included intermodal planning and coordination and the adequacy of the road investment program. The Bank hoped to follow up on these issues in the context of its operational work.

On the development of a socialist financial system Mr. Karaosmanoglu said that there were no successful working examples from other countries. Five issues needed to be considered: the first concerned the management of enterprises and the creation and allocation of financial surpluses for maximum national economic benefit; the second concerned the type of financial intermediary system to use as a channel for financial surpluses; the third concerned the criteria to be used in investing surpluses both in new enterprises and in rehabilitation of existing enterprises; the fourth concerned the incentives to be provided to enterprises to invest in other activities or deposit their surpluses with financial intermediaries; and the fifth concerned the development of a tax system that was both equitable and capable of transferring appropriate levels of resources from enterprises to the Government. Mr. Karaosmanoglu said that both Hungary and Yugoslavia were working on these issues but the Bank could not endorse either approach as being appropriate for China. In this area, it appeared that China would need to seek its own unique solution. The Bank would hope very much to contribute to this effort. Mr. Lim added that it was necessary to look at a number of markets, including commodities, labor and finance, because experience had shown that it was only through all these markets working together that national efficiency could be significantly enhanced. Both Hungary and Yugoslavia had dealt with the development of commodity and labor markets but the development of a financial market and the mobility of funds was still a problem.

With regard to the development of the tertiary sector Mr. Wood said that commerce was particularly important because it would provide the infrastructure for market regulation. The commercial sector in the Soviet Union and Eastern Europe was small relative to other economies. Enterprise support services were also very important for the overall process of specialization. Personal services (including retail commerce) were a third important element in the tertiary sector. All three types of service could contribute to as well as be a consequence of economic reform.



With regard to the use of direct and indirect levers, Mr. Karaosmanoglu said that it would be difficult to apply China's previous planning techniques to a reformed economic system. The issue was how to move to a set of indirect levers that were effective both in preserving equity and in ensuring internal and external balance. The Bank report had provided a few suggestions but the development of a set of economic levers must be part of the overall development of the economic and legal system. If the Bank was going to work further on such issues it would need to cooperate very closely with colleagues in China.

Mr. Karaosmanoglu concluded by thanking the Premier for the support China had provided to the Bank in the writing of the economic report. It had helped bring the Bank to a new level in its understanding of China. He hoped that the Bank would be able to address some of the issues more intensively in the future and with the opening of the Bank's office in Beijing.

Premier Zhao said that he was very interested in the views of the Bank and he hoped that after finalizing the economic report the Bank would undertake follow-up work on some key issues. The Premier said that since China had regained its position in the World Bank it had enjoyed fruitful cooperation with the Bank and he would like Mr. Karaosmanoglu to convey the Premier's appreciation to the senior management in Washington. The Premier also said that China welcomed the establishment of the World Bank office in Beijing and the appointment of Mr. Lim as the head of the office.

## SUMMARY AND CONCLUSIONS

1. China's ultimate economic objective is to catch up with the developed countries, while maintaining a socialist system in which the benefits of prosperity are widely shared. Major, though uneven, progress toward this goal was made in the past three decades. During the next two decades, there could be substantial further progress. The foundations for rapid and equitable growth in the twenty-first century could also be laid. But this will require steering a difficult course, in both development strategy and system reform.

2. This report looks at some of the key issues for China in the next 20 years, and at some of the options for addressing them, especially in light of international experience. It covers many specific topics, including agriculture, energy, technology, industrial location, internal and external trade, population, education, employment, and finance (health was addressed in another recent report). The first section of this summary assembles some of its conclusions in the context of a more general discussion of the pattern of economic growth. Common themes regarding the system of economic management and planning are pulled together in the second section. A third section covers some related aspects of social policy. At the end of the summary there is a brief overview.

3. The most careful forecasts are often confounded. The lessons of international experience are often ambiguous and controversial. In any event, they are hard to apply to China, a country that in important respects differs from all others, and is not easy for outsiders to understand. The projections of this report are thus not predictions, and its suggestions are tentative. They are no more than an attempt to contribute to the debate in China about the difficult questions that must be confronted during the country's unique socialist modernization.

### Pattern of Growth

4. National income per capita in the developed countries is (in real terms) approximately ten times higher than in China, and will increase in the future by perhaps 2% per year. To catch up by 2050, China's per capita income would have to increase at an average rate of 5.5% per year. Such rapid progress has been rare elsewhere. In 1960-82, excluding small and oil-dominated economies, only two developing countries achieved annual per capita income growth above 5%: South Korea (6.6%) and Greece (5.2%). More generally, only one country - Japan - has indisputably caught up with the developed nations from a position of economic backwardness.

5. China's past record, on the other hand, is quite encouraging. From 1952 to 1982, despite relatively rapid population growth and periods of acute economic mismanagement, per capita national income grew at an average annual rate of 4.0%, with phases of significantly faster growth. Of particular relevance is China's performance during the past few years of policy and system reforms: from 1978 to 1983, per capita national income grew at 5.5% per year.

6. Although the basic objective is to improve living standards and eliminate poverty, the Government has set targets of quadrupling the gross value of industrial and agricultural output (GVIAO) between 1980 and 2000 and increasing per capita national income from about \$300 to \$800 (about 5% per year). If China's future investment efficiency were similar to the average of the past three decades, but allowing for increased investment in economic and social infrastructure, quadrupling GVIAO would require an investment rate of about 30% of national income. This is comparable to the rates in other fast-growing East Asian economies, as well as East European countries, and in line with China's past investment rate. With reasonable improvements in energy and materials use, and provided that the population in 2000 is fairly close to the official target of 1.2 billion people, quadrupling GVIAO would allow the Government's per capita income target to be attained.

7. The target growth rate of per capita income is far above the 2.6-3.6% range projected by the World Bank for middle-income countries in 1985-95. It seems feasible because China's projected population growth is unusually slow (1% p.a., as compared with an expected 2.2% in middle-income countries), and because China's investment rate has consistently been unusually high (the 1982 average for middle-income countries was 24%). But its attainment depends crucially on the efficiency with which resources are used. For example, if the overall efficiency of investment were similar not to China's 1952-82 average but to the 1957-77 average - roughly comparable to that of the Soviet Union in 1950-75 and India in 1960-82 - the growth rate of per capita income would be about one percentage point lower.

8. If agricultural or energy production (discussed below) increased unexpectedly slowly, or if domestic or international misfortunes adversely affected China's efficiency or investment rate, growth could be slower still. In any event, experience in China and other socialist countries strongly suggests the desirability of cautious planning. Unrealistically high growth targets cause fluctuations, shortages and inefficiency; while aiming too low has few adverse consequences. Indeed, continuation of China's recent practice of setting modest annual and medium-term targets could greatly facilitate reform of the system of economic management.

### Sectoral Balance

9. Experience elsewhere also confirms the importance of striking an appropriate balance among the different broad sectors of the economy. In particular, favoring industry at the expense of other sectors does not seem to generate rapid and efficient growth. In China, incentives for agricultural production have recently been substantially increased, but investment in agriculture may have declined, and additional measures to stimulate agricultural production and incomes (discussed below) should be pursued. Moreover, emphasis on quadrupling GVIAO should not imply neglect of infrastructure and services, which are vital for industrial and agricultural efficiency. The adverse consequences of past underinvestment in electricity and transport are well recognized in China; but there are still difficulties in diverting sufficient funds from directly productive investment into infrastructure. And the importance of commerce and other services (including finance and enterprise support services) still appears to be insufficiently appreciated.

10. The share of the service sectors - including commerce - in output and employment in China is at present strikingly small by comparison with other developing countries, despite an unusually large education and health sector. The pattern in China, however, is characteristic also of the Soviet Union and Eastern Europe. Continued emphasis on increasing the physical volume of production (for example, the target of quadrupling GVIAO) might cause this pattern to persist. But China also has the option of a change of emphasis, with accelerated development of the service sectors causing a substantial shift toward the pattern of growth characteristic of all market-regulated economies, including Japan.

11. Faster growth of the service sectors would have obvious costs in terms of investment, skilled labor and (to a lesser extent) materials. But experience elsewhere suggests that it would also have benefits. One aspect is the direct benefit to households from more convenient retail commerce, and from more restaurants, tailors, hairdressers, and so on. The other concerns indirect contributions to the efficiency of industry and agriculture. A bigger, better-equipped and more responsive commercial sector could reduce requirements for both circulating capital and - by permitting greater specialization and realization of economies of scale - fixed capital. Enterprise support services (accounting, advertizing, design, data processing, repairing, and so on) also help to make fuller use of specialized equipment and personnel, while financial institutions can contribute to better investment decisions. Larger commerce and enterprise support service sectors may also contribute to reducing material input requirements, especially by accelerating improvements in product quality, which make the cost of materials a smaller fraction of the price.

12. Service sector expansion would probably be associated in important respects with reform of the system of economic management. Larger commerce and enterprise support service sectors, for example, would be of limited usefulness if most flows of goods were administratively directed or most enterprises and localities aimed at self-sufficiency. Moreover, rapid growth of services probably could not be accomplished through administrative directives and centralized resource allocation, but would have to be pulled by demand. Individual and collective enterprises may also be better suited than state enterprises to providing many types of services.

13. An alternative development path, involving both greater emphasis on services and more efficient resource use, was therefore analyzed in the report. With a level of investment efficiency similar to the average in Japan in 1950-80 and in all middle-income countries in 1960-82, it could attain the Government's target national income growth rate with an investment rate of only 26%, and hence faster growth of consumption. (The growth rate of industry would be 7% p.a. rather than 8%, however, and hence GVIAO would less than quadruple.) On this path, China would also have the option of maintaining the investment rate at 30%, which would cause national income to grow one percentage point faster than the target rate.

Human Resources

14. Faster service sector expansion could also make it easier for China to absorb growth in the labor force, averaging about 10 million workers per year in 1980-2000. In the usual pattern of development - even in rapidly industrializing countries - the main intersectoral employment shift is from agriculture into services, with a more moderate increase of employment in industry, which is less labor intensive. In China, however, employment has grown faster in industry than in services. Continued emphasis on increasing the physical volume of production could perpetuate this pattern. This is especially likely because the prospective decline in the primary school age group will cause the number of teachers - now approaching a quarter of all service sector employment in China - to increase only modestly. Service sector employment in 2000 might thus remain as low as 70% of industrial employment (similar to the ratio in the Soviet Union in 1959).

15. On the alternative development path, by contrast, service sector employment in 2000 could be as much as 150% of industrial employment (similar to the ratio in Japan in the early 1950s). Such a change in the composition of nonagricultural employment could ease some problems in China's urban areas, which now suffer from a combination of surpluses of some sorts of labor and shortages of other sorts of labor (including competent, able-bodied workers even at relatively low skill levels). A much higher ratio of service sector to industrial employment would help to reduce this structural mismatch between labor demand and supply, since service sector jobs tend to be disproportionately filled by the categories of labor that are now in surplus in urban China - particularly women.

16. Perhaps more important, faster service sector expansion, by raising the overall level of nonagricultural employment, could reduce the proportion of China's labor force that must remain in agriculture, where the earnings and contribution to production of most workers are likely to remain unsatisfactorily low for the next two or three decades. On the quadrupling path, the proportion of the labor force in agriculture - excluding brigade industries - might decline by 2000 to only slightly under 60%. On the alternative development path, though, it could decline to nearer 50%, a difference of perhaps 40 million workers.

17. Even the latter percentage, which implies an absolute increase in agricultural employment of 13 million, is much higher than most Chinese projections, which envisage a decline in the agricultural employment share to under 40%. This would be normal for a country with a per capita income roughly double the Chinese target for 2000. Given the likely growth rates of nonagricultural output and the present very large agricultural employment share, it could be achieved only if nonagricultural labor productivity grew slowly, which might well be incompatible with efficient industrialization. In the early decades of the twenty-first century, however, agricultural employment is likely to shrink rapidly.

- v -

18. Especially because many of the children of today's farmers will move into nonagricultural employment at some point during their working lives, it will be important for China to continue to emphasize the wide diffusion of basic education, and to improve its quality. International experience strongly suggests that this could contribute not only to faster economic growth, but also to a less unequal distribution of its benefits. In recent years, however, there have been problems in maintaining the primary school enrollment ratio (although it remains well above the developing country average); and the secondary school enrollment ratio has dropped below the developing country average. There are also wide variations in educational quality, and the proposals in some provinces to increase local self-reliance in basic education could increase such disparities. So could continuation of the key school policy (recently modified in name, but less in substance) at the primary and secondary levels. More guidance and financial support from the central government will be needed if the important target of making nine years of basic education universal by 2000 is to be attained.

19. As regards advanced education and training, the need for rapid progress to make up for the damage inflicted by the Cultural Revolution is well recognized in China, but some changes in emphasis seem advisable. University-level courses are too specialized, partly because many educational institutions are subordinate to sectoral ministries and other agencies. The Government's present policy of vocationalizing secondary education could suffer from similar problems. The case for sound general education, supplemented by subsequent, briefer training in highly specialized skills, is particularly strong in China over the next few decades. Rapid technical advance and structural change will require constant alterations in the skill composition of the labor force. The slow prospective growth of the labor force in the twenty-first century will reduce the scope for achieving such alterations through changes in the pattern of training of new labor force entrants. It will correspondingly increase the required amount of retraining, which is more difficult for people whose original education was highly specialized.

#### Food and Agriculture

20. Despite its long history of food problems, China's per capita consumption of calories and protein is currently similar to the average for middle-income countries. The share of animal products in the diet, however, is that of a low-income country, and a major issue is how far and fast this share should increase. This issue is hard to address because of uncertainty about China's agricultural production potential: depending on what past period in China is regarded as representative, and on what international evidence is taken to be relevant, the future trend growth rate of agricultural output could lie anywhere between 2-3% and 5-6% per year.

21. In addition to the successful measures already implemented in recent years, especially introduction of the production responsibility system, the Government could take a number of steps to enhance agricultural growth prospects. These include improvements in agricultural research, education and extension services; irrigation and drainage projects; better nutrient balance in fertilizer supplies, as well as changes in the pricing and distribution

system so that fertilizer is allocated more in accordance with its potential contribution to production of particular crops and in particular localities; greater flexibility of agricultural product prices; increased availability of agricultural credit; and improvements in rural transport, storage, and marketing facilities.

22. To permit consumption of animal products to rise from 6% of total caloric intake in the early 1980s to 15% by the end of the century, gross agricultural output would have to increase at about 4.5% p.a., with crop production growing at 3.6% p.a. (less than the 1965-83 average) and animal husbandry at 7.5% p.a. (well above past rates). This agricultural growth rate could simultaneously satisfy the other demands of economic growth at the government's target rate, with agricultural exports and imports more or less in balance in 2000. But it is very high by international standards - well above the 3.0% average for middle-income countries in 1960-80, and surpassed only by Thailand and the Philippines, which started with more uncultivated land and lower yields.

23. To achieve such rapid growth of animal production would also not be straightforward. China's pastures are now seriously over-grazed, which makes it unlikely that present targets for beef and mutton production growth can be achieved. Much higher priority than at present would need to be given to improving techniques for the production of poultry, a potentially efficient converter of feed into animal protein. The most important issue, however, appears to be availability of grain and protein-based feeds, on which an increasing proportion of animal husbandry will have to be based. This is partly a matter of the backwardness of China's feed-processing industry, partly of the cropping pattern.

24. With rapid growth of animal husbandry, the Government's present targets for increasing production of specific crops could tend to create a large shortage of the coarse grains needed for animal feed, and a large surplus of rice, whose consumption is likely to grow only slowly. Feedgrain imports could make up any conceivable shortage, probably without an appreciable increase in world prices; but it would be possible to export only a part of the potential rice surplus at economically attractive prices. It may be necessary to alter the future crop production pattern, switching some rice land either into coarse grains or into other crops that could be more easily exported.

25. The future pattern of agricultural production and foreign trade thus depends quite heavily on the rate of increase in consumption of animal products. The possibility of a rapid increase cannot be ruled out, but there are some significant problems and uncertainties, which could be greater in the twenty-first century. (Even with a favorable feed conversion ratio, an increase of 10 percentage points in the share of animal products in the average diet is equivalent to the disappearance of 35-40% of China's cultivable land, or a 35-40% increase in population.) Particularly undesirable would be an increase in per capita consumption of animal products to a level that could not be sustained - because of a slowdown in crop production growth, poor feed-meat conversion ratios, or unwillingness or inability to sustain large feedgrain imports - and therefore had to be reduced.

26. Although there appears to be little danger of a decline in China's present very satisfactory food intake level, caution is accordingly needed in managing food demand. It seems especially important that consumers should pay the full economic cost of animal products, without subsidies or administrative restrictions on prices. Japanese experience suggests that high prices can bring consumer demand for animal products into line with limited supplies in a socially acceptable manner. By contrast, the experience of countries which have subsidized and rationed consumption of animal products has been extremely unfavorable.

#### Energy Demand and Supply

27. The Government's preliminary plan has been to quadruple GVIAO by 2000 while only doubling primary energy production, on the grounds that there is great scope for increasing the efficiency of energy use. Although this emphasis on conservation is entirely appropriate, this report's analysis of energy demand and production prospects raises questions about some of the specific targets involved.

28. The proposed quadrupling of electricity production by 2000 will require a huge amount of investment, but appears technically feasible, and would meet the demand arising from quadrupling GVIAO, given likely progress in conservation. The Government's target of doubling crude oil production by 2000 also seems consistent with the likely level of demand, although some changes in the structure of refining capacity will be required, and although the plausible range of demand is quite wide. How much crude oil will in fact be produced in 2000, however, cannot be at all accurately predicted, especially because China's currently producing fields are unlikely to provide more than 15% of the 200 million ton target. To secure the remainder, from new fields, will require upgrading of equipment, technology and management at all stages of exploration and development, as well as a long-term strategy for exploration.

29. For coal, the picture is quite different. Even on the most optimistic assumptions regarding progress in conservation, quadrupling GVIAO could cause the demand for coal in 2000 to exceed the Government's present coal production target (1,200 million tons) by over 200 million tons. With a more realistic rate of progress in conservation, the projected shortfall could be about 400 million tons. Demand for coal could be substantially reduced by slower industrial growth: for example, if industry grew at 7% p.a. rather than 8% (either because of slower overall growth or because of greater emphasis on the service sectors), the demand for coal in 2000 could be reduced by about 150 million tons. Even then, coal demand would approach the coal production target only on the most optimistic assumption about progress in conservation.

30. Fuel imports - except possibly on a limited, temporary basis - would not be an economically attractive way of closing these large potential gaps, because China could produce more coal at a cost well below that of imports. Coal reserves are ample; production technology is straightforward; mine development should require only about five years; and the total investment cost, though large, would still be far less than that for electricity.



However, if the necessary increases in coal production over and above the present target are to be achieved, especially at minimum cost, action will be needed soon, to prepare more mine projects, to streamline construction procedures, to plan for even faster development of coal transport facilities, to make the necessary financial resources available, and to give adequate incentives and support for the development of small, local mines.

31. The possible magnitude of the required increase in coal production underlines the importance of energy conservation (as well as the need for strong - but technically feasible - measures to minimize air pollution). The mixture of administrative controls and financial incentives so far applied has led to substantial energy savings, but further improvements are needed. The quota system gives enterprises an incentive to exaggerate their needs. More seriously, administrative restrictions on energy use are often not economically efficient, because they do not take enough account of the varying circumstances of individual enterprises. Some enterprises may be forced to reduce energy consumption at a high cost in terms of lost production or additional investment, while others that could reduce energy consumption with less cost to the economy are not obliged to do so. It is very probable that more energy could be saved, with less waste of other resources, if enterprises were more strongly motivated to reduce all costs and faced with prices that better reflected the economic values of all their inputs and outputs.

#### Specialization and Urbanization

32. China's size and past emphasis on local self-sufficiency offer opportunities for enormous economic gains through increased specialization and trade among localities. In recent years, agricultural specialization has proceeded rapidly. In industry, by contrast, specialization does not seem to be increasing, and indeed local planning bureaus are still promoting the development of a wide range of industrial activities, with continuing emphasis on local self-sufficiency. This appears to result partly from transport problems, but also from shortcomings in the commerce and material supply systems, distorted prices and insufficient competition. It could have a serious adverse effect on China's overall investment efficiency.

33. To facilitate further agricultural specialization and to stimulate industrial specialization, there is an urgent need for improvements in commerce, and in transport, especially road transport. For specialization will involve much movement in fairly small lots of a great variety of goods, often perishable or fragile, over short to medium distances, to and from dispersed origins and destinations. This is only feasible by road, albeit at higher cost per ton-kilometer than by rail (which will remain the most efficient means of transporting raw materials and heavy industrial products over long distances). However, China now has a rural road network half the size of India's and fewer trucks per rural person than the impoverished Sahelian countries of West Africa. To build up an adequate road network in rural areas, advantage could be taken of the large amount of underutilized agricultural labor, which China has successfully mobilized in the past for infrastructural improvement. It will also be essential, simultaneously, to expand and improve major intercity highways, the vehicle fleet, and vehicle fuel production.

34. In industry, to prevent continued proliferation of plants of suboptimal scale and product quality, there is also an urgent need for measures to reduce the present conflict between what is rational for a particular locality and what is rational for China's whole economy. Of particular importance would be changes in the system of economic management (discussed below), regarding enterprise motivation, competition and prices. In addition, the central government might consider legal measures to back up its existing general prohibition of barriers to interlocality trade, including possibly the establishment of a special regulatory institution, with the power to levy large fines.

35. Sub-optimal plant size is not China's only current industrial location problem. There is also too much concentration of industry in large and medium-sized cities. Research and experience in other countries suggest that economic efficiency requires weight-reducing heavy industry (e.g. steel production) and agroprocessing to be located near raw material sources, with other space-intensive or standardized industrial activities in specialized small cities. Industries such as petrochemicals and bicycles benefit from large-scale operation, but not from proximity to other industries - or at any rate not enough to justify the much higher economic cost of land and labor in large cities. By contrast, industries whose technology is evolving rapidly or which must respond to constantly changing demand, as well as many specialized service activities, benefit substantially from mutual proximity and clustering in large urban areas. Development of both large and small cities, as well as smaller towns providing goods and services to rural areas, could thus contribute to rapid and efficient growth in China; but planners and prices (discussed below) will need to give better guidance on what activities should go where.

36. How much the overall level of urbanization should increase in the decades ahead is a difficult issue, partly because the distinction between urban and rural is itself blurred in many densely populated parts of China. In any event, substantially increased rural-urban migration seems probable and desirable. Indeed, without some rural-urban migration, China's overall urbanization rate (as officially measured) would decline from 20% in 1981 - quite normal for a low-income country - to 19% by 2000, simply because the natural population growth rate in existing urban areas over the next two decades is likely to be much lower than in rural areas. This could cause the general labor shortages that have already appeared in some Chinese cities to become widespread within a few years. Increasing urbanization would probably be a more economically efficient response to such shortages than accelerated automation of urban production. An urbanization rate in 2000 of 30% (implying that more than a third of the urban population would have come from rural areas) would still involve an unusually large amount of rural non-agricultural employment. Lower-middle-income countries today (at a similar income level) have an average 34% of their population in urban areas.

37. Whatever the overall rate of urbanization, efficient development of towns and cities will require a very large increase in urban infrastructure and services. The administrative responsibilities for their provision, and potential financing and cost recovery mechanisms, need to be carefully reviewed. In many countries, efficient and equitable development of urban

services has been seriously constrained either by fragmented and unclear allocation of responsibility among different administrative levels, or by inadequate growth of urban revenue sources.

### Foreign Trade and Capital

38. China's recent resumption and expansion of external economic contacts have raised exports to 9-10% of national income, which is within the normal range for large countries. However, inflows of foreign loans and direct investment have remained small, partly because of foreign trade surpluses. For the future, there appear to be two large and related issues. The first is how much, and in what directions, to further increase external contacts. The second is how best to manage such contacts, and in particular whether to continue the present insulation of the domestic economy from the world outside by administrative intermediation and separate price systems.

39. Over the next two decades, China will need to change the composition of its manufactured exports. Exports of textiles and clothing, in particular, are likely to grow fairly slowly. China will therefore need to make a major effort to expand exports of machinery and metal products. Rapid growth in such exports would permit rapid growth of intermediate and capital goods imports, as well as consumer goods imports. Exports of manufactured goods could also be used to pay for purchases of licenses and technological assistance, which in many advanced as well as developing countries have proved to be very effective ways of upgrading domestic technology.

40. As regards foreign borrowing, the Government's policy of cautious progress seems well founded. For a low-income country to run foreign trade surpluses, as China has done in recent years, has some obvious disadvantages, as compared with a net inflow of foreign capital to supplement domestic savings. But experience in other countries, including socialist ones, has shown how easy it is to slide into excessive or unproductive borrowing, especially when domestic enterprises and planners are not sufficiently conscious of investment costs or responsible for bad decisions.

41. However, China might give greater encouragement than at present to direct foreign investment, less for the foreign capital or advanced technology it would bring than for the demonstration effect of modern management techniques. The example of, and competition from, well-run foreign companies could help domestic firms identify weak links in management, product design, material supply, and so on, and spur them to make changes they might otherwise never consider. But such examples of the way modern industry operates in more advanced countries would be effective only if contrasted and competing with locally managed firms. This would require foreign and joint ventures to be spread throughout China, rather than confined to special economic zones or enclaves.

42. International experience suggests that decentralization of foreign trade to the enterprise level can also make an important contribution to realizing the potential benefits of increased external economic contacts. Direct exposure of exporting firms to foreign buyers and competitors has proved elsewhere to be an extremely effective way not just of learning in the

abstract about new and better products and processes, but also of learning how (and being put under pressure) to introduce them in practice. Similarly, allowing enterprises - including commercial enterprises - and consumers to choose directly between imported and domestically produced goods could greatly increase competitive pressure on Chinese producers to introduce new, better, and cheaper products.

43. Such decentralization of foreign trade could have some potentially serious disadvantages, too, including damage to promising but newly established industries in China, as well as greater exposure to world price instability and unpredictable fluctuations in foreign markets. But skillful use of policy instruments - including the exchange rate, tariffs, and selective administrative interventions - could minimize the costs while securing many of the benefits. China will also always be a large and diverse economy, with a relatively small foreign trade sector, which greatly reduces the possible damage that unexpectedly unfavorable external developments could inflict, even through particular industries and localities might experience quite sharp swings in prosperity.

44. Especially following the recent unification of foreign exchange arrangements - and given the current account surpluses of recent years, large reserves, and the ready availability of external capital - China appears to be well placed to move toward a decentralized and mainly indirectly regulated foreign trade system, without the problems (of external insolvency or internal inflation or deflation) that many other countries attempting a similar move have simultaneously had to contend with. To do this immediately, or at one stroke, would probably be unwise, since most domestic enterprises do not yet have appropriate motivation or independence, and since some prior changes of domestic prices would ease the adjustments required. But it could proceed steadily, in parallel with internal economic reform.

#### Managing the Economy

45. How far China will have risen into the middle-income range by 2000 will depend crucially on how successfully the economy is managed. This is a matter partly of mobilizing financial and human resources, and of importing and developing modern technology, partly of putting these things to effective use. China's past record of economic management, for all its unevenness, is superior to that of other low-income countries, in terms of both growth and poverty reduction. But maintaining the past pace of economic progress is likely to require greater efficiency.

46. Efficiency in the relevant sense means ceaseless, intense efforts by producers to reduce costs, to increase productivity, to improve product quality, to introduce new products, and to seek out and respond to changing needs and opportunities. It involves bold yet frugal investment decisions, increasing specialization, and the constant displacement of more expensive or inferior products and processes by cheaper and better ones.

47. These conditions for rapid, sustained growth are at present far from fully met in China, except in agriculture, where outstanding progress has been made in recent years with the introduction of the production responsibility

system. Recognizing this, the Central Committee of the Chinese Communist Party in October 1984 announced a program of urban economic reforms, with invigoration of state enterprises as its central theme, to be implemented over a period of about five years. Much of the discussion in the present report is premised on the Central Committee's decision.

48. To be efficient, enterprises must be motivated to improve their economic performance; they must have some freedom of maneuver; they must be faced with economically rational prices; and they must be subjected to competition. None of these elements is individually easy to establish, and the absence of any one of them reduces or nullifies the benefits of the others. In addition, the state must retain the ability to direct the overall pace and pattern of development. The essence - and the difficulty - of a successful and comprehensive reform thus lies not only in bringing together the several elements of market regulation, but also in combining them with an appropriately modified system of planning.

#### Enterprise Motivation

49. The unsatisfactory results of direct administrative control of enterprises - whether by central ministries or local governments - lead irresistibly to the principle of greater enterprise independence. Yet establishing independent and appropriately motivated enterprises may be the hardest single aspect of reform in a socialist system - and perhaps also the most fundamental, since an unmotivated enterprise cannot be expected to motivate its workers, or to respond to price and tax signals, or to compete.

50. Appropriate enterprise motivation should include a strong desire to increase profits. Avoidance of losses is an important aspect of this, but is insufficient, since China needs enterprises that not merely pursue a passive strategy of staying out of trouble, but actively seek to increase production and sales, and to cut costs of all kinds. With rational prices and competition, the best single measure of enterprise performance in this regard is usually medium-term profits (especially after deduction of the cost - depreciation and interest - of the capital employed). The active desire of peasant households to increase sales and cut costs, because their standard of living depends on it, lies at the heart of China's recent agricultural successes. Outside agriculture, the same motivation is a natural feature of individual and family enterprises, and of small enterprises owned and operated collectively by their workers. In medium-sized and large enterprises, however, things are not so simple.

51. State Enterprises. Some important enterprises should clearly remain subject to direct government control, and should not primarily pursue profit. At a minimum, this applies to public utilities (e.g. electricity, railways, and telecommunications), large-scale mineral exploitation, and many defense-related industries. Direct control of other key enterprises might also help to achieve specific development objectives, including the technological upgrading of particular sectors. What is less clear is the best way to organize and motivate the remainder - probably the great majority - of state enterprises, which would be relatively independent. Each of the available options has strengths and weaknesses.

52. Giving direct control of state-owned enterprises to their workers is a socially attractive possibility. Japanese experience also shows the economic advantages of strong worker commitment to the enterprise. But there are also disadvantages, especially because state enterprises should operate for the benefit of the whole society and not only of those who work in them. Experience in Yugoslavia and elsewhere suggests that worker control could result in excessive wages and worker benefits, inadequate labor discipline and effort, restriction of employment, and comparative indifference to profitability.

53. Experience in developed capitalist economies suggests that giving control of enterprises, instead, to their managers would increase their propensity to expand, improve and innovate. But completely independent managers sometimes choose a quiet life or, more commonly, pursue personal power through expansion with insufficient attention to profitability. In socialist countries, moreover, managerial control tends to differ only slightly from worker control, since managers find it hard to resist worker demands for greater benefits or to insist on the often unwelcome changes in work practices that are needed for innovation and increased efficiency. This is already a problem in China: studies of experimentally reformed enterprises controlled mainly by their managers reveal large increases in worker benefits, but small increases in economic efficiency.

54. An alternative approach, common in non-socialist countries (and now being tried in Hungary), is to give strategic decision-making authority in each enterprise to a Board of Directors. Such a board could contain some representatives of society at large, as well as of the workers. But to impart the necessary motivation, the board would mainly have to represent institutions with a strong interest in the enterprise's profits. It could insist that the enterprise managers behaved accordingly, partly by appointing and dismissing them, partly by linking their remuneration to profitability. The managers might in practice make most decisions, but would be greatly influenced by their ultimate accountability to the directors.

55. Such boards should be free from direct government intervention. But, precisely because these are state enterprises, this may be difficult to achieve. In China, for instance, even if the boards were to consist of representatives of the Ministry of Finance or a new Ministry of State Property, rather than of sectoral ministries or the governments of the localities in which the enterprises are situated, informal connections and pressures for direct administrative control could persist. A possible solution might be to spread the ownership of each state enterprise among several different institutions, each in some way representing the whole people, but with an interest mainly in the enterprise's profits rather than directly in its output, purchases or employment. Such a system of socialist joint stock ownership could perhaps be created initially by suitable dispersion of the ownership capital of existing state enterprises. Over time, it could be reinforced by a more diversified pattern of investment finance (discussed below), with a variety of state institutions acquiring financial interests in existing and new enterprises.

56. Collective and Individual Enterprises. China's policy is to encourage the coexistence of state and other sorts of enterprises. In small-scale economic activities, individual and collective enterprises are already making a valuable contribution, although they could be even more productive if given better access to materials, credit, and technology. Their potential role in medium- and large-scale activities, however, remains to be determined.

57. Experience elsewhere suggests that genuine collectives flourish only in certain lines of activity, and rarely above a certain size. Many of the most successful examples elsewhere are in commerce, and are marketing or purchasing cooperatives. There are far fewer examples of medium-sized genuine worker collectives, or of any sort of collectives in manufacturing. China's numerous township and village enterprises may appear an exception; however, these are not collectives in the ordinary sense, but community enterprises. They have been successful partly because of restrictions on personal mobility among communities, which has given local residents a strong common interest in their establishment and profitability.

58. Collectives and community enterprises could in the future constitute a significant proportion of China's medium-sized enterprises. Many individual enterprises could also grow rapidly to medium size, if allowed to do so, and could be an important dynamic force in the economy. As an alternative to the present restrictions on the size of individual enterprises, these enterprises might be obliged to sell majority ownership to one or more state institutions once they reached a certain size. The then minority owners could continue as managers, supervised by a board of directors representing all the owners.

59. Accounting and Law. The best way of motivating independent state enterprises, and the best balance among state, collective, individual and mixed enterprises, can only emerge from experience and experiment over a protracted period. But certain necessary conditions for success can already be identified.

60. One is improvement of enterprise accounting and auditing, which at present leave much to be desired. Without accurate accounts, subject to thorough, compulsory and independent audits, with severe penalties for non-compliance, it is hard to see how any system of independent enterprises - state or non-state - could function properly.

61. Moreover, a decentralized economy cannot function properly without a comprehensive system of commercial and contract law, and institutions and personnel to implement it. Laws are also needed to regulate the economic activities of independent enterprises. Among other things, laws or decrees should prohibit specified types of monopolistic, anti-competitive, or exploitative behavior, with legal institutions to interpret and implement these prohibitions. At present in China, the situation is unsatisfactorily vague, with enterprises and local officials free to place their own interpretations on general guidelines from the center.

## Competition

62. As the Central Committee's 1984 decision clearly states, competition among enterprises is crucial to efficient growth - without it, customer requirements are neglected, innovations diffuse slowly, and market-regulated prices are distorted for monopolistic gain. One key ingredient of competition is allowing purchasers to buy from the best and cheapest source. China has already taken some significant steps in this direction, but further progress is needed. It could probably be assisted by dismantling the annual production planning and allocation system, either in one step (as in Hungary) or more gradually, by reducing each year in each enterprise the proportion of material requirements covered by the state allocation and, in parallel, the obligatory state production and procurement quota.

63. It would also be assisted by dismantling administrative barriers to internal trade, which would be easier if fewer enterprises were directly controlled by government organs anxious to avoid competition within their "families" of enterprises. But consolidation of enterprises into large sectoral corporations would normally tend to reduce competition, although this could be offset by increased exposure to foreign competition. Equally important would be measures to enlarge, diversify and strengthen commerce and related services. Individual and collective enterprises might be given a greater role in wholesaling and material supply, and better access to transport facilities.

64. Another key ingredient of competition is free entry of new producers into particular markets. One step in this direction for China could be to allow larger enterprises to diversify more freely out of their existing lines of business. Provided that prices are rational, such diversification can transfer profits earned in one line of activity into other lines where the economic returns to investment are greater. And it can permit enterprises to transfer workers who can no longer be profitably employed in one line to other lines, without having either to discharge them or to keep them idle.

65. Another important step toward free entry could be to allow individual and collective enterprises to operate in more lines of activity, including technologically dynamic sectors. Studies in other countries have shown that small enterprises are just as innovative as large ones. (Chinese visitors to foreign countries are often given a misleading impression in this regard, because they are usually taken only to well-known, large enterprises.) Particularly because of the strong incentive that small enterprises have to innovate, the overall pace of technological advance could very probably be accelerated by letting them compete for some of China's skilled manpower, technology imports and research support.

66. Lastly, effective competition has to involve the elimination of obsolete or unwanted products and processes. Subsidies or protection for backward technology and inefficient enterprises - (other than on a temporary basis to permit reorganization) - hold back the growth of efficient enterprises, and remove a powerful negative stimulus to innovation and improved efficiency. At the same time, this aspect of competition can obviously cause hardship, especially for displaced workers. Social policies and institutions



(discussed below), and government retraining schemes, can alleviate this hardship. But the conflict between the gains of the majority from greater competition (and faster technological change) and the losses of particular individuals and groups cannot be completely eliminated.

### Prices

67. The Government is well aware of the need to establish economically rational prices, without which the decisions of independent, profit-oriented enterprises would often be inefficient for the whole economy. The Government also recognizes that this must be accomplished by changing the price-setting system to give market supply and demand forces a greater role, and not only by administered changes in prices set by the state, which tend to lack the flexibility, complexity and precision needed in a modern economy. The prices of many minor items, and of some transactions in more major items, have already been successfully decontrolled.

68. Further progress in this direction is impeded by chronic shortages of many goods. It is feared that these shortages, if prices were no longer subject to direct state control, would cause general price inflation, as well as obstructing the allocation of materials to key projects. For this reason, it is often argued in China that further price decontrol should be postponed until rising production has eliminated most of the shortages.

69. Soviet and East European experience suggests, however, that chronic shortages are not the temporary result of inadequate production capacity, but an enduring feature of administrative economic management, which can be eliminated only by systemic reforms, including price decontrol. This view is supported by China's experience in the past few years, especially in agriculture, where relaxation of direct controls has turned long-standing shortages into abundance. The same could happen in industry. Increases in specific prices could eliminate specific shortages by stimulating supply and reducing demand. These price increases, moreover, would tend to reduce purchasing power over (and hence the prices of) other goods, provided that the government kept strict control of the budget balance and credit. Additional revenues could be raised for key projects adversely affected by price changes.

70. Nonetheless, there is substance to the fear of immediate and general decontrol of prices in China. The downward inflexibility of some prices, and of wages, could obstruct the smooth adjustment outlined above. The full response of demand and supply to price changes may take years. China lacks experience in indirect fiscal and monetary regulation of the general price level; and other countries with much greater experience still suffer from rising prices. The elimination of shortages, moreover, would also require increased competition and stronger enterprise motivation to hold down costs, including investment costs, which cannot be brought about overnight. For these reasons, price decontrol probably has to be gradual though steady - perhaps in conjunction with the gradual dismantling of annual production planning and allocation mentioned earlier.

71. Some steps, however, could be taken more quickly. Large, administratively imposed, increases in the prices of most forms of energy - and some

other materials - are a case in point (although even this could be done in a series of pre-announced steps). Without them, there would be little chance of achieving the essential reductions in energy use discussed earlier. There is concern in China that large energy price increases would have ripple effects, since energy-intensive industries and enterprises could not absorb all the increased cost through conservation and profit reduction, and would therefore have to raise their prices. But most such ripple effects should in fact be welcomed (and cushioning through reduction of taxes and profit remittances avoided): experience elsewhere suggests that they could make a very important indirect contribution to energy conservation by cutting the demand for energy-intensive products.

72. Agricultural prices are another instance. There is a growing contradiction between the new system of household agriculture and the continuing direct administrative regulation of producer prices for major agricultural commodities (the prices of minor items have already been decontrolled, to good effect). If major surpluses and shortages are to be avoided, it will be necessary to let these prices respond flexibly to supply and demand trends. At the same time, it would be desirable to avoid the large short-term price fluctuations - often because of weather - that characterize unregulated markets for agricultural commodities. This suggests the possibility of market-determined prices, but with a price stabilization scheme - Government intervention to keep fluctuations at any given time within a pre-determined range by purchasing for addition to stocks at the lower end and selling from stocks at the upper end.

73. A third instance concerns the relationship between producer and retail prices, which needs to be altered not only to reduce the presently high level of subsidies, but also to encourage consumers to buy less of things (such as energy or animal products) in short supply or whose production costs are increasing, and more of things in abundant supply and whose production costs are falling. This could be achieved by establishing and maintaining normal commercial margins for all goods (with relative retail prices also influenced, if desired, by unequal indirect tax rates).

74. In the near term, what is mainly needed are some substantial increases in the retail prices of food and coal, and in rents. These should be as fully and accurately compensated as possible, by wage increases, income supplements to households with high dependency ratios (discussed later), and special supplementary interest payments on saving deposits which would otherwise lose part of their real value (financed perhaps by a corresponding special levy on borrowers, whose loan repayment burden would otherwise decrease in real terms). The volume of saving deposits on which compensation would have to be paid could be substantially reduced by a large-scale program of selling state and enterprise-owned housing to its present tenants, who would otherwise face increased rents. This reduction in saving deposits would also reduce the possible scale of panic buying in anticipation of price increases.

75. There is room for disagreement as to whether such a major realignment of retail prices, incomes and assets should be done in one step, or more gradually. The social problems that have sometimes followed large

retail price increases in other countries seem to have occurred mainly because of the absence of compensation - often deliberate, because of the need to reduce real consumption in the face of economic difficulties. In China, however, there is no need for a cut in household consumption, and full compensation could be provided (although this would mean no net improvement in the state budget balance). A carefully prepared and well-explained one-step adjustment could thus be quite acceptable, and would avoid the protracted uncertainty and delays to other necessary reforms associated with gradual adjustment. But it would also obviously increase the cost of errors in preparation (especially calculating the required changes in prices, wages and other forms of compensation) or implementation.

76. Following this initial phase of adjustment, subsequent rises and falls in producer prices could be reflected in retail prices. Experience in other countries suggests, however, that it would be inadvisable to provide continuing automatic compensation for retail price increases in the form of general wage or income indexation, since this tends to aggravate inflation. Even selective indexation (of low incomes, for example, or for pension funds) should be approached cautiously.

77. A fourth instance concerns prices that influence the spatial location of economic activities. One is transport: prices for each mode should more accurately reflect long-run marginal economic costs, without cross-subsidies among different-length hauls, to provide incentives to reduce the present waste of rail facilities, to encourage greater use of roads, and to enable proper assessment of the costs and benefits of locating particular activities in particular places. The other is urban land: for social as well as economic reasons, enterprises and planners should be made to feel the dramatically varying economic usefulness (or opportunity cost) of different sites - higher in coastal cities than in more remote regions, higher in large than in small cities, higher near the center than in the outskirts (in a city the size of Shanghai, experience in other countries suggests that a central site is worth approximately 150 times as much as one in the suburbs).

78. A differentiated urban land tax reflecting these variations could be introduced, with a competitive rental market - which is in principle more efficient, and quite consistent with public ownership of all land - as a possible alternative. (Either or both could provide a useful supplement to municipal revenues.) This would encourage better use of existing sites, and more economically efficient location decisions. The presently huge incentives for rural-urban migration would likewise be reduced to more economically rational proportions, especially if differing land values were reflected in house rents and wages, and hence in the costs of living and employing workers in large urban areas.

79. Finally, further strengthening of the linkages between internal and world prices could be beneficial - with some important exceptions, including rice (where an increase to the present world price could aggravate incipient overproduction). For most goods, especially manufactures, enterprises should eventually directly feel the relationship between their value (for exports) or cost (for imports) to China in world markets and their domestic prices. Such linkages (which are now standard in Hungary, and have begun to be introduced

in China) are essential for the efficient functioning of a decentralized foreign trade system. They would also contribute to a much-needed widening of price differentials between low and high quality products, without which enterprise incentives to innovate and improve quality will remain small.

#### Labor and Wages

80. To reduce the risk of shortages of highly skilled workers constraining China's growth in the next two decades, measures to improve their allocation and motivation seem worth considering. Among the more important possibilities would be freedom of job choice, for both new graduates and experienced staff, allowing employers to recruit and release freely and competitively, and higher and more flexible salaries (subject to progressive income taxation, discussed below). Provided that they were accompanied by reform of enterprise motivation, competition and prices, these measures could help move highly skilled labor to where its economic contribution was greatest, speed the diffusion of new technology, improve motivation (with better matching of jobs to personal preferences and skills just as important as more money), and send much clearer signals of needs and priorities to education and training institutions.

81. It might also be desirable to take steps in the direction of encouraging and enabling enterprises to make better use of all categories of labor. This is because long-term growth of average per capita income will be almost entirely determined by growth of labor productivity, most of which must come not from movement of labor out of agriculture into other sectors, but from higher productivity within each sector. Unskilled labor is currently in surplus: but this will change in the twenty-first century; and experience elsewhere shows how hard it is at a late stage to break out of an established pattern of low productivity and indifference to labor costs.

82. It would therefore be economically advantageous to give enterprises more discretion in deciding how many, and which, less-skilled workers to employ. This should in principle encompass not only the right to dismiss idle or negligent workers, but also to release or reject workers who are simply not needed for production. The present pattern of lifetime employment would not necessarily disappear (Japanese experience confirms its potential advantages in training and motivation), but would be likely to be chosen only by larger enterprises.

83. Some open unemployment would be an inevitable consequence of these changes. In addition to its adverse human consequences (which could be mitigated by changes in social policies and institutions, discussed below), this would involve waste of human resources. The waste of unemployment, however, has to be weighed against the waste of human resources associated with the present employment system, which transfers unemployment from the streets into the factories and discourages managers from realizing the full productive potential of their workers. It is also important to bear in mind the tremendous potential for creation of new jobs in the service and small enterprise sectors. Nonetheless, gradual movement seems appropriate, perhaps with an early end to the obligation of enterprises to accept unwanted new workers (usually as part of a package also containing some useful recruits),

and subsequent release of unneeded workers each year up to a specified percentage of an enterprise's labor force.

84. Greater flexibility of less-skilled wages might smooth this transition, as might stronger linkages between individual pay and performance (letting each manager choose the payment system best suited to his unit). But these changes, too, could be only gradually introduced, to avoid a sharp drop in unskilled wages. It will probably also be necessary to retain some form of administrative control over state enterprise wage bills, to prevent excessive increases in response to pressure from workers, even though managers may be given discretion in the distribution of the wage bill among different categories of workers.

85. Gradual wage adjustments could also help remote and backward localities. At present, nationally uniform state sector wages, and unofficial pressure to tie collective sector wages to state wages, make it harder for enterprises in these localities to compete effectively against enterprises in more advanced regions, or in international trade. Nonagricultural employment in backward areas might therefore increase faster if unskilled wages in these areas declined in relative terms. At the same time, though, these areas probably need to offer skilled workers higher wages than elsewhere.

#### Investment Decisions and Finance

86. In energy, transport, education, health and defense, the Government will undoubtedly retain direct control over most investment decisions, mobilizing the necessary finance through the budget. The same will apply to major land and water development projects, although most other agricultural investment will probably be undertaken by households and collectives. In industry and services, however, the degree to which investment decisions should be devolved to enterprises, subject only to indirect government regulation, remains an open question.

87. Such devolution could have a number of advantages. It would give greater meaning to enterprise independence, especially since the economic performance of an enterprise at any given time depends heavily on previous investment decisions. It would increase the medium and long-term responsiveness of production to evolving needs and demands. It would make fuller use of the detailed knowledge of enterprise managers. It might also provide a way of strengthening incentives for sound investment decisions, in whose outcome enterprise managers could be given a substantial direct personal financial interest. Experience suggests that this would encourage bold and innovative thinking combined with thorough analysis, hard-headed calculation, and the avoidance of waste.

88. Delegating more responsibility for investment decisions to independent enterprises might also help in striking a better overall balance between infrastructural and other investment. China's local governments have proved dedicated and resourceful investors, but are probably unduly biased in favor of directly productive industrial investment. Making enterprises independent, with more investment responsibility, could thus give local governments a stronger incentive - as in other countries - to improve infrastructure in order to attract industrial investment.

89. China's recent mixed experience with devolution of investment decisions to enterprises, however, confirms that without other systemic changes such an arrangement can have undesirable results. Inappropriate managerial incentives, irrational prices, lack of competition, and shortcomings in commerce and material supply can lead enterprises to undertake investments of little economic merit, while neglecting other investments of much greater use to the economy.

90. Reforms in enterprise motivation, competition, and prices could eventually overcome many of these problems, making it possible to consider devolving a much greater proportion of investment decisions to enterprises and, relatedly, allowing state enterprises to retain a much larger proportion of their profits. More mobility of investment funds, through more varied channels, could also increase the efficiency of decentralized investment decisions.

91. Investment flows in China in the past have been largely vertical, with most savings being mobilized upward through the budget and dispensed downward through sectoral ministries and state banks. In addition, there has been some compartmentalized reinvestment of savings generated within particular sectors and localities. In the future, although vertical flows and compartmentalized reinvestment will remain important, they could advantageously be supplemented and replaced to an increasing extent by horizontal investment fund flows, of three main types. The first, mentioned earlier, would be allowing existing enterprises to diversify into new lines of activity. The second, which overlaps with the first, is direct investment linkages among economic units: enterprises could increasingly be permitted to invest in other enterprises, establish new enterprises, or participate in various sorts of joint ventures. The third sort of horizontal flow is through socially owned financial institutions, acting as intermediaries between the suppliers and users of resources.

92. Such financial institutions, offering interest rates that reflected the scarcity of capital, could mobilize funds from households and institutions, including enterprises with limited internal investment opportunities. They could make these funds available to potential investors, especially enterprises of all kinds, perhaps mainly in the form of loans, but also in the form of ownership capital - partly because many worthwhile projects are too risky to be largely loan-financed, partly because directly sharing in the risks and benefits would motivate financial institutions to provide more assistance in project design and implementation, including information on markets and technology. These institutions could in effect create a socialist market for investment funds.

93. For such a market to function well, the financial institutions should be numerous and diverse, acting in most respects as independent state or collective enterprises. Nonetheless, government regulation of their activities would be essential. At a minimum, as in all other countries, rules to protect depositors would need to be designed and enforced, with other rules and central bank intervention in the financial market to regulate the overall supply of money and credit. In addition, the government could - as for many years in Japan and South Korea - influence the allocation of funds in

accordance with strategic economic objectives. This could be done in various ways, including channelling some budgetary savings through these institutions and subsidizing or taxing loans for particular purposes, as well as by selective direct controls on interest rates and loan allocation.

94. For China, continued experimentation and exploration in the area of investment decision-making and financing will be necessary, especially since the experience of other countries provides no precedent for a socialist financial market. The relative shares and importance of the various possible elements discussed above - vertical and compartmentalized, as well as horizontal - should be allowed to evolve with experience and the development of institutions. In general terms, however, it seems likely and desirable that diversified investment arrangements will emerge as both consequence and cause of a diversified pattern of enterprise ownership.

### Planning

95. Reform of the system of economic management along the lines of the Central Committee's 1984 decision will reduce the Government's direct involvement in production, commerce, prices, employment, and so on, but should not diminish its responsibility or capacity to promote and steer China's development. The preceding discussion has touched repeatedly on areas in which continued, and often enlarged, direct government involvement is needed, especially in establishing the physical, educational, scientific, institutional and legal infrastructure essential for rapid and efficient growth. The Government will also continue to intervene directly in some other key sectors and enterprises, though more in investment decisions than in current operations.

96. Indirect Control. In the remaining areas of the economy, where decisions will increasingly be made by households, farmers, and independent enterprises, there will be a shift from direct to indirect control. This, however, need not diminish - and indeed might well increase - the Government's ability to manage the economy. For up to now in China, what has not been directly controlled has often not been properly planned. The broader reach of indirect controls, which shape the environment in which all economic units operate, could more than compensate for the associated loss of direct control over particular economic units.

97. Instruments of indirect control fall into two main categories - those connected with credit and those connected with taxes or subsidies. A third category is prices. But indirect control through administrative determination of prices has the drawback of being able for any particular commodity to govern either demand or supply, but not in general both, and hence having to be supplemented with administrative quotas either on demand (in the case of shortages caused by a low price) or on supply (in the case of surpluses caused by a high price). Moreover, reduction in the scope of administrative price determination will gradually change prices - apart from their tax or subsidy element - from instruments of government control into independent indicators of value, cost and scarcity. These both influence and are influenced by the actions of producers and consumers, usually in economically appropriate directions. Government intervention, however, may still be needed in some

cases to damp fluctuations, as well as to set one very basic price, namely the exchange rate, which strongly affects exports and imports in a decentralized economy.

98. Control of the overall level and growth of credit, which depends not only on caution in financing budget deficits by note issue or borrowing from banks, but also on regulating the whole banking system (according to well-established rules), is a fundamental element of indirect macroeconomic management. And, as mentioned earlier, preferential interest rates and repayment terms in certain sectors or regions, as well as direct government intervention in the allocation of credit, are feasible and effective ways of influencing the composition of investment. But experience elsewhere suggests that they should be used cautiously, to avoid undesired side-effects. Low interest rates on rural credit, for example, can lead to uneconomic mechanization in areas with surplus agricultural labor.

99. Personal income taxation, including progressive rates and selective relief, can influence the proportion of household income saved and the composition of consumer demand. Above-average indirect taxes on particular goods (for example, luxuries) can reduce the amounts purchased and supplied by driving a larger wedge between the price paid by the customer and that received by the producer; and vice-versa for below-average indirect taxes or subsidies (as on food, children's clothing, books and the arts in many countries). Taxes on enterprise profits, including selective concessions by product or locality, can be designed to regulate the total amount of funds available to enterprises, the proportion of profits reinvested, and the amount of external finance used; and can stimulate investment in certain activities or regions while discouraging it in others. Similarly, import tariffs can be used to promote increased production in particular sectors through import substitution (although without complementary export incentives they produce an inefficient bias toward the domestic market), and in certain cases it is rational to tax exports.

100. This range of instruments can enable planning and markets to coexist and develop harmoniously, though it involves greater emphasis than hitherto in China on managing demand rather than supply. Direct control of supply will, as mentioned earlier, continue in some important sectors. But to a large and increasing extent, rather than dictating what should be produced, the Government could simply guide the changing level and composition of demand, and intervene to influence the relative profitability of different sorts of production and investment, allowing supply to respond through the decentralized decisions of enterprises and farmers.

101. Experience in other countries suggests that this indirect approach can be as effective as direct controls in shaping the pattern of development, and often more economically efficient. But the relationship between objectives and instruments is much less precise and predictable, especially in the absence (as in China) of much systematic study of the behavior and responses of economic units. This element of unpredictability can be reduced by research, and by flexible and responsive implementation, with adjustment of policies to achieve desired objectives over the medium term. But it can never be eliminated, and many countries (including Hungary in recent years) have



experienced practical difficulties in indirectly regulating their economies. The increased uncertainty associated with greater reliance on indirect controls thus has to be weighed against the inefficiency of direct controls.

102. Scope of Plans. To the extent that direct control of production and allocation was reduced as part of the reforms, annual plans would become less significant in themselves, although they (and the budget, with which they should be linked) would remain important as a means of monitoring and adjusting medium-term plans. The medium-term plan, by contrast, would become the core of the entire planning process. Although the instruments for its implementation could be different, and although there should be a corresponding shift of emphasis from specific numerical targets towards what is called in other countries "policy planning," the general form of the plan document might be much the same as at present. Its preparation could serve even more than now as a focus for the exchange of views on strategy and policy among different government agencies, and between the center and local governments (who would still have their own, complementary, medium-term plans, at least at the provincial level). Other sorts of planning could also play an important role.

103. One is location planning. Even with more economically rational pricing of transport and urban land, most countries have found that zoning plans and regulations are necessary to preserve urban amenities. Moreover, in industries where a single optimal-sized plant would supply a high proportion of the national market (for example, automobiles or electronic chips), but many alternative sites would be equally attractive in economic terms, the Government needs to arbitrate among competing localities to prevent wasteful duplication. In other industries (cement and fertilizer, for example), government intervention is required because the location and scale of all the enterprises need to be simultaneously determined to minimize transport plus production costs.

104. In addition, Japanese experience suggests the potential usefulness of long-term sector planning, especially where major technological changes are expected or desired. (In China, such plans would provide a particularly useful framework for establishing industry-specific priorities for modernization - a very difficult task because of the comprehensiveness as well as the backwardness of the whole industrial sector.) However, Japanese experience also suggests that such plans should not be designed and imposed from above, and must have competitiveness in international markets as their not-too-distant objective. Through close contact with the enterprises in an industry, sectoral planners need to create a consensual "vision" of future development, which increases the consistency (and reduces the risks) of investment decisions. This vision has to be backed up by, for example, government financial participation in - or loans to - key investments, including pilot plants, or by temporary restrictions on imports and assistance to exports. But enterprises that wish to pursue a different strategy should often be allowed to do so: though this may seem wasteful, the flexibility it provides has proved valuable, since neither planners nor enterprises can pick technological winners consistently.

105. Long-term (10- to 20-year) plans in individual sectors need not, and probably cannot, be coordinated in detail. But they could benefit from a

projected long-term framework for the whole economy - a broad and fairly aggregated "vision" of future growth and structural change, worked out and regularly revised by central government planners. Such a plan could also provide guidance to enterprises in industries without specific sectoral plans, as well as for the planning of direct state investment in infrastructure and natural resource development, and as a context for the medium-term plans.

106. In all these areas, although the common sense and good judgment of planners will remain fundamental, China could make some significant technical advances in planning methods, including greater use of quantitative models of various kinds. This could be assisted by improvements in economic training (for both planners and other relevant people). Increased use of computers could permit better and more flexible use of the large amounts of data now collected at lower levels. These, and other sorts of economy-wide and sectoral information, should increasingly be disseminated to lower-level decision-makers, including enterprises - who at present receive far less information from the Government than in many other countries.

#### Social Issues and Policies

107. China has been outstandingly successful in reducing extreme poverty. Although there is substantial income inequality between urban and rural areas and among different rural localities, the hunger, disease, high birth and infant death rates, general illiteracy, and constant fear of destitution and starvation that haunt very poor people in other countries have been more or less banished. It will be of the utmost importance in the future to preserve and build on this achievement. But will the policies and institutions that have worked so well in the past meet the social objectives of a middle-income China? And are they compatible with changes in the system of economic management?

108. To a large extent, the answer to both questions is "yes." Social ownership of land and other productive assets, widely dispersed access to basic education and health care, and a guaranteed minimum food intake should all contribute to maintaining much less inequality and poverty than in other developing countries. Continued encouragement of agriculture and of other small-scale and labor-intensive activities should also - in light of experience both in China and elsewhere - play a vital role.

109. However, economic reforms and greater technological dynamism could increase income disparities, while economically desirable changes in the price, wage and employment systems could make it more difficult to use these things as instruments of social policy. Demographic trends, and major changes in the pattern of disease, will also pose new problems. Some changes and innovations in social policies and institutions may thus be necessary.

#### Income Disparities

110. Improving the allocation and motivation of skilled labor could involve some substantial increases in relative wages. Even higher incomes could be earned - and in some instances already are being earned - through entrepreneurship. Although perhaps not yet fully accepted in China, entrepre-

neurship can make an important economic contribution. Entrepreneurs perceive and supply hitherto unmet needs, initially at a high profit, thus luring others into the same activities, which increases supply and drives profits down. If allowed to, entrepreneurs in China could also - as in other countries - play a major role in technological innovation, whose risks may require the stimulus of high rewards.

111. In such cases, there is unavoidably some conflict between considerations of economic efficiency and the desire for minimal income inequality. But this conflict can be eased by progressive income taxation (tax rates that rise with income level) and by high indirect taxes on luxury goods. China already has a progressive personal income tax, aimed mainly at resident foreigners, which could be extended to cover, say, the top quarter of personal incomes. Although this would have administrative costs, it would probably make it easier for the central government to prevent the informal income redistribution that is now reportedly occurring in some localities.

112. International experience also suggests the desirability of not attempting to conceal economically necessary income disparities. In some countries, for example, bribery has been aggravated by keeping the wages of public officials low for political reasons. In other countries, formal incomes are fairly equal, but for important people there is better housing, privileged access to shops providing goods not available elsewhere, and sometimes even unrecorded but regular supplements to official salaries. Since these and similar practices quickly become well-known, their social benefits are temporary, while they seem to have a high long-term cost in terms of corruption and the evolution of a society based on special privileges.

### Social Security

113. At the other end of the income spectrum, a social security system consistent with a reformed economy is urgently needed. It will be increasingly difficult to reconcile the need for greater enterprise independence and efficiency with the present role of enterprises as providers of social welfare benefits and life-time employment. Prices and wages will be increasingly governed by economic considerations, which will make it much harder to use them to guarantee minimum urban living standards. Faster structural change will involve contraction and closure of some enterprises. Some skills will become obsolete, and some workers - often through no fault of their own - may become at least temporarily unemployed.

114. In devising new institutions and policies to tackle these problems, China might draw on the experience of the developed Western countries, all of which over the past few decades have established social security systems aimed at providing an adequate income for all citizens and at eliminating poverty due to old age, illness, disability, and unemployment. These systems have not been free of problems, but have effectively attained their main objectives. All but a few developing countries, however, have been deterred from introducing such comprehensive social security systems by their financial cost and administrative complexity. The challenge for China will thus be to devise a social security system that is effective, affordable and workable for a lower-middle-income country.

115. In developed countries, the social security system consists mainly of a state-run insurance scheme, financed primarily by compulsory wage-related contributions from workers and their employers, which provides old-age pensions, unemployment benefits, sickness and maternity benefits and so on, to those who have contributed. In addition, some noncontributory income supplements are usually provided to households whose per capita income (including social insurance benefits) would otherwise fall below some minimum level. This would be one possible approach for China, which could be implemented by consolidation and extension of the present enterprise-based labor insurance and welfare arrangements.

116. An alternative approach, which could involve lower budgetary cost, less danger of wage-related contributions discouraging employment, and fewer problems of extending coverage to the agricultural population, might be for the state in China to concentrate its resources on noncontributory income supplements to low-income households, while encouraging collective and local development of contributory pension and insurance schemes. Some of these pension and insurance schemes might, as in other countries, be organized by enterprises and other employers. But they should be financially independent (or "funded"), so that, for example, a scheme would be able to continue paying pensions even if the enterprise that had originally organized it were closed. Such pension and insurance schemes, which would have substantial funds to invest, might play an important role in a socialist financial market.

117. The state income supplement scheme could perhaps advantageously be financed partly from the taxes on high incomes mentioned above, although some additional contribution from general revenues might well be required. The total fiscal cost of these supplements could be substantial, but, because they would be targeted on the poor, would be a fraction of the cost of equivalent price subsidies, which benefit rich and poor alike. Their administrative cost could be minimized, and their effectiveness maximized, by making use of existing institutions. In urban areas, there is the household registration system used to administer grain rations. This might be a particularly useful basis for providing income supplements to households with high dependency ratios that would otherwise on balance lose from the upward adjustment of retail prices and wages mentioned earlier. In rural areas, the scheme could be implemented by the administrative successors to communes, brigades and teams.

118. In administering any such scheme, China, like other countries, would face some difficult choices concerning coverage and benefits. There might be a uniform urban scheme, including the self-employed as well as state and collective employees. It could be hard, however, to extend the same scheme to rural areas, because incomes are much lower and vary widely among localities. A compromise also always has to be struck among the desire to alleviate existing poverty, the need to give people an incentive to avoid poverty, and the wish to minimize budgetary and administrative costs. For example, setting unemployment benefits high, though it reduces hardship, also reduces the incentive to seek (or remain in) work, especially if the alternative to unemployment is a monotonous or arduous job at a low wage.

119. Because many complex issues are involved, and because improved social security arrangements could be essential to a successful reform of the

economic system, a commission could perhaps be established soon to formulate proposals. These might be implemented in stages, and should probably initially be of a modest kind. But the long-term objective should be to maintain China's social achievements, as in the past, well above those of other countries at comparable income levels.

### Housing and Social Services

120. China's large and medium-sized enterprises are now unique in the degree to which they provide housing and education and health services to workers and their families. As with social security arrangements, it would be much easier for enterprises to function as independent, efficient economic units if these obligations were removed from them. This would enable managers to concentrate on economic activities, facilitate labor mobility, reduce the social problems caused by the release of unneeded workers and closure of inefficient enterprises, and diminish the present reluctance of many workers to consider employment in small urban enterprises.

121. The social services now provided by enterprises could be taken over by local governments. So might some of the housing. But experience in China and elsewhere (including Eastern Europe) suggests the advantages of giving households as much responsibility as possible for their own homes, through individual ownership or housing cooperatives. This can provide a powerful stimulus to personal saving, release government resources for other purposes, and produce a higher quality and better maintained housing stock. The Government could usefully assist this, as mentioned earlier, by selling more existing urban housing to tenants, as well as by "sites and services" projects (planning and providing basic utilities for new individually-constructed housing), coupled with technical assistance and limited subsidies or tax concessions to housing cooperatives. At the same time, universal entitlement to a minimum standard of accommodation could be maintained, through both income supplements and direct provision.

122. Increased central and provincial government support of rural social services seems to be needed, especially in poor and backward localities. The introduction of the production responsibility system adversely affected social services in such places, with a sharp decline in cooperative health programs, as well as in primary and secondary school enrollment rates, especially among girls. This is unfortunate, especially since powerful evidence from other countries confirms that improvement of basic education and health is one of the most effective ways of helping poor people, as well as contributing to economic growth. Thus although self-reliance may remain an appropriate policy in more prosperous rural areas, the state should consider financing a larger proportion of the costs of social services in poor areas, for example through matching grants.

### Population

123. A further reason for taking financial and other steps to maintain and improve basic social services is that studies in other countries have shown that both education - especially of females - and health are major contributors to voluntary fertility reduction. As noted earlier, the expected

slow rate of population increase, due also to successful birth planning policies, is an important ingredient of China's relatively favorable economic growth prospects. Given, in addition, the limited amount of cultivable land in China, the achievement of replacement level fertility (2.1 children per woman) is clearly desirable.

124. The population projections in this report, however, which explore alternative possible paths to the end of the twenty-first century, raise some questions about the economic desirability of trying to reduce fertility well below the replacement level. Of particular concern would be the long-term impact of very low fertility on the labor force, which could decline rather rapidly in the middle decades of the twenty-first century. Negative labor force growth might have some economic advantages, but would inevitably cause problems of adjustment. There would also be a rise in the average age of the labor force, with shortages especially of younger, more recently trained, more adaptable workers. In addition, maintaining very low fertility could cause the proportion of elderly (65 and over) dependents to bulge temporarily above its ultimate long-term level. The gains of drastic fertility reduction in terms of a smaller population thus need to be weighed carefully against the cost of transitional changes in the population's age structure.

125. The increase in the proportion of elderly people will be a serious social issue in the twenty-first century even if fertility is reduced more gradually. It will increase from about 5% today eventually to about 20%. Though there will be an offsetting decline in the proportion of young dependents, providing financial support to elderly people is more costly, and more difficult to organize. China's existing institutions, including the family, for supporting elderly people are unlikely to be able to cope with their increased numbers. This strengthens the arguments mentioned above for starting now to plan long-term reform of the social security system. The early establishment of wider and better pension schemes in rural areas would, among other things, make it easier to reduce fertility.

### Health

126. The aging of the population will also contribute to the fundamental changes that are occurring in the nature of China's health problems. These have already moved from the pattern typical of low-income countries to one where the leading causes of death are heart disease, strokes, and cancer, as they are in high-income countries. These chronic diseases constitute a fundamental challenge for China, which other countries have had difficulty in meeting despite vast financial outlays.

127. One essential ingredient of the required "second health care revolution" will be prevention. Some steps - particularly control of salt intake and tobacco consumption - could be taken straight away. But much additional research is needed to identify and field test appropriate preventive strategies, which are much less straightforward than with communicable diseases. Another essential ingredient will be strategies for dealing with the large number of cases of chronic disease that will, inevitably, occur. These strategies should include capacity for treatment where treatment holds promise of results and can be afforded; they should pay

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careful attention to affordable plans for rehabilitation of incapacitated individuals; and they should be concerned with humane care for the terminally ill (an area in which there have been major and quite affordable advances in Western medical practice).

128. A third ingredient of the second health care revolution will be designing an insurance and financing structure that encourages prevention, and discourages current tendencies toward overuse of facilities and introduction of high-cost procedures. Assembling these three ingredients will, inevitably, be difficult. But, to the extent that success is achieved, China could become a world leader in the effective and humane handling of the burden of chronic disease without succumbing, as other countries have, to endlessly costly investments in medical technologies of limited efficacy.

### Rural Poverty

129. Increases in agricultural labor productivity should permit agricultural incomes to grow quite rapidly over the next two decades. It is not easy, however, to find a plausible set of assumptions under which agricultural productivity would grow fast enough to narrow the large agriculture-nonagriculture earnings gap (even in proportionate terms) until the twenty-first century. Because members of farm families will increasingly be engaged in nonagricultural activities, their total incomes will rise faster than their earnings from agriculture, but could still remain unsatisfactorily low. Additional measures to raise them are worth considering.

130. Higher agricultural procurement prices and lower prices for agricultural inputs would increase peasant incomes, but could well conflict with other objectives of agricultural pricing policy, including avoidance of surplus production and encouragement of efficient input use. It might be possible, though, to increase farmers' incomes without such adverse economic effects by gradually unifying producer prices, with a single price for each commodity instead of the present multi-tier structure (with a low quota price and generally higher prices for above-quota, negotiated or free market sales). This measure, which could perhaps be implemented in parallel with the recent decision to abolish quotas, would reduce what is now a substantial implicit tax on agriculture.

131. Increased government expenditure on things that mainly benefit the agricultural population, financed by taxation of other sectors, could provide another means of transferring nonagricultural productivity gains to those who must remain farmers. Development of agricultural and other rural infrastructure, improvements in agricultural research and extension services, and support to rural social services are obvious examples. Another possibility is subsidies to rural participants in social security schemes.

132. Though generally low agricultural incomes are an important problem, the most serious rural poverty in China is concentrated in specific localities, where incomes are far below the average. (For example, in Dongye township, in Dingxi county, per capita income in 1983 - the township's best-ever year for agricultural production - was about one-sixth of the national rural average.) Many such localities will benefit absolutely, and some

relatively, from reform of the economic system - this appears to be the reason why the production responsibility system has not yet generated the anticipated increase in overall rural income inequality. But others will tend to remain very poor, and could even become worse off, especially if they are remote or have meager land and water resources.

133. To solve the problems of poor localities would generally require packages of complementary measures, whose composition would vary according to the particular circumstances of the locality and other government priorities. Improved education and health services, in addition to meeting immediate social needs, build up capacity to work and innovate. Focused research and extension services can release untapped agricultural potential. Agricultural specialization and industrial development can be made possible by better roads and other infrastructure, and assisted by temporary subsidies for local industry. Allowing part of the population to move elsewhere, thus increasing per capita land and water availability, can also be an effective and economic way of reducing poverty.

#### Overview

134. To sustain rapid growth for several more decades will be a hard and complicated task for China. Better access to advanced foreign technology than in the past will make it easier, but will not be sufficient: the cumulative economic effect of individually inconspicuous improvements in processes and products has been shown to be larger than that of radical innovations, and the size of the technological gap between the best and the average enterprise in an industry to be more important than the technological level of the best enterprise. Nor will availability of energy, land and other natural resources - despite their importance - be the deciding factor. China's economic prospects will depend, rather, on success in mobilizing and effectively using all available resources - especially people.

135. This in turn will depend largely on success in reforming the system of economic management, including coordinated progress on three fronts. First, greater use of market regulation to stimulate innovation and efficiency. Second, stronger planning, combining indirect with direct economic control. Third, modification and extension of social institutions and policies to maintain the equity in distribution that is fundamental to socialism, despite the greater inequality and instability that market regulation and indirect controls would tend to cause.

136. On each of these fronts, there are promising ways forward, but also problems and hard choices to be faced. In addition, it is hard to overstate the importance and difficulty of striking a correct balance among the three. Very few countries have combined state and market regulation in such a way as to produce rapid and efficient growth, and fewer still have also managed to avoid intolerable poverty among the less privileged segments of their populations. On the contrary, there are far more countries in which unhappy combinations of plan, market and social institutions have produced neither rapid growth, nor efficiency, nor poverty reduction.



137. There is thus a vital need to guard against losing the strengths of the existing system - its capacity to mobilize resources, as well as to help the poor - in the course of overcoming its weaknesses. This will surely not deter China - a successful pioneer in many areas - from moving ahead. But it argues for a gradual advance, with experimentation and evaluation at each step, even though a one-stroke change would in principle involve fewer internal inconsistencies. Experience in Eastern Europe also suggests the importance of moving steadily, and of trying to avoid ill-judged steps in the direction of market regulation that subsequently have to be reversed or administratively tampered with, thus creating needless uncertainty.

138. Not all the steps need be small, though. In some cases, despite the greater risk of error, it may be best to introduce substantial packages of simultaneous reforms. Nor need progress be slow. What has been accomplished in China's rural areas in the past few years has provided not only an example, but also an excellent opportunity and indeed a vital need, for complementary and similarly rapid progress in the urban economy. Though in many ways more complicated and troublesome than rural reform, urban economic reform probably has the advantage of not needing to be so uniform. Other countries have successfully applied different management methods in different sectors and enterprises, and China should be able to do the same, while constantly seeking to refine and improve the mixture.

139. In system reform, and in the many other areas covered by this report, both the potential for progress and the problems involved are so large, and there is so much that is without historical precedent, that an even-handed and credible conclusion may be impossible. At a minimum, though, China's long-term development objectives seem attainable in principle, and if recent experience is any guide, there is a good chance that they will be attained in practice.

## OFFICE MEMORANDUM

DATE October 12, 1984

TO Files

FROM Mr. Vineet Nayyar, Acting Chief, EGYDI *Vineet Nayyar*

EXTENSION 7-4085

SUBJECT CHINA: Minutes of the Meetings Held With the Chinese Delegation Led by the Minister of Petroleum Industry on September 14, 1984.

1. Minister of Petroleum Industry, Mr. Tang Ke and Secretary General of the State Council, Mr. Du Xingyuan, visited the Bank on September 14, 1984. The Minister of Petroleum met initially with Mr. Karoasmonoglu and Mr. Rovani and subsequently with Mr. Clausen and Mr. Dherse.
2. Mr. Tang Ke initiated discussion by expressing satisfaction at the level of cooperation which had been built up between the Bank and the petroleum sector in China. Over a short period of time, the World Bank had funded three projects and, while some problems were being encountered in procurement, the physical implementation of the projects was very satisfactory. Over and above the financial assistance which had been made available for these projects, his Government was especially grateful for the technical assistance which had been secured as a result of the Bank's participation.
3. The Minister then proceeded to give an overview of the petroleum sector. He indicated that when Mr. Clausen visited Beijing last year, some concern had been expressed at China's capability to sustain oil production at the level of 100 million tons per year and some of the Bank's experts had alluded to the possibility of an imminent decline in production. Since then, there had been a qualitative improvement in China's petroleum prospects. As a result of China's continuing exploratory efforts, additional reserves (oil-in-place) to the extent of 600 million tons had been established onshore; of this, 200 million tons were considered recoverable. Oil production in 1984 was likely to be of the order of 112 million tons; this was a significant increase over last year's production level of 106 million tons. Initially, the target of oil production established for 1990 was 120 million tons. However, in view of the oil reserves proven last year, target for oil production by the end of the decade had been raised to 150 million tons. In addition, by 1990 offshore oilfields would supplement production by at least 5 million tons. For natural gas, against the current annual production level of about 12 billion cubic meters, a target for onshore production by 1990 was fixed at about 20 billion cubic meters. Offshore, a significant gas discovery had already been made near the Hainan Island and the reserves were currently being estimated at about 100 billion cubic meters. Once the optimum end use pattern of this gas has been determined, the gas field would be developed which would add significantly to the annual production of gas within China.

4. However, massive capital investment would be required to sustain production from the existing oilfield and to discover and develop new oilfields in order to achieve the production targets established for 1990. This investment requirement would in part be funded by an internal mechanism where revenues from the production of oil in excess of a predetermined target, was earmarked for oil exploration. In addition, for exploring and developing its offshore areas, participation agreements had been entered into with a large number of foreign oil companies. Further, the Government of China was now in the process of inviting foreign oil companies to undertake exploration in some of its onshore basins. It is quite possible that some offerings be made by January 1985.

5. Internal resources and private equity capital notwithstanding, there was still a significant financial gap which needed to be bridged. It is in this context that the Minister wanted to determine the magnitude of World Bank assistance earmarked for China's petroleum program. Mr. Karaosmanoglu indicated that the Bank shared the Government's view that the highest priority should be afforded to its energy sector. It was for this reason that energy lending to China had been 25% of the Bank's overall lending. The Bank would continue to afford the same priority for the energy sector, but at this stage it would be difficult to put a precise figure on lending for the petroleum sector, which would depend on many factors including the overall IBRD lending agreed to with the Government.

6. The Minister indicated that it was his impression that the Bank was closing the door on lending for the oil sector. Mr. Rovani pointed out, that the Bank was currently in the process of reviewing its policy on oil and gas lending. Further, while it was quite possible that lending for oil may become somewhat restrictive in the future, Bank would continue to lend, as heretofore, for the gas sector and infrastructure related thereto. As China had a large petroleum sector, there should not be any difficulty in identifying and financing projects which conform to Bank's revised guidelines. For example, the Bank could help finance, inter-alia, government portion of the joint ventures with the foreign oil companies, the development of gas fields, oil and gas pipeline, service industry to support offshore exploration, training programs etc. However, for the Bank to identify appropriate projects for funding and in order to ensure that the lending continues at the present pace, it was necessary that the Government recommends, very early, a number of projects for Bank selection. This was agreed to.

7. Reverting to the issue of procurement, Mr. Rovani pointed out that while in the initial stages procurement was characterized by tardy decision making, most of the issues and procedural problems seem to have been resolved and the contracts under the first two petroleum projects were in the process of being awarded. However, it was important to learn from the experience of the previous two projects and ensure that similar problems do not recur for the Karamay Petroleum Project. Mr. Tang Ke agreed that the progress in regard to the procurement was less than satisfactory; it resulted from cumbersome bureaucratic methods within China and relative unfamiliarity with Bank procedures. Delay in procurement had resulted in China having to incur avoidable expenditure in terms of commitment fee, and he would very much wish to avoid similar waste of public resources in future.

8. In his meeting with Mr. Clausen, the Minister once again gave an overview of the oil prospects in China (para 3). He indicated that China was capable of not only sustaining the present level of oil production but also enhancing it significantly. However, to achieve the revised and somewhat ambitious targets in regard to oil production, China would require a massive inflow of capital resources. To achieve this, China had invited private oil companies to explore in its offshore areas and was now considering onshore basins for similar joint ventures. However, even after taking into account the resources which would become available from these ventures and the borrowings it would otherwise secure in the commercial market, there would still be a significant financing gap. Mr. Tang Ke, therefore, hoped that the Bank would not close the door on oil lending. Mr. Dherse clarified that it was not the Bank's intention to reduce the lending in the sector, but to use its limited resources for attracting additional capital in the form of commercial borrowings and private equity. Mr. Clausen endorsed China's policy of inviting private oil companies for oil exploration as it would result in an efficient transfer of both resources and technology. In that context welcomed its latest decision to invite international oil companies for exploration in its onshore areas. Mr. Tang Ke hoped that Mr. Clausen would use his good offices in securing from Bank's overall lending to China a larger share for the petroleum sector. In conclusion, Mr. Tang Ke stated that the financial assistance provided by the Bank would be very useful; however, what he valued more was the transfer of technology which the Bank had been instrumental in affecting and the technical assistance provided by the Bank staff.

Cleared with and cc. Mr. C. Koch-Weser, AEACH

cc. Mr. A.W. Clausen

Messrs. E. Stern (SVPOP); Jean-Loup Dherse (EISVP); A. Karaosmanoglu (AENVP); S. Kirmani, D. Turnham (AEPDR); G. Kaji (AEADR); Y. Kimura (AEACH); A. Vorkink (LEGEP); Y. Rovani, P. Bourcier, E. D. McCarthy (EGY).

VNayyar:njd

## OFFICE MEMORANDUM

DATE October 10, 1984

TO Files

FROM Caio Koch-Weser, AEACH *ckw*

EXTENSION 72565

SUBJECT CHINA - Mr. Clausen's Meeting with State Councillor and Finance Minister,  
Mr. Wang Bingqian, Washington, September 22, 1984

Present: Messrs. Wang Bingqian  
Wang Liansheng  
Xu Naijiong  
Fei Lizhi  
Yang Guanghui  
Jin Liqun  
Clausen  
Stern  
Husain  
Karaosmanoglu  
Kaji  
Koch-Weser

1. Mr. Clausen welcomed the Minister to the Annual Meetings. He said that the program of cooperation between China and the Bank was developing well. Lending amounts and the sectoral distribution of lending had developed according to plan. The economic report would be discussed with Government during the coming months. He was grateful for the cooperation that the Bank's economic team had received from the Government. There were at present no major issues affecting the program; however, as discussed on various occasions in the past, a longer-term planning horizon for the Bank's work should be introduced. Also, operations should not be "bunched" as they will be this year. The Minister agreed. His Government was satisfied with the very good cooperation that had developed between China and the Bank.

2. The Minister then reported on recent developments in the economy. Economic performance was excellent again this year, partly due to the Bank's important assistance in recent years; the Bank's experience had been very helpful. The Seventh Five-Year Plan would be finalized in early 1985 and reform of the system of economic management would be accelerated in urban areas over the next five years. He expected the Bank's second economic report to contribute to the Government's plans in these areas, and to come as a "timely rainfall". China had to draw on the experience of other countries. With regard to the Bank's lending program, he agreed that the planning horizon had to be extended and this should be possible once the Seventh Five-Year Plan became available. Also, implementation of the agreed lending program had to be improved. The FY85/86 program seemed fairly firm. For FY85/87, the overall lending targets discussed in the past should be adhered to. The IDA/IBRD blend should be 40/60 but the Government could consider additional borrowing from IBRD on a case-by-case basis for high-priority projects in energy, transport, and industry.

3. Mr. Clausen said that he was keenly disappointed with the outcome of the IDA 7 negotiations. There was at present no political will among Part I countries to increase the replenishment level above \$9 billion. The situation would be reassessed by the middle of next year. Therefore, it was very difficult to address the issue of the IDA/IBRD blend for the China program. Mr. Stern added that the Bank would make efforts to increase China's share of IDA within the limited amounts of IDA available. He agreed with the Minister that China should then consider whether additional borrowing from IBRD on a project-by-project basis would fit the country's medium-term plans.

4. The Minister replied that the IDA/IBRD blend issue could be discussed again later. He said that China would now welcome the establishment of a resident office by the Bank in Beijing. Such an office would facilitate communications, and the preparation and implementation of projects. Mr. Clausen said that, with a lending program of more than \$1 billion a year, the China program was now one of the largest in the Bank; a resident mission would be very helpful in facilitating work on both sides. However, the cost, the functions and the organization of such an office required careful study. In response to a suggestion by the Minister, he said that the Bank welcomed the publication of important Bank documents in Chinese. For example, Chinese editions of the annual World Development Report, and issues of Finance & Development, were helpful in transferring the experience of other countries to China.

5. Minister Wang pointed to some of the controversial issues that had been raised in the context of the discussion of the future role of the Bank. Mr. Clausen said that he would remark on these issues during the coming days in his presentations to the Development Committee and to the plenary session. He would deal with the international economy, the Bank's role in this environment, and the issue of the resources needed for the Bank to play that role. In spring 1985, there should be a full discussion of these issues in order to develop a consensus on the Bank's capital increase by about a year from now. The Bank's role would be tailored to the needs of individual countries. The Minister and Mr. Clausen agreed that they would exchange views further during the coming days on the future role of the Bank.

cc: Messrs. Clausen, Stern, Husain, Karaosmanoglu, Kaji, Kirmani, Turnham

CKW:caa